

We set out below the views of ComplianceAsia Consulting Limited (“ComplianceAsia”) in response to the Commission’s Consultation Paper on Proposed Changes to the Fund Manager Code of Conduct for issued on 25th June 2020 (the “Consultation Paper”).

GENERAL COMMENTS

Q1 - 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

Several broad trends in relation to the implementation of Environmental, Social and Governance (“ESG”) factors in the asset management industry have emerged in this field:-

- Impact investing involves deliberately investing capital to create measurable social or environmental benefits. Fund managers use their expertise, skill set and investment toolkit to deliver investment returns around a bespoke, viable strategy. Impact investing adds a positive impact dimension, be it health and wellbeing, sustainable growth or clean energy alongside a financial return.
- ESG integration or incorporation involves accounting for ESG factors in risk or investment management decisions via:-
 - Integration which is explicitly and systematically including ESG issues in investment analysis and decisions to better manage risk and returns.
 - Screening which involves applying filters to lists of potential investments to rule companies in out of contention for investment based on an investor’s preferences, values or ethics.
- Active ownership or stewardship for investors to encourage investee companies to improve their business practices via an ESG overlay and which is often expressed through engagement or proxy voting.
- Socially responsible investing (“SRI”) involves a particular strategy, for example green investment or choosing not to invest in arms.

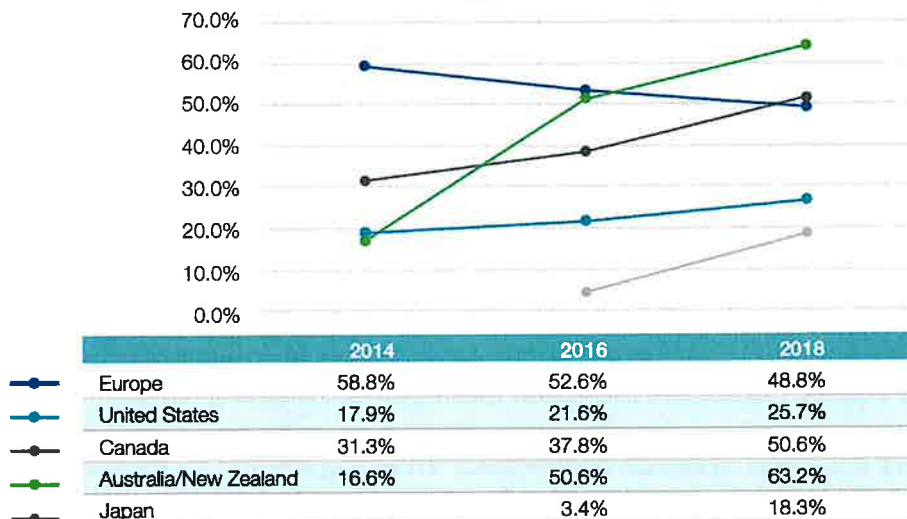
To date the primary driver in relation to the implementation of the above strategies for non-retail FMs has been investor demand rather than regulation.

For example, in a report published by KPMG International, CREATE-Research, AIMA and CAIA in February 2020, 85% of the hedge funds surveyed reported that institutional investors are the biggest drivers of demand for ESG orientated funds.

The requirements of these investors is also dependent upon their jurisdiction of domicile which further influences the demands on FMs depending on whether they have a primarily international or local investor base. In private equity and venture capital funds, the LPs drive ESG considerations in their mandates or LP terms.

The chart below from the Global Sustainable Investment Alliance in 2018 illustrates that the current trends in this regard.

