Vivien Teu & Co LLP
張慧雯律師事務所
有限法律責任合夥

SYNOPSIS SERIES

Hong Kong Green or ESG Investing & SFC Authorised Funds

Background & Introduction

In December 2015, parties to the United Nations Framework Convention on Climate Change (**UNFCCC**) reached an agreement to combat climate change and to accelerate and intensify the actions and investments needed for a sustainable low carbon future (**the Paris Agreement**). The central aim of the Paris Agreement is to "strengthen the global response to the threat of climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue effort to limit the temperature increase even further to 1.5 degrees Celsius". The parties to the Paris Agreement represent major global greenhouse gas emission countries, including China, and China has since been active in promoting green finance, with the "Green Bond Endorsed Project Catalogue (2015 Edition)" and "Guidelines for Green Bond Issuance" both published in 2015, and the People's Bank of China (PBoC) leading global efforts in addressing climate issues in financial supervision and co-founding the Central Banks and Supervisors Network for Greening the Financial System (**NGFS**).

The Hong Kong Securities and Futures Commission (**SFC**) issued its Strategic Framework for Green Finance (**the Framework**) on 21 September 2018, aiming to develop green finance in Hong Kong, and considering that Hong Kong is well positioned to complement Mainland China's green development ambitions and to connect green finance flows between Mainland and the rest of the world.

Pursuant to the Framework, the SFC has the following action agenda, in summary:

- Enhance listed companies' environmental and climate-related disclosures;
- Conduct a survey on integrating environmental, social and governance (**ESG**) factors, in particular environmental, in investment and risk analysis process;
- Facilitate the development of a wide range of green-related investments and financial products;
- Support investor awareness, education and capacity building in green finance and investment-related matters;
- Promote Hong Kong as an international green finance center.

With respect to the fund management industry in particular, subsequent to the issue of the Framework, on 11 April 2019[1] the SFC issued its "Circular to management companies of SFC-authorised unit trusts and mutual funds – Green or ESG funds" (**the Circular**). The purpose of the Circular is to enhance disclosure comparability between similar types of SFC-authorised green or ESG funds, and their transparency and visibility in order to facilitate investors making informed investment decisions.

The SFC also conducted an industry-wide survey (**the ESG Survey**) from March to September 2019, intended to understand how and to what extent licensed asset management firms and leading institutional asset owners consider ESG in investment decisions and risk management, particularly those relating to climate change. The SFC issued the key findings of the ESG Survey in December 2019.

Separately, last year a public consultation was conducted by the Hong Kong Stock Exchange (**HKEX**) and in December 2019 the consultation conclusions was issued on the review to the ESG Reporting Guide and Related Listing Rules for companies listed on HKEX. This introduced enhanced requirements on the reporting and disclosure by listed companies on ESG, in particular on board governance,

[1] Please refer to our update and publication in April 2019 on the issue of the Circular: http://www.vteu.co/2019/04/14/green-or-esg-funds-hong-kong-regulator-issues-guidelines/

requiring mandatory disclosure of board engagement on a corporation's consideration and reporting of ESG issues in its business activities, including materiality and quantitative assessment, risk management and strategy. On climate, there is now a new requirement for disclosure on the policies and measures to identify and mitigate climate-related issues which have impacted or may significantly impact the listed issuer, and which reflects the Recommendations of the Taskforce on Climate-related Financial Disclosures (**TCFD**)[2]. The disclosure obligation on all social issues have been upgraded from recommended or voluntary disclosures to mandatory "comply or explain" disclosures. The new requirements apply for financial years commencing on or after July 2020, and are expected to enhance the availability and quality of ESG data on HKEX-listed companies.

In this synopsis, we focus specifically on green or ESG investing of Hong Kong licensed investment managers, and on the current range of green or ESG investment funds in Hong Kong, in particular SFC authorised funds available for public offer. We hope this will be beneficial to fund managers in considering their green or ESG investment strategies, and also their product development plans, which may contribute to the further development of green or ESG investing and related fund products in Hong Kong.

SFC Circular on Green or ESG Funds

An action agenda of the Framework is to provide disclosure guidance and harmonised criteria to facilitate disclosure and reporting of green-related investment products, so as to encourage the development of more such products and also raise the credibility of green product offerings in Hong Kong. The Framework also noted the risk of "greenwashing" as one element that calls for regulatory involvement.

The Circular is applicable to management companies of unit trusts and mutual funds authorised by the SFC for retail offer, and specifically SFC authorised funds which incorporate one or more of the globally recognized green or ESG criteria or principles as their key investment focus, and reflect such in their name and investment objective or strategy (**Green or ESG funds**). Details of the recognized green or ESG criteria or principles and the requirements of the Circular are further discussed below.

