

## HK SFC enhances disclosure requirements for ESG funds

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From January 2022, environmental, social and governance (ESG) funds, and climate-focused funds products will have to disclose how they incorporate ESG factors, report and reference ESG criteria, showcase portfolio measurement approaches and release periodic assessments annually.

### Who does the circular apply to?

The SFC (**Securities and Futures Commission**) has published an amended circular providing guidance to asset managers on enhanced disclosure expectations for funds which incorporate ESG factors as a key investment objective and/or strategy (ESG funds).

The circular supersedes a previous version (2019 circular) issued to management companies of SFC-authorized unit trusts and mutual funds claiming a green or ESG focus in their investment products.

### What does the circular require?

The revisions come on the back of international and local regulatory developments as ESG continues to gain momentum.

The circular provides further guidance on enhanced disclosures and reporting for ESG funds and contains additional guidance for funds with a climate-related focus. The key updates are outlined below.

- Disclosure in offering documents
  - To include the ESG focus of the fund through a clear description of the fund's aim, and the ESG criteria such as filters, metrics, ratings etc. used to meet the fund's focus.
  - To include the ESG investment strategy by describing the specific approach, methodology used and if an exclusions approach is employed with the associated exclusions.

- Asset allocation showcasing the expected or minimum proportion of securities aligned with the fund's ESG focus.
- Where a fund is tracking an ESG benchmark the manager must disclose details of this and how it is relevant to the fund.
- Risks or limitations must be disclosed (e.g. reliance on third party sources).
- Climate focused funds: funds with a climate-related focus (climate funds) are required to specify the climate focus of the fund (e.g. mitigation, adaption, positive impact etc.), associated climate metrics and details of how any reference climate benchmarks aligns to the fund's focus (where the climate fund tracks a climate benchmark).
- Disclosure of additional information on websites
  - ESG funds should disclose a description of how the ESG focus is measured and monitored throughout the lifecycle of the fund, methods employed to measure ESG performance, due diligence procedures, engagement approach adopted and ESG data sources and associated data assumptions. This may be disclosed on websites or by other means.
- Periodic assessment and reporting
  - To conduct at least annually periodic assessments, to assess how the funds has attained its ESG focus.
  - This information should be disclosed to investors (e.g. annual reports) including the proportion of underlying investments aligned with the ESG focus of the fund, the proportion of the fund included/excluded as a result of the ESG-related screening, comparison of the fund's ESG factors against the reference benchmark (if any), steps taken by the manager to achieve the fund's ESG focus (e.g. proxy voting), and any data estimates used or limitations, trend analysis between prior reports.
- Ongoing monitoring
  - Managers to regularly monitor and measure the underlying investments to ensure the ESG funds continues to meet its focus.
  - If an ESG fund no longer wishes to pursue its stated ESG focus, the manager is expected to inform investors and the SFC.

## How does this impact UCITS funds?

SFC has considered the European regulations on sustainability-related disclosures (**SFDR**) and notes that UCITS funds will be ESG funds in Hong Kong if they incorporate ESG factors as their key investment focus. This is irrespective of whether they are classified as Article 8 or Article 9 under SFDR. Where UCITS funds meet SFDR requirements under Article 8 and 9 they will be deemed to have generally complied with the SFC requirements – however the SFC may vary the requirements as they deem fit at any time.

## What action should you take?

- **Existing ESG funds** - undertake a review of your fund's current disclosures in light of the updated circular requirements, make necessary updates and revisions by 1 January 2022 (**Effective Date**), and seek appropriate advice where necessary.
- **New ESG funds:**
  - continue to adopt the 2019 circular measures and make the necessary updates and revisions required under the updated circular by the Effective Date, and seek appropriate advice where necessary;
  - complete circular compliance checks before submitting self-confirmation of compliance;
  - confirmation supported with independent third party certification or fund label to demonstrate compliance. The SFC expects the independent third party or fund labelling agency as part of the certification or labelling process to review, at a minimum, the ESG fund's primary investments to reflect the particular ESG focus which the fund represents, investment selection and ongoing monitoring process.
- Take steps now to enhance your board and senior management team's understanding of ESG and climate risk.
- Consider generally if you are clear on your disclosure and reporting obligations under the circular.
- Refresh internal procedures and training to ensure you are prepared for the updated requirements.

