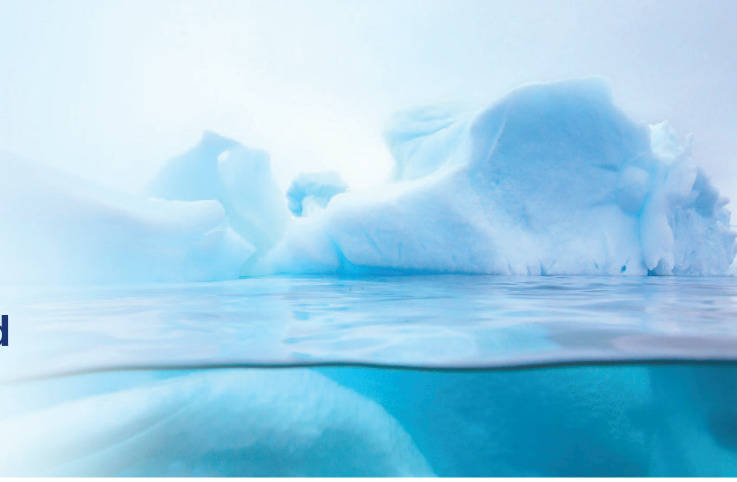

KPMG

Asset Management

SFC's Consultation on Management and Disclosure of Climate-related Risks

March 2022 update

In this update to our previously published commentary on the SFC's Consultation on Management and Disclosure of Climate related Risks, we provide additional analysis of the regulatory requirements for fund managers

On 20 August 2021, the Hong Kong Securities and Futures Commission ("SFC") issued the Consultation Conclusions on the Management and Disclosure of Climate-related Risks by Fund Managers. The resulting conclusion set out by the SFC is to implement the recommendations using a two-tiered approach; a baseline set of requirements which will apply to all fund managers managing collective investment schemes; and a set of "enhanced requirements" that will apply to fund managers with assets under management (AUM) that are equal to or in excess of HK$ 8 billion (excluding the AUM of discretionary accounts).

The SFC proposed that the Fund Manager Code of Conduct (FMCC) be amended to provide high-level principles and that a circular be issued to set out expected standards for complying with the FMCC. Consequently, this new regulation will materially impact governance, investment and risk management, conduct, and reporting for more than 1,800 Hong Kong-based asset management firms.

The asset management industry has been under pressure to manage its climate risk exposure. The consultation conclusion is a sign of convergence between institutional investor demands and the regulatory agenda.

When will the rules come into effect?

Manager Profile (assuming 31 Dec year-ends)	Large Fund Managers	All Other Managers
Baseline Requirements	20 August 2022	20 November 2022
Enhanced Requirements	20 November 2022; quantitative disclosures due in 2023	Not applicable

Determining your compliance needs

Is climate risks relevant to your fund/entity?

YES → **Are climate-related risks material to your fund/entity?**

NO → **Requirement C**

Requirement C

Climate-risks are Neither relevant Nor material

For all fund mangers managing CIS with investment discretion

- required to periodically reevaluate the relevance of climate risks in the investment management process

For fund manager responsible for overall operation of the fund

- required to list out the types of investment strategies/funds which are not relevant to climate-risk to meet disclosure requirements

Collective Investment Scheme (CIS)
Greenhouse Gas (GHG)

YES → **Requirement A**

NO → **Requirement B**

Requirement A

Climate-risks are relevant and material

For all fund mangers managing CIS with investment discretion

- Required to meet all Baseline Requirements for:
  - ✓ Governance
  - ✓ Investment Management
  - ✓ Risk Management including tools and metrics

For Large Fund Mangers managing CIS with investment discretion

- Required to meet all Baseline Requirements above PLUS
- Enhanced standards for Risk Management on scenario analysis implementation plan and portfolio carbon footprint assessment for Scope 1 & 2 GHG emissions

For fund manager responsible for overall operation of the fund

Other fund managers: all Baseline requirements for disclosures at the entity level

Large Fund Managers: all Baseline disclosure requirements PLUS Enhanced standards for disclosure of Engagement policy at entity level and portfolio carbon footprint at fund level

Requirement B

Climate-risks are relevant but NOT material

For all fund mangers managing CIS with investment discretion

- Required to fulfil the Baseline requirements for Governance
- Required to periodically reassess the relevance and materiality of climate-related risk in the investment and risk management process

For fund manager responsible for overall operation of the fund

- Required to fulfil the Baseline requirements for Disclosures at entity level on:
  - ✓ Governance arrangement; and
  - ✓ Investment and risk management process(es) adopted to identify and determine the relevance and materiality of climate-related risks

Regulatory Requirements

1. Governance - Board of Directors:

(1) Oversight of climate risk issues and setting tone at the top
(2) Define the board's or the board committee's role in overseeing the incorporation of climate-related considerations into the investment and risk management processes
(3) Oversee progress against goals for addressing climate-related issues
(4) Determine how the board or the board committee executes this role, including the process and frequency by which the board or the board committee is informed about climate-related issues

