

Corporate Communications Department
Hong Kong Exchanges & Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

By email (response@hkex.com.hk)

17 September 2015

Dear Sirs,

Re: Consultation Paper on the Review of the ESG Reporting Guide

Hermes Equity Ownership Services (Hermes EOS) welcomes, on behalf of the asset owners we represent, the intentions of the Hong Kong Stock Exchange to strengthen environmental, social and governance ('ESG') reporting requirements listed companies in Hong Kong.

By way of background, Hermes is one of the largest investment managers in the City of London. It is wholly owned by the BT Pension Scheme, the UK's largest corporate pension scheme. As part of our services, we respond to public consultations on behalf of clients with an objective to support better governance, and therefore, contribute towards creating a more enabling environment for responsible ownership. To summarise, Hermes EOS advises clients with assets totalling US\$182 billion (as at 31 July 2015).

Hermes EOS has a strong and experienced team of engagement specialists who monitor clients' investments and support companies in improving their performance. Our activities are based on the premise that companies with informed shareholders are more likely to effectively manage risk, integrate material information to capture growth opportunities, and as a result, achieve superior long-term performance.

For this consultation, the following long term investors have given us permission to disclose their names as a means of support for our work. They are:

- Environment Agency (UK)
- The BBC Pension Trust (UK)
- Mineworkers Pension Scheme (UK)
- British Coal Staff Superannuation Scheme (UK)

- PNO Media (Netherlands)
- VicSuper (Australia)
- Canada's Public Sector Pension Investment Board [CPPIB] (Canada)
- Lothian Pension Fund (UK)

From page 2, there are detailed comments responding to each question set out in the consultation. In particular, we would like to highlight the following main points concerning the proposed Review:

- Investors find company reports most informative and useful when the content is material, meaningful and comparable with their peers. Whilst we appreciate the great efforts shown by companies in enhancing their disclosure of ESG risks and opportunities, we recommend a strategic approach towards identifying the material environmental, social, governance and economic issues.
- This means that the role of the board in overseeing ESG disclosure and integration into the business is of paramount importance. We strongly recommend board level involvement in understanding relevant ESG issues, and that board members are able to articulate the impact of these issues through a clear explanation of their business implications.
- With board leadership, we hope to see that overtime; companies are able to provide an integrated report. Based on our engagement experiences globally, companies that have a coherent timeframe of producing annual reports and ESG reports are well positioned to align data collection cycles and human capital required to integrate material information for decision-making and innovation, ultimately benefiting the business. This Review is an important step in guiding companies towards that productive path, which also supports better communication between companies and their stakeholders.
- Corporate social responsibility (CSR) is an established concept in China and CSR reports are a widespread practice amongst Chinese companies. However, the understanding of material ESG issues and how they can be interpreted and addressed may take very different perspectives. The Hong Kong Stock Exchange is a major listing destination for Mainland Chinese companies; it plays a crucial role in bringing global best practice of ESG integration into business management to listed companies. We recommend the Exchange to further develop structured and more detailed guidelines that shape ESG content for issuers to ensure materiality and comparability.

Please feel free to contact me on the details below if you would like to discuss our comments and suggestions further.

Yours Sincerely,

Dr. Christine Chow

Email:

Direct:

Mobile:



The following comments refer to the number of the questions in the consultation paper July 2015, page 21 to 29.

1. Do you agree with our proposal to amend Rule 13.91 to require issuers to disclose in their annual reports or ESG reports whether they have complied with the “comply or explain” provisions in the ESG Guide and if they have not, they must give considered reasons in the ESG reports?
 - Yes.
 - The concept of “comply or explain” is deemed a pragmatic tool to create change in company’s culture and to improve corporate governance, although its limits have been a subject of healthy debate¹.
 - We agree that by requiring issuers to state in their annual or ESG reports whether they have complied with the provisions of the ESG Guide encourages proactive reinforcement of their commitment to take into consideration key non-financial information in their reports. Quality explanation forms the basis of an engaged dialogue between the company and its investors, conducive to stewardship and responsible ownership.
 - However, we feel the disclosure requirement is only half the equation. We propose that further guidelines on how companies and investors could engage to resolve non-compliance matters, as and when they arise, would be desirable. Otherwise, without guidelines on ‘next steps’, the company and investors will be left with a negative sentiment of non-compliance as an end in itself, rather than a working objective of both parties. In our experience, we find that companies make progress by taking the initiative to approach us on strategy and ESG related issues they find challenging, and show willingness to collaborate on finding ways to address these challenges.

