HKGFA
香港綠色金融協會
Hong Kong Green Finance Association

Charles Li, CEO
Hong Kong Exchanges and Clearing Limited
8/F, Two Exchange Square
8 Connaught Place
Central, Hong Kong

July 19, 2019

Dear Mr. Li,

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

On behalf of the Hong Kong Green Finance Association ("HKGFA"), I wish to applaud the HKEX for taking the initiative to enhance the Environmental, Social and Governance ("ESG") Reporting Guide and related Listing Rules.

We are in strong support of the proposals outlined in the May 2019 HKEX Consultation Paper on the ESG Reporting Guide. In particular, we believe that the following two proposals will go a long way in enhancing the robustness and effectiveness of the regime, namely:

- the introduction of the Mandatory Disclosure Requirements requiring a Statement from the Board regarding the key elements (oversight, the process and review); and
- the amendment of the Reporting Principle on "Materiality" to make it clear that materiality of ESG issues is to be determined by the board…

It is imperative that there is explicit and clear evidence that the company boards have taken an active role in materiality assessment. And this would include inter alia, what process and criteria has the issuer adopted to identify, select and engage key stakeholder groups; what process has been undertaken to analyse and select material ESG factors, what are the reasons for certain factors to be selected and what are the implications of these factors to businesses in terms of risks and opportunities, and what are the follow up action points.

In addition, the requirements should not only apply to listed issuers, but to listing applicants too, as we believe that ESG principles should be applied to the whole lifecycle of capital market activities.

Meanwhile, we are mindful that our listcos members – from large conglomerates to SMEs – have indicated that the new requirements may pose some major challenges to them, due to lack of capacity and resources as well as time constraints. One plausible approach to addressing these challenges is to adopt a phased approach so as to give them more time to build up the infrastructure and capacity.

More importantly, we believe that HKEX should take a pro-active approach in providing support to listcos and fund managers. We would exhort HKEX to develop a comprehensive program on capacity building for ESG disclosure, which should cover various types of market participants, including asset owners, asset managers, issuers, and NGOs.

We would like to propose that HKEX and HKGFA jointly host a debrief meeting with members of the HKGFA (including issuers, investors and other stakeholders) after the consultation result and updated ESG Guide are released later this year. At this meeting, HKEX can brief our members about the key findings of consultation, and explain some details of the ESG Guide. The ESG Working Group and Policy Research Working Group of the HKGFA will be happy to work with your designated HKEX team to organize this joint meeting. Our ESG WG can be reached on [redacted] (Joy Song)/[redacted] (Sally Wong).

Thank you very much for your attention and we look forward to working with your team on greening Hong Kong's capital markets.

Yours sincerely,

[redacted]

Dr. Ma Jun
Chairman and President of HKGFA

c.c. Mr. Stephen Wong/Angela Mo, Chair of Policy Research and Dissemination Working Group, HKGFA
Ms. Sally Wong/Joy Song, Co-chairs, ESG Integration and Disclosure Working Group, HKGFA

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.

From investors' perspective, the ESG report should be published at the same time as the financial statements as investors evaluate material ESG issues together with the information made available in the statements. The two are inter-related and should NOT be studied in silos.

From the issuers side, they point out that it is a major challenge to provide the information in the time frame specified. For large conglomerates, they have to spend much effort and time to gather information from all of their operating business units and subsidiaries, to process and mostly importantly verify. The proposed timeline would be challenging, if not impossible. Also, for companies that are just listed and those do not have system in place, it would take time to set up the process. For SMEs, they may not have the requisite expertise and resources.

Some issuers have suggested a two step approach -
(a) implement the proposal
(b) and set a clear timeline to mandate that all issuers should publish ESG Report at the same time as the Annual Report.

More specifically, some have suggested adopting a staggered approach:
Year 1 - reduce the gap from 3 to 2 months after publication of the AR
Year 2 - reduce the gap further to 1 month after publication
Year 3 - align with the publication of AR

Some investors point out that the curent data in fact show that a large percentage of the issuers are already producing the data at the same time and thus do not believe that this is a major issue for most: 60% of issuers sampled disclose ESG report at the same time as financial accounts (see footnote 57 in HKEX https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/May-2019-Review-of-ESG-Guide/Consultation-Paper/cp201905.pdf?la=en), thus a majority of the issuers are already doing this.

