Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEX website at: http://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/May-2019-Review-of-ESG-Guide/Consultation-Paper/cp201905.pdf.

Where there is insufficient space provided for your comments, please attach additional pages.

Timeframe for Publication of ESG Reports

1. Do you agree with our proposal to amend Main Board Listing Rule 13.91 and GEM Listing Rule 17.103 to shorten the time required to publish an environmental, social and governance ("**ESG**") report from three months after the publication of the annual report to within four months for Main Board issuers or three months for GEM issuers from the financial year-end date?

   ☒ Yes

   ☐ No

   Please give reasons for your views.

   The proposal to reduce the four-plus-three month reporting period for main board issuers (three-plus-three months for GEM issuers) to align with publication of the annual report is sensible and entirely justified. The point referenced in the Consultation Paper is correct – that a seven month (six month for GEM issuers) period following the end of the financial year is too long for disclosure to be meaningful, accurate and assessable. More than this – the alignment of timing for release with the annual report (whether physically included in the annual report or published separately) serves an important purpose in allowing investors to see what should be considered the full mix of material information available in respect of the issuer at the time of release of the annual report. It is our contention that ESG reporting should be considered part of the full mix of information deemed material and upon which investors should rely upon when making an assessment of the investment merits of the issuer in question. Alignment of timing, whilst also assisting in providing relevance and freshness to the information disclosed, also serves to suggest this point.

Printed Form of ESG Reports

2. Do you agree with our proposal to amend the Listing Rules and the Guide to clarify that issuers are not required to provide printed form of the ESG report to shareholders unless responding to specific requests, but are required to notify shareholders that the ESG report has been published on the Exchange's and the issuer's websites?

   ☒ Yes

☐ No

Please give reasons for your views.

Introducing Mandatory Disclosure Requirements

General

3. Do you agree with our proposal to amend the Guide to introduce Mandatory Disclosure Requirements ("**MDR**")?

☒ Yes

☐ No

Please give reasons for your views.

Governance Structure

4. If your response to Question 3 is positive, do you agree with our proposal to introduce an MDR requiring a statement from the board containing the following elements:

   (a) a disclosure of the board's oversight of ESG issues?

   (b) the process used to identify, evaluate and manage material ESG-related issues (including risks to the issuer's businesses); and

   (c) how the board reviews progress made against ESG-related goals and targets?

☒ Yes

☐ No

Please give reasons for your views.

The changes proposed are a welcome addition to the ESG guidelines. We agree with requiring the board of the relevant issuer to provide the statement on governance structure. From our experience, placing requirements on the board to consider issues of social risk and similar places an important burden on boards to consider and develop strategies to investigate matters of social risk. We would expect boards to take their obligations in this respect increasingly seriously. We would propose that, in addition to "(ii) the process used to identify, evaluate and manage material ESG-related issues" we would also propose the inclusion of:

(a) the steps issuers are taking in respect of human rights due diligence exercises, and audit; and

(b) the steps taken by issuers to prevent, curtail and remediate issues arising. This would place the ESG guide in more responsive ground when compared with the principles elaborated in the UNGPs, to which all issuers should increasingly be paying attention.

5. Do you agree with our proposal to set out in a note that the board statement should include information on the issuer's current ESG management approach, strategy, priorities and goals/targets and an explanation of how they relate to the issuer's businesses?

☒ Yes

☐ No

Please give reasons for your views.

We agree with the proposal to set out a note in the board statement to include information on the issuer's current ESG approach, strategy, priorities, etc. We would note however that this should also, as above, identify and address risks, as well as identify shortcomings in ESG compliance in the past year.

<u>Reporting Principles</u>

6. Do you agree with our proposal to amend the Guide to introduce an MDR requiring disclosure of an explanation on how the issuer has applied the Reporting Principles in the preparation of the ESG report?

☒ Yes

☐ No

Please give reasons for your views.

We agree with the proposals and these are welcome additions to the ESG Guide.