It was noted in the Circular that the quality of disclosure of SFC authorised funds on climate, green, environmental or sustainable development was varied, in that most of the funds have named the green or ESG factors in their investment objective or strategy, but a majority of these funds had not specifically disclosed how such green or ESG factors were incorporated in their investment selection process. The Circular therefore set out disclosure guidelines to enhance comparability, transparency and visibility such that investors can make an informed decision when investing in SFC authorised green or ESG funds.

SFC noted that given the evolving nature of green or ESG investment landscape, the Circular is "an initial step in the SFC's effort to enhance the disclosure standard of green or ESG funds" and that it will provide further guidance or impose additional requirements for green and ESG funds, where appropriate, in view of local and international market and regulatory developments.

SFC ESG Survey

In December 2019 the SFC released the key findings of the ESG Survey, in the report "Survey on Integrating Environmental, Social and Governance (ESG) Factors and Climate Risks in Asset Management".

According to the report, SFC surveyed 794 active SFC licensed asset management firms and 14 asset owners (such as sovereign wealth funds, family offices, financial institutions, trusts and pension funds).

[2] The TCFD Recommendations were issued in June 2017 under an initiative of the Financial Stability Board, to develop climate-related financial disclosures that would provide the information needed by investors, lenders and insurance underwriters to appropriately assess and price climate-related risks and opportunities.

Out of the 794 active licensed asset management firms surveyed, 83% of them (660 firms) considered at least one ESG factor when evaluating a company's investment potential and to facilitate better investment decisions and risk management, whereas nearly two thirds of them (64%) plan to strengthen their ESG practices in the next two years. Many of these firms are also considering publicly disclosing more information about their ESG investment practices and climate risk management.

Of the 660 firms that responded as having considered at least one ESG factor when evaluating a company's investment potential, 68% of them saw ESG factors as a source of financial risk having an impact on their investment portfolio. 63% of these firms practise responsible ownership, for instance through voting and corporate engagement. However only 35% implemented a consistent approach to systemically integrate ESG factors in their investment and risk management process, as opposed to doing so on an ad-hoc basis, and the remaining 65% did not have any oversight measures in places.

Among the firms that systematically integrate ESG factors, a combination of one or more strategies are adopted, with negative and exclusionary screening (exclusion from a fund or portfolio of certain sectors, companies or practice based on specific ESG criteria) being most-often used, and other strategies such as responsible ownership (corporate engagement and shareholder action), ESG integration, norms based screening (screening of investments based on international norms), positive screening, thematic investing (e.g. investing in clean energy, green technology, or themes and assets specifically related ESG) or impact investing (specific investments targeted at solving environmental or social problems).

According to the ESG Survey and the active asset management firms surveyed, the firms with ESG investment processes in place are of different AUM sizes, reflecting that local asset management firms are catching up with their global counterparts in terms of ESG practices, and also contrary to the general perception that developing ESG practices is an undertaking only large players can afford (26% of such firms have AUM under $100 million). It was observed that local asset management firms lag behind their counterparts with overseas-based parent companies in terms of ESG practices; the latter generally have stronger ESG investment processes and support international initiatives such as the TCFD and the UN Principles for Responsible Investment.

The range of ESG factors can be quite far reaching and diverse. Focusing on climate change, only 23% of the 660 firms have processes in place to manage the financial impact of physical and transitional climate risks. Of these 660 firms which reported giving consideration to ESG factors, 68% indicated that information about their own ESG practices are not available, and even more did not disclose climate risk assessments.

From the perspective of the asset owners surveyed, to reduce greenwashing and identify asset management firms with stronger ESG practices, more disclosure following a prescribed framework is required. For such disclosures to be useful, it should go beyond marketing style narratives of ESG philosophy and policy statements, and instead focus on outcomes and evidence of ESG impact in addition to financial performance, consistency between policies and practices, the rationale behind investment decisions and more supported analysis of asset specific ESG risks, as well as the analytical tools used, results of corporate engagement and voting track records. The majority of asset owners surveyed also indicated that asset managers do not engage with them to understand their ESG investment preferences. Discussion of climate risks is almost non-existent in client engagement and sustainability assessment, while majority of assets owners surveyed expect asset management firms to identify, assess and manage climate-related risks. The limited number of available ESG investment product available in the local market also widens the gap in expectations. 14 asset owners participated in the ESG Survey, which targeted asset owners such as sovereign wealth funds, family offices, financial institutions, pension funds and trusts.

Requirements of the SFC Circular on Green or ESG Funds

As noted above, the Circular applies to SFC authorised Green or ESG funds, being funds which incorporate one or more of the globally recognised green or ESG criteria or principles as their key investment focus, and reflect such in their name and investment objective or strategy.