Taking into account the different views of our members, we believe that it is a shared goal that we should increase transparency and to align the reporting timeline. The difference is more about "how" rather than "why". To help achieve this common goal, what we would advocate is that HKEx come up with a comprehensive plan in capacity building and in particular, earmark a percentage of budget for ESG capacity building - this would tie in with the SEC and HKEx strategy to develop HK as a sustainble finance hub.

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.

Printed reports are not necessary if issuers can inform investors timely the availablity of the report, and the report is readily downloadable; and searchable for key words and issues. Also, this is in line with the "green" approach, and is a right move to reduce unnecessary consumption of natural resources.

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.

We are in full support. As more and more fund managers/asset owners integrate ESG into the investment process, this has become an integral part of the factors to be considered for making informed investment decisions.

We also suggest that this and the following requirements should not only apply to companies that are already listed, but to listing applicants too, thereby to strengthening force to motivate the management of listing applicants to take ESG into serious consideration at an ealier stage.

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.

(1) This Statement is an important tool to improve corporate transparency and enables investors and other stakeholder groups to assess the involvement and engagement of the board in this important subject. The Board's oversight is important and is key to ensuring full integration of ESG consideration into the strategic planning as well as risk and operational management of the company.

It is important that measures should be in place to ensure that this won't become a "boiler plate" text. There should be clear documentary evidence (e.g. Board minutes) to substantiate that the Board is not only involved, but has conducted a rigorous and thorough deliberation process. The Statement from the Board should explain what are the key ESG issues that the Board has identified (not a regurgition of all the risks), how do they come up with these material issues, the process involved, the rationales, and the proposed action points to address these issues - for risk mitigation and for capitalising on opportunities.

(2) Apart from the Board's involvement and consideration of ESG issues, we believe that the role and involvement of the Mangement is equally important and should be included in the HKEX ESG Guide. Management plays a central role in identifying ESG issues, integrating sustainability into the business strategy, overseeing its implementation acorss the business and communicating to investors. At a working level, especially in larger companies, investor relations, finance functions and CSR or sustainbility divisions should be aligned to ensure the quality and consistency of information required.

(3) Also, the HKEX may consider amending Appendix 14 (Governance Report) mandating disclosure of how SD is integrated into risk management and the Board's terms of reference.

(4) For issuers that don't think that ESG issues are material to their businesses at all, they can provide a statement to that effect, and explain why they think so.

For issuers that don't think they can single out 2-3 key ESG issues, they can come up with a longer list, but need to explain why they don't think they can identify the key ones.

If the assessment for a year is different from the previous ones, issuers should highlight the differences and the reasons.

(5) Some suggested that the MDR could be phrased in a way that encourages the creation of ESG committees at the board level (e.g. requiring disclosure of whether an ESG committee has been created).

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.

See answers provided for Q4. This is important to instill rigour into the issuer's deliberation process and to prevent it from being just a tick-the-box exercise.

Some have raised queries as to why the content requirements would be set out in a separate note, however.

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.

(1) The mandatory disclosures to explain application of the four principles are important for understanding whether material ESG issues and risks are sufficiently identified and monitored as well as for data comparability among different issuers.

(2) Would be useful for HKEX to provide more guidance on how to adequately explain the application process of the Reporting Principles.

(3) While HKEX encourage and allow other internationally recognised reporting frameworks to be adopted by issuers, such as Global Reporting Initiative Standards, the International Integrated Reporting Framework and the Sustainability Accounting Standards Board standards to be used as an alternative to the HKEX ESG Reporting Guide, this may potentially raise questions regarding comparability. Specifically, uniformity/linkage of 4 reporting principles in HKEx ESG Guide and those 10 principles in GRI Standard are raised up because issuers want to be sure if they fully fulfill mandatory disclosure requirements on reporting principles of HKEX ESG Guide when they adopt international guidelines.

(4) Helpful if the HKEX can clarify whether the MDR still applies to cases where the ESG Report has been integrated into the annual report.

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.

We are in full support of this proposal. Disclosures about stakeholder engagement and selection criteria of material ESG factors, which some see as a separate issue that should be addressed separately, is important because it justifies issuers' focus on certain material ESG issues. But a more basic issue as raised by some investors is that the Boards in HK have generally been ineffective in addressing ESG issues and they have suggested to highlight Directors' liability (as opposed to just responsibility).

In evaluating materiality, issuers should inter alia:
(1) adopt a long-term view in the evaluation and mangement of material issues.
(2) consider the impacts to external stakeholders and the ecosystem. It can help investors better assess the systemic and longer-term risks that would arise from these impacts,
(3) disclose stakeholder identification and engagement process and criteria; and
(4) disclose how criteria are selected, the process and outcomes.

