Joint Response for the Enhancement of Climate-related Disclosures under the Environmental, Social and Governance Framework

Q1. Do you agree to upgrade climate-related disclosures to mandatory from "comply or explain"? Please provide reasons for your views.

We agree to upgrade climate-related disclosures to mandatory from "comply or explain", with a few years of "grace period".

The Need for Capacity Building

In the very short run, a good reason to retain the "comply or explain" clause is the lack of capacity of many listed companies to satisfactorily report against the proposed requirements. Given time constraints to build capacity, their disclosures may not be at the desired level of precision to guide investors to make the right decision. More importantly, such disclosures may not hold value; in the worst case, they may even mislead investors, albeit unintentionally. In this case, it has been argued that not forcing underprepared firms to make disclosures is crucial not only to protect the credibility of the firm's future climate-related disclosures, but also to protect investors from being misled.

This issue however can be addressed by introducing a transitional period. In particular, firms may be allowed to "comply or explain" in the first few years after the proposed disclosure requirements are introduced, such that they are given sufficient time to build their capacity in making relevant disclosures. After that, the proposed disclosures shall become mandatory. This is in line with the Corporate Sustainability Reporting Directive (CSRD) in the EU, where certain firms are granted a few years of "grace period" before they are mandated to report against the European Sustainability Reporting Standards.

Mandatory Disclosure Better Aligns with National Policy and International Market Practice

In the long run, some may argue that "comply or explain" should still be retained. Their reason is that, through rigorous engagement and consultation processes with key stakeholders, some firms may in fact arrive at the conclusion that certain climate-related disclosures are simply immaterial to their enterprise values. In other words, though some firms are full competent on making accurate disclosures against the proposed requirements, it could be prudent for them to conserve human and financial resources, rather than requesting

these firms to prepare certain climate-related disclosures which deem unimportant to investors.

We find this argument justified in the current policy context. National-level net zero targets have already encompassed more than 90% of global GHG emissions. Driven by policies and regulatory pressures, investors are increasingly concerned with the financed emissions component of their portfolios. If investors and the Chinese government are regarded key stakeholders of listed companies in Hong Kong at all, the latter would be hard pressed to justify the claim that climate-related financial disclosures are immaterial to their key stakeholders. Furthermore, as reported by the Financial Times, Julia Hoggett, chief executive of the London Stock Exchange, had said at a parliamentary hearing that "We have created an environment where 'comply or explain' has become 'comply or else'".[1] In other words, while a "comply or explain" clause may provide a degree of flexibility to fit the diverse needs of different companies, it could also be abused by companies to conceal inconvenient information.

Therefore, we support making climate-related disclosures mandatory after the target companies have been given sufficient time to build relevant capacity.

Q4. Do you agree that issuers may opt to disclose the actual and potential effects of climate-related opportunities they may have identified in response to climate-related risks disclosed as set out in paragraph 3 of Part D of the Proposed Appendix 27? Please provide reasons for your views.

According to the Final Report of Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), climate-related opportunity refers to "**Efforts** to mitigate and adapt to climate change also **produce opportunities for organizations**, for example, through resource efficiency and cost savings, the adoption of low-emission energy sources, the development of new products and services, access to new markets, and building resilience along the supply chain. Climate-related opportunities will vary depending on the region, market, and industry in which an organization operates".[2]

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[1] https://www.ft.com/content/d1bd37cc-e71c-493d-bc12-e1ce0e8989fd

[2] https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf

We agree that issuers should be encouraged to disclose actual and potential opportunities for mitigating material risks that have been disclosed. However, it is important to ensure the necessary details of the disclosure that are flexible enough to be applicable to all business model and robust enough to address feasibility and risks associated with implementation.

