International
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ICMA

ICMA Response to SFC Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers

15 January 2021

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.

Although other jurisdictions have decided to focus more broadly, for example EU on sustainability and Singapore on environmental risks, focusing on climate change would make sense from a policy making perspective given the urgency of this priority.

We believe many asset managers are already integrating ESG factors (including climate risk) in the investment decision process and are actually competing against each other to gain the trust of asset owners by showcasing their model. We believe this healthy competition (combined with regulatory requirements and supervisors' effort) is the driving force, which will enable progress in the short/medium term. The approach proposed by SFC is general in nature, leaving room and flexibility for fund managers to apply as they see fit and as the technology, standards and methodologies continue to develop.

It is however important to highlight that climate risk modelling is still a methodological challenge.

Assessing physical, transitional and liability risks necessarily need to rely on assumptions. For instance for the implementation of climate scenario analysis at portfolio level, investors need to choose a warming scenario and all the various attached assumptions (i.e. the energy supply and demand mix, GDP growth and a discount rate). Many different methods of scenario analysis are being suggested and promoted, each with different assumptions and data sets. Several approaches are also proposed to estimate carbon budgets compatible with a scenario of 1.5°C. The allocation of a carbon budget between countries, regions, sectors and issuers is also another challenging step from a methodological point of view.

These challenges were also recently recognised by the *NGFS climate scenarios for central banks and supervisors* (which may considerably contribute over time to progress on methodological issues): 'Climate scenarios produce a number of useful

outputs, but there are still gaps which limit their ability to fully assess macro-financial risks. These gaps fall into three categories.'

Scope	Coherence	Uncertainty
• Mapping of scenarios to economic (statistical) sectors • Downscaling of transition pathways to countries • Scope of macroeconomic modelling outputs • Relevance of outputs to financial risks	• Integration of macro modelling across physical and transition risks • Consistency and comparability of assumptions across models • Interactions with the financial sector	• Lack of a systematic approach to quantifying Uncertainty • Research gaps on the nature and size of impacts from physical risks

Another important implementation challenge for asset managers when it comes to climate risk analysis is the lack of disclosure by issuers. Conducting temperature scenario analysis at a portfolio level requires having access to verified data from issuers, which are currently missing: the carbon emissions (scope 1,2,3), revenues and production by business lines, current investment in low carbon technologies and future capital expenditure plans to measure how far on the transition pathway a company, a sector, and/or a country, and hence an investment portfolio is.

It is our understanding that HKEX's mandatory ESG disclosure requirements applied to listed companies effective for financial years commencing on or after 1 July 2020 and a "comply or explain" provision can be referred to by issuers. Bond issuers are not captured under the ESG disclosure requirements. The Cross-Agency Steering Group has recently announced that as part of Hong Kong's Green and Sustainable Finance Strategy, climate-related disclosures aligned with TCFD recommendations will be mandatory for companies across relevant sectors by 2025. In China, ESG disclosure is currently not mandatory for companies listed at Shanghai Stock Exchange and Shenzhen Stock Exchange, although it has been reported that authorities will table mandatory environmental disclosure requirements for listed companies and bond issuers in the upcoming 14th five-year plan cycle (2021-2025).

Also, we note that funds in Hong Kong may invest in assets which are issued or listed globally, not only in Hong Kong and mainland China. This will create challenges to fund managers to provide quality disclosure, as the proposed climate risk rules for asset managers will be applied early 2022, but not all issuers will have to disclose on environmental or climate risks and for those who will start to report the data quality may take time to improve and become comparable. This timeline issue is not specific to Hong Kong and is also problematic in the EU where the

Sustainable Finance Disclosure Regulation (SFDR) will apply before disclosure requirements for issuers are made mandatory (upcoming NFRD review). We believe this will seriously limit the quality of the information, further inflate data costs at the expense of investors and undermine the attempt of asset owner to shift toward sustainable investments.

Given the lack of audited data and uncertainties around climate risk modelling we highly recommend favouring at this stage a phased approach starting with:

- A high-level requirement regarding the consideration of the impact climate risk has on investment funds (i.e. no prescriptive methodology)
- Cautious and modest disclosure requirements (it will be difficult to ensure comparability given the disparity of assumptions/methodologies and fund profiles at this stage)

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?

Regarding individual portfolio management, asset managers are already helping their listed institutional clients fulfil their reporting obligations and understand their carbon footprint and in theory these requirements could therefore also cover mandates. But because public reporting obligations could be problematic for client confidentiality reasons and as not all institutional clients are yet required to comply with reporting requirements, we agree that this should either remain optional at this stage.

