

## **Business and Human Rights Network Hong Kong**

### **Submission to the Hong Kong Stock Exchange on its Consultation Paper on Review of the ESG Reporting Guide and Related Listing Rules (19 July 2019)**

#### **1. The Business and Human Rights Network Hong Kong**

The Business and Human Rights Network Hong Kong (BHR Network) is a Hong Kong-based network of local and international civil society organizations and individuals that is concerned with and focussed on promoting awareness of and respect for human rights in business operations.

The BHR Network welcomes the review of the Environmental, Social and Governance Reporting Guide and related Listing Rules as set out in the May 2019 consultation paper. In this submission, the BHR Network shares its views and recommendations in response to the consultation paper. These views and recommendations relate to the Exchange's overall approach to ESG matters, specifically "comply or explain provisions" of the Listing Rules and mechanisms for ensuring compliance.

#### **2. The Exchange's overall approach to ESG**

##### **(a) The Exchange's duties and international standards and best practices**

The principal function of The Hong Kong Stock Exchange Limited (the Exchange) is to provide a fair, orderly and efficient market for the trading of securities. The institution and enforcement of continuing obligations on listed issuers in the Listing Rules are central to the Exchange's statutory duty to ensure an orderly, informed and fair market and in particular, that potential investors are given sufficient information to enable them to make a properly informed assessment of an issuer and that investors and the public are kept fully informed by listed issuers.

In line with such duties, the HKEX's mission to be a globally respected organisation<sup>1</sup> and its strategy to be a leading global exchange in terms of global relevance and regulatory standards<sup>2</sup>, and in light of the ever-growing concerns among international investors and other stakeholders over ESG issues, the Exchange should actively direct issuers to become conversant and comply with international standards and best practices on ESG matters.

##### **(b) International standards and best practices**

First, international investors, many of whom are active in the Hong Kong stock market, in assessing listed issuers, view ESG matters as both minimising investment risks *and* enhancing overall returns.<sup>3</sup> "Investors realize that ESG activities can have negative or positive financial consequences and they want to anticipate and account for the operational, regulatory, and

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<sup>1</sup> [https://www.hkexgroup.com/strategic\\_plan\\_2019/index.htm](https://www.hkexgroup.com/strategic_plan_2019/index.htm).

<sup>2</sup> <https://www.hkexgroup.com/-/media/HKEX-Group-Site/ccd/About-HKEX/Strategic-Plan-2019-to-2021/HKEX-20192021-Strategic-Plan.PDF>.

<sup>3</sup> Hans-Jörg Naumer, Global Head of Capital Markets & Thematic Research, Allianz Global Investors, "Added value or a mere marketing tool? What does ESG mean for investments?" (December 2017); <https://hk.allianzgi.com/-/media/allianzgi/ap/hongkong/pdf/en/investment-themes/201712-esg-hk-en-final.pdf?la=en&hash=B0D8CEC991F95718B38B0D7752ABF5E0C303D703>.

reputational impacts of ESG issues. They see the link between ESG and the value of the business.”<sup>4</sup> For these reasons, the statements in paragraph 4 of the consultation paper that characterise ESG solely as risks are not in keeping with the times. We recommend that the Exchange, when publishing the conclusions related to the consultation paper, restate ESG to acknowledge their positive impact on business operations and value.

Second, we encourage the Exchange to refer, in fact and explicitly in the conclusions related to the consultation paper, to the following international standards and best practices:

(i) Sustainable Stock Exchanges Initiative (SSE) and World Federation of Exchanges (WFE)

HKEX is a partner exchange of the [SSE](#), an initiative of the UN Secretary General aimed at building the capacity of stock exchanges in promoting responsible investment in sustainable development and advancing corporate performance on ESG issues through research, consensus building and technical assistance.