There are multiple reasons as to why this is good practice:

Justification of Climate-related Efforts (Mitigated Impact)

We opine that if an issuer claims that an expected financial or business risk will be mitigated and that mitigation is included in the financial projections, then disclosure of climate-related opportunities should be mandated. The issuer should be compelled to provide justification for that mitigation with a climate solution which impact has to be comparable in size to the mitigation. The proposed opportunities should have been investigated sufficiently, approvals from board members sought as they are responsible for overseeing climate-related risks have deemed the solution feasible, either currently available or possible with technological advancement, and can justify that assumption.

Besides, it enables companies to evaluate the cost-effectiveness of technology adoption and calculate own's total abatement cost. By comparing the cost of adoption and mitigated emission of each technology, companies can obtain the cost effectiveness of each technology adopted. Such information could help the company to adapt and enrich their decarbonising strategy in future.

Signal to Innovators and Investors

Issuers understand the climate-related risks facing their business and may have insight into opportunities to mitigate those risks. However, large corporations could face struggles in the early-stage development and incubation of solutions, particularly if providing engineered or technical climate solutions is not core to their business. This presents a great opportunity to spur technological advancements and green innovation. Requiring issuers to perform an analysis in identifying potential solutions that can signal to innovators and the early-stage investment community where demand and, therefore, opportunities exist.

Ability to maintain a climate opportunity register

It is a fact that the actual or expected impact of potential opportunities identified to mitigate material risks will vary over time, as technology changes or projects come closer to implementation. To ensure that the issuer is maintaining an accurate baseline from which climate impacts and their mitigations are applied, constant disclosure of climate opportunities can be maintained through an opportunity register, similar to a risk register.

Q5. Do you agree that an issuer shall consider the applicability of and disclose the metrics when assessing and making disclosure of climate-related risks and opportunities as set out in paragraph 4 of Part D of the Proposed Appendix 27? Please provide reasons for your views

It is crucial that companies disclose the metrics they use to evaluate climate-related risks and opportunities in proportion to the expected impact. If a company has identified a risk that could significantly affect their businesses, they should disclose the metrics used to quantify opportunities or solutions. On the other hand, if the impact is not significant, the assessment of the proposed solution should be appropriate to the size of the risk. Meaning that the necessary rigour as to the assumptions should be reduced; or the metrics that are used to assess the risk or solution is reduced.

The Exchange Should Provide Guidance on Metric Development and Adoption

However, we believe that the Exchange should provide clear guidance on which metrics and reporting systems companies should use, and this reporting guidance should be aligned with international reporting standards. The reporting standards should be in line with internationally recognised standards such as the (Sustainability Accounting Standards Board) SASB. This will help investors confidently evaluate comparable risks across companies, considering their business models, strategies, and resource allocation. Using uniform basic metrics will also benefit non-listed companies by aligning impact metrics, it will create efficiencies when integrating products and companies into the issuers' businesses.

While bespoke, industry-specific and solution-specific metrics are necessary in some cases, we strongly advocate for the Exchange to provide a list of simple baseline metrics that all companies must use when assessing the impact of climate-related risks and the feasibility of solutions. This will ensure that all companies are on the same page when it comes to

evaluating climate-related risks and opportunities. Furthermore, exchanges should consider providing guidance on how to use these metrics effectively to ensure that companies can provide comprehensive and accurate reporting.

Q12. Do you agree to require disclosure of the current financial effects of climate-related risks, and where applicable, climate-related opportunities as set out in paragraph 10 of Part D of the Proposed Appendix 27? Please provide reasons for your views.

We agree to the disclosure of the current financial effects of climate-related risks, and where applicable, climate-related opportunities. There are two reasons.

