FSDC Paper No.44

HK FINANCIAL SERVICES DEVELOPMENT COUNCIL 香港金融發展局

Hong Kong – Developing into the Global ESG Investment Hub of Asia

July 2020

Content

Foreword

'Green finance' has become one of the key agenda items of the Financial Services Development Council ("FSDC") since four years ago. In May 2016, the FSDC published a research report, with an aim of helping Hong Kong position itself as a preferred centre for green finance in the region. At that time, green finance was at its nascent stage for Hong Kong as well as many other financial centres in Asia.

The centre of gravity has shifted rapidly since then. Discussions within the financial services industry about green finance have further been extended to cover the wider spectrum of Environmental, Social and Governance ("ESG") matters. Amid the fast-evolving landscape, in November 2018, the FSDC published a relevant report (the "2018 report") to present the value proposition of ESG integration from the perspectives of both financial investors and investee companies. The report also sets out key recommendations for fostering the development of an ESG ecosystem in Hong Kong, focusing on the part of the public sector. In about a year's time, most of the recommendations have been implemented and a handful of others are in progress.

On the back of such momentum, Hong Kong – as an ESG investment hub – has entered the growth stage. In this paper, the FSDC looks into how better the efforts of the public and private sectors can be coordinated for the further development of the ESG investment ecosystem of Hong Kong. The overarching theme is to map out what have been done and what else could be done to nurture this ecosystem.

PHASE 1 – LAUNCH

2016

FSDC's report "Hong Kong as a Regional Green Finance Hub"

2018

FSDC's report "ESG Strategy for Hong Kong"

PHASE 2 – GROWTH

2020

FSDC's report "ESG Integration – the Continuous Journey for Hong Kong"

A Cluster of Key Stakeholders is Building Up in Hong Kong

A critical factor behind the development of ESG investment ecosystems is the concerted effort of key stakeholders, a cluster of which has emerged in Hong Kong.

Asset owners

Asset owners in public and privates sectors, including pension funds and sovereign wealth funds, are increasingly integrating ESG strategies in their investment portfolios.

Asset and wealth managers and product owners

Asset and wealth managers and product owners (e.g. banks) uncover opportunities, identify risks and generate appealing returns for asset owners and other clients through incorporating ESG factors into their investment strategies and ongoing engagement with investee companies.

Investee companies

Enhanced ESG disclosure/ reporting is becoming a commonplace among companies of different sizes, partly due to new regulatory requirements but also enhanced risk-adjusted returns, lower funding costs, and new sources of capital.

Government and financial regulators

A combination of 'carrots and sticks' (i.e., incentives and regulations) has been a common approach adopted by governments and regulators in different markets, and Hong Kong is no exception.

Academia, civil society organisations and other stakeholders

Universities, non-governmental organisations and professional bodies collaborate to enhance ESG capacity-building. A cluster of stakeholders, including services providers such as index compilers and research providers, is critical in ensuring ESG standards and needed support are in place.

ESG is Integral to Hong Kong as an International Financial Centre

Hong Kong's success as an international financial centre allows the city to enjoy a combination of first-mover advantages in ESG investment initiatives. Owing to its world-leading capability in capital raising, ample risk management experience and solid expertise in serving international financial actors and investors, Hong Kong attracts a wealth of asset owners and asset managers to explore their ESG investment journey. With green finance being key in the development of of the Guangdong - Hong Kong - Macao Greater Bay Area, Hong Kong's role in providing financial services support will likely become more prominent.

At the same time, companies in Hong Kong are increasingly incentivised to embrace ESG practices and disclose the relevant information for the benefits that lie within, including –

- Enhance risk-adjusted returns: Researches show that share price of companies with high ESG scores outperformed sector peers through identification, mitigation or management of key risks[1];
- Lower funding costs: High ESG-rated companies generally experience lower levels of beta and thus lower costs of capital (both in terms of cost of debt and cost of equity capital)[2]; and
- Attractiveness to new sources of capital and AuM: Globally, financial investors have increasingly expressed commitment to adopt ESG integration, which opens high-quality sources of capital and assets to companies with a strong ESG profile[3].

Following the outbreak of the pandemic, market participants believe that investors will further prioritise investments with conscience, placing sustainability at the front and centre of their investment approaches.

Fast facts:

- **Green bonds** arranged and issued in Hong Kong (2019): US$10bn. Bond issuers with a wide range of diversity, including real estate companies, energy firms and financial institutions, and notably multilateral development banks[4]
- **Green loans** acquired by Hong Kong banks (April 2019): US$2.56bn+[5]
- **Green assets** owned by Hong Kong banks (April 2019): US$7.82bn+[6]
- Hong Kong companies recorded the **best overall performance in Asia** for environmental sustainability (2019)[7]

1 According to the University of Oxford's meta study ("From the Stockholder to the Stakeholder", March 2015) of 200 studies, 90% of the studies found a relationship between strong sustainability performance and lower cost of capital. In 88% of the studies, companies with strong sustainability practices had better operational performance which translated into better cash-flow, and that 80% of the studies showed that firms with strong sustainability practices outperformed. These results were also supported (not identical) by a meta study of 2,000 studies on ESG by Deutsche ("ESG and financial performance: aggregated evidence from more than 2,000 empirical studies", January 2016).
2 ibid.
3 Global Sustainable Investment Alliance's "2018 Global Sustainable Investment Review", April 2019, found the sustainable investing recorded at almost US$ 31 trillion at the beginning of 2018, a 34% increase since 2016.
4 Climate Bonds Initiative, "Hong Kong Green Bond Market Briefing", May 2020.
5 According to a survey conducted by HKMA in 2019 which covered approximately 50 banks in Hong Kong as stated in the Belt and Road Global Forum's "News and Updates", August 2019.
6 ibid.
7 Refinitiv, "Financing a Sustainable Future in Asia", October 2019.

How Did Hong Kong Get Here?

Similar to other emerging subject matters, the truly 'concerted' effort among key stakeholders did not start right at the beginning. It usually takes both incentives and regulations to set out the vision, mission and expectation, and thereafter to map out a strategy and execution plan to achieve the goal.

