November 2021

Analysis of IPO Applicants' Corporate Governance and ESG Practice Disclosure in 2020/2021

CONTENT

CHAPTER 1: EXECUTIVE SUMMARY

A. PURPOSE

1. There is a growing trend for investors factoring in corporate governance (“**CG”**) and environmental, social and governance (“**ESG**”) in their investment decisions. Investors’ assessment of an IPO applicant no longer only focuses on the business or financial performance but also on its governance and environmental and social activities.

2. It is therefore important for IPO applicants to take into serious consideration CG and ESG issues at an early stage, build the necessary mechanisms into the listing process and disclose such information in the prospectus. This has been emphasised in our training and guidance letter on prospectus disclosure[1] (“**IPO Guidance**”). The quality of disclosures and practice would affect investors’ perception and hence their evaluation of the IPO applicants.

3. The Stock Exchange of Hong Kong (“**Exchange**”) reviews listed issuers’ CG and ESG practices on a regular basis[2] to maintain the quality of our listed issuers and of our market. This review (“**Review**”) aims to enhance IPO applicants’ readiness for compliance with the Exchange’s CG/ESG requirements by providing guidance regarding prospectus disclosures and expected practice for meaningful and decision-useful information.

4. The Review focuses on new applicants (“**Applicants**”) seeking a primary listing on the Exchange between July 2020 and June 2021, totalling 121 Applicants[3]. We reviewed the Applicants’ practice on the following areas at the time of their IPO:

    (i) *Corporate governance:* board’s oversight and involvement (in particular the Applicants’ compliance culture), and the extent of independent non-executive director (“**INED**”) holding seven or more listed company directorships (“**Over-boarding INED**”)[4] (see Chapter 2);

    (ii) *Board diversity:* board diversity and policy, and commitments on how to achieve board gender diversity[5]. We also tracked the progress made post listing by single gender board issuers listed between July 2019 and December 2020 (“**Single Gender Board Issuers**”) by reviewing their CG reports[6] (see Chapter 3); and

    (iii) *ESG:* governance of ESG matters and disclosures on environmental and social issues[7], in light of the global direction towards developing a sustainable financial ecosystem (see Chapter 4).

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1 HKEX-GL86-16: https://en-rules.hkex.com.hk/rulebook/gl86-16.
2 The reports can be found at the following hyperlink: https://www.hkex.com.hk/Listing/Listed-Issuers/Exchange-Report?sc_lang=en.
3 See Appendix for the listing platform and sector distributions of these IPO applicants.
4 Since July 2020, the IPO Guidance requires disclosure of an applicant’s compliance culture, and why the board believes an Over-boarding INED would be able to devote sufficient time to the board.
5 Since May 2019, the IPO Guidance requires applicants with single gender boards to disclose how to achieve gender diversity of the board after listing.
6 Out of the 53 single gender board IPO applicants listed between July 2019 and December 2020 with measurable targets set, two have not published their first CG report as of 31 July 2021.
7 As of 31 July 2021, 101 Applicants published their first ESG reports after listing, and we further reviewed the ESG reports of 30 randomly selected Applicants.

B. OUR OBSERVATIONS AND RECOMMENDATIONS

Corporate Governance (Chapter 2)

Board's oversight and involvement (Part A)

5. We are delighted to see that all Applicants included the CG measures they had put in place as part of their risk management policies and procedures in their prospectuses. All Applicants confirmed whether there was any material impact non-compliance, and if there is, provided detailed disclosures on the non-compliance(s).

6. Around 23% of the Applicants further disclosed a statement on their compliance culture. Most Applicants appeared to have considered their compliance track record as their disclosure on compliance culture. While compliance with laws and regulations may be the product of a compliance culture (from a regulatory perspective), it is not conclusive of compliance culture and does not inform investors of the framework in which the company encourages a compliance culture. A comprehensive disclosure would include details regarding (i) the board's attitude or commitment towards lawful, ethical and responsible operation of the businesses; (ii) measures to ensure such culture is embedded in the organisation; and (iii) evaluation of the effectiveness of the measures in place.

Over-boarding INEDs (Part B)

7. Amongst the 363 INEDs on the boards of the Applicants, five (1.4%) were Over-boarding INEDs[8] at the time of listing. Excessive board commitments would affect an INED's ability to devote sufficient time and attentiveness to the company's affairs. In the past year, the Exchange has tightened its scrutiny of the explanations given by IPO applicants in respect of Over-boarding INEDs. Since June 2021, the Exchange has adopted a more stringent approach to request IPO applicants to consider replacing any Over-boarding INED and has not accepted any IPO applicants with an Over-boarding INED.

Board Diversity (Chapter 3)

Board diversity and policy (Part A)

8. All Applicants disclosed their board diversity policies, and elaborated on how they would review and evaluate such policies on a regular basis. Setting measureable objectives would facilitate progress evaluation and drive continuous scrutiny towards enhanced board diversity. This is also in line with the proposals in our latest CG consultation ("**2021 CG Consultation**")[9] to require issuers to conduct an annual review of their board diversity policy and set numerical targets and timelines regarding gender diversity.

9. Single gender board applicants are required to set targets in their prospectuses to achieve board gender diversity since May 2019[10]. We are delighted to see that the percentage of single gender board applicants dropped from 30% in 2019 to 21% in 2020, and further down to 12% in 1H 2021. IPO applicants should prioritise achieving board gender diversity, and should note that if the proposals in the 2021 CG Consultation are implemented, IPO applicants seeking a listing status in Hong Kong are not expected to have single gender boards.

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8 These five Over-boarding INEDs were holding a total of 41 listed company INED directorships.