7. Do you agree with our proposal to amend the Reporting Principle on "materiality" to make it clear that materiality of ESG issues is to be determined by the board and that the issuer must disclose a description of significant stakeholders identified, the process and results of the issuer's stakeholder engagement (if any), and the criteria for the selection of material ESG factors?

☒ Yes

☐ No

Please give reasons for your views.

We particularly agree to require boards to determine material factors, the criteria for selecting material factors and requirements to disclose significant stakeholders identified. These are all changes in line with the highest standards of ESG reporting on exchanges elsewhere in the world. Our preference is to encourage issuers to identify all potential forced labour and human trafficking concerns as material. We would expect investors to consider these material, and would expect the potential for reputational damage arising from breaches within their operations to be of material concern. Better still would be to adopt the practice developed and adopted in the UK and Australia under their respective Modern Slavery Acts, which makes reporting on this compulsory even where no material concerns have been identified. This, in hand with requirements to report on steps taken to identify and remediate labour abuse in the business and supply chains of issuers (see our response on questions 4 and 5 above), will more effectively push issuers to transparently account for the state of their operations and any concerns recognised.

8. Do you agree with our proposal to amend the Reporting Principle on "quantitative" to:

(a) require disclosure of information on the standards, methodologies, assumptions and/or calculation tools used, and source of the conversion factors used for the reporting of emissions/energy consumption (where applicable); and

(b) clarify that while key performance indicators (**"KPIs"**) for historical data must be measurable, targets may be expressed by way of directional statements or quantitative descriptions?

☒ Yes

☐ No

Please give reasons for your views.

See response to 7 above

Reporting Boundary

9. Do you agree with our proposal to amend the Guide to include an MDR requiring an explanation of the ESG report's reporting boundary, disclosing the process used to identify the specific entities or operations that are included in the ESG report?

☒ Yes

☐ No

Please give reasons for your views.

This is a crucial addition and we agree with the proposal. We would however encourage issuers to see this requirement as a broad and not a narrow, technical requirement. The reporting boundary should ideally be stated to include, and should be clearly understood by issuers to include not only the issuers entities and operations but also its wider supply chains. This reflects the significant possibility that problematic labour practices are most likely to exist in more opaque parts of the wider supply chain of an issuer's operation. From a reputational point of view, social risk in the wider supply chain should be of material interest to investors and the disclosure standard set in the ESG report should adequately reflect this.

Introducing Aspect on Climate Change and Revising the Environmental KPIs

Climate Change

10. Do you agree with our proposal to introduce a new Aspect A4 requiring:

    (a) disclosure of policies on measures to identify and mitigate the significant climate-related issues which have impacted, and those which may impact the issuer; and

    (b) a KPI requiring a description of the significant climate-related issues which have impacted, and those which may impact the issuer, and the actions taken to manage them?

    ☒ Yes

    ☐ No

    Please give reasons for your views.

Targets

11. Do you agree with our proposal to amend the Environmental KPIs to require disclosure of a description of targets set regarding emissions, energy use and water efficiency, waste reduction, etc. and steps taken to achieve them?

    ☒ Yes

    ☐ No

    Please give reasons for your views.

GHG Emissions

12. Do you agree with our proposal to revise an Environmental KPI to require disclosure of Scope 1 and Scope 2 greenhouse gas ("**GHG**") emissions?

☒ Yes

☐ No

Please give reasons for your views.

Upgrading the Disclosure Obligation of the Social KPIs

13. Do you agree with our proposal to upgrade the disclosure obligation of all Social KPIs to "comply or explain"?

☒ Yes

☐ No

Please give reasons for your views.

The upgrade of all Social KPIs from recommended disclosures to "comply or explain" is very welcome. This sits well with the reference made elsewhere in the Consultation Paper that ESG reporting should not be considered a CSR marketing exercise but a rigorous reporting, transparency and disclosure obligation. This should be a minimum standard across all aspects of ESG reporting for both main board and GEM issuers.