To this end, the FSDC made a number of recommendations in the 2018 report, with an aim of achieving this first step, i.e. setting the scene for expectations. Encouragingly, most of the recommendations have been adopted in a year's time.

Continuous concerted efforts

In the 2018 report, the FSDC recommended…

Asset owners

- **the Government to take leadership role in encouraging public funds' support for ESG integration**

  The Hong Kong Monetary Authority ("HKMA"), as the manager of the Exchange Fund, announced its responsible investment measures in May 2019, including that it: (a) has incorporated ESG factors in its credit risk analysis of bond investment, (b) has invested two tranches of US$1 billion each in the Managed Co-lending Portfolio Programme run by the International Finance Corporation, (c) will further grow the Exchange Fund's green bond portfolio, (d) will participate in ESG-themed public equities investments through external managers in passive and active mandates targeting ESG benchmark index, (e) will accord green accreditation as a key factor in investment in its real estate portfolio, and (f) will consider an appropriate framework for disclosing information on the Exchange Fund's Green and ESG investing efforts without arousing market sensitivity in the process.

  The HKMA has also become a signatory to the Principles for Responsible Investment and a supporter of the Task Force on Climate-related Financial Disclosures ("TCFD").

- **the HKMA to scale up ESG requirements on external investment managers**

  In August 2019, the HKMA required external managers of Hong Kong equities and China active equities portfolios to comply with the Principles of Responsible Ownership issued by the Securities and Futures Commission ("SFC") in 2016 on a "comply-or-explain" basis. The external managers of developed market equities portfolios need to adhere to generally accepted international ESG standards.

  The HKMA has included ESG factors in the selection, appointment and monitoring of external managers.

the FSDC also recommended…

Asset managers and other product owners

- **the SFC to strengthen the emphasis on ESG through upgrading the Principles of Responsible Ownership**

  In accordance with its Strategic Framework for Green Finance of September 2018 to conduct a survey of asset managers and asset owners participating in the Hong Kong market on their sustainable investment practices, the SFC issued the findings of its survey on licensed asset management firms' integration of ESG factors and climate risks. The survey found that there is significant interest among these firms to step up their ESG efforts and management of environmental and climate risks.

  To help firms move forward and more closely align the SFC's regulatory regime with global standards, the SFC intends to, in the near term,

  - set expectations of asset management firms in areas such as governance and oversight, investment management, risk management and disclosure, focusing on environmental risks with an emphasis on climate change;

  - provide guidance, best practices and training in collaboration with the industry and relevant stakeholders to enhance the capacity of asset management firms to meet the SFC's expectations; and

  - establish an industry group to exchange views amongst the SFC and experts in environmental and climate risks, as well as sustainable finance.

- **the SFC (and other relevant regulators) to provide more guidance on ESG thematic investment products**

  In accordance with its Strategic Framework for Green Finance issued in September 2018 to facilitate the development of a wide range of green-related investments by providing disclosure guidance, the SFC published guidance on enhanced disclosures for SFC-authorised green or ESG funds in April 2019. To increase their visibility, a central database of these funds has become available on the SFC's website since Q4 of 2019.

- **the Mandatory Provident Fund Schemes Authority ("MPFA") to incorporate ESG factors into the trustee approval and monitoring process and to encourage trustees to take into account international ESG standards**

  The MPFA issued a circular in November 2018 to encourage Mandatory Provident Fund Scheme ("MPF") trustees to apply ESG standards in areas such as investment decision-making and disclosure. MPF trustees are also encouraged to discuss with their investment managers the possible inclusion of green bonds in their MPF portfolio holdings.

In 2019, the MPFA continued its communication with MPF trustees and their appointed investment managers for further understanding the trend and market development in ESG investing and adoption of ESG standards by MPF funds. During the year, MPFA also worked with the SFC and invited MPF trustees, in their role as asset owners, to participate in a survey conducted by the SFC on integrating ESG factors and climate risks in asset management.

The International Organisation of Pension Supervisors ("IOPS") issued supervisory guidelines in October 2019 on the integration of ESG factors in the investment and risk management of pension funds. MPFA, as a member of IOPS, is studying the guidelines and will consider how to adopt accordingly.

Investee companies

- **the Stock Exchange of Hong Kong ("SEHK") to strengthen the emphasis on ESG for both listing applicants and listed issuers by - (a) requiring listed issuers' ESG reports to demonstrate the issuers' governance structure on ESG, with emphasis on the role of the board; (b) clearly elaborating the link between the Corporate Governance ("CG") Code and the ESG Reporting Guide; and (c) recommending specific ESG disclosure for listing applicants**

To further raise the quality of ESG reporting, the SEHK launched a consultation in 2019 to review and revise its ESG Reporting Guide for listed companies. Following strongly supportive responses to this consultation, the SEHK concluded to amend the ESG Reporting Guide and related Listing Rules in December 2019. The changes include introducing mandatory disclosure requirements regarding ESG governance and board's oversight of ESG issues to emphasise the board's leading role and improve its accountability, requiring climate change disclosure to echo the international focus on the area, and shortening the publication deadline for ESG reports to improve timeliness of information.

The SEHK also added new Frequently Asked Questions[8] in May 2019 to clarify how different aspects of ESG relate to the CG Code. A more elaborated link between CG Code and ESG Reporting Guide will be considered in due course, as part of the SEHK's ongoing effort to review the two documents.

For listing applicants, the SEHK sets out the expected disclosure of ESG matters, including material information on an applicant's environmental policies, and details of the process used to identify, evaluate and manage significant ESG risks, in the form of Guidance Letter.[9]

These efforts reflect the SEHK's commitment to enhancing Hong Kong's ESG regulatory framework and to meeting investor and stakeholder expectations in accordance with international best practices.

[8] Hong Kong Exchanges and Clearing Limited ("HKEX"), FAQs No. 24K and 24L in Series 17 and FAQ No. 2A in Series 18, May 2019.
[9] HKEX, HKEX Guidance Letter (HKEX-GL86-16), May 2019.

Connecting the Dots by Letting Stakeholders Hear Each Other

ESG integration is a continuous journey. As different groups of stakeholders are respectively adopting and facilitating ESG integration, or increasingly expressing their demand for ESG integration, a natural next step is to connect these stakeholders together to create synergy and ultimately make ESG investment a mainstream.

