STANDARDS BOARD FOR ALTERNATIVE INVESTMENTS

Consultation Response

Management and Disclosure of Climate-related Risks by Fund Managers

SBai
Standards Board for Alternative Investments

1. Introduction

The Standards Board for Alternative Investments ("SBAI") welcomes the opportunity to respond to the Hong Kong Securities and Futures Commission's ("SFC") Consultation Paper on Management and Disclosure of Climate-related Risks by Fund Managers ("Consultation Paper").[1]

The SBAI actively contributes to the global debate on Responsible Investment and recently published a "Review of Responsible Investment Regulatory Expectations".[2] The review highlighted the evolving regulatory landscape in this area and explored the spectrum of approaches and policy choices authorities face. Some of the findings of this review are set out further below (Section 2.1) allowing a comparison of the SFC's approach to global peers.

The SBAI supports effective regulation and welcomes efforts to enhance risk awareness and disclosure in relation to climate-related risks. Climate risk is one of many investment risks that can emerge and (where applicable) need to be addressed as part of a fund manager's risk management process. In addition, adequate risk disclosure (of all types of risks) enables better investment decision making and facilitates the efficient pricing of risk and opportunities in global markets. Accordingly, effective risk management and risk disclosure is at the heart of the SBAI's Alternative Investment Standards[3] and often addressed in asset management regulation in a principles-based manner (as discussed further in Section 2.2).

This consultation response contains:

1. Important high-level observations on the proposed approach (Section 2)
2. The responses to the consultation questions (Section 3)

2. High Level Observations on the Proposed Approach

Prior to responding to the specific questions in the Consultation Paper, we would like to provide some context to the responses with specific observations on three topics:

1. Conclusions from the SBAI's own review of the global regulatory landscape for Responsible Investment
2. Considerations for effective regulation in Responsible Investment
3. Observations on the key issues raised in the Consultation Paper.

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[1] https://apps.sfc.hk/edistributionWeb/api/consultation/openFile?lang=EN&refNo=20CP5
[2] https://www.sbai.org/toolbox/responsible-investment/
[3] https://www.sbai.org/standards/

2.1 SBAI review of the Global Responsible Investment Regulatory Landscape

The SBAI has completed research into the global regulatory environment for Responsible Investment (please find the full memo here), including Environmental ("E"), Social ("S") and Governance ("G") considerations, focussing on regulation and guidance for issuers, investors and investment managers. In this memo we make several observations including:

- Governance has long been a key focus of regulators and investors, while environmental factors have attracted more significant attention in recent years.
- Regulators have tended to focus on creating market-based solutions, rather than taking a prescriptive approach on how specific requirements are to be implemented.
- There is a natural sequencing for Responsible Investment regulation, with the mandating of issuers to disclose relevant ESG metrics as a starting point. This enables better informed investment decision making and reporting by fund managers and institutional investors.
- Regulation for fund managers is the newest type of regulation and has typically been preceded by regulation on issuers and investors.
- Fund manager disclosure typically focusses on policy publication (detailing how sustainability is integrated into decision making processes) rather than prescriptive metrics-based disclosure.
- For the most part, regulations only become more prescriptive and metrics-based where products hold themselves out to have a "Responsible Investment", "ESG" or "Sustainable" mandate to address greenwashing concerns.

Illustration: Data flow

The importance of data availability has also been highlighted in a recent report by the US Government Accountability Office on the "Disclosure of Environmental, Social, and Governance Factors and Options to Enhance them".[4] The report highlights that reporting by companies or issuers currently lacks consistency, comparability, and reliability. This creates hurdles for market participants to efficiently use this information in investment decision making.

To facilitate better reporting by fund managers, regulators in the EU and the UK (in its proposed legislation) have focussed on first mandating listed company disclosures.

At present there are several reporting frameworks for climate-related metrics (including TCFD, Standards Board for Sustainable Accounting (SASB) and others). The industry has not yet converged on one single framework. This makes consistency of reporting challenging as fund managers and investors may find different frameworks useful for different purposes.

