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/eng/newsconsul/mktconsul/Documents/cp201507.pdf

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

1. Do you agree with our proposal to amend Rule 13.91 to require issuers to disclose in their annual reports or ESG reports whether they have complied with the "comply or explain" provisions in the ESG Guide and if they have not, they must give considered reasons in the ESG reports?

   ☒ Yes

   ☐ No

   Please give reasons for your views.

At WiFA we share the view formulated by the UN PRI that:

"The world is changing rapidly. While our market-based economy has emerged as the most efficient system for allocating scarce economic resources, it is giving rise to a growing array of social inequalities, environmental impacts and negative externalities which are affecting companies. Unprecedented environmental and social pressures driven by food, water and energy security, access to natural resources, climate change, human rights, supply chain labour standards and ageing populations have become material issues for business and the corporate world. The impact of poor corporate governance practices on shareholder value, accentuated by the global financial crisis, has also lifted issues such as transparency, corruption, board structure, shareholder rights, business ethics, risk management and executive compensation to the top of the investor agenda.

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors, and the long-term health and stability of the market as a whole. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems. It is driven by a growing recognition in the financial community that effective research, analysis and evaluation of ESG issues is a fundamental part of assessing the value and performance of an investment over the medium and longer term, and that this analysis should inform asset allocation, stock selection, portfolio construction, shareholder engagement and voting. Responsible investment requires investors and companies to take a wider view, acknowledging the full spectrum of risks and opportunities facing them, in order to allocate capital in a manner that is aligned with the short and long-term interests of their clients and beneficiaries."

Source: http://www.unpri.org/introducing-responsible-investment/

Responsible investment is only possible if corporates make proper disclosures of financial factors and ESG factors.

Inversely as well, there have been sufficient high profile cases of significant loss in investment value as a result of poor ESG practices of corporates, further underscoring the need for proper disclosure.

The impact on the British Petroleum (BP) share price and earnings as a result of the deep-water horizon spill (http://www.theguardian.com/business/2015/jul/28/bp-loss-deepwater-horizon-bill) and the impact of the collapse of the factory in Bangladesh on the reputation of international companies who sourced garments from the factory both serve as poignant recent reminders of the importance of ESG disclosure to investors.

We also believe that the trend of importance of ESG factors to investors - both from a financial and from a non-financial standpoint - is "here to stay".

For example, climate science is evolving and 2015 may well end up being the hottest year on record, beating 2014's record (http://www.metoffice.gov.uk/climate-guide). This will continue to draw the attention of governments and policy-makers and may lead to expectations of changes in corporate behavior. Corporates will be faced with a need to change highly polluting processes to less polluting ones. This has financial implications that investors have a "right and need to know".

Also, research on the importance of solid governance continues to evolve (http://www.robeco.hk/en/market-views-news/2015/corporate-governance-in-asia-generates-higher-returns.jsp).

Finally, the importance of diversity factors in corporate behavior and performance is gaining ever greater attention (http://www.ft.com/intl/cms/s/0/cdb790f8-c33d-11e4-ac3d-00144feab7de.html#axzz3UdhQLWe3 .) We insert more detail on this in 15 below.

2. Do you agree with our proposal to amend Rule 13.91 to require the issuer to report on ESG annually and regarding the same period covered in its annual report?

☒ Yes

☐ No

Please give reasons for your views.

As noted above, responsible investment is only possible if corporates make proper disclosures of not only financial factors but also of non-financial ESG factors.

Inversely as well, there have been sufficient high profile cases of significant loss in investment value as a result of poor ESG, further underscoring the need for proper disclosure.

For these reasons we are in support of the GRI "Sustainable Stock Exchange" initiative that is referenced in the Consultation paper.

We also took note of the below in the Consultation paper:

"We also note that 83% of the H-share issuers within the Sample Issuers had reported on ESG, as compared to 38% of the Hong Kong incorporated companies. The main reason for the high level of ESG reporting by H-share issuers may be due to the Mainland exchanges requirements for ESG reporting."

This underscores the importance and effectiveness of a clear regulatory expectation. Also, to ensure continued relevance of Hong Kong as an IFC it should not fall behind the standards of other markets on ESG disclosure and integrated reporting.

For gender disclosure, see the attached comparison of Stock Exchange mandated reporting: http://www.paulhastings.com/genderparitysupplement2014/.