The Exchange should honour the commitment to SSE and provide issuers with guidance on sustainability reporting in line with SSE-backed standards and practices. That the Exchange introduced the ESG Reporting Guide in 2013 ahead of the SSE’s Model Guidance on Reporting ESG Information to Investors ([SSE Model Guidance](#)) is laudable. We believe that the Exchange should take further steps, to publicise the SSE Model Guidance as well as tools in it (such as the Value Driver Model and tools for identifying ESG factors for reporting<sup>5</sup>), and incorporate their substance in the Listing Rules.

HKEX is also a member of the long-established World Federation of Exchanges ([WFE](#)), the global industry group for exchanges and clearing houses. The [WFE’s ESG Guidance and Metrics Revised June 2018](#) is also relevant in that it supplements the SSE Model Guidance, identifies specific metrics as baseline indicators for disclosure by issuers, and recognises new sustainability developments such as the UN Sustainable Development Goals and the Task Force on Climate Related Financial Disclosures Recommendations (which are given prominence in the consultation paper).

(ii) The United Nations Guiding Principles on Business and Human Rights (UNGPs)

The responsibility to respect human rights is a global standard of expected conduct for all business enterprises wherever they operate. The [UNGPs](#) make clear that the responsibility exists independently of States’ abilities and/or willingness to fulfil their own human rights obligations, and over and above compliance with national laws and regulations protecting human rights. Business enterprises should prevent, address and remedy adverse human rights impacts and undertake other commitments or activities to support and promote human rights throughout their business operations.

Given this responsibility in relation to fundamental rights, issuers should be required to disclose their human rights track record to investors and the public. Issuers’ disclosure, particularly in the various aspects of ESG reporting, would play a key role in ensuring

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<sup>4</sup> Olivier Jan, partner of Deloitte Global, at the Harvard Law School Forum on Corporate Governance and Financial Regulation (February 25, 2019); <https://corpgov.law.harvard.edu/2019/02/25/the-board-and-esg/>.

<sup>5</sup> See Annex D and Annex E of the SSE Model Guidance. For details of the Value Driver Model, refer to [https://www.unglobalcompact.org/docs/issues/doc/Financial markets/ESG Investor Briefing/Hosting an ESG Investor Briefing.pdf](https://www.unglobalcompact.org/docs/issues/doc/Financial%20markets/ESG%20Investor%20Briefing/Hosting%20an%20ESG%20Investor%20Briefing.pdf).

corporate accountability for identifying, preventing and addressing human rights risks and adverse impacts in business operations.

The Exchange should incorporate the UNGPs into its ESG Reporting Guide by requiring issuers, for example, to disclose publicly commitment and measures to meet their responsibility to respect human rights and put in place due diligence and grievance processes for addressing impacts on human rights.

(iii) Global Reporting Initiative (GRI)

The [GRI](#) has developed the [Sustainability Reporting Standards](#) as global best practice for reporting on a range of economic, environmental and social impacts.

The Exchange should incorporate the GRI Sustainability Reporting Standards when specifying disclosure and other requirements in the ESG Reporting Guide and related Listing Rules.

(iv) Principles for Responsible Investment (PRI)

The [PRI](#), a global initiative supported by the United Nations, is a set of principles developed by international institutional investors to reflect the relevance of environmental, social and corporate governance issues to investment practices. PRI signatories have become the leading global network for investors to demonstrate publicly their commitment to responsible investment, and number over 2,200 across the world. Incorporating ESG issues into investment practice and enhancing the transparency of issuers in ESG reporting have become leading trends in the global capital market. Stock exchanges, as facilitators for the trading of securities, should adhere to and promote the PRI in order to align with international practices in ESG reporting. The Exchange should make issuers and their professional advisers aware of such developments and encourage issuers to consider and disclose their commitment to PRI by becoming signatories.

