ICGN
International Corporate Governance Network

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By email to: response@hkex.com.hk

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Re: Consultation Paper on Review of the ESG Reporting Guide and Related Listing Rules

Led by investors responsible for assets under management in excess of US$34 trillion, the International Corporate Governance Network (ICGN) is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide.

ICGN offers an important investor perspective on corporate governance to help inform public policy development and the encouragement of good practices by capital market participants. Our policy positions are guided by the ICGN Global Governance Principles and Global Stewardship Principles, both of which have been developed in consultation with ICGN Members and as part of a wider peer review. [1] Non-financial reporting, which includes environmental, social and governance (ESG) reporting, is addressed in Principle 7.5 of ICGN's Global Governance Principles, presented in the Annex to this letter. ICGN recently joined forces with the Principles of Responsible Investment and other investor bodies to publish a working paper preventing an investor agenda for ESG.[2] ICGN has engaged with other regulatory bodies and standard setters globally relating to ESG reporting.[3]

[1] For access to ICGN's Global Governance Principles and Global Stewardship Principles, along with other policy statements, including ICGN's 2019 Policy Priorities, please visit: www.icgn.org.
[2] ICGN and Principles for Responsible Investment: "Investor Agenda for corporate ESG reporting" (2018): https://www.icgn.org/investor-agenda-corporate-esg-reporting

[3] See ICGN Comment Letter on to the Corporate Reporting Dialogue Better Alignment Project Consultation (April 2019):
https://www.icgn.org/sites/default/files/ICGN%20Response%20to%20the%20Corporate%20Reporting%20Dialogue%20Better%20Alignment%20Project%20Consultation-%20April%202019.pdf

We are pleased to respond to the Hong Kong Exchanges and Clearing Limited (HKEx) Consultation Paper on Review of the ESG Reporting Guide and Related Listing Rules. ICGN congratulates HKEx on its leadership in promoting (ESG) reporting in the Hong Kong market, and in setting a positive example in the Asian region and globally. It is positive to see ESG reporting becoming increasingly established in Hong Kong, and we believe this is of fundamental importance for companies and boards to better understand and govern opportunities and risks related to ESG. Equally, it is a building priority for investors to better understand how material ESG factors can affect investment decision making, valuations, engagement and voting. ESG reporting should seek to reflect the complexities inherent in a contemporary business and the context of a company's current and future strategic direction. It should support and enhance the information in the financial statements and help the reader to form an assessment of the company's future prospects.

We believe the HKEx Consultation Paper is well-presented and that it is generally sensible and progressive in many ways. Our main response is one of encouragement. We recognise the important step forward in mandating aspects of ESG disclosure, and we agree with your focus on this disclosure including the governance structure and how ESG and its disclosure is overseen by a company's board.

We would like to raise several specific points for your review. Some of these are in direct response to the consultation's questions; others reflect additional considerations we believe are relevant for this discussion.

- **Separate ESG report versus integrated report.** We think it is positive for Hong Kong listed companies to issue ESG reports. But we also place great emphasis on integrated reporting—the fusion on financial and business reporting, including both financial and extra-financial information (including ESG factors). Particularly for investors, integrated reporting is an opportunity to understand how ESG risks and opportunities feature in the context of the company's overall strategy, operations and financial performance. We think it is critical to look at ESG information in a way that directly "joins the dots" with company financial risks and strategic opportunities. The risk of a standalone report is that can be an end unto itself and become disjointed with from a report on the company's past and future commercial and financial performance. ESG reports lacking this linkage will be of less value to

and ICGN Comment Letter to US SEC on Request for Rulemaking on ESG Disclosure (March 2019): https://www.icgn.org/sites/default/files/ICGN%20Comment%20on%20Request%20for%20Rulemaking%20on%20ESG%20Disclosure%20March%202019.pdf investors.

