The Stock Exchange of Hong Kong Limited: Consultation Paper on Enhancement of Climate Related Disclosures under the ESG Framework
Respondent: Financial Services Research Group
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The Financial Services Research Group ("FSRG") is pleased to make this submission to the Stock Exchange of Hong Kong Limited (the "Exchange") in response to its Consultation Paper on Enhancement of Climate Related Disclosures under the ESG Framework ("Consultation Paper", together with brief additional comments. FSRG's remarks are based on discussions with the members of our internal Expert Groups and other market participants. We do not address every consultation question in detail, but focus on key areas and crosscutting themes.

Introduction

As a frontline regulator of more than 2,600 listed companies, the Exchange plays an important role in ensuring that the information requirements of investors are met. The Exchange also has a role in encouraging stronger environmental, social and governance ("ESG") and sustainability performance by listed companies. It carries out this role through listing regulation, advocacy and education.

Since the introduction of the ESG reporting framework in 2013, the Exchange has made a number of enhancements to the ESG reporting regime, including the incorporation of key elements of the Financial Stability Board's Task Force on Climate Related Financial Disclosures ("TCFD") recommendations in 2020. Its currently proposed mandatory disclosures are based on the draft of the climate related disclosure standards originally issued by the International Sustainability Standards Board ("ISSB") in March 2022, and subject to further discussions until April 2023. The ISSB standards, which have subsequently been finalised and issued, were developed based on the four core pillars of the TCFD recommendations: governance, strategy, risk management and metrics and targets.

We support the Exchange's efforts to emphasise consistency in the ongoing development of its reporting framework, with the TCFD recommendations and the largely aligned ISSB standards at its core, but have a number of concerns with regard to implementation in the Hong Kong market, which are highlighted below.

1. Do you agree to upgrade climate related disclosures to mandatory from "comply or explain" ?

We agree that some climate related disclosures should be upgraded to mandatory from "comply or explain". Investors are beginning to require more consistent, comparable and reliable disclosures on climate related issues to guide their investment and voting decisions. Hong Kong, as an international financial centre, should seek to satisfy this demand.

There is an argument for strong alignment with the ISSB standards, which will allow companies and investors around world to utilise a single, global baseline of sustainability disclosures for the capital markets, ensuring better consistency and comparability across borders. The ISSB's work has received strong support from investors, companies, policy makers and market regulators globally, including the Financial Stability Board, International Organisation of Securities Commissions, the G20 and the G7.

However, the new regime represents a significant increase in the disclosure requirements placed upon listed issuers in Hong Kong. Some of the information demanded involves a high degree of uncertainty and requires issuers to make estimations and predictions of the future. Issuers will also need to collect data from third parties, such as suppliers or customers, over whom they have no control, and to analyse data from multiple jurisdictions in which they operate.

Not all issuers will have the skills, experience or financial resources to adapt easily to the new regime. The Interim Period proposed by the Exchange is short relative to the additional burden on issuers which will need to put in place new procedures and systems for the collection and analysis of data, and we suggest that this period be extended.

2. Do you agree to introduce new governance disclosures focusing on climate related issues as set out in paragraph 1 of Part D of the Proposed Appendix 27 ?

We agree with the new governance disclosures, which are a reasonable extension of the existing requirements to disclose board oversight and governance of ESG issues.

3. Do you agree to require disclosure of climate related risks as set out in paragraph 2 of Part D of the Proposed Appendix 27 ?

We agree that disclosure of climate related risks is important for investors. Depending on the industry sector, location and operating parameters, specific risks will vary widely, so the focus should be on the identification of climate related risks that are material to an individual issuer's business model, strategy and cash flows.

We question whether all issuers have the skills, experience or access to data to allow them to disclose in detail according to all the issues raised in paragraph 2. In particular, many may not be in a position to make predictions of how climate risks may evolve over the medium or long term. We would also like to clarify if the disclosures under paragraph 2 can be entirely qualitative.

4. Do you agree that issuers may opt to disclose the actual and potential effects of climate related opportunities they may have identified in response to climate related risks disclosed as set out in paragraph 3 of Part D of the Proposed Appendix 27 ?

We agree that issuers should be able to choose whether to disclose actual and potential climate related opportunities, as not all issuers may have identified such opportunities.

5. Do you agree that an issuer shall consider the applicability of and disclose the metrics when assessing and making disclosure of climate related risks and opportunities as set out in paragraph 4 of Part D of the Proposed Appendix 27 ?

We would like to clarify if the disclosures under paragraph 2 can be entirely qualitative. See response to question 3 above.

6. Do you agree to require disclosure of how the issuer is responding to climate related risks and, where an issuer chooses to, any climate related opportunities as set out in paragraph 5 of Part D of the Proposed Appendix 27 ?

See response to question 3 above.

7. Do you agree to require disclosure of climate related targets set by the issuer as set out in paragraph 6 of Part D of the Proposed Appendix 27 ?

