Securities and Futures Commission ("SFC") consultation conclusions on the management and disclosure of climate-related risks by fund managers

mazars

Introduction

Addressing climate change is at the top of regulators' agenda globally. In achieving Hong Kong's carbon neutrality target before 2050 and in complying with its strategy on the management of climate-related risks for the asset management sector, the Hong Kong Securities and Futures Commission ("SFC") has recently taken a significant step towards addressing such in the industry.

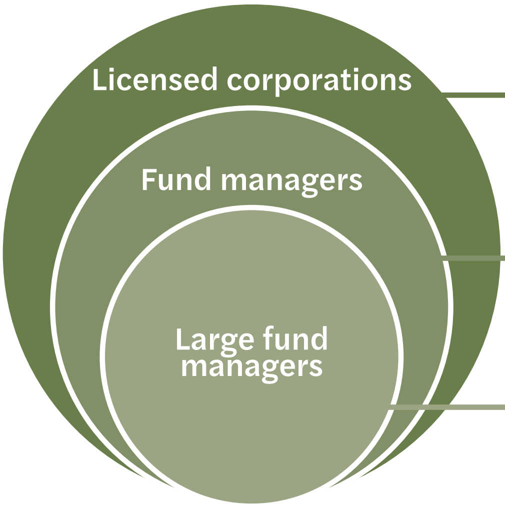
In August 2021, the SFC issued its consultation conclusions on the Management and Disclosure of Climate-related Risks by Fund Managers (the "Consultation Conclusions"), and will amend the Fund Manager Code of Conduct ("FMCC") to require fund managers managing collective investment schemes ("CIS") to take climate-related risks into consideration in their investment, risk management processes and make appropriate disclosures.

This publication provides an overview of the new regulatory requirements as a result of the Consultation Conclusions and the consequential changes to the FMCC. Mazars offers a wide range of financial advisory services to assist you in achieving compliance with the rules and regulations relevant to you.

Key takeaways

1. Scope and applicability

The chart below sets out the scope that are expected to comply with the revised regulations:



New requirements apply to an LC which has discretion over the investment management process, excluding those solely provide investment advice or act as a fund distributor.

Baseline requirements of governance, investment management, risk management and disclosure will be required for all fund managers who manage CIS.

Enhanced standards of risk management and disclosure will be required for large fund managers (with AUM over HK$8 billion for any three months in the previous reporting year).

Relevance & materiality assessment

Fund managers should identify the relevance and assess the materiality of climate-related risks based on their investment strategies, where a pragmatic approach and flexibility are allowed in determination. The applicability of the requirements vary depends on the assessment result.

Other key definitions:

- **"Climate-related risks" –** this is represented as physical or transition risks under the Consultation Conclusions. They may also trigger liability risks which fund managers should also take into consideration in the risk assessment process.
- **"Group policies" –** group-wide policies and disclosure could be adopted locally in Hong Kong if they meet or exceed the SFC's requirements.
- **"Proportional approach" –** the principle of proportionality should be adopted in developing policies and procedures, which are commensurate with the nature, size, complexity and risk profiles of the firms and their investment strategies.

2. Implementation timeline

Large fund managers (AUM over HK$8 billion) will need to comply with the baseline requirements from August 2022 and the enhanced standards from November 2022; and other fund managers will need to comply with the baseline requirements from November 2022.

3. Approach and requirements

When setting out the requirements, the SFC adopted a principles-based approach and made reference to the Task Force on Climate-related Financial Disclosures Recommendations, as well as considered the global regulatory trend towards harmonisation and comparability of standards across jurisdictions.

The Consultation Conclusions outline the baseline requirements and enhanced standards for complying with the new requirements under the amended FMCC. The requirements cover the following four key elements which are explained in further details below:

A. Governance

Baseline requirements for all fund managers

The SFC notes in the Consultation Conclusions that the involvement of the board and management are crucial to ensure the effective integration of climate-related risks across an organisation. Therefore, the FMCC will be amended to require the following:

1. **The board** to define its role in overseeing the incorporation of climate-related risks considerations into investment and risk management processes; oversee progress against goals for addressing climate-related issues; and determine the execution details of its role including informing process and frequency.

2. **The management** to maintain an appropriate management structure which reports to the board and assign its roles and responsibilities for managing climate-related risks. For the purpose of supervising the status and progress of efforts in managing climate-related risks, the management should determine the monitoring mechanism and establish a process to be regularly informed. These include devoting human and technical resources for the proper performance of the duty, establishing internal controls and written procedures, setting goals as well as developing action plans.