Annex 1 of the Circular currently lists the following criteria or principles:

- United Nations Global Compact Principles;
- United Nations Sustainable Development Goals;
- Common Principles for Climate Mitigation Finance Tracking;
- Green Bond Principles of the International Capital Market Association; or
- Climate Bonds Taxonomy of the Climate Bonds Initiative.

However, the list is not intended to be exhaustive, and other green or ESG criteria or principles recognised globally or nationally may also be considered by the SFC on a case-by-case basis. The SFC may also accept reference benchmarks or indices which in their construction and management adopted any of the accepted green or ESG criteria or principles.

Green or ESG funds falling within the scope of the Circular will need to comply with the following on investment strategies, disclosure and compliance requirements:

(a) To "invest primarily' in the green or ESG focus

Pursuant to the Circular, a Green or ESG fund should invest primarily in investments to reflect the particular green or ESG investment focus which the fund represents.

As there are different common ESG investment strategies, according to the SFC's guidance note in the Circular, the SFC expects that to 'invest primarily', it refers to (i) funds adopting screening strategies or thematic investment strategies, investing at least 70% of its total net asset value in securities or other investments reflecting the stated green or ESG related investment focus; or (ii) funds adopting strategies like ESG integration or impact investing, which demonstrates to the SFC on a case by case basis on how the fund complies with this.

(b) Disclosure requirements

At the same time, the offering documents (including the product key facts statement) of Green or ESG funds should disclose, at a minimum (note: all examples marked * below were given by the SFC in the Circular):

- Description of the key investment focus (*e.g. climate change, green, low carbon footprint, sustainability) and targeted objective;
- Description of the investment strategies adopted, including but not limited to:
  - the relevant green or ESG criteria or principles considered;
  - the expected exposure to securities that reflect the green or ESG criteria;
  - the investment selection process and criteria, such as the assessment criteria of the underlying investment (*e.g. reference to any ESG ratings or third party certificate or labels, constituents of any green or ESG-related indices, the carbon footprint and environmental impact associated with companies, the proportion of revenue or profits generated from the relevant green or ESG activities of the issuer companies), ESG analysis and evaluation methodology (*e.g. proprietary tool with internal ESG ratings, research provided by third party agencies on ESG rating or certificates or labels, engagement with issuer companies), reference ESG benchmark being tracked and the characteristics and general composition of the benchmark;
  - description of whether exclusion policy is adopted and types of exclusion, relevant risks associated with the investment theme (*e.g. lack of standardized taxonomy, subjective judgement in investment selection, reliance on third party certification;
  - and any other relevant information considered necessary by the manager.

(c) Compliance certification

The Circular also requires the managers to regularly monitor and evaluate the underlying investments with proper procedures in place to ensure the Green or ESG fund continues to meet the stated investment objective(s) and the requirements of the Circular.

To be classified as a Green or ESG fund on SFC's list, existing SFC authorised funds or new funds seeking SFC authorisation should provide to SFC a certification in a format set out in Annex 2 of the Circular:

1) A self-confirmation of compliance; or
2) Confirmation supported with independent third party certification or fund label to demonstrate compliance.

For independent third party certification or fund label, SFC expects that such third party or fund labelling agency should at a minimum review the Green or ESG fund's primary investments to reflect the particular green or ESG investment focus which the fund represents, investment selection and ongoing monitoring process, and adherence to globally recognized green or ESG criteria or principles.

* * * * *

SFC Authorised Green or ESG Funds

The SFC has set up a database[3] on its website that lists out the Green or ESG funds that the SFC has approved as having complied with the requirements of the Circular, to enhance the visibility of these funds to the public.

As of publication of this synopsis, there are 31 SFC authorised Green or ESG funds listed on a dedicated webpage on the SFC's website. These are funds that have met the requirements of the Circular and are accepted by the SFC as Green or ESG funds, and this represents a significant step in developing Green or ESG funds in Hong Kong and establishing standards.

We set out below an analysis on these funds which we believe would be helpful in having a close look at the green or ESG fund products currently available to the public in Hong Kong. All information on the Green or ESG funds are available from the list on SFC's website and the links to the current offering documents as filed with the SFC. The investment objectives, strategies or policies of each fund referenced below are based on the disclosures and should be considered in the entirety of the relevant offering document, while we draw certain examples only for general discussion below.

(a) Overview of SFC authorised Green or ESG funds following the Circular

SFC authorised funds with purported green or ESG investment focus were required to comply with the Circular and update disclosures by 31 December 2019. A key emphasis of the Circular is on having adequate and appropriate disclosures, which has effectively enhanced the transparency of the green or ESG investment policies or strategies being pursued by a Green or ESG fund. Investors with the desire to put their investment to specific green or ESG purposes would now have greater clarity and comparability on the available investment products for green or ESG investing, compared to the state of play before the issue of the Circular where some funds had only general reference to investing with green or ESG factors but it was unclear as to the extent or manner in which green or ESG investing was actually undertaken.