<u>Alignment With IFRS ISSB S2 Standard</u>

Firstly, the proposed item in question evidently corresponds to paragraph 16 (a) and (b) in the newly launched IFRS ISSB S2 standard. This means that the proposed change can align with the climate-related disclosures of listed companies in Hong Kong with a highly regarded global baseline. As it is expected that an increasing number of companies will report against the ISSB standards in the near future, the requirement can ensure that Hong Kong listed companies provide information comparable to those reported by firms listed in other jurisdictions. From the investors' perspective, higher comparability of disclosures across firms in different jurisdictions allow them to conduct better climate risk analysis, which in turn reduce their investment uncertainty. On the contrary, if Hong Kong listed companies do not follow the global baseline of ISSB standards, investors would see a data gap in the climate-related disclosure of the former, which in turn weaken their investment confidence. Thus, on the basis of international comparability, the proposed item could increase the competitiveness of Hong Kong listed companies in attracting overseas climate-conscious capital.

<u>Provision of Positive Signals to Investors</u>

Secondly, the proposed item can help Hong Kong listed companies deliver positive signals to climate-conscious investors, both to domestic and overseas investors. As an increasing number of companies disclose their climate transition plans, investors begin to face the challenges of appraising the credibility of these plans; an ambitious decarbonization plan is meaningless unless coupled with a decent probability of actualization. In Chan, Cheung, and Shen (2023), this report demonstrates how the transition credibility of a firm can be partly

assessed through examining the level of transition risk perceived by the firm; intuitively, the latter is a measure of the firm's actual transition urgency, which could differ from its proclaimed transition urgency.[3] Reporting anticipated climate-related financial impacts thus play a significant role in bolstering a firm's transition credibility. In response to this question, reporting the current financial impacts of climate-related risks – as against merely those in the short, medium and long term – brings additional strategic benefits. It shows that:

(a) The firm is already facing the impacts at this moment rather than in some hypothetical future, which increases investors' confidence that the firm is aware of climate-related risks posed by its physical, regulatory and market environments, and is thus serious about addressing these risks;

(b) The firm has the knowledge and capability to attribute financial losses to climate-related events, which increases investor's confidence the firm has integrated climate risks into its risk management system – climate governance is another crucial factor of transition credibility in Chan, Cheung, and Shen (2023);

(c) The firm is willing to be accountable for its forward-looking climate claims, since in a few years investors would be able to compare the anticipated climate-related financial impacts with the actualized ones, which increases investor's confidence that the firm is less likely to misrepresent its climate risks.

All the above help Hong Kong listed companies to signal their competence in assessing and managing the challenges posed by climate change, as well as the credibility of their net-zero transition plans. Needless to say, these are also instrumental in attracting climate-conscious capital.

Q14. Do you agree to require disclosure of anticipated financial effects of climate related risks and, where applicable, climate-related opportunities as set out in paragraph 11 of Part D of the Proposed Appendix 27? Please provide reasons for your views.

In principle, we agree that forecasting climate-related risks and opportunities is a good idea. Proper forecasting can lead to sound decision-making that improves the issuer's overall profitability and climate impact. However, forecasting the financial impacts of climate-related risks and opportunities requires numerous assumptions that are specific to some of the

[3] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4504017

industries. For example, issuers that rely on a significant amount of natural resources as inputs or operate in at-risk jurisdictions need to make detailed assumptions in their forecasting. Moreover, the risks associated with climate change may be difficult to quantify as they may be "Black Swan" in nature, and it is up to the issuer to decide how to reflect that impact on their forecast.

Issuers should make Reference on Industry-specific Standards for Reporting

Therefore, we do not advocate for a one-size-fits-all methodology imposed by the Exchange. Instead, issuers should use industry-specific standards such as the SASB and TCFD when defining assumptions and executing forecasts. The Exchange should create an outline and set basic inputs as to how those are common to all financial forecasting, including carbon price (both internal and external), input costs, avoided costs due to mitigation initiatives, and discount rates.

Most importantly, the issuers should be explicit about all climate-related risk assumptions made in order to formulate the financial forecast and provide guidance on the sensitivity of those assumptions.

Question 18:

(a) Do you agree with the proposed approach for the disclosure of scope 1 and scope 2 emissions and the related information as set out in paragraphs 13 to 14 of Part D of the Proposed Appendix 27? Please provide reasons for your views.

