STATE STREET GLOBAL ADVISORS

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Via electronic submission: response@hkex.com.hk

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

Dear Sir/Madam,

State Street Global Advisors appreciates the opportunity to comment on the *Review of the Environmental, Social, and Governance Reporting Guide and Related Listing Rules* (the "Consultation Paper"), in which the HKEX (the "Exchange") offers proposals to amend the disclosure requirements for listed companies.

State Street Global Advisors is the asset management business of State Street Corporation, one of the world's leading providers of financial services to institutional investors. We have a research-focused global presence, with 27 global offices, 11 investment centers, and 24-hour global trading capability via trading desks in Boston, London, and Hong Kong. We have over $2.8 trillion (USD) of assets under management (AUM) across a range of asset classes and investment styles and are one of the largest investment managers in Hong Kong with more than $41 billion (USD) of equity AUM in the market.[1]

Mandatory Disclosure Requirements

We conceptualize "sustainability" as encompassing a broad range of environmental, social, and governance ("ESG") issues that include, for example, effective independent leadership and oversight at the board level, diversity and talent development with respect to company employees, appropriate attention to safety issues, and commitment to minimizing the impacts of climate change. ESG issues can encompass both risks that need to be mitigated and opportunities to be incorporated into strategy.

[1] As of March 31, 2019

Information on ESG practices is important because it offers investors insights into how companies manage a range of important issues. Over the long-term these issues can have a material impact on a company's ability to generate returns. Therefore, effective investment analysis requires high-quality data on companies' ESG practices. Reliable data is critical for any investment analysis; it is thus particularly crucial with respect to metrics of companies' sustainability practices, since ESG factors have become increasingly important in investment decisions.

However, we have found that the lack of standardization and transparency in ESG reporting and scoring presents major challenges for investors across all regions.[2] Companies are providing more ESG information, driven by voluntary requirements to produce regular reports on their activities pertaining to Corporate Social Responsibility objectives. However, the intended audience for such reporting means it is often designed for a broader stakeholder group and not always centered on the financially material information useful to investors. We consider quality ESG data to be that which is material, consistent, comparable, and as easily accessible as traditional financial data. In our view, there are certain established international frameworks, referenced throughout this response, which the Exchange should adopt in order to help companies generate quality data with respect to ESG issues.

Given the Consultation Paper seeks input from investors so they will have access to higher-quality information about listed companies' ESG practices, we are providing feedback in our capacity as a long-term investor in the market.

Governance Structure: Board Oversight

Section A of the Consultation Paper proposes disclosure requirements that would help shed light on how corporate governance policies ensure appropriate oversight with respect to sustainability issues. We support the Exchange's progressive endeavor to strengthen disclosure on board oversight of these factors.

As long-term investors we want insight into how companies' boards govern ESG risks, as we believe it is essential that boards assess the potential impacts of sustainability issues on their company's overall long-term strategy. We also believe that this is a necessary aspect of the board's oversight function.

Reporting Principle: Adopting a Common Reporting Framework

Material ESG information is often industry-specific but market agnostic. For example, the impacts of climate change transcend geographical borders; however, they affect industries differently. As mentioned, we urge the Exchange to consider adopting a common framework that is internationally accepted and developed according to investor needs. Adopting a common reporting framework improves the consistency and comparability of data and reduces the ability of companies to cherry-pick disclosure. It also allows investors to make global comparisons of companies. As Hong Kong is an international financial market, the Exchange should aim to meet global expectations.

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[2] https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/ESG%20Data%20Challenge.pdf

Although the Consultation Paper notes various existing frameworks, we think the Sustainability Accounting Standards Board's ("SASB") framework would be more appropriate. Reporting frameworks predating SASB provide disclosure guidance on a broad set of ESG topics but lack the specificity needed to ensure measurable, comparable, and consistent reporting of material ESG issues, in our view. SASB addressed this shortcoming with an appropriate focus on defining financial materiality by industry, thereby providing industry-specific and standardized guidance to companies while removing guesswork for all users of the framework.

Reporting Principle: Focusing on Financial Materiality

We agree with the Consultation Paper's assertion that "the key to a meaningful and concise ESG report is materiality." For investors to fully integrate ESG into their investment process they must have confidence that the ESG considerations are financially material and have a demonstrated link to sustainable long-term value creation.

Section A of the Consultation Paper suggests that "the materiality of ESG issues is to be determined by the board," and Question 7 specifically solicits comments on this proposed approach. We have found that leaving the difficult decision of determining materiality within each sector to each company has contributed to the inconsistencies in ESG reporting that we often see today.

Rather than relying solely on the board's determination, SASB's materiality framework provides investors and companies with a baseline for understanding and assessing material ESG issues.[3] Academic research demonstrates that companies that score higher on SASB's material ESG metrics for their industries generate stronger long-term sustainable returns.[4]

As drafted, the Consultation Paper omits the distinctions between industries when considering which Key Performance Indicators ("KPIs") that a company must disclose. For example, Question 16 solicits comments on revising KPIs related to supply chain management across all listed companies. On the other hand, SASB's materiality map classifies supply chain management issues as material for companies in the Household and Personal Products industry but not for companies in the Asset Management and Custody industry. Hence, SASB's framework correctly reflects the fact that such issues are not equally critical across different sectors.

Separately, the Exchange's proposal does not compel disclosure on certain issues that are material across multiple sectors. For example, while SASB identifies product design and lifecycle management as material issues applicable to these two industries and provides in-depth guidance on the particular KPIs to be disclosed, the Consultation Paper does not include such issues in the proposed disclosure requirements.

Another advantage of the SASB framework is that it is regularly updated to integrate investor and company feedback. While a less dynamic framework would require constant monitoring and updating by regulators, SASB's process builds in adaptations to market changes.

