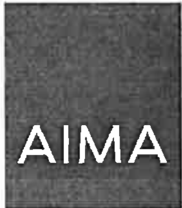

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19 January 2021

Securities and Futures Commission
54/F, One Island East
18 Westlands Road, Quarry Bay
Hong Kong

Sent via email

Dear Sir or Madam,

AIMA Response to the SFC Consultation Paper on the Management and Disclosure of Climate-related Risks (the "Consultation")

The Alternative Investment Management Association ("**AIMA**")[1] appreciates the opportunity to provide feedback on the Securities and Futures Commission's ("**SFC**") Consultation in relation to managing climate change risks.

Previously on 14 August 2020, we provided the SFC with initial comments to the private consultation based on feedback from a small pool of fund managers in our ESG Working Group. Since the release of the official draft Consultation, we have had the opportunity to canvass the opinions of a much broader and more diverse group of fund managers across different sectors of the fund management industry spanning many jurisdictions.

[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than US$2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 170 members that manage US$400 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

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At the initial launch of the Consultation, a large majority of our members expressed that they were deeply concerned about the scope and implications of the Consultation, and have flagged that they are likely to face significant challenges and resource constraints in implementing the baseline requirements and enhanced standards proposed (where applicable). In view of the impact of some of the proposals on our members, AIMA has organized several informal and formal feedback sessions in the course of November 2020 to January 2021 to gather feedback to the Consultation. We reflect the feedback in our response as set out in **Appendix A**.

Regarding the proposed requirements by the SFC, we wish to emphasize below some of the key concerns set out by many fund managers below, which we believe warrant further attention by the SFC.

Limits of SFC's mandate

AIMA would like to emphasize that the prescriptive requirements as set out in the baseline requirements and enhanced standards for LFMs ("**LFMs**") will pose considerable restrictions for fund managers and, with all due respect, go beyond the SFC's intention to take climate risks into consideration and make appropriate disclosures.

Many fund managers have reflected that such climate risk related recommendations are more effective where applied as mandatory disclosures for listed companies, and the SFC risks over-stepping on its mandate in regulating non-ESG focused managers or funds and unauthorised funds in such a broad manner for such a select and specific issue as climate risk.

In particular, a large number of fund managers are of the view that the proposed requirements will likely have an unintentionally negative impact on the ability of fund managers to choose the most suitable investments in a portfolio because climate-related risks are not the same as investment risks, and this may potentially lead to fiduciary duty issues (for instance where pursuing more climate-friendly investments leads to a financial loss). Some fund managers have also brought up the issue of potential conflicts for certain fund managers (eg. fund managers who manage capital for US ERISA governed plans given the counter position the DOL in the US has taken recently with regard to ESG investing[2]), which will limit their ability to subordinate the interests of plan participants and beneficiaries to non-pecuniary goals.

Scope and recommendations of Consultation

The majority of fund managers also believe that the Consultation in its current form is too over-

[2] https://www.dol.gov/newsroom/releases/ebsa/ebsa20201030

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reaching and prescriptive, and does not provide sufficient flexibility to fund managers, each of which is managing its own investment strategy, its own unique client base, and its own regulatory considerations given its operations across multiple jurisdictions. In this regard, it was noted that the Hong Kong requirements appear to be an outlier and are much more onerous than other guidance that we have seen implemented in other Asia jurisdictions with regard to climate risk related issues, including Singapore, Taiwan, Australia, New Zealand, South Korea, Taiwan, and Thailand. As such, the Consultation will likely lead to a chilling effect on the fund management industry in Hong Kong as it poses onerous resource, time and talent constraints on fund managers, at a time when many fund managers are still recovering from the Covid-19 fallout.

Many fund managers have also flagged serious concerns about the assumptions cited in the Consultation, the prescriptive approach outlined for some of the data and governance requirements and expectations, and the onerous resource and talent constraints faced by fund managers, even for many of those who may meet the currently proposed large fund manager threshold of HK$4 billion. It has been suggested by most managers we have spoken to that this threshold be doubled and raised to US$1 billion to also be more aligned with the threshold for a large fund manager in comparative jurisdictions eg. Singapore, or be aligned to a larger fund size (eg. AUM of US$1 billion and above). However, we would like to emphasize that even if the threshold is doubled to US$1 billion and above, the reality is that many local Hong Kong managers with that level of AUM do not have large teams able to meet the demands of these requirements as currently drafted. A firm's AUM is not as closely correlated with the availability of resources as this Consultation seems to assume.