Amongst other channels, establishing a dialogue platform for these stakeholders to communicate with each other on their demands, interests and challenges in ESG investment (/integration) would enable policy advisors and policymakers to map out the current standing and understand what is lacking. In this context, in Q3 of 2019, the FSDC hosted numerous closed-door roundtable discussions, with some 40 asset owners (e.g. public funds, university endowment funds and pension funds), asset managers and other corporates to seek their feedback on the positioning of Hong Kong as the regional ESG investment hub. The asset owners and asset managers were with a diverse background (including American, European and Mainland) and with operations in Hong Kong. Other corporates include listed and non-listed companies of different sizes headquartered or placing business focus in Hong Kong. Below are some common themes identified from these roundtable discussions.

Globally ...

Most, if not all, developed jurisdictions have realised the importance and potential of ESG investment and are moving proactively towards this stream. Several have even imposed fiduciary duty on asset managers to consider ESG factors in their investment decision-making process, amongst other policies.

ESG investment is gaining traction among insurance firms, particularly across European ones. Focus areas include integrating ESG factors into their underwriting process (as risk managers) and in their investment process (as asset owners).

Regionally ...

Genuine demand for ESG investment has arisen in Asia and appeared to be ahead of the supply (i.e., supply of ESG investment products, quality ESG data disclosure, and professionals).

The volume of ESG data, at its current stage, is not lacking in Asia. However, the deficiency lies on 'comparable' ESG data, which somehow explains why listed companies in the region suffer from relatively lower valuation. Over time, a well-crafted taxonomy, similar to which of the EU, could be desired.

Hong Kong...

Regulators are stepping up their respective efforts in pushing forward the ESG agenda, yet Hong Kong needs a more coordinated policy environment for the betterment of its ESG investment ecosystem.

There remains room for improvement in the understanding of how ESG reporting can benefit them among small- to mid-cap listed companies. Some also do not fully understand the rationale for the SEHK's expectation for the ESG reporting.

Other points raised by the stakeholders about Hong Kong's ESG ecosystem...

Asset Owners

Most are seeing more pull and push factors in recent years in Hong Kong: pension funds and asset owners (of the younger generation) increasingly ask for quality ESG data / ESG integration.

There is degree of challenge to find companies in Asia to invest in as these companies either do not fit the asset owners' ESG portfolios or cannot provide sufficient material ESG information.

There are plenty of ESG-related services providers, and their differences in scale and scope make ESG investment somewhat overwhelming: different parameters, standards, etc. are adding complexity to issues involved.

Asset Managers

Hong Kong's financial infrastructures are considered top-notch in the region to support the ESG investment ecosystem but the city needs a wider variety of ESG investment products/solutions. The target market is beyond the limited critical mass here, as the momentum in Mainland and other Asian markets starts rising.

Shortage in ESG professionals is apparent in Asia; and government support is needed.

Most are looking for ESG data that is more forward-looking, and of better comparability and materiality.

Some highlight the pivotal role of ESG indexes, for that they would incentivise corporates to perform better in relevant areas in order to draw more capital inflow from passive investment vehicles. Meanwhile, several rating agencies are begining to incorporate ESG scores into the credit rating system to essentially achieve ESG 'integration'.

Other Corporates

A meaningful number of corporates, predominantly large-sized companies that can afford the resources to take up ESG seriously, have had their ESG practices and reporting aligned with international standards.

Some smaller companies - including some small- to mid-cap listed companies - are struggling to understand the essence of ESG reporting, partly because they are confused by the overwhelming (and indeed increasing) number of international standards and principles.

Some of them have yet to see the true value of ESG practices and ESG reporting because their traditional way of making money still works; some others start to feel the pressure (through investors along the supply chain and financiers such as banks) but are uncertain how to start.

The "Hong Kong Solution"

The FSDC's 2018 report aimed at setting the scene for Hong Kong to 'build' its ESG investment ecosystem. Recommendations set out in the report specifically proposed short-term initiatives that the Government and financial regulators could undertake to expedite development; and a majority of these recommendations have been adopted. The efforts of the public sector (together with the endeavours of the private sector), have laid an encouraging foundation for Hong Kong's ESG investment ecosystem.

With that being stated, there is still room for Hong Kong to improve further to make the ecosystem thrive. Thanks to the views and suggestions made by asset owners, asset managers and other corporates, together with the references drawn from Hong Kong's success in other investment streams, we have summarised three key elements of a flourishing ESG investment ecosystem as follows:

- clear policy directives and support;
- disclosures; and
- intellectual capacity.

With these three key elements in mind, the FSDC, in this paper, sets out a number of policy recommendations for Hong Kong to consider. Some of these recommendations are specific and considered lower-hanging fruit, while some others tend to be more aspiring and may only be realised over the medium to long term. That stated, these recommendations, collectively, are considered crucial to Hong Kong as it strives to maintain its standing in the ESG investment race which other financial centres are keen to dominate.

Key elements	Current landscape	Recommendations	Expected Timeframe
1. Clear policy directives and support	Financial regulators have developed various initiatives to develop ESG investment market but stakeholders look for a more coordinated approach The Green and Sustainable Finance Cross-Agency Steering Group was established in May 2020	(i) A more coordinated policy environment should be promoted with the development of an ESG policy roadmap	Short to medium term

Key elements	Current landscape	Recommendations	Expected Timeframe
2. Disclosures	Requirement for disclosure is imposed on listed companies and certain other companies incorporated in Hong Kong	(ii) Insurance Authority to encourage insurers' disclosure of their ESG policies	Short-term
	Volume of disclosures has increased but quality of such disclosure remains deficient	(iii) Regulators to commence preparatory work on strengthening oversight of non-financial reporting	Medium to long term
3. Intellectual capacity	ESG talent gap; larger companies are generally better resourced to carry out ESG reporting than small to medium sized companies which may struggle to understand the value proposition of ESG	(iv) Government to provide companies with subsidies on eligible ESG training courses to enhance knowledge and skills	Short-term
	The global ESG investment landscape is developing rapidly – policies and regulations in some instances are not harmonised and can lead to investor confusion	(v) An information-sharing platform should be established to promote best practices	Medium-term