[4] https://www.gao.gov/assets/710/707949.pdf

Question:
Has the SFC considered mandating appropriate disclosure at the source of the data (for example Hong Kong listed entities) as a potentially more suitable starting point? This would enable better data availability for fund managers and ultimately better disclosure to end investors.

2.2 Considerations for effective regulation in Responsible Investment

Effective regulation needs to consider many factors including the achievement of public policy objectives such as conduct, investor protection, market integrity, systemic stability, and market development. The proposed amendments to the Fund Manager Code of Conduct appear to focus on risk management ("requiring fund managers to take climate-related risks into consideration in their investment and risk management processes") and disclosure to investors.

ESG Regulation Considerations - Risk Management

From a regulatory perspective, it is desirable that fund managers have robust risk management practices that consider all material risks and operate in line with the risk mandate of the specific products. As set out in our response to Question 1, financial regulation does not typically detail in a rules-based manner all the risks investment managers should consider, due to the impracticability of the regulator being able to identify all these risks. It also typically does not prescribe how these risks should be managed or reported, as there is no singular correct way to do this.

Regulation typically takes a more principles-based approach allowing for a wide range of risk management practices and ongoing innovation of risk management techniques[5]. The focus of regulation is typically on the expectations for risk procedures, frameworks and governance, ongoing risk monitoring and investor reporting. Often, there is reference in regulatory frameworks to important general portfolio risk management techniques, such as liquidity risk, market risk and counterparty risk.[6] Incorporating the specific risk factor "climate-related risks" alongside these general portfolio risk management techniques seems somewhat unusual, since it gives the appearance of elevating this particular risk factor above many other important risks, including many other ESG risks.

As highlighted in Section 2.3, a flexible approach is needed to allow fund managers to focus their (often limited) research and risk management resources on those risks that are most material in light of considerations such as strategy, holding period, and asset class, rather than putting a singular emphasis on climate-related risks (which are a sub-set of the broader area of environmental risk).

Elevating one risk factor above others (by singling it out for more prescriptive rules) can have some unintended consequences. Resources will be spent monitoring and reporting on this single set of metrics when it may not be one of the more financially material risk factors within the strategy. This could result in a "tick-box approach" to meet regulatory requirements rather than ensuring the risk management process is effective for the style and strategy.

ESG Regulation Considerations – Investor Disclosure

[5] As discussed in section 2.2 above, the SBAI believes this diversity of risk management to be positive for the asset management industry.
[6] The Alternative Investment Standards provide a robust risk management framework (Standards)

Regulation on investor disclosure can take two forms: disclosure-based reporting providing details of how ESG considerations are integrated into investment processes and metrics-based reporting that requires specific data points to be disclosed to investors on a portfolio or line by line basis.

Disclosure-based reporting including descriptions of how ESG factors are considered in the investment process or a written ESG integration policy can be applicable to many asset managers. As discussed above, all material risks should be considered in an effective Risk Management policy and in turn this framework can be disclosed to investors.

Metrics-based reporting, however, relies on a chain of data availability as previously discussed in Section 2.1. There are typically two ways for data to be obtained by fund managers to report these metrics:

1. Issuer Disclosure - Data disclosed by the underlying issuers which provides these metrics either sourced directly from issuer reporting or through a third-party data vendor, or
2. Engagement – Data sourced directly from the issuer through contact, again either directly or through a third-party data vendor.

In jurisdictions where issuers have not been mandated to provide the metrics that fund managers will be required to report on, there will be no consistency of availability of this data. As noted previously, ESG regulation that requires reporting of any specific metrics will be more effective if issuers have first been mandated to provide this data. This is the approach that has been taken by the EU and the proposed approach by the UK FCA.

Using engagement with issuers to source this data also presents challenges. Direct engagement by a fund manager is only practical in certain strategies and asset classes (as discussed further in Section 2.3). Third party vendors in this space will also have some limitations in terms of coverage, consistency, and reliability.

Therefore, when accounting for both the Risk Management and Data and Disclosure considerations above, the SBAI would be more supportive of principles-based regulation on risk management and portfolio risk reporting (including climate-related risks) rather than prescriptive rules. This would allow for the required flexibility to ensure that any risk management processes, as well as disclosure and reporting, are both effective and relevant to the specific product.