Revising the Social KPIs

Employment Types

14. Do you agree with our proposal to revise a KPI to clarify “employment types” should include “full- and part-time” staff?

☒ Yes

☐ No

Please give reasons for your views.

We agree with the proposal but we would also propose to widen the coverage to include "full and part-time" staff, where possible, and particularly where material, the coverage should ideally extend also to cover seasonal staff, sub-contracted staff and migrant workers in the wider supply chain – this is in recognition of the greater vulnerability of these categories of workers to exploitative labour practices within issuers' supply chains. In addition, we would propose including KPIs relating to work practices covering the full range of workers proposed above, including contractual arrangements.

Rate of Fatalities

15. Do you agree with our proposal to amend the KPI on fatalities to require disclosure of the number and rate of work-related fatalities occurred in each of the past three years including the reporting year?

☒ Yes

☐ No

Please give reasons for your views.

Supply Chain Management

16. Do you agree with our proposal to introduce the following new KPIs in respect of supply chain management?

(a) Description of practices used to identify environmental and social risks along the supply chain, and how they are implemented and monitored.

(b) Description of practices used to promote environmentally preferable products and services when selecting suppliers, and how they are implemented and monitored.

☒ Yes

☐ No

Please give reasons for your views.

We agree with the proposal to introduce KPIs in respect of supply chain management. This is at the heart of the new focus referred to in the section entitled "International developments in business disclosure" above and requires ever greater focus from issuers if ESG reporting is to be accurate, complete and effective. Please see contiuation page for further details.

Anti-corruption

17. Do you agree with our proposal to introduce a new KPI requiring disclosure of anti-corruption training provided to directors and staff?

☒ Yes

☐ No

Please give reasons for your views.

We agree with the inclusion of a new KPI to require disclosure on anti-corruption training. We would however propose that Aspect B7 could be widened to include information on compliance with economic sanctions and to extend KPIs B7.1 to B7.3 to include money-laundering as well as anti-corruption measures and investigations. Our work has focused heavily on the impact of laundering of funds arising from labour abuse and as robust a reporting requirement in this area as possible is required to match the scale of the issue. Given the compliance focus at issuers on both the main board and GEM, we would expect issuers to be able to cover compliance with anti-corruption, economic sanctions and anti-money laundering regulations as part of a package and the HKEX should encourage issuers to do so under this KPI.

Encouraging Independent Assurance

18. Do you agree with the proposal to revise the Guide's wording on independence assurance to state that the issuer may seek independent assurance to strengthen the credibility of ESG information disclosed; and where independent assurance is obtained, the issuer should describe the level, scope and processes adopted for assurance clearly in the ESG report?

☒ Yes

☐ No

Please give reasons for your views.

We would strongly encourage the revision proposed in encouraging seeking independent assurance. We note the extensive resources available for HKEX issuers to consult in obtaining advice on ESG reporting, and we would encourage further and more comprehensive advice to issuers on how they can undertake a rigorous human rights due diligence exercise, audits and assurance. It is recognised that in the absence of binding legislation relating to transparency in business and supply chains, issuers may be approaching this aspect of corporate governance for the first time. From our experience, we note that one aspect of the post-implementation feedback exercise in the United Kingdom in relation to the Modern Slavery Act was the feedback from board directors as to how boards recognised a huge benefit in undertaking such exercises, by bringing to the board's attention more opaque practices in their business and supply chains. This can only benefit the financial and operational health of companies and we would expect a similar level of enthusiasm in Hong Kong as these board practices develop. The Consultation Paper (paragraph 82) refers to "identifying, evaluating and managing ESG-related issues" as an "opportunity", and the most effective way to maximise this opportunity is through enhanced due diligence and subsequent audit/assurance. We would encourage issuers to embrace this.