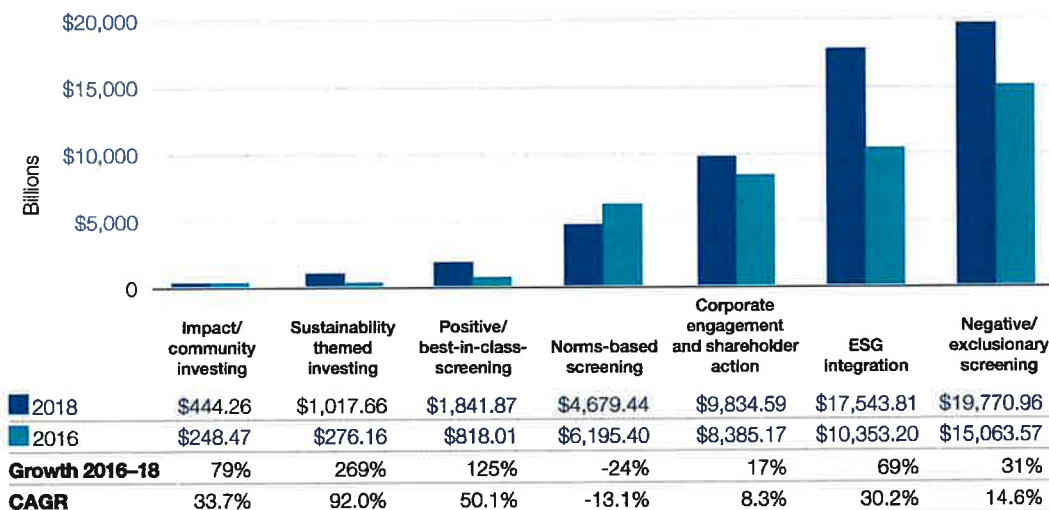
FIGURE 3: PROPORTION OF SUSTAINABLE INVESTING RELATIVE TO TOTAL MANAGED ASSETS 2014-2018



Note: In 2014, data for Japan was combined with the rest of Asia, so this information is not available.

Further it important to note that AUM is not evenly distributed amongst these strategies as shown in the following extract from the GSIA report:-

FIGURE 6: GLOBAL GROWTH OF SUSTAINABLE INVESTING STRATEGIES 2016-2018



Further as a general consideration, there are multiple guidelines and standards in place globally in relation to both ESG and SRI, many of which include environmental as a reporting item and there is a need some flexibility for global managers to determine which standards that they adhere to. Our clients have a preference that standards imposed should not be Hong Kong or SFC specific but allow managers to adopt standards which it can comply as part of their wider ESG obligations globally and recognize the influential role of asset owners and other investors

We disagree with the specific focus on climate change in the Consultation Paper as this is the area that is arguably the most difficult to ensure compliance with for medium

to small sized asset managers which make up a large percentage of Type 9 LCs in Hong Kong. We highlight this later in this report.

Q2 - Do you agree that at the initial stage, the SFC's proposed requirements should apply to the management of CISs but not discretionary accounts?

There are certain types of investment vehicles typically used by institutional investors (such as funds of one) for tax or other reasons which may be structured as funds rather than discretionary accounts, albeit their objective is to serve only one or a small number of investors. Such investment products may technically be considered as CIS which is broadly defined under the SFO, although they are highly similar to a discretionary account. We do not consider such funds should be in scope.

Further:-

1. It may be appropriate to exclude very small fund managers on the grounds that with the limited amount of AUM they manage, most forms of impact or stewardship investing will both insignificant in achieving change and outside their capabilities given their limited operational scope.
2. The applicability to an FM should be determined by their role in the product construction process and their level of activity rather than them holding discretion in Hong Kong. For example:-
 - If an international firm delegates the management of only a portion of a fund to their Hong Kong subsidiary although the Hong Kong FM may have discretion over that part of the portfolio they may nevertheless have no influence over to the original structure of the fund and its investment restrictions or risk parameters.
 - There should be a distinction based on capital type/fund manager's level of control. Debt funds with minimal discretion over daily operations should not be subject to the same guidelines as PE funds which have a controlling stake over the businesses.
 - If the fund is a regulated investment vehicle elsewhere, the Hong Kong FM will be

Q3 - 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?

There are a number of current options used by FMs when adopting ESG frameworks as appropriate to their strategy:-

- Becoming a signatory to the UN PRI;
- A firm specific customized ESG framework based on internal models (e.g the RobecoSAM product);
- TCFD or other models for larger global firms which are already adhering to them; or
- Comply or explain.