9 HKEX, Consultation Paper on "Review of Corporate Governance Code and Related Listing Rules", 16 April 2021.

10 HKEX-GL86-16: https://en-rules.hkex.com.hk/rulebook/gl86-16.

Diversity progress of Single Gender Board Issuers (Part B)

10. Amongst the Single Gender Board Issuers with target deadlines lapsed, over 70% had appointed one woman director to their boards[11]. Of the remaining Single Gender Board Issuers with target deadlines not yet due, around one-sixth reached their targets ahead of their deadlines, and almost 30% voluntarily reported on their progress in their CG reports.

11. The board of an issuer should monitor and regularly evaluate the progress of achieving the commitments made in the prospectus, and make appropriate disclosure in their CG report. The Exchange will take follow-up actions if the undertakings or commitments made in the prospectus are not fulfilled. Explanations and considered reasons should be provided in the CG reports for any shortfall to diversity commitment.

ESG (Chapter 4)

Governance of ESG matters (Part A)

12. Around one-third of the Applicants disclosed in their prospectuses the board's oversight of ESG issues, and only a small number (11%) disclosed their materiality assessment in relation to ESG factors. Most Applicants identified none or few material ESG risks in their prospectuses, and disclosures were mainly regarding the impact of regulatory compliance.

13. In contrast, the Applicants' first ESG reports contained comprehensive details on the process used to identify ESG risks, information on material ESG risks and their impact on the businesses.

14. ESG risk management starts before listing. IPO applicants should conduct a thorough analysis and assessment to identify material ESG risks. Proper risk management would improve the company's resilience, and quality disclosures in the prospectus of the business impacts of material ESG risks and how they are managed are conducive to investors' evaluation of the company. It is important for IPO applicants to plan ahead before listing to implement the necessary measures to ensure future compliance.

Disclosures on specific environmental and social issues (Parts B and C)

15. Most Applicants made disclosures on environmental and social issues at IPO. Some Applicants considered the relevance of climate change to their business operations and strategy formation process, and a few Applicants made high quality disclosures that addressed physical and transition risks as a result of climate change. Some Applicants further provided meaningful disclosures on how their internal policies could align with a low-carbon economy.

[11] As of 31 July 2021.

16. Climate change and climate-related risks have attracted growing global concerns. Investors are demanding for decision-useful, climate-related information for capital allocation and investment decisions. Regulators have already stepped up their scrutiny of how businesses should respond to climate risks in joint efforts towards developing a common reporting standard that builds on the Task Force on Climate-related Financial Disclosures ("**TCFD**") framework[12]. IPO applicants should consider climate-related issues and make appropriate disclosures in their prospectuses (e.g. climate-change related issues oversight; assessment of climate-related risks and opportunities and impact on business, strategy and financial performance). IPO applicants may refer to our latest "Guidance on Climate Disclosures"[13] which guides our issuers in preparing TCFD-aligned disclosures.

17. Further to the carbon neutrality target to be achieved by 2050, the Hong Kong Government announced Hong Kong's Climate Action Plan 2050[14] in October 2021. To align with the decarbonisation targets, IPO applicants should also consider employing (and providing disclosures on) infrastructure and/or technology to reduce carbon emissions and control climate-related risks. Ongoing monitoring of the decarbonisation progress and engagement with stakeholders on climate transition strategy would support a smooth transition to a low-carbon economy.

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12 Making progress towards mandating climate-related disclosures aligned with the TCFD framework by 2025 across relevant sectors, the Hong Kong Green and Sustainable Finance Cross-Agency Steering Group announced its support towards the efforts by the International Sustainability Standards Board under the International Financial Reporting Standards Foundation to develop a new reporting standard which would be built on the TCFD framework in July 2021, and further expressed its support for the Hong Kong's Climate Action Plan 2050 (see footnote 14) in October 2021.

13 HKEX, Guidance on Climate Disclosures, 5 November 2021.

14 Hong Kong's Climate Action Plan 2050 sets out the vision of "Zero-carbon Emissions - Liveable City - Sustainable Development" and outlines the strategies and targets for combating climate change and achieving carbon neutrality. See the Climate Ready website (http://www.climateready.gov.hk/) and paragraphs 96 to 98 in the Chief Executive's 2021 Policy Address of the HKSAR Government.

CHAPTER 2: CORPORATE GOVERNANCE DISCLOSURE

A. BOARD'S OVERSIGHT AND INVOLVEMENT

18. Corporate governance defines the way a company is directed and controlled. Good governance is pivotal to the long-term success and sustainability of a business, and relies on effective board oversight in establishing a robust risk management system and nurturing a healthy corporate culture. Our review therefore focuses on the following disclosures in prospectuses[15]:

    (a) corporate governance measures (including board oversight); and

    (b) the applicant's compliance culture statement.

    Key observations

    (a) Corporate governance measures

19. All Applicants explained the CG measures they had put in place as part of their risk management policies and procedures, e.g. the management of conflicts of interest between the companies and their controlling shareholders.

20. We are pleased to note that a few Applicants have made comprehensive and detailed disclosures of their directors' commitment to and oversight of corporate governance, with clear division of roles and regular review of CG policies by the board of directors.

    (b) Statement on compliance culture

21. All Applicants confirmed whether there was any material impact non-compliance, and if there is, provided detailed disclosures on the non-compliance(s) such as enhancement of internal controls and implementation of rectification actions.

22. Around 23% of the Applicants further disclosed a statement on compliance culture in their prospectuses.

23. The IPO Guidance recommends that the statement on compliance culture be supported by '*measures and processes to ensure such culture is embedded into everyday workflow and set the expectations for individual behaviour across the organisation*' [16]. However, many disclosures on compliance culture appeared to comprise boilerplate statements, simply repeating the above from the IPO Guidance without setting out details of the measures and processes adopted.

[15] See paragraph 3.2 of "Business" section in the IPO Guidance.
[16] See paragraph 3.2 of "Business" section in the IPO Guidance.