Proposed timeline

Given the low stage of maturity of the industry in terms of ESG integration, and the lack of reliable and consistent ESG data either from listed companies or from third-party service providers, AIMA is of the view that any requirements or recommendations should be phased in for the industry. In this regard, we believe that an 18-month transition period for the baseline requirements and a 24-month period for the enhanced standards -- or such later date when more reliable ESG data becomes available to allow managers to actually comply in a meaningful way with the standards -- will give the industry more time to prepare, assess the available options from public issuers and service providers, and provide meaningful information in the required disclosures.

The phased timeline should also focus on implementation for ESG products and authorised funds, and focus on best practices to consider for those types of managers, rather than mandatory guidelines for non-ESG focused managers or fund managers managing unauthorised funds.

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We thank you in advance for your consideration of this important matter.

We would be happy to provide further information or engage in dialogue which would be helpful to this purpose. Please let us know if this may be of interest and we would be happy to set up a meeting / call for this purpose with some of our members, so that you may hear this feedback and ask any questions directly.

Yours faithfully,

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APPENDIX A

SFC CONSULTATION PAPER ON THE MANAGEMENT AND DISCLOSURE OF CLIMATE-RELATED RISKS BY FUND MANAGERS

Responses on behalf of the Alternative Investment Management Association

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.**

   As we noted in the first response to the soft Consultation, we appreciate that the SFC's general proposal to suggest climate change related guidelines reflects global regulatory developments to make Environmental, Social and Governance ("**ESG**") concerns a central plank of regulation in the financial services industry.

   However, our members are deeply concerned that the requirements in the Consultation are much more over-reaching and prescriptive than climate risk related regulations that have been implemented in other jurisdictions in Asia, including but not limited to Singapore, Taiwan, Australia, New Zealand, South Korea, Taiwan, and Thailand.

   As we noted in our first response to the soft Consultation, given the current low stage of maturity of climate-related risk and investment management practices among fund managers and issues regarding access to reliable data in Asia, many fund managers are likely to 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 prescriptive requirements as set out in the baseline requirements and enhanced standards for LFMs ("**LFMs**") will pose considerable hardships for fund managers and with all due respect, goes beyond the SFC's intention for fund managers to take climate risks into consideration and make appropriate disclosures and is surely an unintended consequence of the Consultation.

   Many fund managers have also flagged that 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 (for instance where pursuing more climate-friendly investments leads to a financial loss or lower profit than another investment). In effect, the SFC runs the risk of overreaching by requiring fund managers to include a new investment criterion being climate-related risks, which will differ from the expectations of investors who invested capital with the manager under the manager's original investment strategy

   Problematic definitions and assumptions

   In particular, we note that some of the factual assumptions cited in the Consultation (see for example our observations on weighted average carbon intensity ("**WACI**") data in Q7) may be subject to challenge, which poses issues when the prescriptive approach outlined for some

of the data and governance requirements and regulatory expectations are clearly based on some of these assumptions.

As an example of a fundamental definition issue, climate-related risks have been defined to encompass physical risks, transition risks and liability risks. However, liability risks are not covered in the Table 1 of the TCFD Recommendations, and are broadly worded in the Consultation Paper, and not easy to interpret. Hence, fund managers are likely to encounter difficulties in discerning the chain of causation required for a listed company to be deemed liable and for a particular scenario to qualify as carrying liability risks. We suggest that SFC can refer to TCFD Recommendations whereby liability risks can result from physical / transition risks, and do not pose a standalone risk.

Issue creep

We note that the Consultation states that climate change is the proposed area of focus, rather than ESG or sustainability factors. However, as a general observation, several of the key examples / industry practices provided in the Consultation refer extensively to ESG or sustainability factors and practices, such as the UN Global Compact Principles and the OECD Guidelines (Practice 4), sustainable factors in governance (Practice 5 to 7), and other social equality and inclusive growth factors (Practice 8). If it is intended for the SFC to focus on climate-risk related areas only, it would be helpful for SFC to only include climate-focused examples in the guidance to avoid confusion about regulatory expectations.

Focus on ESG authorised funds

We are also of the view that there should be a clearer line drawn between the requirements that should be applied to funds that are ESG funds (or advertise themselves in some manner to be ESG) and those that do not. In particular, we are of the view that the requirements in the Consultation should only be applicable for authorized funds with an ESG strategy (see further elaboration in Q5 below), as there should be a higher level of compliance expectation for ESG funds. Currently there is no delineation between ESG and non-ESG funds.

