

**Hong Kong Green Finance Association (“HKGFA”) comments re SFC Consultation Paper on Climate Risks
(January 11, 2021)**

General	
<p>➤ The consultation paper is not clear in making a clear distinction of climate risks (forward-looking) and ESG (backward-looking). It may potentially allow fund managers (“FM”) to use and reuse ESG score as a means to climate disclosures, which should not be allowed as it defeats the objective</p>	
Questions	Comments and suggestions
<p>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.</p>	<p>➤ In general, members welcome SFC’s focus on climate risks; and stress the need to assess climate-related financial impacts.</p> <p>➤ Broader spectrum of sustainable finance is desirable but given the urgency of climate change, we agree that climate risks should be prioritized.</p> <p>This document should be seen as a roadmap towards normalizing climate disclosure across all asset managers as climate change is recognized by NGFS as a systemic risk (Source: NGFS, June 2020, The Macroeconomic and Financial Stability Impacts of Climate Change Research Priorities).</p> <p>While this paper is a move in the right direction, we believe that there should be a clear roadmap regarding the way forward as to how to address the broader spectrum of sustainable finance (including but not limited to what aspects would be addressed, how and when)</p>
<p>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?</p>	<p>➤ If SFC decides to exclude discretionary managers in the initial stage, it would be helpful for SFC to provide a timeline to indicate when they will be included in the future.</p>
<p>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?</p>	<p>➤ Agree to make reference to and align with the TCFD framework so as to avoid multiple standards of reporting and streamline the process. Please refer to the Better Alignment Project Annex II, page 34 onwards. The Better Alignment Project is an exercise on alignment mapping conducted by CDP, CDSB, GRI, SASB and IIRC. This will make it easier for fund managers that are already reporting against existing standards to understand which areas of their disclosure already aligns with the TCFD. This would be helpful to investors too.</p>

<p>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.</p>	<ul style="list-style-type: none"> ➤ Some members point out that the HKD4billion threshold is reasonable and in line with other countries. ➤ Meanwhile, there are some who would recommend that disclosure be based on fund size v/s AUM. Reason being, large fund managers also have emerging strategies and maybe investing in smaller funds (for example, focusing on early stage investments) where underlying entities may not be in a position to provide the data that fund managers are seeking. The other option is that fund sizes of CIS that are below a certain threshold be excluded from reporting in the initial phase, though this may add complexity to compliance.
<p>5. Do you have any comments on the proposed amendment to the FMCC requirements, baseline requirements and enhanced standards? Please explain your view.</p>	
<p>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?</p>	<ul style="list-style-type: none"> ➤ Yes, FMs should outline the climate-related considerations, state why not relevant, what metrics have been applied to arrive at this conclusion, and update on those regularly.
<p>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?</p>	<ul style="list-style-type: none"> ➤ Agree that climate-related disclosures should be made at an entity level to reduce burdens as well as duplication. For entities, we recommend SFC reference the TCFD Supplemental guidance on which sectors, as a priority.
<p>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?</p>	<ul style="list-style-type: none"> ➤ Yes, agree that climate related data such as WACI disclosures should only be made at fund level. WACI and Emission intensity, Total Carbon Footprint, etc. are simple calculations while providing good comparable insight across funds. If no data are available (such as re the frontier market), they can work on an estimation basis. ➤ More specifically, in the CP, it is proposed that at a minimum, managers provide the weighted average carbon intensity of Scope 1 and Scope 2 GHG emissions

associated with the funds' underlying investments at a 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.

This gives leeway to fund managers to decide whether to use revenues or enterprise value (EV) for the calculation. Revenues was initially recommended by the TCFD, while EV is set as the basis for calculation of carbon footprint by the EU.

However, in the Technical Glossary in appendix, the SFC only mentions revenues, as initially recommended by the TCFD. We would suggest that normalization by both revenues and EV are both possible. And SFC can complement the technical glossary accordingly, with the expectations that fund managers disclose the carbon footprint calculation method used for proper investor information. Indeed, for EU-based fund managers following EU rules, it is more likely that they will use the EV calculation.

2. WACI is a representation of a portfolio's exposure to carbon-intensive companies expressed in tons of carbon dioxide equivalent emissions (CO₂e) per million dollar revenue of investee companies. This metric is recommended by the TCFD.