\- End -

Continuation page – Liberty Shared Submission to the Questionnaire on Consultation Paper on Review of the Environmental, Social and Governance Reporting Guide and Related Listing Rules

Supply chain management - Question 16 (continued)

As above, we would propose that the wording relating to "practices used to identify…social risks along the supply chain, and how they are managed and monitored" should be widened to include specific diligence and audit measures taken by issuers in respect of their businesses and supply chains to identify labour abuses, as well as how social risks relating to labour abuse are prevented and/or curtailed and remediated. This disclosure should ideally be dual-aspect: (1) not only the significant social risks that could impact issuers and their businesses, but (2) the impact that issuers' supply chain management, and specifically a failure to undertake adequate due diligence, can create in masking labour abuse within broader business operations. Issuers should be reminded that they should be adopting high standards of transparency, disclosure and increasingly, undertaking human rights due diligence in order to address the potential for labour issue in wider supply chains. This is of particular importance given the regional dimension of issuers operating within and out of the Asian region, where the risk of forced labour and human trafficking are heightened, given a number of the most problematic and opaque labour markets are in Asia.

We take note of the point made in paragraph 26 of the Consultation Paper – that there is a lack of discussion on how ESG issues relate to an issuer's business. In our view, ESG factors will always relate to and impact on an issuer's business, and investors for profit or for impact consider the same. Furthermore, it is important to adjust the business perspective and consider how issuers' businesses create social risks – forced labour and human trafficking issues have been shown to arise from unscrupulous operations in the supply chain, and issuers should be aware of this. This is not always apparent but is the fundamental basis for the need for further investigation, and effective reporting on this promotes higher standards of corporate behaviour.

We would propose that KPI B5.1 should be broadened to include the requirement for a list of first and second tier suppliers and the nature of the products made and services provided by workers.

Additional comment - Labour standards (Aspect B4)

In addition to the comply or explain upgrade in this aspect, the HKEX should consider including additional KPIs to address:

- what measures issuers have taken in their businesses and that exist in their wider supply chains to create fair, transparent and accessible grievance mechanisms for workers (full and part-time, sub-contacted, seasonal and agency staff) to seek prevention, curtailment and remediation of labour abuse issues; and
- disclosures relating to recruitment practices, including any agency fees paid, recruitment practices, source of labour (in particular migrant and seasonal workers within the supply chain) and any instances of excessive fees charged to workers upon recruitment.

General Observations

International developments in business disclosure

The HKEX's consultation exercise on mandatory reporting is timely, coming as it does in the midst of a rising tide of green, ethical and impact investment. Listing regulations at bourses worldwide are slowly developing the means to address this increasing investor focus. The Consultation Paper makes cross-reference to proposed and implemented changes in Mainland China, the UK, Singapore, Japan and others in the section relating to "Developments in International Practice", and this is a fair peer group to reference. Benchmarking against competitor and peer exchanges is a reasonable approach, but we would also like to point to a broader developing trend in mandatory reporting and transparency relating to that goes beyond stock exchange regulation and guidance, and into the legislative sphere, and which is not referred to in the Consultation Paper. This includes, amongst others: the United Kingdom and Australia (each of which have adopted mandatory modern slavery and human trafficking reporting requirements in recent years), California, the Netherlands and France. The development in France raises the bar even further by requiring a mandatory diligence plan to be set out each year by large French companies with presence in markets elsewhere in the world, and is part of a trend in European legislatures towards mandatory modern slavery diligence. This goes some way further than ESG reporting.

Such legislative developments are of greater relevance when considering the legislative process to promote a modern slavery statute in Hong Kong, which began in 2017. Presently, the proposed Modern Slavery Bill 2019 has been finalised in draft form, and submitted to the Legislative Council President on 21 March 2019 for tabling. The draft is currently awaiting comments from the Security Bureau on their substantive feedback. The bill, should it pass, would contain provisions requiring companies in Hong Kong to report on steps taken to identify instances of human trafficking and forced labour in supply chains. The proposed bill represents the direction of travel in this space.