Our comments and recommendations

(a) Corporate governance measures

24. Directors have a collective responsibility in overseeing CG matters and ensuring the companies are in compliance with the Corporate Governance Code upon listing[17]. IPO applicants should disclose details on the board's roles and accountability in corporate governance, which may cover the following:

(i) Oversight structure, e.g. any delegation to board committee(s) and reporting process;

(ii) Engagement of an external compliance advisor to provide guidance on the applicant's internal control systems; and/or

(iii) Mechanisms for monitoring implementation of CG measures on an ongoing basis and regular review of their effectiveness (e.g. at least annually).

25. Comprehensive disclosures on the oversight structure help potential investors understand the internal allocation of responsibilities and the check and balance put in place in respect of CG measures. Below are some examples for reference:

- A properties and construction company emphasised the board's responsibility in overseeing CG matters in its prospectus: '*[the board of directors] will be collectively responsible for the management and operations, including the establishment of such mechanisms. Our Directors will be involved in the formulation of the mechanisms and the related policies*.'

- A consumer goods operator demonstrated a clear division of roles between the board and the management in risk management and internal control systems: '*(o)ur directors are responsible for the establishment and updating of our internal control systems while our senior management monitors the daily implementation of internal control procedures and measures with respect to our subsidiaries and functional departments.*'

(b) Statement on compliance culture

26. Most Applicants appeared to have considered their compliance track record as their disclosure on compliance culture. While compliance with laws and regulations may be the product of a compliance culture (from a regulatory perspective), it is not conclusive of compliance culture and does not inform investors of the framework in which the company encourages a compliance culture. IPO applicants should seek to instil a strong corporate culture that fully adopts and prioritises compliance and governance measures of integrity to support the company's purpose and values, and provide a comprehensive disclosure that would include details regarding:

(i) the board's attitude or commitment towards lawful, ethical and responsible operation of the businesses;

(ii) measures to ensure such culture is embedded in the organisation; and

(iii) evaluation of the effectiveness of the measures in place.

[17] See paragraph 3.7 of "Business" section in the IPO Guidance.

27. While each company may have its own philosophy in cultivating and promoting its corporate culture, IPO applicants should include in the prospectus examples of the steps taken to embed the compliance culture into everyday workflow, in accordance with the IPO Guidance. These may include:

    (i) establishing a set of regulatory compliance policies and manuals governing individual behaviour across the organisation;

    (ii) setting up a dedicated committee or taskforce to supervise compliance matters and conduct internal compliance checks; and/or

    (iii) conducting regular compliance training for employees.

28. Below are some disclosures for reference:

    - A properties and construction operator disclosed that '*we regularly conduct internal compliance checks and inspections, adopt a rigorous internal accountability system and conduct regular and ad hoc compliance trainings for our employees*.'

    - An information technology company set up a dedicated committee to oversee compliance matters and established compliance policies: '*(w)e have compliance policies in place that clearly define the company's compliance requirements, including business ethics, vendor access and the acceptance and provision of travel and entertainment and gifts. We have also established an ethics committee under the oversight of the audit committee to supervise matters related to FCPA compliance. Our whistle blowing policy and the related reporting mechanism provide a confidential and protected channel for reporting suspected compliance violations. Regardless of position or location, we require all [employees] to comply with our anti-corruption compliance policies and attend related trainings to embrace the highest standard on integrity.*'

    - A logistics services company also provided compliance training to employees and offered sufficient formal channels for reporting and following up complaints: '*(w)e require our employees to follow our employee manual and these policies. We also carry out regulatory on-the-job compliance training to our management and employees to maintain a corporate compliance culture and enhance their compliance perception and responsibility. We have a number of channels for reporting of misconducts or wrongdoings within our network, including a whistleblowing letter box, the [president's] mailbox and 24/7 [complaint] hotlines.*'

B. OVER-BOARDING INEDS

29. It is important for IPO applicants to ensure that each director can give sufficient time and attention to the applicants' affairs[18]. IPO applicants with Over-boarding INED(s) on their boards are required under the IPO Guidance[19] to disclose in their prospectuses why their boards believe that the Over-boarding INED(s) would be able to devote sufficient time to discharge their responsibilities at the board of the applicant.

Key observations

30. We identified five (1.4%) Over-boarding INEDs amongst the 363 INEDs on the Applicants' boards at the time of listing. These five Over-boarding INEDs were holding a total of 41 listed company INED directorships. Amongst the seven Applicants with Over-boarding INEDs, most of them were listed in 2020.

Our comments and recommendations

31. INEDs holding excessive directorships may not be able to dedicate sufficient time to each of their boards, as their board responsibilities in aggregate are increasing. The decrease in the number of Applicants with Over-boarding INEDs reflects the Exchange's tightened scrutiny of the explanations given by IPO applicants in respect of Over-boarding INEDs in the past year. Since June 2021, the Exchange has adopted a more stringent approach to request IPO applicants to consider replacing any Over-boarding INED and has not accepted any IPO applicants with an Over-boarding INED.

[18] See paragraph 3.7 of "Directors, Supervisors and Senior Management" section in the IPO Guidance.
[19] See paragraph 3.8 of "Directors, Supervisors and Senior Management" section in the IPO Guidance.

CHAPTER 3: BOARD DIVERSITY

A. BOARD DIVERSITY AND POLICY

32. Diversity of the board is often regarded as a driver of good governance which could raise board quality, enable better decision-making and add value to the long-term success of the business. IPO applicants are encouraged to incorporate diversity in their board composition.

33. Under the IPO Guidance, IPO applicants should disclose a policy on board diversity (including gender) in their prospectuses[20].

34. Since May 2019, an applicant with a single gender board is further required by the IPO Guidance[21] to disclose and explain in its prospectus:

(a) how and when gender diversity of the board will be achieved after listing;

(b) what measurable objectives it has set for implementing gender diversity; and

(c) what measures the applicant has adopted to develop a pipeline of potential successors to the board that could ensure gender diversity of the board.

Key observations

(a) <u>Board diversity policy</u>

35. We are pleased to note that all Applicants disclosed their board diversity policies, and the systems and/or mechanisms put in place to regularly review and refresh their board diversity policies.

