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Transnational Sustainable Finance & Clashing Conceptions of ESG Materiality in East Asia

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Transnational Sustainable Finance Reforms



- Climate & Sustainability Disclosure
 - Task Force on Climate-Related Financial Disclosure (climate)
→ International Sustainability Standards Board (ISSB) (climate & sustainability)
 - EU Corporate Sustainability Reporting Directive (CSRD) (2022)/ESRS (2023)
- EU Environmental Taxonomy (2019); EU & PRC 'Common Ground (climate) Taxonomy' (2021)
- Basel Committee, Principles for the Effective Management & Supervision of Climate-Related Financial Risks (2022)
- EU Sustainable Finance Disclosure Regulation (SFDR) (2019)



Green Finance Reforms in Hong Kong & Singapore

- Green Plan 2030
- 2019 MAS Green Finance Action Plan; 2023 Net Zero (FiNZ) Action Plan
- SGX Sustainability Reporting Guide (2016, 2021)
- Singapore-Asia Taxonomy for Sustainable Finance (2023)
- MAS Environmental Risk Management Guidelines for banks, asset managers, and insurers (2020)
- MAS 2023 Consultation on Proposed Guidelines on Transition Planning for banks, asset managers, and insurers (2023)
- Climate Action Plan 2050
- SFC Strategic Framework for Green Finance (2018); SFC Agenda for Green and Sustainable Finance (2022)
- ESG Reporting Guide (App. 27) (am. 2021)
- HK SFC Fund Manager Code of Conduct (FMCC) (2021)
- HKMA Supervisory Policy Manual – Climate Risk Management (2021)
- SFC Circular to Management Companies of SFC-Authorized Unit Trusts & Mutual Funds (29 June 2021)



- Financial materiality is the bedrock of green finance in both these markets, but is ESG materiality business as usual?
- How does ESG materiality fit (or clash with?) how materiality has been defined in these markets historically?
- What are the implications for company law of ESG capital market regulation?
 - Will the embrace of stakeholder financial materiality by capital market regulators shift how corporate fiduciary duties, corporate purpose, and indeed 'material' risks are understood? (Lim & Varottil 2022)
 - Or will the tensions between corporate law (and common law interpretations of materiality) impede corporate transition to a sustainable future?

Varieties of Materiality

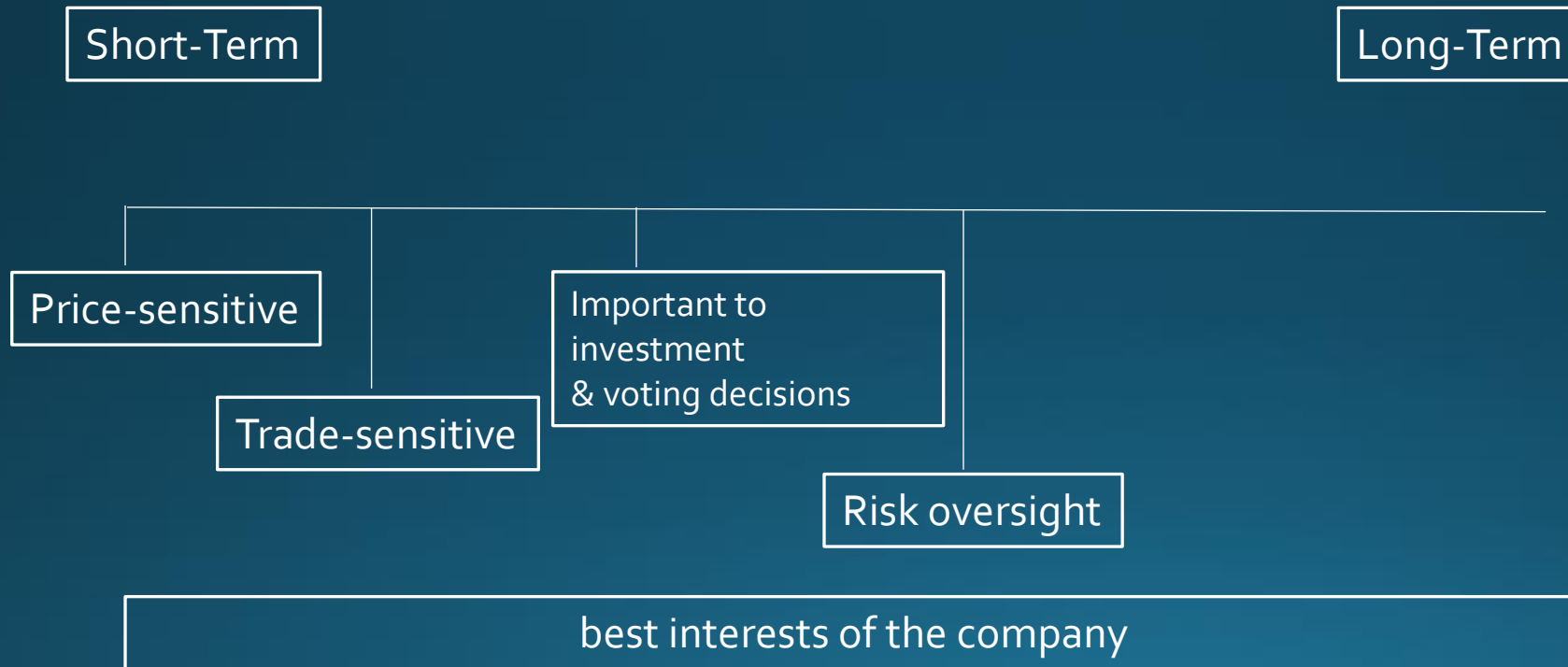
Where materiality matters:

- Accounting and audit standards
- Securities regulation (and related caselaw)
 - (i) to limit the scope of affirmative disclosure obligations; and
 - (ii) to define the bounds of potential civil or criminal liability for a fraudulent or misleading statements, or for insider trading on nonpublic information
- Corporate risk analysis and risk management – supported by listing rules and corporate governance codes may require corporate management to identify and disclose 'significant' or 'material' risk factors that may affect future corporate financial performance

Baseline Materiality Concepts

	Hong Kong	Singapore
General materiality standard	Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity . Materiality depends on the nature or magnitude of information, or both. (IFRS IAS 1.7) (under HKFRS/SFRS)	
Continuous disclosure (inside information) disclosure	price-sensitive	price-sensitive or trade-sensitive
Insider trading	price-sensitive	trade-sensitive
Prohibition on false or misleading statements	price-sensitive	price-sensitive
Risk factor disclosure	probability and magnitude (per IFRS)	probability and magnitude (per IFRS)

Baseline Materiality Concepts

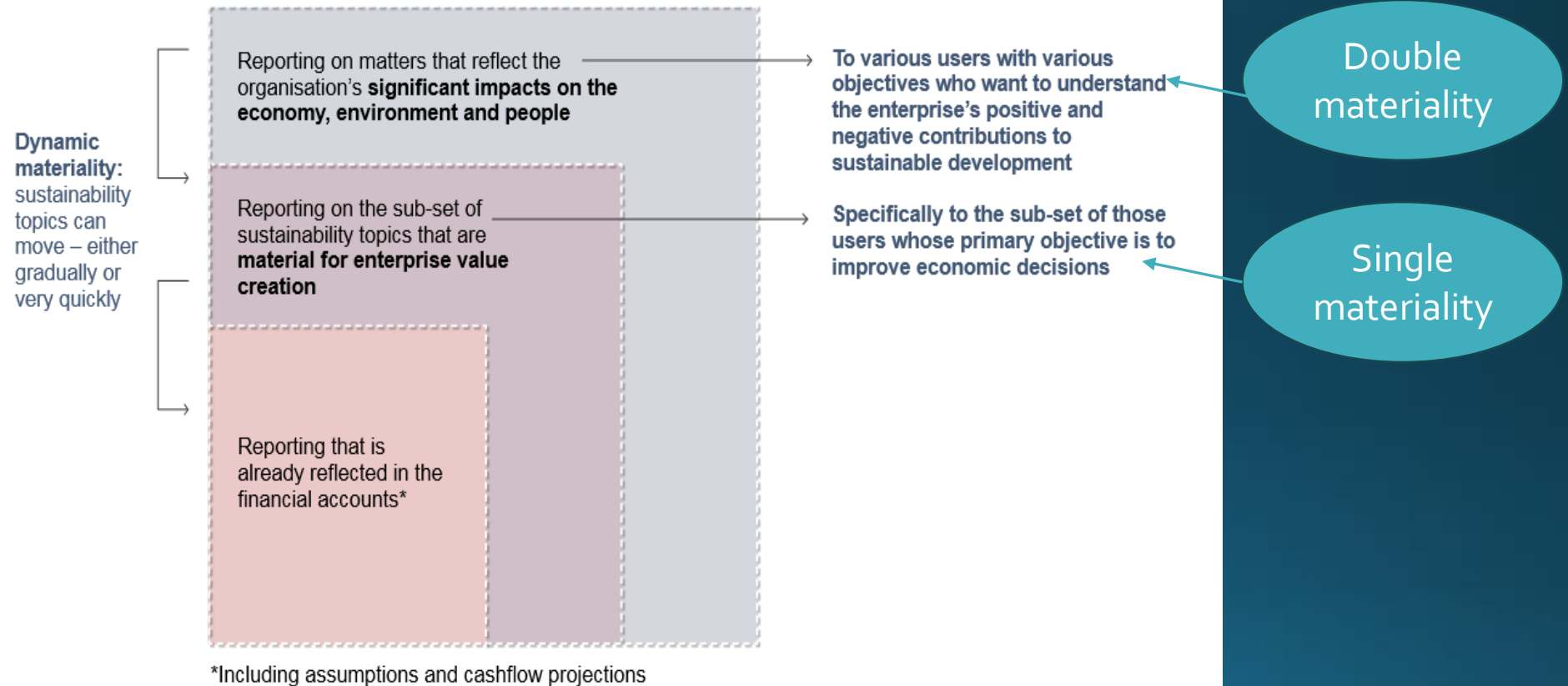


Transnational Sustainable Finance Reforms

- Corporate climate & sustainability (ESG) disclosure mandates
- Taxonomies – standards for sustainable investment activities
- Investor-facing Sustainable Finance Reforms
 - Climate & sustainability (ESG) disclosure mandates for investment advisers, asset managers, and other fiduciaries
 - Prudential climate risk measures for banks and other financial institutions
 - ESG fund regulation (anti-greenwashing)

Dynamic Materiality of ESG Factors

Figure 1. Dynamic materiality¹¹



ESG Disclosure

- 2016 SGX Voluntary ESG Guidance becomes mandatory (comply-or-explain)
- TCFD-based climate reporting on a comply-or-explain basis (FY 2022) (mandatory for some sectors FY 2023-2024)
- SGX 2024 Consultation on Sustainability Reporting (ISSB alignment – IFRS2 Climate)
- HKEx mandatory ISSB-aligned climate disclosures (IFRS2 Climate) (FY2025)

Task Force on Climate-Related Financial Disclosure (TCFD) Framework

Figure 8. The Recommendations of the Task Force on Climate-related Financial Disclosures