B. Investment management

Baseline requirements for all fund managers

Whilst the SFC acknowledges the importance of ESG factors and encourages fund managers to consider a broader spectrum of sustainability risks, it will focus initially on climate-related risks which could have an adverse impact on the value of a wide range of financial assets.

To protect the value of investors' investments, fund managers are required to identify relevant and material physical and transition climate-related risks and ensure that material risks are taken into account in its investment management process for funds. In this regard, fund managers are encouraged to look beyond their usual investment horizon when identifying such risks, and adopt an appropriate and proportionate approach during materiality assessments.

Where relevant, the SFC elaborated that fund managers should factor material climate-related risks into the investment management process. For example, fund managers should include climate-related risks in the investment philosophy and investment strategies and incorporate climate-related data into the research and analysis process, also take reasonable steps to assess the impact of these risks on the performance of underlying investments.

3. Approach and requirements (Cont'd)

If the risks are assessed to be material, fund managers should comply with the baseline requirements for governance, investment management and risk management. If the risks are assessed to be not material, fund managers should comply with the baseline requirements for governance, and reevaluate the relevance and materiality assessment periodically. Only when fund managers are responsible for overall operation of the fund ("ROOF"), should they comply with further disclosure requirements.

C. Risk management

Baseline requirements for all fund managers

The Consultation Conclusions indicate that the FMCC will be amended to the effect that a fund manager should establish and maintain effective systems, policies and procedures for identifying, assessing, managing and monitoring relevant and material climate-related risks.

Whether a risk is deemed to be material or not changes how the SFC requires fund managers to act. Where a risk is material, fund managers should take action to manage it. If the risks are not deemed material but relevant, they should nevertheless monitor them on an ongoing basis as they would with other risks. Fund managers can apply appropriate tools and metrics including carbon footprint-related metrics, forward-looking metrics or physical climate-related metrics to assess and quantify climate-related risks.

Enhanced standards for large fund managers

In particular, large fund managers are expected to adopt a more robust and systematic approach. This includes engagement policy and scenario analysis under the enhanced standards. The SFC requires large fund managers to assess the relevance and utility of scenario analysis in evaluating the resilience of investment strategies to climate-related risks under different pathways and to keep these records. Where material, fund managers should take an additional step of making reasonable efforts to identify the portfolio carbon footprint, through acquiring or estimating the Weighted Average Carbon Intensity of Scope 1 and Scope 2 greenhouse gas ("GHG") emissions associated with the funds' underlying investments.

D. Disclosure

Baseline requirements for all fund managers

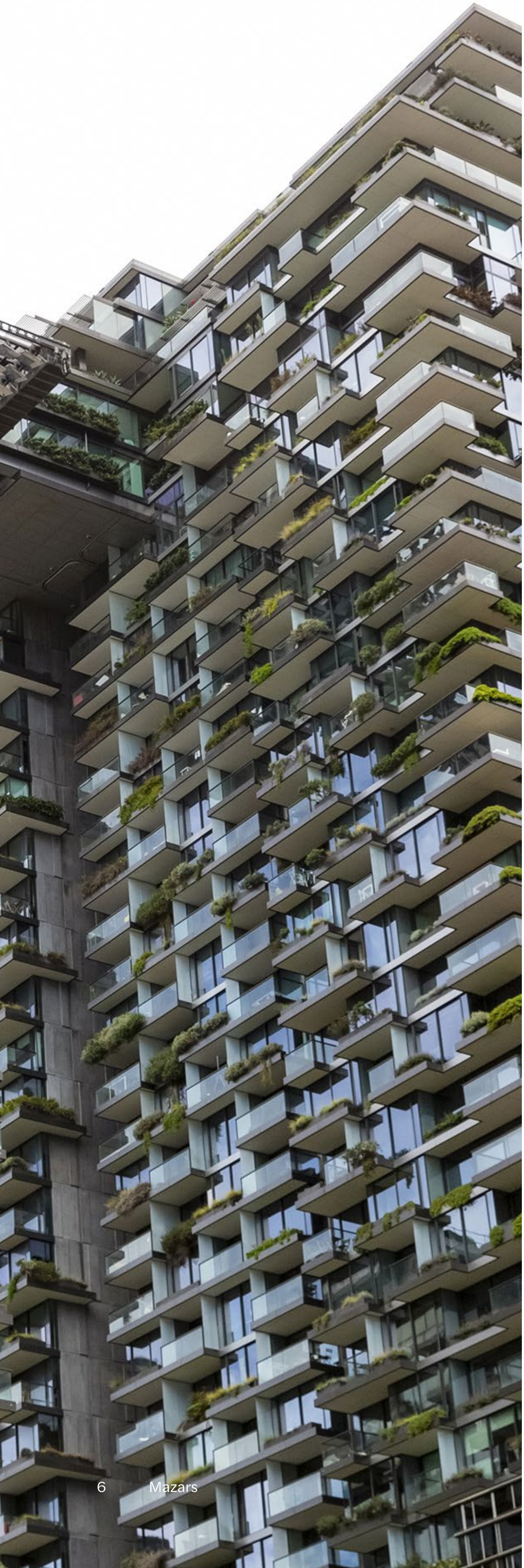
The disclosure standards require fund managers who are responsible for the overall operation of funds, to make an informed judgement about their investment into the fund. The appropriate disclosures of information in writing should be communicated to fund investors through electronic or other means (e.g. company websites, newsletters or reports), which should be proportionate to the degree climate-related risks are considered in the investment and risk management processes, and should be reviewed at least annually.