36. The key areas of their disclosures are summarised in Chart 1 below:

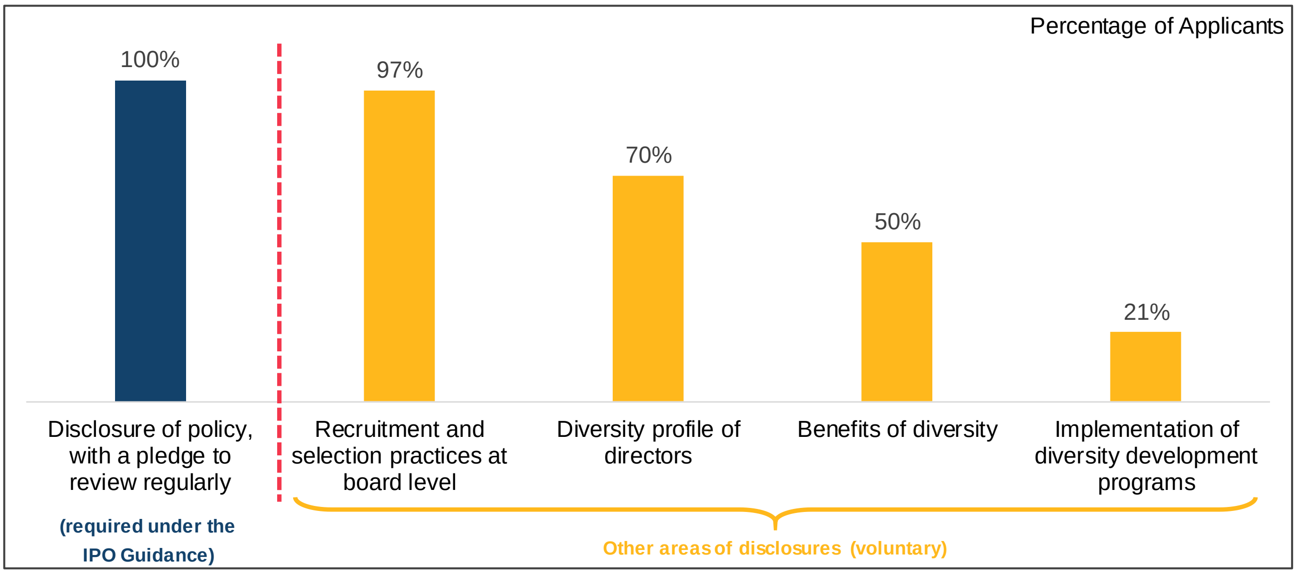

Chart 1: Key areas of disclosures on board diversity policies

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20 See paragraph 3.5 of "Directors, Supervisors and Senior Management" section in the IPO Guidance.
21 See paragraph 3.6 of "Directors, Supervisors and Senior Management" section in the IPO Guidance.

(b) Commitment in prospectus

37. We are delighted to see the percentage of single gender board applicants dropped from 30% in 2019 to 21% in 2020, and further down to 12% in 1H 2021.

38. Out of the 121 Applicants, 20 (17%) were with single gender (all-male) boards at the time of listing. We are pleased to note that they all disclosed how and when gender diversity would be achieved after listing in accordance with the IPO Guidance, with noticeable shorter target deadlines set (see Chart 2 below).

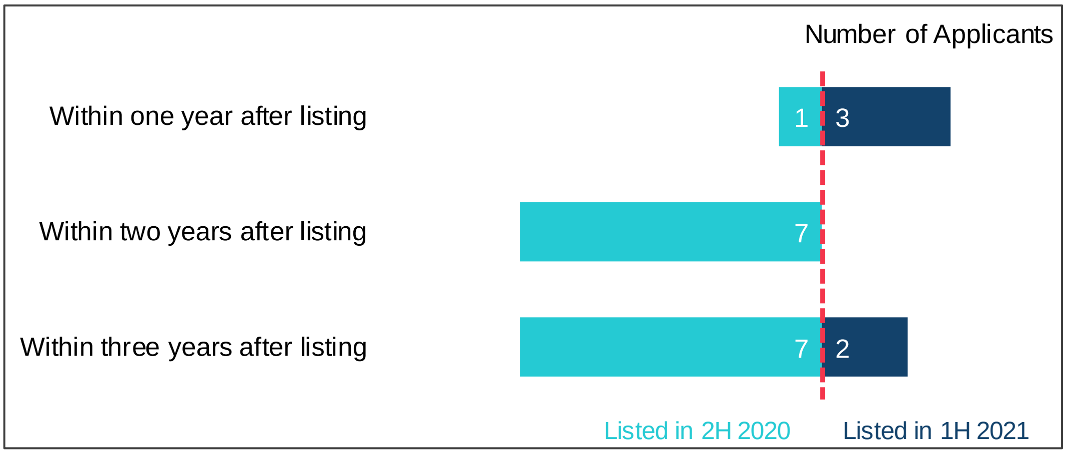

Chart 2: Target timelines for Applicants with single gender boards to achieve better board diversity

Our comments and recommendations

(a) Board diversity policy

39. The board's responsibility does not end with having a policy in place. As board composition and circumstances may change over time, it is important for IPO applicants have systems and/or mechanisms in place to continually evaluate the appropriateness and effectiveness of their board diversity policies from time to time after listing. Setting measureable objectives would facilitate progress evaluation and drive continuous scrutiny towards enhanced board diversity. This is in line with the proposals in the 2021 CG Consultation[22] to require issuers to conduct annual review of board diversity policy and set numerical targets and timelines regarding gender diversity.

22 See footnote 9.

40. To demonstrate the board's effectiveness and diversity commitment, IPO applicants may consider including the following aspects in their disclosures:

(i) benefits of board diversity and the importance of being able to attract, retain and motivate employees from the widest possible pool of available talent;

(ii) board diversity profile (including gender balance of the directors) for aligning directors' diverse competencies and perspectives with the company's strategy, and the progress in achieving any diversity objective(s) set;

(iii) recruitment and selection practices at board level, in particular process to ensure that a diverse range of candidates are considered; and

(iv) any talent development programme(s) across all levels within the company.