3. Do you agree with our proposal to include a Note under Rule 13.91 to clarify that:

(i) an ESG report may be presented as information in its annual report, in a separate report, or on the issuer's website; and

(ii) the issuer should publish the ESG report as close as possible to, and in any event no later than three months after, the publication of the issuer's annual report?

☐ Yes

☒ No

Please give reasons for your views.

We believe that ESG disclosures would better be part of integrated reporting. Separate reporting leads to the implication of lesser importance of disclosure of ESG factors. It also leads to silo-reporting whereby there is a disconnect (or "lack of connect") between financial and non-financial reporting. As noted above, poor ESG has financial implications and it is therefore possibly wrong to place it in a separate report. For these reasons, we are in support of the position taken by the Integrated Reporting Initiative (IIGC; http://integratedreporting.org/) cited in the Consultation paper.

Even if integrated reporting cannot be achieved on the short term, it must remain a target on the long term, especially in Hong Kong which has listed corporates from the PRC where policy change is rapid and will require change in processes by corporates. We insert more detail on this in 11 and 12 below.

4. Do you agree with our proposal to revise the introductory section of the Guide into four areas (i.e. "The Guide", "Overall Approach", "Reporting Principles" and "Complementing ESG Discussions in the Business Review Section of the Directors' Report"), and with the wording set out in Appendix II to the Consultation Paper?

☒ Yes

☐ No

Please give reasons for your views.

No further comment.

5. Do you agree with the proposed wording of the Reporting Principles (i.e. "Materiality", "Quantitative", "Balance" and "Consistency") in the introductory section of the Guide, as set out in Appendix II to the Consultation Paper?

☒ Yes

☐ No

Please give reasons for your views.

No further comment.

6. Do you agree with the proposed wording in the Guide linking it to Appendix 16 to the Main Board Listing Rules (in relation to the requirement for ESG discussions in the business review section of the directors' report), as set out in Appendix II to the Consultation Paper?

☒ Yes

☐ No

Please give reasons for your views.

However please also note our preference above for integrated reporting.

7. Do you agree with the proposal to re-arrange the Guide into two Subject Areas (A. Environmental and B. Social) and re-categorise "Workplace Quality", "Operating Practices" and "Community Involvement" under Subject Area B?

☒ Yes

☐ No

Please give reasons for your views.

ESG is by now a broadly used and recognized term. Therefore we agree with simplification and alignment of the subject areas to this term. Also, there are a large number of data vendors that track ESG factors in increasingly standardized fashion under the headings of E, S and G respectively. We support that the HKEx aligns its reporting requirements with such by now widely established data vendor tracking practices as this in turn allows for greater comparability between corporates on these factors. Data vendors in the field include MSCI, Sustainalytics, Bloomberg, FTSE etc. Each apply a standardized and comparable approach to the factors they track under E, S and G respectively.

8. Do you agree with the proposal to change the heading "Workplace Quality" to "Employment and Labour Standards"?

☒ Yes

☐ No

Please give reasons for your views.

No further comment.

9. Do you agree with our proposal to upgrade the General Disclosures for each Aspect of the ESG Guide to "comply or explain"?

☒ Yes

☐ No

Please give reasons for your views.

As noted above, responsible investment is only possible if corporates make proper disclosures of not only financial factors but also of non-financial ESG factors.

Inversely as well, there have been sufficient high profile cases of significant loss in investment value as a result of poor ESG, further underscoring the need for proper disclosure.

For these reasons we are in support of the GRI "Sustainable Stock Exchange" initiative that is referenced in the Consultation paper.

We also took note of the below in the Consultation paper:

"We also note that 83% of the H-share issuers within the Sample Issuers had reported on ESG, as compared to 38% of the Hong Kong incorporated companies. The main reason for the high level of ESG reporting by H-share issuers may be due to the Mainland exchanges requirements for ESG reporting."

This underscores the importance and effectiveness of a clear regulatory expectation. Also, to ensure continued relevance of Hong Kong as an IFC it should not fall behind the standards of other markets on ESG disclosure and integrated reporting.

For gender disclosure, see the attached comparison of Stock Exchange mandated reporting: http://www.paulhastings.com/genderparitysupplement2014/ .

10. Do you agree with our proposal to amend the wording of paragraph (b) under current Aspects A1, A2, A4, B1, C2 and C3, re-numbered Aspects A1, B1, B2, B4, B6 and B7, to "compliance with relevant laws and regulations that have a significant impact on the issuer..." in order to align it with the language of the relevant provisions of the Companies Ordinance?