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?**

Although a CIS typically possesses a much larger investor base compared to discretionary accounts, there are certain types of investment vehicles 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.

For example, fund-of-one products and club deals in a fund structure are not rare arrangements in the hedge funds / private funds industry down to a variety of reasons e.g. tax consideration in certain jurisdictions. As such, we are of the view that it would be more appropriate for the SFC to take into consideration the size of investor base in the vehicle, rather than determining that an investment product is in-scope simply because of its classification as a CIS under the SFO. We believe that carving out CIS with a relatively small

investor base shares the same logic and rationale as that of carving out discretionary accounts.

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?**

   Although the SFC makes reference to the TCFD Recommendations, which can be the primary framework in developing the proposed requirements, we think that there should be a flexible and principles-based approach to setting out their requirements. There is also guidance issued by the Climate Disclosure Standards Board and the Sustainability Accounting Standards Board and fund managers should have the flexibility to make the assessment of which requirements and benchmarks to reference for their unique business models. A phased approach is warranted in light of the limitations listed below.

   In particular, it is important that the SFC takes into account the level of maturity of the ESG regulatory landscape in developing the proposed requirements. This is a particular issue for Asia, where the availability of WACI data is limited and the regulation of and social awareness regarding ESG matters among listed companies lags behind other regions, such as Europe and America. Therefore, while making reference to existing international frameworks would help Hong Kong in aligning with international standards in respect of climate risk related disclosures, the practical limitations faced by fund managers in Hong Kong must be taken into account when formulating the final requirements.

   Disclosures based on insufficient and unreliable data would be unfeasible and lead to misleading results. In the case of asset managers that manage portfolios with investments in listed companies in Asia, we also note the lack of relevant disclosure by listed companies in Asia as one of the key bottlenecks when it comes to fund managers' ability to obtain data and determine climate change risks effectively – the starting point from the TCFD is that companies with public debt or equity implement its recommendations and provide relevant data.

   However, Hong Kong fund managers do not have sufficient access to data to meet the requirements on disclosure. This is made even more difficult since many fund managers invest across 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 certain other Asian countries that our members invest in (unlike what is contemplated in Europe to narrow the ESG data gap).

Most fund managers we have spoken to have determined that a large portion of the companies in their portfolio do not provide the requisite data. As such, the obligation for data disclosure at this time is better suited for listed companies rather than for fund managers who will need to hire service providers to provide varying and inconsistent estimates of data which would render any valid comparison meaningless. Hence, we would highly recommend adopting a phased approach to disclosure requirements until the data universe is more mature, with a focus on optional indicators, narrative disclosures, and qualitative information.

Please also see Q8 for our specific comments on WACI.

4. **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 note that the SFC has expressed in the Consultation Paper that LFMs would be required to adopt a more robust approach and make more detailed disclosures, having regard to factors such as the size and complexity of a fund manager's business and investment strategies adopted by the funds under its management.

In principle we do not object to LFMs being subject to enhanced standards. However, despite the larger size of these fund managers, the ability to assess factors such as greenhouse gas ("**GHG**") emissions depends on the availability of data, which is a particular area of concern among fund managers.

Moreover, the currently proposed definition of LFMs would cover a significant portion of fund managers that still do not have enough resources to handle the more stringent enhanced standards. We note that the SFC set this HK$4 billion threshold by picking a specific population (200 firms) that it wished to cover. We respectfully disagree that this is the correct methodology. Given fee pressure in the fund industry today (including fee discounts given to the vast majority of investors in younger funds), AUM size does not necessarily correlate to the level of monetary resources available for a manager to be able to hire additional staff and engage service providers in order to meet the enhanced requirements.

Further, many members who are LFMs have reflected that they have very small teams (2-5 people) in Hong Kong in practice, and they will have to recruit additional staff and expend considerable additional resources in order to fulfil the relevant requirements.

We also note that many of the practice examples provided by the SFC in the Consultation Paper require significant resources (monetary and human) to put in place (see Practice 5-9). As such, we propose that the threshold of LFMs be revised and increased to managers managing Hong Kong assets over US$1 billion. We are concerned that the current threshold of HK$4 billion is very low and would capture a significant number of fund managers that lack the resources to properly comply with the proposed measures. Alternatively, the SFC should consider basing the requirement on specific fund size only rather than manager size, and fund managers have proposed a fund size of US$1 billion as the appropriate threshold.

