

SHAPING A SUSTAINABLE FINANCIAL SYSTEM

Future-proofing global finance for a net-zero, nature-positive world

HONG KONG

INTRODUCTION

In 2021, the government underlined its commitment by announcing plans to issue up to

HK\$175.5 billion (US\$22.6 billion) government green bonds by 2026⁴.

Hong Kong's climate footprint is miniscule, accounting for just over 40mmt CO₂e in 2019¹ and dwarfed by that of China, which reported 13.55bmt of emissions².

However, Hong Kong's role as a financial hub gives local regulators influence far beyond the city's borders, particularly with respect to Chinese companies and projects, as a large share of high-emitting projects and corporations outside of Hong Kong secure funding through Hong Kong markets.

As of 2020, some 51% of companies listed on the Hong Kong Stock Exchange (HKEx) are Mainland enterprises, and these companies represent over 80% of market capitalization on the exchange³. Similarly, nearly two-thirds of China's outward and inward investment originated in or intermediated via Hong Kong. Given these connections, developments that originate in Hong Kong and migrate to China could impact projects and investment carried out further afield through China's Belt and Road Initiative.

Hong Kong stakeholders have moved rapidly to develop an ecosystem for sustainable finance since the Securities and Futures Commission released a Strategic Framework

for Green Finance in 2018. In 2020, HKEx launched the Sustainable & Green Exchange (STAGE), a clearing house of information on sustainable finance products. The same year, key stakeholders convened the Green and Sustainable Finance Cross Agency Steering Group (CASG), which produced both a strategic plan to develop long-term sustainable financial and a set of five immediate steps to take in order to bolster the city's capacity to deploy sustainable finance products. One such step included mandatory TCFD-aligned disclosure by financial institutions (FIs) within five years. In 2021, the government underlined its commitment by announcing plans to issue up to HK\$175.5 billion (US\$22.6 billion) government green bonds by 2026⁴.

These initiatives take place within both the context of Hong Kong and China's carbon neutrality targets (2050 and 2060, respectively) as well as the development of the Greater Bay Area in Southern China, a key component of China's 13th Five Year Plan.

1. Hong Kong SAR Government (2021): Hong Kong greenhouse gas inventory for 2019 released

2. Climate Action Tracker (2021): China.

3. HKEx (2020): Fact Book 2020.

4. Hong Kong SAR Government (2021): The 2021-22 budget.

KEY SUSTAINABLE FINANCE POLICY ACTORS

Actor	Responsibilities and actions taken
HONG KONG MONETARY AUTHORITY (HKMA)	Recently issued White Paper on Green and Sustainable Banking. Central bank and NGFS member.
SECURITIES AND FUTURES COMMISSION (SFC)	Analyzing results of consultation on requiring funds to consider climate risk. Issued Strategic Framework for Green Finance in 2018. IOSCO member.
HONG KONG STOCK EXCHANGE (HKEX)	Functions as regulator and market operator. Recently added ESG listing requirements. Member of SSEI.
GREEN AND SUSTAINABLE FINANCE CROSS AGENCY STEERING GROUP (CASG)	Comprised by HKMA, SFC, HKEx, and other entities. Action plan includes instituting mandatory TCFD reporting and adoption of Common Ground Taxonomy.
Civil society groups	
HONG KONG GREEN FINANCE ASSOCIATION (HKGFA)	Promotes green finance and contributes to policy development in Hong Kong. Members include local and global FIs, NGOs, corporations, and consultancies.
Guangdong-Hong Kong-Macau Greater Bay Area Green Finance Alliance (GBA-GFA)	Created to facilitate the sustainable development of the Greater Bay Area (GBA) of Southern China, matching Hong Kong's finance capabilities with the GBA's development needs.