☒ Yes

☐ No

Please give reasons for your views.

No further comment.

11. Do you agree with our proposal to revise proposed Aspect A1 ("Emissions") by upgrading to "comply or explain" the current KPIs B1.1, B1.2, B1.4 and B1.5, re-numbered KPIs A1.1, A1.2, A1.4 and A1.5, concerning disclosure of emissions and non-hazardous waste?

☒ Yes

☐ No

Please give reasons for your views.

As noted above, climate science is evolving and 2015 may well end up being the hottest year on record, beating 2014's record (http://www.metoffice.gov.uk/climate-guide). This will continue to draw the attention of governments and policy makers and may lead to expectations of changes in corporate behavior, especially concerning emissions. Corporates will be faced with a need to change highly polluting processes to less polluting ones.

Furthermore, the PRC has been piloting carbon exchanges since 2011. If the PRC places a price on carbon such will financially impact HKEx listed PRC corporates that are unprepared and have high carbon emissions (http://usa.chinadaily.com.cn/business/2015-09/09/content_21827859.htm). This further emphasizes the need for proper disclosure.

12. Do you agree with our proposal to upgrade to "comply or explain" the current KPIs B1.3 and B1.6, re-numbered KPIs A1.3 and A1.6, concerning disclosure of hazardous waste?

☒ Yes

☐ No

Please give reasons for your views.

Hazardous waste is of proven negative impact to the surrounding environment and society. Therefore it is a critical disclosure. ***We also took note of the evolution in China to allow for boarder social engagement on the topic of pollution of for example rivers and waterways (http://usa.chinadaily.com.cn/china/2015-09/14/content_21849869.htm), which taken together with the revised PRC Environmental Protection Law that became effective on January 1, 2015 further heightens the financial and reputational risk of HKEx listed PRC corporates that are non-compliant and fail to make a proper disclosures in this regard.***

13. Do you agree with our proposal to upgrade to "comply or explain" the KPIs under the current Aspect B2, re-numbered Aspect A2, "Use of Resources"?

☒ Yes

☐ No

Please give reasons for your views.

See our comments above.

14. Do you agree with our proposal to upgrade to "comply or explain" the current KPI B3.1, re-numbered KPI A3.1, concerning disclosure of the significant impacts of activities on the environment and natural resources?

☒ Yes

☐ No

Please give reasons for your views.

See our comments above.

15. Do you agree with our proposal to incorporate gender disclosure in proposed Subject Area B. Social, under the sub-heading "Employment and Labour Standards"?

☒ Yes

☐ No

Please give reasons for your views.

We refer the HKEx in this regard to the WiFA response to the HKEx Consultation paper in regards to Consultation Paper on Board Diversity, an extract of which is inserted below in the Annex.

We maintain the same philosophy expressed in our prior response that Gender Diversity is critical to optimal and balanced corporate performance. There is an increasing body of research providing further supporting data in this regard, for example:

The Credit Suisse Research Institute's report released this month reviewed 2360 global companies and found that companies with women directors out performed companies without women directors in return on equity, average growth, and price book value multiples. Bottom line? Companies with at least one-woman director had better share price performance than those companies without women for the last six years. Supporting the 2020 Index findings, the report said that larger companies have a higher proportion of women directors.
https://www.credit-suisse.com/hk/en/news-and-expertise/economy/articles/news-and-expertise/2014/09/en/womens-impact-on-corporate-performance-letting-the-data-speak.html

In November, MSCI ESG Research released its annual Women on Boards report, previously produced by GMI Ratings, the governance research and analysis firm that is now part of MSCI ESG Research. The report highlights key global trends, including:

- A slow, but steady, increase in the overall percentage of women on boards (WOB) globally;
- An increase of WOB that was partially or largely driven by increased regulatory mandates;
- A strong correlation between female executive leadership and higher percentages of WOB.

While the report covers trends for female participation on boards in 2014, it noted some interesting correlations between WOB and broader ESG metrics. Specifically, using our database of controversial business activity, boards with gender diversity above and beyond regulatory mandates had fewer instances of governance-related scandals such as bribery, corruption, fraud, and shareholder battles.
https://www.msci.com/esg_manager/2014/11/esg-insights-newsletter-november-2014.html

For this reason we support clearer and more comprehensive gender disclosure. We also hereby highlight the following comparative study of Stock Exchange mandated reporting of gender disclosure: http://www.paulhastings.com/genderparitysupplement2014/.