2.3 Observations on the key issues raised in the Consultation Paper

As highlighted in the Consultation Paper in the Executive Summary[7] and confirmed in the results of the SFC's asset management survey, fund managers "generally considered environmental, social and governance (ESG) factors" including climate-related risks.

Key concerns raised in the Consultation Paper include:

- Lack of consistency of integration of climate-related risks into investment decisions[8]
- Lack of consistency of disclosure of climate-related risk

[7] Page 6, Item 2
[8] Including the statement that "only a limited number of asset managers had processes in place to manage the financial impact of climate-related risks" (Consultation Paper, Page 6)

Is Consistency of Integration of Climate-related Risks into Investment Decisions Realistic?

Fund management is a diverse industry in terms of investment strategies, asset classes and risk management approaches. Climate-related risk, which is one of many investment risks that need to be assessed, will have varying materiality as a function of the considerations below amongst others:

- Investment strategy and process (for example systematic vs. fundamental analysis),
- Asset classes in the portfolio (equities, fixed income, commodities, FX, infrastructure, and others),
- Investment rationale (for example short term arbitrage strategies vs. long-term appreciation strategies), and
- Typical holding periods for the portfolios.

The illustrative examples below provide more detail regarding the factors that can cause differences in integration for several strategies. These examples highlight that "consistent integration" of climate-related risks is difficult to accomplish and could indeed be counterproductive.

Illustration: Typical strategy considerations[9]

Strategy	Considerations

Systematic or Quantitative Strategies	▪ Skill-sets required are for quantitative analysis and therefore resource is not dedicated to fundamental research which may be required to source information where there is a lack of publically available information.
	▪ The portfolio characteristics make meaningful engagement on a per entity level more difficult to accomplish. These include:
	  ○ Large number of individual investments
	  ○ Individual positions that tend to be smaller in relative size in relation to the overall portfolio
	  ○ Holding periods that can be much shorter with a higher portfolio turnover
	▪ The shorter holding periods can also result in climate-related risks being financially less material than other risk factors.
	▪ Any metrics based reporting will be a snapshot in time and may not be representative of the strategy as a whole.
	▪ Many of these strategies trade asset classes such as Futures, Options and FX, where the materiality of climate-related risks can be limited and which do not allow for engagement with the underlying issuers.
	
	However
	▪ Climate-related risk data can be incorporated into systematic modelling to provide additional data points for overall analysis.
	▪ Exclusion lists can be implemented systematically (though these would likely be at the request of an individual investor mandate).

Macro Strategies	▪ Where FX and Sovereign Debt are traded, there is limited scope for an individual manager's engagement. There will be a heavy reliance on publically available data which is only available in certain (and typically more developed) jurisdictions.

[9] Observation: Within each of these investment strategies, some managers will have dedicated products marketed with attributes such as "ESG", "Responsible Investment", or "Sustainable" with a higher resource allocation to researching these issues and therefore capability for more comprehensive reporting catering to specific investor preferences.

	▪ Macro strategies can trade a wide range of asset classes not all of which will be materially impacted by climate-related risks or have opportunities for engagement. ▪ Metrics based reporting may only be practical for a subset of the portfolio and would therefore not be representative of the strategy as a whole.
Equity Long/Short Strategies	▪ Active engagement (beyond voting) requires a dedicated skill set with both sophisticated views on specific engagement topics and adequate resoucing. ▪ There are varying degrees of ESG data availability, depending on factors such as whether the jurisdiction mandates disclosure and the size of the companies in the investment universe (for example, large caps will tend to have more resources to report this information). ▪ Shorting of stocks can cause metrics based reporting to be inaccurate if not treated properly. ▪ The use of both short positions and derivatives in the portfolio do not allow opportunties for either enhanced engagement or voting. **However** ▪ Strategies based on fundamental analysis will typically allow for integration of climate-related risks (among many other risk factors) ▪ More concentrated portfolios are more likely to be suitable for enhanced engagement where data is not available.