3 The list of Green or ESG funds on SFC website is available at: https://www.sfc.hk/web/EN/regulatory-functions/products/list-of-environmental,-social-and-governance-(esg)-funds.html

The Circular also serves to obligate investment managers offering green or ESG investment strategies to carefully assess and consider in their product offerings whether their funds comply within the SFC's expectations for Green or ESG funds and are able to make the list. It is clear from the Circular that whether a manager would seek to obtain a third party certification or labelling or would rely on its self-confirmation, there should be appropriate and robust investment process, assessment criteria and ongoing monitoring for investing in line with the stated investment objective or principles of the Green or ESG fund.

Once authorised and accepted by the SFC as a Green or ESG fund and be designated as such, being added to the list of Green or ESG funds published on SFC website provides greater visibility among the existing group of small but growing list of investment options for investors and asset owners with focus on green and ESG investments.

(b) Recent and historical authorizations

Allianz Global Investors GmBH has 3 Green or ESG funds authorised by the SFC in 2019 (bringing its total number of Green or ESG green funds to 5). The only other fund on the list authorised in 2019 is the *Janus Henderson Horizon Fund – Global Sustainability Equity Fund*.

BNP Paribas has 2 funds authorised in 2018 – *BNP Paribas Funds Aqua* and *BNP Paribas Funds Global Environment*, while its other fund on the list (*BNP Paribas Funds Green Tigers*) was authorised in 2013. HSBC Global Investment Funds (Luxembourg) also has 2 funds on the list authorised in 2018 – *Global Lower Carbon Bond* and *Global Lower Carbon Equity*, while its other fund on the list (*Global Equity Climate Change*) was authorised in 2008. Other funds were authorised at varying times, including 15 which were authorised more than 10 years ago. The latest one on the list is the *Global Environment Fund* of Ninety One Luxembourg S.A., authorised by the SFC in May this year. It is also noteworthy that in January 2020, Mirae Asset Global Investments (Hong Kong) Limited launched the first ETF on the list.

(c) Hong Kong Products

Most of the funds are UCITS funds, with only 2 HK domiciled funds which are unit trusts - *Green Planet Fund* of Amundi Hong Kong Limited, and *Hang Seng Corporate Sustainability Index Fund* of Hang Seng Investment Management Limited).

Besides the *Hang Seng Corporate Sustainability Index Fund*, and the *BNP Paribas Green Tigers* which invests in companies based in the Asia-Pacific region, most of the other funds are global in geographic focus.

The *Hang Seng Corporate Sustainability Index Fund* tracks the Hang Seng Corporate Sustainability Index, the constituents of which include stocks limited on the Hong Kong Stock Exchange that must pass the relevant eligibility screening and undergo sustainability assessment of the Hong Kong Quality Assurance Agency[4] (**HKQAA**) with reference to international standards, including ISO 26000 Guidance on social responsibility and Global Reporting Initiative.

In January 2020, Mirae Asset Global Investments (Hong Kong) Limited launched the *Global X China Clean Energy ETF*, a sub-fund of the *Global X Exchange Traded Funds Series OFC*, and which seeks to track the performance of the *Solactive China Clean Energy Index*.

Another point worth noting is that there is only one fund on the list which is approved by the Mandatory Provident Fund Authority (**MPFA**), the Green Planet Fund of the Amundi HK MPF Series, although the Green Fund of AIA MPF is one fund out of 469 constituent funds in the MPF system identified as having

[4] The HKQAA is an independent assessment body which has launched its Green Finance Certification Scheme – Green Fund (https://www.info.gov.hk/gia/general/201909/25/P2019092500390.htm) in September 2019 which provides third-party conformity assessments for green finance issuers.

explicit ESG elements in the 2018 FSDC Paper *ESG Strategy for Hong Kong*[5] and which is not on an SFC-authorised Green or ESG fund. The MPFA in November 2018 issued a letter[6] asking all approved trustees to consider ESG factors in MPF investments and consider investing in green bonds. We expect to see more from the MPFA on green or ESG investments. The MPFA has in May 2020 just become a member of the newly established Green and Sustainable Finance Cross-Agency Steering Group[7] led by the HKMA and the SFC. Other members of the Steering Group are the HKEX, the Environment Bureau, Financial Services and Treasury Bureau, and the Insurance Authority.

(d) Global Principles or Criteria

The UN Global Compact Principles (**UNGC**) are most commonly referenced, either considered within proprietary sustainable investing strategy or in the investment policy of the fund, or as part of the exclusion policy. For example, all 3 funds of BNP Paribas (Aqua, Global Environment, Green Tigers) apply the UNGC alongside its proprietary sector policies in the ESG standards in its investment process, and would exclude investing in securities or companies that violate the UNGC. The *Investec Global Strategy Fund – Global Enviroment Fund* issued by Ninety One Hong Kong Limited takes into account sustainability factors and UNGC when evaluating companies.

