

Our Ref
Your Ref
Direct Tel
Direct Fax
E-Mail
Date

[REDACTED]
[REDACTED]
18 September 2015



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

Information Request for the Consultation Paper on Review of the Environmental, Social and Governance (ESG) Reporting Guide

Legal & General Investment Management (LGIM) is one of the largest investors in the UK with £715 billion of assets under management (as at June 2015). We are also growing internationally having established an office in Hong Kong in 2013.

We welcome the opportunity to provide the Hong Kong Stock Exchange (HKEx) with information regarding our expectations for the content and structure of the proposed ESG Guide.

As a long-term shareholder in Hong Kong listed companies we want to ensure that the integrity of the market is strengthened and standards are upheld in order to maintain its long term attractiveness to global capital.

Reporting on non-financial issues that are material to the issuer are important as it provides investors with a more comprehensive view of the issuer's performance in terms of financial and non-financial information. It is also an important element in the management of our investments, providing a basis for engagements with issuers to influence better practices.

There are six main areas which we feel warrant attention:

1. Materiality

Issuers should identify the ESG issues that are most material to their business and highlight them in their annual reports. This information is crucial for investors in understanding the ESG risks posed to the business and is a key determinant in the issuer's long-term performance.

2. ESG report timing of release date

The ESG report should be published at the same time as the annual report. It adds we will also expect key elements of the ESG report to be integrated in the annual report.

3. Integrated reporting

According to the International Integrated Reporting Council, an "Integrated Report" is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term.

As Hong Kong issuers may only just be starting with ESG reporting, integrated reporting may seem too ambitious. However, issuers should be incentivised to move in the direction of integrated reporting with the HKEx otherwise separate ESG reports would be published too far beyond the end of the fiscal year and become irrelevant.

4. **Comply or explain monitoring**

Due to the flexible nature of “comply or explain”, issuers should provide meaningful explanations if they cannot comply and state specific action plans to ensure they do comply in future. The exchange should put in place a monitoring process, whereby failure to adequately explain non-compliance leads to consequences.

5. **Recommended disclosures to be upgraded**

The requirement for “comply or explain” should apply to all *Aspects* of the guide as only doing so in particular *Aspects* would favour some issuers. As it has been recommended to introduce these requirements gradually to the market, the general disclosures act as guidelines so issuers must only comply where it is relevant for their business.

6. **The use of global reporting standards**

The proposed guide should align the key performance indicators (KPIs) with those already established in international guidelines such as the Global Reporting Initiative, Carbon Disclosure Project and ISO 26000 as much as possible.

Lastly, we would also like to refer you to the ACGA’s response to the consultation paper where we also fed through our views. We provide our own response as it builds on the ACGA’s answers in some questions.

Our submission to the questions in the information request follows this letter. We are available to discuss any of the issues highlighted in this submission.

Yours sincerely

A solid black rectangular box used to redact the signature of the sender.

Meryam Omi
Head of Sustainability

**RESPONSE TO CONSULTATION PAPER ON REVIEW OF THE ENVIRONMENTAL, SOCIAL
AND GOVERNANCE REPORTING GUIDE**

Question 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.

We agree with the proposal to upgrade provisions in the ESG Guide to “comply or explain”.

However, we disagree with the wording and level of expectation signalled by rule 13.91. We believe that issuers should be held to a mandatory requirement to disclose information in their annual reports (further explanation in question 3) and believe that the proposal to upgrade some of the sections in the ESG Guide and not others is unreasonable (further explanation in question 9).

Also, in the event that issuers are unable or do not think it is relevant to comply with general disclosures, it is critical that they provide meaningful explanations about why they cannot comply. They should state why it is not relevant for them to comply or if it is relevant, then state specific plans about when and how they intend to change this.

We recommend that the exchange should also have a monitoring process to review the guidelines and whereby issuers may suffer consequences for failing to reply adequately.

Question 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.

Incorporating the issuer’s material ESG issues and performance on metrics into annual reports alongside financial statements provides investors with a clearer view of the issuer’s performance, in terms of both financial and non-financial information. It also allows comparisons between issuers on their business strategy and allows auditors to check whether data is accurate.

We believe that issuers should be encouraged to work through the process of considering the issues that are most financially material as they are the ones with the best understanding of the characteristics and challenges of their business. They should then outline these main issues in their annual reports, identifying KPIs to measure their performance on these issues. If investors require a more comprehensive overview that includes ESG issues that are not necessarily material they can follow up with the issuer at a later date.