In response to the specific question about other tool and metrics, we note the work of the European Reporting Lab at:-

<http://www.efrag.org/Assets/Download?assetUrl=/sites/webpublishing/SiteAssets/European%20Lab%20PTF-CRR%20%28Main%20Report%29.pdf&AspxAutoDetectCookieSupport=1>

Through the review of corporate reports for the purposes of its project, the PTF-CRR identified the following list of standards and frameworks used by companies for climate-related reporting :

1. CDP (formerly the Carbon Disclosure Project)
2. Climate Disclosure Standards Board (CDSB) Framework
3. European Bank for Reconstruction and Development (EBRD) and the Global Centre for Excellence on Climate Adaptation (GCECA) – Advancing TCFD guidance on physical climate risks and opportunities
4. Framework for Impact Statements (FIS), Impact Institute
5. Global e-Sustainability Initiative (GeSI)
6. Global Reporting Initiative Sustainability Reporting Standards (GRI Standards)
7. Greenhouse Gas (GHG) Protocol
8. International Integrated Framework, International Integrated Reporting Council (IIRC Framework)
9. Recital 9 of the NFRD • The Introduction to the EC Guidelines on non-financial reporting
10. Section 2.5 of the EC Guidelines on non-financial reporting: Supplement on reporting climate-related information
11. IPIECA, API and OGP (IPIECA) Oil and gas industry guidance on voluntary sustainability reporting
12. Polish Non-financial Information Standard (Standard Informacji Niefinansowych, SIN)
13. Principles for Responsible Banking, UNEP Finance Initiative
14. Principles for Responsible Investment (PRI)
15. Responsible Care Management Framework
16. Sustainable Development Goals, 2030 Agenda for Sustainable Development – United Nations General Assembly (UN SDGs)
17. Sustainability Accounting Standards Board (SASB) Standards •
18. The Sustainability Code, German Council for Sustainable Development (RNE)
19. United Nations Global Compact (UNGC)

We note that the SFC refers a number of reporting standards in the Consultation Paper however the focus is primarily on the use of concepts arising from the TCFD system. We would note that the implementation of TCFD reporting requirements, the methodology is complicated and at this stage reporting has not been fully implemented globally.

In 2019 a TCFD Poll conducted by the Global Sustainable Investment Alliance conducted a TCFD Poll via the various country or regional alliances of which included

responses from 84 international asset management firms. The results were published in 2020 and show that only 16% of total respondents are already reporting in line with the TCFD recommendations, and a further 19% intend to do so in 2020.

An additional 28% of respondents are exploring the possibility. Respondents in the UK were most likely to be currently reporting in line with the TCFD recommendations (35%), while those in Europe and Australasia were most likely to be in the planning stages (66% and 59% plan to in 2020, or are exploring the possibility).

Respondents in Japan and the US were least likely to consider reporting in line with the TCFD recommendations: 53% and 38%, respectively, said they had no plans to do so. Asset owners reported the highest positive response to this question, with 24% of asset owners already reporting in line with TCFD recommendations, and another 27% planning to do so in 2020.

Reporting in line with the TCFD recommendations is arguably less relevant to the financial advisors/ planners respondents, and only 5% of them are reporting in line with TCFD recommendations, and 42% have no plan to do so. While slightly more service providers and “other” types are currently reporting (16% and 12%), 46% and 38% of them have no plans to do so, compared to the 53%-64% of asset owners, asset managers, and financial advisors/ planners with plans in progress.