United Nations Sustainable Development Goals (**SDGs**) are the second most referenced framework. AllianceBernstein's *Sustainable Global Thematic Portfolio* and *Sustainable US Thematic Portfolio* both invest in companies in multiple industries that are positively exposed to environmentally or socially oriented investment themes derived from the SDGs. *Janus Henderson Horizon Fund - Global Sustainable Equity Fund* seeks to adopt an investment framework aligned with the SDGs. BlackRock's ESG Multi-Asset Fund references the UNGC for excluding direct investment in securities which have breached one or more of the principles of the UNGC, while the Blackrock Sustainable Energy Fund adopts investment policy broadly consistent with SDG7 and SDG13 of the SDGs.

Only 5 of the existing list of 31 funds are bond funds. Out of the 5 bond funds on the list, the *Allianz Green Bond* adopts the Green Bond Principles of the International Capital Market Association ("**ICMA**") in its investment objective and strategy, while the *HSBC Global Equity Climate Change* references both the ICMA and the Climate Bonds Taxonomy of the Climate Bonds Initiative in its investment strategy in climate transition themes. Both the Green Bond Principles of the ICMA and the Climate Bonds Taxonomy of the Climate Bonds Initiative are among the five globally recognized green or ESG principles or criteria referred to in Annex 1 of the Circular.

Amundi Green Planet Fund discloses that Amundi's proprietary environmental rating methodology combines a quantitative approach with a qualitative analysis, and its qualitative analysis involves ESG analysis based on universally recognised international texts such as the UNGC, the SDGs and the Kyoto Protocol.

Fidelity's Sustainable Strategic Bond Fund discloses that it adopts a best-in-class strategy to invest at least 70% of its net assets in securities deemed to maintain sustainable characteristics, to be determined according to ESG rating of the investment manager based on quantitative and qualitative assessments. Besides, it adopts a principles-based exclusion framework which incorporates norms-

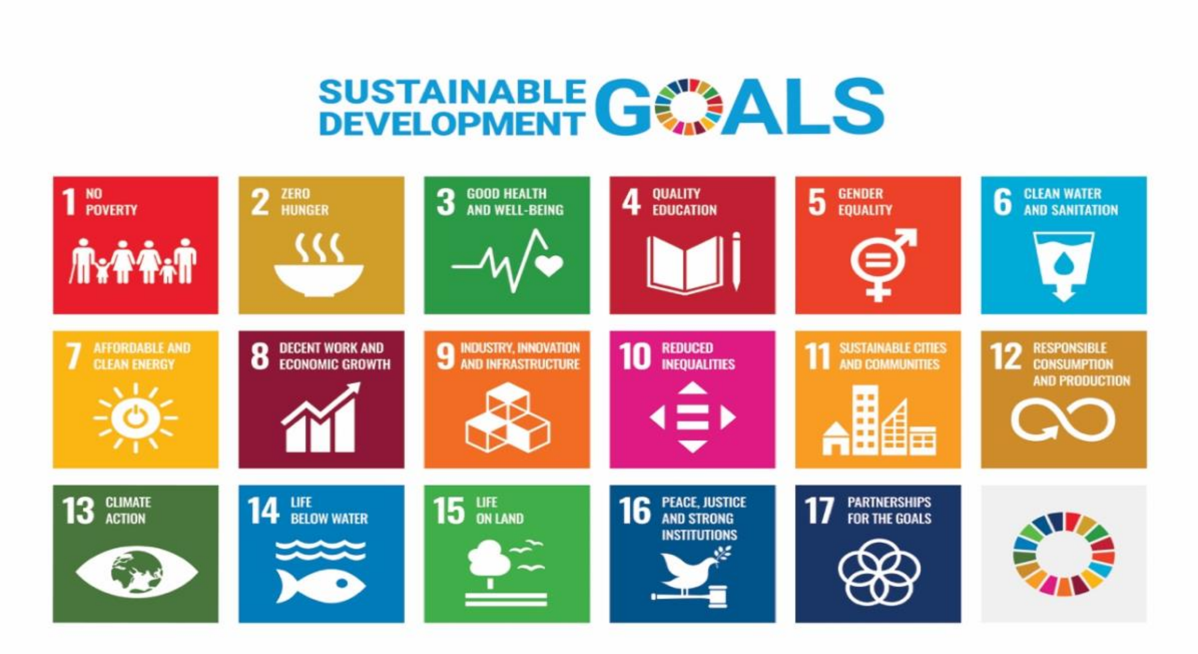
5 FSDC Paper No.36, Environmental, Social and Governance (ESG) Strategy for Hong Kong, Financial Services Development Council (November 2018).