Question 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?

Yes.

Refer to ACGA.

We would also like to add that supplementary information can be included on the website. This should be easy to access and included in the investor relations section. Again, the issuer should be aiming to highlight the key issues relevant to their business and identify KPIs to measure performance against the ESG issues they face.

Question 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?

See below in “box 1” for some suggested comments on the introductory section of the proposed new guide.

Comments on the introduction of the proposed new guide

Box 1: The Guide

1. This Guide comprises two levels of disclosure obligations: (a) “comply or explain” provisions; and (b) recommended disclosures.

2. An issuer must report on the “comply or explain” provisions of this Guide. If the issuer does not report on one or more of these provisions, it must provide reasons in its ESG report. The issuer is encouraged, but not required, to report on the recommended disclosures of this Guide.

SUGGESTION: *“If the issuer does not report on one or more of these provisions, it must provide meaningful reasons in its ESG report.”*

3. An issuer must disclose ESG information on an annual basis and regarding the same period covered in its annual report. An ESG report may be presented as information in the issuer’s annual report, in a separate report, or on the issuer’s website. Whichever format is adopted, the ESG report should be published on the Exchange’s website and the issuer’s website. Where not presented in the issuer’s annual report, the issuer should publish this information as close as possible to, and in any event no later than three months after, the publication of the issuer’s annual report.

SUGGESTION: *“It is recommended that the reports are posted on the investor relations section of the website.”*

Box 2: Overall Approach

4. This Guide is organised into two ESG subject areas (“Subject Areas”): Environmental (Subject Area A) and Social (Subject Area B). Corporate Governance is addressed separately in Appendix 14 of the Main Board Listing Rules.

5. Each Subject Area has various aspects (“Aspects”). Each Aspect sets out general disclosures (“General Disclosures”) and (“KPIs”) for issuers to report on in order to demonstrate how they have performed.

6. In addition to the “comply or explain” matters set out in this Guide, the Exchange encourages an issuer to identify and disclose additional ESG issues and KPIs, including recommended disclosures that reflect the issuer’s significant environmental and social impacts; or substantially influence the assessments and decisions of stakeholders. In assessing these matters the issuer should engage stakeholders on an on-going basis in order to understand their views and better meet their expectations.

7. This Guide is not comprehensive and the issuer may refer to existing international ESG reporting guidance for its relevant industry or sector. The issuer may adopt international ESG reporting guidance so long as it includes comparable disclosure provisions to the “comply or explain” provisions set out in this Guide. The issuer may also consider obtaining assurance on its ESG report.

SUGGESTION: *“Name the additional reporting guidance tools that issuers could consult with: the Global Reporting Initiative (“GRI”), Carbon Disclosure Project (“CDP”), International Organization for Standardization (“ISO”) 26000 or Dow Jones Sustainability Indices (“DJSI”)”*

Box 3: ESG strategy and reporting

8. The board has overall responsibility for an issuer’s ESG strategy and reporting.

9. In line with the Corporate Governance Code, the board is responsible for evaluating and determining the issuer’s ESG-related risks, and ensuring that appropriate and effective ESG risk management and internal control systems are in place. Management should provide a confirmation to the board on the effectiveness of these systems.

10. The ESG report should state the issuer’s ESG management approach, strategy, priorities and objectives and explain how they relate to its business. It would be useful to discuss the issuer’s management, measurement and monitoring system employed to implement its ESG strategy. An ESG report should also state which entities in the issuer’s group and/or which operations have been included in the report. If there is a change in the scope, the issuer should explain the difference and reason for the change.

SUGGESTION: *“They should also provide analysis on the risks and opportunities that impact them in the present as well as what may impact them in the future. Action plans to deal with these issues should be disclosed.”*

Question 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?

Yes.

We agree with the inclusion of these four principles as being key areas to influence how information is presented.

However, we do not agree fully with their wording. The HKEx states that the reporting principle

“materiality” is the threshold at which ESG issues become sufficiently important to investors and other stakeholders that they should be reported. It is necessary that issuers be encouraged to first focus on what they believe as being most material as this is a key determinant in ensuring the ongoing success of their business in future. They are also in the best position to understand the challenges the business faces as well as forming risk management solutions and implementing control systems.