41. It is beneficial for IPO applicants to implement programmes for developing a broad and diverse pool of skilled and experienced employees (encompassing gender diversity) and that, in time, such diversity will be able to prepare them for more senior positions including board positions. For example:

- An industrial goods operator disclosed in its board diversity policy that the company was committed to '*providing career development and training opportunities for female staff whom we consider have the suitable experience, skills and knowledge with an aim to promote them to senior management members or directors*.'

(b) <u>Commitment in prospectus</u>

42. Diversity is an important driver of board's effectiveness, brings unique perspectives to the boardroom and enhances board performance. To further promote gender diversity within the boardroom, we propose in the 2021 CG Consultation[23] to highlight that diversity is not considered to be achieved by a single gender board. If the proposal is implemented, IPO applicants seeking a listing status in Hong Kong are not expected to have single gender boards.

43. IPO applicants should prioritise achieving board gender diversity and should adopt a more proactive approach in recruiting female directors to their boards.

44. It is highly encouraging to see a number of applicants striving to enhance board diversity by increasing the percentage of women representation on board. Several Applicants which already have at least one woman on their boards committed towards furthering their board's gender diversity. This is in line with the proposals in the 2021 CG Consultation[24] to require all issuers to set numerical targets and timelines to improve gender diversity. For example:

- A properties and construction operator (which had one woman director on board) mentioned in the board diversity policy its intention to '*continue to identify a pipeline of potential female Board candidates internally and aim to achieve a Board composition of at least 30% being female members within five years from Listing.*'

[23] See footnote 9.
[24] See footnote 9.

B. DIVERSITY PROGRESS OF SINGLE GENDER BOARD ISSUERS

45. In addition to the commitment set out in the prospectuses, we also tracked the progress made by Single Gender Board Issuers in achieving board gender diversity by reviewing their CG reports.

Key observations

46. Chart 3 summarises the progress made by the Single Gender Board Issuers as reflected in their subsequent CG reports:

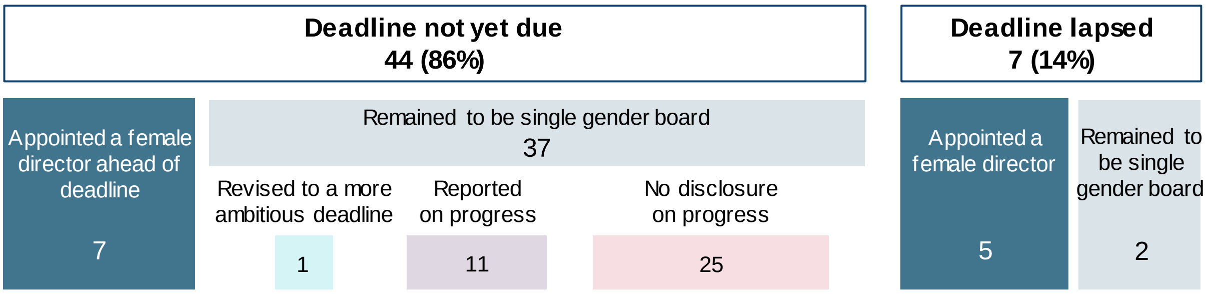

Chart 3: Progress made by the 51 Single Gender Board Issuers

47. In respect of the Single Gender Board Issuers with CG reports reviewed:

(i) Amongst those with target deadlines lapsed, over 70% had appointed one woman director to their boards. Two issuers were unable to honour their commitment, without any explanation.

(ii) Of the remaining issuers with target deadlines not yet due,

(1) around one-sixth reached their targets to have one woman director on board ahead of their deadlines; and

(2) almost 30% voluntarily reported on their progress, with one proactively revising to an earlier deadline (from three years after listing to two years).

Our comments and recommendations

48. The purpose of setting out the gender diversity commitment in prospectus is to ensure this is on the board's agenda, urging the board to take actions to improve boardroom diversity. The board should monitor and regularly evaluate the progress of achieving the commitments made in their prospectuses, and make appropriate disclosures in their CG reports for shareholders and potential investors to understand and appraise the efforts made by the board.

49. IPO applicants are reminded that the Exchange will take follow-up actions if the undertakings or commitments made in the prospectuses are not fulfilled. Explanations and considered reasons should be provided in the CG reports for any shortfall to diversity commitment.

50. We also noted that a Single Gender Board Issuer postponed the committed deadline by explaining that the relevant committee '*actively identified female candidates but no suitable female director candidates have been found*' by the original deadline. IPO applicants should further elaborate on the steps taken to demonstrate their efforts, and what additional actions will be taken to achieve the target.

CHAPTER 4:
ENVIRONMENTAL, SOCIAL AND GOVERNANCE DISCLOSURE

A. GOVERNANCE OF ESG MATTERS

51. The association between ESG factors and financial performance has increasingly been recognised by investors globally in recent years. The ESG issues faced by a company may vary significantly by industry and business model, and it is important to elevate the ESG discussion to board level to ensure the risks and impacts are appropriately assessed and addressed.

52. Our review focuses on the following areas:

(a) **ESG oversight** – This includes the board's oversight of ESG matters, and directors' collective responsibility for the formation of mechanisms and policies that enable an applicant to meet the Exchange's ESG requirements upon listing[25].

(b) **ESG materiality assessment and risk management** – This includes assessment of the materiality of ESG risks facing the applicant's business, and integration of ESG risks into an applicant's risk management and internal control framework[26].

(c) **ESG compliance matters** – This generally refers to an applicant's compliance with applicable environmental laws and regulations, and details of material impact non-compliances (if any)[27].