- **Report timing.** If there are to be two separate reports – and annual report and ESG report—we believe these should be published at or around the same time. The proposed reduction of the lag from four to three months seems to us to be of limited incremental improvement. As noted above, is important to join up the thinking between financial reporting and ESG reporting, and separate reporting dates suggests a possibly siloed approach to governing ESG factors-- which investors generally discourage. We believe it is important for investors to receive financial reports and ESG reports at the same time to allow investors to integrate ESG issues into their own investment analysis, valuation models, engagement strategies and voting decisions.

- **Mandated disclosure requirements.** We recognise that mandated disclosure requirements may be provocative to some listed companies, but we support this proposal. We think is important to mandate some basic reporting elements to "kick into play" ESG reporting. But this is just the beginning of the journey, and the nature of what is and is not formally mandated is likely to evolve as ESG reporting matures.

  At the same time, we need to be alert to the fact that not all ESG factors will have the same relevance for all companies. In particular the specific "E" and "S" environmental and social factors can differ significantly between companies, often driven by the individual environmental and social risks presented by the company's sector. So, while it is good for companies to have some required basic ESG reporting requirements, one size will not fit all companies in terms of which ESG factors and reporting metrics are the most material. Environmental and social factors are often endogenous to the company's own business mix. So, we expect that any basic mandated ESG reporting should also be accompanied by more complete set of ESG metrics, that is customised by the company's management, with board oversight, to reflect those ESG factors of greatest financial materiality and relevance to investors.

- **Sectoral and ESG reporting standards.** Following from the point above, we believe the development of further ESG standards for companies should be strongly influenced by the ESG risks and opportunities presented in individual industrial sectors; geographic sectors can also be relevant, particularly where political risk is involved. As ESG reporting grows and develops around the world we anticipate building a greater understanding of which ESG risks are of greatest relevance in specific sectors, and we would hope that can lead to better convergence, comparability and consistency of reporting standards and metrics. The good work of the Global Reporting Initiative (GRI) is mentioned in your Consultation Paper, but we expect you are also aware that the Sustainability Accounting Standards Board (SASB) has done considerable work linking ESG data to a wide range of industries. ICGN is supportive of GRI, SASB and other bodies that are standard setters in ESG reporting. But while GRI, SASB and others may have their own distinct frameworks and stakeholders, it is our vision that these standard setters continue to collaborate on establishing a more coherent and consistent foundation to ESG reporting, so that we are all ultimately working with the same "atoms and molecules" when it comes to ESG data. Particularly now that HKEx is now mandating some aspects of ESG disclosure, we encourage HKEx to become active in this debate to advocate better global consistency of ESG reporting.

It is appropriate to reference specific global developments in climate reporting, notably the recommendations by the Taskforce on Climate-related Financial Disclosures (TCFD). The Consultation Paper rightly notes that the TCFD disclosure framework has received support in many markets around the world. For example, linked to its Sustainable Finance Initiative, the European Commission is now reviewing whether it should adopt the TCFD framework within its own regulatory requirements. ICGN supports the development of the TCFD framework as a global ESG standard, and encourages HKEx to build its climate reporting in alignment with TCFD—rather than possibly mix or dilute it with other standards that might be developed locally.

- **Climate reporting and other ESG risks.** It is appropriate that particular attention is focused on climate risk, given its urgency. But important that ESG reporting also reflects other environmental risks such, as pollution or water usage. The social KPIs that are specified in the Consultation Paper are generally sensible, and as noted earlier, their relevance or materiality will differ from sector to sector. While we do not necessarily suggest adding to this list for your required reporting KPIs, we would observe that the social KPIs presented in the Consultation Paper is not a comprehensive list of social factors of relevance to investors. Other topics of investor engagement on social issues can include human rights (beyond the issues of child and forced labour mentioned in the guide), tax policy, inclusion policies, or political lobbying. Again, critical KPIs can be sector specific, but HKEx should be prepared to encourage ESG disclosure on a possibly wider array of social factors, to the extent they may be financially material. In addition to TCFD for climate disclosure, there are other credible global reporting frameworks with different purviews that HKEx might wish to consider as ESG reporting develops further in Hong Kong. Examples of such global frameworks include the OECD Guidelines for Multilateral Enterprise, the United Nations Global Compact, the United Nations Sustainable Development Goals, and the United Nations Guiding Principles on Business and Human Rights.

