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Response to HK SFC Consultation Paper

- The Management and Disclosure of Climate-related Risks by Fund Managers

From Morningstar Inc. and Sustainalytics, a Morningstar Company

Submitted by email to: 2020_Climate_Consultation@sfc.hk

15th January 2021

Dear Sirs,

Morningstar welcomes the opportunity to comment on the proposed standards-setting of sustainability reporting. We bring several perspectives to this comment letter. First, we have a long track record of categorizing and rating mutual funds that pursue different sustainability strategies. Second, our equity analysts use environmental, social, and governance (ESG) analysis as part of their approach to assessing investments. Third, Sustainalytics, which is now part of the Morningstar family, is a leading global provider of ESG ratings, research and data to asset owners, investment managers, financial institutions, issuers/corporates, and a variety of other financial intermediaries.

1. Do you have any comments on the SFC's proposal to focus on climate change or should a broader spectrum of sustainable finance should be considered in developing the requirements? Please explain your view.

Morningstar believes that ideally the SFC should initially narrow its focus on those standards and frameworks that address sustainability from the perspective of enterprise value creation and should address the full range of sustainability (ESG) factors that are material to enterprise value creation (not only focus on climate change). That said, internationally there is a lot of in-progress work aimed at bringing some level of standardisation to the many existing disclosure formats and requirements that exist. Against that backdrop, commencing with an initial focus on climate, using TCFD recommendations as a base, can be prudent, both in terms of making the implementation more manageable and of leveraging international progress at a later date without reinventing the wheel. A commitment to and outline timetable around expanding the initial climate focus would provide market participants with an expectation of what else is to come and in what timeframe.

2. Do you agree that at the initial stage, the SFC's proposed requirements should apply to the management of CISs but not discretionary accounts?

While we have some concerns about limiting the scope it is pragmatic to establish standards for CIS whilst not closing the door to extending the requirements to a broader set of products and managers in future.

3. Do you agree that the SFC should make reference to the TCFD Recommendations in developing the proposed requirements so as to minimise fund managers' compliance burden and foster the development of a more consistent disclosure framework? Other

than the TCFD reporting framework, is there any other standard or framework which in your opinion would be appropriate for the SFC to refer to in developing the proposed requirements?
We agree. TCFD recommendations are increasingly being adopted in countries around the world and opportunities for standardisation should be taken wherever possible. The more consistent the disclosure frameworks, the more comparable the information will be for investors and the lower the cost of compliance will be, also ultimately benefiting investors.

4. Do you have any comments on the proposed basis for determining the threshold for Large Fund Managers, ie, HK$4 billion, and the basis for reporting? Please explain your view.
We understand the criterion used in determining the threshold and support the international consistency. We would argue that once a firm has been deemed a Large Fund Manager and made the commensurate disclosures, that it should continue to do so, rather than dropping back to a lower standard, and potentially flip-flopping between the two levels of disclosure, impinging upon the continuity and comparability of its information to its investors.

5. Do you have any comments on the proposed amendment to the FMCC requirements, baseline requirements and enhanced standards? Please explain your view.
We would recommend that under both the Risk Management and Disclosure sections, that identification and disclosure of Scope 1 and Scope 2 emissions be elevated to a baseline requirement. Standardized metrics are the most useful information for investors and are vital in substantiating a manager's narrative around their aims and claims. Correspondingly, the underlying source data is becoming more and more available.

6. To provide a clear picture to investors on whether a fund manager has integrated climate-related considerations into its investment strategies or funds, do you agree that if the fund manager considers that climate-related risks are irrelevant to certain investment strategies or funds, it should make disclosures and maintain appropriate records to explain the rationale for its assessment?
We agree. It is important that these determinations are made pro-actively to investors together with the rationales.

7. Do you agree that climate-related disclosures (except for the disclosure of WACI) to investors should be made at an entity level at a minimum and supplemented with disclosures at a strategy or fund level to reduce burden on fund managers?
We fundamentally disagree with this aspect of the proposals, for a few reasons. Firstly, investors are usually buying a fund or product, rather than an entity. While entity level data can show a macro position at a market level it is not helpful to individual investment decision-making. Secondly, entity level disclosures will by their nature be an average that will likely mask a wide dispersion across the underlying products of the entity. Consider a situation where an entity manages mandates for third-party firms, where the third-party set specific climate-related targets that may differ from those applied to the entity's own products. Thirdly, to produce the entity level data, a bottom-up approach, aggregating the individual product data

will likely be necessary and arguably the most accurate way to arrive at the entity level position.

8. Do you agree that disclosures of quantitative climate-related data such as WACI should only be applicable to Large Fund Managers having regard to the resources required and the size of assets covered? Do you agree that at the initial stage the disclosure of the WACI should be made at the fund level instead of the entity level?
We do not agree that climate-related metrics should only be applicable to Large Fund Managers. Standardized metrics are the most useful information to investors and are vital in substantiating a manager's narrative around their aims and claims. At a minimum we would argue for all managers to disclose their scope 1 and scope 2 WACI. We do agree that WACI should be disclosed at fund level.

9. Do you think the following transition periods are appropriate?

- ♣ **a nine-month and a 12-month transition period for Large Fund Managers to comply with the baseline requirements and enhanced standards respectively; and**
- ♣ **a 12-month transition period for other fund managers to comply with the baseline requirements.**

If not, what do you think would be an appropriate transition period? Please set out your reasons.
We agree these are appropriate.

On behalf of Morningstar we again thank you for the opportunity to contribute and will be happy to engage further, answer any questions or provide any additional information that may be helpful.

Yours faithfully,

Andy Pettit
Director, Policy Research