Special remarks at the Asian Financial Forum 2021

Mr Ashley Alder
Chief Executive Officer

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Tonight I want to give you an update on what we are doing in Hong Kong in the vital area of environmental finance, and especially around climate change.

This effort was given fresh impetus last year when the Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) set up a new cross-agency steering group to coordinate how we manage climate and environmental factors in the financial sector. This signified a major step change in the sustainable finance agenda for Hong Kong, complementing and supporting the Hong Kong Government's broader climate strategies.

Our strategy

A few weeks ago, the steering group announced a bold strategic plan to take this effort to the next level. The plan includes measurable, concrete steps which we will take to strengthen the financial ecosystem to support a more sustainable future.

Our initial focus is on the environment, and specifically the financial risks and opportunities arising from climate change.

Clearly, there is now an urgent need to do more to address the climate threat. And the financial sector will undoubtedly have a critical role to play in financing activities which can lower carbon emissions over time.

Our action plan starts from the premise that, to allocate capital wisely, investors need the best available information about how climate change is affecting companies and financial assets. They also need the best available information on how the activities of the companies and funds in which they invest affect climate change—whether positively or negatively.

This means they must have consistent, comparable and decision-useful disclosures from companies as well as from financial market intermediaries such as asset managers.

But right now we are still a long way from this goal. Instead, we have seen the development of a dizzying number of alternative sustainability disclosure frameworks. Many of these are strictly voluntary or only set out high-level principles, which in some respects can be conducive to greenwashing.

But it should go without saying that the climate crisis is a global issue which demands a global solution.

Note: This is the text of the speech as drafted, which may differ from the delivered version.

If reporting and disclosure standards are to be effective, they have to be universally recognised and applied across the board. It needs to be more of a science and less of an art.

To address this head-on, the Financial Stability Board created the Task Force on Climate-related Financial Disclosures (TCFD) in 2015. Since then, the TCFD has developed a framework to help companies and financial institutions consistently measure and communicate their climate-related exposures as well as their impact on climate change.

So our first concrete action point for Hong Kong is to require that climate-related disclosures must be aligned with all the TCFD recommendations no later than 2025.

By taking this step, we will join the UK, the European Union (EU) and New Zealand in mandating TCFD climate reporting.

Concrete steps

To move this along, the SFC is now consulting on proposed changes to our Fund Manager Code of Conduct. These changes will require fund managers to factor climate-related risks into their investment processes and mandate their disclosure to end-investors.

This is far from straightforward. At the most basic level, asset managers face major data challenges which need to be tackled head-on over the coming months.

The ultimate goal is to produce disclosures which reveal considerably more about what is being financed—especially the volume of carbon dioxide emissions, whether investment portfolios are climate-aligned and how fund managers address climate risks.

We have been working locally and with our international partners on ways to allow funds to do this in ways which are both meaningful and decision-useful.

For example, investment funds will need to calculate the carbon footprints of their portfolios by disclosing weighted average carbon intensity at the fund level. These calculations are highly data-dependent, so the changes we propose will depend on access to the right data as well as the reliability and comparability of that data.

It is important to recognise that this will ultimately depend on getting high-quality information from companies operating in the real economy, where the TCFD recommendations also play a vital role.

To ensure we get to meaningful, decision-useful information, our proposal incorporates double materiality.

There are two perspectives for looking at whether climate is a material issue for a business. The first is financial materiality, that is, how climate affects the value of a company or of a fund's assets. This perspective is particularly important for investors, and is where much of the climate finance effort is directed.

The second perspective relates to the external environmental impact of the company's or a fund's activities. Impact disclosures are of broad interest to consumers, community organisations and environmentalists, but it is increasingly clear that investors also need this information to have a clear picture of the overall climate profile of their portfolios.

Achieving an outcome where disclosures in both dimensions provide quality, consistent and comparable information for investors is far from easy. A great deal depends on the quality of reporting at the corporate or real economy level as this is the end point of the investment chain.

While the Hong Kong stock exchange has already adopted those TCFD recommendations which relate to a company's governance of climate-related risks and opportunities, it is not yet clear how investors are using these disclosures.

So it is absolutely critical that we move forward with mandating the totality of the TCFD requirements here in Hong Kong, and that they are also adopted globally.

IFRS proposal

To help get to that stage, another of our strategic objectives is to support the IFRS[1] Foundation's proposal to establish a new, global sustainability standard-setting board alongside the existing International Accounting Standards Board.

In the proposal, the new board's standards would use the TCFD requirements as a base. This approach would build on the IFRS Foundation's proven standard-setting process for financial accounting, embed it in a robust governance structure and ensure public accountability.

Other action items

Climate change has long-term consequences, but—and this is critical—these are heavily dependent on the decisions we make right now.

For investors and the firms which serve them, the key is how they interpret and use sustainability metrics and climate-related data in the investment decision-making process. For example, how is this information used in a forward-looking analysis of potential climate risks?

Therefore, another of our action items is to promote the greater use of climate-focused scenario analysis by industry participants.

Scenario analysis is an essential tool to assess the materiality of future physical and transition risks under different climate pathways and to align what we do now with what we hope to achieve in the future.

As a further concrete step, the SFC has proposed to require that large fund managers evaluate the use of scenario analysis in the investment process.

Another action point is to adopt a so-called Common Ground—or universal—taxonomy for green finance, which is being developed under the EU's International Platform on Sustainable Finance. Both the SFC and HKMA are members of this platform. China and the EU are co-leaders of the taxonomy project, following an initiative launched by the SFC early in 2019.

[1] International Financial Reporting Standards.

Taxonomies are vital to the green finance effort. They provide a universal, common catalogue to enable capital to be allocated to the right places to support the transition to a greener economy, such as directing investments to initiatives which help address climate change.

Hong Kong leads the way

To wrap up, I want to highlight the fact that because of the extremely large footprint and international significance of Hong Kong's financial market, we are uniquely situated to be a natural global leader in climate and environmental finance.

This follows from the fact that Hong Kong's vast capital market includes a huge swath of Mainland businesses. It is also universally acknowledged that solutions to climate change will depend in large part on successfully reducing emissions in China, in line with its national goals. Hong Kong may only be small geographically, but its influence in global climate finance will be of critical importance.

A great deal is at stake. In partnership with our fellow regulators and government agencies, we have set out an ambitious plan with concrete steps which are already being implemented. But this will be a collective effort, and it is imperative that it succeeds. We hope you will join us in making a difference.