

Hong Kong Investment Funds Association (“HKIFA”) members’ comments on the SFC consultation paper on climate risks (January 15, 2021)

General:

We are in full support of SFC’s initiative to develop a robust framework to address climate risks. The proposal as outlined in the Consultation Paper (“CP”) is a good starting point; and has by and large struck the appropriate balance. To ensure its effective implementation, we believe that it is important that when finalising the Code, the following principles can be fully factored in:

- Whilst “climate risks” has topped the regulatory agenda globally, the market is far from mature – the approaches, standards and methodologies are still evolving. In view of the fluid nature of the market and that global standards are yet to be developed, we believe it is important that the regulatory approach should be high-level and principle-based, rather than prescriptive. The framework should allow sufficient room for the managers to adopt new models, approaches and best practices. It should refrain from mandating a particular model/approach nor oblige managers to use certain metrics/tools. Even widely used models such as TCFD and WACI have their own limitations; and they should not be treated as sacrosanct. Nor should the model prescribe how a manager structure its operational set-up or organise its resources. The key is to accord managers the necessary flexibility to develop the relevant policies and procedures so that they can effectively integrate ESG into the investment/risk management process.
- To refrain from mandating the set-up is particularly important as many fund managers are part of the global groups. For global firms, the risk management, investment management and governance structures are typically applied consistently across-the-board amongst all group entities. The processes and policies are determined and managed at the group level; and applied and adhered to at the local level. Any imposition of HK-specific or be-spoke requirements will not only undermine the effectiveness of the model and reduce efficiency, but will increase compliance burdens/costs and operational risks. We appreciate that the SFC has addressed this in the CP, but there are some proposed requirements, particularly with respect to Governance, which seem to be still predicated on the assumption that the HKLC operates on a stand-alone basis, and that there should be implementation at the local level. We would exhort SFC to make it explicit in the Code that LCs may rely on Group policies and practices to satisfy SFC’s requirements, including that issues associated with climate-related risks may be subject to oversight at the Group/parent entity level

rather than at the level of the board and senior management of the local entity. However, if SFC maintains that oversight should sit with the Board of the HKLC; we believe that at least there should be flexibility to allow the overseas affiliates, which have the relevant expertise, to be responsible for discharging the functions, with the proviso that the said affiliates would keep the HKLC Board apprised and provide regular updates to it.

- Under the investment management function, there are different roles that the HKLC can assume (e.g. as investment manager, sub-manager, or advisor) and there are different ways that the function can be delegated. Thus, we hope that flexibility can be provided in the final Code to give managers flexibility to accommodate different arrangements.
- We fully concur that the lack/limited availability of data is not a reason for not moving forward. But we wish to stress that the lack of data or its limited availability is a major concern as it affects the quality of outputs and their comparability. The problem is particularly acute in the fixed income space. To address this, we will form a Work Group to study how to come up with more meaningful data so as to facilitate investors to make informed decisions. We warmly welcome SFC and other regulators' participation to partake in this initiative.
- As a substantial portion of SFC-authorized funds being sold in HK are UCITS, the development in Europe (SFDR, Taxonomy Directive, just to name a few) has direct implications to the HK market. The effective launch of the HK regulatory regime hinges on our ability to move in tandem with the European regime. We appreciate that SFC has factored these in, and we hope to see that in the finalised Code, etc, there are arrangements to ensure that the HK requirements and the timeline can be in sync with the European ones.

Apart from the European requirements, global managers also have to observe and transpose other markets' requirements, such as the US rules (e.g. DOL rules about non-pecuniary factors). Again, if the HK rules are detailed and prescriptive, they would potentially be incongruous with the overseas requirements. This would pose challenges for any managers which hope to align their product offerings as much as possible in different markets.

Questions raised in the Consultation Paper ("CP")	Comments/questions by HKIFA members
1. Do you have any comments on the proposal to focus on	Fund managers ("FMs") are broadly supportive of SFC's proposal to focus on climate change as a first step since it is the most advanced risks among ESG internationally.