We agree that an issuer should disclose any climate related targets it has set and any emissions targets it is required to meet by local legislation.

8. Do you agree that where an issuer has yet to disclose climate related targets, it should make alternative disclosures as set out in note 2 to paragraph 6 of Part D of the Proposed Appendix 27 ?

Many listed issuers do not currently have a work plan or a timetable for setting climate related targets, especially if climate related risks are not material to their businesses. It is unduly onerous, therefore, to require them to disclose this supplementary information.

9. Do you agree to require disclosure of progress made in the most recent reporting year in respect of plans disclosed as set out in paragraph 7 of Part D of the Proposed Appendix 27 ?

See response to question 8 above.

10. Do you agree to require discussion of the issuer's climate resilience as set out in paragraph 8 of Part D of the Proposed Appendix 27 ?

We would like to clarify if the disclosures under paragraph 8 can be entirely qualitative.

11. Do you agree to require issuers to apply a climate related scenario analysis that is commensurate with the issuer's circumstances, and to require disclosure of information on climate related scenario analysis as set out in paragraph 9 of Part D of the Proposed Appendix 27 ?

We suggest that not all issuers have the skills, experience or access to data to carry out climate related scenario analysis, and we welcome the flexibility in paragraph 86 of the Consultation Paper. We would like to clarify the time period during which issuers are expected to move from qualitative to quantitative analysis. We would also like to clarify whether flexibility will continue to be extended to those issuers for which climate related risks are not material.

12. Do you agree to require disclosure of the current financial effects of climate related risks, and where applicable, climate related opportunities as set out in paragraph 10 of Part D of the Proposed Appendix 27 ?

We suggest that not all issuers have the skills, experience or access to data to assess impacts of the climate related risks on its financial position, especially over the medium or long term. This requirement seems unduly onerous for issuers for which climate related risks are not material.

13. Do you agree that during the Interim Period, where an issuer has yet to provide quantitative disclosures pursuant to paragraph 10(a) of Part D of the Proposed Appendix 27, it should make the interim disclosures as set out in the paragraph immediately following paragraph 10 of Part D of the Proposed Appendix 27 ?

We welcome the flexibility to provide qualitative disclosure during the Interim Period, and suggest that this should be maintained subsequently for issuers for which climate related risks are not material.

14. Do you agree to require disclosure of anticipated financial effects of climate related risks and, where applicable, climate related opportunities as set out in paragraph 11 of Part D of the Proposed Appendix 27 ?

We suggest that not all issuers have the skills, experience or access to data to disclose the anticipated effects of climate related risks on their financials. Even qualitative disclosure on anticipated future risks is challenging, given that this will be dependent on assumptions and projections which may not be reliable. We suggest that the Exchange give more guidance to issuers on how to gather and analyse reasonable data, without needing to expend undue costs and resources, and to draft this disclosure.

15. Do you agree that during the Interim Period, where an issuer has yet to provide information required in paragraph 11 of Part D of the Proposed Appendix 27, it should make the interim disclosures as set out in the paragraph immediately following paragraph 11 of Part D of the Proposed Appendix 27 ?

We welcome the flexibility to provide more limited qualitative disclosure during the Interim Period, and suggest that this should be maintained subsequently for issuers for which climate related risks are not material.

16. Do you agree to require disclosure of the process an issuer uses to identify, assess and manage climate related risks as set out in paragraph 12(a) of Part D of the Proposed Appendix 27 ?

We agree that disclosure of climate related risk management is important for investors.

17. Do you agree that issuers may opt to disclose the process used to identify, assess and manage climate related opportunities as set out in paragraph 12(b) of Part D of the Proposed Appendix 27 ?

We agree that issuers should be able to choose whether to disclose how they manage climate related opportunities, as not all issuers may have identified such opportunities.

18 (a). Do you agree with the proposed approach for the disclosure of scope 1 and scope 2 emissions and the related information as set out in paragraphs 13 to 14 of Part D of the Proposed Appendix 27 ?

We agree with the proposed approach. Disclosure of scope 1 and scope 2 emissions has been required by the Exchange on a "comply or explain" basis since 2016, and we understand that many issuers are familiar with this process already.

18 (b). Do you agree with the proposed approach for the disclosure of scope 3 emissions and the related information as set out in paragraphs 13 to 15 of Part D of the Proposed Appendix 27 ?

We suggest that a significant number of issuers do not have the skills, experience or access to data to report on their scope 3 emissions currently. There are practical difficulties in collecting data from upstream or downstream parties in the value chain over which they have no control. We suggest that the Exchange extend the time period during which companies can put in place processes, collect data and fully prepare for disclosure of scope 3 emissions.

19. Do you agree with the proposed approach for the interim disclosures in respect of scope 3 emissions during the Interim Period as set out in the paragraph immediately following paragraph 15 of Part D of the Proposed Appendix 27 ?

We welcome the flexibility in the Interim Period, but suggest that the period be extended. See response to question 18 (b) above.

