KING&WOOD MALLESONS
金杜律师事务所

ESG and sustainable investment in Hong Kong

April 2021

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2021 is the year in which all businesses need to develop a plan for their migration to a carbon-neutral future.

Cutting through all the jargon, the message is simple: measure, reduce and offset greenhouse gas* (GHG) emissions.

The starting point is to develop an environmental, social and governance (ESG) policy.

* The main greenhouse gases are: carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride and nitrogen trifluoride. The phrases ‘carbon-neutral’ and ‘carbon-footprint’ refer to greenhouse gases, principally carbon dioxide, that are released into the atmosphere by human activity.

Why we should be worried

The scientific evidence for global warming is overwhelming.

- ↑ **CO^2 emissions** 413 parts per million
- ↑ **Global temperature** 2.1^0 F since 1880
- ↑ **Sea level** 3.5 mm per year since 1993
- ↑ **Ocean acidity** 30% approx.
- ↓ **Ice sheets** 427 gigatons per year

The 10 warmest years on record have occurred in the past 12 years. The Hong Kong Observatory projections for Hong Kong as a result of global warming include:

- ↑ >200% increase in very hot days (≥33ºC)
- ↑ >400% increase in hot days (≥28ºC)
- ↑ 2.4 – 2.7 mm increase in sea levels per year
- ↑ storms and extreme weather

Since joining the Paris Agreement, China* has pledged to lower carbon intensity per unit of GDP by 60 – 65% by 2030; to increase non-fossil fuels for primary energy consumption by 20% and to increase forest stock by 4.5 billion cubic meters (in each case from the 2005 level). China’s targets extend to Hong Kong. In response, the Government of the Hong Kong SAR has launched the Hong Kong Climate Action Plan 2030+ and has pledged to reduce carbon intensity per unit of GDP by 65 – 70% by 2030. Key themes for Hong Kong’s CO^2 emissions reduction targets include infrastructure, city-planning, water security, conservation and biodiversity, multiple co-benefits (e.g. transport, lifestyle, sustainability, climate resilience, efficient homes and offices, health) and consumption-based emissions.

Governments around the world have committed to achieve net-zero emissions by 2050 and the financial sector will be critically important in meeting that target. With increasing regulatory pressure and stakeholder demand, the case for staying ahead of the sustainability curve has never been more compelling. The Taskforce on Scaling Voluntary Carbon Markets estimates that the voluntary carbon market will need to grow by more than 15 times by 2030 to support the rising demand for voluntary offsetting.

* For the purposes of the Paris Agreement, “China” means The People’s Republic of China including The Hong Kong Special Administrative Region and The Macau Special Administrative Region.

By the time we see that climate change is really bad, your ability to fix it is extremely limited… The carbon gets up there, but the heating effect is delayed. And then the effect of that heat on the species and ecosystem is delayed. That means that even when you turn virtuous, things are actually going to get worse for quite a while. Bill Gates

statistics: https://climate.nasa.gov/ ; https://hko.gov.hk/ ; https://enb.gov.hk/ ; https://iif.com

What is the solution?

Climate change affects everyone, everywhere.

The key questions are:

- how can we slow the rate of climate change?
- how can we lessen the impact of climate change?
- how can we repair the damage that has already been done?

The answer to each of these questions is that we must all:

MEASURE	**REDUCE**	**OFFSET**
our carbon footprint	our GHG emissions	what we cannot reduce

Meaningful climate action can only be achieved by reducing net GHG emissions.

A business's carbon footprint is made up of a variety of sources – notably office energy consumption and employee transportation. Some industries, such as power generation, aviation and mining, are significantly more GHG intensive than others.

Accurately measuring a business's direct (e.g. fossil fuels burned on-site) and indirect (e.g. electricity consumed, supply chain and raw materials) GHG emissions is critical to establishing a baseline, implementing an effective GHG emissions reduction plan, setting appropriate GHG reduction targets, and accurately reporting GHG reduction results.

Ultimately, a business's ability to implement sustainable solutions to effectively reduce and offset GHG emissions will have a direct impact on its ability to compete and survive. Investors, financial institutions and regulators are increasingly insisting on businesses being able to measure, report and verify GHG emissions according to recognised, robust and comprehensive standards.

Conversely, a business that under-performs or inaccurately reports its sustainability credentials will experience increasingly material, financial, physical, reputational and regulatory risk.

Environmental risks may be event driven (e.g. toxic spills; wildfires; floods) or affect businesses over longer periods (e.g. mandatory requirements for airlines to reduce fleet carbon intensity).

Credible offset techniques are key part of our sustainability infrastructure particularly when managing our transition towards renewable energy and minimising waste. Investment in carbon-neutral (or even carbon-negative) projects and products (e.g. through own-project development or via a carbon credit trading platform) will help to create new markets that will ultimately bridge the sustainability gap.

Asset risk

- stranded assets and obsolete technology
- climate change impact on financial markets and physical risk to assets (e.g. extreme weather)
- litigation relating to GHG emissions
- industry or geography specific regulation

Investor risk

- GHG pricing tariffs
- reputational damage for "financing climate change" or "unethical business practices"
- declining investor support for environmentally damaging activity
- climate related and social reform

You cannot get through a single day without having an impact on the world around you. What you do makes a difference, and you have to decide what kind of difference you want to make. Dr. Jane Goodall

Where to start?

Identify emissions sources	**Select** emissions calculation method	**Collect** emissions data	**Apply** emissions calculation tools

The crucial, first step for all businesses is the creation and implementation of an ESG policy which identifies the applicable sustainability objectives, strategy and methodology as well as the optimal reporting standards that are used to monitor and measure performance in relation to ESG issues.