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

Applicable scope of regulatory requirements

We note that the proposed amendment to the FMCC requirements, baseline requirements and enhanced standards are intended to apply to Hong Kong-based, SFC licensed fund managers generally rather than only to products that are to be regarded as ESG funds.

We suggest that strategy or fund level disclosures should apply only for funds with a climate related strategy. We suggest that the classification of climate-related funds be aligned with the requirements in the SFC's *Circular to management companies of SFC-authorized unit trusts and mutual funds - Green or ESG funds* ("**Circular**"), such that fund level disclosure will only be required for funds investing at least 70% of net asset value in investments reflecting climate-related factors.

At an entity level, we suggest that fund managers be permitted to implement the measures commensurate with their respective business models, size, and particular circumstances. This is essential as fund managers need flexibility and discretion to apply different approaches and considerations as to how climate-related considerations are integrated into the investment management process.

Fund managers should be permitted to implement the updates in a way that is commensurate with the size and nature of its activities, including the investment focus and strategy of its funds.

FMCC requirements, baseline requirements and enhanced standards

We note that the proposed regulatory requirements cover four key aspects, namely governance, investment management, risk management and disclosure.

Specifically with reference to the proposed baseline requirements, we note that with respect to governance, certain duties are imposed on the board and management in relation to climate-related risks, which may be difficult to implement in practice. We suggest that fund managers are given the flexibility to formulate and implement an approach that is most appropriate to them given their respective circumstances.

We note that as a baseline requirement, fund managers are required to factor material climate-related risks into the investment management process, which include, for instance, the incorporation of climate-related data into the research and analysis process. Given the lack of ESG data availability in Asia, this may in practice be a requirement for fund managers to conduct primary research on the companies they invest in, and instead it would be more appropriate if such climate-related data is required to be provided by the relevant companies.

As for risk management, we note that in respect of the enhanced standards, fund managers are required to assess the relevance and utility of scenario analysis in evaluating the resilience of investment strategies to climate-related risks under different pathways. The use of scenario analysis is concerning as it is vulnerable to data manipulation and distortion as

well as tainted by subjective elements – it is questionable if scenario analysis will be able to yield helpful data in practice.

We also note that fund managers are required to identify the WACI of Scope 1 and Scope 2 GHG emissions associated with the funds' underlying investments, where data is available or can be reasonably estimated, and define its calculation methodology and underlying assumptions. It will be difficult for fund managers to assess such data in practice or conduct a reasonable estimation of such data.

Regarding disclosure requirements, please refer to our response to Question 6 below.

Stewardship requirements

It is important to note that listed company engagement in itself is a type of investment strategy that many funds do not engage in. Investors will look for funds that employ this strategy if they want it and similarly, investors who invest in funds that do not have an engagement strategy may not want those funds to start doing so.

We would also like to re-assert our observations about stewardship requirements being imposed on fund managers. As we have noted in response to the soft Consultation, discretionary authority and engagement alone may not be effective in changing listed company behaviour, where the manager is only a minority shareholder, as it may not have enough influence.

Some fund managers have also noted the limitations of access to investee companies. Proxy voting may not be relevant to certain hedge fund strategies e.g. those that are not direct equity strategies such as those that use only derivatives which usually do not carry voting rights. In such circumstances, the ability and scope for a hedge asset manager to be able to influence investee companies will depend on whether at all it has any access to the investee company. Also, some asset managers have reflected that the proxies of the companies that they invest in do not contain any ESG measures typically and are therefore not an effective tool to push for ESG change at a company in Asia.

This may also create an uneven playing field for asset managers. Large fund managers often have more resources and indeed larger holdings to make their engagement efforts more meaningful and effective in managing material climate risks. For active hedge funds, if they see a material risk associated with a holding it often makes more sense to divest instead of spending resources on engagement. The requirement to disclose an engagement policy, applying to all managers, creates an uneven playing field where smaller/active managers could be perceived as not doing enough. Also, it places an obligation on some managers to devote resources where the cost/benefit analysis may not make sense.

This requirement would also conflict with foreign direct investment restrictions in various jurisdictions. For example, Japan's new FDI regime requires pre-approval for investments above a certain threshold if the investor is not purely passive and looks to exert influence on the company's operations.

The extent to which the asset manager would be expected to effect change will generally depend on the specific situation, the amount owned by the fund, and where the fund sits in the capital structure of the listed company.

