Vivien Teu & Co LLP *Solicitors*

張慧雯律師事務所 有限法律責任合夥

17th Floor
29 Wyndham Street
Central, Hong Kong
Tel: +852 2969 5300
Fax: +852 2997 3385

香港 中環
雲咸街 29 號 17 樓
電話：+852 2969 5300
傳真：+852 2997 3385
Email: enquiry@vteu.co
www.vteu.co

Ref: VT/AM/2021/SFC_climate

15 January 2021

To:

The Securities & Futures Commission
54/F One Island East
18 Westlands Road
Quarry Bay
Hong Kong
(By Email: 2020_Climate_Consultation@sfc.hk)

Dear Sirs

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

First and foremost, we applaud this initiative of the Securities & Futures Commission (**SFC**) in proposing enhanced requirements on Hong Kong licensed fund managers on the management and disclosure of climate-related risks, which is no doubt an important step in further developing Hong Kong as a sustainable finance for more green and ESG investment funds, requiring Hong Kong managers to address and manage climate-related risks, properly support and leverage on opportunities for climate-transition at a critical time as Hong Kong and Mainland China aims for climate neutrality, as well as combat green washing in the interest of investor protection and Hong Kong's reputation as a premier financial market and asset management centre.

Vivien Teu & Co LLP is a Hong Kong corporate and commercial law practice with particular focus on investment funds, asset management and financial services, private wealth, tax and trusts. The lawyers at Vivien Teu & Co LLP carry in-depth Hong Kong and international legal practice experience, combined with deep and broad knowledge of China and regional markets. Our lawyers are regularly involved in advising asset managers or other financial institutions in the establishment and structuring of investment management or advisory services entities, investment funds or financing structures, and related legal and regulatory issues, licensing and compliance requirements. With our lawyers having extensive China knowledge, Vivien Teu & Co LLP is a go-to firm for offering seamless Hong Kong law support on cross-border Mainland China and Hong Kong matters relating to asset management, investment funds, cross-border securities and investments, China market entry strategies, joint ventures and acquisitions.

Our firm has strengthened ESG and sustainability focus of our investment funds and corporate practice, seeing these as natural and necessary extensions of the existing corporate and investment funds practice areas, and which reflects our belief that it is increasingly important, and also necessary, for all corporates and enterprises to be responsibly taking into account environmental, social and governance (ESG) factors in the conduct of business activities, for both risk mitigation as well as the business case. The firm has also dedicated efforts in advising and working with family offices, charities, foundations and social enterprises in the areas of philanthropy and impact investing.

With strengthened ESG and impact focus in our practice, following global developments of the Paris Climate Agreement and increasing global adoption of the United Nations Sustainable Development Goals, we have accumulated knowledge and experience in considering and advising on the fast evolving global landscape and requirements related to ESG issues and green finance, and our firm has engaged in responding to market consultations with respect to developments of soft law and hard law relating to ESG or green finance (for example, initiatives or consultations of the United Nations Principles of Responsible Investment and the CFA Institute), and actively engages in other thought-leadership initiatives in the industry on ESG.

We very much appreciate the opportunity to submit our response on the SFC's Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers issued in October 2020 (**Consultation Paper**) and hope our comments will assist in the SFC's further deliberation of the proposed requirements that will have significant impact on how the industry moves forward on sustainable finance.

According to the consultation questions in the Consultation Paper and in the same order, we set forth our specific responses as follow:

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.**

Clarify distinct objectives – (1) consideration of climate related risks; and (2) encourage investments in climate-conscious opportunities

We gather from the Consultation Paper that the SFC's proposal is driven primarily by concerns on climate-related risks as a potential source of extreme financial risks to businesses and which may result in systemic risk in financial markets, while at the same time the SFC is also drawing attention to the energy-related investments and capital that will need to be directed to avoid irreversible climate change. The potential catastrophic consequences of climate crisis require urgent action, and accordingly we agree with the SFC's proposal to focus on climate change in developing the requirements. However, we suggest that the SFC can further recognise and clarify the distinct objectives the expectation for managers to take into account climate-related *risks* in their portfolios in investment decision-making as necessary risk management on the one hand, and on the other hand what the SFC expects on managers investing in climate-related *opportunities* and directing capital towards climate transition.