We note that the London Stock Exchange’s guide to ESG reporting” sets out a list of “The global ESG frameworks” that include the above and others.<sup>6</sup> The Nasdaq Stock Exchange’s guide to ESG reporting features a whole section on “Standards” that discusses in detail the standards and practices of five organisations.<sup>7</sup>

Recommendations:

- (i) The Exchange, in the conclusions related to the consultation paper, restate ESG matters to reflect their positive impact on business operations and value and inform issuers and professional advisers of the Value Driver Model and similar tools.
- (ii) The Exchange, in fact and in the conclusions related to the consultation paper, refer explicitly to the international standards and best practices and incorporate such standards and practices into the ESG Guide and related Listing Rules, as described above.

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<sup>6</sup> See p. 24 of “Your guide to ESG Reporting” published by the London Stock Exchange group dated January 2018. [https://www.lseg.com/sites/default/files/content/images/Green\\_Finance/ESG/2018/February/LSEG\\_ESG\\_report\\_January\\_2018.pdf](https://www.lseg.com/sites/default/files/content/images/Green_Finance/ESG/2018/February/LSEG_ESG_report_January_2018.pdf).

<sup>7</sup> See pp.11-13 of “ESG Reporting Guide 2.0: A Support Resource for Companies” published by the Nasdaq Stock Exchange and dated May 2019. <https://business.nasdaq.com/esg-guide/>.

### 3. Recommendations on KPIs of ESG guidelines

We welcome the upgrade of all social KPIs reporting obligation from “recommended disclosures” to “comply or explain”. We also welcome the expansion of the scope of social KPIs. A more transparent and comprehensive disclosure framework in this subject area should provide better information to investors, the public and the Exchange itself and enable issuers to track their own performance, in terms of both risk mitigating and value creation.

We believe that employment and labour practices should be broadened to cover the workers of the entire supply chain, not just employees. Contracted workers and workers of suppliers of goods, labour and other services can be significant to the business of many issuers; in such circumstances, they should not be treated differently under the disclosure regime. Issuers, having the privilege of access to the facilities of the Exchange, should not operate overt and covert work forces; and the Listing Rules should not condone such a division. The ESG Reporting Guide and related Listing Rules provisions should extend to all types of workers – not just employees – who contribute to the business of an issuer.

We also believe that ratios can be meaningful disclosure alongside descriptions of policies and strategies and can serve as measures of the extent to which an issuer has been successful or otherwise in realising its policies and strategies. For instance, a company’s policy may include gender equality but its operations show a significant pay gap in the gender context.

We recommend amending the title of Aspect B1 from “Employment” to “Workforce” and the scope of related KPIs should be amended accordingly. We also recommend the inclusion of ratios where appropriate. Our markup of the “Comply or explain” Provisions below is founded on the reasons stated above but should not be regarded as comprehensive.

On top of the amendments proposed in the consultation paper, we recommend further amendments and expansions (highlighted in red, for ease of reference) of the following social KPIs (Note: sections with no suggested changes have been omitted in the following table):

	<b>“Comply or explain” Provisions</b>
B. Social	
<b>Workforce and Labour Practices</b>	
<b>Aspect B1: Workforce</b>	<p>General Disclosure</p> <p>Information on:</p> <p>(a) the policies; and</p> <p>(b) compliance with relevant laws and regulations that have a significant impact on the issuer</p> <p>relating to compensation and dismissal, recruitment and promotion, working hours, <b>overtime compensation</b>, rest periods, equal opportunity, diversity, anti-discrimination, and other benefits and welfare; <b>and relating to procurement and selection of suppliers of goods, labour or other services that have a significant impact on the business of the issuer (“significant suppliers”)</b>.</p> <p><b>Workforce includes employees (whether full- or part-time and whether or not on a short-term contract, whether seasonal, of migrant status) as well the workforce</b></p>

