Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email (2020_Climate_Consultation@sfc.hk)

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Our Ref.: C/CFAP/IFRAP, M128713

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

Dear Sirs,

Re: Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers

The Corporate Finance Advisory Panel and Investment Funds Regulatory Advisory Panel of the Hong Kong Institute of CPAs ("the Institute") have considered the Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers ("CP"), issued by the Securities and Futures Commission ("SFC"). Based on their feedback, our views on the proposals are as outlined below.

In principle, the Institute supports the proposed direction of travel that fund managers should be equipped to assess the potential impact of environmental, social and governance ("ESG")-related issues on their business, and to disclose more ESG information to investors. We agree that, in order to do so effectively, fund managers need to have suitable institutional arrangements and processes in place for information gathering, risk assessment and management, strategy development and disclosure, among other things. We would also agree that suitable points of reference and benchmark should be provided and that, in relation to climate-related financial disclosure, the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD") are widely recognised as providing an appropriate framework.

On the implementation side, the fund management sector is better placed to comment on industry readiness, timetables, etc. However, it would seem to us that additional practical guidance will need to be provided in order to realise the objectives in a meaningful way.

Our responses to the specific questions in the CP are as indicated below.

Q1 - Do you have any comments on the SFC's proposal to focus on climate change or should have a broader spectrum of sustainable finance should be considered in development the requirements? Please explain your view.

The Council for Sustainable Development in Hong Kong recently issued a *Report on Public Engagement on Long-term Decarbonisation Strategy* calling for Hong Kong to be carbon neutral by 2050 (https://www.susdev.org.hk/download/report/council_report_e.pdf. Subsequently, in the Policy Address (paragraph 126), the chief executive announced that Hong Kong SAR will strive to achieve carbon neutrality before 2050. This is also listed as one of the items in Policy Address highlights, under "Sustainable City Development" (https://www.policyaddress.gov.hk/2020/eng/highlights_1.html).

Concrete steps will need to be taken as early as possible in order to achieve this objective, which itself should be seen in the context of the Paris Agreement to which Hong Kong acceded under the commitments of the People's Republic of China.

In view of the above, it makes sense to focus on climate change first rather than waiting for the development of a framework to cover a broader spectrum of sustainable finance, which could be more complicated.

However, going forward, SFC should at an appropriate time consider including requirements in relation to other key ESG factors.

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

The CP proposes that, at the initial stage, the requirements should be applicable to fund managers thath manage collective investment schemes ("CISs"), irrespective of whether they have delegated their investment management function to other intermediaries, because, it is stated, CISs account for a significant proportion of the total assets under management ('AUM") by licensed corporations.

At the same time, we note from the SFC's "Asset and Wealth Management Activities Survey 2019" that managed accounts contribute around 30% of the total of AUM (Chart 6A) and, it would seem, an increasingly large share, judging by the very substantial increase between 2018 and 2019. Therefore, while it may be more straightforward to apply and monitor the proposed regulatory regime in relation to CISs initially, in our view, there should be roadmap for applying the regime to discretionary accounts. This should be the case, particularly where 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, because the relevant fund managers should be providing similar information to that being proposed to demonstrate that they have the ability to comply, and are complying, with the investment mandate. Even where there is no such mandate, it should not be assumed that investors are not interested to have ESG information, and having such information may influence investors to pay more attention to climate-related issues, which should be among the objectives of the proposals. We note also that the consultation paper (paragraphs 41-42) proposes that "Large Fund Managers" should be subject to a "more robust approach" and make more detailed disclosures, and that discretionary account assets under management will be taken into consideration when determining whether or not a fund manager is regarded as a Large Fund Manager.

Q3 – Do you agree that the SFC should make reference to the TCFD Recommendations in developing the proposed requirements so as to minimise fund managers' compliance burden and foster the development of a more consistent disclosure framework? Other than the TCFD reporting framework, is there any other standard or framework which in your opinion would be appropriate for the SFC to refer to in developing the proposed requirements?

We agree that the TCFD Recommendations provide a good and increasingly-widely-adopted framework for reporting climate-related financial disclosures. We would, however, suggest that the SFC take note of the dynamic situation and recent developments in this area before finalising implementation plans. These developments include:

- Statement of intent to work together towards comprehensive corporate reporting by CDP, Climate Disclosure Standards Board, Global Reporting Initiative, International Integrated Reporting Council ("IIRC") and Sustainability Accounting Standards Board ("SASB") (11 September) (https://impactmanagementproject.com/structured-network/statement-of-intent-to-work-together-towards-comprehensive-corporate-reporting/)
- IFAC calls for creation of an International Sustainability Standards Board Alongside the International Accounting Standards Board (11 September 2020) (https://www.ifac.org/news-events/2020-09/ifac-calls-creation-international-sustainability-standards-board-alongside-international-accounting?utm_source=IFAC+Main+List&utm_campaign=b40da4d1be-SMP_Survey_Email_to_MBs_11_3_2016_COPY_01&utm_medium=email&utm_term=0_cc08d67019-b40da4d1be-80290401)
- IFRS Foundation Consultation Paper on Sustainability Reporting (https://cdn.ifrs.org/-/media/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf) (September 2020)
- IIRC and SASB announced their intention to merge into a unified organisation, the Value Reporting Foundation (25 November 2020) (https://integratedreporting.org/news/iirc-and-sasb-announce-intent-to-merge-in-major-step-towards-simplifying-the-corporate-reporting-system/?utm_source=IFAC+Main+List&utm_campaign=cfd424a26e-SMP_Survey_Email_to_MBs_11_3_2016_COPY_01&utm_medium=email&utm_term=0_cc08d67019-cfd424a26e-80290401).