<p>climate change or should a broader spectrum of sustainable finance should be considered in developing the requirements? Please explain your view.</p>	<p>It is of significant urgency to address this subject, and regulators can play a pivotal role in compelling FMs to focus on climate change risks in their portfolios. The increased focus will not only enhance investors' awareness and understanding of climate risks, but also compel FMs to take up more engagement activities with portfolio companies to reduce their carbon footprints and manage climate risks in their businesses.</p> <p>FMs also support the efforts of the SFC to recognize the work already done in this space, and to utilize the TCFD framework, which is probably the most widely recognized and most comprehensive framework for addressing climate risks in investments, and the support of other organizations such as the PRI for their efforts in highlighting such risks. Being a champion of climate action is one of UNPRI's focus in the coming years and this includes investor education on responsible investing, challenge barriers to a sustainable financial system, and support investors incorporating ESG issues. FMs hope that the SFC continues to adopt the principle of using a globally recognized standard in its regulatory efforts rather than to introduce idiosyncratic or HK-centric approaches. It is important that the regime adopts a principles-based approach to reduce the risks of conflicting or duplicative regulatory requirements.</p> <p>While focusing on climate change as a first step is a sensible move, FMs believe that climate change is only a subset of sustainable finance ("SF"). Typically, SF investing also takes into account elements of Social and Governance and FMs call for a more comprehensive approach to cover these aspects too.</p> <p>We can take reference from the HKEX consultation paper on Review of the Environmental, Social and Governance Reporting Guide and Related Listing Rules and its consultation conclusions - while it has adopted climate change, it is only part of its Environmental criteria, and the HKEX emphasises that "effective governance structure of ESG matters is fundamental to quality ESG performance and reporting".</p>
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	<p>As frameworks globally evolve around E, S and G (e.g. Singapore & EU) it is important that SFC aligns its approach with the international one. SFC should provide a clear a roadmap as to when to adopt a broader approach on sustainability risk integration by including other sustainability factors (e.g. S and G).</p> <p>If the SFC were to expand the scope to cover other sustainability-related issues, it is important that SFC allows FMs sufficient flexibility to implement policies and procedures that address the wider spectrum of issues. Also, it has to consider the implementation challenges: FMs have expressed concerns that the requisite data are just not available for certain asset classes, such as corporate credits.</p> <p>Specific comments on the wordings: Para 26: Propose to change “where appropriate” to “where practicable” as we understand SFC would allow some room for FMs to exert their influence through active engagement as deemed possible, in addition to through divestment.</p>
<p>2. Do you agree that at the initial stage, the proposed requirements should apply to the management of CISs but not discretionary accounts?</p>	<p>In general, FMs are supportive of applying the requirements to all FMs that manage collective investment schemes (“CIS”).</p> <p>As to the CISs that should be in scope, FMs believe that we should start off with authorised funds; and we can explore the feasibility of extending the coverage to other CISs under phase two.</p> <p>Also, many authorised funds are domiciled in Europe (and thus subject to SFDR), and the CP has explicitly mentioned SFDR in Appendix 4. Level 2 of SFDR is expected to be published in 2021. Can SFC confirm that they will have regard to the obligations under SFDR (both level 1 and 2); and align the HK requirements with SFDR?</p> <p>As for discretionary accounts, we support the SFC proposal to exclude them because the clients, which are typically institutional ones (including public and government bodies), are already aware of such risks. And most, if not all, have</p>