This is illustrated in the following charts:-

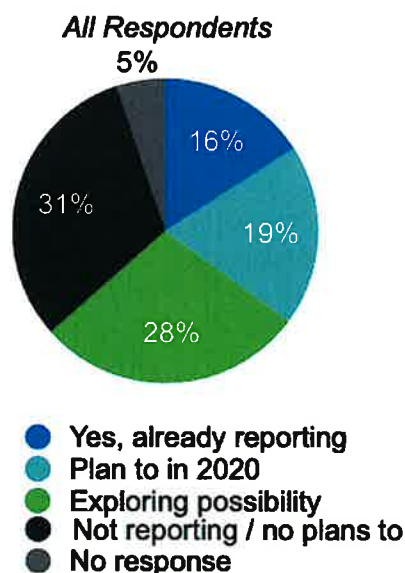
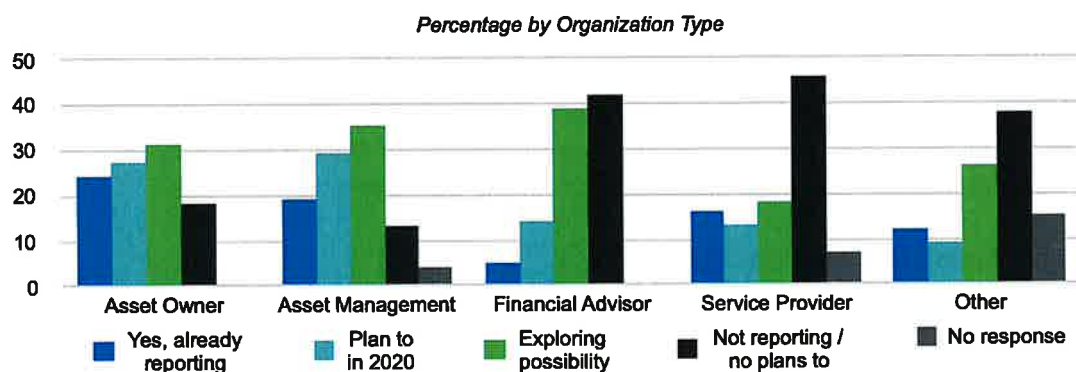
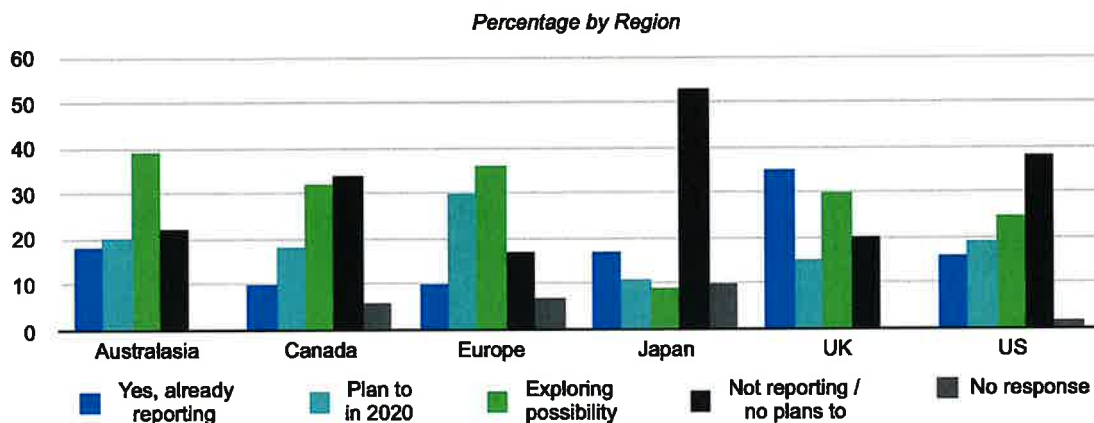


Chart sums to <100% due to rounding.



It is fair to assume that many of those firms that initially replied that they would be reporting by 2020 will have changed their plans in light of the Covid-19 pandemic.

Whilst reporting is only one aspect of the TCFD framework in light of these results, we consider that it will be extremely difficult for most Hong Kong based fund managers including the larger FMs to achieve meaningful adherence to TCFD requirements around scenario analysis, portfolio risk monitoring from an environmental perspective and ultimately reporting given that in many cases they are part of an international group, have limited operational capacity or small AUM.

Fund managers should be permitted to implement ESG in a way that is commensurate with the size and nature of its activities, including the investment focus and strategy of its funds. FMs need flexibility and discretion to apply different approaches and considerations as to how climate-related considerations are integrated into the investment management process.

