

15 January 2021

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

By email: 2020_Climate_Consultation@sfc.hk

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

Dear Madam / Sir,

CFA Institute¹ and CFA Society Hong Kong are pleased to provide you with our perspectives on areas for consideration in relation to the consultation paper issued by the Securities and Futures Commission (“SFC”) on the management and disclosure of climate-related risks by fund managers (the “Proposal”).

Our comments are consistent with the objective of CFA Institute and CFA Society Hong Kong to promote proper disclosures for products and services that claim to utilize specific processes and provide specific outcomes in relation to sustainability, climate change, and environmental, social and governance (“ESG”) issues. We believe the integration of material ESG factors is an important component of a complete and thorough financial analysis. We are specifically focused on the advancement of the availability, quality, consistency, and comparability of ESG information from corporate issuers and fund managers, since better transparency helps the investing public make informed decisions. CFA Institute is in the process of developing a global, voluntary standard for ESG disclosures for investment products and we support regulators requiring such disclosures from institutional fund managers.

As attention has intensified on potential risks brought about by ESG issues, there has been a proliferation of investment products with green, climate change, sustainability or ESG themes. However, products differ in their approach, and the lack of common definitions has led to much confusion among investors, as well as concerns over green- or ESG-washing. Indeed, in a global survey² of CFA Institute members carried out in March 2020, in which CFA Institute surveyed 325 C-suite executives and 373 ESG specialists, 78% of respondents thought there is a need for standards

¹ CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154 member societies in 77 countries and territories.

² “Future of Sustainability in Investment Management: From Ideas to Reality”, CFA Institute, December 2020, <https://www.cfainstitute.org/-/media/documents/survey/future-of-sustainability.ashx>

to mitigate greenwashing. In this light, CFA Institute and CFA Society Hong Kong welcome the SFC's effort in mandating climate-related disclosures from asset managers.

While we agree in principle with the direction of travel as laid out in the Proposal, we recognize that mandating disclosures from asset managers on sustainability, climate risk and ESG issues is a relatively recent phenomenon, and with the exception of the European Union ("EU"), the mandatory requirement has not been adopted on a large scale. That said, the trend is clear: there is an urgent need for standardized information. Further, the EU initiatives will likely have extra-territorial impact on the Asia Pacific region, given the number of UCITS funds marketed here. It is therefore reasonable to assume that the demand for such disclosures will grow and evolve over time as international best practice emerges, and as it becomes clear what is achievable and useful in the Asia Pacific or Greater China context. We therefore anticipate this consultation to be the first of a series from the SFC, and we hope that it will accelerate the move toward higher transparency on sustainability matters, which will in turn help combat greenwashing.

In the draft Regulatory Technical Standards³ ("RTS") to Regulation (EU) 2019/2088 (on sustainability-related disclosures in the financial services sector), released as an open consultation in April 2020 by the three European Supervisory Authorities, the ambition is clear. The expected level of detail required from asset managers in the EU both at the entity level and at the fund level is significant, with 16 proposed indicators under the climate and environment chapter (including both quantitative and qualitative ones), and another 16 under social, employee and human rights. The consultation process for the draft RTS ended in September 2020. The conclusions, as and when they become available, will be instructive for everyone in the industry.

In Hong Kong, the Proposal outlines baseline requirements and enhanced standards on governance, investment management, risk management, and disclosures. There are two levels of disclosure requirements: first, fund managers have to disclose their approach, process and structure for governance, investment management and risk management, and whether climate-related risks have been assessed to be irrelevant either at the entity level or at the fund level. If a fund manager exceeds a certain size of assets under management ("Large Fund Managers"), they will also have to disclose their engagement policy and examples of such engagement. Second, for Large Fund Managers, fund-level disclosures on weighted average carbon intensity ("WACI") are required.

We believe the first level of disclosure, where a fund manager essentially provides a description of their processes and structures, is reasonable, well within the control of the fund manager, and in line with expectations of stakeholders and with the emerging international best practice. If climate-related risks have been assessed to be irrelevant, we believe both the fact itself as well as the rationale should be disclosed. In the Proposal, there is no specific requirements as to where such disclosures should be placed. Our view is that these disclosures should be part of the key facts statements, so that investors can have ready access to this information as part of the sale process, even if the information may not be fund-specific.