KEY SUSTAINABLE FINANCE POLICIES AND REGULATIONS

	Policy/Regulation	Supervisory/ Implementation	Implementing Agency	Sustainable Finance Positioning	Year of Implementation	Addresses Climate Change?	Addresses the Safeguarding of Water Resources?	Addresses the Protection of Forests?
1	Supervisory Policy Manual GS-1: Climate Risk Management	HKMA	HKMA	<p>The draft guidelines were issued for public consultation in July 2021 and explicitly draw from the work of the Financial Stability Board (namely, the TCFD recommendations), the Basel Committee on Banking Supervision, and NGFS. The manual provides guidelines reflecting HKMA's expectations regarding climate risk management in the shape of non-statutory guidelines.</p> <p>The guidelines take a comply-or-explain approach and are broadly aligned with the recommendations of the TCFD, although the stringency of the guidelines is limited (for example, FIs are not clearly advised to measure and report financed emissions).</p>	2022 (anticipated)	x	-	-
2	Circular to management companies of SFC-authorized unit trusts and mutual funds - ESG funds	SFC	SFC	<p>The circular requires that trusts and mutual funds marketed as "green" or "ESG" funds disclose how relevant ESG factors are incorporated into their investment strategy and selection process. Such funds are expected to invest primarily in assets corresponding to their stated ESG focus. Managers are required to regularly monitor and evaluate investments for continued alignment with the fund's ESG orientation and confirm this compliance to the SFC.</p> <p>Funds are required to disclose in its offering documents:</p> <ul style="list-style-type: none"> ▼ Description of the fund's ESG focus and criteria used to track progress toward the fund's ESG focus ▼ Description of the investment strategies adopted, including detail on the fund's selection policy ▼ Expected or minimum proportion of securities/investments commensurate with the ESG focus ▼ Description of exclusion policies used ▼ Any risks associated with the fund's ESG focus ▼ Any information required for investors to make an informed decision <p>The circular will be updated in 2022 to specify examples of climate focus (i.e. adaptation and mitigation); climate indicators (i.e. GHG emissions); and benchmarking and tracking progress. SFC maintains a database of qualifying green and ESG funds.</p>	2019 (initial circular) 2022 (climate-specific guidance)	x	-	-
3	Guideline on the Green and Sustainable Finance Grant Scheme	HKMA	HKMA	<p>HKMA's Green and Sustainable Finance Grant Scheme (GSF Grant Scheme) covers costs for green and sustainable bonds issued in Hong Kong. Eligible costs include those associated with general bond issuance (up to HK\$2.5 million) and external review (up to HK\$800,000). The scheme runs until 2024.</p>	2021	The circular does not explicitly discuss qualifying ESG issues.		
4	White Paper on Green and Sustainable Banking	HKMA	HKMA	<p>The White Paper outlines HKMA's thinking on the direction of green and sustainable banking in Hong Kong. It offers a three-phased approach:</p> <ul style="list-style-type: none"> ▼ Baselineing the "greenness" of 50 regulated entities ▼ Consulting with regulated entities on supervisory expectations ▼ Establishing targets and requirements, and tracking progress of entities toward these targets. <p>It also lays out nine principles for sustainable banking:</p> <ul style="list-style-type: none"> ▼ Governance (board accountability and oversight with respect to climate issues) ▼ Strategy (formulation and implementation with reference to climate risk) ▼ Risk management (identification, measurement, monitoring and reporting, and control and mitigation) ▼ Disclosure 	2020	x	The paper mentions CDP's water and forests questionnaires, but it does not go into further detail about these issues	The paper mentions CDP's water and forests questionnaires, but it does not go into further detail about these issues