As to how the responsibility is discharged, some have suggested to amend the wording such that more flexibility can be provided, e.g. an option is to require the Board to determine the materiality of ESG issues…". Another option is to require "The Board to approve the materiality of ESG issues identified". Thus, the responsibility will be vested with the management of the issuer, and the Board's role is to provide oversight. Comparing the two approaches, managers prefer the former as they believe that the Board have the responsibility to map out the strategy of the company - thus an expectation of a more proactive role.

We understand that HKEX define "Materiality" as influential issues to all key stakeholders. One asset manager suggested that HKEX may consider including wording such as the International Accounting Standards Board used in definition of "Materiality" as that which could, if omitted or mistated, influence the economic decisions of readers relying on the financial statements.

As pointed out in earlier questions, to help the SMEs to start this journey, which would ultimately be in their interests if they wish to attract managers/analysts coverage, it is important that HKEx provides support to build capacity.

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.

Investors believe that both targets should be required from issuers. In general, targets should be quantitative to be meaningful to facilitate measurement and comparability, which remains a challenge.

HKGFA understand that HKEX has tied disclosure requirements to a number of international guidelines as a reference for issuers, still individual companies have flexibility to decide how they calculate KPIs and which methodologies they adopt depending on their operating regions and industries. Some asset managers hope that HKEX to go further and set specific methodologies/matrics based on international general practices (e.g. common ESG metrics PRI reports) for measuring emissions/energy consumption (at a minimum) so that to ensure data comparability. Ultimately, investors need this information to make informed investment decisions; and lack of comparability across firms is one of the greatest barriers to the use of ESG information in investment decision making today. Some

One caveat:
(1) some have expressed concerns that it may lead to more "box-ticking" and thus, this should be monitored closely to evaluate its effectiveness and provide further explanation to issuers what is a good example of directional statements to avoid "box-ticking".

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.

In general, members support this proposal. In addition, some believe that the HKEX should go further by setting minimum boundaries for inclusion, such as a percentage of assets or turnover. In general, members opine that it is important to be specific about the reporting boundary of each KPI and explain how the included entities and operations are impacted by different ESG issues. It has also been suggested that an exclusion list (above a certain threshold) will be useful for due diligence purposes and can enhance transparency. There should be disclosures of a list of entities over a certain % of any one of the issuer's assets or turnover, which have NOT been included in the report and the reason for non-inclusion. A full list may be too lengthy and not necessarily helpful.

Introducing Aspect on Climate Change and Revising the Environmental KPIs

<u>Climate Change</u>

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.

We are in full support of the introduction of disclosures related Climate Change and encourage issuers to review and assess the impact of risks and opportunities that arise from Climate change.

However, as for a New Aspect A4 under Environment, it may be implicit to issuers they only need to report climate change risks and opportunies related to environmental impact, and therefore neglect the impacts on social aspects. We would suggest to consider relocating the structure for this issue. Meanwhile, there is also a confusion between A3 and the new A4 Aspect because influence on environment and natural resources are correlated with climate change as well.

In general, climate-related issues (e.g. exposure to physical and regulatory impacts) have becoming increasingly relevant for all businesses; and we believe that it should be a standing item to be reported on. If the risks are identified as material, issuers should explain them in details, especially how they would affect the businesses and the action plans to addess them (not just a statement of intent).   Re what constitutes "signficant", issuers should describe how they define such.

In addition, not only should the issuers provide a description of signficant climate-related issues, ideally, they should also provide historical data of total consumption over the last 3-5 years as a quantitative indicator.

Having said that, we are aware that climate-related issues are likely to be more material to some businesses rather than others. If, after assessment, issuers believe that the impacts are immaterial, they should have the discretion to say so.

But in any events, investors would be interested in knowing how the issuers come to such a decision, what is the process that they have gone through and the reasons underpinning the decisions.

Also, it is important to demonstrate that issuers consider long term strategies and disclose transition plans and specific action measurs across the value chain. TCFD Recommendations have been widely adopted and HKEX can explicitly encourage to use TCFD as reference framework for issuers to take reference. And possibly, support a pilot for companies on TCFD disclosures.