Key Recommendations

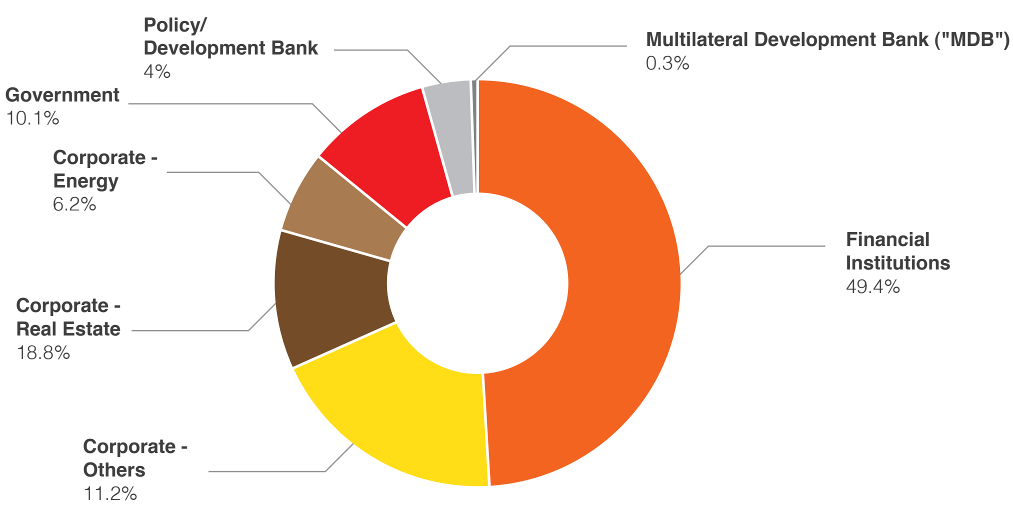
01 Clear Policy Directives and Support

Incentives are an important driver of a flourishing ESG investment market. When the market is at its nascent stage, incentives often include an area of removing friction to adoption. For reducing impediments such as higher cost of issuing green bonds (versus traditional bonds due to additional certification requirement), monetary/financial incentives are a tool commonly used.

Similar to some other markets, Hong Kong has taken monetary/financial means as one of incentive approaches. The Government's Green Bond Grant Scheme, launched in June 2018, to subsidise issuers in obtaining certification under the Green Finance Certification Scheme for their green bond issuance, can be viewed as one of the examples. Apart from this, Hong Kong's basket of incentives also includes the Pilot Bond Grant Scheme which encourages more bond issuance (including green bond) in Hong Kong and the enhanced Qualifying Debt Instrument Scheme which offers tax concessions to attract more investors to our bond market (including green bond).

For the ecosystem to be sustainable, evidence of durable customer demand is crucial. According to the Climate Bonds Initiative's figures, in 2019, green bonds arranged and issued in Hong Kong totalled US$10 billion.[10] The Government's earlier commitment in expanding green finance, as explicated in the Policy Address, together with initiatives taken by the HKMA and others, have also encouraged market actors to consider Hong Kong as the ESG investment venue. The Government's plan, as announced in Budget 2020-21, to issue green bonds totalling $66 billion within the next five years from 2020-21, will likely be a further stimulus.

2019: Issuers come from diverse sectors



Source: Climate Bonds Initiative

Over time, as the momentum has been built up, incentives often need to take another form, beyond mere monetary support. To both investors and investees (as well as other stakeholders), a favourable policy environment for ESG investment is deemed equally influential, in that it entails the predictability and stability that would present Hong Kong as 'the' place for investment.

[10] See footnote 4.

(i) A more coordinated policy environment should be promoted with the development of an ESG policy roadmap

Currently, in Hong Kong, different financial regulators are proactively encouraging ESG investment and practices. In terms of disclosures, for example, the SEHK has recently updated its ESG reporting requirement to strengthen the boards' oversight of ESG issues of the listed companies. As for ESG incorporation, the HKMA as an asset owner has required certain external managers of equities portfolios of the Exchange Fund to adhere to generally accepted international ESG standards. In terms of ESG product development, the SFC issued guidance on enhanced disclosures for SFC-authorised green or ESG funds in April 2019. To increase their visibility, a central database of these funds has become available on the SFC's website since Q4 of 2019. Green or ESG funds may adopt common ESG investment strategies such as screening (positive or negative screening), thematic, ESG integration and impact investing. As early as later this year, the HKEX Sustainable and Green Exchange would be launched to provide easy access to information of sustainability, green and social bonds and ESG-related Exchange traded products. More broadly, the Green and Sustainable Finance Cross-Agency Steering Group[11] was established in May 2020 to co-ordinate the management of climate and environmental risks through facilitating policy direction and coordination to ensure that Hong Kong has a cohesive and comprehensive green and sustainable finance strategy.

These efforts by the public sector are well acknowledged by market participants, as we understood from our outreach engagements. Accordingly, regulators' respective efforts have enabled Hong Kong to be seen as a relevant place for ESG investment; yet, if Hong Kong wants to further strengthen itself as the preferred investment venue of choice, the city would need to demonstrate stronger commitment in a more coherent manner. Particularly, a coordinated policy environment toward ESG can foster institutional investors' confidence in seeing Hong Kong as the investment market that is committed to making sustainable finance a prominent feature of the city.

With reference to fast-developed markets in ESG, such coordination can be effectively illustrated through a roadmap or action plan. In this context, there are two major approaches to the matter -

- First, it can be a specific strategy that looks into sustainable finance and investment, connecting different sectors such as banking system, insurance sector, equities market, etc.

  For example, France has created its brand through the Finance for Tomorrow initiative, which provides a platform to showcase its sovereign green bonds, as well as prominent environmental legislation such as Article 173, which among other things, mandates carbon reporting from a wide range of investors including asset managers and pension funds.

[11] The Steering Group was initiated by the HKMA and the SFC. Other members are the Environment Bureau, the Financial Services and the Treasury Bureau, Hong Kong Exchanges and Clearing Limited, the Insurance Authority and the MPFA.

