

30 June 2023

BY email to hongkong.consultations@climatebonds.net

**ASIFMA Response to the Prototype of a Green Classification Framework
for Hong Kong Discussion Paper**

Dear Sir / Madam,

The Asia Securities Industry and Financial Markets Association (“ASIFMA”)¹, on behalf of its members appreciates the opportunity to provide feedback on the Prototype of a Green Classification Framework for Hong Kong Discussion Paper (“Prototype”) and welcomes the opportunity for engagement with the Hong Kong Monetary Authority (“HKMA”). The Prototype is an important step in producing a taxonomy that aspires to align with international standards and to facilitate the development of green and sustainable finance in Hong Kong and the transition to a more sustainable economy and society. We welcome and support the work done under the leadership of HKMA and appreciate the opportunity for an ongoing dialogue with the industry².

Our members are generally supportive of the taxonomy and its approach, with interoperability at its core. We believe, supported by our taxonomy survey conducted last year³, that an

¹ASIFMA is an independent, regional trade association with over 170 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region’s economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

²All feedback, comments, questions and the position set forth in this letter represent ASIFMA’s members’ collective position and cannot be attributed to any specific member either in part or in its entirety.

³asifma.org/wp-content/uploads/2022/12/final_ey-asifma-taxonomy-survey_report_december-202248.pdf

interoperable taxonomy is key to furthering the sustainable finance agenda and would support Hong Kong's objective in establishing itself as an international sustainable finance hub. Members acknowledge that several aspects of a fully mature taxonomy framework remain to be developed, such as its application and whether it will be voluntary or mandatory. In this vein, we seek clarification on the intended application of the taxonomy and whether compliance with it will be voluntary or a regulatory requirement. We suggest, at least in the first instance, the taxonomy regime be implemented on a voluntary basis and focus on products, labelling and investment screening. In addition, international coordination amongst equivalent authorities in taxonomy development are key to ensuring successful and effective regional and national taxonomy development in international capital markets.

Specific answers to consultation questions

Question 1 - What are your views on the design and structure of the prototype? Do you agree with the principles on which the prototype is built?

We generally accept the current approach to the design and structure of the Prototype. We see the rationale behind having a three-layered approach and the associated decision-tree and its use to provide different degrees of precision when considering the complexity of the activities and their relevance in Hong Kong. For the most part, the layered approach is aligned with key reference taxonomies such as the structure of the steps taken to determine alignment with the EU Taxonomy for Sustainable Activities ("EU taxonomy") and Climate Bonds Taxonomy ("CBT"). In addition, the first layer is like the Chinese Green Bond Endorsed Projects Catalogue ("China taxonomy"), which is whitelist-based, and the ASEAN taxonomy foundation framework, whilst layers two and three broadly align with the ASEAN taxonomy plus standard. The HKMA could consider aligning the Prototype further with the EU taxonomy where the first layer equates to 'Eligibility' and layers two and three equate to 'Alignment'. Beyond the principles of the layered approach, which we believe we understood, in our view there is a need for further clarification of the differences in the layers, particularly for layers two and three. It is not currently clear whether the second layer implies a set of minimum mandatory metrics or whether it intends to provide initial flexibility and/or a building blocks approach to metrics to determine whether an activity is eligible under the technical screening criteria ("TSC"). For the second layer, we suggest that the HKMA consider additional measures alongside emissions-based metrics, which are inherently backward looking. For example, capturing the direction of travel by including green capex. Additionally, we suggest that, in the third layer ("proposing TSC"), HKMA should focus on a core set of metrics and thresholds applicable to the region, including Mainland China.

The core principles guiding the design and structure of the Prototype are relevant and helpful in ensuring a credible scientific approach and alignment with comparable taxonomies. In addition to the five core principles listed in the Prototype, which support the credibility, useability and interoperability of the taxonomy, HKMA could consider the addition of a principle that supports prioritisation of which sectors, TSC and other elements of the taxonomy should be included and/or developed first in future versions of the taxonomy. This should be prioritised based on the most urgent environmental objectives, and then specific activities that pose most potential harm or good

to those environmental objectives. For Do No Significant Harm (“DNSH”) and Minimum Social Safeguards (“MSS”), see our response to Question 5.