20 (a). Do you agree to require disclosure of the amount and percentage of assets or business activities vulnerable to transition risks as set out in paragraph 16 of Part D of the Proposed Appendix 27 ?

We suggest that not all issuers have the skills, experience or access to data to assess the amount and percentage of assets or business activities vulnerable to transition risks. This requirement seems unduly onerous for issuers for which climate related risks are not material.

20 (b). Do you agree with the proposed interim disclosures during the Interim Period in respect of the metric regarding transition risks as set out in the paragraph immediately following paragraph 16 of Part D of the Proposed Appendix 27 ?

We welcome the flexibility in the Interim Period, and suggest that this should be maintained subsequently for issuers for which climate related risks are not material.

21 (a). Do you agree to require disclosure of the amount and percentage of assets or business activities vulnerable to physical risks as set out in paragraph 17 of Part D of the Proposed Appendix 27 ?

We suggest that not all issuers have the skills, experience or access to data to assess the amount and percentage of assets or business activities vulnerable to physical risks. This requirement seems unduly onerous for issuers for which climate related risks are not material.

21 (b). Do you agree with the proposed interim disclosures during the Interim Period in respect of the metric regarding physical risks as set out in the paragraph immediately following paragraph 17 of Part D of the Proposed Appendix 27 ?

We welcome the flexibility in the Interim Period, and suggest that this should be maintained subsequently for issuers for which climate related risks are not material.

22 (a). Do you agree to require disclosure of the amount and percentage of assets or business activities aligned with climate related opportunities as set out in paragraph 18 of Part D of the Proposed Appendix 27 ?

As stated in the Consultation Paper, not all issuers may have identified climate related opportunities so this requirement will not be applicable to them.

22 (b). Do you agree with the proposed interim disclosures during the Interim Period in respect of metrics regarding climate related opportunities as set out in the paragraph immediately following paragraph 18 of Part D of the Proposed Appendix 27 ?

See response to question 22 (a) above.

23 (a). Do you agree to require disclosure of the amount of capital expenditure, financing or investment deployed towards climate related risks and opportunities as set out in paragraph 19 of Part D of the Proposed Appendix 27 ?

This requirement seems unduly onerous for issuers for which climate related risks and opportunities are not material.

23 (b). Do you agree with the proposed interim disclosures during the Interim Period in respect of the metric regarding capital deployment as set out in the paragraph immediately following paragraph 19 of Part D of the Proposed Appendix 27 ?

We welcome the flexibility in the Interim Period, and suggest that this should be maintained subsequently for issuers for which climate related risks are not material.

24. Do you agree that where an issuer maintains an internal carbon price, it should disclose the information as set out in paragraph 20 of Part D of the Proposed Appendix 27 ?

We agree with this disclosure.

25. Do you agree with the proposed approach for the disclosure of how climate related considerations are factored into remuneration policy as set out in paragraph 21 of Part D of the Proposed Appendix 27 ?

We would like to clarify whether a statement is required if climate related considerations are not factored into remuneration policy.

26. Do you agree with the proposed approach for the industry based disclosure requirements prescribed under other international ESG reporting frameworks such as the SASB Standards and the GRI Standards as set out in paragraph 22 of Part D of the Proposed Appendix 27 ?

We welcome the flexibility to allow issuers to make disclosures prescribed under other international ESG reporting frameworks as they see fit.

27. Do you have any comments regarding whether the manner in which the proposed consequential amendments are drafted will give rise to any ambiguities or unintended consequences ?

No comment.

28. Do you have any comments regarding the topics/matters that we intend to give guidance on ?

Many small to medium sized issuers do not have the financial resources to employ expensive consultants to help them with comprehensive ESG and climate disclosures. However, there is now a growing number of technology platforms providing services to issuers, including ESG reporting and climate disclosure, which are more affordable and often aimed specifically at smaller companies. Guidance from the Exchange that assists issuers to identify how these services could help them, and to evaluate the capabilities of the providers, could be very useful and help to raise the quality of disclosure by smaller companies.

29. Do you have any feedback on the new developments announced by the ISSB subsequent to the publication of this paper that may impact on the proposals in this paper ?

In May 2023, the ISSB launched an international consultation seeking feedback on its priorities for the coming two years, suggesting potential focus areas such as biodiversity, ecosystems and ecosystem services, human capital, human rights and integrating sustainability related disclosures into financial statements. It would be helpful to understand the corresponding priorities of the Exchange as it continues to develop its ESG disclosure regime.

Financial Services Research Group

The Financial Services Research Group ("FSRG") was established in 2021 by a group of financial services and business professionals to support the development of Hong Kong's financial markets and to accelerate Hong Kong's leadership in the rapidly evolving areas of global asset management, green finance and virtual assets. FSRG draws on the expertise of the local business and financial communities, together with international best practice and a deep understanding of global trends, to build on Hong Kong's premier position in the region, as well as identifying new opportunities for growth and competitive advantage.