

ICMA Publishes Draft Hong Kong ESG Data and Ratings Code of Conduct

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Introduction. The environmental, social and governance (“ESG”) landscape is shifting, and ESG factors play an increasingly important role in financial markets. As such, the demand for ESG ratings and data products is also increasing, but it brings with it concerns around transparency, quality and reliability of such services. This is resulting in calls for closer scrutiny of the ESG ratings and data products providers (“Providers”).

Accordingly, in November 2021, the International Organization of Securities Commissions (the “IOSCO”) encouraged regulators to develop or follow voluntary industry standards or codes of conducts focused on ESG ratings and data products. The IOSCO also published recommendations for Providers to improve practices across four core areas: transparency, governance, systems and controls and management of conflicts of interests.

The Hong Kong Environmental, Social and Governance Ratings and Data Products Providers Voluntary Code of Conduct Working Group (the “Working Group”) launched a public consultation on May 17, 2024 seeking feedback on a voluntary code of conduct for Providers (the “Code of Conduct”) in Hong Kong. The public consultation will remain open until June 17, 2024. The Code of Conduct is another positive step taken by the Hong Kong government to promote the city’s development into an international hub for green and sustainable finance.

Background. The industry-led Working Group comprises 14 members from Hong Kong and mainland China, including international ESG service providers and key users from the finance industry. The development of the Code of Conduct was led by the International Capital Market Association (the “ICMA”) and supported and sponsored by the Hong Kong Securities and Futures Commission (the “SFC”). It aims to develop and promote a globally consistent, interoperable and proportionate voluntary code of conduct for Providers. The SFC, alongside the Hong Kong Monetary Authority and the Insurance Authority, were designated as observers to the Working Group.

In 2022, the SFC conducted a fact-finding exercise and industry outreach survey to better understand matters related to ESG ratings and data products providers, which are

not regulated by the SFC. In its report on the survey published in October 2023, the SFC noted some common concerns highlighted by surveyed asset managers. Common issues include data unavailability, lack of transparency, inconsistent corporate sustainability disclosure standards and inadequate conflicts of interest management. The SFC therefore expressed its support for the Code of Conduct, which is envisaged to provide a consistent, streamlined and reliable framework for asset managers to conduct due diligence or ongoing assessment on ESG service providers.

Alignment with International Standards. The Code of Conduct is modelled on international best practices recommended by the IOSCO and existing industry standards. It is the third voluntary code of conduct maintained and hosted by the ICMA. Similar to the ICMA’s Singapore and United Kingdom codes (the “ICMA Codes”), it aligns with the IOSCO recommendations. The Working Group deemed that the Code of Conduct did not require specific tailoring to operate in the Hong Kong market. The scope, definitions and principles of the Code of Conduct are, therefore, substantively the same as the equivalent provisions in the other ICMA Codes.

By modelling on international standards, the Code of Conduct intends to form part of a globally consistent regulatory framework. Aligned with the IOSCO recommendations, the Code of Conduct focuses on promoting transparency, good governance, conflict of interest management and strengthening systems and controls of Providers. A parallel can also be drawn with the EU regulation on the transparency and integrity of ESG ratings activities. The principles under the EU regulation are similar to those in the draft Code of Conduct, but in addition, Providers established in the European Union are encouraged to provide ratings on a “double materiality” basis and must be authorised and supervised by the European Securities and Markets Authority. Consistent with the other ICMA Codes, the Code of Conduct focuses on the seven recommendations pertaining to “ESG ratings and data products providers” rather than the full 10 IOSCO recommendations and does not cover regulators and other market participants.

The Six Principles. Providers that sign up to the voluntary Code of Conduct must meet the expectations of the following six principles (“Principles”) therein:

- **Good Governance:** Providers should ensure appropriate governance arrangements are in place that enable them to promote and uphold the Principles and overall objectives of the Code of Conduct.
- **Securing Quality (Systems and Controls):** Providers should adopt and implement written policies and procedures designed to help ensure the issuance of high-quality ESG ratings and data products.

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- **Conflicts of Interest:** Providers should adopt and implement written policies and procedures designed to help ensure their decisions are independent, free from political or economic interference and appropriately address actual or potential conflicts of interest that may arise from, among other things, Providers' organisational structure, business or financial activities or the financial interests of Providers, their officers and employees.
 - **Transparency:** Providers should make adequate levels of public disclosure and transparency a priority for their ESG ratings and data products.
 - **Confidentiality (Systems and Controls):** Providers should adopt and implement written policies and procedures designed to address and protect all non-public information received from or communicated to them by any entity or its agents.
 - **Engagement (Systems and Controls):** Providers should regularly consider whether their information gathering processes with entities covered by their products leads to efficient information procurement for both the providers and these entities.

Each principle is underpinned by a non-exhaustive list of actions which serves as a practical guide to the application and interpretation of each principle. Suggested actions include using publicly disclosed data sources for ESG ratings and data products, implementing defined methodologies that are rigorous, systematic and applied continuously and giving covered companies the opportunity to comment on any factual errors or omissions in any ESG ratings or data products.

The Code of Conduct is not intended to prescribe a singular approach as to how the Principles should be embedded into a Provider's organisation. Providers are free to adapt any of the suggested actions in the Code of Conduct to their own business model and structure, provided that they still meet the expectations set out in the Principles.

Implementation Period. Providers who sign up to the voluntary Code of Conduct will have an implementation period of six months for ESG ratings providers and 12 months for ESG data product providers. Upon expiry of the implementation period, Providers must publish the self-attestation document to explain their approach to the implementation of the Code of Conduct and to confirm that the six principles have been embedded within their organisations. The self-attestation document is intended to facilitate end users, such as SFC-licensed intermediaries, to compare the conduct of Providers during their due diligence and ongoing assessment processes.

Conclusion. The Code of Conduct is intended to be internationally interoperable and marks another important step in promoting globally consistent standards on sustainable finance. It is anticipated that the Code of Conduct would enhance the

transparency, reliability and quality of ESG ratings and data products for end users. If taken forward, the Code of Conduct would align Hong Kong with other jurisdictions in the region such as Singapore, Japan and South Korea who have already implemented oversight frameworks for Providers.

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Please do not hesitate to contact us with any questions.



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