6 Letter dated 29 November 2018 of the MPFA to all Approved Trustees on "Corporate Social Responsibility of Mandatory Provident Fund (MPF) Trustees: https://www.mpfa.org.hk/eng/legislation_regulations/legulations_ordinance/circulars/mpf/2016_2020/files/CIR-20181129.pdf

7 Hong Kong government's press release: Joint statement on establishment of Green and Sustainable Finance Cross-Agency Steering Group: https://www.info.gov.hk/gia/general/202005/05/P2020050500720.htm

based screening and negative screening pursuant to criteria determined by the investment manager from time to time. Its norms-based screening includes excluding issuers which violate the principles of the UNGC.

Ten Principles of United Nations Global Compact	**Human Rights** • Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and • Principle 2: make sure that they are not complicit in human rights abuses. **Labour Standards** • Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining; • Principle 4: the elimination of all forms of forced and compulsory labour;• Principle 5: the effective abolition of child labour; and • Principle 6: the elimination of discrimination in respect of employment and occupation. **Environment** • Principle 7: Businesses should support a precautionary approach to environmental challenges; • Principle 8: undertake initiatives to promote greater environmental responsibility; and • Principle 9: encourage the development and diffusion of environmentally friendly technologies. **Anti-Corruption** • Principle 10: Businesses should work against all forms of corruption, including extortion and bribery.



(e) Investment Strategies

Most of the Green or ESG funds on the list adopt screening strategies or thematic investment strategies, and according to the requirement of the Circular, invest primarily at least 70% of its total net asset value in investments reflecting the stated green or ESG investment focus. A number of funds that do not apply this requirement of investing at least 70% in its stated investment objective appear to apply ESG integration in investment decisions, including corporate engagement and exclusion policy, (for example Pictet and Schroders funds), which from the fund disclosures suggest having a systematic and explicit inclusion of ESG factors into the investment process and financial analysis.

Quite often, a Green or ESG fund may adopt a combination of the investment approaches within its investment strategies. Most would adopt some measures of positive screening and/or negative screening, while about half of the funds disclosed active ownership.

As a further example, *Jupiter Global Ecology Growth* states that it will invest at least 70% of its net asset value in companies considered to provide products or services which contribute to environmental improvement, facilitate adaptation to the impacts of climate change or help mitigate the impacts of climate change. The fund adopts an investment style of investing in companies that consistently generate more than 50% of revenue (or make a clear strategic intent in this direction with specific timeframe) from one or more of the sustainable solution/impact themes: Circular Economy, Clean Energy, Water (protection of water and marine resources), Sustainable Agriculture as well as Nutrition and Health and Environmental Services, while the fund also seeks to avoid investments in activities which do not align with its sustainability objectives, including breaches of the UNGC.

- *Thematic Investing*

A majority of the Green or ESG funds adopt green or sustainability investment themes (e.g. clean energy, green technology or sustainable agriculture). For example, *BNP Paribas Funds Aqua* is a thematic fund that invests in companies within the global water value chain which support the protection and efficient use of water as natural source, whist *BNP Paribas Funds Global Environment* is focusing on investments in "environmental markets" which include renewable & alternative energy, energy efficiency, water infrastructure & technologies, pollution control, waste management & technologies, environmental support services, and sustainable food.

- *Positive or negative screening & exclusion policies*

A number of funds provide rather detailed description in relation to their exclusion policies, excluding from the fund or the portfolio certain sectors, companies or projects based on specific ESG criteria. Allianz Global Investors has three funds investing in companies which meet the requirements of its Sustainable and Responsible Investment Strategy (SRI Strategy). Its SRI Strategy will be based on its internal SRI ratings to apply negative or positive screens on the fund's investment pools by excluding or including issuers whose respective SRI ratings are below or above prescribed threshold as determined by the fund from time to time. The fund assesses an aggregation of the results of the external and/or internal analyses of ESG factors with its proprietary tool taking into account the ESG activities of a corporate or sovereign issuer regarding 5 domains, namely human rights, environment, social, governance and market conduct, and an internal rating i.e. the SRI Rating is assigned to such corporate or sovereign issuer accordingly. The *Schroder International Selection Fund – Global Sustainable Growth* excludes investee companies with material exposure in certain sectors or practices which include (but not limited to) high interest rate lending and human embryonic cloning.

- *Impact investing*

Impact investing refers to targeting investments aimed at solving environmental or social problems, and including community investing where capital is specifically directed to traditionally underserved communities or individuals. One of the stated core objectives of the *Allianz Green Bond* is to intentionally provide a positive environmental outcome while at the same time generating a financial return by investing in green bonds, with the strategy to actively participate in the mobilization of the capital markets towards the transition to a low carbon society, natural capital preservation and adaption to climate change.