## How Ogier can help

Ogier's ESG and Impact Advisory Services practice is a dedicated advisory business offering bespoke **ESG** fund strategy, investment integration and disclosure solutions. We support our funds clients to navigate ESG and climate goals and to leverage the landscape of sustainable investing opportunities.

Ogier ESG and Impact Advisory Services can support fund managers to set out offering documents, conduct periodic assessments and ongoing monitoring and reporting needs.

Our clients can also leverage Ogier's legal services in respect of the laws of Luxembourg, Guernsey, Jersey, the British Virgin Islands and the Cayman Islands.

## Our ESG Services

### Market benchmarking

Market benchmarking is a tool through which market conditions may be reviewed and positive change motivated. Through conducting detailed market analysis, Ogier can ascertain best practices, standards, approaches and performances in order to assist in processes of continuous improvement. Through the regular systematic measurement of the fund's actions in relation to best in class practices, actionable improvements on performance management can be made, thereby driving the client in their pursuit of joining that best in class rank.

### **Regulatory scan**

The navigation of the incoming regulatory framework presents compliance/transition risks and opportunities. Regulatory scanning refers to the practice of forwards looking analysis, in which challenges and opportunities for the client are anticipated and prepared for. Depending on the size and status of the fund, the extent of adjustment necessary can differ significantly, with some regulatory changes being relatively simple to become compliant with. Ogier can contribute to the essential capacity to identify, understand and react to these changes in a timely and appropriate manner. Without these services, previous practices can rapidly degrade into regulatory gaps and non-compliance.

### **Fund's ESG strategy and approach**

Ogier's sector expertise can be utilised in the construction and integration of an ESG strategy into the fund's investment approach. During this process, ESG themes and evidence-driven theories of change will be engaged with, through the review of current investment objectives and pipelines. The consideration of these themes and theories will facilitate the establishment of the client's unique strategic ESG objectives. Ogier can assist in the monitoring of those objectives by curating a set of measurable metrics, through which objective disclosure practices can be established. This practice can also be integrated into an impact measurement framework, through which the fund can maintain compliance with international standards.

### **ESG due diligence**

The integration of impact and ESG considerations into due diligence procedures is an integral element of proper engagement with portfolio sustainability and risk. Ogier can curate appropriate resources, through which pipeline investments can be screened against the relevant impact criteria. This criterion can be tilted to ensure its materiality for the fund's investment philosophy and focus, through converging on ESG materiality and thematic emphasis. Furthermore, an ESG-specific due diligence process can be established through the creation of resources designed to examine the impact consequences of specific investment decisions.

### **ESG portfolio monitoring and management**

The construction of a sustainable thematic or impact portfolio presumes the intention of value generation through ESG risk and opportunity management, as well as impact engagement. This

differs from traditional socially aligned portfolios which operated through negative screening, due to the proactive seeking of positive impact. As such, assessing the intended and actual value creation of the portfolio is an essential function of ESG and impact investing, which funds are often illequipped to pursue. Ogier's ESG and impact expertise allow us to draw on deep industry knowledge and analytical tools to carry out ongoing impact portfolio monitoring, where the client may not have the appropriate processes in place.

## **ESG reporting and third party certification**

Following on from the establishment of ESG performance measurement practices, Ogier can aid in the interpretation, reporting of the resulting information, firstly, through the drafting of the client's ESG report. Secondly, through the design and publication of the ESG measurement and management approach. Thirdly, through supporting the internal ESG audit of non-financial data. In this manner, Ogier can provide tailored end to end support for the integration of ESG considerations into your portfolio, from regulatory preparation, strategy designing, portfolio monitoring, to public disclosure.

## **Ogier ESG Align**

Ogier Global will be launching our new cloud-based digital product soon, ESG Align, offering online training and compliance assessments. Our Understanding Risk module helps investment professionals, boards, compliance teams understand the why, what and how of climate-related risks. Our Compliance Check – Hong Kong helps SFC licenced fund managers get ready for the upcoming FMCC climate-related risk requirements.

Please contact [esg.align@ogier.com](mailto:esg.align@ogier.com) to find out more.

## **About Ogier**

Ogier is a professional services firm with the knowledge and expertise to handle the most demanding and complex transactions and provide expert, efficient and cost-effective services to all our clients. We regularly win awards for the quality of our client service, our work and our people.

## **Disclaimer**

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