香港董事學會
The Hong Kong Institute of Directors
FOUNDED 1997

19 July 2019

Corporate Communications Department
Hong Kong Exchanges and Clearing Limited
8/F, Two Exchange Square
8 Connaught Place
Central, Hong Kong

Dear Sirs

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

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our response to the captioned paper.

HKIoD is Hong Kong's premier body representing directors to foster the long-term success of companies through advocacy and standards-setting in corporate governance and professional development for directors. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In developing the response, we have consulted our members.

Should you require further information regarding our response, please do not hesitate to contact me on tel no. 2889 9986.

Thank you very much for your kind attention.

Yours sincerely
THE HONG KONG INSTITUTE OF DIRECTORS
[redacted]

Dr Carlye Tsui
Chief Executive Officer

Enc

cc: Dr Christopher To, Chairman, HKIoD
Mr Henry Lai, Immediate Past Chairman, HKIoD & Chairman, Corporate Governance Policies Committee

2104 Shanghai Industrial Investment Building, 48 Hennessy Road, Wan Chai, Hong Kong
香港灣仔軒尼詩道 48 號上海實業大廈 2104 ● T: (852) 2889 9986 F: (852) 2889 9982 ● executive@hkiod.com ● www.hkiod.com

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The Exchange's Consultation Paper on
Review of the Environmental, Social and Governance Reporting Guide
and Related Listing Rules (May 2019)

In relation to the captioned Consultation Paper, The Hong Kong Institute of Directors have the following views and comments:-

* * *

General Comments

HKIoD appreciates the Exchange's continuing efforts to raise the awareness of ESG reporting among issuers.

Previously, HKIoD responded to the Exchange's consultation paper to introduce the ESG Reporting Guide (December 2011) and the consultation paper to upgrade ESG reporting (July 2015). HKIoD holds the belief that proper consideration of ESG matters in light of the issuer's business model should help the issuer's board devise strategy to better manage risks and capture opportunities, enhancing long-term value.

Mandating governance for ESG and its disclosure is touted to be the most important aspect of the current proposals. Consultation Paper para 6. And the key to a meaningful and concise ESG report is materiality. In the context of a "comply or explain" provision, if a particular Aspect in the ESG Reporting Guide is deemed not material to the issuer's business, the report should explain rather than disclose immaterial information/data. Consultation Paper para 7. In our assessment, one useful outcome of the current proposals could be to reinforce the board's involvement in ESG governance. The board's involvement, in turn, needs to be one that showcases the ability to identify and assess ESG issues that are critical – material – to the issuer's success.

ESG reporting and the board's role

One may rationally dispute the actual link between ESG issues and financial performance, but HKIoD can recognise, at least in aspiration if not hard evidence, that proper consideration of ESG matters in business strategy can lead to better performance in the long run. It is prejudice to dismiss ESG matters as having no place in creating value.

Whether in the older industrial-based or the newer knowledge-based economy, a firm is not likely to truly create value if it has no regard to the interests and does not enlist the support of stakeholders. ESG reporting does have the utility of facilitating a fuller and more differentiated assessment of the risks and opportunities brought on by ESG factors. The ability of a company board to identify those risks and manage them, and the ability of the board to seize opportunities in anticipation of emerging trends to keep and create competitive edge, can be a strong reflection of board leadership and management quality.

But while ESG reporting can serve as a surrogate of board leadership and management quality, calculating metrics and ultimately KPIs does not replace the need for risk assessments. KPIs themselves do not necessarily tell you how ESG issues interact, and they do not necessarily tell you the trade-offs between and among issues. Having KPIs do not replace, and in fact requires more, the exercise of judgment in developing company strategy in light of those risks and opportunities.

The board has the task to make appropriate assessments on the relative weights of the various ESG factors confronting the company, devise a strategy to tackle those issues, and communicate that strategy. The aim of creating long-term value provides the necessary criteria for weighing the competing interests. The success or not of value creation in turn becomes a check on the performance of the board and management.

ESG reporting has much value in making an issuer's board engage in a deep understanding of the business, identifying the issues affecting the issuer's long-term success, and to fulfil the board's duty in setting corporate strategy accordingly. But if the context is lost, ESG reporting could quickly become an exercise to report for reporting's sake.

About KPIs

Key performance indicators, or KPIs, should reflect the critical success factors of an organisation. The Exchange's ESG reporting regime may in various "KPIs" be calling for data that could be useful metrics in their own right, but do not necessarily amount to be company-specific "KPIs". Wanting to have better comparability across issuers may be a consideration, but then ESG issues vary by industry and by region and ESG priorities can shift over time.

It should be for issuers to identify, with reference to the business models and production processes they engage in, those ESG issues that are material to them. And so, it should be for issuers to identify and report metrics and ultimate KPIs that are material to their business. This is a check on the ability of the issuer's board to identify risks and trends that may affect its business and devise strategies to seize opportunities in light of those trends.

We surmise stakeholder groups' expectations will have effect in making issuers recognise the type of information and range of metrics and ultimate KPIs relevant to them.

ESG reporting in context

Not everything that counts can be measured, and not everything that can be measured counts. Keeping track of metrics, for one, involves considerable time and costs. The aim for doing all that must be put in the perspective of an issuer's long-term value creation, not to give the investment community or stakeholder groups some ostensibly standardised scorecards for ranking one issuer over another.

The purpose of an issuer's ESG reporting should be to facilitate the identification of risks and opportunities in setting strategy for creating long-term value. If the aim becomes slanted towards suiting some reporting guide's prescription to achieve good scorecards, the focus on strategy blurs. We could end up in a trap where boards and management pursue with corporate resources their own personal favourite social behaviour in the name of increasing social welfare but that in fact undermines the value-seeking objective.