Key observations

53. The overall findings on disclosures on each subject mentioned in paragraph 52 are set out in Chart 4 below:

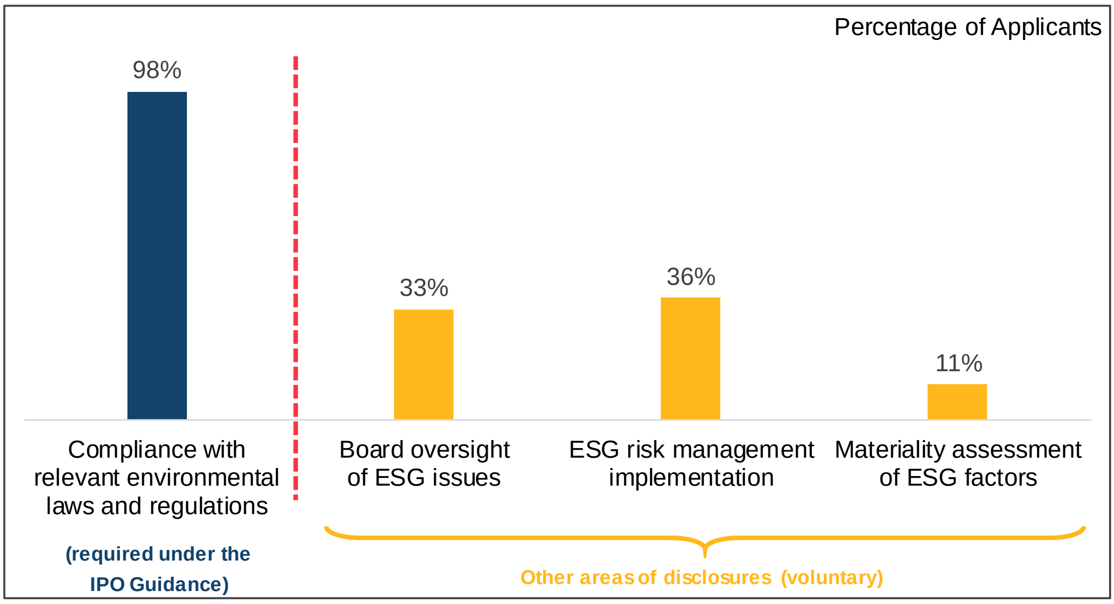

Chart 4: Disclosures on ESG governance by Applicants

[25] See paragraph 3.7 of "Business" section in the IPO Guidance.
[26] See key area "risk management and internal control systems" under paragraph 4.1 of "Business" section in the IPO Guidance.
[27] See key areas "environmental and social matters" and "compliance matters" under paragraph 4.1 of "Business" section in the IPO Guidance.

54. We are pleased to observe that some Applicants regarded environmental protection and/or sustainability as part of their "corporate social responsibility", and were committed to fulfilling the ESG requirements under the Listing Rules upon listing.

55. Around one-third of the Applicants made disclosure on the board's oversight of ESG issues and mentioned that they had developed policies and risk management systems that incorporated ESG elements. Only a small number (11%) of the Applicants disclosed their materiality assessment regarding ESG issues. Most Applicants identified none or few material ESG risks in their prospectuses, and disclosures were mainly regarding the impact of regulatory compliance.

56. We further compared the first ESG reports of 30 randomly selected Applicants with their prospectuses. In contrast, such Applicants' first ESG reports contained comprehensive details on the process used to identify ESG risks, information on material ESG risks and their impact on the businesses.

Our comments and recommendations

(a) ESG oversight

57. Governance and oversight of ESG matters, and management of material ESG risks (including climate-related risks), are an integral part of good corporate governance. It is important for the board to identify the ESG issues that are material to the operations of the company, assess the impacts, and formulate plans to address or mitigate such risks[28]. Set out below are examples on ESG oversight for reference:

- An industrial goods operator disclosed that the board '*has the collective and overall responsibility for overseeing the formulation and reporting of the ESG strategies and assessing and determining the ESG-related risks at least once a year.*' The board also might '*assess or engage independent third party(ies) to evaluate the ESG risks and review our existing strategy, target and internal controls.*'

- A services operator applicant established '*an environmental protection, health, and safety team*' that used a number of '*ESG metrics*' to assess and control potential risks. The applicant had also '*developed a series of internal policies and programs for environmental risk prevention*', demonstrating effective management and governance of environmental risks.

58. Different approaches may be adopted to enhance the effectiveness of board oversight of ESG matters, for example:

(i) taking into account ESG matters in boardroom discussions and strategic planning;

(ii) conducting and regularly refreshing a materiality assessment to identify and assess all ESG issues that are material to the applicant's business and its stakeholders from time to time;

(iii) developing and regularly reviewing policies on ESG risk management;

[28] See also Main Board Rules Appendix 27 (GEM Rules Appendix 20) paragraph 13. An issuer is required to disclose in its ESG report a statement from the board containing: (i) a disclosure of the board's oversight of ESG issues; (ii) the board's ESG management approach and strategy, including the process used to evaluate, prioritise and manage material ESG-related issues (including risks to the issuer's businesses); and (iii) how the board reviews progress made against ESG-related goals and targets with an explanation of how they relate to the issuer's businesses.

(iv) monitoring ESG performance against the company's goals on a regular basis; and

(v) engaging an external advisor to assess and provide guidance on ESG matters.

(b) <u>ESG materiality assessment and risk management</u>

59. IPO applicants are encouraged to disclose the identification process or selection criteria of material ESG risks that are relevant to the company[29]. Generic "negative statements" regarding ESG risk materiality assessment, such as '*we do not involve / are not subject to any material ESG risks*', do not provide meaningful information for understanding how the board arrives at such conclusion. IPO applicants should further explain the process and discussions involved in reaching the conclusion, preferably supported by a holistic consideration of the business operations with quantitative data (where applicable).