Recent research by MSCI[10] highlights that Governance ("G") aspects are far more significant than Environmental ("E") and Social ("S") considerations over shorter time periods, in terms of their impact on profitability, idiosyncratic risk and systematic risk. This is because G is most directly linked to short-term events and incident risk. Conversely, E and S indicators were more significant over longer periods (the study covered the period from 2006-2019).

The study also highlights sectoral differences in terms of the impact of E, S and G, with G being particularly relevant in Financial and Consumer Discretionary GICS[11] sectors, while E showed strong significance in the Materials and Energy sectors. Information Technology, in contrast, was more affected by human capital issues (part of S). This demonstrates that even looking at purely E risk related factors, different issues (or combinations thereof) can have varying relevance for different industries (for example amongst others, carbon emissions, climate change vulnerability, biodiversity, water stress, and toxic emissions or waste).

This demonstrates that a flexible approach is needed to allow fund managers to focus their (often limited) research and risk management resources on those risks that are most material in light of the considerations discussed. It would also avoid the appearance of elevating this single risk factor above other E, S and G related factors (alongside many other portfolio risks) and irrespective of materiality to the strategy, which could dilute the effectiveness of a firm's risk management process.

Principles-based regulation that requires a fund manager to assess the materiality of E, S and G related risks and (where required) factor them into an effective and relevant risk management process may be a more effective scope of regulation to address these issues.

[10] https://www.msci.com/esg/deconstructing-esg-performance
[11] Global Industry Classification Standard jointly developed by Moodys and Standard & Poor's

How to Best Achieve Consistency of Disclosure of Climate-related Risks?

As set out in Section 2.1, disclosure of relevant ESG metrics relies on a chain of data availability with corporate (and other) issuers mandated to produce this data as the starting point.

To facilitate more consistent reporting by fund managers, regulators in the EU and the UK (in its proposed approach) have focussed on mandating listed company disclosures to enable fund managers to make better informed investment decisions.

With inconsistency on both the availability and quality of climate-related data from the underlying issuers, there will inevitably be inconsistency in data reported by fund managers. In addition, certain climate-related risks will be more financially material in certain strategies and as such the metrics reported are likely to diverge. Hence, starting with the source data by mandating better disclosure by issuers is the starting point for improving data quality (see Section 2.1).

Conclusion:

ESG related risks are relevant to effective risk management processes in the alternative investment industry.

The SBAI does not disagree that there is a need for climate-related risk factors to be integrated into investment processes (where relevant) and that investors need to be able to obtain data that is financially material to their investment and appropriately comparable across different funds. The danger with being prescriptive too early in the journey of ESG frameworks is that this could become a “tick box exercise” where risks are integrated in a way to satisfy specific regulatory requirements rather than careful thought being put into the area to come up with an effective framework relevant for the strategy. This could be detrimental to risk management processes.

From a regulatory perspective, a more principles-based approach, as commonly applied to the broader area of risk management, is a more suitable approach to ESG related risk management than prescriptive rules-based regulation which mandates the disclosure and reporting of specific metrics.

Principles based regulation would focus on:

- Fund managers having adequate risk management processes to identify, manage and monitor all relevant risks (including climate-related risks where applicable),
- Disclosure of the risk management approach to investors to enable well informed investment decisions, and
- Risk reporting on material risk factors to investors.

This type of framework would allow fund managers to identify the materiality of climate-related risks to their investment strategy and to develop a practical implementation approach taking account of the considerations discussed in this response.

The SFC has noted in its consultation paper that there is a “lack of consistency of implementation” with regards to climate-related risks. Given that there is no one size fits all approach to integration of climate-related risks in different strategies, the SBAI, therefore, does **not** consider “lack of consistency of implementation” as an issue that regulators need to address through regulation**.** As in many other areas of risk management, for good reason, there is a wide diversity of approaches.

The SBAI would be more inclined to support a disclosure requirement that allowed fund managers flexibility on reporting the climate-related metrics that are appropriate to the products they manage. In addition, this would avoid putting singular emphasis on climate-related risks (as discussed in our response to Question 1) when other risk factors may be more material. This singular focus could have the unintended consequence of diluting the effectiveness of risk management processes.