It is worth noting that since the publication of the SFC's proposal, and following China taking a lead with its commitment to achieve net-zero carbon emissions by 2060, more countries have committed to climate neutrality, Hong Kong's own pledge for 2050, and some corporations and financial institutions have also committed to achieving net-zero in their business and operations. With Hong Kong's position as a key international financial market and asset management centre, besides and beyond setting baseline expectations on managing climate-related risks, the SFC may consider to further encourage fund managers to be proactive in taking steps and efforts towards climate neutrality or investments in climate transition, although we see that the enhanced requirements carry that intention and initially applicable to large fund managers of the proposed criteria. We further comment on the enhanced requirements in our response to question 4 below.

Encourage broader S or G factors

While the SFC's proposal focuses on climate change, we note that SFC acknowledges the importance of ESG factors and encourages fund managers to consider a broader spectrum of sustainability risks. We also note that it is part of the SFC's strategic framework for green finance, to work towards obligating fund managers to disclose how and to what extent fund managers consider ESG factors in investment processes and risk assessments.[1] As sustainable finance rapidly evolves, and with events in 2020 having driven significant attention on social issues, there is increasing expectation for investment managers to take into account ESG issues in investment decisions, and we urge the SFC to consider widening the scope to cover S and G factors in 'ESG'. Many framework, tools or metrics in the industry that fund managers may adopt for climate-related risks or investments may also cover S or G factors, such that fund managers when developing climate-related investment and risk management processes can be encouraged to also manage and disclose its investment policy or risk management around S or G, while not making these mandatory. We hope the SFC will consider also including relevant provisions to that effect in the proposed amendment to the FMCC and when issuing its circular to further guide fund managers.

Having said that, we agree with the SFC and suggest clear reiteration and emphasis that the requirements are not prescriptive on how, when or what E, S or G risks the fund managers should take into account, being subject to the investment strategies and specific portfolio as well as investment management discretion in each case, but that the gist of the SFC's proposal is to require fund managers to intentionally adopt a policy on how climate-related risks (and S or G factors) are taken into account in investment decisions and risk management, and to appropriately disclose such policy to investors.

2. Do you agree that at the initial stage, the SFC's proposed requirements should apply to the management of CIS but not discretionary accounts.

Yes we agree with the SFC's proposed requirements applying to the management of CIS initially but not discretionary accounts. Discretionary accounts would typically be tailor-made to the specific requirements of the specific client/investor. However, the SFC may consider encouraging (while at this stage not mandating) fund managers to proactively clarify the client/investor's intention or expectation on managing E, S or G issues in the investment portfolio, which may be included under the SFC Code of Conduct as part of know-your-client / suitability requirements, and/or an item to be agreed in the client agreement.

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 agree with the SFC making reference to the TCFD Recommendations in developing the proposed requirements, especially in the emphasis on governance and the expectation for the board and management of fund management companies to oversee the incorporation of climate-related risk considerations in investment and risk management processes. TCFD Recommendations as a framework is getting broad acceptance globally, and we note that under the Strategic Plan of the Green and Sustainable Finance Cross-Agency Steering Group published in December 2020, one of the near-term action plans is for climate-related disclosures aligned with TCFD Recommendations to be mandatory across relevant sectors no later than 2025. The revised ESG reporting guide for companies listed on the Hong Kong Stock Exchange published in December 2019 also seeks to be TCFD-aligned for listed companies managing and addressing ESG in business and operations.

Distinction in entity level and fund level requirements

Having said that, in applying TCFD Recommendations to fund managers, one needs to keep aware that different considerations and outcome relate to risks and opportunities relevant to a fund manager as an organization, which are distinct from risks and opportunities that are relevant to the specific investment

[1] Paragraph 12 of the Consultation Paper.

strategy or investment portfolio managed by the fund manager. The approach for identifying, assessing and managing climate-related risks, the potential financial impact and the relevant metrics and targets would be quite different between those two levels, and for the managers' assets-under-management, from one portfolio to another subject to the investment strategy. Unlike companies with climate-related balance sheet risks, with the core business activities of fund managers being engaging in providing investment management services to investment funds/collective investment schemes (or discretionary accounts), typically fund managers do not carry much balance sheet risks. However, for the board and management of the fund managers to manage and oversee climate-related risks under TCFD Recommendations, it is not always clear how TCFD Recommendations apply or adapt in the practicalities of fund management companies addressing climate-related risks of portfolio companies or funds-under-management.