Additionally, the HKMA could expand on the governance structure for the development of the taxonomy, that is, how the HKMA will ensure flexibility and ongoing evolution of the taxonomy so it remains current and relevant for its intended use and purpose.

We understand the desire to start the taxonomy with a relatively narrow focus, increasing the sophistication over time. Nevertheless, we suggest that transition should be included from the outset. If the detailed standards governing transition are yet to be set in the EU and China, putting in place some principles as criteria could suffice in the initial stages. These could then be upgraded as and when more precise standards are introduced.

To provide more detailed feedback, it would be useful for the HKMA to clarify which industries the taxonomy will cover. If the taxonomy is intended to be applicable across industries (as we suspect it is), this will reduce complexity and costs for institutions in implementing the taxonomy as it alleviates some of the burden on financial institutions to conduct assessments of counterparties and investees against metrics, TSCs and thresholds, as entities in other industries will presumably have to disclose their taxonomy alignment. For more details, see our response to Question 6.

Question 2 - Do you have any comments on the metrics, TSC and thresholds? If you foresee any operational difficulties in implementing the metrics, TSC and thresholds, please provide specific details of alternative/substitute metrics with supporting information and evidence.

In line with our comment on the application and scope of the taxonomy under Question 1, we suggest that, to facilitate the implementation of metrics, TSC and thresholds in practice, the taxonomy should be applicable across industries and to the extent possible, it should rely on international metrics, TSCs and thresholds to facilitate interoperability. As counterparties and investees have the most in-depth knowledge and understanding of their economic activities, they are best placed to categorize their business into activity descriptions noted in the taxonomies, for example in the Common Ground Taxonomy (“CGT”), the China taxonomy and the EU taxonomy, as well as reviewing whether the TSCs are met. Regarding the Sectoral Activity Cards, we would like to see more nuance for cases that may be considered “transition” and not strictly “green”. For example, if the use of proceeds do not fully comply with the “green” activity description, such as in cases of sustainability-linked financing where proceeds are used for renewable energy capex or other decarbonization measures.

For specific sectors, we note the following:

- i. Electricity, Gas, Steam and Air Conditioning Supply:
 - More Renewables Energies to be considered, such as hydropower given Hong Kong utilities may be interested in pumped storage facilities in Mainland China.
 - Power Transmission and Distribution is an important activity to add as well, as they are integral to incorporating more renewables.

- ii. Transportation and Storage:
 - AER (design metric) and EEOI (operational) metrics are good, if design metrics are accepted, then more design metrics such as EEXI and EEDI could also be used.
 - The EU has approved the new shipping criteria in principle, which includes a criterion on the carbon intensity of the ship propulsion.
- iii. Water supply; sewerage, waste management and remediation activities:
 - There are some gaps between the criteria that is currently proposed in the Prototype and the CBI, EU and China taxonomies' criteria.
 - For the anaerobic digestion criteria, the CBT waste management criteria for methane emissions have been used, but no rationale for the omission of the other criteria was provided. It would be useful to include more criteria for this definition.
 - For the reuse or recycling activity criteria, only collection has been included, but not recycling facilities themselves. We suggest recycling facilities and processes be included as they are included in the CBI criteria, as well as EU taxonomy activity 5.9 and the China taxonomy.
 - We recommend to include certain activities such as landfill emissions capture (present in both CBI and EU taxonomies), or circular economy-related activities.
- iv. Construction:
 - Doing and disclosing a mapping of all Hong Kong and international certifications would be useful.

Question 3 - Are there any metrics, TSC and thresholds that could be further adapted in the local context?