2. Governance - Management:

(1) Supervision and integration monitoring of climate risk into investment and risk management processes
(2) Assign roles and responsibilities for managing climate-related risks to management level positions or management committees which report to the board or the board committee, and determine the appropriate management structure
(3) Determine how the management (through specific positions or management committees) will monitor the status and progress of efforts to manage climate-related risks
(4) Establish a process for the management to be regularly informed about the status and progress of efforts to manage climate-related risks
(5) Devote sufficient human and technical resources for the proper performance of the duty to manage climate-related risks
(6) Establish satisfactory internal controls and written procedures to ensure compliance with internal policies and procedures as well as regulatory requirements related to the management of climate-related risks
(7) Set goals for addressing climate-related issues and develop action plans for managing climate-related risks

3. Investment Management:

(1) Identification of material physical and transitional risk
(2) Factor in material climate-related risks into the investment process where relevant
(3) Assess impact on performance

4. Portfolio Risk, Management and Operations:

(1) Incorporate climate-related risks into portfolio risk management
(2) Process to identify, assess, manage and monitor material climate related risks
(3) Develop tools and metrics to assess and quantify climate-related risks
(4) Assess the relevance and utility of scenario analysis in evaluating the resilience of investment strategies. If it is deemed to be relevant and useful, develop a plan to implement scenario analysis within a reasonable timeframe*
(5) Identify the portfolio carbon footprints of the Scope 1 and Scope 2 GHG emissions associated with the fund underlying investments, and define the calculation methodology and underlying assumptions*

5. Investors Reporting and Disclosures:

(1) Review disclosures at least annually, update disclosures where considered appropriate and inform fund investors of any material changes as soon as practicable

Entity level disclosures

Governance

(1) Governance structure

(2) Board's roles and oversight, including whether the board review the risk management framework covering climate risks and the process and frequency by which the board is informed about climate-related issues

(3) Engagement policy and preferably provide examples to illustrate how material climate risks are managed in practice, including how the engagement policy is implemented*

Investment management and risk management

(1) Steps taken to incorporate relevant and material climate risks into the investment management process

(2) Process for identifying, assessing, managing and monitoring climate risks, including the key tools and metrics used

Fund level disclosure

At a minimum, provide the portfolio carbon footprints of the Scope 1 and Scope 2 GHG emissions associated with the funds' underlying investments at the fund level, and indicate the calculation methodology, underlying assumptions and limitations, and the proportion of investments*

**Enhanced requirements for fund managers with more than HK$ 8 billion in AUM*

How KPMG Can Help

From impact assessment, development and review of climate-related governance structures and risk management frameworks to quantitative analysis and reporting, KPMG can help you navigate the complexity of implementing climate-related considerations and climate risk management across the organisation.

Effective Governance:

KPMG specialists can work with Board and senior management in order to implement a robust governance framework and strategy at the entity and fund level, to ensure effective oversight of climate-related risks.

KPMG specialists can also support in performing applicability studies, gap analysis of governance, investment and risk management frameworks, and an internal controls review focusing on climate-related controls.

Map climate-related risks:

KPMG specialists can help you to understand your company's exposure both to the physical impacts associated with climate change and to the forecasted regulatory and economic impacts of the shift to a low-carbon economy. We can identify the areas of your investment strategies, as well as the countries where your investments are located, which are - or will be - most affected by climate change.

Use scenario analysis to assess resilience:

KPMG can help you understand how climate-related risks and opportunities could affect your investment strategies through scenario analysis across a range of different climate pathways, including mapping out a variety of regulatory and economic scenarios. We can explore the business impacts of these scenarios in the short, medium and long terms and develop methodologies to assess and quantify the potential financial impacts.

KPMG can also support in the development of more sophisticated climate risk scenario models used to simulate and assess the potential climate risk in the fund's portfolio under different climate pathways.

Informed business strategy:

KPMG can help you identify and prioritize the climate risks that your company and portfolio is most susceptible to. We can provide recommendations on how to develop a robust climate resilience investment strategy taking into consideration different climate pathways.

KPMG can also provide support through recommending remedial actions required and assessing the adequacy and effectiveness of remedial actions designed or implemented by fund managers to close gaps identified.

Assess and improve readiness for reporting:

Using advanced tools, KPMG professionals can evaluate the extent to which your business's processes, methods and disclosures currently fulfil the TCFD recommendations and assessment on your specific circumstances that may require flexibility on the disclosure. We can benchmark your company's performance against industry best practice to show where you stand in the market.

Manage and report on risks:

KPMG can help you design appropriate climate data collection systems and define metrics and targets to monitor, manage, and report on climate-related risks in line with the SFC (TCFD) recommendations. We can provide advice on how best to disclose your climate-related risks in your financial disclosures and provide good practice examples to guide your reporting.

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