60. ESG risk management starts before listing. IPO applicants should conduct a thorough analysis and assessment to identify material ESG risks. Proper risk management would improve the company's resilience, and quality disclosures in the prospectus of the business impacts of material ESG risks and how they are managed are conducive to investors' evaluation of the company. It is important for IPO applicants to plan ahead before listing to implement the necessary measures to ensure future compliance. For example:

- A machinery and equipment operator clearly described the steps involved and the factors considered to assess the materiality of ESG factors: "*We performed environmental factor identification and summarised 22 factors in regards of risk or opportunity. We analysed their importance based on the frequency, range, recoverability, concern and effect degree. In the result, there are five important environmental factors.*" The Applicant further set out in the prospectus how the current design in its operations could manage each identified high and moderate risk, and what metrics were established to evaluate such risks on an annual basis.

(c) <u>ESG compliance matters</u>

61. We highly appreciate the Applicants' efforts in making transparent disclosure of their compliance with relevant environmental laws and regulations. IPO applicants should note that, however, material ESG risks are not limited to violation of laws and regulation. It is important to ensure systems are in place to monitor and mitigate the impact of all material ESG risks to the company, with board's oversight over the management of such risks.

[29] See also Main Board Rules Appendix 27 (GEM Rules Appendix 20) paragraph 14. An issuer's ESG report should disclose, regarding materiality: (i) the process to identify and the criteria for the selection of material ESG factors; and (ii) if a stakeholder engagement is conducted, a description of significant stakeholders identified, and the process and results of the issuer's stakeholder engagement.

B. DISCLOSURES ON ENVIRONMENTAL ISSUES

62. This section summarises our findings regarding the Applicants' environmental and climate-related issues (such as energy consumption and carbon footprint) disclosures in their prospectuses.

Key observations

(a) Environmental issues

63. A vast majority of Applicants disclosed some form of environmental issues in the prospectuses. Around two-thirds of the Applicants made disclosures in at least one key area under the Environmental Subject Area[30].

(b) Climate-related issues

64. We are delighted to see that some Applicants considered the relevance of climate change to their business operations and strategy formation process. A few Applicants further made high quality disclosures that addressed physical and transition risks[31] as a result of climate change.

65. Some Applicants (especially energy-intensive companies and those operating within the digital economy) provided meaningful disclosures on how their internal policies could align with a low-carbon economy.

66. Amongst the ESG reports reviewed, around 60% reported on climate-related issues, even though such requirement was yet to apply to the relevant reporting year[32].

Our comments and recommendations

(a) Environmental issues

67. We applauded comprehensive environmental disclosures made by some Applicants that would enable shareholders to readily assess the environmental risks or opportunities they are facing. IPO applicants are further encouraged to include disclosures on how their business operations could materially impact the environment and natural resources, as well as the policies to mitigate such impact on the environment. Below are examples for reference:

- A services operator identified the types of key pollutants generated during the production of its products, and disclosed the measures and mechanisms put in place to minimise the impact of such pollution.

- A few Applicants further disclosed quantitative information on their environmental impact, such as pollutants and greenhouse gas emissions (in tonnes), waste discharged (in tonnes) by type and volume of water consumed (in cubic metres) in each financial year during the track record period. Some further engaged qualified professionals to implement environmental management strategies and solutions, and collect and review data for effective quantitative disclosure.

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30 See Main Board Rules Appendix 27 (GEM Rules Appendix 20) Part C. The Environmental Subject Area has four Aspects, namely Emissions, Use of Resources, The Environment and Natural Resources, and Climate Change.

31 Physical risks include natural disasters such as draught, floods, severe typhoons, persistent and abnormal heat waves, etc. that may seriously affect an IPO applicant's business and operations; whereas transition risks include changes in policies, laws/regulations and market behaviour that may increase operating, compliance and other costs.

32 See Main Board Rules Appendix 27 (GEM Rules Appendix 20) Part C, Aspect A4. The requirement came into effect from 1 July 2020, whereas the ESG reports reviewed covered the year ended 31 December 2020 or 31 March 2021.

- A consumer goods operator disclosed the receipt of ESG certification (ISO 14001) that accredited its environmental management systems. Such recognised ESG certifications could enhance an applicant's credibility as an environmentally responsible operator.

68. Some environmental factors may be more likely to be relevant to a particular sector or industry, which could hinge on the applicant's core strategies and warrant detailed disclosures in its prospectus. IPO applicants may refer to the Sustainability Accounting Standards Board's Materiality Map®[33] or the Exchange's materiality table[34] for a general idea of which factors may be relevant for businesses in different sectors or industries. For example:

- A consumer goods operator specialising in the production of textile and apparels disclosed the measures adopted in relation to the storage and handling of colouring dyes and additives.

- Properties and construction operators should consider disclosing information on the industrial waste they produce/emit and the policies to mitigate the environmental risks arising from their operations.

- Companies with manufacturing activities as their primary business should consider disclosing how their production processes impact the environment, and consider including a description of their industrial waste management policy and system.

(b) Climate-related issues

69. Climate change and climate-related risks have attracted growing global concerns. Investors are demanding for decision-useful, climate-related information for capital allocation and investment decisions. Making progress towards mandating climate-related disclosures aligned with the TCFD framework by 2025 across relevant sectors[35], the Hong Kong Green and Sustainable Finance Cross-Agency Steering Group announced its support towards the efforts by the International Sustainability Standards Board under the International Financial Reporting Standards Foundation[36] to develop a new reporting standard which would be built on the TCFD framework[37] in July 2021, and further expressed its support for the Hong Kong's Climate Action Plan 2050 (see paragraph 71) in October 2021. IPO applicants, depending on their industries and business models, should consider the following climate-related issues and make appropriate disclosures in their prospectuses:

(i) climate change-related issue oversight, such as the board's overall responsibility (as well as the role of the management, if applicable) in overseeing, evaluating and managing climate-related risks and opportunities, and details of any policy to address climate-related issues;

(ii) actual and potential impact of climate-related risks and opportunities on business, strategy and financial performance;

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33 See https://materiality.sasb.org/materiality.html.