One of the two funds of Schroder Investment Management invests in companies which the fund believes will benefit from efforts to limit or accommodate the impact of global climate change. *Schroder International Selection Fund – Global Climate Change Equity* is targeting investee companies whose long-term business outlook, in its opinion, is impacted by efforts to mitigate or adapt to climate change. Their overarching principle is that climate change must have a significant impact on the long-term business outlook for a stock to be included under this "Climate Change Strategy". The strategy is also thematic investing under which investments are made across five key climate change themes: energy efficiency, environmental resources, sustainable transport, clean energy and low-carbon leader.

As noted above, AllianceBernstein's *Sustainable Global Thematic Portfolio* and *Sustainable US Thematic Portfolio* both invest in companies in multiple industries that are positively exposed to environmentally or socially oriented investment themes derived from the SDGs. The investment firm discloses that as part of its strategy to integrate ESG investment considerations, it employs a proprietary toolkit which involves ESG materiality mapping and scoring of individual companies and factors for ESG consideration, and as part of its proprietary toolkit, utilizes third-party research as part of its due diligence process (such as tracking carbon footprint), and conducts proprietary research including monitoring social and labour practices for satisfaction of ESG factors. These funds are applying a threshold to typically invest in companies with at least 50% of the revenue from products and services that the investment manager believes are aligned with the SDGs.

- *Active ownership*

A number of funds adopt corporate engagement, stewardship and active ownership (such as through use of shareholder power to influence corporate behavior, including communicating with senior management of investee companies, and/or filing shareholder proposals or proxy voting) to encourage improved performance in environmental and social issues, for example (but not limited to) Henderson Management, Pictet Asset Management, Franklin Templeton International Services and Allianz Global Investors.

In 2016, the SFC published The Principles of Responsible Ownership which are a set of principles and guidance to assist investors to determine how best to meet their ownership responsibilities. However, the said Principles are non-binding and only voluntary.

(f) ESG Benchmark or Indices

The above green or ESG criteria or principles that are recognized globally or nationally are not intended by the SFC to be exhaustive. Reference benchmarks or indices which in their construction and management adopted any of the green or ESG criteria or principles above are said to be considered on a case by case basis according to the Circular.

For example, of funds that adopt reference benchmarks or indices as their performance benchmarks, Allianz Global Investors have their funds managed in reference to benchmarks or indices such as the *Dow Jones Sustainability World Index (Total Return) (Allianz Global Sustainability)*, *ICE BOFAML Green Bond Index (Allianz Green Bond)*, *JP Morgan ESG EMBI Global Diversified (Allianz Emerging Markets SRI Bond)* and *JP Morgan ESG CEMBI Broad Diversified (Allianz EM SRI Corporate Bond).*

Having said that, a number of funds adopt benchmarks that are not green or sustainability benchmarks as their performance benchmarks. Each of the investment objectives of the HSBC *Global Lower Carbon Equity* and *Global Lower Carbon Bond* respectively seeks to provide long term total return by investing in a portfolio (equities, and respectively, corporate bonds) seeking a lower carbon footprint than the reference benchmark (*MSCI World Net Index* and *Bloomberg Global Aggregate Corporates Diversified Index Hedged USD*, respectively).

(g) ESG Evaluation Methodology

Many firms adopt ESG methodologies for portfolio construction and monitoring of any deviations, with a number of them applying their own proprietary framework or tools with ESG ratings, such as BNP Paribas Asset Management's Sustainable Investment Policy which takes into account ESG standards and analysis in their investments. Besides, the firm with 3 Green or ESG funds has defined a series of ESG guidelines to understand the investee companies' ESG preferences and investment strategies such as investments in sensitive sectors including but not limited to palm oil, wood pulp, mining activities, oil sands, tar sands, nuclear, coal-fired power generation, tobacco, controversial weapons and asbestos.

Besides BNP Paribas Asset Management, one of the funds managed by Schroder Investment Management (Europe) (*Schroder International Selection Fund – Global Sustainable Growth*) discloses that it has in place internal policies and its proprietary sustainable investment approach when assessing a potential investment. This approach includes an analysis of ESG factors, which is integrated into its fundamental stock analysis, using a systematic process, referred to as its proprietary Sustainability Quotient (SQ) framework for evaluating sustainability characteristics. The framework incorporates critical ESG-related factors and elements of corporate performance across four broad categories namely, respect for the environment, fair and equitable treatment of employees, suppliers and customers, good corporate citizens, and prudent allocation of capital.

