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Hong Kong Exchanges and Clearing Limited
8th floor, Two Exchange Square
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Central
Hong Kong

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

By email: response@hkex.com.hk

Dear Sir/Madam

We welcome the opportunity to provide feedback on this consultation. Hermes Investment Management (Hermes) is an asset manager with a difference. Our purpose is helping beneficiaries retire better by providing world class active investment management and stewardship services. With £34.1[1] billion in assets under management, we focus on holistic returns – outcomes for our clients that go far beyond the financial - and consider the impact our decisions have on society, the environment and the wider world. Our stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on £450.5[2] billion on behalf of over 40 international institutional investors. The views expressed in this communication are those of Hermes EOS and do not necessarily represent the views of all clients.

Firstly, we would like to express our general support for the Hong Kong Stock Exchange's commitment to enhance issuers' governance and disclosure of ESG activities and metrics. We are pleased to see the latest developments in this process since the launch of the ESG Reporting Guide in 2013.

We summarise below some comments on the key elements of the consultation and enclose the related consultation questionnaire. Overall, we support the proposals and believe that they reflect progress in improving meaningful ESG reporting. The challenge nonetheless is to encourage companies to avoid 'boilerplate' responses and demonstrate meaningful progress over time. We would be interested to learn if the exchange envisages any oversight of the ESG reports that result from these new requirements and the potential mechanisms for enforcement.

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[1] Source: Hermes as at 31 March 2019. Please note the total AUM figure includes £6.2bn of assets managed or under an advisory agreement by Hermes GPE LLP ("HGPE"), a joint venture between Hermes Fund Managers Limited ("HFM") and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. £23.4m of total group AUM figure represents HFM mandates under advice.
[2] Source: Hermes as at 31 March 2019

Introduction of Mandatory Disclosure Requirements

We welcome the proposal to introduce mandatory disclosure requirements (MDR), covering the responsibilities of the board with regard to ESG issues, how the company has applied the guide's reporting principles and an explanation of the boundaries of reporting.

We believe that the board should demonstrate leadership on ESG issues and support the principle that it should be involved in determining which ESG issues are material to the business. The proposed MDR would also provide clarity on the process through which material ESG issues are identified, evaluated, and managed, as well as how progress against targets is being reviewed. We recommend that companies include board director engagement with employees across the organisation as part of the director on-boarding process with the aim of promoting an open and constructive corporate culture and opportunities for signalling ESG leadership from the top. We also recommend guidance for companies to promote a similarly open and constructive dialogue with shareholders, with due attention paid to minority shareholder concerns.

The MDR for disclosure of boundaries of reporting is a positive step. We believe, however, that there would be value in explicitly mentioning supply chains as an area of reporting, together with the proposed terms *entities* and *operations.* Specifically, Aspect B5 would be improved by seeking disclosure of material risks identified in the supply chain.

Environmental KPIs

Aspect A4, disclosing descriptions of climate-related issues that have or may impact the company, provides useful information on past events and projections for the future. Aligned with the references provided in the exchange's current online reporting FAQs, we would encourage the exchange to consider explicitly aligning Aspect A4 with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) to include climate-related governance, strategy, risk management, and metrics and targets. In addition, we would encourage guiding companies to use the Climate Action 100+ and Transition Pathway Initiative when assessing and reporting on their progress against the TCFD recommendations.

We welcome the proposal for a requirement to disclose targets connected to reducing the company's environmental impacts and the steps taken to achieve them. We also encourage the inclusion of ambitious target timeframes and base years, to ease understanding and comparison.

Explicitly requiring Scope 1 and 2 greenhouse gas (GHG) emissions reporting is a good step forward. We encourage the inclusion of wording recommending that companies consider reporting Scope 3 emissions as well when appropriate.

Social KPIs

We welcome the upgrading of social aspects from recommended disclosure to "comply or explain", aligning them with the disclosure of environmental issues.

However, we caution against focusing companies' attention on single issues, rather than encouraging them to take a holistic approach. We recommend referencing the United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises to assess, develop and maintain readiness for, and effectively manage the human rights impacts of their operations and supply chains. We would encourage companies to use the OECD National Contact Points as platforms for mediation and conflict resolution, and to work with local stakeholders to strengthen their legitimacy and influence. Companies should also engage with the UN peer-learning platforms on business and human rights as they are established regionally.

