



Our Hong Kong Foundation’s Response to HKEX’s Consultation Paper on Review of the ESG Reporting Guide and Related Listing Rules

Our Hong Kong Foundation released a research report titled “Leading Global Capital Markets Towards a New Era: A Policy Review on Environmental, Social and Governance (ESG) Reporting for Corporates and Investors in Hong Kong” on 16 May 2019. With reference to the report and in addition to the attached questionnaire, we would like to present our views in response to the consultation paper of the Hong Kong Exchanges and Clearing Limited (HKEX) on review of the Environmental, Social and Governance Reporting Guide (ESG Guide) in the following manner:

A Right Step towards Strategy-driven ESG Reporting

1. As argued in our report, one of the fundamental problems of ESG reporting of Hong Kong’s listed companies is compliance-driven reporting – listed companies perceive ESG reporting as an administrative burden and adopt a box-ticking approach. The next stage of ESG reporting development should constitute a shift from compliance-driven to strategy-driven ESG reporting, where ESG reporting is conducted with the aim of creating strategic value for the company and provide decision-useful information for investors. The transformation would be conducive to the development of ESG investment in Hong Kong as a laggard, thereby maintaining Hong Kong’s status as a leading international financial centre.
2. We recognise that the proposed revisions of the ESG Guide is a right step towards strategy-driven ESG reporting. Particularly, the introduction of mandatory disclosure requirements (MDRs) about ESG governance and materiality assessment and the inclusion of climate-related disclosures would encourage corporates to consider ESG issues from a strategic perspective and thus facilitate strategy-driven ESG reporting.

Introduction of Mandatory Disclosure Requirements

3. The introduction of MDRs concerning ESG governance structure is crucial to establishing board’s accountability for ESG issues. The top-level commitment to ESG issues would filter down to all levels of the company and help it internalise the strategic value of ESG reporting, thereby reducing “box-ticking” phenomenon. Mandatory disclosures about ESG management approach, strategy, priorities and goals/targets in relation to their materiality for the company would nudge the management to think about ESG issues from a strategic perspective and provide more decision-useful information for investors.
4. While we are glad to see the HKEX’s recognition of the board’s role in ESG governance and reporting, these views are yet to be formally incorporated into the Corporate Governance Code (CG Code). We noticed that the HKEX recently clarified that “governance” has an ESG component and that material risks should include ESG risks in Frequently Asked Questions Series 17 and 18, but ESG may remain peripheral in practice



if ESG responsibilities are not explicitly listed among other board responsibilities and remain undefined in the CG Code at all. Therefore, in addition to the proposed inclusion of a board statement, the HKEX should clarify in its CG Code that the board is responsible for ESG reporting and strategy development, including assessment of material environmental and social risks, for better alignment with the expectations set in the ESG Guide.

5. MDRs concerning the two reporting principles, namely “materiality” and “quantitative”, are likely to enhance the quality of ESG reports. In particular, mandatory disclosure of materiality assessment process would encourage companies to identify and report ESG issues that are material from a strategic point of view.
6. The above ESG information, including ESG governance, strategy, management approach and materiality assessment process, is important for evaluating any company in any industry. Therefore, it is reasonable to make the relevant disclosures mandatory for all listed companies.

Climate-related Disclosures

7. We are glad to see the introduction of a new Aspect requiring climate-related disclosures. Among different ESG issues, climate change is definitely one of those that receive most investors’ attention given its well-proven financial materiality and Mark Carney’s repeated warnings about a ‘climate Minsky moment’. Improvement in climate-related disclosures will certainly catalyse more strategic thinking about the potential impacts of climate change on companies and enable better-informed investment decisions by investors.
8. We hope that the Aspect of climate change will contain more specifications in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Particularly, the TCFD recommendations include a sector-specific approach to metrics and KPIs, which could serve as a useful reference for specifying the KPI disclosure requirement that is for now rather general.

Refining and Potentially Narrowing Disclosure Requirements

9. Our report unravels the “chicken-and-egg” situation of ESG development in Hong Kong, where the lack of high-quality and actionable ESG information hinders investors from the uptake of ESG strategy, and companies may have little incentive to devote resources to producing high-quality ESG reports if the investor uptake is low. To solve this predicament, we recommend the HKEX should consider a sector-specific revision of the ESG Guide, which has not been addressed in the consultation.
10. As different industries face very different ESG risks, we believe the HKEX, as a facilitator, should refine and potentially narrow the scope of the ESG Guide to help companies identify the most material sector-specific ESG risks and issues. The HKEX should also offer sector-



specific guidance to assist companies in quantifying environmental and social impacts on a “comply-or-explain” basis. Certain key criteria in each sector-specific matrix should be reported on a mandatory basis.

11. Imposing more stringent and well-defined requirements on ESG disclosures at the sector level enables investors and other stakeholders to conduct meaningful examination of material ESG data on a comparable basis without being overwhelmed by data. This is especially important for small and medium enterprises where the paucity of resources may limit their capacity to identify material ESG risks and produce decision-useful ESG reports. In fact, an industry-specific approach is widely adopted by different international ESG disclosure standards such as the one of Sustainability Accounting Standards Board (SASB). International frameworks of this nature provide a foundation for the HKEX to further refine its current 11-aspect ESG Guide into a curated list of what is the most material to companies and meaningful to investors for higher-quality reporting.