Reliance may also be placed on external data or ratings. The HSBC *Global Lower Carbon Equity* and *Global Lower Carbon Bond* respectively seeks to provide long term total return by investing in a portfolio (equities, and respectively, corporate bonds) seeking a lower carbon footprint, and it is disclosed that it will rely on carbon expertise, research and information provided by well-established financial data providers, when assessing the carbon footprint and environment impact associated with companies.

The takeaway

The SFC's current regulatory approach has significantly enhanced product disclosures, while not being overly prescriptive, narrow or final in what may be accepted as green or ESG investments. This gives room for flexibility in the growing field, as the approaches and principles of ESG and green investing are still evolving globally, with hundreds of existing as well as growing numbers of ESG or green investing framework, policies, principles, standards and ratings, besides proprietary approaches.

Undeniably green finance is becoming more and more prominent in the financial and investment industry. Going forward, to address the demands of investors, asset management firms may consider engaging clients more in understanding their requirements relating to ESG and offer ESG investment products catering to their needs, such as clear and concrete disclosures, and adopting investment strategies that may meet the clients' specific ESG goals whilst balancing the financial risks and returns. We hope the analysis of the currently available ESG products as set out on SFC's website provides a useful overview, and information for the further development and offering of new ESG products.

The SFC is expected to issue more regulatory policies or guidance on green or ESG investment products or approaches, which will be key to further develop and encourage considered and sustainable development of the field. The investment industry, including all asset managers and asset owners being institutional investors or agents of the investing public, has an important and necessary role to lead broader impact and further engagement to meet goals in line with green or ESG principles.

Contact

If you would like to learn more or to discuss the subjects covered in this publication, please contact the following people or your usual contact at our firm.

Vivien Teu **Managing Partner** Tel: (852) 2969 5316 vivien.teu@vteu.co	**Christina Suen** **Counsel** Tel: (852) 2969 5318 Christina.suen@vteu.co

__Vivien Teu__ is the founding and managing partner of Vivien Teu & Co LLP. She has extensive, in-depth experience as a corporate and commercial lawyer, specialising in the financial services sector, funds and wealth management matters. Vivien has diverse legal practice experience with top-tier and magic circle firms in the areas of tax, trusts, banking and financial services, investment funds, securities regulatory and corporate commercial matters. Along with significant in-house counsel experience at a global investment firm, Vivien offers unique insights and practical commercial approaches in her practice, with extensive China knowledge. Combining in-depth Hong Kong and international legal practice experience with deep and broad knowledge of China and regional markets, Vivien regularly advises on cross-border matters, including local and international clients establishing or operating asset management platforms in Hong Kong, as well as on fund formation across asset classes, retail and private funds offerings, and on the legal, regulatory and market environment in Hong Kong for asset management and investment funds.. Driven by a passionate belief in responsible capital and sustainable finance, Vivien has strengthened an ESG and impact focus within the firm's practice areas.

__Christina Suen__ is a counsel with more than ten years' legal experience across corporate, commercial, asset management and financial services matters. She was previously senior in-house counsel at a leading global investment management firm, with responsibility for the legal and regulatory affairs of the firm's investment management business in Hong Kong, including UCITS and Hong Kong retail investments funds and mandatory provident fund schemes. She brings this practical commercial experience to her work advising on the authorisation of investment funds by the Securities and Futures Commission, ongoing compliance requirements, as well as other aspects of the conduct of fund management and/or fund distribution businesses in Hong Kong.

__Vivien Teu & Co LLP__ is a Hong Kong corporate and commercial law firm with particular focus on investment funds, asset management and financial services, securities and regulatory, tax and trusts. The firm has been highly rated for technical ability and innovation, with its lawyers having in-depth Hong Kong and international legal practice experience, combined with deep and broad knowledge of China and regional markets.

The legal practice areas at Vivien Teu & Co LLP encompass providing corporate and commercial law advice, as well as on securities law and financial regulatory advice in local and international transactions, and typically a go-to firm for corporate transactions, funds formation and clients seeking legal and regulatory advice involving Mainland China and Hong Kong elements. The firm has gained a reputation of offering seamless support on cross-border Hong Kong and Mainland China matters in the areas of asset management, investment funds, cross-border securities and investments, inbound and outbound mergers & acquisitions, China market entry strategies.

Besides an enviable corporate and institutional client-base including global and regional investment management firms and financial institutions, the firm is also increasingly serving private clients and high net worth entrepreneurs, in its wider financial services, private wealth, tax and trusts practice. As a strong believer in responsible capital and social finance, the firm has strengthened the ESG and sustainability focus of its investment funds and corporate practice, as well as advising and working with family offices, charities, foundations and social enterprises in the areas of philanthropy and impact.

This publication is for general information only and is not intended to provide any advice or recommendations in any specific case. We expressly disclaim any liability for the consequences of action or non-action based on this publication.