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 LFMs 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 agree with the use of a phased implementation approach. That said, regarding the enhanced standards, in view of the broad definition of LFMs, they will likely face practical challenges in implementing the relevant requirements (particularly in relation to quantitative assessment and disclosures pursuant to the enhanced standards). In particular, please see Q8 for our concerns that presently there may be a lack of reliable data from listed companies and asset managers will need more time to assess the available options from service providers, which are still developing.

As such, we propose that the baseline transition period be extended to 18 months in view of the considerable challenges for fund managers in the industry to deal with the proposed amendments, which is also in line with the extended timeline in Singapore for the Environmental Risk Management Guidelines. We also suggest that a 24-month transition period be given to LFMs to comply with the enhanced standards, or such later date as more reliable data becomes available in the industry.

The phased timeline should also focus on implementation for ESG products and authorised funds, and focus on best practices to consider for those types of managers, rather than mandatory guidelines for other non-ESG focused managers or fund managers managing unauthorised funds.

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 note that the SFC proposes to allow fund managers to explain where they consider climate-related risks are considered irrelevant. These fund managers would be subject to corresponding disclosure obligations at an entity or fund level in addition to maintaining the appropriate record of justifications (the "**Explanatory Statement**"). The SFC has proposed that fund managers would be required to review and update disclosures at least annually and inform fund investors of any material changes made as soon as practicable.

We note that there are many fund managers which do not have an express ESG focus. Some fund managers carrying out quant, high frequency trading and macro strategies have also reflected that climate risks are not as relevant to their strategies. Many of our members have

reflected that it will be onerous and resource intensive for these firms to have to prepare detailed public statements or make regulatory submissions as to whether the ESG disclosure requirements do not apply to such funds. It will also be difficult for such fund managers to make assessments on a specific product-by-product level.

We also disagree with the SFC that such cases will be rare, as many fund managers have reflected that it is quite likely that on balance, climate related risks would be irrelevant to the investment risk of their fund strategy. As such, we would urge the SFC to make the preparation of such an Explanatory Statement optional for fund managers that are not LFMs, given the considerable resources required needed.

We also note that there was lack of clarity in the Consultation as to the implications of having issued an Explanatory Statement. It would appear that upon determining that climate risks are irrelevant, the fund manager would need to issue an Explanatory Statement, and then there will be no more obligations. If the climate risks are relevant, the manager then needs to assess whether the climate risks are material. If they are not material, then only the governance requirements need to be complied with. It would be preferable for SFC to confirm and clarify that this is the intended approach as many fund managers have expressed that the relevant considerations applicable are unclear upon the issuance of an Explanatory Statement.

Some fund managers have also brought up the issue of potential conflicts for certain fund managers (eg. fund managers who manage capital for US ERISA governed plans). The United States Department of Labour ("**DOL**") has introduced changes to the Employee Retirement Income Security Act of 1974 ("**ERISA**"), which severely limits the ability of ERISA fiduciaries to invest in ESG investments. In particular, the proposed rule requires ERISA fund managers to invest based on financial considerations only and prohibits them from subordinating the interests of plan participants and beneficiaries to non-pecuniary goals like ESG, ESG factors can be pecuniary *"only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories",* which creates a high hurdle for ERISA investors to invest in funds that consider climate-risk related factors. We propose that fund managers should also be able to cite such relevant conflicts as a justifiable explanation for opting out through the Explanatory Statement.

There are also some types of fund strategies where such disclosures may be difficult. In the case where a manager has a position in exchange traded funds for example, there are issues in classifying such funds, and how to assess the materiality of climate risks for such funds. Where such funds are rebalanced on a regular basis, it is also likely to impact relevant disclosures.

We note that there may be fund managers with an overall ESG policy, which allow for ESG considerations to be factored into a decision or investment management and governance, but which do not themselves pursue specific ESG strategies or have any ESG focused funds. We suggest that such fund managers should still have the option of also opting to prepare an Explanatory Statement only since ESG specific disclosures are not relevant to their business model. Such overall ESG policies are often drafted to encompass corporate level ESG measures irrespective of the fund-level ESG orientation.