Recognising some sectors' growing reliance on indirect labour (agency or contract workers) and that such workers are often more vulnerable to adverse working conditions than direct employees, we would recommend the addition of this part of the workforce as a category to be reported on alongside full- and part-time employees.

Assurance

As ESG reporting becomes more commonplace and material to decision-making, external assurance makes it more likely that the information will be of value. Considering this, we encourage the guide to include language recommending companies to consider what steps are needed to prepare for future ESG reports to be externally assured.

Overall, we believe that these proposals represent positive developments in the evolution of ESG reporting for Hong Kong listed companies. As representatives of long-term investors, we value efforts to improve disclosure of the relationship between material ESG issues and company strategy, which we believe is fundamental to long-term value creation.

We sincerely hope that you find our response helpful and of constructive input to your proposals. If you would like to discuss any specific issues or exchange views, please do not hesitate to contact us.

Yours faithfully

[redacted]

Marcus Wilert
Associate Director
Hermes EOS

[redacted]

Hannah Shoesmith
Associate Director
Hermes EOS

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.

   We welcome the alignment of ESG reports with the timelines of financial reports.

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.

   Agree.

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.

We welcome the introduction of MDRs. Understanding board oversight of and responsibilities for material ESG issues, the application of reporting principles, and the boundaries of reporting is key to understanding whether effective governance of ESG issues is in place.

Carefully considered implementation of such mandatory disclosure requirements should allow ESG reporting to be linked to company long-term strategy and enable investors to conduct global peer and historical comparisons.

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.

We believe the role of the board to be fundamental to a company's approach to manage and monitor material ESG risks and opportunities and the creation of long-term value. We welcomed the amendments to the Corporate Governance Code and related listing rules, which came into effect in January 2019 and would encourage the MDRs related to the board to be included in this in future, perhaps in the associated Guidance for Boards and Directors.

The requirement that the board signs off on which ESG issues are material to the business and its long-term success highlights the importance of such issues and strengthens the mandate of those in charge of carrying out the work. The current reporting principles set out in the Hong Kong Stock Exchange's guidelines for ESG reporting are based on sound principles and the proposed addition would make it clearer to stakeholders how the company applies them in practice.

However, we urge the stock exchange to include a recommendation that companies should assess the relevance of the Sustainable Development Goals to the business and how they are responding in areas material to their business.

We recommend companies include board director engagement with employees across the organisation as part of the director on-boarding process with the aim of promoting an open corporate culture and opportunities for signalling ESG leadership from the top. We also recommend guidance for companies to promote a similarly open and constructive dialogue with shareholders, with due attention paid to minority shareholder concerns.

It may also be worth considering a requirement regarding disclosure of ESG training provided to the board, including the areas covered. We believe the board of directors should receive training on ESG issues in order to gain updates and a better understanding of the risks and opportunities for the business.

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.

This would provide a clear demonstration of the board's commitment to and accountability for material ESG issues.

Reporting Principles

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.

The reporting principles provide a useful way of encouraging consistency in ESG reports. However, interpretation and application of the principles can vary between companies, which might impact the quality of reporting. We therefore welcome the introduction of an MDR requiring an explanation of how companies have applied the reporting principles.

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 would agree that the board should play a key role in determining the company's material ESG issues and should give final sign-off. We would expect the board to work with internal experts on these topics.

Disclosure of significant stakeholders is a welcome step although caution should be taken not to identify stakeholders against their will. This is especially important in cases where stakeholders belong to a vulnerable or marginalised group (eg from a minority ethnic group, or a group discriminated against based on sexual, political, or religious orientation). There may also be cases when a stakeholder does not want engagement with the company to be made public. Identifiable details about a stakeholder should be kept on a need-to-know basis unless the stakeholder has given consent.

We would also recommend that the exchange considers the language in this reporting principle so that it is clear to companies that material issues are not restricted to their own operations but can (in some cases predominantly) exist in the supply chain.

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.