Similarly, a number of other markets, such as Italy, Luxembourg, Mainland China and Singapore have issued their national financial system roadmaps or action plans regarding green finance and investment. The Singaporean one is a one-page graphic, whereas the ones of Italy, Luxembourg and Mainland China contain more granular details:

- Italy: The ‘Report of the Italian National Dialogue on Sustainable Finance’[12], issued in 2016, sets out a number of priority areas in sustainable finance for the country to focus on. The report also suggests a performance framework to measure green progress of the Italian financial system. The five-stage framework includes: defining the indicators; data quality and availability; data collection; assessment; and then regular monitoring.

- Luxembourg: The ‘Luxembourg Sustainable Finance Roadmap’[13], published in 2018, highlights amongst others the importance of leading by examples and proof of concepts. It also sets out how progress should be measured under a controlling framework.

- Mainland China: In 2016, China’s State Council adopted a set of ‘Guidelines for Establishing the Green Financial System’[14], developed by the People’s Bank of China and six other Chinese financial regulators, aiming to establishing the green financial system through a series of policy areas. These policy areas include, amongst others, green loans, green funds and green insurance.

- Second, it can be a macro-roadmap that houses green finance together with other broad areas such as waste management, green building, etc, under the same umbrella.

  For example, the German government promulgated last year its Climate Action Programme 2030, a policy package that covers aspects such as carbon pricing, transport, and financial sectors, with correspondent legislation in place.

These two approaches are not mutually exclusive although the second initiative may take a longer term to be materialised.

In the context of Hong Kong, a macro roadmap can enable Hong Kong to achieve synergies across different streams within ESG. The Government’s Steering Committee on Climate Change, established to coordinate actions of government policy bureaus and departments in combating climate change holistically, is best positioned to bring sustainable finance (and investment) to the equal footing with other areas such as transportation, buildings and renewable energy. While we appreciate that Hong Kong’s Climate Action Plan 2030+ has acknowledged the connection between climate change and financial services, it is believed that there could be more emphasis on how the financial services industry can contribute in the combat against climate change, thus achieving a greater impact.

[12] UN Environment Inquiry, "Financing the Future", December 2016.
[13] Luxembourg Government, "Luxembourg Sustainable Finance Roadmap", October 2018.
[14] The State Council Information Office of the PRC, "Guiding Opinions on Building a Green Financial System", June 2017. (in Chinese only)

That stated, we understand the challenges in formulating a full-embracing action plan for the city that covers each and every area taking account of priorities and resources. With this in mind, we recommend that the lower-hanging fruit should be tackled first, through the formulation of a strategy specific to sustainable finance and investment. In particular, the Green and Sustainable Finance Cross-Agency Steering Group could look into the development of a roadmap that clearly outlines the direction for Hong Kong's financial services industry in this regard. The roadmap can comprise two parts: one, stock-taking of existing initiatives of various financial regulators; and two, mapping out the action plans and opportunities for Hong Kong's sustainable finance and investment market based on the regulators' respective work plans and by way of a gap analysis, followed by a progress measurement framework to keep track of the effectiveness of the initiatives carried out.

Internally, such a roadmap can avoid duplicated efforts among different regulators; and externally, it can show to the global investment community that Hong Kong is ready and committed to becoming a preferred sustainable finance and investment hub. To facilitate the process of developing a roadmap, the Green and Sustainable Finance Cross-Agency Steering Group could keep abreast of the latest developments in international and national policies and projects, including ecological civilisation and Green Gross Domestic Product (GDP) initiatives that the Central Government is exploring.

02 Disclosures

ESG or sustainability disclosure, oft-considered interchangeable with the broader term non-financial reporting, is generally perceived as the disclosure of any information that is beyond what is required on the financial statements. While dubbed as 'non-financial', the information disclosed in the ESG reports may indirectly be correlated to a company's financial performance and forecast, especially when it is assessed in the medium to long term.

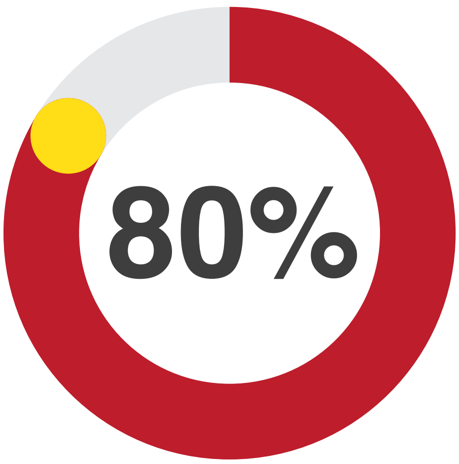
In recent years, the volume of ESG disclosures has risen exponentially – partly due to the increasing sets of non-financial reporting requirements that relate to ESG matters; and partly owing to the increasing investor demands for ESG data analysis in their investment decision-making process. Some companies also conduct ESG reporting for risk management, branding, and other purposes.

All these attributes are applicable to the context of Hong Kong. Here, laws and regulations are an important driver for increased ESG disclosures: listed companies are required by the listing rules to publish their ESG reports; meanwhile, certain companies (including non-listed ones) incorporated in Hong Kong are required by laws to set out in the directors' reports: (i) a discussion of the company's environmental policies and performance, and (ii) an account of the company's key relationships with its employees, customers and suppliers and others, amongst others. At the same time, the demands of asset owners and institutional investors are driving behavioural changes of asset managers and capital-raising companies. These large pockets of capital are exerting pressures on asset managers and companies if the latter would like to remain invested.

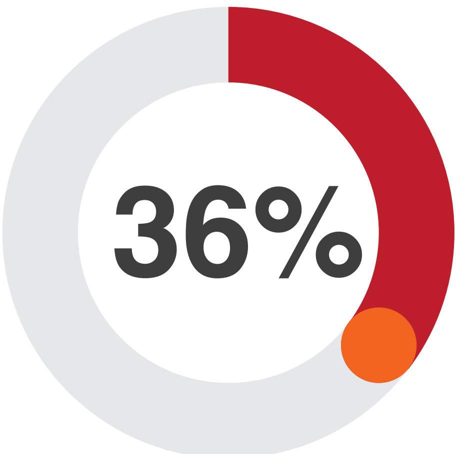
(ii) Insurance Authority to encourage insurers' disclosure of their ESG policies

ESG disclosures (and integration) of insurance firms were less of a commonplace in earlier years, but this trend is experiencing a transformational change. Insurance firms, as risk managers and carriers, are starting to take a more active approach to the ESG agenda. ESG matters, especially climate change, poses increasing challenge to the underwriting and risk modelling process, thus resulting in pricing uncertainty. Scientific research to testify the positive correlation between ESG integration and the risk resilience level of insurance firms, for now, is not as systematic as that for other financial sectors; nevertheless, a number of European insurers are seen to have increased their consideration of ESG parameters by limiting their underwriting exposure to coal-dependent industries, for instance.