The implications of some of these developments may not be entirely clear for some time, but the point to emphasise is that the area of ESG, including climate-related reporting, is a changing landscape and any specific proposals should, as far as possible, be sufficiently flexible as to be able to accommodate relevant future developments in the field.

Q4 – Do you have any comments on the proposed basis for determining the threshold for Large Fund Managers, i.e., HK$4 billion, and the basis for reporting? Please explain your view.

Based on the information provided, HK$4 billion seems to be a reasonable threshold. We understand that the SFC made reference to overseas regulations, i.e. (a) Article 173 of the French Law on Energy Transition and Green Growth; and (b) Alternative Investment Fund Managers Directive issued by European Union ("EU") for determining the threshold for Large Fund Managers, and the basis for reporting (paragraph 43 of the CP).

Meanwhile, we would like to seek the clarification on whether the monthly AUM, as stated in paragraph 42 of the CP, refers to the "average monthly AUM".

Q5 - Do you have any comments on the proposed amendment to the Fund Manager Code of Conduct ("FMCC") requirements, baseline requirements and enhanced standards? Please explain your view.

It is indicated in paragraph 44 of the CP that the SFC plans to issue a circular setting out the baseline requirements and enhanced standards for fund managers, together with sample industry practices based on input from the Climate Change Technical Expert Group, which it has set up. This will obviously be a very important document and we would suggest that it may be advisable to have further consultation with stakeholders before this is issued. We note that Appendix 2 of the CP gives an indication of the proposed baseline requirements and enhanced standards, but more detailed and specific guidance could be provided on, for example:

- The level of detail expected in disclosing the climate-related risk in the portfolio construction process and the frequency of such disclosures.
- Climate-related risk management for common investments such as collateralised debt instruments; credit default swaps; options; loans, pre-initial public offering stocks; debentures and start-up projects.
- The threshold for "materiality" in terms of climate-related risk exposure in CISs managed by fund managers (referred to in paragraph 64 of the CP).
- The extent of the requirements for different types of investment strategy. In addition to many global asset managers catering to the retail public, Hong Kong is also the centre for many family offices, hedge funds and private equity managers, who cater mainly to professional investors and institutions, and engage in various strategies, such as macro, loans, derivatives and other bespoke mandates. Under the proposed baseline requirements for risk management, fund managers need to identify, assess, manage and monitor the relevant and material climate-related risks for each investment strategy and fund. If fund managers managing discretionary accounts are to be included within the framework in the future, then, to facilitate alternative managers, more guidance and clarification on the extent of requirements for different types of investment strategy may be needed.

Under Section 3.1 – *tools and metrics* in the CP, it is expected that fund managers can apply appropriate tools and metrics to assess and quantify the climate-related risks. Although, at paragraph 55, the SFC explains that fund managers may consider adopting methodologies suggested by international reporting frameworks, such as SASB and the United Nations-supported Principles for Responsible Investment, in conducting the assessment, in practice, whether fund managers can make an appropriate assessment of climate-related risk will be highly dependent on the information and data that they can obtain from investee companies. As the information from investee companies, as well as the tools and metrics to be used by different fund managers will not be standardised, the level of information provided by fund managers may vary. We suggest that the SFC consider giving further guidance to fund managers on the disclosure requirements, with a view to e.g. standardising some disclosures, so that the investors can more easily compare the information that they receive from different fund managers.

Further, we suggest that the revised FMCC requirements should, as far as possible, be aligned with the requirements of EU, on the basis that there are many Undertakings for Collective Investment in Transferable Securities ("UCITS") selling to the public in Hong Kong. This would help to make the revised rules easier for managers of different types of funds, including UCITS, to follow and to avoid confusion for investors.

Q6 – To provide a clear picture to investors on whether a fund manager has integrated climate-related considerations into its investment strategies or funds, do you agree that if the fund manager considers that climate-related risks are irrelevant to certain investment strategies or funds, it should make disclosures and maintain appropriate records to explain the rationale for its assessment?

Q7 – Do you agree that climate-related disclosures (except for the disclosure of weighted average carbon intensity ("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 with the above two proposals.

Q8 – 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 recovered? 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?

There are concerns about the data quality and accuracy relating to climate-related risks provided by various service providers, especially for the purpose of calculating the WACI of Scope 1 and 2 greenhouse gas emissions. These are acknowledged but not really addressed by the SFC in the CP (paragraphs 76-78). This could prove to be relatively technical and challenging for fund managers as data availability is also an issue. It would be helpful, therefore, if the SFC could provide more guidance in the selection of third party data providers.

At the same time, the SFC may also consider requiring or encouraging Large Fund Managers to obtain assurance from external professional service providers with expertise in this area, on the disclosures and/or the process itself, with regard to climate-related risks.

Q9 – 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.

The fund industry will be better placed to provide views on the feasibility of the proposed transition periods.

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Should you have any questions on this submission, please feel free to contact me at the Institute.

Yours faithfully,

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