For investors trying to evaluate and select the right investments, disclosures on key ESG indicators at the fund level may be more pertinent and useful, especially if (1) they are presented as a time series;

³ "Joint RTS on ESG disclosure standards for financial market participants", EBA, EIOPA, ESMA, April 2020, <https://eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/joint-rts-esg-disclosure-standards-financial-market-participants>

(2) targets for such indicators are set (and a track record is shown to determine if the targets are being met); (3) they can be compared across funds from the same fund manager; and (4) they can be compared across funds from different fund managers. However, we recognize that such disclosures are difficult to compile and have many dependencies and limitations. While this may not be attainable at this juncture, it is certainly something to aim for.

Currently, the Proposal calls for disclosure of WACI at the fund level for Large Fund Managers. This requirement is a reasonable one but there are certain caveats.

- First and foremost, WACI at the fund level is highly dependent on the availability and quality of disclosures by portfolio companies. Some of these investments may be unlisted, or may be listed in markets where issuer ESG disclosure is still in the nascent stage. Even in markets where issuer ESG disclosure is relatively more advanced, such disclosures are often not assured, leading to questions on data integrity.
- Second, if company disclosures are not available, the fund manager has the option of acquiring data from third party providers, or excluding from the calculation those investments for which data is not available. The first option would mean higher costs for Large Fund Managers, and we acknowledge the rationale that Large Fund Managers have relatively more resources to spend on data acquisition and compilation. The second option, however, means that the calculation of WACI is highly subjective, and may potentially be manipulated, which would diminish its usefulness to end investors.
- In addition, since it is not time-weighted, the proposed measure only provides an indication of a fund's carbon intensity at the point of calculation, and hence is subject to potential window dressing — fund managers may sell a carbon intense investment and buy it back shortly afterwards as a means to manipulate a fund's WACI. While a time-weighted WACI may not be achievable at this stage, it should be kept in view.
- Fourth, there should be more clarity on (1) the methodology for calculating carbon intensity for bonds, be they corporate, sovereign, or green bonds; and (2) the treatment of cash and derivatives. For example, for corporate bonds, additional adjustments may be needed to take into account the size of the bond issue relative to an issuer's enterprise value. For sovereign bonds, GDP and/or GDP per capita adjustments may be desired. As a reference, in the EU, the intention is to precisely calibrate this calculation through the EU Taxonomy and the associated RTS.
- Lastly, WACI is a backward-looking metric and doesn't provide fund managers and investors with the information on the extent of transition risks embedded in the portfolio. In the CFA Institute report titled [Climate Change Analysis in the Investment Process⁴](#), we note the importance of scenario analysis as a tool to understand how a company in a climate-sensitive industry might be affected by a diverse set of global regulations over the next 10 years. Instead of waiting for perfect information, fund managers may wish to use some of the well-known open-source climate scenario tools such as the Paris Agreement Climate Transition Assessment (PACTA) and the Transition Pathway Initiative (TPI). PACTA, for

⁴ "Climate Change Analysis in the Investment Process", CFA Institute, September 2020, <https://www.cfainstitute.org/-/media/documents/article/industry-research/climate-change-analysis.ashx>

example, aims to help financial institutions integrate climate objectives and risks into portfolio management. It is used by more than 1,500 financial institutions and regulators, such as the Bank of England, to assess the climate risk of their regulated entities. The SFC may wish to consider highlighting some of the resources available to help the transition process.

Given general data gaps, the explanations provided by fund managers on data sourcing, underlying assumptions, and limitations would be as important as the fund WACI itself, and the SFC should set a high bar to ensure disclosures are meaningful and not boiler-plate. In this regard, as part of the proposed enhanced disclosure standards, a discussion by the fund manager on the direction of travel as well as an indication of a target for WACI would be extremely helpful for investors.

We agree that a passive investment strategy should not automatically be carved out from the proposals — stewardship and engagement are important responsibilities of a fund manager and an area of increasing focus for passive fund managers. Further, the SFC should clarify whether the proposed enhanced standards (including the disclosure of engagement policies and WACI) would apply to all Large Fund Managers regardless of whether they consider climate-related risks relevant. Our view is that they should.

While increasing transparency and disclosure is a laudable goal, one refrain we have heard consistently in the past is that investors don't "understand" or "need" such information. In the aforementioned CFA Institute report on climate change analysis, a global survey was conducted to help gauge investment professionals' understanding of ESG and climate change issues. When asked if investment professionals faced client demand for portfolios with transition pathways for lower carbon intensity, and if clients were asking for more on climate change, 68% and 55% of global respondents, respectively, replied "no". When segmented into three key regions of the Americas, Asia Pacific, and Europe, Middle East and Africa, the proportion of respondents selecting "no" to both questions was the highest in Asia Pacific: 77% and 66%, respectively⁵.