We note that it is the SFC's intention under the Consultation Paper to focus on managing climate-related risks of the funds under management and not the fund managers' own operational or financial risks, and we gather that the SFC is applying TCFD Recommendations such that fund managers adopt this as a framework for its overall governance and approach for assessing, managing, disclose and measuring climate-related risks (across its portfolios or assets-under-management). Accordingly, under the proposed requirements, assessment of climate-related financial risks would primarily relate to such risks in the investment funds or portfolio, the nature and degree of which would differ from strategy to strategy.

Therefore, we suggest that there be further clarification in the proposed FMCC amendments in terms of what the SFC expects as requirements that apply to the fund managers at the entity-level, and the requirements that apply to the funds or investment portfolio under the fund managers' management.

Governance requirements at entity level and fund level

We also suggest that under the governance arrangement, it should be clarified what is actually expected of the board of the fund managers (at the entity-level), and how this applies at the portfolio level, in the oversight and management of climate-related risks by the individual portfolio manager (or key responsible manager of the specific fund or portfolio). Under the section 'Governance' of 'Appendix 2 – Proposed baseline requirements and enhanced standards', – the Board is required to *"determine how the board or 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"*.

Frequently, for larger fund houses the board is not engaged in the day-to-day investment management decisions, and also there would more likely be a wide range of different investment funds of varying investment strategies of which climate-related risks may be relevant to different extent or need to be managed differently. Very likely such fund houses will manage a wide range of portfolios, private equity funds, real estate funds, equity funds, fixed income funds where each of such funds will have quite different extent or exposure to climate-related risks, as well as management or operational process that caters to different strategies. Some of these funds may be structured with specific governance framework (for example as a separate legal entity with its own board of directors or trustees, or with an investment committee), and if domiciled or registered in another jurisdiction, may be subject to different regulatory requirements with respect to climate-related risks or sustainability.

Readiness of fund managers in Hong Kong

With reference to the PRI's *"Climate Snapshot Reporting Framework 2016-2019 – Analysis and Responses to TCFD Recommendations"* which includes mapping of PRI Reporting to TCFD Recommendations, it reveals that of all the signatories who reported to the 2019 PRI Reporting Framework, 15% is reported as having an organisation-wide climate strategy, 8% not, while 76% is not reported, while 9% is reported as publicly supporting TCFD, 15% as not, and 76% as not reported. This appears to indicate that the adoption of specific climate investment policy as well as TCFD Recommendations are still at the early stages in the investment industry, although we note PRI has introduced mandatory TCFD-aligned strategy and governance indicators in

PRI Reporting Framework from 2020 (while voluntary to disclose). As PRI signatories include both asset owners and investment managers, the adoption by investment managers may at present be lower.

In view of this, even as advocates of responsible investments and sustainable finance, we wish to highlight there may be real concerns on the readiness and capacity for fund managers in Hong Kong, and what support is necessary and available to adopting TCFD Recommendations, when the industry is still in the process of developing and implementing best practices. It would be helpful for the SFC to provide more specific guidance and details on how fund managers are expected to adopt TCFD Recommendations / comply with the amended FMCC.

TCFD alignment over strict TCFD adoption

While the goal is to align global reporting standards, at this stage there are currently many different reporting frameworks and standards such as the CDP, CDSB, GRI, SASB, and many fund managers just beginning to introduce management of climate-related risks may be relying on external advisers and ratings with varying indicators or methodologies. In so far that the Consultation Paper is introducing the requirements with TCFD Recommendations in mind (similar to PRI, as "TCFD-based") and not requiring full TCFD-alignment, it provides wriggle-room. SFC may consider encouraging adopting TCFD or providing a timeframe for adoption, short of mandating that fund managers adopt a specific framework or a single policy or approach for managing or disclosing climate-related risks as an organisation, as there may otherwise be potential unintended and undesirable consequences of managers adopting broad-brush general policy or disclosures which carry increased risk of green-washing.