	<p>been taking actions in this space.</p> <hr/> <p>Assuming that the proposed requirements just apply to CISs, there are areas that need clarifications:</p> <ul style="list-style-type: none">● Applicability of the requirements to sub-investment managers - Para 35 sets out that FMs who are the sub-investment managers (with full discretion over the investment management) would be required to observe the proposed requirements applicable to its role. It is unclear what does “observe” mean in the context (i.e. whether the proposed requirements in relation to governance, investment management and risk management process be applicable to such sub-investment managers).● Paragraph 32 specifies that the proposed requirements in the FMCC (as well as baseline requirements and enhanced standards) would not be mandatory in respect of climate-related risks. Nevertheless, “if a client’s climate-related investment preference has been incorporated into the investment mandate of a discretionary account or a pre-defined model investment portfolio, the fund manager should ensure that it acts accordingly.” Can SFC clarify is the FM required to comply with the proposed requirements in the FMCC as well as baseline requirements and enhanced standards (e.g. Governance, Investment Management, Risk Management, Disclosure) for investment mandate with climate-related investment preference? Based on the flowchart in Appendix 3, we expect the proposed requirements will not be applicable to discretionary account with climate-related investment preference. Please confirm our understanding is correct.
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<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>FMs generally agree that the SFC should leverage on the TCFD framework in developing the proposed requirements as it is the most developed and recognised framework globally. It can also foster the development of a more consistent disclosure framework; and facilitate compliance.</p> <p>However, there are certain caveats:</p> <p>(a) TCFD provides overview on metrics, however, since no market standard has evolved, managers emphasize the importance of giving discretion to managers to determine and to disclose which metrics be applied.</p> <p>(b) some managers further point out that as the knowledge base in SF and climate change is still developing globally, the authorities should be more embracing and provide a framework that can factor in the evolving global best practices so as to facilitate HK to establish its own set of standard or framework to achieve its regulatory objectives rather than solely relying on the TCFD Recommendations.</p> <p>(c.) In addition, when setting the standards, we should take into consideration the uneven and early stage of development in ESG/climate change reporting by issuers across Asia as compared with the European and American counterparts.</p> <p>In view of the evolving landscape, will SFC consider allowing compliance with material TCFD Recommendations at a "best effort" basis or a "comply or explain" basis, at least for a transition period?</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>	<p>Ideally, for fairness and to ensure a level playing field, the same requirements should be applicable to all LCs, and size should not be a differentiator. However, on balance, we believe that SFC's proposed two tier approach is proportionate; and is line with the standards in key markets.</p> <p>But we do have some questions re how to calculate the HK\$4 billion threshold that require clarifications:</p> <ul style="list-style-type: none"> ● Should the threshold test be performed every year by looking at whether the AUM equals or exceeds HK\$4 billion for any three months during the past 12

	<p>months?</p> <ul style="list-style-type: none"> ● Should portfolios fully delegated by the LC to say group affiliates be counted towards the HK\$4 billion AUM? ● Does the HK\$4 bn include discretionary assets which are given to the HK LC for management under an IMA contracted with the HK LC, but with discretionary management delegated to an overseas affiliate? ● Should HK\$4 billion just include the AUM for CISs given that the proposed requirements are not mandatory for discretionary account assets (para 32)? <p>Also, what happens if the AUM falls below the threshold, i.e. the change mechanism, and migration from one tier to another?</p>
<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>FMs are supportive of the requirements that investment managers must integrate ESG into the investment processes.</p> <p>But some members have expressed concerns regarding the practicality of implementation because ESG/climate change reporting by Asian issuers lags the European and American counterparts, and the availability of ESG data on Asian issuers is at best limited. Thus, imposing such requirements at this stage may be premature and inadvertently places regional specialist FMs of China and/or other Asian funds at a competitive disadvantage. The qualifier of “where data is available” is very important – until and unless issuer level disclosure is available or improved, there is no way that FMs can fulfil the requirements. If such requirements were to be imposed, what would be SFC’s expectations if the data are not available? Some have suggested that if such data are not available, FMs should not be expected or required to make disclosures.</p> <p>Also, there are concerns that the proposed framework is too prescriptive. For instance, Practice 6 stipulates the different committees that a FM must set up. It seems to prescribe exactly how a FM must structure its ESG research and integration teams. In particular, the draft proposal seems to regard ESG ratings as</p>