	Policy/Regulation	Supervisory/ Implementation	Implementing Agency	Sustainable Finance Positioning	Year of Implementation	Addresses Climate Change?	Addresses the Safeguarding of Water Resources?	Addresses the Protection of Forests?
5	HKEx Listing Rules – Appendix 27	HKEx	HKEx	<p>HKEx has a mix of mandatory and comply-or-explain ESG listing requirements.</p> <p>Relevant mandatory requirements from an environmental perspective include information on:</p> <ul style="list-style-type: none"> ▼ Board oversight of ESG issues ▼ Processes used to assess materiality of ESG issues ▼ Information on methodologies, standards, assumptions, and calculation of quantitative data ▼ Notice of any factors that may affect consistency of reported data from year to year ▼ Narratives explaining the boundaries of the ESG report <p>Comply-or-explain rules are concerned with:</p> <ul style="list-style-type: none"> ▼ Emissions (types, amounts, policies, etc) ▼ Use of resources (water, energy, and packaging) ▼ Impact of issuer activity on the environment (description of impacts and policies, and remedial measures related to these impacts) ▼ Climate issues (policies on the identification and mitigation of climate issues with a potential impact on the issuer) 	2020	x	x	-
6	CASG Strategic Plan	CASG	CASG	<p>The CASG Strategic Plan identifies six key focus areas designed to strengthen Hong Kong's sustainable finance ecosystem:</p> <ul style="list-style-type: none"> ▼ Strengthening climate-related financial risk management ▼ Promoting the flow of climate-related information, at all levels, to facilitate risk management, capital allocation and investor protection ▼ Enhancing capacity building for the financial services industry and raising public awareness ▼ Encouraging innovation and exploring initiatives to facilitate capital flows towards green and sustainable causes ▼ Capitalizing on Mainland opportunities to develop Hong Kong into a green finance centre in the Guangdong-Hong Kong-Macao Greater Bay Area ▼ Strengthening regional and international collaboration <p>These focus areas are underpinned by five near-term action items:</p> <ul style="list-style-type: none"> ▼ Mandatory TCFD-aligned disclosure across all sectors ▼ Aim to adopt the Common Ground Taxonomy ▼ Support IFRS efforts to establish the SSB and create global standards ▼ Promote the use of scenario analysis ▼ Establish a platform to drive collaboration among regulators, investors, industry and academia. 	<p>Launched 2019</p> <p>Various timelines</p> <p>2021 (adopt Common Ground Taxonomy)</p> <p>2025 (mandatory TCFD reporting)</p>	x	-	-
7	Strategic Framework for Green Finance	SFC	SFC	<p>The framework outlines SFC's vision for green finance in Hong Kong to both complement Mainland China's green finance ambition and to facilitate the flow of sustainable capital between the Mainland and the rest of the world.</p> <p>The framework includes five action items:</p> <ul style="list-style-type: none"> ▼ Improve levels and quality of corporate environmental disclosure ▼ Engage with FIs (namely asset owners and managers) to formulate policy ▼ Grow the market for green financial products, including by means of providing guidance and harmonized criteria and frameworks on disclosure ▼ Raise awareness among investors through capacity building ▼ Promote Hong Kong as a hub for sustainable finance 	2018	x	-	-

⁶ Nb: This is not an exhaustive list of actors but key regulatory and policy initiatives in Hong Kong

ANALYSIS (INCLUDING GOVERNANCE CHALLENGES)

At present, there is no environmental criteria in supervisory regulation. However, HKMA's 2020 White Paper on Sustainable Banking indicates that the authority intends to expand its supervisory criteria to cover environmental elements in the near future⁵. HKMA's indicative timeline allows for industry consultation through 2021, with implementation as early as 2022.

The white paper identifies nine guiding principles animating HKMA's supervisory approach. The principles provide for board accountability and involvement with respect to climate issues, and for climate issues to be embedded throughout the corporate strategy. In terms of risk management, companies are expected to develop channels and capacity to identify and measure climate-related risks. Companies are also expected to monitor, control, and mitigate such risks.

The SFC is also considering changes to the Fund Managers Code of Conduct (FMCC) that would require fund managers to take climate-related risks into consideration in their investment and risk management processes, and to disclose climate data. The proposed revisions to the FMCC would require managers of larger funds to make more robust disclosures, including metrics such as weighted average carbon intensity (WACI) of Scope 1 and Scope 2 emissions.

Hong Kong has shown rapid development in this area. In June 2020, HKEx revised its listing rules to include ESG disclosure. The expanded rules include both mandatory disclosure requirements and comply-or-explain provisions. A CDP analysis found that the mandatory requirements aligned with one recommended disclosure in each of the four TCFD pillars. Three additional comply-or-explain provisions were found to be at least partially aligned with the TCFD recommendations on risk management and metrics and targets.

The results of the analysis suggest that HKEx's listing requirements could be strengthened, with more robust disclosure requirements

on governance and strategy, and by making these comply-or-explain provisions mandatory.

Beyond the HKEx listing requirements now in effect, in December 2020 the CASG announced that TCFD-aligned reporting would be mandatory for all financial institutions by 2025. While full details on the mandatory reporting scheme are yet to come, the CASG has indicated that large funds (over US\$520 million) will be subject to more stringent disclosure requirements, including WACI and the fund level use of scenario analysis. In July 2021, HKMA issued non-bind, draft guidelines on climate risk management for consultation. The guidelines have a 12-month implementation period.