Meanwhile, insurance firms, as sizeable asset owners, are stepping up their role in ESG investment for enhancing the longer-term investment return and other reasons. Overseeing about one-quarter of all invested assets globally, insurers are planning to move their way to the ESG investment universe. Goldman Sachs surveyed over 300 senior executives representing about half of the assets of the global insurance industry (i.e., some US$13 trillion) in 2019.[15] About 80% of the respondents in Asia-Pacific have considered ESG and/or impact investing. Of those insurers who consider ESG in the investment process, dedicated investment (as opposed to negative screening) are most utilised in the region. Across different asset classes, ESG and impact bonds are becoming investment vehicles of high priority. According to a BlackRock 2019 survey, 36% of the 360 surveyed senior executives across some 20 countries in the insurance and reinsurance sectors expressed their intention to allocate their assets to ESG or impact bonds.[16]



of surveyed insurance sector senior executives in APAC have considered ESG and/or impact investing



of surveyed reinsurance and insurance sector senior executives expressed intention to allocate assets to ESG/impact bonds

Either in their capacity as the risk managers (and carriers) or as the asset owners, insurance firms are getting to understand that they cannot neglect and put aside ESG matters. How they choose to run their businesses in the face of ESG risks may affect their competitive edges and reputations in the marketplace. Against this background, a significant number of insurers have come to realise the need and benefits of ESG practices and disclosure.

[15] Goldman Sachs Asset Management, GSAM Insurance Survey 2019, April 2019.
[16] BlackRock, Global Insurance Report 2019 - Re-engineering for resilience, September 2019.

Apart from self-driven motive, the rising regulatory involvement is another push factor. For example, European policymakers are taking a closer look at insurers' resilience and capacity in ESG. France is leading the way by having its law on "energy transition for green growth" enacted to require a wide range of investors, including insurance companies, to report on how they incorporate ESG factors into their investment policies, with specific emphasis on climate change considerations.[17] The United Kingdom started off with a softer approach and more from the risk management perspective. In April 2019, the Prudential Regulation Authority ("PRA") issued its supervisory expectations on insurance companies (and banks) to develop an enhanced approach to manage financial risks arising from climate change. Accordingly, the PRA expects insurers (and banks) to provide their boards and relevant sub-committees with management information on their exposure to the financial risks from climate change, for instance, based on scenario analysis and the mitigating actions and associated timeframe proposed to be taken.[18] In Asia, regulation or guidance on insurers' ESG integration remains relatively quiet.

With Asia's highest concentration of insurers (162, as of March 2020), Hong Kong is positioned to more proactively address the strong market expectations for insurers' ESG disclosures. In this connection, how the Hong Kong insurance regulator responds to ESG can influence the behaviour – or at least the awareness – of insurance firms licensed here toward the agenda. It will strengthen the risk management practices and ultimately bring the Asian ESG investment ecosystem on a par with the European counterparts. To this end, we recommend the Insurance Authority ("IA") to encourage authorised insurers to (i) publish and explain their policies on the consideration of ESG risks in their investments; and (ii) provide their boards with information on their exposure to financial risks arisen from climate change.

As far as we understood, the IA has promulgated guidelines respectively on the Corporate Governance of Authorised Insurers and Enterprise Risk Management, but there is not yet a dedicated set of guidance or regulation that covers the entirety of ESG to encourage (or where appropriate, require) insurance firms to publish and explain their policies on the consideration/management of ESG risks in their asset allocation process. Given the current infrastructure and datasets, imposing a mandatory requirement of such in the form of regulations, at this stage, may be an aggressive step forward that could cause unmanageable compliance burden to insurance firms. To the contrary, issuing some forms of guidance such as FAQs or non-binding guidelines would be helpful to insurance firms that are planning or have started to step up their efforts in ESG practices and disclosure. The SFC's Principles of Responsible Ownership and the SEHK's ESG Reporting Guide can be useful references in this context.

To facilitate insurers' disclosure, particularly of their climate risk exposures, some market actors also propose that insurers should be equipped with climate related data that is of sufficient granularity, which to some extent requires the government's tools or infrastructures to generate. As what is made available in Hong Kong now is largely confined to historical climate-related data, there are the suggestions that the climate data variety should be enriched. A possibility to consider is to set up a centralised ESG database that enables open access to historical and future climate information, with a point of reference being the Climate Data Portal launched by Canada for example.[19] While seeing the merits of having such a database, we also acknowledge the challenges in generating a wide variety of climate related data – for example, the technical resources required and the feasibility that lies within. As this would likely require further in-depth study, this suggestion may be an agenda item that Hong Kong can consider in the long-term future.

[17] LOI n° 2015-992 du 17 août 2015 relative à la transition énergétique pour la croissance verte — Article 173., August 2015.
[18] UK Prudential Regulation Authority, Supervisory Statement SS3/19 Enhancing banks' and insurers' approaches to managing the financial risks from climate change, April 2019.
[19] The portal aims at providing experienced users with actual and future climate data by different climate variables and scenarios, as granular as the short-duration rainfall intensity with its frequency of occurrence.

(iii) Regulators to commence preparatory work on strengthening oversight of non-financial reporting

Amid the mounting ESG information/disclosures available in the market, there are also increasing calls in Hong Kong for disclosures of better quality. As noted in our roundtable discussions, a majority of the asset owners and managers expressed their keen interest in ESG information of comparability and materiality.