	<p>being something centralized rather than strategy- or style-dependent, and that would sit best in asset managers where this ESG research fulfils more of a compliance function. While FMs would have a centralized repository of E, S and G related information that covers both proprietary as well as 3rd party data, FMs should have the discretion as to how such ratings are integrated as this can be a key distinguishing/competitive factor to achieve higher risk-adjusted returns. In short, one must take into account that different FMs have different, but equally valid approaches on integration.</p>
	<p>Proposed area of focus – definitions of climate-related risks</p> <ul style="list-style-type: none"> ● Para 27 : climate-related liability risks are deemed as a potential consequence of physical and/or transition risks, rather than a standalone risk. It is suggested to remove liability risks as a separate category (table in Par 51 of the CP) so as to align with the TCFD Recommendations. This would also be better aligned with the proposed wording for the new Para E1 of Appendix 2 of the FMCC.
	<p>Proposed scope and FMs adopting group-based policies (Para 33-38), also linked to the question re disclosures, etc.</p> <ul style="list-style-type: none"> ● SFC states that for FMs which are part of a global organization it is possible for the local manager to adopt the ESG related policies and procedures developed at the global level. Under such scenarios, what would SFC require from FMs to demonstrate that the local oversight and accountability of the responsibilities under Governance, Investment Management and Risk Management processes are comparable? SFC expects “the board of the LC to develop action plans, establish controls and procedures, devote sufficient resources, set goals for addressing climate related issues.” For portfolios which are managed by the LC under internal delegation arrangement, such governance/direction/oversight typically have already been established at the Fund board level/Manco/Manager level. We expect that in terms of the local LC’s requirement to “explain how the group-wise policies and practices are being adopted locally”, that as long as the LC’s disclosure states that such Group wise policies and practices are

	<p>adopted and applied consistently across the Group, it would suffice to demonstrate compliance. Can SFC confirm that this would suffice?</p> <ul style="list-style-type: none"> ● For portfolios that have been fully delegated out (i.e. no discretion over investment management and risk management process) but the HK LC is ROOF, are the conduct requirements (governance, investment management and risk management) not applicable, and only the disclosure requirements will apply to the HK LC as it is ROOF? Or the disclosure requirement will not be applicable too? How about if the FMs consider climate-related risks are irrelevant to the fund, what would be the disclosure obligations, if at all? ● Will SFC regard a delegated asset manager to have discretion over “risk management processes” if the delegated manager, while having investment discretion under the delegation arrangement, is subject to the risk management framework, process and parameters implemented at the level of the delegating entity level or at the level of the fund? Para 4 states that “the proposed governance, IM, RM and disclosure would apply to fund managers which have discretion over investment management and risk management processes”. In the above mentioned case, does the LC need to comply with all of the requirements under Governance, investment management and risk management; or just the governance and investment management; or none of that would apply to the LC? ● If the investment management and/or risk management processes are delegated by the HK manager to an overseas non-SFC licensed sub-manager, to what extent should the HK manager monitor the compliance of the climate-related risk requirements in the revised FMCC as the HK manager is not involved in the daily investment and risk management process of the CIS? ● If the HK manager is a sub-manager of a CIS (with a PRC manager or an EU manager) where the HK manager has only been delegated with the daily investment management and order placing function, to what extent should the HK manager comply with the climate-related risk requirements in the revised FMCC? ● How about if the HK manager is only involved in the distribution of the CIS in
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	<p>HK (say a UCITS), and the investment management/risk management functions are borne by the overseas affiliates or a third-party manager?</p> <ul style="list-style-type: none"> ● Can SFC provide a list of which overseas practices and standards align with the SFC requirements and/or are acceptable to SFC? E.g. If the group already meets UK, EU or French requirements, is it deemed sufficient? We would strongly advocate that the governance, investment management, risk management process and disclosures requirements for both the baseline/enhanced requirements be aligned with the EU standards so that global managers would not be required to work towards disparate standards/requirements. <p>Governance: Appendix 2 of the CP – Baseline : 3rd bullet : Given the SFC is minded to primarily make reference to TCFD recommendations, we suggest amending as follows for alignment with the TCFD wordings : «determine how the board or the board committee executes this role, including the process and frequency by which the board or the board committee is informed of the status of incorporating climate related considerations into the investment and risk management processes through appropriate reporting and escalation about climate-related issues. »</p> <p>Investment Management :</p> <ul style="list-style-type: none"> ● FMs support the proposal to include an indication of certain types of funds/strategies that may not consider climate risk as relevant. However, it should only be indicative, but not exhaustive and should up to the Manager to determine on a case-by-case basis. ● For passive funds adopting a partial replication or enhanced passive strategies, FMs express major concerns re SFC’s expectation for FMs to adjust the weightings of poor ESG rating investee companies or exclude them from the portfolio. One must bear in mind that for passive products that do not have explicit sustainability objectives or features, the investment objective of these products, as represented in their offering documents and on which basis
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investors have chosen to invest, is to track the underlying index. FMs have a fiduciary responsibility to be faithful to the stated investment objective of the fund and do their best to minimise tracking error within the parameters of the stated investment strategy. Even for “partial replication” or “enhanced passive” strategies (as defined by the PRI), unless the fund’s disclosures clearly indicate that ESG factors will be taken into account to mis-weight or exclude benchmark constituents, it would be entirely inappropriate to suggest that FMs should unilaterally decide to do so. Not only is this misleading (as investors in such circumstances would simply not expect these funds to behave this way) but any resulting incremental tracking error can potentially be detrimental, for example for institutional investors who use passive index funds for hedging purposes.

