

MEMO# 34855

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Asia ESG: HK SFC Second Industry Workshop on ESG Funds

[34855]

TO: ICI Global Members

ESG Task Force

Global Regulated Funds Committee - Asia SUBJECTS: ESG

International/Global RE: Asia ESG: HK SFC Second Industry Workshop on ESG Funds

On January 12, 2023, the Hong Kong Securities and Futures Commission (SFC) hosted a second industry workshop on ESG funds. The workshop focused on practical difficulties and questions that fund managers have encountered during the ESG fund application process, and in complying with the requirements of the Circular to management companies of SFC-authorized unit trusts and mutual funds - ESG funds.[\[1\]](#)

The SFC has published the presentation materials of the workshop on its website.[\[2\]](#) It provided further clarity on the regulatory expectations for some ESG strategies, which was discussed in the first workshop held in March 2022,[\[3\]](#) and reiterated the guidance on its expectation on the name of Non-ESG Funds.[\[4\]](#)

Some key takeaways from the January 2023 workshop are:

- UCITS ESG Funds. As noted in the ESG Fund Circular, regardless of whether a UCITS is an Article 8 or 9 fund under the EU Sustainable Finance Disclosure Regulation (SFDR), it would be regarded as an ESG fund in Hong Kong only if it incorporates ESG factors as the key investment focus ("UCITS ESG funds"). The SFC clarified that including SFDR template information in the offering document as part of the enhanced disclosure would not affect the ESG fund status of the particular UCITS in Hong Kong, i.e., if an Article 8/9 fund is not considered an ESG fund in Hong Kong, it would continue to be the case even the SFDR template information is included in offering document.
- Deemed Compliance for UCITS ESG Funds. While the UCITS ESG funds that meet disclosure requirements for SFDR Article 8 or 9 funds will be deemed to have generally complied with the disclosure requirements set out in the ESG Fund Circular, the SFC reiterated that it may request clarification on any unclear disclosure.
- Demonstrating ESG is "key investment focus" for Positive Screening Strategies. The SFC had previously indicated in the March 2022 industry workshop that ESG funds that adopt best-in-class/positive screening strategies should demonstrate that the ESG assessment performed as part of the investment strategy has a significant influence

on the stock selection process. It had given two examples - (i) removing at least 20% of companies from the investment universe based on the company-level ESG assessment, or (ii) improving the overall ESG rating at the portfolio level by at least 20% compared to the reference benchmark. The SFC clarified at the January 2023 workshop that this threshold is a general guideline instead of a hard requirement, and that it understands that the 20% threshold may not always be applicable given the wide range of ESG investment strategies. Besides the 20% threshold, the SFC will evaluate whether a best-in-class/positive screening fund can demonstrate that ESG ratings have a "significant" influence on the selection of underlying investment.

- ESG Assessment for Certain Asset Classes under Positive Screening Strategy. The SFC understands that ESG assessment of certain asset classes, (e.g., sovereign debts and money market instruments) is challenging due to data constraints and insufficient direct linkage between the instruments and the ESG performance of the issuers. The SFC is closely monitoring this space and welcomes industry feedback on this topic.
- Measurable Impact and Disclosures for Impact Funds. The SFC clarified its expectation that the positive ESG outcomes of an impact fund should be measurable at both the underlying investment level and the fund level. The SFC further clarified the disclosure required for impact funds. Asset managers are expected to disclose: (i) in the offering documents, how the fund measures its positive outcomes; and (ii) in the annual reports, the positive outcomes achieved by the fund and the methodology to measure such outcome.

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Notes

[1] See Circular to Management Companies of SFC-authorized Unit Trusts and Mutual Funds - ESG Funds("ESG Fund Circular"), available at <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/products/product-authorization/doc?refNo=21EC27>. Also See ICI Memorandum [33665], dated July 7, 2021, available at <https://www.ici.org/memo33665>.

[2] See Industry Workshops on ESG funds, at Section B, p.21-28, available at <https://www.sfc.hk/en/faqs/Publicly-offered-investment-products/Presentation-Materials-on-ESG-fund-applications>.

[3] The SFC hosted the first industry workshop on ESG fund applications on March 4, 2022, during which the SFC staff shared observations and regulatory expectations for how a fund could demonstrate its compliance with the ESG Fund Circular. See Industry Workshops on ESG funds, supra note 2, at Section A, p.2-20. Also See ICI Memorandum [34070], dated March 10, 2022, available at <https://www.ici.org/memo34070>.

[4] The SFC updated its guidance on its expectation on the name of Non-ESG Funds in October 2022. See Industry Workshops on ESG funds, supra note 2, at Section C, p.31-32. Also See ICI Memorandum [34324], dated October 26, 2022, available at <https://www.ici.org/memo34324>.

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