One of the five near-term action items identified in the CASG's strategic plan is the adoption of the Common Ground Taxonomy. Both the SFC and HKMA are members of the International Platform on Sustainable Finance Working Group on Taxonomies, which is responsible for developing the taxonomy.

The CASG also supports the IFRS proposal to establish a new Sustainability Standards Board (SSB) tasked with developing global sustainability reporting standards. The CASG intends to develop a roadmap to evaluate and potentially adopt the standard developed by the SSB⁶.

The policy measures and exercises described above comprise a clear signal that Hong Kong is determined to become a sustainable finance hub. With the creation of the CASG, Hong Kong appears to have a suitable mechanism to grow and govern its sustainable finance market.



5. HKMA (2020): White Paper on Green and Sustainable Banking.

6. HKMA (2020): Cross-Agency Steering Group announces next steps to advance Hong Kong's green and sustainable finance strategy.

The way forward

Capacity building

Companies will require support for both reporting their emissions and putting in place the systems and initiatives necessary to decarbonize their businesses. Effective capacity-building programs can reassure policy actors of the fairness of more stringent requirements, which could in turn drive more ambitious policy action. Reflecting the importance of capacity building in the territory, the CASG has recently established a Centre for Green and Sustainable Finance. One of the Centre's two working groups is capacity building.

▼ Reporting

FIs will likely require assistance developing the capacity to meet mandatory TCFD disclosure requirements expected in 2025. Although no plans for mandatory reporting among other corporations have been announced, companies are under increasing investor and market pressure to submit TCFD-aligned reporting; higher quality corporate reporting would in turn improve the quality of FI's own reporting on finances emissions.

▼ Decarbonization

FIs and corporations will also need support going beyond disclosure to affect the scale of decarbonization to meet Hong Kong and China's net-zero goals. There is a particular need to build capacity in setting net-zero and science-based targets among FIs and listed corporations.

▼ Scenario analysis

The CASG has identified scenario analysis as a key tool to be promoted among FIs. As in many jurisdictions, familiarity with scenario analysis is uneven; FIs and corporations will require training in carrying out and reporting the results of scenario analysis, and regulators will rely on actors like CDP to help shape requirements relating to scenario analysis.

Developing supervisory requirements

HKMA continues to develop its supervisor requirements for Hong Kong FIs. So far, HKMA has developed and used framework to assess a "greenness baseline" and released best practices in its 2020 white paper. Next steps include industry consultation with FIs to develop requirements and carrying out climate stress-testing exercises. HKMA has also commissioned studies into the barriers hindering the uptake of sustainable finance among local banks. CDP can support efforts to create robust supervisory requirements through data provision, use of the CDP platform, capacity building, and sharing global best practices.

The Greater Bay Area

As much of the financing for the Greater Bay Area will originate in or be intermediated via Hong Kong, careful coordination among local, Mainland Chinese, and global FIs and regulators will be needed to ensure that development occurs in a sustainable way and through sustainable financial products. CDP's Hong Kong and China teams would be well positioned to support its network of stakeholders in this process.

For more information please contact:

CDP Policy Engagement:

Pratima Divgi

Director Hong Kong
pratima.divgi@cdp.net

Joseph Gualtieri

Policy Manager
joseph.gualtieri@cdp.net

CDP Worldwide

4th Floor
60 Great Tower Street
London EC3R 5AZ
Tel: +44 (0) 20 3818 3900
climate@cdp.net
www.cdp.net

About CDP

CDP is a global non-profit that drives companies and governments to reduce their greenhouse gas emissions, safeguard water resources and protect forests. Voted number one climate research provider by investors and working with institutional investors with assets of over US\$106 trillion, we leverage investor and buyer power to motivate companies to disclose and manage their environmental impacts. Over 9,600 companies with over 50% of global market capitalization disclosed environmental data through CDP in 2020. This is in addition to the hundreds of cities, states and regions who disclosed, making CDP's platform one of the richest sources of information globally on how companies and governments are driving environmental change. CDP is a founding member of the We Mean Business Coalition.

Visit <https://cdp.net/en> or follow us @CDP to find out more.