- **Materiality versus salience.** We support the stress on materiality to investors. Otherwise ESG would be unfocused and of less relevance to investment decision-making. We also recognise that it can be challenging to determine what aspects of ESG performance have the greatest materiality. We observe in some areas of environmental and social performance that "salience" may also be a relevant consideration for HKEx – as well as investors. In an ESG context an environmental or social issue may sometimes not have clear financial materiality, at least in a past reporting period. But its salience – sometimes defined as a level of egregiousness – may present other business or enterprise-wide risks for the future. For example, a large resource company might be able to "afford" a workplace fatality if it has no material impact on the company's aggregate earnings, cash flow or balance sheet in the most recent financial reporting period. But while it may not be material in financial reporting, at least not immediately, it could be salient to the extent it might lead to a future weaker of stakeholder relations with employees and communities. The art of ESG reporting for regulators, companies, investor and other stakeholders is to ensure that "salient" ESG issues with potential to become financially material are also included within the reporting umbrella.

- **Relevance for creditors as well as shareholders.** We note that the purview of this Consultation Paper is focused on companies as issuers of equity securities. We clearly support the HKEx approach to listed equities, but we would also encourage HKEx to consider the relevance of ESG reporting to bondholders and other creditors. For a creditor, ESG factors are largely seen in a risk context, and creditors will also have an interest in monitoring company ESG performance and its potential to increase credit risk. The leading global credit rating agencies are now integrating ESG factors more extensively into their credit ratings, and as investor stewardship extends beyond equities to fixed income and other asset classes, we expect further integration of ESG reporting into credit risk assessments and into creditor engagement with companies.

- **Assurance.** We support your encouragement of assurance for ESG reporting. As part of the journey of ESG reporting to integrate successfully with other forms of financial reporting, investors increasingly will seek assurance that the ESG data has gone through the discipline of an audit process as a foundation of confidence and indication of data quality. We also recognise that assurance in the ESG area is less well-developed. But over time we believe that the more ESG data can be trusted, the more it will be used by investors.

In conclusion, we support the HKEx direction of travel in the Consultation Paper and we hope that our input is helpful in your decision-making. ICGN enjoys strong relationships with a vast network of experts in ESG and financial reporting, and we are pleased to participate in these debates for the benefit of our members. In this context we look forward to engaging with you in this or other matters where we could provide meaningful input.

Should you wish to discuss our comments further, please contact me or George Dallas, ICGN's Policy Director, by email at [redacted].

Yours faithfully,

[redacted]

Kerrie Waring,
Chief Executive Officer, ICGN

Copy:
James Andrus, Co- Chair, ICGN Disclosure and Transparency Committee:
[redacted]

Appendix

Global Governance Principles

Principle 7.5

An integrated report that puts historical performance into context should be published and portray the risks opportunities and prospects for the company in the future. This helps investors and stakeholders understand a company's strategic objectives and its progress towards meeting them.
Such disclosures should:

a) be linked to the company's business model;
b) be genuinely informative and include forward-looking elements where this will enhance understanding;

c) describe the company's strategy, and associated risks and opportunities, and explain the board's role in assessing and overseeing strategy and the management of risks and opportunities;
d) be accessible and appropriately integrated with other information that enables investors to obtain a picture of the whole company;
e) include environmental, social and governance related information that is material to the company's strategy and performance;
f) use key performance indicators that are linked to strategy and facilitate comparisons;
g) use objective metrics where they apply and evidence-based estimates where they do not; and
h) be strengthened where possible by independent assurance that is carried out annually having regard to established disclosure standards.