Governance	Strategy	Risk Management	Metrics and Targets
<p>Disclose the organization's governance around climate-related risks and opportunities.</p>	<p>Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.</p>	<p>Disclose how the organization identifies, assesses, and manages climate-related risks.</p>	<p>Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.</p>
<p>Recommended Disclosures</p>	<p>Recommended Disclosures</p>	<p>Recommended Disclosures</p>	<p>Recommended Disclosures</p>
<p>a) Describe the board's oversight of climate-related risks and opportunities.</p>	<p>a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.</p>	<p>a) Describe the organization's processes for identifying and assessing climate-related risks.</p>	<p>a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.</p>
<p>b) Describe management's role in assessing and managing climate-related risks and opportunities.</p>	<p>b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.</p>	<p>b) Describe the organization's processes for managing climate-related risks.</p>	<p>b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.</p>
	<p>c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.</p>	<p>c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.</p>	<p>c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.</p>

Taxonomies

(classification systems for sustainable activities)

- Foundation of sustainable finance – may be linked to other disclosure or compliance obligations for corporates or financial institutions
- Sets use of proceeds standards for green or transition financial products
- Key anti-greenwashing principles of many taxonomies:
 - Do No **Significant** Harm (to any of the other identified sustainability goals, including climate change mitigation)
 - EU: Requires disclosure of Principal Adverse Impacts (PAIs) (i.e. externalities)
 - Taxonomies may provide quantitative thresholds for 'significant' harm
 - Minimum Social Safeguards

Financial Institution/Asset Manager ESG Regulation

- MAS Guidelines on Environmental Risk Management (ENRM) for banking, asset management, insurance sectors (2020)
- HK SFC Fund Manager Code of Conduct (FMCC) (2021)
- HKMA Supervisory Policy Manual – Climate Risk Management (Dec. 2021)