Unsurprisingly, this is not a phenomenon applicable only to Hong Kong. In other parts of the world, investors and other stakeholders have similar requests for more meaningful ESG disclosures to facilitate their decision-making. In the United States for instance, a group of investors (and associated organisations) representing more than $5 trillion in AuM filed a petition to the US Securities and Exchange Commission in October 2018, asking the authority to formulate a framework for companies to disclose "specific, much higher-quality ESG information". These investors believe that high-quality ESG information promotes a better informed, more efficient capital market. Further, high-quality information can facilitate capital formation, by mobilising sources of capital from investors who are currently having reservations about ESG investing due to information asymmetries.

Globally, notwithstanding the fact that there are rules or laws to require non-financial (or ESG) disclosure, the oversight of information disclosed now often resides at the company level, for example at the board of directors. On the regulatory front, there is yet to be consensus globally as to how non-financial reporting should be overseen. While some industry bodies attempt to take the initiative to promulgate some guidance to facilitate non-financial reporting disclosure (e.g., the International Auditing and Assurance Standards Board (IAASB) conducted a consultation last June on its guidance on extended external reporting (EER) assurance), the market tends to look for stronger regulatory push to achieve more substantial impact. To this end, different developed jurisdictions are exploring feasible options, such as (i) designating a body (for example, through an independent investigatory council) or respective bodies to investigate into reporting irregularities; and (ii) mandating reporters to obtain third-party assurance on their disclosures.

Regulatory oversight, if not carefully designed and implemented, could easily lead to onerous burden on parties being regulated – in this case, the ESG reporting entities. To the contrary, if it is at the reporting entities' liberty to produce ESG disclosures in whatsoever manner without proper oversight, this may run the risk of encouraging reporters' box-ticking exercise or boilerplate practices. While one could argue that substandard ESG reporting of an entity would be 'penalised' commercially (e.g. by failing to raise investment capital or weakened risk management), market actors are generally of the view that a proper oversight framework could motivate reporters to improve their practices.

As an international capital-formation centre, Hong Kong is borne with the expectation to maintain an informed market for the investment community. Until more international discussions and concrete plans are in place, it may be premature for Hong Kong now to decide how exactly the city's oversight framework of non-financial reporting should go toward. Nonetheless, it is necessary for Hong Kong to start considering the feasibility of different possible oversight options. In this connection, we recommend regulators to commence the necessary preparatory work to explore how the oversight of non-financial reporting can be strengthened in the medium to long term. References may be drawn from the experience in the regulation of financial reporting. Despite the difference in scope and landscape, the formation of Hong Kong's Financial Reporting Council back in 2006 may be a relevant example to look at. By commencing the proposed preparatory work, it is believed that Hong Kong can on the one hand signal to the market that the city is taking a close look at the quality of ESG disclosures; and on the other hand, keep the city aligned with international policy agenda on this important subject matter.

03 Intellectual Capacity

The effective functioning of an investment market requires all relevant actors to have the capacity to play their roles properly. For instance, companies should be equipped with the resources, knowledge and skills to produce ESG disclosures that are of good quality, so that investors could perform meaningful analysis and make informed decisions with their expertise accordingly. Likewise, investors such as asset and wealth managers expect to be provided with sufficient resources and information (e.g. the latest regulatory developments) to deliver on their ESG-related goals. While such capacity-building places heavily on the initiatives undertaken by companies and investors, the Government can have a role to play to facilitate the process.

(iv) Government to provide companies with subsidies on eligible ESG training courses to enhance their knowledge and skills

For corporates (including listed and non-listed companies of different sizes), the challenge in making ESG disclosure or reporting in recent years has been alleviated but not completely vanished. While recognising that a considerable number of training workshops and courses are available in Hong Kong to guide corporates in undertaking ESG disclosure, the levels of skills and knowledge cultivated by these offerings vary.

A common comment is that the more economical options of training workshops and courses tend to take a rather one-size-fits-all approach. In other words, corporates of different sizes and from different industries appear to be receiving the same type of training. In turn, some still struggle to understand the essence of 'materiality' and hence fail to make comparable, consistent ESG disclosures. Particularly, some small to medium sized companies still find it difficult to carry on with their ESG journey meaningfully. Without proper training that fits their needs, these companies may run the risk of having boilerplate practices, eventually suffering from the deteriorating attractiveness to international investors. Given the limited supply of ESG talents (including ESG training personnel) across the region, the more technical, tailored type of training in Hong Kong naturally becomes fairly costly, which often can only be afforded by larger companies. Further, there is the observation that courses available in Hong Kong place rather less emphasis on the linkage between ESG and finance. This may explain why ESG remains to be mis-viewed, by some companies, as a standalone subject matter that cannot impact their financial performances.

Admittedly, to cultivate the integration of ESG involves a cultural shift over a period of time. Nonetheless, if Hong Kong continues to develop as a mature and robust ESG investment market, each and every player in the ecosystem is crucial. The varying needs of companies – listed or non-listed, large corporates or small and medium-sized enterprises – should be considered and ideally addressed by having more enhanced capacity-building initiatives.

Taking into account that cost is often a key concern to companies in furthering their improvement in ESG performance and disclosures, we recommend the Government to provide companies with subsidies on eligible training courses in relation to ESG practices, integration and/or disclosure. Limiting the subsidies to eligible courses would enable these companies to better understand what sort of knowledge they should pursue, with the influx of training activities available in the market. Further, such subsidies could facilitate the reskilling of incumbent staff of the companies, partly easing the regional difficulty in identifying the right ESG talents.

To better gauge and manage the impact of such subsidies, the Government can start off in the form of a pilot-run by providing subsidies to companies that are required, by the SEHK's Listing Rules and/or the laws of Hong Kong[20], to carry out ESG disclosure/reporting. This subsidy scheme can make reference to the Government's Pilot Programme to Enhance Talent Training for the Assent and Wealth Management Sector.[21] After a year of pilot-run of the proposed scheme, the Government can evaluate whether the overall quality of ESG performance has improved and, thereafter, decide whether to make the subsidising scheme a regular initiative.

(v) An information exchange platform should be established to promote best practices

Apart from skills and knowledge, access to relevant and latest information is also an element of importance in the capacity-building of market actors.