The SBAI does agree with the concept of baseline and enhanced standards, however, (as noted in the response to Question 5) it may be more appropriate to mandate the enhanced standards for products where climate-related targets are within the investment mandate or products that are marketed as ESG related or similar. Any such reporting should align with the metrics used to determine either individual investments or the overall investment mandate and as such some flexibility will still be required.

3. Responses to Questions:

Question 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.

As set out on page 13 of the Consultation Paper, climate-risk can include physical risks, transition risks, and liability risks, which can affect the value of specific assets or groups of assets. As such, they can be idiosyncratic where they are particular to a specific investment or more systematic where they affect an entire asset class or sector. Examples of other idiosyncratic risks in equity investments for example, include internal risk factors such as the underlying issuers' corporate culture, operating strategy, financial strategy, or investment strategy alongside many other external risk factors including environmental risks. Systematic risks typically involve macroeconomic factors such as interest rates and inflation, but could also include risks such as geopolitical, financial stability, political, or specific events such as infectious diseases.

From a regulatory perspective, it is desirable that asset managers have robust risk management practices that take account of all material risks and operate in line with the risk mandate of a specific product. Regulation, however, does not typically detail in a rules-based manner all the idiosyncratic and systematic risks investment managers should consider, due to the impracticability of the regulator being able to identify all these risks. It also typically does not prescribe how these risks should be managed, as there is no singular right way to do this. Instead, regulation usually takes a more principles-based approach allowing for a wide range of risk management practices and ongoing innovation of risk management techniques[12]. The focus of regulation is typically on the expectations for risk procedures, frameworks and governance, ongoing risk monitoring and investor reporting. Often, there is reference in regulatory frameworks to important general portfolio risk management techniques, such as liquidity risk, market risk and counterparty risk.[13]

Incorporating "climate-related risks" alongside these general portfolio risk management techniques appears somewhat unusual, it gives the appearance of elevating this particular risk factor above many other important risks, including other ESG risks. As set out in Section 2.3 above, depending on factors such as investment strategy, asset class, investment rationale and holding period, other elements of ESG may be more material risk factors within the portfolio. From a fund manager's perspective, these other risk factors would therefore be more suitable areas for deployment of potentially limited research and risk management resources. As discussed in Section 2.2 above, focus on a singular risk factor may also have the adverse effect of turning part of the risk management process into a "tick-box exercise", where fund

[12] As discussed in section 2.2 above, the SBAI believes this diversity of risk management to be positive for the asset management industry.
[13] The Alternative Investment Standards provide a robust risk management framework (Standards)

managers design risk management processes to satisfy a particular prescriptive regulation, as opposed to implementing an effective risk management approach based on the materiality of all risk factors to the specific strategy.

The proposed framework also raises the question whether this marks the beginning of an overall shift in the SFC's approach towards being more prescriptive on specific risk factors, where other sustainability risk factors will be dealt with in an equally detailed manner. If this is not the case, it again raises the question as to why this one specific risk factor is being treated in a more prescriptive way by the SFC than others.

In the spirit of a more "principle-based approach" to better align with other risk management regulations, a higher-level starting point focussing on considering all ESG factors within the risk management process (as per the EU approach) may be more appropriate as opposed to mandating the reporting of specific risk metrics.

An exception to this may be where the asset manager holds themselves out to be running an ESG related strategy (or similar), in which case reporting of metrics that support the investment strategy could be mandated allowing for some flexibility. Again, this is similar to the EU's approach where enhanced disclosures are required for dedicated "sustainable" funds and the US SEC's examination approach which only requires ESG related data for ESG funds.

Question 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?

Whether the proposed scope of the application of these regulations is appropriate, depends on the objective of the regulations (for example, better investor disclosure, exercising pressure on issuers to improve disclosure, standardisation of climate-related risk reporting).

For discretionary accounts, risk parameters (including potential ESG risk factors) and investor reporting are typically fully defined between the fund manager and the investor in the investment mandate. Typically, the investor will receive the fund manager's risk management processes and metrics by default and the investor can choose to remove or add certain aspects within the specific risk mandate and risk disclosures (which may include specific ESG metrics). Therefore, the SBAI agrees with the proposal that discretionary accounts do not need to be included for this regulatory objective.