Fully replicated passive portfolios should generally be carved out because the objective of such a strategy is to provide investors with exposure that is identical to the respective benchmark, and by default climate-related risks can be deemed as not relevant to the investment and risk management processes. For other types of passive strategies, we agree that they should be carved out where the manager has assessed climate-related risks to be irrelevant. However we are concerned that the prescriptive nature of the proposed requirements, particularly in relation to investment management and risk management, would make it difficult for passive managers to demonstrate compliance. We therefore strongly urge that the SFC includes a note in the FMCC, similar to the Singapore MAS’ approach to provide regulatory guidance, that passive managers will have the flexibility to implement the requirements as appropriate to the strategy and as such will not be penalised for following a fund’s investment objective and strategy:

“Note: Fund managers’ approach to managing environmental risk could be influenced by the investment objective and strategy (active versus passive) of the fund that they manage. Passive managers have limited leeway in their

	<p>research and portfolio construction process beyond benchmark selection and engagement of index providers on universe of sustainable indexes. Similarly, active managers may be constrained in the extent to which they can deviate from a reference benchmark or index. Where such constraints exist, FMs are expected to implement the requirements under the Investment Management and Risk Management sections (and corresponding requirements in the Disclosure section) of this circular in a way that is appropriate to and commensurate with the fund’s strategy.”</p> <p>We believe sustainability can and should feature in passive investing in two important ways. The first is by developing products that have explicit sustainability objectives or features, where sustainability considerations are embedded in the index methodology. Secondly, ESG integration for passive strategies can be addressed at the platform level through (a) investment stewardship activities seeking to manage material sustainability risks; (b) engagement with index providers on index design and broader industry participation on ESG principles; and (c) enhancing transparency and reporting of sustainability characteristics of products to investors.</p> <ul style="list-style-type: none">● In cases where conflicts of interest arise between climate-related risks and other investment factors (e.g. financial returns), can SFC share its expectations as to how managers should resolve the conflicts which will be considered as acting in the best interest of investors? Examples to illustrate the expectations would be helpful.● The CP provides examples of quantitative and qualitative approaches (Para 55). We would exhort SFC to allow flexibility in the approach when assessing compliance by LCs – i.e. follow the spirit, but not strictly follow the letter.● Para 57: this paragraph seems to conflate climate risk integration (i.e. factoring material climate-related risks into the investment process of portfolios generally) with common sustainable investing strategies which are employed in
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sustainable products. The references to “exclusionary screening, best-in-class screening, norms-based screening and impact investing” seem to suggest that climate risk integration is required only in respect of sustainable products. Climate risk integration is part and parcel of an FM’s fiduciary duty in the management of all client portfolios. It is important that SFC articulates its policy intent – not only for this paragraph, but more generally.