It is the view of CFA Institute and CFA Society Hong Kong that client demand is as potent as statutory regulations in encouraging change, and it is of utmost importance that end investors understand, appreciate and in turn help drive these changes. The results of the survey suggest that in this region, there is scope to raise awareness on the demand side.

In Hong Kong, the Investor and Financial Education Council has done exceptional work in retail investor education and will continue to have an important role to play in this area. In a market where funds are "sold, not bought", intermediaries perform an important function, acting as an interface between fund managers and end clients. It may be worthwhile exploring the role intermediaries can play in promoting and educating end clients in this area.

⁵ Ibid, page 19

Conclusion

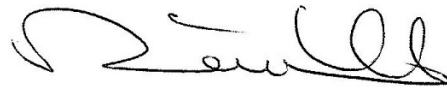
We believe the SFC's effort to require climate-related risk disclosures from asset managers is a worthwhile one. We acknowledge the desire to maintain a balance between the need to provide decision useful information to investors and combating greenwashing without over-burdening asset managers. The Proposal is an important first step and a key milestone for Hong Kong.

Should you have any question about our positions, please do not hesitate to contact Mary Leung, CFA, at mary.leung@cfainstitute.org.

Yours faithfully,



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Appendix A: Answers to specific questions in the consultation paper

- 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.**

We support the SFC's proposal to focus on climate change in developing the requirements, with the expectation that it will broaden over time to include other ESG and sustainability indicators. As both supply and demand for such products increase, there is a risk of green- or ESG-washing. That said, the pace of developments across jurisdictions and across segments of the industry in Hong Kong is uneven. We believe that an initial focus on climate change will provide maximum flexibility and will allow further changes to be implemented as and when appropriate.

- 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?**

We agree that the proposed requirements be applied to CISs but not discretionary accounts at the initial stage, given the potential complexity of managing multiple accounts with diverging mandates. This is particularly pertinent to private wealth managers. If discretionary accounts were to be included at a subsequent stage, it would be important to undertake further industry consultation to establish the appropriate thresholds.

- 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?**

We support making a reference to TCFD Recommendations in developing the proposed requirements. The TCFD Recommendations have been widely recognized and adopted by many stakeholders, including issuers, regulators, and professional bodies. This will help avoid fragmentation and duplication of competing frameworks.

- 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.**

We believe HK\$4 billion is an appropriate threshold and is in keeping with the spirit of proportionality in governance principles and with international standards. Given that nearly 90% of licensed fund managers in Hong Kong fall below the threshold, it is important to focus on the baseline requirements and to refrain from placing undue burden and cost pressures on such a large part of the industry.

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

We support the principles-based approach set out in the proposed FMCC amendments. It is important to provide as much flexibility as possible to the industry in adopting the baseline requirements and in the implementation of the enhanced standards. As mentioned in the main body of our letter, our members have raised concerns on data availability and the uniformity of disclosures from issuers, which may pose challenges to fund managers in assessing and

disclosing climate-related risks. Once the SFC has consolidated feedback from industry practitioners, we expect further guidance to be provided in the form of post-implementation guidelines and circulars.

- 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 agree. For a number of specialised strategies in the funds space (e.g. CTA / managed futures, macro funds, quantitative funds, passive index funds) the climate related considerations could be considered irrelevant. A full disclosure and record-keeping of the rationale for its assessment should be the minimum requirement. In the case of a managed futures fund, it can be argued that the manager may be able to avoid underlying securities considered “climate-deteriorating” (e.g. certain commodity futures). However, in the case of passive equity index funds, it would be up to the fund investors rather than the portfolio managers to push the index provider to exclude companies with high sustainability risks or poor ESG ratings from the index.

- 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?***

Agree. The disclosure requirement at an entity level should enable investors to understand how climate-related risks are being factored into the portfolio construction process, as well as the key tools and metrics used in the investment and risk management processes. Additional disclosures at the strategy or fund level would only be necessary if different processes are adopted among different fund products.