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<u>Responses to questions for consultation</u>

Subject to our general comments above, we state our responses to specific questions here:

<u>Timeframe for Publication of ESG Reports</u>

Question 1: Do you agree with our proposal to amend MB Rule 13.91 and GEM Rule 17.103 to shorten the time required to publish an 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?

HKIoD response:

- AGREE
  - We believe shortening the timeframe for publication of ESG reports to the same as that for annual reports has the practical effect of making issuers consider ESG factors and tying them to operational and financial performance.
  - Within limits, however, we have no objections to some "staggered" approach to give some issuers more time to become fully compliant with the new timeline.

Printed Form of ESG Reports

Question 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?

HKIoD response:

- AGREE
  - The salient issue is whether investors have a practical way to know about the availability of information, and how to get them. Under the proposal, investors who specifically desire a printed report can ask for it.

Introducing Mandatory Disclosure Requirements, Generally

Question 3: Do you agree with our proposal to amend the Guide to introduce Mandatory Disclosure Requirements?

HKIoD response:

- AGREE

Governance Structure

Question 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?

HKIoD response:

- As to (a), AGREE
- As to (b), AGREE
- As to (c), AGREE

Question 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?

HKIoD response:

- AGREE

Reporting Principles

Question 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?

HKIoD response:

- AGREE
  - The Reporting Principles refer to "materiality", "quantitative", "balance" and "consistency". The "consistency" principle should not draw much doubt or opposition.
  - The "balance" principle may raise some doubts; what is presented as "in balance" may be a subjective call. In our view, the "balance" principle should be understood and applied against the board's overall business strategy (and therefore, in some way, be assessed alongside the board's application of the "materiality" principle.)
  - As to "materiality", see our response to Question 7.
  - As to "quantitative", see our response to Question 8.

Question 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?

HKIoD response:

- AGREE
  - Our reservation is in the treatment of "stakeholder engagement". We believe the disclosure should centre on the criteria for the selection of ESG factors (item (iii) in the proposed wording of clause 13 of Appendix 27), with stakeholder engagement presented as one method or element in the assessment process.

Question 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 KPIs for historical data must be measurable, targets may be expressed by way of directional statements or quantitative descriptions?

HKIoD response:

- As to (a), AGREE
- As to (b), AGREE.
  - Where an issuer elects to set targets by way of "forward-looking" statements, such statements, so long as there is the proper context or disclaimer, should not be read or revisited with hindsight as to attract undue liability.

<u>Reporting Boundary</u>

Question 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?

HKIoD response:

- AGREE

<u>Climate Change</u>

Question 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 mitigate them?

HKIoD response:

- As to (a), we have no objections.
  - A board should identify the issues and factors that may affect its success (or survival), including climate-related issues. We do note, however, that climate-related issues may not all be a critical factor for some issuers. An issuer's reasoned explanation of their assessment and judgment based on their overall business strategy should be taken to have met the disclosure requirements.
- As to (b), we have no objections.
  - But issuers should be given the leeway to determine what metrics (if at all) and ultimately KPIs (if at all) are material to their business.

<u>Targets</u>

Question 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?

HKIoD response:

- We have no objections.
  - But issuers should be given the leeway to determine what metrics (if at all) and ultimately KPIs (if at all) are material to their business. Only on that basis would any "target set" be meaningful to the issuer.

Question 12: Do you agree with our proposal to revise an Environmental KPI to require disclosure of Scope 1 and Scope 2 GHG emissions?

HKIoD response:

- We have no objections.
  - But issuers should be given the leeway to determine what metrics (if at all) and ultimately KPIs (if at all) are material to their business.

<u>Social KPIs</u>

Question 13: Do you agree with our proposal to upgrade the disclosure obligation of all Social KPIs to "comply or explain"?

HKIoD response:

- AGREE
  - Some issuers may be concerned about the "comply or explain" requirement, but we believe it is reasonable as issuers are free to give considered reasons.

<u>Environment Types</u>

Question 14: Do you agree with our proposal to revise a KPI to clarify "employment types" should include "full- and part-time" staff?

HKIoD response:

- We have no objections.
  - But issuers should be given the leeway to determine what metrics (if at all) and ultimately KPIs (if at all) are material to their business.

<u>Rate of Fatalities</u>

Question 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?

HKIoD response:

- We have no objections.
  - But issuers should be given the leeway to determine what metrics (if at all) and ultimately KPIs (if at all) are material to their business.

<u>Supply Chain Management</u>

Question 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.

HKIoD response:

- As to (a), we have no objections.
  - A board should identify the issues and factors that may affect its success (or survival), including issues of or relating to supply chain management. We do note, however, that the effect or impact could differ from issuer to issuer. An issuer's reasoned explanation of their assessment and judgment based on their

overall business strategy should be taken to have met the disclosure requirements. Issuers should be given the leeway to determine what metrics (if at all) and ultimately KPIs (if at all) are material to their business.

- As to (b), we have no objections.
    - But we note that such practices so disclosed by the issuer must be understood and assessed against the board's overall business strategy. An issuer's reasoned explanation of their assessment and judgment based on their overall business strategy should be taken to have met the disclosure requirements.

Anti-corruption

Question 17: Do you agree with our proposal to introduce a new KPI requiring disclosure of anti-corruption training provided to directors and staff?

HKIoD response:

- We have no objections.
    - But issuers should be given the leeway to determine what metrics (if at all) and ultimately KPIs (if at all) are material to their business.

Question 18: Do you agree with the proposal to revise the Guide's wording on independence [sic] 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?

HKIoD response:

- AGREE

<ENDS>