For other potential objectives for these regulations, it is less obvious why discretionary accounts would be excluded. As an example, objectives such as standardisation of climate-related risk reporting for investors or putting pressure on corporates to improve their practices or disclosure. As noted previously in this response, mandatory reporting requirements on issuers may be a more efficient way to achieve any objective involving changing corporate behaviour or disclosure.

Note that the proposed regulation by the Singapore MAS is applicable to both CIS and discretionary mandates; however, its guidelines do not prescribe specific metrics-based reporting.

Question 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?

Frameworks:

In practice, fund managers often invest across different markets that currently have different levels of issuer disclosure of relevant climate-related metrics. At present, there are several reporting frameworks for climate-related metrics (including TCFD, Standards Board for Sustainable Accounting (SASB), UN Sustainable Development Goals (SGDs) and others) some of which have been designed specifically for issuers (such as TCFD) and others that are more flexible (such as SASB and SDGs). There has been no global convergence yet on a single framework. In fact, consistency of reporting may be challenging (and potentially undesirable) as fund managers and investors may find different frameworks useful for different purposes.

At this stage, it is premature to mandate the use of one framework. Instead, any regulatory approach should allow flexibility for fund managers to select an appropriate framework or approach suitable for their investment strategy and that provides investors with the most relevant information about material risks.

Data Challenges in Conforming with a prescribed Framework:

To conform to a prescribed framework, data reported at a fund level would need to be sourced on a look-through basis which requires issuer level data. As noted in Section 2.2 there are several challenges with collection of this data outside of asset managers that trade listed equities in relatively concentrated portfolios.

- Publicly available disclosures are not mandated in all jurisdictions and therefore not necessarily available for all portfolio holdings.

- The alternative way to source data is via direct engagement. This can be of limited practicality to a fund manager depending on asset class and resources which will present challenges to many alternative investment strategies.

Given the lack consistency, comparability, and reliability of data reported by issuers and the challenges with sourcing this data directly, the logical starting point for any regulation is to focus on standardising issuer disclosure. This will then enable fund managers to source this data and use it for both risk management purposes and to facilitate more consistent reporting. Tackling legislation in this order is the approach that has been taken by the EU and the proposed approach by the UK FCA.

Disclosure based Frameworks:

Frameworks with disclosure-based elements focussing on descriptions of how ESG factors are considered in the investment process or a written ESG integration policy and do not mandate metrics-based reporting provide more flexibility for fund managers. This may be a more effective place for a fund manager regulation framework to start.

Question 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

The SBAI agrees with the SFC’s reference to the “principle of proportionality, having regard to factors such as size and complexity of a fund manager’s business and the investment strategies adopted”[14].

[14] Consultation Paper, pages 6-7

However, The AUM of a fund manager is not necessarily an indicator of the availability of resources[15] or relevance of “climate-related” risks.

Typically, global regulation for fund managers related to ESG risks has not defined a threshold for enhanced rules based on the AUM of a fund manager. Regulation for issuers does have size thresholds; however, these are based on the size of the organisation rather than any value threshold (for example EU issuer disclosure is applicable where a company has more than 500 employees and the UK Gender Pay Gap Reporting is applicable to companies with more than 250 employees).

Please the response to Question 5 which suggests that the investment strategy rather than “small” versus “large” may be a more appropriate way to determine the applicability of baseline or enhanced standards.

Question 5:
Do you have any comments on the proposed amendment to the FMCC requirements, baseline requirements and enhanced standards? Please explain your view

The SBAI agrees with the concept of baseline and enhanced standards which is consistent with regulation in other jurisdictions and is appropriate in terms of availability of resources and skill sets.