We concur with the suggested approach for disclosing scope 1 and scope 2 emissions, as well as the corresponding information.

Alignment with ISSB Climate Standard Requirements

The proposed approach offers a standardized metric for the measurement and reporting of such emissions. It better aligned with the metric account Greenhouse Gas emission indicated in the ISSB Climate Standard requirements. Through the implementation of this uniform reporting framework, stakeholders could gain enhanced clarity regarding the environmental impact of listed companies while facilitating meaningful comparisons of emissions performance across diverse industries and sectors.

Empowerment on Stakeholders to Evaluate Companies' Transition

This standardized reporting framework empowers stakeholders to observe the transition pathway of companies, enabling a comprehensive evaluation of their performances throughout the transitioning process from high to low GHG emissions. By accessing and analysing consistently reported data, stakeholders can ascertain the progression made by companies in their pursuit of reduced emissions.

Facilitation of the Adoption of SBTi Net Zero Standard

Furthermore, the proposed approach holds potential for facilitating the adoption of the Science Based Targets initiative (SBTi) Net Zero Standard[4] in the future. Aligning with this standard allows issuers to establish ambitious emissions reduction targets in line with the global objective of limiting the rise in global temperatures to 1.5 degrees Celsius. The inclusion of this approach, therefore, fosters the creation of a more sustainable business landscape and demonstrates issuers' commitment to global climate goals.

(b) Do you agree with the proposed approach for the disclosure of scope 3 emissions and the related information as set out in paragraphs 13 to 15 of Part D of the Proposed Appendix 27? Please provide reasons for your views.

We concur with the proposed approach for disclosing scope 3 emissions and the associated information.

Alignment with ISSB Climate Standard Requirements

Scope 3 emissions encompass all indirect emissions occurring within a company's value chain and contribute significantly to its total carbon footprint. In parallel with the disclosure of scope 1 and scope 2 emissions, the inclusion of scope 3 emissions in the reporting framework better align with the metric account GHG emission indicated in ISSB Climate Standard requirements[5]. Regrettably, merely one-third of the listed companies currently volunteer to disclose their scope 3 emissions, thereby impeding a comprehensive understanding of their environmental impact[6]. Consequently, the standardization of scope 3

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[4] https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf
[5] https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf
[6] https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Environmental-Social-and-Governance/Reports-on-ESGPD/esgreport_2022.pdf

emission disclosure serves to facilitate a meaningful comparison between listed companies within the same industry or sector, allowing stakeholders to make more informed evaluations of their respective emissions performance.

Improvements on Accountability through addressing the Gap of Scope 3 Emissions Disclosure

Notably, scope 3 emissions constitute a significant gap among firms operating in the same industry or sector, thus underscoring the vital importance of their disclosure. By incorporating this element of disclosure, issuers provide vital information necessary to comprehend the complete carbon footprint generated throughout their value chain. Consequently, this comprehensive reporting fosters a heightened sense of accountability, coercing issuers to acknowledge and assume responsibility for emissions extending beyond their immediate operational boundaries.

Question 19: Do you agree with the proposed approach for the interim disclosures in respect of scope 3 emissions during the Interim Period as set out in the paragraph immediately following paragraph 15 of Part D of the Proposed Appendix 27? Please provide reasons for your views.

We concur with the proposed approach for interim disclosures pertaining to scope 3 emissions during the designated period.

As previously mentioned, scope 3 emissions encompass all indirect emissions that occur within an entity's value chain and make a significant contribution to its overall carbon footprint. However, the calculation of scope 3 emissions is highly reliant on the industry sector and business model of the issuer. Many issuers have necessitated additional time to thoroughly assess their value chain in order to identify and calculate substantial scope 3 activities, as the disclosure of scope 3 emissions was not mandatory in the previous iteration of Appendix 27.