To promote interoperability, the taxonomy should rely on international metrics, TSCs, thresholds, certifications and labels to the extent possible. Industry associations and experts should be consulted to ensure the metrics, TSCs and thresholds are truly applicable in the Hong Kong context. This will support Hong Kong's ambition to be a leading international sustainable finance hub. For example, for the construction of new buildings within Hong Kong, the TSCs refer to Beam Plus, however, as with new building outside of Hong Kong and criteria used in other taxonomies, EDGE could also be referenced here. Specifically, we suggest the improvement threshold for buildings should be changed to +20% from +30% otherwise this may risk excluding a disproportionate number of buildings in Asia.

See Question 2 – a way to manage this could be to provide a mapping of all Hong Kong and international certifications.

Question 4 - Are there any other certification schemes or labels in Hong Kong that can be used as proxies for compliance with TSC?

We have no comments on this question.

Question 5 - Do you have comments on the elements and activities to be included in the future development of the taxonomy, such as any new sectors, transitional activities, new environmental objectives and the DNSH and MSS criteria?

Accommodation of transition activities and pathways

i. Scope and eligibility of transition activities

Transition activities are one of the elements included for potential expansion in future development of the taxonomy, and HKMA have also indicated in other forums that transition activities will be included. We suggest transition activities be included in the taxonomy as early as practicable because addressing transitional activities is critical to the success of the taxonomy and will facilitate the achievement of decarbonization efforts across industries in Hong Kong and the region. In developing the proposed definition of 'green', it should consider the reality that some key economic sectors have very few low-carbon options. Therefore, it is important that the taxonomy facilitates capital flows towards such sectors to support transition activities to achieve decarbonization. Initially, this could include temporary criteria with sunset dates or appropriate science-based decarbonization pathways.

Furthermore, recent international discussions, such as the recently issued recommendations on transition finance from the European Commission, and some regional taxonomies include transition activities, recognizing their importance and critical role in achieving the final net-zero goal. The EU and China are also considering their approach towards transition and a traffic light system has been introduced in version 2 of the ASEAN taxonomy and is considered by the Green Finance Industry Taskforce ("GFIT") in Singapore.

We would welcome the HKMA clarifying its plans to incorporate transition activities into the taxonomy. We suggest the HKMA consider and clarify the eligibility of transition activities and/or plans that relate to phase-out and the conversion of high-emitting assets, for example through carbon capture and storage and avoided emissions, in addition to how steps towards incremental decarbonization may be considered. For example, we would encourage the inclusion of managed phaseout transactions under transition-aligned activities. Similarly, given the transitional nature of nuclear and gas related activities, we strongly suggest that HKMA fully incorporates the EU taxonomy criteria for both mitigation and DNSH, transposed appropriately to the relevant nuclear regulations in Asia.

HKMA could consider reframing the taxonomy as a "sustainable" taxonomy. This will allow for nuclear, gas and other transition activities to be included as they are "sustainable" but not necessarily "green".

ii. Decarbonization pathways

Alignment with the Paris agreement is a core principle underpinning the Prototype and reference is also made to achieving net zero by 2050 ("NZ2050"). It is possible to be Paris-aligned whilst on a slightly lower decarbonization pathway, particularly for hard-to-abate sectors. A limiting factor for such sectors is the absence of country- or sector-specific guidance on feasible decarbonization pathways. Therefore, it may be worth considering the development of a national and/or regional

level pathway that provides an important reference point for companies and borrowers to follow. In this regard, it would be useful to align with the transition pathways outline in the ASEAN taxonomy as this will ensure consistency across the region and reduce fragmentation. The HKMA could also indicate when national and/or regional level pathways could be formulated and if there are any interim solutions whilst these are being developed, such as the International Energy Agency (“IEA”) decarbonization pathways for the energy sector.

Environmental objectives and other criteria

The Prototype recognizes the difficulty of implementing criteria such as DNSH and MSS. Could the HKMA elaborate further on how these criteria are intended to be applied in practice so they are not a disproportionate burden on users of the taxonomy.