With regard to disclosures that are required for ESG funds, these should only needed to be reviewed annually and updated where considered appropriate. Whilst an annual review may be reasonable, disclosures should only be required to be updated when considered appropriate and necessary by the manager. More importantly, it does not make sense to inform fund investors every time material changes are made to firm-wide policies and processes, especially in a nascent area such as sustainability which is expected to evolve, where changes could well be material but not decision-useful. Managers should be able to exercise its own judgement as to whether and how investors are notified of changes to such policies and procedures.

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 only to the extent that such disclosures should be required only for funds with a climate related strategy. We suggest the classification of climate-related funds should be aligned with the requirements in the SFC's *Circular to management companies of SFC-authorized unit trusts and mutual funds - Green or ESG funds* (the "**Circular**"), so that fund level disclosure should only be required for funds investing at least 70% of net asset value in investments reflecting climate-related factors. Fund managers should have the flexibility to scope their disclosures with a focus on proportionality and materiality considerations.

We also note that the Circular also sets out disclosure requirements in respect of ESG authorised funds which certain fund managers within the industry are already finding challenging to comply with.

The regulatory framework for non-SFC authorised funds has always focused on manager conduct, as opposed to fund level regulation. We believe ESG requirements should be no exception. Investors in private funds are typically sophisticated and are in a position to request related information from managers should this be of concern (in fact almost all investors already do so). To implement disclosure requirements to non-SFC authorised funds would be overly burdensome and will not add much value to enhancing information disclosure. For this reason, we do not agree with applying product disclosure requirements to climate/ themed funds that are not authorised by the SFC.

8. **Do you agree that disclosures of quantitative climate-related data such as WACI should only be applicable to LFMs 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?**

As noted in our response to Question 4, our view is that the currently proposed definition of LFMs is overly broad. Consequently, resource and manpower issues will likely be faced by a considerable proportion of fund managers falling under the current definition of LFMs.

In addition, while we understand the rationale for the requirements on governance, investment management decision making, risk management and tools and metrics, fund

managers are concerned with the practical implications of these requirements, especially to the extent that quantitative assessment is expected of managers on climate-related risks.

There remains the question of access to reliable data for fund managers, which is needed in the implementation of their targets or processes as required under the proposed FMCC changes. Even where third party experts are engaged, the same data limitations may be faced.

There may also be data manipulation issues which may lead to distortion of the results of climate-scenario testing, and lack of standardization of ESG scores. Quantitative assessment and disclosure is a key area of concern among fund managers.

We would ask the SFC to allow fund managers to have greater flexibility over (1) the level of detail of such processes, controls, procedures, actions, goals and targets; and (2) how fund managers evaluate their performance against such goals and targets. We also suggest that quantitative assessment should be optional, and that any regulatory expectations consider the level of maturity and availability of data in the industry.

WACI data specific considerations

In particular, we suggest that the requirement on WACI disclosure by LFMs should be only a suggested, rather than a mandatory, approach in view of challenges in relation to the reliability and usefulness of such data, and practical difficulties in implementation.

Many managers have reflected that WACI data would not be useful for investors in general and will be relevant only for ESG funds. Further, WACI disclosure at an entity level, aggregated over potentially many unrelated portfolios, is not an informative or decision-useful metric to ask for. It will not provide investors with any valuable information about the product or the manager in question.

While we note that such requirements are qualified in that it applies where data is available or can be reasonably estimated, this may in effect impose a duty upon LFMs to make reasonable estimations of such data which would be difficult, if not impossible, in practice to achieve. Some fund managers have reflected that WACI data is currently not published by issuers for a large majority of the universe of the companies in which they invest, given that many countries have not yet implemented mandatory listed company ESG disclosures of a standardised nature. The core skill set of fund managers is identifying and evaluating financial metrics and investments. To estimate WACI data to any useful level of accuracy is a highly specialized task that requires expertise in environmental sciences that is completely tangential to the core competencies expected for fund management. It is therefore not possible for a fund manager, without hiring environmental expertise, be able to make a "reasonable estimate" of WACI data.

Although there are data providers who currently provide WACI related data, such services come with their own costs and limitations and fund managers will have to spend time and effort to assess these different options. It has been noted by some members for example that this would likely be more challenging in Hong Kong compared to Singapore, where there

have been some monetary grants[1] provided by the Monetary Authority of Singapore to aid fund managers with such efforts.

[1] Please see https://www.mas.gov.sg/schemes-and-initiatives/financial-sector-development-fund-fsdf for examples of the grants which have been made available, which some fund managers operating in Singapore have reflected have assisted them to put into place infrastructure to help comply with the MAS Environmental Risk Management Guidelines.