Risk Management (also address Q7)

- The CP proposes Large Fund managers to estimate the WACI of Scope 1 and 2 GHG emissions... if climate-related risks and disclose it accordingly (Para 66 and 77).
- There are different ways for FMs to assess climate risks of the underlying investments. For example, apart from WACI, there are four other metrics which asset managers commonly use to report (such as portfolio carbon footprint, total carbon emissions and carbon intensity). Thus, we believe the risk management approach should be principles-based (e.g. there are cases where the data may not be available) and the Code should not mandate one particular set of metrics.
- Scenario Analysis –
Scenario analysis may not be meaningful in all circumstances as there may be a mismatch between some risk scenarios (e.g. physical risk and transition risk) and the asset classes. For example, FMs may not be able to see a significant impact of physical risks (e.g. Sea level rise, global temperature increase) against certain asset classes (i.e. impact on the revenue or profitability of the investee company) since climate change usually involves longer time frame. Furthermore, as ESG-related tools and metrics as well as data availability are still evolving and may not be available, we would exhort SFC to give flexibility to FMs to determine whether to implement scenario analysis as and when the FM deems it as appropriate, instead of mandating a hard timeframe for FMs to implement. Also, can SFC provide examples to explain its expectations re how the relevance/usefulness assessments are to be made so as to ensure

	<p>consistency in application across the industry?</p> <ul style="list-style-type: none"> ● Para 61 - New paragraphs would be included in Appendix 2 - Suggested risk management control techniques and procedures for funds of the FMCC to elaborate on climate-related risks and our expectations of fund managers. Climate-related risks should be treated in the same manner as other material risks, including market, liquidity and counterparty risks, which a fund is or may be exposed to. Does it mean that the current paragraph E titled "Operational risk" will be regrouped under paragraph F? ● Para 63 - "For climate-related risks which are assessed to be material, fund managers are expected to adopt appropriate measures to manage the risks. There are different approaches..." We would suggest to replace "or collaborate with other stakeholders" by "<i>use voting power/discretion which fund managers may consider to adopt in managing climate-related risks</i>". ● Para 64: For relevant and material climate risks, we agree that ongoing monitoring is necessary. However, for relevant but immaterial climate risks, a periodic review should be sufficient to assess if the risks have become material. We suggest clarifying that periodic reassessments should be carried out as part of the ongoing risk management to determine if additional material climate risks exist. ● We suggest adding the phrase "and material" to the proposed new Paragraph E2 under Appendix 2 of the FMCC: "<i>A Fund Manager should establish and maintain effective systems, policies and procedures to: (i) identify relevant and material climate-related risks...</i>" This would align with the wording of Paragraph 3.11.1 of the FMCC, which refers to risks which are both relevant and material. ● Appendix 2 of the CP, Risk Management – Enhanced – Tools and metrics, 1st bullet: feasibility of implementation is an important prerequisite to this requirement, and hence we suggest amending as follows: : "<i>Assess the relevance and utility of scenario analysis in evaluating the resilience of investment strategies to climate-related risks under different pathways. If the assessment result is deemed to be relevant, and useful and feasible, fund</i>
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managers are required to develop a plan to implement scenario analysis within a reasonable timeframe".

- Para 67 - in respect of assessing the relevance and utility of scenario analysis in evaluating the resilience of the investment strategies to climate-related risks, can SFC provide examples on the types of scenarios or further guidance on the methodology for such scenario analysis?

Disclosure requirements:

- Para 53 - FMs are required to disclose the types of investment strategies or funds for which climate-related risks are considered irrelevant at the entity or fund level. How would the entity and fund level disclosures be different? Can SFC provide examples to explain the differences?
- The proposed baseline requirements in appendix 2 of the CP sets out the manner and frequency of disclosures. Do they also apply to the disclosure requirements under the enhanced standards? If not, what is the SFC's expectation regarding the format, manner and frequency of disclosure as required under the enhanced standards?
- Appendix 2 of the CP, Disclosure – Baseline – Governance, 2nd bullet: Whilst we agree that an annual review of the disclosures may be appropriate, any updates to the disclosures should only be required when the FM considers that material changes need to be made. We strongly oppose to the requirement to inform investors of any material changes made. Sustainability-related processes are expected to continue to evolve. Having to notify fund investors each time there are material changes to such policies and procedures would be disproportionate. We urge the SFC to adopt a less prescriptive approach and instead allow FMs to make a professional judgement of what information would be decision-useful and hence need to be notified to investors. Based on these, we would suggest amending the requirement to *"review and update disclosures at least annually and update disclosures where considered appropriate inform fund investors of any material changes made as soon as practicable.*
- Where should FMs disclose the WACI of Scope 1 and 2 GHG emissions