Regarding environmental objectives, in addition to climate change mitigation it may be beneficial to consider inclusion of climate change adaption given the real conditions of Hong Kong, its industries and the region. Adaption may be more feasible for certain activities and circumstances, particularly if there are mitigation co-benefits, for example through mangrove restoration and seawalls with nature-based carbon benefits. Other environmental objectives such as biodiversity, circular economy, pollution and water management, which are included in other key taxonomies, such as in the EU, Singapore and China, are also important for the region and should be considered.

Question 6 - Do you have any comments on how the taxonomy should be used in Hong Kong?

Clarification on how the taxonomy will be implemented

i. Scope & mandate

We seek clarification on several points regarding the scope of the taxonomy as soon as practicable as this may affect feedback and comments on the proposed taxonomy:

- We suggest the HKMA consider whether the taxonomy will serve as guidance or if it will be implemented on a mandatory basis. If the taxonomy is intended to be mandatory, the Prototype as well as the fully fleshed-out taxonomy should be further consulted with the industry. It is also important that the HKMA publish timelines for implementation, including reporting, expected disclosures and alignment to facilitate effective implementation of the taxonomy amongst institutions.
- Recognizing the HKMA has a mandate to regulate financial services, the taxonomy should be applicable across industries as this will facilitate disclosure and reporting and consequently enable better data availability and reliability. The HKMA should work with other regulators and policymakers in Hong Kong, such as HKEX, to ensure consistency in the use of the taxonomy across the market for all entities, not just those that are regulated by the HKMA. This will reduce complexity and costs for financial institutions as they can rely on data provided by counterparties and investees instead of performing resource-intensive internal assessments, which might not be as accurate in comparison to data coming from the corporates themselves. We presume this is intended, but would welcome the HKMA clarifying its intention.
- For institutions that are head-quartered in Hong Kong, HKMA should elaborate how the taxonomy will apply to their overseas operations and activities.

- Many institutions operating in Hong Kong especially banks, asset managers and listed entities have regional exposures, so we suggest that the HKMA and CBI consider expanding the scope of the taxonomy so it accounts for activities in the Greater Bay Area to reflect the current economic environment in Hong Kong.

ii. Application

We suggest that the taxonomy first be implemented on a voluntary basis, initially to support institutions in product labelling, with the development of product standards whilst making the relevant disclosures and obtaining related certifications and assurances. Institutions and other market participants should have the option to use other taxonomies in the local market if that is preferable as this would be driven by the market's preference, for example, local issuers may elect to use the EU taxonomy to attract EU investors and vice versa. The local framework should seek to avoid creating inefficiencies by also requiring those issuers to use the Hong Kong taxonomy in parallel.

As noted under i), a mandatory regime would require the development of a clear roadmap toward compliance and the publication of detailed guidance on how to calculate and disclose any taxonomy-related ratios or metrics. Members are concerned that the roll out of a fully-fledged taxonomy-based mandatory framework (e.g., EU SFDR and CSRD frameworks) in the near term could be counterproductive with implementation costs significantly out-weighting the benefits. If the taxonomy is intended to be implemented on a mandatory basis, the requirements should be purposeful, proportionate and contribute towards achieving its stated outcomes, for example, to support incentives to finance eligible sustainable assets such as China's approach with a preferential funding rate.

An extensive scope of applications under a mandatory regime should only be considered in the longer term, once the market and all stakeholders have worked out practical and interoperability issues.

iii. Timeline

The Prototype does not indicate required disclosures or timelines for first reporting. The HKMA should develop and make public a detailed roadmap with adoption timelines so that the industry can prepare itself for the upcoming requirements. Based on EU taxonomy experience, it can be a long journey to being reporting ready given interpretation and data sourcing challenges. We would also like to suggest that when considering timelines, the HKMA should take into account the model set forth in the EU taxonomy; that is, financial institutions are expected to report taxonomy alignment a year after non-financial institutions. This will allow financial institutions to rely on taxonomy-aligned reports as opposed to conducting their own resource-intensive assessments.