In addition we would also like to highlight the following research papers which further support gender diversity and its relationship to corporate performance.

Gender Diversity and Corporate Performance: https://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=88EC32A9-83E8-EB92-9D5A40FF69E66808

The CS Gender 3000: Women in Senior Management: https://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=8128F3C0-99BC-22E6-838E2A5B1E4366DF

Finally, in view of the research above, we would support this disclosure to be "comply or explain", at least as it concerns Board gender diversity. In particular, while it is understood that broader workforce diversity may differ between corporates (with some due to the line of business more naturally inclined towards men and some towards women), it is clear from the research above that Board diversity matters in terms of financial and non-financial performance.

- End -

Annex:

Extract of WiFA response to the HKEx Consultation Paper on Board Diversity in 2012:

Observations:

We are particularly encouraged that the Consultation Paper has highlighted the statistics with respect to gender as representative of diversity (or lack thereof) on issuer's boards. In this regard, we note that several of the qualitative and quantitative data indicators included in the Consultation Paper are not currently favourable towards gender diversity. We list a few items taken directly from the Consultation Paper below, which indicates that there are current diversity issues that should be focused on and dealt with:

- *"The average board size for all issuers is 8.6 directors, comprising 0.92 female directors and 7.68 male directors per issuer. On average, a large-cap or small-cap issuer's board has 0.93 women, but a mid-cap issuer has 0.89 women on its board...)."*
- *"Most available statistics on board diversity focus on gender. Although it appears to score better than China and Singapore, Hong Kong does not fare well when compared with the US, Australia and most European countries."*

The Consultation Paper also cites that a *"recent study by Standard Chartered Bank and Community Business with regard to women on boards of Hang Seng Index companies shows that for HSI companies, 9% of board positions are held by women. This represents a nominal improvement since 2009 when the figure was 8.9%."* The statistics show that international focus on board diversity in and of itself has not led to substantial market based adjustment in Hong Kong. This in turn provides further support for a clearer and more pro-active stance by Hong Kong policy makers.

A more pro-active stance would be in line with international efforts. As noted in the Consultation Paper several jurisdictions have moved into taking a more pro-active stance on the topic:

- *"Globally, many governments and exchanges are promoting board diversity. They do so either through legislation, regulation (including introducing "comply or explain" provisions in their corporate governance codes) or voluntary efforts. For instance, Norway introduced a gender quota law in 2004, when it required all listed companies and State Owned Enterprises to increase the percentage of female board members to 40%. Spain adopted gender quota legislation in 2007, effective in 2015, requiring all publicly traded companies with over 250 employees to have at least 40% of each gender on the board. France imposed a 20% gender diversity quota to be implemented 8 within 3 years and a 40% quota to be implemented within 6 years from January 2011. Similar laws have been enacted in Belgium, Iceland, Italy and Finland."*

In the UK, Lord Davies in his report on women on boards[1] recommended a target of a minimum 25% female representation on boards which has been set for 2013 and 2015. The Lord Davies report[2] also notes that the focus should be as much as to "improving business performance as about promoting equal opportunities for women."

- The EU Commission most recently set forth a 40% criterion for non executive directors.

Furthermore, and importantly, an increasing body of fundamental research is showing compelling data in favour of gender diversity on boards. We insert in Annex 1 a link to a publicly available study entitled "Gender Diversity and Corporate Performance" by the Credit Suisse Research Institute (CS Study) that was issued in August 2012. The CS Study explores the issue from a global perspective, analyzing the performance of close to 2,400 companies with and without women board members from 2005 to present. The CS Study found that large-cap companies with at least one woman on the board have outperformed their peer groups with no women on the board by 26% over the last six years. It also presented that in the middle of the last decade when economic growth was relatively robust, there was little difference in share price performance between companies with and companies without women on the board. However, after the 2008 financial crisis and the subsequent deterioration in the macro environment, stocks of companies with women on the board have strongly outperformed those without any woman on the board.

Proposals:

For the reasons above, we fully support a more proactive approach by the HKEx to increase board diversity and as such a supportive of the consultation efforts done by the HKEx.

However, we are concerned that the current recommendations in the Consultation Paper may not provide sufficient direction or catalyst for meaningful change. In particular, the current definition of diversity is broad and contrasts with the acuteness of the problem as underscored by the data.