- 8. *Do you agree that disclosures of quantitative climate-related data such as WACI should only be applicable to Large Fund Managers having regard to the resources required and the size of assets covered? Do you agree that at the initial stage the disclosure of the WACI should be made at the fund level instead of the entity level?***

As mentioned in the main body of letter, we agree that the disclosure of quantitative climate-related data should be applicable to Large Fund Managers, given the potential heavy burden for smaller fund managers who have limited resources to devote to compliance with more complex requirements.

The SFC should clarify if the proposed enhanced standards (including the disclosure of engagement policies and WACI) would apply to all Large Fund Managers regardless of whether they consider climate-related risks relevant. Our view is that they should.

The disclosure of WACI at the fund or strategy level is reasonable but we would like to reiterate the challenges fund managers face, especially in terms of the availability and quality of the data for the computation of WACI. Further, different reporting requirements by issuers across different markets may hinder the proper calculation of the WACI for multi-asset global/regional funds.

9. Do you think the following transition periods are appropriate?

- ***a nine-month and a 12-month transition period for Large Fund Managers to comply with the baseline requirements and enhanced standards respectively; and***
- ***a 12-month transition period for other fund managers to comply with the baseline requirements.***

If not, what do you think would be an appropriate transition period? Please set out your reasons.

In our view the proposed transition periods of nine months for Large Fund Managers and 12 months for other fund managers to comply with the baseline requirements are sufficient, as the transition mostly involves establishment of processes and structures for governance, investment, and risk management. On the other hand, a 12-month transition period for Large Fund Managers to comply with the enhanced standards may be challenging as it will involve, in addition, the development of new IT tools and system enhancements.

Appendix B: List of CFA Society Hong Kong professional learning events on ESG and sustainability

ESG and sustainability issues have become increasingly important and relevant to investment professionals, regulators and governments. As Hong Kong's leading investment professional body, CFA Society Hong Kong has been actively promoting the common standards and best practices in sustainable investing and helping investment professionals understand the emerging regulatory and policy landscapes. Set out below is a list of professional learning events on a range of related topics, including, for example, incorporating ESG factors into the real estate sector, the corporate governance in Asia, and the investor role in combating human trafficking.

Event Date	Event Name	Speakers / Originators	Involved Parties
15 Mar 2019	Focus Group Meeting on ESG Integration	The Hong Kong Polytechnic University & Friends of the Earth	Supported by CFA Society Hong Kong & CFA Institute
25 Mar 2019	ESG Asset Owner Roundtable	Mercer & CFA Institute	Attended by: Ms Ashley Khoo and Ms Verna Lin , Co-chairs of ESG Special Interest Group , CFA Society Hong Kong
9 Apr 2019	ESG Valuation & Climate Risk	Prof. Entela Benz-Saliasi , Adjunct Associate Professor, Department of Finance, Hong Kong University of Science and Technology Co-founder of Ipsum Opus Limited, Hong Kong, PhD in Financial Engineering, Swiss Finance Institute	CFA Society Hong Kong
12 Jun 2019	ESG Forum by PRI, CFA Institute and CFA Society Hong Kong - ESG Integration Across Asia Pacific: Risk Management, Client Demand and Regulation Complimentary Event	Speakers: Mr. Ashley Alder , Chief Executive Officer, Securities and Futures Commission (Keynote) Ms. Mary Leung , CFA, Head, Advocacy, Asia Pacific, CFA Institute Ms. Sammie Leung , CPA, Partner, PwC Hong Kong Mr. Matthew Orsagh , CFA, Director, Capital Markets Policy, CFA Institute	Co-hosts: PRI, CFA Institute, CFA Society Hong Kong, PwC

		<p>Moderator and Panelists: Ms. Hannah Routh, Partner, Deloitte (Moderator) Mr. Kim Chong, Head, Risk Management & Compliance, HKMA Ms. Mary Leung, CFA, Head, Advocacy, Asia Pacific, CFA Institute</p>	
5 May 2020	<p>ESG Disclosure in Asia - Key findings from HK listed companies [Webinar]</p>	<p>Mr. Piotr Zembrowski, CFA, Manager, Advocacy Research and Content, APAC, CFA Institute Mr. Ricky Cheng Director, Head of Risk Advisory, BDO Dr. Artie Ng, Deputy Director, PolyU SPEED International Associate Centre for Social and Environmental Accounting Research (CSEAR)</p>	CFA Institute & CFA Society Hong Kong
15 Jul 2020 2020	<p>S of ESG Series: What is the investor role in combating human trafficking? [Webinar]</p>	<p>Mr. Matt Friedman CEO, The Mekong Club</p>	CFA Society Hong Kong