It is important for the HKEx to enforce the highest standards, which will impact the quality of disclosures and help to avoid boiler plate statements. In addition, this will be beneficial to investors in judging performance and for issuers to identify core challenges to shape their long-term strategy. Most critically, we urge that the wording for the 2nd principle “quantitative” should change to be more forceful i.e. targets **should or must** be set to reduce a particular impact.

Question 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 with the proposal to link the Guide with Appendix 16. We would however, urge the HKEx to consider making some adjustments to the wording (underlined below).

(ii) a discussion of the issuer’s compliance with the relevant laws and regulations that **have had or are likely to have** a significant impact on the issuer.

(iii) an account of issuer’s key relationships (**and how they monitor and manage those relationships**) with its employees, customers and suppliers and others that have a significant impact on the issuer and on which the issuer’s success depends.

Question 7: Do you 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?

Yes.

Refer to ACGA’s response.

Question 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.

Question 9: Upgrading General Disclosures to comply or explain Do you agree with our proposal to upgrade the General Disclosures for each Aspect of the ESG Guide to “comply or explain”?

Yes.

However, we noted that the proposal is to only upgrade KPIs for *Aspect A* to “comply or explain” rather than for both *Aspects A and B*. Despite the exchange’s concern in placing a burden on issuers, we believe that they are given the opportunity to explain in instances where they are unable to comply.

We do not believe that the environmental and social *Aspects* of the Guide should be given different levels of importance with respect to materiality. This is because sectors differ considerably in both their impact as well as exposure to environmental and social risks.

To demonstrate this point more clearly in the case of the Guide, KPI A2.1 calls for information on direct and/or indirect energy consumption by type (e.g. electricity, gas or oil) in total (kwh in 000s). This is generally a highly material issue for the oil and gas sector, but it may not be an issue of

such high importance for the pharmaceutical sector. Whereas KPI B6.1 calls for information on the percentage of total products sold or shipped subject to recalls for safety and health reasons. This is generally a highly material issue for the pharmaceutical sector.

By placing different reporting requirements on the social and environmental *Aspects*, this puts different expectations on issuers across sectors and could result in issuers being able to report according to different expectations.

Question 10: Wording of Aspects Do you agree with the proposed amendments to the wording of paragraph (b) [relevant laws and regulations that have a significant impact on the issuer] 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 to 104?

Yes.

Refer to ACGA's response.

Question 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 to 118?

Yes.

However, KPI A1.5 perhaps relies too much on how the issuer has mitigated its historic impact, and could also include more specific wording about targets that they are committed to.

For example, from a global perspective this is especially important for the supermajors, where recently a clear distinction has formed between those issuers that have a forward looking approach and have adopted quantitative goals for reducing greenhouse gas emissions and establishing plans to transition to lower carbon fuels and those that have not.

Question 12: Do you agree with our proposal to upgrade to “comply or explain” the current KPIs B1.3 and B1.6, re-numbered KPIs A1.3 and A1.6, as discussed in paragraph 119?

Yes.

Refer to ACGA's response.

Question 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?

In *Aspect A2*, there is a requirement for issuers to report on the level of water consumption, but there is no requirement both for disclosing the level of water reduction already achieved and establishing future reduction targets. This could be worded in the following format:

- a) What level of reduction in water consumption has been achieved in your operations year on year?
- b) What targets do you have in place to reduce water consumption in the future?

Question 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.

However, there are concerns over whether this KPI would lead to the use of boiler plate language as it calls for a descriptive answer and the term “significant impacts” may be interpreted ambiguously. *Aspect A2* has also already addressed the consumption of resources. The KPI should be more focused and ask for a description of the impacts that the issuer considers most material and what is being done to manage and mitigate those issues. Measurement of efforts to

mitigate these issues in quantitative terms is also highly recommended (as highlighted in question 11).

Question 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 believe that gender disclosure should be incorporated into the ESG Guide as it is an area adopted by most international ESG reporting standards like the GRI, but the HKEx is encouraged to upgrade this KPI to “comply or explain” (as discussed in question 9).

Appendix 14 already addresses gender diversity at the board level. However, since it only requires issuers to disclose a general policy relating to gender diversity, the ESG guide is advised to consider including a meaningful KPI that addresses whether an issuer’s policy encourages the promotion or active participation of women throughout the workforce. There should also be a clear level of transparency and disclosure on the steps that need to be taken by the issuer to achieve this target.

The HKEx is also encouraged to consider including other forms of diversity as part of this KPI, for example minority groups, in accordance with international standards like the GRI.