<i>Weighted average carbon intensity (WACI)</i>	
<i>Formula</i>	$\sum_n^i \frac{(\text{current value of investment}_i \cdot \frac{\text{issuer's Scope 1 and Scope 2 GHG emissions}_i}{\text{issuer's \$ million revenue}_i})}{\text{current portfolio value}}$
<i>Methodology</i>	Scope 1 and Scope 2 GHG emissions are allocated based on portfolio weights (the current value of the investment relative to the current portfolio value), rather than an equity ownership approach. Gross values should be used.
<i>Key points + / -</i>	<ul style="list-style-type: none"> + The metric can be more easily applied across asset classes since it does not rely on an equity ownership approach. + Calculation is fairly simple and easy to communicate to investors. + The metric allows for portfolio decomposition and attribution analysis. - The metric is sensitive to outliers. - Using revenue (instead of physical or other metrics) to normalise the data tends to favour companies with higher pricing levels relative to their peers.

Source: *Implementing the Recommendations of the TCFD*, TCFD, June 2017

➤ Reference should also be taken to the guidance published by the Partnership for Carbon Accounting Financials (PCAF) which provides comprehensive carbon accounting measurements for financial entities (Attachment 3). This will provide guidance to funds that want to extend disclosure beyond WACI.

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.

➤ 12 months for large fund managers are tight but manageable. As the current focus is mainly on GHG rather than physical climate risk, managers should be able to comply with the regulation within the timeframe specified.

Section 1.1 Setting action plans and goals for addressing climate-related issues

Practices	Comments and suggestions
<p>1. In a public statement, the Chief Executive Officer (CEO) of a fund manager positions the firm as the asset manager for a changing world and pledges to stay at the forefront of developments. The firm also focuses on providing long-term sustainable returns to the clients. The fund manager commits to using its investments and influence to advocate a low-carbon, environmentally sustainable and inclusive economy. It seeks to deliver long-term sustainable returns including through making better decisions by systematically and explicitly integrating ESG factors into its investment processes.</p>	<p>➤ Too general and has little to do with climate risks.</p>
<p>2. The Chief Executive of a fund manager states that its key priorities include assisting in the global transition to a low-carbon economy and ESG factors will affect the value of all investments, thus making ESG issues integral to sound investment decisions which preserve clients' capital and deliver long-term growth while supporting the transition to a more sustainable world.</p>	<p>➤ Weak</p>
<p>3. A fund manager sets goals in areas including: (i) engaging with companies and raising the minimum standards set for companies each year; (ii) providing tools and education for clients by incorporating carbon data into some fund factsheets; (iii) providing investment options which address climate-related risks and explore low-carbon opportunities; and (iv) reducing carbon emissions associated with its real estate portfolio by 20% between 2010 and 2020.</p>	<p>➤ Acceptable</p>
<p>4. A fund manager sets key action plans relating to energy transition, environmental sustainability and equality (3Es) to align investments with the goals of the Paris Agreement by 2025. Indicators such as Primary Energy Mix and Electricity Energy Mix; carbon intensity (gCO₂/kWh); CO₂ emissions per portfolio; green share (%) of AUM or total green investments (sustainable economic activities) would be tracked, monitored and publicly reported.</p> <p>As part of this commitment, the fund manager also sets a series of near targets and equips its investment teams with a wide range of ESG analyses, tools and techniques. The fund manager arranges formal ESG training for ESG representatives of each team and screens thousands of companies against the UN Global Compact Principles and the OECD Guidelines to drive engagement, determine exclusions and develop sectoral policies addressing environmental risks. For instance, the fund manager introduced an enhanced coal policy to exclude coal-mining companies which derive more than 10% of their revenue from</p>	<p>➤ Acceptable, but again confuses ESG scores with climate risks.</p>

mining thermal coal or account for 1% or more of total global production. It also excludes coal-power generators whose carbon intensity is above the 2017 global average of 491gCO₂/kWh.

In addition, the fund manager requires its funds to have carbon emissions intensity lower than the benchmark and an overall ESG score higher than the benchmark. Specific funds and strategies have additional requirements such as dedicating a percentage of revenue to environmental objectives or stricter requirements in terms of outperforming the benchmarks by a larger magnitude.