34 See "Materiality table – by industry and aspect" in "How to prepare an ESG Report", page 24.

35 In December 2020, the Hong Kong Green and Sustainable Finance Cross-Agency Steering Group announced its green and sustainable finance strategy for Hong Kong and five key action points, which include mandating climate-related disclosures aligned with the TCFD Recommendations across relevant sectors no later than 2025.

36 The IFRS Foundation is a not-for-profit, public interest organisation established to develop globally accepted accounting standards—the International Financial Reporting Standards—and promote and facilitate their adoption. The International Sustainability Standards Board was established on 3 November 2021.

37 Announcement in July 2021: https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=21PR75.

(iii) identification and assessment of climate-related risks and opportunities over the short, medium and long term, their impact on business, strategy and financial reporting, and steps taken to mitigate such risks; and

(iv) quantitative information on the metrics and targets used to assess and manage climate-related risks.

IPO applicants may refer to our latest "Guidance on Climate Disclosures"[38] which guides our issuers in preparing TCFD-aligned disclosures.

70. Set out below are examples of high quality climate-related disclosures for reference:

- A properties and construction operator with projects based in the PRC referred to the global trend and China's national strategy of addressing climate change, and described plans to '*formulate policies after listing to systematically identify, assess and manage climate change-related risks, and formulate relevant response strategies.*'

- An Applicant addressed the climate-related transition and physical risks by: (i) identifying policy actions around climate change that would '*continue to evolve … and pose varying levels of financial and reputational risk*' to the Applicant; and (ii) explaining measures implemented to mitigate the potential impact of climate change on the Applicant's '*premises, operations, supply chain, transport needs, and employee safety.*'

71. Further to the carbon neutrality target to be achieved by 2050, the Hong Kong Government announced Hong Kong's Climate Action Plan 2050[39] in October 2021. To align with the decarbonisation targets, IPO applicants should also consider employing (and providing disclosures on) infrastructure and/or technology to reduce carbon emissions and control climate-related risks. Ongoing monitoring of the decarbonisation progress and engagement with stakeholders on climate transition strategy would support a smooth transition to a low-carbon economy. For example:

- An Applicant specialising in system applications and IT consulting has launched a paperless initiative to reduce carbon footprint and aligned its practice with the highest industry standard for carbon efficiency. Such policies and practice were widely elaborated on in the prospectus to assure investors of the Applicant's commitment to embracing a low-carbon economy.

[38] HKEX, Guidance on Climate Disclosures, 5 November 2021.

[39] Hong Kong's Climate Action Plan 2050 sets out the vision of "Zero-carbon Emissions - Liveable City - Sustainable Development" and outlines the strategies and targets for combating climate change and achieving carbon neutrality. See the Climate Ready website (http://www.climateready.gov.hk/) and paragraphs 96 to 98 in the Chief Executive's 2021 Policy Address of the HKSAR Government.

C. DISCLOSURES ON SOCIAL ISSUES

72. This section summarises our findings regarding the Applicants' disclosures on social issues in their prospectuses, focusing on employee-related policies, occupational health and workplace safety, as well as supply chain management (which are more likely to be relevant to all types of applicants).

Key observations

73. Most Applicants included disclosures on social issues in the prospectuses, mainly around occupational health and safety, such as:

   (i) implementation of systems and/or policies on occupational health and safety;

   (ii) health and work safety compliance records; and

   (iii) material accidents in the course of an applicant's operation.

Our comments and recommendations

74. We appreciate the efforts made by most Applicants to disclose work safety practices, accident prevention and reporting as well as their commitment to enhancing employees' safety. A strong ESG focus on employee-related issues can help companies attract and retain quality employees, strengthen employee motivation and increase productivity. We therefore encourage applicants to make relevant disclosures on employee matters[40].

75. The impact resulting from social issues may be of no less importance than environmental risks. Social and environmental issues have equal importance to investors, and should be carefully considered as part of an effective CG structure[41]. Apart from employment and labour practices, IPO applicants should also consider other social matters which may have material impact on the company, e.g. matters relating to operation (such as product responsibility and anti-corruption).

76. Supply chain plays an important role to operating a "sustainable business". IPO applicants are encouraged to identify, monitor and manage environmental and social risks (e.g. labour standards and product responsibility) along the supply chain, especially those with businesses involving substantial supply chains or subcontractors. This may facilitate post-listing compliance with the ESG requirements relating to supply chain management[42]. IPO applicants may consider:

   (i) citing international recognitions and certificates (for compliance with relevant laws and regulations) as eligibility criteria for suppliers; and

   (ii) providing a list of factors (containing metrics in areas like product safety and environmental impact of manufacturing facilities) against which the suitability of suppliers would be evaluated.

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40 IPO applicants may also refer to key area "employees" under paragraph 4.1 of "Business" section in the IPO Guidance.

41 Since July 2020, the disclosure obligation of all Social KPIs is upgraded to "comply or explain" under the ESG Reporting Guide. See Main Board Rules Appendix 27 (GEM Rules Appendix 20) Part C.

42 See Main Board Rules Appendix 27 (GEM Rules Appendix 20) Part C, Aspect B5.

APPENDIX: SURVEY STATISTICS

Table 1: Listing platform of the Applicants under review

Platform type	Number of applicants	Percentage*
Main Board	117	97%
GEM Board	4	3%
Total	**121**	**100%**

Table 2: Sector distribution of the Applicants under review

Sector	Number of applicants	Percentage*
Consumer Goods	43	36%
Energy	2	2%
Financials	4	3%
Industrial Goods	6	5%
Information Technology	8	7%
Properties and Construction	39	32%
Services	17	14%
Telecommunications	1	1%
Utilities	1	1%
Total	**121**	**100%**

* Note: The total percentage may not amount to 100% due to rounding.

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