If the regulations are split into baseline and enhanced standards it may be appropriate to not apply this distinction based on the size of the asset manager (whether by AUM or another metric as noted in question 4). It may be more appropriate to apply the enhanced standards where the fund manager is running an ESG-related strategy (or similar). This would help prevent greenwashing of funds by requiring detailed reporting on the ESG considerations in these strategies, whilst not requiring this from managers that are purely considering ESG risks alongside other relevant risk factors. There would remain a need for some flexibility in terms of the metrics reported to ensure they are relevant to the strategy.

Question 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?

The SBAI agrees that if an asset manager details these risks as irrelevant or immaterial it should be able to provide a disclosure statement as to why this is the case. Effective risk management requires a fund manager to determine which risks are and are not material for its strategy and design a risk process based on these determinations. As such, if a fund manager does not take account of ESG related risks in its risk management process, it would be expected that a rationale for not doing this has been formed and could be disclosed to investors. That said, we would repeat an observation from earlier in the response, that this disclosure would be required for a singular risk-factor and is not in alignment with other risk management regulations.

In practice, and as is the case with many other risk factors, the relevance of climate-related risk will not always be as binary as “relevant” or “not relevant” but will sit on a spectrum of relevance as a function of investment strategy, holding period, etc. and can vary over time as a function of underlying investments.

[15] For example, in certain alternative investment strategies, large AUMs can be run with a small team.

Given the non-binary spectrum of relevance noted above there is likely to be a middle ground in terms of disclosure and reporting that should be considered. Many fund managers will likely have determined that ESG related risks are relevant to their strategy; however, reporting on the metrics per the regulation may not be appropriate. As an example, in a high turnover strategy (e.g., systematic) or even an equity strategy trading in a jurisdiction where the data is not routinely disclosed by issuers, the risks may be relevant and can be integrated into risk management processes at an industry, sector or country level; however, reporting of metrics relying on data from individual portfolio line items is not feasible. The SFC could consider allowing managers to disclose in a non-metrics-based manner describing the integration, as opposed to having to select between *the risks not being relevant* or *being relevant* and therefore subject to the full reporting requirements of the regulation.

It would likely be useful to asset managers for the SFC to indicate which strategies it would expect integration and reporting (for example, listed equity strategies with concentrated portfolios) and those that it would likely accept an evidence-based disclosure from (for example, systematic funds, or macro funds).

Question 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?

<u>Disclosure Requirements:</u>

As per the consultation paper the required disclosures will be:

- Governance arrangement for oversight of climate-related risks; and
- How climate-related risks accounted for in investment and risk management processes, including the tools and metrics used to identify, assess, manage and monitor the risks

There is also an additional requirement for "Large Fund Managers" to describe their Engagement Policy to demonstrate to investors (among other things) how they are encouraging better disclosure and practices related to climate-related risks.

<u>Response:</u>

The SBAI agrees that any disclosures based on governance and risk management processes would be more suitable at an entity level. We also agree that this could be supplemented with enhanced disclosures at a fund or product level in strategies where these risks are more material. Note, that as per our response to Question 5, these enhanced disclosures would be more appropriate on ESG related investment strategies rather than based on the AUM of an investment manager.

Disclosure of engagement processes aimed at improving corporate disclosure and practices would similarly be more appropriate for a strategy that engages for this purpose rather than determined on the AUM of the fund. Engagement in general can pose some challenges for certain alternative investment strategies, depending on for example asset classes, holding period, size of position, and number of positions (as detailed in Section 2.3) and as earlier noted attempts to improve corporate disclosure and practices would be better addressed via direct regulation of issuers.

Question 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?

Please see response to Question 4 and 5 which discuss the strategy of the fund being a more appropriate way to determine application of enhanced standards and Question 1 and 3 on mandated metrics on a singular risk factor.

WACI data suffers the same challenges as noted previously on lack of consistent availability. Whilst it does allow for estimates to be used this would lead to inconsistency across fund managers depending on the assumptions made during any estimation.

Question 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.

The SBAI agrees that a transition period should be in place for any disclosure regulation. Asset managers will need time to put in place processes and resources to be able to collate the required information.

Given the lack of data availability currently (particularly in the APAC region) an 18-month transition period may be more appropriate.

Note that the Singapore MAS is proposing an 18-month transition period and the EU had a 15-month transition period.