SFC Fund Manager Code of Conduct (FMCC) Amendments & Climate Risk Circular (Aug. 2021)

- Follows 2020 Consultation
- Based on the TCFD Recommendations, Global GHG Accounting & Reporting Standard of the Partnership for Carbon Accounting Financials (PCAF) and global best practices
- Two-Tier Approach
 - Baseline requirements for fund managers managing collective investment schemes (CIS)
 - Enhanced standards for fund managers with CIS assets > \$8 billion
- Mandates board oversight of climate integration into investment and risk management processes, including internal controls
- Mandates climate risk management action plans and monitoring of progress
- Mandates climate risk assessment for all investment strategies and funds
- Mandates use of appropriate tools and metrics
- Mandates related disclosures
- Enhanced standards: Consider utility of scenario analysis; determine Portfolio Scope 1 & Scope 2 GHG emissions

Singapore



- 2019 MAS Green Finance Action Plan; 2023 Net Zero (FiNZ) Action Plan
- SGX Sustainability Reporting Guide (2016, 2021)
- Singapore-Asia Taxonomy for Sustainable Finance (2023)
- MAS Environmental Risk Management Guidelines for banks, asset managers, and insurers (2020)
- MAS 2023 Consultation on Proposed Guidelines on Transition Planning for banks, asset managers, and insurers (2023)

Hong Kong



- HK SFC, 'Strategic Framework for Green Finance' (2018); SFC Agenda for Green and Sustainable Finance (2022)
- Revised Corporate Governance Code (App. 14) (am. 2021, eff. FY2022) – **ESG Integrated**
- ESG Reporting Guide (App. 27) (am. 2021)
- HK SFC Fund Manager Code of Conduct (FMCC) (2021)
- HKMA Supervisory Policy Manual – Climate Risk Management (Dec. 2021)
- SFC Circular to Management Companies of SFC-Authorized Unit Trusts & Mutual Funds (29 June 2021)

Observations

- ESG financial risk assessment requires stakeholder-related risk assessment (even if no corporate impact assessment)
 - Identify a potentially material ESG risk
 - Determine if financially material (based on relevant IFRS/local guidance)
- Climate-related financial risk includes other environmental factors:
 - Physical risk
 - Transition risk (exposure to changes in regulation, legal liability)
 - Assess GHG emissions, resource consumption, & biodiversity/nature-related financial risk
- Green Finance Regulation requires ESG-integrated decision-making:
 - Integrate into enterprise risk management and internal financial controls
 - Engage board oversight
 - Consider mitigation or adaptation (climate risk)

Observations

Baseline Materiality & Risk Management (HK/SG)

- Limited common law interpretation of materiality largely restricted to traditional (short-term) market impact measures

Risk Management & Company Law (HK/SG)

- Common law interpreting corporate fiduciary duties assumes value maximization
 - Singapore: Entity
 - Hong Kong: Shareholders
- Limited (no) common law guidance outside of Hong Kong and Singapore on corporate risk management obligations
- No equivalent of UK Companies Act s172 ('Enlightened Shareholder Value') approach to fiduciary duty
- Largely shareholder-centric corporate governance rules*

*Caveat – concentrated ownership, creditor rights, etc

Implications of ESG Materiality for Corporate Governance

- ESG Regulation compatibility with
 - liability-based materiality rules (i.e. continuous disclosure, insider trading)
 - HKFRS/SFRS financial materiality principles
- Per ESG Regulation, ESG factors may and even should be considered by the 'reasonable investor'
- ESG Regulation introduces an "Enlightened Shareholder Value" vision of corporate purpose
 - ESG Regulation is stakeholder-integrated, not stakeholder-blind
 - Greater alignment with Singapore's entity-centric view

Tensions: Capital market regulation & company law?

Tension with shareholder-centric traditional risk oversight

Tension with shareholder-centric (Hong Kong) view of 'best interests of the company'

What if compliance with ESG Regulation is profit-sacrificing? (Bassen et al 2022)

Ex. Reducing resource consumption, GHG emissions, rejecting profitable (but unsustainable) investment opportunities

Integrate into enterprise risk management and internal financial controls

Engage board oversight

Consider mitigation or adaptation (climate risk)

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