	engaged by significant suppliers.	
	KPI B1.1	Total workforce by employment type (i.e. full- or part-time; duration of contract; engaged by significant suppliers), and subdivided by gender, age group and geographical region.
	KPI B1.2	Structure (e.g. seniority, function, years of experience or service) and payscale
	KPI B1.3	Median compensation of each of the different classes within the structure; total compensation of executive directors to median full-time employee total compensation; median compensation of workers by gender
<b>Aspect B2: Health and Safety</b>	<p>General Disclosure</p> <p>Information on</p> <p>(a) the policies; and</p> <p>(b) compliance with relevant laws and regulations that have a significant impact on the issuer</p> <p>relating to providing a safe working environment and protecting employees from occupational hazards (including policies for assignment of work to injured, sick, pregnant and disabled workers).</p>	
<b>Aspect B3: Development and Training</b>	<p>General Disclosure</p> <p>Policies on improving employees' knowledge and skills for discharging duties at work, including training on the protection and well-being of the workforce such as occupation health and safety, anti-discrimination, and anti-harassment. Description of training activities.</p>	
<b>Aspect B4: Labour Standards</b>	<p>General Disclosure</p> <p>Information on:</p> <p>(a) the policies; and</p> <p>(b) compliance with relevant laws and regulations that have a significant impact on the issuer</p> <p>(c) grievance mechanisms operated or used</p> <p>relating to preventing child and forced labour.</p>	
	KPI B4.3	Description of protection provided for seasonal, migrant and dispatched workers and their costs of work (eg average agency fee paid by migrant workers).
<b>Aspect B5: Supply Chain Management</b>	<p>General Disclosure</p> <p>Policies on managing environmental and social risks of the supply chain; and identity and other material information of first and second-tier</p>	

	suppliers.	
KPI B5.5		The full names of all authorized production units and processing facilities <sup>8</sup> and the site addresses.
KPI B5.6		The full names and other identifications of the company operating the business at the site as well as the full names and other identifications of their shareholder(s).
KPI B5.7		Type of products made <sup>9</sup> and number of workers at each site. <sup>10</sup>

We recommend adding “Litigation and dispute” as a new subject area. The reasons for including litigation are obvious as they can be costly in terms of court fees, professional charges, management distraction, additional staff costs, fines, reduced turnover and reputational damage. On the other hand, a company’s consistent legal compliance record is instrumental in sustaining its operations. It cannot have escaped the Exchange’s notice that many companies (especially those with cross-border operations) are engaged in disputes with stakeholders in the communities that host their investments or other business operations. These disputes can exact the same magnitude of costs on companies (eg in the form of work strikes or blockades) and warrant disclosure in the same way as litigation. Furthermore, litigation and dispute can arise in relation to all subject areas and aspects of ESG, not just anti-corruption as is currently embodied in KPI B7.1. In the current revision, the Exchange makes no revision to KPI B7.1 - “Number of concluded legal cases regarding corrupt practices brought against the issuer or its employees during the reporting period and the outcomes of the cases”.

We recommend adding a standalone set of “comply or explain” provisions for litigation and dispute that would cover all ESG subject areas and aspects. The contents of the table below may serve a starting point for drawing up relevant KPIs.

“Comply or explain” Provisions	
<b>C. Litigation and Dispute</b>	
<b>Aspect C1: Labour</b>	<p>General disclosure</p> <p>Information on:</p> <ul style="list-style-type: none"> <li>(a) the policies;</li> <li>(b) Compliance with relevant laws and regulations that have a significant impact on the issuer;</li> <li>(c) due diligence;</li> <li>(d) relationship with the workforce;</li> <li>(e) ongoing monitoring and assessment; and</li> <li>(f) dispute mitigation and resolution mechanisms and practices</li> </ul>

<sup>8</sup> Processing factories include printing, embroidery, laundry, and so on.

<sup>9</sup> Indicate the broad category—apparel, footwear, home textile, accessories.