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[3] https://materiality.sasb.org/

[4] Mozaffar Khan, George Serafeim, and Aaron Yoon, Corporate Sustainability: First Evidence on Materiality (November 9, 2016).

We support the Exchange's focus on financial materiality when assessing and reporting on ESG issues, and agree with their emphasis on the board's role in sustainability oversight. It would be prudent for the Exchange to endorse a common reporting framework that offers guiding principles to boards in their materiality determinations such as SASB's materiality map instead of relying solely upon boards to decide. The absence of such guidance could lead to fragmented and incomparable reporting, further exacerbating the data quality issue.

Meaningful Disclosure Improves Engagement

Disclosure requirements focusing on financial materiality would aid companies in efficiently and meaningfully providing information to investors. Establishing clear guidance to companies on which ESG topics to prioritize and disclose to investors reduces the potential for "disclosure fatigue," which is especially helpful for small and midcap companies that may have limited resources and small sustainability teams.

Removing opaqueness around ESG materiality also helps focus conversations between companies and investors on the appropriate issues. We recently launched "R-Factor™," our ESG scoring system which uses commonly accepted financial materiality frameworks to generate a unique score for listed companies.[5] We share R-Factor™ scores and scoring methodology with companies, which has itself proven to enhance the quality of our engagements. This encourages companies to focus on the important issues and provides them with the transparency to meet our expectations, thus creating a mechanism to improve sustainable markets and long-term value for investors.

Alignment with the Task Force on Climate-Related Financial Disclosures

Section B of the Consultation Paper, "Aspect on Climate Change and Revising the Environmental KPIs," proposes mandatory disclosure of the actual and potential impacts of climate-related risks and opportunities posed to each company, per the recommendations of the Financial Stability Board's Taskforce on Climate-Related Financial Disclosures (TCFD). We appreciate the Exchange's attention to the TCFD and support the requirements for additional disclosure.

TCFD is not only a reporting framework but also a framework by which companies can develop strategies to plan for climate-related risks and make their businesses more resilient to the impacts of climate change. State Street Global Advisors has issued a statement of support for the TCFD and as an investor we engage with investee companies on climate-related issues using its framework.[6]

We encourage companies to provide disclosures in line with the recommendations of the TCFD and its four pillars encompassing governance, strategy, risk management, and metrics and targets. We recently analyzed climate-related disclosure for companies in the oil, gas, mining, utility, agriculture, and forestry sectors to develop recommendations on ways that companies can enhance their reporting.[7,8] We found that companies in these

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[5] https://www.ssga.com/investment-topics/environmental-social-governance/2019/04/inst-r-factor-reinventing-esg-through-scoring-system.pdf
[6] https://www.ssga.com/investment-topics/environmental-social-governance/2018/10/tcfd-statement.pdf
[7] https://www.ssga.com/investment-topics/environmental-social-governance/2019/06/climate-disclosure-assesment.pdf
[8] https://www.ssga.com/investment-topics/environmental-social-governance/2019/04/climate-risk-disclosure-in-agriculture.pdf

sectors often clearly communicate how they mitigate climate-related risks but seldom disclose how they are adapting their business to the impacts of climate change. This has been an evident impediment to the work underway in Europe by the European Commission's Technical Expert Group ("TEG") with regard to developing technical screen criteria underpinning the proposed European unified classification system, or taxonomy, of sustainable economic activities. In the final report presented to the European Commission, the TEG focused heavily on technical screening criteria for economic activities expected to make a substantial contribution to climate change mitigation; however, they were only able to recommend a draft framework for activities contributing to climate change adaption due to the lack of quality data.[9]

Furthermore, we recognize that keeping global warming below 2°C would require sustained, large-scale action and additional technological solutions. Reliable and economically meaningful carbon pricing regimes should therefore be set by governments at a level that incentivizes business practices, consumer behavior, research, and investment to significantly advance the energy transition.[10]

Conclusion

We commend the Exchange for its progressive efforts to enhance ESG disclosure requirements for listed companies. In particular, we are encouraged by the Consultation Paper's focus on financial materiality in the context of ESG issues. However, it remains unclear how some of the proposed changes would, in practice, achieve the objective of creating more meaningful disclosure.

Most crucially, we would encourage the Exchange to consider drawing from SASB to establish a common reporting framework as this would ensure that ESG disclosures are material, comparable, and consistent. While the Consultation Paper provides for disclosure standards that closely align with TCFD recommendations and defines various ESG KPIs, under the current proposal boards would ultimately be tasked with determining the materiality of ESG issues likely leading to inconsistent and incomplete disclosures. Whereas, the SASB framework fully embraces and aligns with the TCFD recommendations while also providing concrete and industry-specific standards for materiality-focused disclosure.[11]

The implementation of SASB's guidance would remove opaqueness around ESG materiality and encourage companies to focus on issues appropriate to their sector. We believe this is a mechanism to foster sustainable markets and create long-term value for investors.

[9] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-taxonomy_en.pdf
[10] https://news.nd.edu/assets/323600/2019_vatican_carbon_pricing_statement_final.pdf
[11] https://www.cdsb.net/sites/default/files/sasb_cdsb-tcfd-implementation-guide-a4-size-cdsb.pdf

STATE STREET GLOBAL ADVISORS

We appreciate the efforts of the Exchange and its willingness to consider our perspectives. Thank you again for providing the opportunity to comment on the important matters addressed in the Consultation Paper and we hope that the Exchange finds our feedback useful. If you would like to discuss any of these topics in further detail please contact Kevin Anderson, Head of Investments, Asia-Pacific via email at [redacted] or Benjamin Colton, Head of Asset Stewardship, Asia-Pacific via email at [redacted]

Sincerely,

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