The proposed amendment is a welcome strengthening of expectations on transparency of the process and assumptions for reporting. We support the proposal to expand the reporting principles to require disclosure and greater clarity of key qualitative measures. However, in the interest of guiding companies towards a science-based approach for managing environmental issues, we recommend that companies more explicitly align with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). We find the Transition Pathway Initiative (TPI) and Climate Action 100+ (CA100+) to be useful references in understanding how prepared companies are to align with the TCFD and suggest these reports and rankings are given as reference tools for companies.

This reporting principle would also be improved by requiring companies to specify target timeframes and base years, and whether targets are absolute or intensity-based.

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 can provide clarity to the materiality process. We would also recommend that the MDR explicitly mentions how the company has determined materiality in relation to supply chains.

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.

We welcome the proposed increased clarity of how assessments of climate risk are conducted and how the company plans to mitigate them. However, in line with the reasoning in our response to question 8, we recommend that companies align with the recommendations of the TCFD and consider using the TPI and CA100+ as reference points in order to develop an effective response to significant climate-related issues.

Aligned with the references provided in the exchange's current online reporting FAQs, we would encourage the exchange to consider explicitly aligning Aspect A4 with the recommendations of the TCFD to include climate-related governance, strategy, risk management, and metrics and targets.

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.

We welcome the additional requirement of disclosure description but recommend that the key requirement should be that the company can demonstrate that these KPIs are aligned with the company's material risks and opportunities. We recommend that Environmental KPIs are aligned with the TCFD recommendations to include descriptions of target timeframes and base years.

Furthermore, we would encourage a requirement of disclosure of company operations in water-stressed areas and what steps have been taken to prevent water scarcity in such areas.

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.

We welcome the increased clarity required on Scope 1 and 2 greenhouse gas (GHG) emissions, which is in line with the TFCD recommendations. We would encourage inclusion of a recommendation to companies to consider Scope 3 emissions when appropriate.

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.

Companies' commitment to social issues, both in their operations and supply chains, is a demonstration of their broader corporate culture, enterprise risk management and ability to maintain their social licence to operate. Considering this, we welcome the strengthening of disclosure of social KPIs from voluntary to "comply or explain". However, we would caution against focusing companies' attention on single issues, rather than encouraging them to a taking a holistic approach. We recommend referencing the United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises to assess, develop and maintain readiness for, and effectively manage the human rights impacts of their operations and supply chains. We would encourage companies to use the OECD National Contact Points as platforms for mediation and conflict resolution, and to work with local stakeholders to strengthen their legitimacy and influence. Companies should also engage with the UN peer-learning platforms on business and human rights as they are established regionally.

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 welcome the proposal to clarify employment types. However, as businesses seek flexibility, indirect employment (eg contract, agency workers) is growing in importance. This type of employment can be more vulnerable to adverse working conditions, and as such, we encourage reporting to include this part of the workforce. Such reporting should include the proportion of indirect staff in the total workforce and a description of how they are recruited.

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.

In line with the above reasoning, we would encourage indirect labour (agency, contract workers) to be included in this KPI. We also recommend considering a requirement to provide an analysis of the root causes of fatalities and the associated next steps to address these.

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 that supply chain management is important when managing ESG risks and opportunities. Depending on the sector, the supply chain can present significant social and environmental risks and opportunities. It is therefore key that it is included in the process of determining materiality and the reporting boundary .

However, introducing discrete KPIs in respect of supply chain management may create an artificial distinction between a company's activities to identify material ESG risks in its own operations and its supply chain. We would recommend encouraging companies to take a holistic approach to considerations of materiality both in their own operations and in their supply chains rather than separating these. As such, we encourage an alignment of wording in the reporting guide and listing rules to integrate supply chain considerations into the broader expectations of materiality.

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.

Disclosure of anti-corruption training to directors and staff is a welcome step, but companies should also consider the outcomes of such activities. We encourage consideration of how to measure changes in behaviour, such as increased engagement with the topic and associated risks, examples of leadership by senior managers and openness to addressing the issue both inside and outside the company. We would also encourage adding a description of how the board oversees controls regarding anti-bribery and corruption.

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.

External assurance provides additional trust and confidence in the quality of data reported. This is important as ESG reporting becomes more commonplace and material to decision-making. Considering this, we would encourage the guide to recommend that companies consider which steps would be needed for future ESG reports to be externally assured.

\- End -