

Response to SFC's Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers

By HSBC Global Asset Management Limited ("AMG")

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

We acknowledge the SFC's wish to focus on climate change given the far-reaching scale and urgency of the issue. While this provides a clear priority for the investment industry, we also believe that the consideration of broader spectrum of sustainability risk could be a better approach on the following ground and is the 'right' thing to do in the longer term:

- Many sustainability and ESG risks do not emerge in silo but are inter-connected. For example, there is a natural link between climate change and increased risk of water stress, food shortages and air pollution. Similarly, deforestation and forest degradation account for approximately 10-15% of world's greenhouse gas emissions. By focussing on broader spectrum on sustainability risks, the climate crisis can be tackled more effectively.
- For a company in a given sector, climate change may be one of many material E, S and G issues over a range of timeframes. Sole focus on climate change could dis-incentivize the investment industry, and by extension companies in other sectors, from considering ESG risks and opportunities that are not directly related to climate change.
- The specific set of incoming rules from the EU, in particular, those relating to the disclosure of "sustainable investments" according to the [Regulation on sustainability-related disclosures](#) in the financial services sector defines 'sustainable investments' in a much broader sense including climate change. Consideration of broader spectrum on sustainability risks in Hong Kong will be in alignment with this key international development.
- At HSBC Global Asset Management, we integrate ESG factors into the investment process using an absolute approach (norms-based analysis of a company's compliance with the UN Global Compact principles), and a relative approach (sector-weighted risk ratings based on our materiality assessment). Hence we advocate the consideration of a broad spectrum of material ESG risks in our investment decision making process.
- The United Nation's Sustainable Development Goals (SDGs) define a global political agenda to address the world's key challenges by 2030 by focusing on 17 goals in various areas such as climate action, poverty, gender equality and life below water. Investors are increasingly seeking dialogue with companies on these issues, and thinking through the impact of their investments on these SDGs. The consideration of broad ESG risks aligns more coherently with the SDGs.

However, we also recognise there are not yet common standards or definitions of what should be considered as material ESG risks for investee companies in different sectors and markets. This means that the measurement and quantification of how these issues are assessed and managed will vary, as already seen across different ESG ratings providers. This presents clear challenges if regulations on asset managers are introduced.

As such, the SFC may wish to focus initially on climate change as a priority, as discussed during the Technical Expert Group and the subsequent soft consultation, then expand the scope to include material ESG issues in future revisions once there are further developments in common sustainable finance and ESG definitions and standards.

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

We generally agree with SFC's proposed requirements should apply to management of CISs. However, we would also like to note that in general, for institutional clients such as pension and insurance clients, there is already an expectation on asset managers to consider ESG factors (though not necessarily specifically climate change) in the investment decision making process. As such, while SFC may want to focus on CIS at the initial stage, we would appreciate if the SFC can provide more clarity on its expectations, and the timeline to include discretionary accounts at a later stage.

For para 32, it is noted that "if a client's climate-related investment preference has been incorporated into the investment mandate of a discretionary account or pre-defined model investment portfolio, the fund manager should ensure that it acts accordingly." Can SFC confirm that fund manager only needs to address the client's preference in this case instead of following the FMCC prescribed requirements?

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?

We agree that TCFD should be the reference for reasons outlined in the consultation paper, and support alignment with existing internationally recognised frameworks such as the UNPRI annual submission for asset managers. We generally do not support divergence from these globally recognised frameworks, as this would lead to increased fragmentation and reporting burden.

In addition to TCFD, the SFC may wish to reference the EU Sustainable Finance Disclosure Regulation (SFDR). Given that the EU SFDR provides a key regulatory framework for fund managers in sustainability reporting, and the implementation of Level 1 in March 2021, preparatory work is well underway for many global fund managers. For example, updates to our policies relating to sustainability risks, and all associated processes and procedures as a result of the EU SFDR will be adopted universally by all HSBC Global Asset Management entities globally, since all our investments consider sustainability risk factors as part of investment risk due diligence, irrespective of the fund product or the geographical location of the fund manager.

Given the increasing importance of stewardship through active engagement and voting to identify, assess and manage climate-related risks and opportunities, and to influence investee companies on climate change, we believe the UK Stewardship Code 2020 can provide a useful reference for the SFC.

to further develop and refine the proposed requirements. The Code, which has been revised and strengthened from the 2012 version, has a strong focus on stewardship activities and outcomes, where signatories such as asset managers are expected to integrate ESG issues, including climate change, as part of their responsibilities.

For corporate sustainability disclosures, the SFC may wish to reference global standards such as the [Global Reporting Initiative](#), [International Integrated Reporting Council](#) and [CDP](#).

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

We note that Large Fund Managers are defined as those that have asset under management consisting of “total fund assets and discretionary account assets managed by a fund manager” of HK\$4 billion or above (paragraph 5, footnote 6 of the CP*). We wish to clarify why discretionary account assets are included in this definition when the SFC’s proposed requirements are not intended to apply to discretionary account assets, at least not at this initial stage (ref. Q2). However, we agree that discretionary account assets should be included if discretionary accounts are also in scope.

**Refers to total fund assets and discretionary account assets managed by a fund manager. This covers cases where the fund manager is responsible for managing the entire fund or discretionary account and where it is being appointed to manage part of the fund or the discretionary account.*

Our preference, as outlined in paragraphs 9, 37 and 38 of the CP, is to allow fund managers to adopt global entity level’s (i.e. HSBC Global Asset Management) governance, investment management, risk management and disclosure frameworks, policies and procedures. We acknowledge that these need to be at a similar or higher standards compared to SFC’s requirements.