Independent Assurance

12. Independent assurance could be instrumental to enhancing the credibility and quality of ESG reports. In principle, we agree that the HKEX should be explicit about the benefits of obtaining assurance and its expectation on more transparency of assurance details. Nevertheless, we believe it is equally important to stress that the HKEX should take a gradual approach to promoting the use of independent assurance.
13. Based on our recommendation in paragraph 10, we recommend the HKEX should start with encouraging companies to assure those important sector-specific KPIs related to the most material ESG issues, rather than the full ESG report. For instance, companies in the energy sector should be encouraged to verify their carbon disclosures. The HKEX should prompt the Government to consider subsidising assurance costs during early phases to assuage financial burden concerns stemming from external assurance, particularly for small and medium-sized companies.

International Reporting Standards

14. As the stock exchange of a leading international financial centre, the HKEX should align the ESG reporting mechanism with international standards. Our report revealed that while reporting front-runners adopt internationally recognised ESG reporting frameworks, they face extra costs associated with compliance with the HKEX’s ESG Guide requirements without significant value added. In contrast, middle-tier companies and latecomers may lack incentives to exceed minimum disclosures and fully realise the value of ESG reporting, if the regulators do not set expectations high enough.
15. Therefore, as an alternative to adopting the refined ESG Guide mentioned in point 10, the HKEX should allow other internationally recognised ESG reporting frameworks, such as Global Reporting Initiative Standards, the International Integrated Reporting Framework



and the SASB standards, to be used. This approach offers flexibility to companies which have already been employing advanced practices and performances in reporting to reduce their regulatory burden, while providing more choices for latecomer companies to continuously improve their reporting practices.

Talents and Datasets

16. In addition, the HKEX should play a more active role of facilitator in upgrading ESG-related infrastructure, particularly around talents and datasets – the two fundamental elements of ESG reporting.
17. Preparing and utilising ESG reports require specialist knowledge and expertise in a diverse range of subject areas from climate change to gender inclusion. The board of directors, reporting practitioners, auditors and assurers, and the investment community are key stakeholders within the ESG ecosystem, and significant capacity building is needed to lay the groundwork for quality ESG reporting. The HKEX should thus collaborate with universities and relevant professional groups to support capacity building in the ESG ecosystem, so as to enhance the general quality of ESG reports.
18. Quality environmental and social data are key inputs in any sophisticated ESG analysis and reporting, but can be prohibitively expensive for companies to collect individually. This is particularly the case for reporting in accordance with the TCFD recommendations, which involves scenario analysis for climate-related financial disclosures. The HKEX should be aware of the growing demand for high-quality ESG data, and the need to collaborate with the Government to develop open-access database of environmental and social data, especially of climate-related scenarios. These datasets and models would be essential to assessing ESG risks and opportunities by corporates, and to producing decision-useful information and analyses for investors.

Cross-sector Steering Committee and Blueprint for ESG Development

19. Developing an efficient and effective ESG reporting system takes incremental efforts over time from stakeholders across various sectors. To facilitate this process, the Government should establish a cross-sector steering committee as a platform to enable communication and consensus building among members across the ESG ecosystem. The HKEX is advised to take a proactive position in facilitating the creation of such a committee and steering the development of ESG reporting. The committee should formulate a clear blueprint that allows companies and other stakeholders to efficiently devote resources to building capacity to meet and leverage advancing ESG reporting requirements.
20. As TCFD recommendations are gaining widespread support in the international community, a clear timeline of when and how the TCFD recommendations will be incorporated into the ESG reporting requirements is important for companies to plan ahead, establish relevant management and monitoring systems, and build reporting capacity beforehand. The



steering committee should be responsible for developing the timeline and the HKEX should play an active role in it.

Clear Plan for Sustainable Development

21. For issuers, public policy can significantly influence businesses and is an important source of ESG-related risks and opportunities. The Government, therefore, should send clear and credible policy signals of how businesses will be regulated and supported to contribute to sustainable development. The HKEX, in particular, should join the dialogue with the Government and encourage relevant departments to formulate a clear sustainable development plan. This will help companies better identify ESG risks and opportunities for strategy development and quality reporting.

The Way Forward: From Regulator to Facilitator

22. Following the publication of the ESG research report, we are encouraged to see that the HKEX has taken a decisive step to promote strategy-driven ESG reporting and that many of the proposed revisions of the ESG Guide are broadly in line with our recommendations. While it is great that the HKEX plays an active role as a regulator upgrading and improving the ESG Guide, we believe listed companies and investors would further benefit from the HKEX taking a step further to strengthen its role as a facilitator of strategy-driven ESG reporting.
23. We express our general support for the HKEX's consultation paper and look forward to the implementation of a strengthened ESG reporting regulation. We also hope the HKEX considers the several issues highlighted above and strengthens its role as a facilitator for the market, which we believe is crucial for the prosperous growth of a robust ESG ecosystem in Hong Kong.

Yours sincerely,



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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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions. Specifically for this question, please refer to points 2 and 6 in the attached letter.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions. Specifically for this question, please refer to points 3-4 in the attached letter.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions. Specifically for this question, please refer to points 3-4 in the attached letter.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions. Specifically for this question, please refer to point 5 in the attached letter.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions. Specifically for this question, please refer to point 5 in the attached letter.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions. Specifically for this question, please refer to point 5 in the attached letter.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions. Specifically for this question, please refer to points 7-8 in the attached letter.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions.

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.

Please refer to the attached letter for our detailed responses, rationales and further suggestions. Specifically for this question, please refer to points 12-13 in the attached letter.

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