2. Do you agree with our proposal to amend Rule 13.91 to require the issuer to report on ESG annually and regarding the same period covered in its annual report as discussed in paragraphs 86 and 90?
 - Yes.
 - We agree that by requiring the issuer to report on ESG annually and regarding the same period covered in its annual report will help align data collection and report production cycles, as such, supporting the issuer to consider material and relevant issues that affect its performance in a holistic manner.

3. Do you agree with our proposal to include a Note under Rule 13.91 to clarify that: (i) an ESG report may be presented as information in its annual report, in a separate report, or on the issuer’s website as discussed in paragraph 91; and (ii) the issuer should publish the ESG report as close as possible to, and in any event no later than three months after, the publication of the issuer’s annual report as discussed in paragraph 92?
 - No.
 - We do not agree that the format in which the ESG information is published should be a choice between online and offline.
 - We suggest that in a Note under the Rule, as detailed in paragraph 87, to state that an ESG report may be presented as information in its annual report, in a separate report, **and** on the issuer’s website. The reasons are that when the issuer is given a choice to publish the ESG report only on the website, it makes an automatic assumption that (i) investors have readily available internet access, discriminating against those who do not have such an access; and (ii) many investors still prefer to read the company’s reports and expect all material and

¹ Financial Reporting Council (2012) *Comply or Explain 20th Anniversary of the UK Corporate Governance Code*.
Institute of Chartered Accountants in England and Wales (2013) *When is Comply or Explain the Right Approach?*

relevant information to be included in them. If the ESG information is only available online, investors may miss vital information that key to their decision making.

- We agree that the issuer should publish the ESG report as close as possible to, and in any event, no later than three months after, the publication of the issuer's annual report.
 - Information contained in the ESG report should also have clear definitions that can be referenced and compared on a year on year basis, and if possible, with other comparable companies in the same sector.
 - In addition, we suggest that an additional paragraph be added to highlight that best practice would be to have the annual report and ESG information available at the same time, with a goal for the issuers to move towards a coherent reporting period for the same reason highlighted in paragraph 86 and 90 – supporting the issuer to consider material and relevant issues that affect its performance in a holistic manner.
4. Do you agree with our proposal to revise the introductory section of the Guide into four areas as discussed in paragraphs 94 and 95, and with the wording set out in Appendix II?
- Yes.
 - We welcome the revisions of the introductory sections and suggest more guidelines be provided on reporting governance. At present, a discussion of the issuer's compliance with the relevant laws and regulations that have a significant impact on the issuer covers governance from a compliance perspective. Good governance also requires the company to address issues of board independence, transparency in the election of directors and shareholder communications etc.
5. Do you agree with the proposed wording of the Reporting Principles in the introductory section of the Guide as discussed in paragraphs 96 and 97, and with the wording set out in Appendix II?
- We welcome the change of wording (in Appendix II.6 of the Proposed New Guide) that encourages the issuer to 'engage stakeholders periodically to identify material aspects and KPIs' to the 'issuer **should** engage stakeholders on an **ongoing** basis in order to understand their views and better meet their expectations'.
 - We suggest that in Appendix II.10 of the Proposed New Guide, 'It would be useful to discuss the issuer's management, measurement and monitoring system employed to implement its ESG strategy' can be strengthened to '**It is best practice** to discuss the issuer's management, measurement and monitoring system employed to implement its ESG strategy'.
 - We agree with the proposed definitions under Reporting Principles, however, we suggest that for (2) Quantitative, the following wordings be considered: 'Targets can be set to reduce **or to promote** a particular impact. The reason being environmental, social and governance impact are not necessarily negative. In situations where the issuer can identify a positive impact of ESG initiatives, they have the fiduciary responsibility to amplify them for better company performance.'
6. Do you agree with the proposed wording in the Guide linking it to Appendix 16 as discussed in paragraph 98, and with the wording set out in Appendix II?
- Yes.
 - We agree to the proposed wording in the Guide linking it to Appendix 16 as discussed in paragraph 98, and with the wording set out in Appendix II.12 Proposed New Guide.
7. Do you agree with proposal to re-arrange the Guide into two Subject Areas (A. Environmental and B. Social) and re-categorise "Workplace Quality", "Operating

Practices” and “Community Involvement” under Subject Area B as discussed in paragraph 99?