Provision ofSufficient Time for Preparation and Implementation

The interim disclosures guarantee issuers a more substantial timeframe to adequately prepare and align with their modelling and reporting systems for the accurate dissemination of scope 3 emissions. This interim period could provide issuers with the requisite time to amass and analyze data from pertinent upstream or downstream activities along their value chain. Given

the considerable time required for engaging with suppliers and instituting robust measurement methodologies, a two-year interim period that mandates the disclosure of reasonably available information, as well as a working plan, progress, and timetable for making the necessary disclosure, is warranted.

Provision of Window for Learning and Improving

An interim period will provide an opportunity for issuers who have not previously disclosed scope 3 emissions to enhance their understanding and improve their methodologies for data collection, data management, and emission reduction strategies. During this time, issuers will have the chance to address potential challenges, improve data accuracy, and fill any gaps in their scope 3 emission disclosure. Furthermore, the introduction of an interim period for scope 3 emission disclosure serves as an illustration of issuers' dedication to taking proactive measures in addressing indirect emissions. This initiative allows issuers to showcase their commitment to sustainability goals and their ability to adapt to the evolving demands for sustainability in the market. By taking early action and demonstrating momentum, issuers can also reap reputational benefits and establish themselves as leaders in driving positive environmental change.

Utilisation of Existing Resources

Additionally, the Exchange has the potential to leverage its own resources in order to enhance its capacity for scope 3 reporting. In 2021, the Exchange released the Practical Net-Zero Guide for Business[7], which provides comprehensive guidelines for various aspects of sustainable practices. These guidelines entail establishing a baseline for future planning, aligning targets with national and international objectives, identifying potential areas for emission reduction and strategies for closing the gap, as well as implementing measures for neutralization and mitigation across the entire value chain. The Exchange could reference its previous publication to improve the proposed Part D of Appendix 27.

Q.26 Do you agree with the proposed approach for the industry-based disclosure requirements prescribed under other international ESG reporting frameworks such as the

[7] https://www.hkex.com.hk/-/media/HKEX_Common/Market/Stage/Resources-Library/Guidance-Materials/HKEX-Net-Zero-Guide_E.pdf

SASB Standards and the GRI Standards as set out in paragraph 22 of Part D of the Proposed Appendix 27? Please provide reasons for your views

Proposed Approach More than "Encouraging"

The following are the quote of paragraph 22 of Part D of the Proposed Appendix 27:

"Issuers are **encouraged to consider** the industry-based disclosure requirements prescribed under other international ESG reporting frameworks such as the SASB Standards and the GRI Standards, and make disclosures as they see fit."

We appreciate the Exchange mentioned the concept of "industry-based disclosure" in this proposed update. However, we would like to recommend the Exchange to take a step further. Instead of merely encouraging issuers to consider industry-based disclosure requirements, we suggest the Exchange to follow the approach of the IFRS ISSB S2 standard as stated below:

"An entity **shall disclose industry-based metrics** that are associated with one or more particular business models, activities or other common features that characterise participation in an industry. In determining the industry-based metrics that the entity discloses, **the entity shall refer to and consider the applicability** of the industry-based metrics associated with disclosure topics escribed in the Industry-based Guidance on Implementing IFRS S2."

Q29. Do you have any feedback on the new developments announced by the ISSB subsequent to the publication of this paper that may impact on the proposals in this paper?

We appreciate the Exchange to take the initiative to conduct the public consultation regards to the update of climate disclosure. However, we would suggest the Exchange to extend the consultation period or conduct another round of public consultation. On 26 June, the International Financial Reporting Standards (IFRS) launched its new standards, IFRS S1 and S2, which require companies to disclose climate-related risks and opportunities in their financial statements. This move comes as a response to the growing concern around climate change and the need for businesses to address their impact on the environment. Meanwhile, this consultation ends on 14 July. That means the market will only have less than one month to review the standard and reflect their opinion in the response. In other words, the market will need time to digest and analyze the newly published standards and their implications for companies, investors, and the wider financial ecosystem.

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