STEPHENSON HARWOOD'S COP26 INSIGHTS SERIES

Hong Kong enters into a client friendly era for investment funds

In this article Stephenson Harwood delves into the Securities and Futures Commission's (SFC) *Consultation Conclusions on the Management and Disclosure of Climate-related Risks by Fund Managers (Conclusions),* released August 2021, and examines its key points including baseline requirements, enhanced standards and more.

Introduction

In a nutshell, *Conclusions* is the culmination of the discussion on what fund managers should do to comply with Hong Kong's amended Fund Manager Code of Conduct (FMCC). Key to it are baseline requirements for Fund Managers as well as those - aptly called Large Fund Managers – with AUMs of at least HK$8 billion (approximately US$1 billion) in assets for any three months in the past reporting year. Large Fund Managers will also need to comply with a set of enhanced standards.

These requirements are based largely on principles of proportionality, and fund managers will need to consider the degree of discretion that they have over investment management processes to determine the extent of compliance.

For baseline requirements, Fund Managers and Large Fund Managers have transition periods of 15 months (till November 2022) and 12 months (till August 2022), respectively to adopt climate-related management risks into consideration in their investment and risk management processes, and make appropriate disclosures based on recommendations by the Task Force on Climate-related Financial Disclosures. Further, Large Fund Managers have a transition period of 15 months (till November 2022) for complying with enhanced standards.

Baseline Requirements

These will likely apply to most fund managers in Hong Kong and they cover governance, as well as management of investment and risk.

Governance refers to the board's and management's roles and responsibilities, and how they introduce climate-related considerations into the company's investment and risk management infrastructure. A board or board committees, for instance, should have overall oversight of climate-related issues and set a meaningful tone from the top. Management are then tasked to monitor the inclusion of climate-related issues into investment and risk management operations. This includes detailing sufficient technical expertise and manpower toward effectively managing climate-linked risks, among other things.

Meanwhile, for management of investment and risk, fund managers have certain flexibility in adopting various tools and metrics that best fit their circumstances. They may, for instance, use a qualitative (for example, analyse business models of potential investee entities toward climate-linked risks and opportunities) or quantitative (for example, using ESG scores developed by third-party providers to identity investee entities) approach, a hybrid of both, or something else. They are also encouraged to refer to emerging standards and metrics such as those suggested by international reporting frameworks like the Sustainability Accounting Standards Board and the Principles for Responsible Investment.

Enhanced Standards (for Large Fund Managers)

These apply to Large Fund Managers and include an assessment of how investment strategies hold up to climate-linked risks under various conditions, and when an assessment is relevant, take reasonable steps to comply with greenhouse gas (GHG) emissions disclosure criteria where data is available or can be reasonably gauged. This includes requiring Large Fund Managers to reasonably identify and disclose portfolio carbon footprints of the Scopes 1 and 2 GHG emissions of the funds' underlying investments. They may, for example, use the PCAF Standard (named after the Partnership for Carbon Accounting Financials) which provides a guide on estimating and calculating GHG emissions of various asset classes.

Large Fund Managers may also supplement their findings and disclosures with additional metrics that they consider appropriate, the SFC set out, including value-based, revenue-based, asset class-specific or forward-looking estimates, to provide even more useful and investor-friendly data.

A Worthy Cause

With *Conclusions*, the SFC and the industry aim to push Hong Kong into the forefront of sustainable finance, and in so doing sustain its premier financial hub status. Introducing a comprehensive set of global climate-related risk management best practices into the city's economic framework can only boost its allure in this regard.

For a deeper dive into the baseline requirements and enhanced standards, please read our more detailed article here.

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