The baseline requirements on disclosures include (a) a fund manager's governance arrangement for oversight of climate-related risks; and (b) how the fund manager takes climate-related risks into account in its investment and risk management processes, including the tools and metrics used to identify, assess, manage and monitor the risks.

If climate-related risks have been assessed to be relevant but immaterial to all investment strategies or funds under its management, the fund manager should disclose (a) its governance arrangement and (b) its investment and risk management processes but only in relation to how it identifies and assesses the risks. On the contrary, if climate-related risks have been assessed to be irrelevant to certain types of investment strategies or funds under its management, the fund manager is required to disclose such exceptions at entity or fund level.

Enhanced standards for large fund managers

Furthermore, large fund managers are required to describe the engagement policy at the entity level and preferably provide examples to illustrate how material climate-related risks are managed in practice. Also to provide the portfolio carbon footprints of the Scope 1 and Scope 2 GHG emissions.



How can Mazars help?

At Mazars, we have extensive experience working with the diversity of financial services players. We assist major financial institutions including brokerage houses, asset managers, investment and corporate banks, retail and private banks, central banks, and national regulators in dealing with business and regulatory issues with impacts, domestic and international.

We are here to assist you in every step of your climate-related risks disclosure and management to comply with the revised FMCC, as well as on ESG compliance consulting in general. Depending on the scope, coverage and specifics of your needs, our services would typically involve one or more of the areas set out on the next page:

How can Mazars help?

A. Regulatory reviews and advice

1. Review and provide compliance advisory on your firm's
   - policies and procedures,
   - frameworks, and/or
   - regulatory and marketing disclosure on ESG or climate-related risks at entity or fund level.
2. Provide observations and recommendations to assist you in complying with the SFC climate-related risks disclosure and management requirements under the FMCC.
3. Provide ESG regulatory health-checks.
4. Review related documentation and records to ensure compliance.
5. Evaluate compliance in multiple with related ESG policy and provide strategy consulting.

B. Design and implementation of policies and procedures

1. Provide advice/ assistance in designing and implementing enhancements to the compliance manual, including governance framework, as well as policies, procedures and control of your investment management, risk management and disclosure process.
2. Provide advice/ assistance in updating and designing compliance monitoring plans and programmes.
3. Provide advice/ assistance in designing and reviewing ESG related risk framework and risk matrix.

C. Training and insights

1. Provide training and education for staff, the board, senior management and compliance team.
2. Provide ongoing insights into how peer firms are dealing with the regulatory requirements and any common challenges encountered along the way.

We also take on special projects and ad-hoc mandates. We are flexible in our approach and offerings. Please feel free to contact us with any enquiries.

Contacts

Mazars Consulting (HK) Limited

42nd Floor, Central Plaza
18 Harbour Road
Wanchai
Hong Kong

Tel: (+852) 2909 5555
Fax: (+852) 2810 0032
Email: info@mazars.hk

Ernest Yiu
Managing Director - financial services
(+852) 2909 5585
ernest.yiu@mazars.hk

Pierre Latrobe
Executive Director - financial services
(+852) 2909 5572
pierre.latrobe@mazars.hk

Mazars is an internationally integrated partnership, specialising in audit, accountancy, advisory, tax and legal services*. Operating in over 90 countries and territories around the world, we draw on the expertise of more than 42,000 professionals – 26,000+ in Mazars' integrated partnership and 16,000+ via the Mazars North America Alliance – to assist clients of all sizes at every stage in their development.

*where permitted under applicable country laws

Follow us
LinkedIn: www.linkedin.com/company/mazars-in-hong-kong
Facebook: www.facebook.com/mazarsHK
Instagram: www.instagram.com/mazarshongkong/
Twitter: www.twitter.com/MazarsHK

www.mazars.hk

mazars