Other international developments to consider

As international regulations develop, the SFC may also further consider as the EU Sustainable Finance Disclosure Regulation is implemented and the finalization of the EU Sustainable Finance Taxonomy, in the spirit of global alignment. We also make reference to the PRI and World Bank "Toolkit for Sustainable Investment Policy & Regulation"[2], especially the parts on stewardship and investor ESG regulations that are specifically relevant to investment managers.

4. 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.

We have no comments on the proposed threshold for large fund managers, except to highlight that based on our understanding, there is still significant data and capacity gap in the industry and large fund managers may also be facing issues on having sufficient, adequate and quality resources and data; while there may be some fund managers who are climate-focused that may be more ready to comply with more reporting on climate-metrics, though smaller managers, and who can be specifically encouraged to voluntarily comply with the enhanced requirements.

As noted in our response to question 1 above, for large fund houses the board is not engaged in the day-to-day investment management decisions, and also there would more likely be a wide range of different investment funds of varying investment strategies of which climate-related risks may be relevant to different extent or need to be managed differently. These would present different challenges to fund managers in applying and reporting climate-related metrics.

[2] https://www.unpri.org/policy/regulation-database/policy-and-regulation-toolkit

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

The amendments to the FMCC to enhance requirements and expected standards on managing and disclosing climate-related risks will be crucial in setting the Hong Kong funds industry's standard and providing guidance on best practices for Hong Kong licensed fund managers.

It is noted that the baseline requirements focus on getting fund managers to adopt TCFD framework. As explained in detail in our response to question 3 above, we suggest the proposed amendments to FMCC should be clarified that it is SFC's expectation for fund managers to intentionally adopt policy on managing climate-related risks in investment decisions and risk management, and to appropriately disclose such policy to investors, while also being clear that fund managers retain flexibility to adopt or apply different policies, practices, standards or framework as may be appropriate for its business and different investment funds or different investment strategies under management.

Same as in our response on question 4 under the section "Distinction in entity level and fund level requirements" above, we suggest there be further clarification in the proposed FMCC amendments in terms of what the SFC expects as requirements that apply to the fund managers at the entity-level, and the requirements that apply to the funds or investment portfolio under the fund managers' management. We also submit again our observations under the section 'Governance requirements at entity level and fund level' in our response on question 4 above.

Accordingly, with respect to the disclosure requirements of the baseline requirements and enhanced requirements (as set out in Appendix 1 of the Consultation Paper as proposed amendments to the FMCC and in Appendix 2 of the Consultation Paper which we assume will be further refined and published in a circular to be issued by the SFC to support managers' compliance), we suggest there should be further specific clarifications on what and where disclosures should be made at the fund level with fund documents to investors, and what and where fund managers' entity-level disclosures be made, and to help fund managers who are still early in this journey, with more clarity and guidance on why SFC expects such disclosures and guidance on how to comply with the requirements. (For example, with reference to Appendix 2 of the Consultation Paper, under proposed baseline requirements for investment management: *"Note: Where a fund manager assesses the climate-related risks are irrelevant to certain types of investment strategies or funds under its management, the fund manager should disclose those exceptions when it makes disclosures of how it incorporates climate-related risks into its investment and risk management processes…"*)

More specific guidance and examples on how managers are expected to comply with the baseline requirements and the enhanced requirements in practice would be helpful.

On the enhanced requirements, we would also like to raise the following points for the SFC to consider:

- We gather the enhanced requirements relate to driving climate-related investments and climate transition, and as suggested in our response in question 1 above, the SFC may wish to make this policy intention clear and expressed as a distinct objective to climate-related risk management.

- As noted above, based on our understanding, there is still significant data and capacity gap in the industry and large fund managers may also be facing issues on having sufficient, adequate and quality resources and data. Corporate climate and ESG reporting standards are still developing, as many stock exchanges or regulators around the world are still developing, introducing or implementing enhanced corporate climate or sustainability reporting, and also global reporting framework, standards, tools and metric are still developing and work for alignment and harmonization just underway.