Many FMs in Hong Kong will face considerable initial challenges in implementing the baseline requirements, including in relation to the availability of data and resources, experienced talent, and internal policy, procedure and documentation amendments required. The proposed requirements will likely have a negative impact on the ability of fund managers to choose the most suitable investments in a portfolio and may

potentially lead to fiduciary duty issues particularly for FMs in Hong Kong managing ERISA accounts on behalf of US institutional investors.

Q4 - Do you have any comments on the proposed basis for determining the threshold for LFMs, ie, HK\$4 billion, and the basis for reporting? Please explain your view

We consider the threshold level to be too low and will in particular adversely impact the hedge fund industry in Hong Kong for whom in many cases ESG is not relevant to their investment methodology and who would be required to employ significant human and financial capital to implement and report under the proposed changes. Examples include certain hedge fund strategies (e.g. volatility and arbitrage strategies) or quantitative or algo investing.

Q5 - Do you have any comments on the proposed amendment to the FMCC requirements, baseline requirements and enhanced standards? Please explain your view.

Governance

We have concerns about the proposed governance requirements in relation to international firms where risk management, inclusive of any ESG risk, is often a global function which is centralized in head office and as such would not necessarily involve the entire Hong Kong Board or a specific Hong Kong individual in risk functions

We acknowledge that for a FM in Hong Kong with a strategy focused heavily towards ESG it would be appropriate to have a member of senior management with sufficient ESG skill and experience and it may be more relevant to require such firms to ensure that they have personnel with sufficient experience in this respect not necessarily in the risk function.

We request that it is made clear if these requirements are applicable to FMs who are primarily domiciled in Hong Kong and as such responsible for the overall risk of the fund and client assets.

Tools and Metrics

Our clients with existing ESG overlays report that scenario analysis is currently applied where relevant; however, in many cases, detailed scenario analysis is difficult. Some examples are set out below:-

- Statistical links between natural phenomenon parameters and operational indicators is hard to determine accurately. Historical regression over decades might work but the very concept of climate change negates the veracity of historical correlations
- Difficulties in isolating/refining the almost infinite number of natural variables to just a few key variables that scenario analysis can be run on.

- Difficulties in linking the above to the company's specific situation/asset.
- Scenario analysis is vulnerable to data manipulation and distortion.

Further, the general consensus from clients is that scenario analysis is more equity driven and may not be relevant to debt investment.

Lack of Reporting Data and Risk of Greenwashing

The SFC rightly notes that there are current problems with greenwashing. However many of the problems arise from the quality of reporting from listed companies particularly in Asia and this can make it difficult for FMs to obtain accurate information. Recent press reports in relation to greenwashing by listed companies in the Korean and Mainland markets highlight the ongoing issues in this area.

As many Hong Kong FMs are responsible for the management of portfolios with investments in listed companies throughout Asia, the lack of relevant disclosure by listed companies in Asia makes it very difficult for those FMs to access data from a number of markets with different regulators and disclosure standards, with some markets being substantially behind others.

Even in Hong Kong, it is also presently unclear whether the new proposed disclosure standards by the Hong Kong Exchanges and Clearing Limited will go some way to ensure that listed companies comply with these requirements. Hong Kong is not at the stage of maturity of Europe which has the Non-Financial Reporting Directive (and relevant amendments for sustainability reporting), and there is no public database in Hong Kong or other Asian countries that our members invest in.

We would therefore suggest that at this stage, the appropriate regulatory and government response is to require better data disclosure from listed companies rather than for FMs who will only be able to collate inconsistent data.

Portfolio Construction

In response to the baseline requirements that FMs should during the investment management process

Whilst there is an exemption to have further have noted that this may not be realistic for some strategies (e.g. infrastructure debt given most of the ESG considerations would be more reputational than directly impact the returns of our loan unless it were so severe as to impact the ability of the borrower to repay).

These concerns are partly addressed in section 4.1 of the draft Guidelines where it is stated that environmental risk considerations should be embedded in the research or section 4.6 of the Consultation Paper and draft Guidelines where the SFC deals with active vs passive investing but this is reflective only of a certain (typically retail) sector of the funds managed or advised in Hong Kong.

