

**MEMO# 33538**

May 17, 2021

# Asia ESG: HK SFC Released Draft Revised Circular on ESG Funds

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TO: ESG Task Force

ICI Global Regulated Funds Committee

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On 10 May 2021, the Hong Kong Securities and Futures Commission (SFC) released the proposed revisions to its 2019 Circular on green or ESG funds<sup>[1]</sup> (Draft Revised Circular). The SFC intends to update the 2019 Circular and enhance the scope and the disclosure requirements on ESG funds. The SFC has asked us to share the Draft Revised Circular to ICI members, which we have done via email on 11 May 2021. It is the intention of the SFC to issue the final revised Circular in June 2021. The SFC has advised us that if there are any major/substantive issues which may hinder the smooth implementation of the Draft Revised Circular, the SFC would like to receive comments by 21 May 2021.

## 1. Background

The SFC held a soft consultation with the industry on their draft revised proposals in November 2020 and ICI submitted a written response.<sup>[2]</sup> Since then, the SFC has consulted with other relevant industry stakeholders including ESG experts and the SFC's Product Advisory Committee, which comprises members from a wide range of industry and market backgrounds, public authorities and academia, on the comments received from the soft consultation. We were pleased to see that the Draft Revised Circular addressed many of our comments raised in the soft consultation. While the disclosure requirements in the Draft Revised Circular are largely in line with those proposed in the November 2020 soft consultation, the SFC has further refined the scope of ESG funds and provided guidance on the application to UCITS funds in the Draft Revised Circular. This memo summarizes the key refinements made in the Draft Revised Circular and the implementation timeline.

## 2. Scope of ESG Funds

The Draft Revised Circular would apply to SFC-authorized funds which incorporate ESG factors as their key investment focus and reflect such in the investment objective and/or strategy (ESG funds). SFC envisages that funds that are currently classified as ESG funds

under the 2019 Circular will continue to be eligible as ESG funds under the refined scope and will be required to comply with the disclosure requirements set out in the Draft Revised Circular. SFC has also removed the minimum requirements of the ESG funds which were proposed in the November 2020 soft consultation, e.g., having a minimum threshold on the proportion of underlying investment that is commensurate with the fund's ESG-related focus.

The SFC would generally not expect a fund that does not fall under the scope of ESG funds as defined in the Draft Revised Circular to name or market itself as an ESG fund but may permit exceptions on a case-by-case basis. The SFC proposed in the November 2020 soft consultation that a fund might reference ESG in its name, even if it does not meet the definition of ESG funds, as long as it includes a prominent warning statement that "ESG is not a key investment focus and consideration of the fund." Such requirement has been removed from the Draft Revised Circular.

Notwithstanding the suggestion to align the Draft Revised Circular with the EU Sustainable Finance Disclosure Regulation (SFDR),<sup>[3]</sup> the SFC explains that there are concerns over the uncertainties with the SFDR classification. Therefore, the SFC believes it would be difficult at present to follow the SFDR approach in terms of the scope of ESG funds.

### 3. Application of the Draft Revised Circular on UCITS Funds

A UCITS fund will be an ESG fund in Hong Kong if they incorporate ESG factors as its key investment focus and reflect such in its investment objective and/or strategy ("UCITS ESG funds"). This is irrespective of whether such fund is an Article 8 or 9 fund under the SFDR.<sup>[4]</sup>

Given the similarities between the SFDR disclosure requirements and those pursuant to the Draft Revised Circular, a UCITS ESG fund that meets the SFDR disclosure and reporting requirements for Article 8 or 9 funds will be deemed to have generally complied in substance with the disclosure and reporting requirements set out under the Draft Revised Circular. Nevertheless, where appropriate, the SFC may request enhanced disclosure with respect to the fund's specific strategies and risks.

### 4. Effective Date and Implementation

To facilitate investors to make informed investment decisions in this evolving investment area, the SFC plans to finalize the Draft Revised Circular in June 2021 and proposes that it takes effect on 1 January 2022.

For an existing ESG fund that is on the SFC's dedicated webpage of ESG funds, fund managers should review the fund's current disclosures in relation to the requirements in the Draft Revised Circular and make necessary updates and revisions by 1 January 2022. Applications for new ESG funds submitted on or after 1 January 2022 are required to submit a self-confirmation of compliance, or a confirmation supported with independent third-party certification or fund label agency to demonstrate compliance.

Given the rapid development of ESG funds as well as the work towards harmonization of taxonomies, the SFC will keep in view local and international market and regulatory developments and consider updating the circular (including the scope of ESG funds) when there is more clarity on these issues.

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#### **endnotes**

[1] See Circular to management companies of SFC-authorized unit trusts and mutual funds - Green or ESG funds, HK Securities and Futures Commission (11 Apr 2019), available at <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=19EC18>. See also ICI Memo No. 31740 (30 April 2019), available at <https://www.ici.org/memo31740>.

[2] See ICI Memo No. 32962 (4 December 2020), available at <https://www.ici.org/memo32962>.

[3] REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector, available at <https://eur-lex.europa.eu/eli/reg/2019/2088/oj>.

[4] Article 8 funds are funds that promote, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practice. Article 9 funds refer to funds that have sustainable investment as their objective. See SFDR, supra note 3, Article 8 and Article 9.