9. Global fund managers which adopt group-wide policies and make a single set of group-wide disclosures may make reference to them to satisfy the SFC’s requirements provided that they are subject to similar or higher standards than our proposed requirements and that they explain how the group-wide policies and practices are being adopted locally.

37. Fund managers with overseas parent companies whose group-level governance, investment and risk management, and disclosure policies and procedures are subject to similar or higher standards than our proposed requirements can make reference to their group practices to satisfy our requirements as long as they are relevant and applicable to local operations.

38. The SFC acknowledges that some fund managers may be assisted by their overseas affiliates when carrying out supervision, investment or risk management functions (eg, centralised units may conduct ESG research, monitor risks or prepare reports). Fund managers can rely on their group practices as long as the local senior management have taken appropriate measures to ensure that the practices and standards adopted by their overseas affiliates align with our proposed requirements.

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

We are generally supportive of the proposed requirements to integrate material ESG factors, including climate related considerations into the investment process.

Our preference, as outlined in paragraphs 9, 37 and 38 of the CP, is to allow fund managers to adopt global entity level's (i.e. HSBC Global Asset Management) governance, investment management, risk management and disclosure frameworks, policies and procedures.

With reference to the addition to the scope of application for the FMCC, on page 35 of the CP (copied below), we wish to clarify whether this is still applicable if the client of the discretionary mandate has only specified general ESG risks rather than specifically "climate-related risks":

Paragraph to Appendix 1 of the FMCC under "Particular requirements in the Code which are not applicable to Discretionary Account Managers"

(a) Climate-related risks

The requirement in relation to the consideration of climate-related risks and the corresponding disclosure requirements are not mandatory for a Discretionary Account Manager, 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)

We understand that some of the FMCC, baseline and enhanced requirements are similar to the EU Sustainable Finance Disclosure Regulation. We support alignment with the EU requirements.

On quantitative metrics, fund managers should be given the flexibility to choose which climate-related metric to disclose (e.g. the WACI), and have the flexibility to do so at the entity or fund level. The scope and methodology should be aligned with existing disclosures (e.g. Montreal Carbon Pledge) to minimise reporting burden. Please see our response to Q8 for further details.

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

We generally agree that fund managers should make disclosures if they deem climate risks to be irrelevant for a certain strategy. We wish to clarify what the SFC considers to be 'appropriate records' and its expectations on record-keeping (e.g. frequency of review, length of time, level of details, etc).

For para 52, it makes reference to relevance and materiality of climate related risks, and that there should be a process to identify these. Para 53 goes on to saying where climate-related risk is irrelevant, it needs to be disclosed. In circumstances where climate risk is relevant but may not be material, could the SFC provide more detailed clarifications of its expectations? Also, guidance / examples of what may be constitute as relevant (or not) and material (or not) will be useful.

Our preference is that a fund manager should have the option to provide the proposed disclosures at the global entity level (i.e. HSBC Global Asset Management), as outlined in paragraph 53 of the CP.

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

We agree that climate-related disclosures should be made at the global entity level (i.e. HSBC Global Asset Management). We suggest that this can take a variety of forms, such as a specific climate change policy, PRI submissions, annual stewardship disclosures, Montreal Carbon Pledge reports, or annual reviews.

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?

Fund managers should be given the flexibility to choose which climate-related metric to disclose (e.g. the WACI, carbon intensity, amongst others), and have the flexibility to do so at either the entity level, or fund level. The scope and methodology should be aligned with existing disclosures (e.g. Montreal Carbon Pledge) to minimise reporting burden.

While it is in principle possible to disclose the weighted-average carbon intensity (WACI) at the fund level for equity, fixed income and multi-asset portfolios, a single backward-looking WACI figure may not be meaningful or decision-useful. At the portfolio level, the scope 1 and 2 carbon intensities are attributable to factors such as sectoral mix, weights and markets. Emerging markets tend to have higher WACI and lower data quality/availability than developed markets. For comparability, portfolio WACI should be viewed alongside their respective benchmark, and including additional information such as EM/DM weightings and sector weightings.

We are also wary that the WACI does not account for the potential of a portfolio's underlying investee companies to decarbonise and transition to low carbon. This typically penalises emerging market investee companies. The WACI does not also account for the fund manager's stewardship efforts in climate change and decarbonisation.

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.

We think that a single transition period for both the baseline requirements and enhanced standards would be more appropriate than having two split periods.

Given that the EU SFDR provides a key regulatory framework for fund managers in sustainability reporting, preparatory work is well underway for many global fund managers for the Level 1 implementation in March 2021. With the Level 2 Regulatory Technical Standards being delayed (timeline unknown as of this submission), we would encourage the SFC to include the EU regime in its considerations for the transition period in order to maximise implementation efficiency for global fund managers.

A transition period of twelve months would be reasonable however we would like to clarify how the relevant period of compliance will be calculated. For example, if the SFC finalises the baseline and enhanced requirements in 1H2021, such that the transition period is 1/5/2021 – 31/4/2022, does the SFC expect fund managers with a 31/12 reporting cycle to provide compliant disclosures for y/e 31/12/2021, or y/e 31/12/2022?