We would therefore request that the SFC considers adopting a “comply or explain” approach to these requirements which is similar to the approach being adopted in the

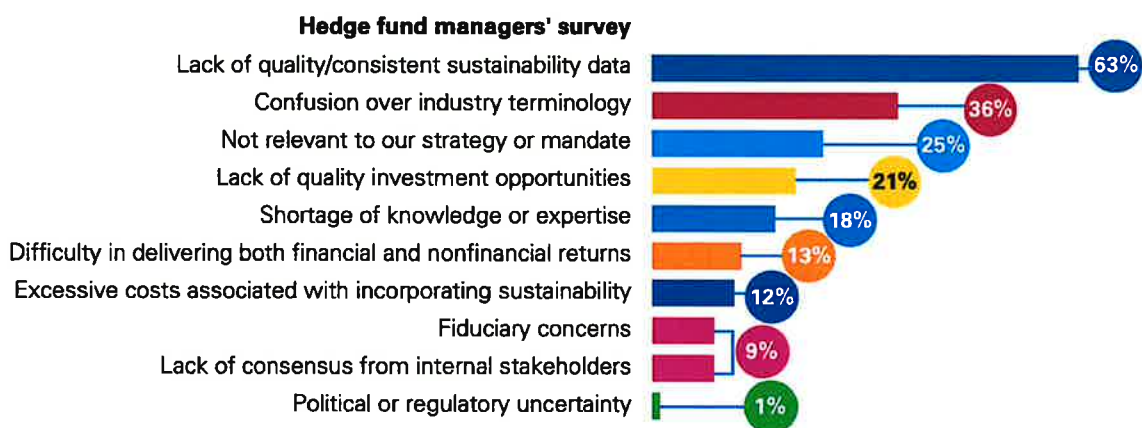
EU (see below) which then allows those fund managers to whom ESG at this stage in their development or who manage funds or strategies where ESG considerations are typically not part of the investment process are required to proactively identify why they do not follow the draft Guidelines in this respect.

Implementation timeline

We note that the SFC has proposed a phased implementation under which a 9-month and a 12-month transition period would be given to LFM's to comply with the baseline requirements and enhanced standards respectively, and a 12-month transition period would be given to other fund managers to comply with the baseline requirements.

We consider that a 12 month implementation period is unfeasible. There are existing challenges in the implementation of ESG strategies as highlighted in the previously referenced KPMG study which will be more broadly applicable to all FM's.

Figure 2.4 What are your organization's biggest challenges in making ESG-oriented investments?



Source: KPMG-CAIA-AIMA-CREATE Survey 2020

For existing FM's who wish to develop a pathway to implementing ESG strategies, the timeline is likely to be a several year process. Challenges to immediate implantation include the high costs involved in implementing ESG across the organization such as:-

- investments in talent (hiring ESG specialists for the investment, research and shareholder engagement teams); and
- investments in data (purchasing datasets and datamining technology from third-party providers); and investments in marketing (sponsorships, PR and thought leadership to build credibility in the market as there are newer FM's who incorporate ESG principles from the outset who have gained traction in this area.

Q6. 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.

Many boutique FMs in Hong Kong manage only one fund to which climate related risks are determined to be irrelevant and in this scenario both the disclosure requirements and the heavy governance overlay at a FM entity level is unnecessarily burdensome. In these circumstances, we suggest that the governance and risk management requirements can also be explained as being not applicable due to the lack of relevance to the only fund that is managed.

Further we do not consider such cases to be rare as suggested by the SFC and as such recommend that the preparation of Explanatory Statements remain optional.

Q7. 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?

This requirement should only be relevant only to funds which have a climate related strategy which is not the majority of funds nor all funds with an ESG strategy. Further it would be more appropriate for this to apply only to SFC authorized funds in alignment with the SFC's *Circular to management companies of SFC-authorized unit trusts and mutual funds - Green or ESG funds*.