	<p>associated with the fund’s underlying investments at a fund level (e.g. Factsheet or website) and corresponding reporting frequency. We believe a standardized reporting frequency and format on WACI can allow investors to compare how climate-related risks affect the performance of assets across fund managers and/or funds. In general, as the proposal covers different types of disclosures, it would be helpful if the SFC can provide a template to clearly show what, how, when and where would the disclosures be made.</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"> ● Re what constitutes “relevant/material”, can SFC provide examples of what SFC deems as relevant or material? We understand that it is for the managers to exercise their professional judgement when determining what is relevant and material, but it would be helpful to understand SFC’s perspectives through examples. ● On the basis that there is an established standard and/or framework, FMs agree with the “comply or explain” disclosure approach. And that appropriate records be retained to explain the rationale for the assessment. But we need clarity as to what is SFC’s expectations as to what constitutes <i>justifiable and appropriate records</i>? ● It must be noted that there are some FMs who have different views and opine that time horizon and turnover are not sufficiently compelling reasons for being exempted from climate disclosures, which should still be possible at end periods as a snapshot of what is held in a given portfolio. Again, disclosures and the management of climate risk, or lack thereof, should still be highlighted to investors, unless, for some reason, as per the currency fund example, it is not relevant to the discussion. ● Assuming the proposal is to proceed as it stands, we would exhort SFC to clarify the following: <ul style="list-style-type: none"> ✦ Re the possibility of excluding certain funds from the proposed requirements, could SFC provide more guidance as to the meaning of “... buying all the index *constituents...”? Even though certain funds will be managed under the full replication model, there will be times when certain

	<p>securities cannot be purchased (e.g. if a particular stock becomes restricted).</p> <ul style="list-style-type: none"> ✦ For index tracking funds which have limited flexibility in the choice of investment, is it possible for them to fulfil certain benchmarks (e.g. exceeding 90% replication of the index) such that these funds can be carved out from complying with the climate-related risk requirements or concluded that climate-related risks are irrelevant? As mentioned above, for index tracking funds, we consider having proper investment stewardship activities seeking to manage material sustainability risks and enhancing transparency and reporting of sustainability characteristics of products to investors be the ways that ESG or climate-related considerations are integrated. ✦ Para 53 states that FMs have obligations to disclose where climate-related risks are deemed to be irrelevant. Will this entail listing all strategies/funds on the FM website? What would be covered under the disclosure obligations?
<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"> ● FMs agree that climate-related disclosures (other than WACI) should be made at an entity level (describing the process for the different strategies deployed), and supplemented with disclosures at a strategy or fund level. This would make the process more efficient and cost effective. ● Disclosures at the fund level and entity level address related but different issues. Fund level disclosure is a communication most relevant to clients. Entity level disclosure provides one measure of climate exposure for the entity, while will be of interest of some clients, may be of greater interest to the regulators and other stakeholders concerned with systemic risk. <p>Also see answers for Q5.</p>
<p>8. Do you agree that disclosures of quantitative climate-related data such as WACI should only be</p>	<p>FMs point out that while CO2 emissions is probably one of the most commonly-disclosed and understood ESG metrics currently available, there are a number of issues with the WACI calculation. Apart from there limited availability of data, there are other issues, such as:</p>