As ESG investment gets into the mainstream, the introduction and enhancement of different standards and principles, mandatory and voluntary initiatives, analysis tools, etc., have also evolved more rapidly. In the ESG standards and principles spectrum alone, there are already hundreds of reporting and disclosure standards, investment principles and certification frameworks. Needless to say, a swathe of other standards and frameworks are underway with increasing technicality.

Under the circumstances where the investment community has varying levels of knowledge and skills in ESG, the rapid developments in standards and initiatives have, to a certain extent, exceeded what some investors and companies can digest. Without a proper understanding of the international developments in ESG, companies would in turn resort to substandard ESG practices and reporting, thus failing to attract international capital. Along a similar line, local investment intermediaries – such as asset managers – would not be able to live up to the expectation of global asset owners toward responsible investment, and hence suffer from weakened competitiveness.

[20] According to Section 2 of Schedule 5 to the Companies Ordinance (Cap. 622 of the Laws of Hong Kong), certain companies incorporated in Hong Kong are required to include in the business review sector of their annual directors' reports a discussion of their environmental policies and performance; a discussion of their compliance with relevant laws and regulations that have a significant impact on them; and an account of their key relationships with employees, customers and suppliers and others that have a significant impact on them and on which their success depends.

[21] As suggested by the industry, to facilitate also the training of practitioners such as wealth and asset managers in ESG integration, the Pilot Programme could be extended to cover training on sustainable finance and ESG investment.

To facilitate the investment community to keep abreast of and understand these different international ESG developments, a feasible option is for Hong Kong to establish an information-sharing platform/portal, whereby the bureau and financial regulators can publish and update relevant information at a one-stop place for the public to access. Apart from the latest international regulatory developments (obtained through, for example, the regulators' access to international organisations such as International Organisation of Securities Commissions ("IOSCO") and IOPS), the proposed portal can also provide useful resources such as categorisation toolkit of different ESG standards and initiatives, driven by technical industry-based reviews from market practitioners, to make it more informative. An example of the categorisation matrix is as follows –

<table>
<tr><th>Capacity
Mandatory/ voluntary initiatives</th><th>Companies listed in Hong Kong</th><th>Non-listed companies incorporated in Hong Kong</th><th>Asset owners</th><th>Asset managers licensed in Hong Kong</th><th>Product owners</th><th>Other intermediaries</th></tr>
<tr><td>Disclosure requirements/ guidance</td><td>√ …</td><td>√ …</td><td></td><td></td><td></td><td></td></tr>
<tr><td rowspan="4">Product guidelines</td><td rowspan="4"></td><td rowspan="4"></td><td rowspan="4"></td><td rowspan="4"></td><td>√
Green bonds
…</td><td rowspan="4"></td></tr>
<tr><td>Social bonds
…</td></tr>
<tr><td>Sustainable bonds
…</td></tr>
<tr><td>Green funds
…
…</td></tr>
<tr><td>Product guidelines</td><td></td><td></td><td>√ …</td><td>√ …</td><td></td><td></td></tr>
<tr><td>Product guidelines</td><td></td><td></td><td></td><td></td><td>√ …</td><td></td></tr>
<tr><td>Product guidelines</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

Potential ownership models for such an information portal include public, private (e.g., industry associations, professional or academic institutions) and hybrid models. In considering the appropriate ownership model, important factors to consider include: authority and impartiality of information shared; level of information technicality; and resources required for keeping the information up-to-date. Owing to the rapidly-changing ESG investment landscape, and bearing in mind that there is no one-size-fits-all approach, the information shared on the portal is not expected to be exhaustive but for accessors' ease of reference. Such a proposed platform should, after all, be intended to serve the predominant purposes of capacity-building.

With easier access of relevant and latest information in ESG through the proposed portal, it is anticipated that the investment community can better equip itself with knowledge, bring about best practices that align with international expectations, and ultimately enhance Hong Kong's competitiveness as the preferred ESG investment hub in the region.

Conclusion

In its 2018 report, the FSDC made a number of recommendations on the part of the public sector, for the development of Hong Kong's ESG investment ecosystem. It is encouraging to note that a majority of these recommendations have been followed up in good progress. Together with other initiatives led by the Government and financial regulators, Hong Kong's prominence as a preferred ESG investment hub has advanced.

Apart from a review of the status of the previous recommendations, the FSDC organised numerous closed-door roundtable discussions with the private sector (including asset owners, asset managers and other corporates) and gathered constructive input about the current landscape of Hong Kong's ESG investment ecosystem. While stakeholders express appreciation for the upbeat momentum in ESG investment, driven by the Government and financial regulators, there are areas which the city can improve to advance its attractiveness vis-à-vis other global counterparts. Regionally, they call for a wider range and stronger supply of ESG investment products; they also look to have more 'comparable' ESG data. For Hong Kong, stakeholders look for a more coordinated policy environment and strengthened capacity-building initiatives around ESG reporting, amongst others.

In this connection, this report sets out a total of five policy recommendations for consideration:

i. A more coordinated policy environment should be promoted with the development of an ESG policy roadmap;

ii. Insurance Authority to encourage insurers' disclosure of their ESG policies;

iii. Regulators to commence preparatory work on strengthening oversight of non-financial reporting;

iv. Government to provide companies with subsidies on eligible ESG training courses to enhance knowledge and skills; and

v. An information-sharing platform should be established to promote best practices.

Some of these recommendations are specific and considered lower-hanging fruits, while some others tend to be more aspiring and may take a medium to long term to materialise. That stated, these recommendations, if properly implemented, can strengthen the foundation of Hong Kong as a preferred ESG investment hub and, in the longer term, enhance Hong Kong's eminent role in the continuous journey of ESG integration.

About the Financial Services Development Council

The Hong Kong SAR Government announced in January 2013 the establishment of the Financial Services Development Council (FSDC) as a high-level and cross-sector platform to engage the industry and formulate proposals to promote the further development of Hong Kong's financial services industry and map out the strategic direction for development. The FSDC advises the Government on areas related to diversifying the financial services industry, enhancing Hong Kong's position and functions as an international financial centre of our country and in the region, and further consolidating our competitiveness through leveraging the Mainland to become more global.

Contact us

Email: enquiry@fsdc.org.hk
Tel: (852) 2493 1313
Website: www.fsdc.org.hk