In view of the foregoing, we suggest that, in addition to the current broad criterion on diversity, language be added to give clearer direction on gender diversity on boards.

We believe this can be achieved in a variety of ways as set out in our proposals below:

1. **Proposal 1: Set a minimum 20% women board representation**

   In support of the proposal advocated by the Women's Commission,[3] we see several advantages with setting a minimum 20% women board representation:[4]

   a. As an IFC, Hong Kong has a unique and directly relevant advantage: a deep and diverse talent pool which includes a large number of professional women.[5] This should make a 20% target

[1] "Women on Boards", Lord Mervyn Davies report dated February 2011.

[2] See footnote 3 above.

[3] A letter dated 18 March 2011 from the Women's Commission in response to the Consultation Paper on Review of the Code of Corporate Governance Practices and Associated Listing Rules.

[4] This minimum 20% quota for women would be at the lower end of the European trend.

[5] Note that this likely explains why the few women on HKG Boards currently have multiple directorships as noted in the Consultation Paper *"Statistics also show that 91% of the female directors hold only one directorship, 7% hold two and 2% hold three. In contrast, for male directors, 85% hold one directorship, 9% hold two and 3% hold three. This indicates that male directors are more likely to hold multiple directorships than female."*

achievable without great difficulty or negative externalities. We hereby respectfully submit that Hong Kong should leverage on this unique position and that by taking a leadership stance on matters of international interest such as diversity, Hong Kong will further its objective to remain a leading IFC;

b. While it is encouraging to see that 37% of companies have 1 female board member, for the reason explained in paragraph 40 onward of the Consultation Paper (Groupthink – *"One study examined the Enron board's decision-making process following its disastrous collapse and concluded that it suffered from symptoms of groupthink"*), it is clear that 1 person is a minority on the Board and would have difficulty convincing the group of his or her view. Essentially, groupthink may still prevail in such case;

c. A clearer target helps the market understand the direction and expectation better than broad guidance as currently suggested;

d. A set target tends to achieve results over a shorter timeframe as the Norway example suggests.

While we see a possible downside with setting a 40% target as it is probably overly optimistic unless viewed on a very long term basis and as such we do not suggest such 40% target at this time, we do not see any equivalent or obvious downside with setting a reasonable 20% target over the medium term. In particular, we believe that thanks to its unique status as an IFC the bench of professional working women in Hong Kong is deep enough to not lead to the indirect costs set out in paragraphs 57 and 58 and "tokenism" noted in paragraph 63 of the Consultation Paper.

If the HKEx chooses to adopt our suggestion and introduces a 20% target, recognizing that change management takes time, we would further suggest compliance by 2016.

With respect to assisting issuers achieve this 20% target, the Consultation Paper cites alternative approaches that have been adopted to promote board diversity, whether through legislation, "comply or explain" or on a voluntary basis. We respectfully suggest an additional approach that could be considered by the HKEx and which would involve building on international literature around the concept of "nudges",[6] i.e. encouraging or "nudging" companies to achieve the minimum quotas by way of inducements, financial or otherwise. This may involve the HKEx working closely with the central government as well as Hong Kong's policy makers and regulators. One example of an inducement which might be worth considering is the introduction of a tax deductible or rebate or other financial incentive for issuers who achieve the minimum quota of 20% of female board representation.

2. **Proposal 2: If setting a minimum requirement is viewed as too progressive, then at a minimum we suggest modification of the language below by adding the clarification highlighted in grey:**

"Board diversity will differ according to the circumstances of each issuer. Diversity of board members can be achieved through consideration of a number of factors, including but not limited to gender, age, cultural and educational background, or professional experience. Each issuer should take into account its own business model and specific needs, and disclose the rationale for the factors it uses for this purpose. While doing so

[6] **"Nudge: Improving Decisions about Health, Wealth & Happiness" (2008), book by Thaler & Sunstein in which they state "*A nudge, as we will use the term, is any aspect of choice architecture that alters people's behaviour in a predictable way without forbidding any options or significantly changing their economic incentives.*"**

each issuer should endeavour to set targets commensurate with international best practice for achieving board diversity including gender diversity."

3. **Proposal 3: A third approach could be to adopt Proposal 2 and combine it with a statement of intention** that the situation will be reassessed under a given time frame (e.g. in 2014) and that if at the proposed juncture the market has not by itself made improvements to the current low female representation on boards, that at such point, due consideration will be given to the introduction of minimum quota. This could be further combined with stating an aspirational target of 20%.