Interoperability

The Prototype has been developed based on the CGT and with reference to other key taxonomies such as the EU, China and CBI taxonomies to support the principle of interoperability. To ensure this principle is accomplished in practice and recognizing the taxonomy is intended to be a living

document – to account for changes in this fast-developing sphere, we suggest that the HKMA have a governance structure in place to regularly assess and ensure that any changes in the underlying taxonomies are considered for adoption in the Hong Kong taxonomy in a timely manner. This governance mechanism should include review and consideration of any changes in industry classification codes as consequent discrepancies cause significant burden for taxonomy users. In addition, it would be helpful to spell out what the process would be for updating the taxonomy when changes in the referenced taxonomies are made. Would this happen on an ad hoc basis, following changes in the referenced taxonomies, or at regular intervals. The same question applies for metrics, criteria and thresholds – would they be changed automatically if changes occur in the reference taxonomies or during regular and planned updates? If the process of updating results in discrepancies between referenced taxonomies and the Hong Kong taxonomy, how would this be reconciled?

Furthermore, recognizing that the Prototype refers to the new industry sector standards expected from the construction sector, Hong Kong Green Building Council (“HKGBC”) Zero-Carbon-Ready Building Certification and Net Zero Building Certification scheme, we note that one of the certifications would include de facto transition activities, which are currently outside the scope of the proposed Prototype. Our members seek clarification on how this would be handled.

Members would also like to emphasize, recognizing the ASEAN taxonomy is still in its development phase, it is important that, where relevant and feasible, references are made to the ASEAN Taxonomy (version 2), for example by including comparisons of the ASEAN taxonomy criteria in the sectoral activity cards as this would allow Hong Kong to strengthen its status as an international finance center in addition to fostering interoperability and the flow of capital in the region focused not just on Mainland China but also South East Asia. To avoid any unnecessary regulatory fragmentation, the HKMA should also discuss with equivalent authorities in regional jurisdictions, including Singapore, ASEAN and Mainland China as well as other international authorities such as in the EU, to propose that the financing of activities which are considered eligible green finance under one taxonomy should be considered “green”, even where the detailed standards regarding the activity may differ. Mutual recognition, in that if an activity or financing is recognized to be compliant under another taxonomy, could be considered compliant with the Hong Kong taxonomy if the outcomes are substantially similar.

Data

Further to the point raised previously under the scope and application of the taxonomy regarding data availability and reliability, while we appreciate challenges in relation to the availability and reliability of counterparties and investees’ ESG-related data are identified within the Prototype, currently we understand no mandate exists in Hong Kong for ESG-related disclosures to be made by local market participants, such as borrowers, corporates and issuers but for the current HKEX Listing Rules consultation on how to implement ISSB standards. Within the EU, local market participants are required to disclose such information which is subsequently leveraged by third party market data vendors and regulated financial institutions for the purpose of taxonomy reporting. We would propose that the HKMA work with the other agencies under the Cross-agency taskforce to consider such a model for its taxonomy.

Conclusion

Overall, we believe the Prototype provides a good basis on which to further the green and sustainable finance agenda in Hong Kong and the APAC region. We particularly appreciate the phased approach suggested by the HKMA, which, provided sufficient transparency and time is provided, should allow all stakeholders, including financial institutions, to adapt and implement a truly beneficial taxonomy, which will unlock and channel finance in the most efficient way towards achieving green and sustainable outcomes.

We thank the HKMA for considering our comments and would be happy to meet with HKMA and CBI to discuss any of the issues raised and clarify our response. If you have any questions, please contact Diana Parusheva-Lowery, Executive Director, Public Policy and Sustainable Finance at dparusheva@asifma.org.

Sincerely,



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