<sup>10</sup> Indicate whether the site falls under the following categories by number of workers: for instance, fewer than 1,000 workers; 1,001 to 5,000 workers; 5,001 to 10,000 workers; more than 10,000 workers.

	relating to labour (including rights and protective measures).	
	KPI C1.1	Number of pending and concluded cases regarding labour disputes (including in relation to occupational health and safety issues) involving the issuer or its workforce during the reporting period and the outcomes of the cases, including fines, payment and other form of compensation and remedial measures.
<b>Aspect C2: Environmental Impacts</b>	<p>General disclosure</p> <p>Information on:</p> <ul style="list-style-type: none"> <li>(a) the policies; and</li> <li>(b) compliance with relevant laws and regulations that have a significant impact on the issuer</li> <li>(c) due diligence;</li> <li>(d) ongoing monitoring and assessment;</li> <li>(e) dispute mitigation and resolution mechanisms and practices</li> </ul> <p>relating to the issuer's exploitation or use of natural resources and its operations' impact on the environment.</p>	
	KPI C2.1	Number of concluded cases regarding non-compliance with environmental regulations brought against the issuer or its workforce and disputes relating to exploitation or use of natural resources or environmental impact involving the issuer or its workforce during the reporting period and the outcomes of the cases, including fines, payment and other form of compensation and remedial measures.
<b>Aspect C3: Other Social Impacts</b>	<p>General disclosure</p> <p>Information on:</p> <ul style="list-style-type: none"> <li>(a) the policies;</li> <li>(b) compliance with relevant laws and regulations that have a significant impact on the issuer;</li> <li>(c) due diligence;</li> <li>(d) relationship with host communities;</li> <li>(e) ongoing monitoring and assessment; and</li> <li>(f) dispute mitigation and resolution mechanisms and practices</li> </ul> <p>relating to social impact (such as livelihood, land use, education).</p>	
	KPI C3.1	Number of pending and concluded cases regarding social disputes involving the issuer or its workforce during the reporting period and the outcomes of the cases, including fines, payment and other form of compensation and remedial measures.

Recommendation:

The Exchange should amend the “comply or explain” provisions in accordance with the substance and the drafting recommended above.

**4. Grievance and other mechanisms for ensuring compliance by issuers**

The Exchange noted, in its analysis of ESG disclosures by issuers published in 2018, that the quality of ESG reporting by issuers varied (even though the overall level of compliance with the ESG Guide was high) and in particular, that some reports fell short of being meaningful and comprehensive with issuers taking a “box-ticking approach”, not giving considered reasons for non-disclosure, making inadequate disclosure or simply not meeting the requirements.

In order to ensure issuers’ ESG reportings are fit for the set purpose, we recommend the Exchange to devise clear mechanisms and procedures (including remedies and sanctions) that will be deployed in cases of non-compliance.

Furthermore, in order to ensure that such mechanisms and procedures would be applied in a fair and inclusive manner, the Exchange should establish a grievance mechanism available to investors and members of the wider community of stakeholders to receive information on, consider and address alleged inaccurate, incomplete or misleading disclosure of material ESG-related information. The grievance mechanism should take into account the UNGP<sup>11</sup> criteria: legitimate, accessible, predictable, equitable, transparent, rights-compatible, a source of continuous learning, and based on engagement and dialogue.

Recommendation:

The Exchange should consult separately on the feasibility and design of grievance and other mechanisms for ensuring compliance by issuers.

**5. Regular ESG review**

We commend the Exchange for its efforts in regularly reviewing and seeking to improve its ESG Reporting Guide and related Listing Rules. We encourage the Exchange to continue such efforts in the coming years, with active engagements with investors, issuers and professional advisers but also civil society and other stakeholders, in order to steer issuers toward producing more meaningful and comprehensive ESG disclosures and observing international standards and best practices. This approach will help to enhance the quality of companies taking advantage the Exchange’s market facilities and in turn HKEX’s own reputation, global standing and shareholder value.

We look forward to providing more input on subsequent rounds of consultation on the very important subject of ESG.

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<sup>11</sup>See paragraph 2(b)(ii) above and pp. 34-35 of the UNGP document.