Section 1.2 Governance processes for climate-related risks

Practices	Comments and suggestions
<p>5. A fund manager:</p> <ul style="list-style-type: none"> ▪ has its CEO publicly announce the inclusion of sustainable development goals in its social and environmental responsibility policy; ▪ sets targets to align its investments with the goals of the Paris Agreement by 2025; ▪ has a sustainability centre involving experienced people from different fields which provides investment teams with company- and sectoral-level sustainability information as well as facilitates the integration of sustainability risks and opportunities into investment strategies; and ▪ tracks the evolution of its carbon footprint, the temperature pathways of fund portfolios, exposure to high-carbon sectors and each portfolio's green share and brown share to monitor the status of climate-related risk management. 	<p>➤ Acceptable</p>
<p>6. A fund manager has established four committees which are monitored by the CEO and dedicated to different purposes:</p> <ul style="list-style-type: none"> ▪ ESG Strategy Committee - Chaired by the CEO, it meets quarterly, defines the firm's global ESG policy and key orientations and validates policies and themes for engagement. ▪ ESG Rating Committee - Chaired by the Chief Responsible Investment Officer, it meets monthly, defines and validates ESG ratings and the evolution of the exclusion policy and integrates ESG ratings into investment strategies. ▪ Voting Committee - Chaired by the Chief Responsible Investment Officer who examines and validates the firm's engagement and voting policies and ensures that they relate well to key ESG engagement themes. ▪ Social Impact Committee - Chaired by the Chief of Social Impact investing, it meets bimonthly and manages investment strategies in social and solidarity investments. 	<p>➤ Very weak</p>
<p>7. A fund manager has a dedicated team to oversee the firm's sustainable investment efforts globally. This team works together with investment professionals to integrate sustainability considerations across investment processes and drive sustainable investment research. The team's progress is supervised by a designated ESG global head. In addition, the fund manager has a risk management team which evaluates the risks of all investments, including sustainability risks, for</p>	<p>➤ Acceptable</p>

portfolio managers' periodic review. The global executive committee, with members including the global heads of investment, oversees investment processes and consistency across the firm.

Section 2.1 Identifying climate-related risks

General

- Re the disclosures of climate-related risks, managers agree that there should be full disclosures, but one must bear in mind that in Asia there are major challenges in obtaining the data:
 - Transition risk: Most companies, especially the frontier market do not disclose carbon footprint at all
 - Physical risk is very difficult to assess as data are lacking or very fragmented
 - Technology risk: some companies indicate that they do not want to share this kind of sensitive information

Section 2.3 Factoring material climate-related risks into the investment process

General

- Overall confusion of ESG and Climate risk again. Integrating ESG does not mean at all that the company is managing climate risks. Reference to carbon and GHG is only the beginning of climate risk considerations.

Practices

Comments and suggestions

- | | |
|--|--|
| <p>8. A fund manager has incorporated climate-related considerations into its investment process by taking steps which include: 1) using ESG scores for insight into risks and opportunities; 2) exercising investment stewardship to enhance its understanding of the investee companies and drive positive changes; 3) identifying responsible business conduct and excluding specific sectors; and 4) focusing on thematic areas such as energy transition, environmental sustainability, social equality and inclusive growth. The fund manager has also adopted sustainable investment approaches such as best-in-class and exclusionary screening.</p> | <ul style="list-style-type: none"> ➤ Extremely weak (should not be accepted in the context of climate risk) |
| <p>9. A fund manager built an in-house tool which provides indicative scores capturing a company's ESG risk exposure and developed an ESG Country Scoring system for consideration by the investment teams when making investment decisions. The tool scores companies by comparing them to their peers on a range of environmental metrics including green revenue, carbon emissions intensity, stranded asset risks, integration of water risks and comprehensiveness of environment policies. At a country level, the fund manager assesses countries' vulnerability to climate-related risks by weighing the resilience of existing</p> | <ul style="list-style-type: none"> ➤ Weak |

<p>infrastructure and their ability to respond using financial and fiscal means. The country score includes climate change exposure and sensitivity, total country GHG emissions as well as exposure to water and heat stress.</p>	
<p>10. A fund manager uses a “traffic light” system to assess the impact of GHG emissions on companies in a sector. For example, Scope 1 and 2 GHG emissions are regarded to have a large impact on cement and steel production companies while they have a mild impact on banks. However, Scope 3 GHG indirect emissions which occur in the upstream and downstream value chains would have a larger impact on banks if they are associated with project financing and facilities given to carbon-intensive sectors or activities.</p>	<p>➤ Weak</p>

(END)