We do recognise that stock exchanges do not exist to promote and pass legislation, and instead anchor an investor community with a view to promoting investment. But in the social risk space, there is value in recognising that the water level is rising quickly beyond mere "comply and explain" reportage, and companies will soon be expected to provide a lot more by way of disclosure into their business and supply chains. This is an opportunity for the HKEX to take that agenda on and raise the bar for ESG reporting.

International best practice

By developing the HKEX's mandatory reporting framework clearly the HKEX is looking to international best practice, and this is to be applauded. In particular the HKEX is recognised as a leading exchange on the Sustainable Stock Exchange Initiative and the standards proposed in the Consultation Paper would reflect well on the standards proposed under the Global Reporting Initiative. The standards set here and through other business and human rights standards (to include the UNGPs and the United Nations Principles for Responsible Investment) provide stock exchanges around the world with a wealth of information and guidance on best and improving practice, and the HKEX should look to match and exceed those standards.

That said, it is worth considering how high it would like to set its standards in the social risk sphere, whether it is content to require a similar standard of disclosure to competitor exchanges, or whether it is willing to set Hong Kong apart as a leader in the region for ESG reporting standards.

On balance, the proposals, if adopted, would place Hong Kong at a comparable level of standard for ESG disclosure obligation to Singapore (which has required mandatory reporting on a "comply or explain" basis since June 2016). Any like-for-like comparison of this nature reveals relative strengths and weaknesses, but it is worth considering whether, amongst other things, if the Singapore Exchange (SGX) Sustainability Reporting Guide standards demonstrate a superior recognition of industry-specific reporting, and risks arising from operations based in high-social risk jurisdictions. We would encourage HKEX to give consideration to these points when developing the ESG guidelines further. We would argue that there is little in the Consultation Paper that goes above and beyond the standard set in Singapore, and this may be a missed opportunity to set the bar higher.

Looking beyond Singapore, leading the way in Asia, the Stock Exchange of Thailand (SET) takes a holistic approach to improved sustainability reporting, including Sustainability Investment lists, its sustainable development centers and others. This show a best-in-class approach. The ESG reporting scenery in London looks more sophisticated again – with a focus on higher quality, usable "investment grade data", workable reporting formats and drawing links between ESG performance at a company and its financial and operating performance. Hong Kong will need to ensure that its underlying advice and guidance reflects these standards once the ESG Guide are updated, as it is not clear from the proposed changes that compliance will ensure better quality data (rather than merely more data).

We would encourage the HKEX to take the opportunity to recognise Hong Kong's unique characteristics - a major financial centre in a region susceptible to the incidence of social risk and including several high-risk jurisdictions in which issuers may operate their businesses or contract with parts of their supply chains. This consultative process could be an opportunity to showcase Hong Kong's ability to take the lead in this area and raise the bar accordingly.

ESG Reporting versus CSR Marketing

Liberty Shared has consistently advocated the tightening of regulation and the raising of standards to, amongst other things, promote better, more meaningful, more accurate and more relevant disclosure on the social aspects of business and their supply chains. We strongly agree that ESG reporting should not allow itself to become an exercise in corporate social responsibility exposure – far from it in fact, as such reporting should require difficult and probing assessments of the impact of businesses and their supply chains on workers, the environment, and other social factors. We note the absence of any coverage relating to forced labour issues arising from Imperial Pacific International Holdings (Stock Code: 1076) work in Saipan in either the ESG report or the annual report of the same issuer, despite widely-reported litigation underway. This is an example of how ESG reporting must bear an obligation on the part of issuers to address social risk without favour or selection. As a minimum, it should be necessary for issuers to provide a list of all material litigation in the social and environmental spaces in the ESG report, and the HKEX should consider remedies for non-compliant companies in this respect. This would reflect the emerging trend towards genuinely worthwhile and mandatory disclosure. As such, the point made in the preliminary observations of the consultation paper are to be commended in this respect.