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 that the SFC should make reference to the TCFD recommendations, as they are globally recognised and approved standards, so as to promote greater harmonisation between different standards and to avoid market fragmentation.

We also suggest that the SFC look at the Climate Transition Finance Handbook as a potential framework for issuer disclosures. The recommended disclosures in the Climate Transition Finance Handbook, launched by the Green & Social Bond Principles reference existing climate change disclosure frameworks developed by relevant industry groups, regulatory bodies and the scientific community.

The recommendations have four key elements:

- Issuer's climate transition strategy and governance;
- Business model environmental materiality;
- Climate transition strategy to be 'science-based' including targets and pathways; and,
- Implementation transparency.

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.

No response

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 integration of climate risks among other risks to be considered by fund managers (i.e. appendix 1 and appendix 2 investment and risk management) but we would caution against singling out climate risks (i.e. appendix 2-governance). Singling out climate risks may have implications regarding the weighing of other risks and potential unintended consequences. We want to avoid a situation with separate climate risk analysis which is not integrated in the overall risk management process. All risks need to be considered together as they may interact, neutralise or reinforce themselves.

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?

Yes, the fund manager should make disclosures and maintain records to justify why climate-related risks have been deemed irrelevant. This should be reassessed on regular basis. This aligns with article 6 of the EU SFDR where financial market participants need to justify where sustainability risks are deemed not relevant with "clear and concise explanation of the reasons".

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?

Yes we agree with this proposal, which we believe is well balanced.

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?

Yes we agree with this proposal but would like to reiterate our comment made in our response to question 1: the success of this will depend on publicly available and reliable corporate issuer disclosure. This data is not always available and disclosure rules for issuers need to change as soon as possible.

For smaller issuers the use of proxies will be needed to avoid capital only flowing towards large issuers. A public body should be in charge of establishing such proxies and its use should be free of charge. In any case asset managers should be allowed to deviate from proxies if they happen to have a better understanding of the carbon footprint of smaller issuers.

We would also like to highlight that asset managers may face challenges as for instance the scope 1 and 2 emissions of a specific project/asset level are not always available especially when green bonds are focused on environmental objectives other than climate change mitigation. For green bonds it would be helpful to allow asset managers to use freely KPIs adapted to the variety of environmental objectives they pursue or to include at least two separate KPIs adapted to green bonds and for which we know that data is to some extent available:

- Carbon emission avoided
- Energy mix for power generation

We believe disclosing the WACI at fund level (instead of entity level) is appropriate given that investors invest via funds and mandates and not in an asset management company. However, consideration should be given on developing a reasonable methodology to be applied to certain types of bond issuers, such as sovereign issuers and ABS SPVs, to which “issuer revenue” and/or “issuer GHG emissions” may not be applicable.

Weighted average carbon intensity (WACI)	
Formula	$$\sum_{n}^{i} \frac{\left(\text{current value of investment}_i * \frac{\text{issuer's Scope 1 and Scope 2 GHG emissions}_i}{\text{issuer's \$ million revenue}_i} \right)}{\text{current portfolio value}}$$

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.

As explained in our response to question 1 we believe the timeline for issuers and investors should be synchronised. TFCD disclosures should become mandatory for all issuers in 2022 and not 2025.

About ICMA

The International Capital Market Association (ICMA) is a not-for-profit membership association, with offices in Zurich, London, Paris and Hong Kong, that serves the needs of its wide range of member firms in global capital markets. It has around 600 members in more than 60 countries, including some 70 institutions in the Asia-Pacific Region. Among its members are private and public sector issuers, banks and securities houses, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others.

In Asia-Pacific, ICMA is regarded as the market-leading association in the cross-border debt capital markets and sustainable finance, a key partner to policymakers and banks, and an authority on understanding of international regulation and reform. ICMA works closely with its members and also central banks, regulators, trade bodies and government authorities to support robust development of capital markets in the region.

ICMA is one of the few trade associations globally that includes both buy-side and sell-side representation. ICMA's buy-side members, including asset managers, institutional investors, private banks, pension funds and insurance companies, are represented on its committees, councils and working groups and have a forum for discussion on investment issues through its Asset Management and Investors Council (AMIC).

Through its work with the Green Bond and Social Bond Principles, the principal globally recognised framework for issuance of sustainable bonds, and its key role in other sustainable finance initiatives (including representation on the EU Technical Expert Group and Platform on Sustainable Finance, as well as the Hong Kong Green Finance Association) ICMA is at the forefront of the financial industry's contribution to the development of sustainable finance and in the dialogue with the regulatory and policy community.

ICMA would welcome further enquiries or requests for information, and the Hong Kong office may be contacted at apac@icmagroup.org.