A basic ESG policy framework (having regard to the HKMA Common Assessment Framework on Green and Sustainable Banking and guiding principles for financial institutions (**HKMA Framework**)), is set out below.

Governance	Corporate planning and tools	Risk management process	Business policies, products and services	Performance and results	Disclosure and communication
Board has primary responsibility	Climate strategy, structure and process	Develop measurement tools and methodologies	Investment policy	Key performance indicators	Follow TCFD recommendations
Specific board level roles	Identify and assess physical and transition risk factors	Monitor climate risks and identify data gaps	Lending policy	Targets	Qualitative narratives and quantitative data
Approval of climate strategy	Stakeholder engagement	Report to the board	Enhancement, offset and review policy	Data collection and processing	Prioritise governance and risk management.

With effect from 2022, financial institutions in Hong Kong must implement, and thereafter effectively monitor and report against their ESG targets (including GHG emissions reduction targets) in accordance with the HKMA Framework. The availability and pricing of debt and equity products for high GHG emitters, GHG intense activities and their respective value chains will be impacted accordingly.

Companies in Hong Kong are already required to report on their environmental policies and performance under the Companies Ordinance (Cap. 622) and to 'comply or explain' with regards to their environmental impact under the Listing Rules. The regulatory requirements for all businesses as regards ESG issues (and the consequences for poor performance) will only become stricter under the multi-agency effort of the Hong Kong Green and Sustainable Finance Cross-Agency Steering Group.

Climate change is an existential threat. We all recognize that, and there's increasing urgency around it. But the converse is, if you are making investments, coming up with new technologies, changing the way you do business, all in service of reducing and eliminating that threat, you are creating value. And what we have seen increasingly, spurred initially by the Sustainable Development Goals, accelerated by Paris, and then by social movements and governments, is societies putting tremendous value on achieving net zero. Companies, and those who invest in them and lend to them, and who are part of the solution, will be rewarded. Those who are lagging behind and are still part of the problem will be punished.

Mark Carney UN Special Envoy on Climate Action and Finance

sources: https://hkma.gov.hk/ ; https://un.org

Identifying standards

Whilst the international markets are far from reaching a consensus in relation to transparent and consistent standards for the rating and monitoring of ESG metrics, the key themes are aligned:

Understand
- data sources, ratings and measurement techniques
- regulatory requirements
- provide training for staff

Define
- objectives, strategy and methodology
- targets and key performance indicators

Evidence
- use data tools to measure your ESG status
- be consistent and transparent in approach

Disclose
- incorporate ESG information in all relevant materials
- be consistent and transparent in approach
- performance against ESG targets and key performance indicators

Review
- check product offerings to ensure they offer sustainable solutions
- evaluate all stages of the value chain and how to enhance ESG performance

Avoid
- avoid unsubstantiated labels and "green-washing"
- treat anecdotal information with caution

Regional and sector specific guidelines and regulations (including local regulatory requirements) must also be complied with in addition to the above core concepts.

International initiatives – general application

- Paris Agreement
- United Nations Framework Convention on Climate Change
- United Nations Framework Convention on Climate Change
- International Organization for Standardization

International initiatives – finance (general)

- Principles for Responsible Investment
- Taskforce on Climate-related Financial Disclosures
- World Bank Environment Health and Safety Guidelines
- IFC Performance Standards on Social and Environmental Sustainability
- Equator Principles IV

International initiatives – finance (product specific)

Loans	Bonds	Structured products
Green Loan Principles	Green Bond Principles	Equity Index Futures and Options Contracts
Sustainability Loan Principles	Sustainability Bond Principles	Credit Default Swaps
Transition Finance	Social Bond Principles	

Hong Kong regulatory – finance

- Securities and Futures Commission
- Hong Kong Monetary Authority
- The Stock Exchange of Hong Kong Limited
- Green and Sustainable Finance Cross-Agency Steering Group

Mainland China regulatory – finance

- China Banking Regulatory Commission
- China Green Finance Committee
- Chinese Securities Regulatory Commission
- The People's Bank of China
- National Development and Reform Commission

The dialogue has shifted from viewing climate change as a risk, to seeing the opportunity, and really translating that into a single objective, which is to move our economies to net zero as quickly as possible. That's a tremendously exciting development because what we have now in private finance is a focus on a clear goal – net zero – and finding the opportunities to advance that and to be rewarded by it.

Private finance is judging which companies are part of the solution, but private finance, too, is increasingly being judged. Banks, pension funds and asset managers have to show where they are in the transition to net zero. And people are voting with their money. That is creating the type of investment that we're going to need to get to net zero.

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image: https://hongkongliving.com ; quotation: https://un.org/

Next steps…

Sustainability and accountability are a focal point for the financial markets in 2021.

Market participants will be expected not only to deliver against their own ESG objectives but to proactively encourage clients and suppliers to do so. The emissions reduction targets set by the Mainland and the Hong Kong governments are ambitious. There is a collective responsibility to deliver results and a regulatory expectation that objectives will be met.

The priority for all businesses is to ensure that appropriate policies are put into place and thereafter to ensure that such policies are complied with, reviewed and enhanced.

Achieving sustainability objectives will not only require a significant reduction of our overall GHG emissions but also sustained investment in meaningful offset techniques.

King & Wood Mallesons has a long track record in helping clients to develop and implement ESG policies and to launch successful ESG financial products, including private equity funds, green bonds and social impact bonds.

Please contact us if you have any questions.

We would be delighted to help.

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