<p>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"> ● In relation to the disclosure of WACI, one of the biggest challenges is the availability of data: not all companies disclose the Scope 1 or Scope 2 GHG emission numbers (on Bloomberg). What is SFC's expectations if such data are unavailable, how should the computation be performed (e.g. estimated based on companies of a similar nature), or what assumptions should be used? ● Furthermore, based on the formula, one can see how it would apply to corporate fixed income issuance. However, it is less clear for rates or sovereigns. For eg, would short positions or CDS constitute negative positions in this calculation? Also, how about securitized assets such as mortgage-backed securities, for instance for a pool of residential mortgages, and how such a calculation could be obtained. ● Typically, if an asset manager says it owns 1% of the equity, it claims 1% of the emissions. But is that right? That implies 100% of the emissions are allocated to the equity. If you do the same for debt (e.g., you own 1% of the debt, you get 1% of the emissions) then you are double counting. ● There is no set way to do this and typically FMs see 1% equity = 1% of the emissions. Theoretically, if that's case (and it could be since the equity holders "own" the company), then debt should get nothing. A lot of people are pushing for a split Debt + Equity = 100% and the emissions are divided up that way – based on the claims on the assets. This isn't settled and it seems that managers have different approaches (although technically easier to calculate with 100% going to equities). ● And how about real assets or derivatives? There is also a question around what to do with a long/short fund. Should FMs assume if you are short the stock of the company, that it's WACI is negative? ● In view of the lack of clear industry standards, it seems such regulatory reporting is premature, and the ecosystem enabling and supporting FMs to make the requisite disclosures needs to further mature to enable meaningful disclosures. At this stage, it is vital to take a more principles-based approach by
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allowing FMs to determine which type of data to be disclosed and the tools/metrics to be used instead of mandating the use of WACI – this is vital to help support the investment industry’s ability to effectively measure and manage environmental risk.

More importantly, we would like to stress that metrics/tools are only useful or meaningful if relevant data at the issuer level are widely available. Absent of this basic condition, FMs should not be held to a regulatory requirement. Forward looking metrics can be problematic to the extent things are likely to change in the future. If the FMs cannot meet the metrics then, what would be the consequences and liabilities for FMs?

However, if, despite all these constraints, SFC still wishes to proceed on the basis as specified in the CP, we believe a possible solution is to limit the requirement of WACI to equities first. As the use of metrics/tools in the fixed income is still at a very early and immature stage, we do not think that there is sufficient analysis to support a robust framework for applying these requirements to the fixed income space. Thus, we would strongly exhort SFC to consider extending it to fixed income or multi-asset funds only when there are a more informed and thorough discussions/analysis, on how to consider WACI for these asset classes. To take this forward, HKIFA plans to form a Working Group to study how to apply this to the fixed income space.

We wish to reiterate that WACI disclosure should only be made at the fund level (and not just at the initial stage), and there should NOT be any requirement to mandate WACI disclosure at the entity level. Any WACI disclosure at the entity level is simply not decision-useful. For any FMs with more than a handful of portfolios under management, a metric aggregated across a number of unrelated portfolios does not provide meaningful information on any individual product. It also says very little about what the FM is actually doing in terms of managing climate risks. Furthermore, as mentioned above, there are increasingly debates about the value of GHG emissions as a useful metric. Thus as the landscape is still

	<p>evolving, we would strongly exhort the SFC not to hardwire into the Code any metrics or tools.</p>
<p>9. Do you think the following transition periods are appropriate?</p> <ul style="list-style-type: none"> • 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. 	<p>The proposed timeline is too aggressive, in particular for large fund managers. Due to the complexity of establishing the process to fulfil the requirements, sufficient lead time should be allowed for managers to inter alia, make the necessary changes to the investment process, testing and validating results, implementing changes to the operational processes and systems, repapering, as well as coordination with internal and external stakeholders. Also, one has to assess the relevance and utility of scenario analysis and develop a plan for implementation if it is deemed to be relevant and useful; provide the WACI of Scope 1 and 2 GHG emissions at fund level. Changes to prospectuses of UCITS would require multiple approvals from different regulatory authorities and the approval process is sequential. Based on the assessments of the aforesaid, the larger FMs would at least require 12 months (for meeting the baseline requirements) and 18 months (for enhanced standards).</p> <p>Moreover, we would exhort SFC to align the implementation timeline with that of the EU and (and extend the transition period if there is any delay in the implementation timeline in EU given that the EU regulatory framework is the most advanced regulation and that most funds are UCITs). Keeping in sync the timelines would be extremely important or else there will be various rounds of changes to the ODs and investor notices, which would just overwhelm investors rather than encourage them to embrace this cause.</p>

(End)