- As noted in our response to question 1 above, for large fund houses there would more likely be a wide range of different investment funds of varying investment strategies of which climate-related risks may be relevant to different extent or need to be managed differently.

- It would be helpful to clarify what the SFC expects from fund managers as an entity in the conduct of its investment management business across different funds and portfolio under management, and what the SFC expects with respect to specific funds, in terms of applying tools, metrics and disclosures.

  (For example, with reference to Appendix 2 of the Consultation Paper, under Risk Management - proposed enhanced requirements – *"If climate-related risks are assessed to be material, take reasonable steps to identify the weighted average carbon intensity 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."*)

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 that fund managers should be required to disclose whether climate-related considerations are included in its investment strategies or funds. As noted in our response to question 5 above, we suggest there should be further specific clarifications on what and where disclosures should be made at the fund level with fund documents to investors, and what and where fund managers' entity-level disclosures. On this point, we consider these disclosures will need to be made at the fund level for transparency to investors, and especially as whether climate-related risks are relevant varies depending on the specific investment strategies or make-up of the fund portfolio.

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?

As noted in our response to question 6, we consider that the disclosure on whether the fund manager integrate climate-related considerations and the position and reasons that climate-related risks are irrelevant should be at the fund level. This will provide fund investors with transparent information on the fund and should be included as appropriate in the fund disclosure documents so that fund investors will have all the necessary information in one place for investment decision. On the contrary, the SFC may consider allowing fund managers to offer additional information on the entity-level policy on managing climate-related risks that investors may separately access or obtain.

Here, we would also suggest SFC to consider encouraging fund managers to develop and disclose climate-related or ESG stewardship policy, if this is in line with SFC's policy objective for fund managers to direct capital towards climate transition and sustainability.

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 noted in our response in question 5 & 6 above, we understand there is still significant data and capacity gap in the industry and large fund managers may also be facing issues on having sufficient, adequate and quality resources and data, while there may be some fund managers, possibly smaller managers, who are climate-focused that may be more ready to comply with more reporting on climate-metrics, and who can be specifically encouraged to voluntarily comply with the enhanced requirements.

9. Do you think the transition periods are appropriate?

Depending on the final form of the SFC's proposed amendments to the FMCC and proposed requirements, a longer transition period may be required. As noted above, corporate climate and ESG reporting are still developing, and also alignment and harmonisation of global reporting framework, standards, tools and metric are still developing and just underway. It may be helpful for the transition period for fund managers to comply with specific requirements involving data, tools, metrics to give some time for those developments, while balancing the urgency to act.

As this is the first time the SFC will introduce specific requirements for fund managers to take action on managing and disclosing climate-related risks and on sustainable finance (other than the requirements applicable to SFC authorised green or ESG fund issued in 2019), the SFC may consider adopting requirements that clearly set out the policy and principles of the SFC's regulatory expectations, while providing for different timelines for complying with different requirements as appropriate, differentiating not just between small fund managers and large fund managers, but also in terms of different stages of enhanced standards for Hong Kong managers in climate-related investments and risk managements, sustainable finance and ESG.

We sincerely thank the SFC and its team for all efforts leading Hong Kong in green and sustainable finance, and for proactively engaging the industry in the process. This is a huge and meaningful undertaking, while we also appreciate the issues and tasks involved are highly challenging and complex. We hope the SFC will find the comments in this submission to be clear and helpful in this important work. We further thank the SFC in advance for considering this submission, and are most happy to address any feedback the SFC may have or to further clarify, suggest or offer any support the SFC may require.

Please contact our Managing Partner, Vivien Teu (vivien.teu@vteu.co) for any questions on this submission. (Kindly note that after 15 March 2021, Vivien Teu will join Dentons Hong Kong LLP together with her team members, as Partner, Head of Asset Management & ESG. Our firm will then cease practice, although emails can still be received at the email address for a transition period.)

Thank you again for your attention.

Yours faithfully,

Vivien Teu & Co LLP