- Yes.
 - We agree with the proposal to re-arrange the Guide into two Subject Areas (A. Environmental and B. Social) and re-categorise “Workplace Quality”, “Operating Practices” and “Community Involvement” under Subject Area B as discussed in paragraph 99.
8. Do you agree with the proposal to change the heading “Workplace Quality” to “Employment and Labour Standards” as discussed in paragraphs 100 and 101?
- Yes.
 - We agree with the proposal to change the heading “Workplace Quality” to “Employment and Labour Standards” as discussed in paragraphs 100 and 101.
9. Do you agree with our proposal to upgrade the General Disclosure for each Aspect of the ESG Guide to “comply or explain”?
- Yes.
 - We agree with the proposal to upgrade the General Disclosure for each Aspect of the ESG Guide to “comply or explain”.
10. Do you agree with the proposed amendments to the wording of paragraph (b) under current Aspects A1, A2, A4, B1, C2 and C3, re-numbered Aspects A1, B1, B2, B4, B6 and B7, as discussed in paragraphs 103 and 104?
- Yes.
 - We agree with the proposed amendments to the wording of paragraph (b) under current Aspects A1, A2, A4, B1, C2 and C3, re-numbered Aspects A1, B1, B2, B4, B6 and B7, as discussed in paragraphs 103 and 104.
11. Do you agree with our proposal to revise Aspect A1 by upgrading to “comply or explain” the current KPIs B1.1, B1.2, B1.4 and B1.5, re-numbered KPIs A1.1, A1.2, A1.4 and A1.5, as discussed in paragraphs 109 to 114, and 117 and 118?
- Yes.
 - We agree with the proposal to revise Aspect A1 by upgrading to “comply or explain” the current KPIs B1.1, B1.2, B1.4 and B1.5, re-numbered KPIs A1.1, A1.2, A1.4 and A1.5, as discussed in paragraphs 109 to 114, and 117 and 118.
12. Do you agree with our proposal to upgrade to “comply and explain” the current KPIs B1.3 and B1.6, re-numbered KPIs A1.3 and A1.6, as discussed in paragraph 119?
- Upgrading the disclosure obligations on hazardous waste is a controversial issue.
 - Referring to paragraph 119, we agree that hazardous waste is only a material issue for certain types of industry, and a ‘comply or explain’ principle, with the flexibility it provides, can demonstrate its effect by subjecting the matter to a ‘reasonable test’ by investors.
 - As such, we agree with the proposal to upgrade to “comply and explain” the current KPIs B1.3 and B1.6, re-numbered KPIs A1.3 and A1.6, as discussed in paragraph 119.
 - The opponents’ argument that it is difficult for companies to identify and separate hazardous waste from non-hazardous waste is not a valid argument because the negative environmental and social impact could be disastrous and the consequences irreversible.

13. Do you agree with our proposal to upgrade to “comply or explain” the KPIs under the current Aspect B2, re-numbered Aspect A2 as discussed in paragraphs 120 to 122?
- Yes.
 - We agree with the proposal to upgrade to “comply or explain” the KPIs under the current Aspect B2, re-numbered Aspect A2 as discussed in paragraphs 120 to 122.
14. Do you agree with our proposal to upgrade to “comply or explain” the current KPI B3.1, re-numbered KPI A3.1, as discussed in paragraphs 123 to 125?
- Yes.
 - We agree with the proposal to upgrade to “comply or explain” the current KPI B3.1, re-numbered KPI A3.1, as discussed in paragraphs 123 to 125.
15. Do you agree with our proposal to incorporate gender disclosure in Subject Area B under the sub-heading “Employment and Labour Standards”?
- Yes.
 - We agree with the proposal to incorporate gender disclosure in Subject Area B under the sub-heading “Employment and Labour Standards”.
 - In addition, we propose that the wordings ‘Total workforce by gender, employment type, age group and geographical regions’ can be strengthened to ‘Total workforce by gender, **ethnicity**, employment type, age group and geographical regions’.
 - We also recommend that the issuer provides a breakdown of gender diversity at director and senior manager levels. A consultation paper ‘Closing the Gender Pay Gap’ by the UK Government Equalities Office launched on 14 July 2015 provides some thought-provoking topics for discussion.
 - We understand that providing gender pay disparity information may be too demanding at this point, but it is a disclosure objective that we wish to achieve with our engaged issuers in Hong Kong over time.

In addition to your above questions, we propose that for Recommended Disclosures under Aspect B8: Community Investment, KPI B8.1 and B8.2 should also include the objective of the investment or involvement with community, the intended outcomes, measurement methods and the impact of contribution.