Further many in many cases multinational FMs operating in Hong Kong are already required to comply with ESG requirements imposed at the level of the funds they manage including:

These include the following EU regulations, of relevance in Hong Kong given the large number of EU domiciled fund structures advised, managed or marketed in Hong Kong.

EU/UK legislation/proposals	Timing	Key impact
<p>EU legislation Disclosure Regulation (Regulation 2019/2088) Applies to 'financial market participants', including AIFMs, UCITS ManCos and MiFID investment firms providing portfolio management advice</p>	<p>Came into force at the end of December 2019. The main provisions will apply 15 months later (from 10 March 2021) From 2021 asset managers with over 500 employees (or that are the parent of a group that has) will have to publish their DD policies with respect to the</p>	<p>Firms will be required to integrate sustainability risks into their operating models, provide more detailed disclosures on ESG policies and sustainability risks and increase due diligence on the ESG profile of funds. Disclose how sustainability risks (environmental, social or governance</p>

	<p>principal adverse impacts of investment decisions on sustainability factors</p> <p>Also applies to as well as to non-EU fund managers marketing their funds in the EU</p>	<p>considerations) are part of their investment decision-making process and how their investment decisions impact on sustainability factors ("adverse impacts statement")</p>
<p>EU pending legislation</p> <p>Taxonomy Regulation (2018/0178(COD))</p> <p>Applies to 'financial market participants', including AIFMs, UCITS ManCos and MiFID investment firms providing portfolio management advice</p>	<p>Expected to come into force in 2020 (awaiting European Parliament approval)</p> <p>Level 2 measures/technical input awaited</p> <p>Phased implementation expected (end 2021/2022)</p>	<p>Establishes an EU-wide classification system or taxonomy of environmentally sustainable activities. Assessment against 6 environmental objectives eg climate change mitigation. Imposes supplemental disclosure obligations on fund managers eg a statement of whether or not a financial product has an environmental-sustainable investment objective (and if so, to what extent the criteria are met). Required updates to pre-contractual documentation and periodic reports for ESG-focused products.</p>
<p>EU proposed delegated legislation</p> <p>Delegated Regulation integrating sustainability into operating conditions for MiFID investment firms</p> <p>Delegated Directive integrating sustainability into product governance obligations</p>	<p>Draft Delegated Regulation and Directive published on 8 June 2020 and open for feedback until 6 July 2020</p> <p>For the Regulation, to apply 12 months after coming into force</p>	<p>Firms to carry out a mandatory assessment of sustainability preferences of their clients and take these into account when selecting financial products to be offered</p> <p>Firms to prepare a report explaining how the recommendation meets a retail client's investment</p>

	For the Directive, a transitional period of 12 months will apply	objectives, risk profile, capacity for loss bearing and sustainability preferences MiFID firms are also required to integrate sustainability preferences into the product oversight and governance process
EU proposed delegated legislation Additional Level 2 delegated acts re sustainability risks and factors to be taken into account for MiFID, AIFMD and UCITS regimes	Draft Regulations and Delegated Directive published on 8 June 2020 and open for feedback until 6 July 2020 Timing as above for other proposed delegated legislation	To ensure that sustainability risks and sustainability factors are integrated within a manager's organisational, operating, risk management and product governance processes. For instance: AIFMs to take into account sustainability risks and adverse impacts of investment decisions on sustainability factors in their DD policies and processes; and AIFMs to have the necessary resources and expertise for the effective integration of sustainability risks.
UK proposals on governance of climate decision-making FCA's work plan on climate change and green finance (as set out in its Consultation Paper on new climate-related disclosures for large asset owners and listed issuers)	To be implemented for accounting periods beginning on or after 1 January 2021 (therefore applying to reports published in 2022) on a 'comply or explain' basis	These proposals are aligned with the Taskforce for Climate-related Financial Disclosures' (TCFD) recommendations The FCA is separately considering how best to enhance climate-related disclosures by regulated financial services firms

In the case of alternative funds (many of which are domiciled in the Cayman Islands), the typical investor base is primarily institutional and other professional investors who already request detailed ESG disclosures from the asset managers during the pre investment due diligence process.