Meanwhile, some have suggested that further guidance would be needed (perhaps in the form of FAQs) since climate related issues are broad and can be interpreted in a variety of ways. EU Taxonomy and the UK Green Finance Strategy could be referred as good examples. It is also recommended that re physical risks, the HKEX should cover not only natural disasters, but other chronic changes in environmental conditions such as water stress.

<u>Targets</u>

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.

Investors generally opine that it is pertinent to have quantifiable targets and that there should be action plans that detail specific measures. It is also important that companies consider the impacts of different external contextual factors, including regulations and climate change, when setting their targets. Examples of targets suggested: * water withdrew and water recycling are readily identifiable targets. An example of water withdrew would be from water bills: there should be clear records of water bills, which make collection of withdrawal data easy to gather. Water recycling is less obvious in data collection. However, managers would wish to have recycling rate, even partial ones, so that they can gauge the level of management oversight and environmental strategy. Others believe that instead of delving into the specifics, this should be best left with the issuers' management.

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.

In general, fund managers believe that disclosure of Scope 1 and 2 would be useful as they can provide a more accurate risk exposure profile, which can facilitate better risk assessment. In fact they believe that issuers should start reporting emissions data sooner rather than later; as it takes time for the reported data to stabilize. Also, some have further suggested that there should be projections of emissions data; and that issuers should work towards disclosing Scope 3 targets.

It has been pointed out that not all companies will have Scope 1 emissions from operations due to the nature of their businesses, but all should have Scope 2 emissions which are indirect emissions resulted from purchasing electricity, heating, cooling and steam. Meanwhile, for certain industries, Scope 3 is highly significant, and should be included, for example worked related travels.

But some issuers do not share such views and believe that for some industries, they are immaterial; and generally speaking, they are difficult and expensive to calculate.

For some issuers identifying greenhouse gas emissions as material to their businesses, they should not be obliged to provide the KPIs as long as they can justify why they do not think that emissions are material.

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.

Full suport. HKEX should consider increasing disclosure requirements around D&I to be in line with international best practices, e.g. gender gap pay disclosures. HKEX should also refer to the ILO Standards and the UN guiding principles on business and human rights for minimum social safeguards.

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.

Some suggested that HKEX should encourage issuers to cover in its Disclosure Statement subcontracted services (which many large firms can escape their social responsibility) and workers categorized as "self-employed" yet working only for the reporting company.

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.

This KPI is considered best practices in many jurisdictions, although the reporting is only likely to be material for certain high-risk industries. Reporting of supply chain management standards (see Q16 below) should also require information on workplace fatalities; injuries (e.g. those that involve in-patient hospitalisation) and incidents for high-risk industries; as well as actions taken to reduce these risks.

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.

Management of supply chain is a good proxy for the quality of risk management in the value chain. Thus, it is useful to introduce this piece of information.

Disclosures of selection procedure of suppliers should include information described in the environmental and social aspects as covered in the HKEX ESG Guide.

Disclosures should also include a definition of environmentally preferable products and services, and the percentage of such products being used.

Disclosures should also show that issuers have considered the impacts of external contextual factors, including regulations and climate change impacts on the supply chain, and what actions are being taken to address relevant supply chain risks and how are they monitored.

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.

We fully support the newly added KPI related to training on anti-corruption. Ideally, the training should be carried out by third parties, and of recognised standards. Some have expressed doubt about the effectiveness of anti-corruption training, however.

More importantly, there should be disclosure of internal policies on Bribery and Corruption.

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.

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Most members believe that that it is important to ensure that material ESG information is accurate and reliable so as to facilitate informed investment decisions.

But an important caveat is that currently, the quality of assurance varies and it is questionable to what extent can one rely on the outputs.

One plausible approach as suggested by some managers is that the HKEX highlights the importance of assurance, but issuers should not be mandated to appoint external third parties to provide assurance - as long as it is conducted independently and there is a robust mechanism, e.g. having the board audit committee to have oversight; that could be a good starting point.

In addition, there are requests that clarity is needed on the assurance work over ESG information - e.g. auditing standards adopted, the qualification of the assurance provider, in addition to the scope and process. Also, some suggest that the GL should encourage the adoption of internationally accepted standards such as ISAE3000 and AA1000.

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OTHERS - INSURANCE

Some members point out that one key aspect missing from the Report is "Environmental Risk management".

It would be a huge step forward if the ESG report discloses the environmental risks management practices and there are sufficient details of the risk exposures, how the issuers mitigate and manage those risks; and the insurance they have in place in the event of an accident/environmental event.

It would be helpful if the Report contains information as to whether the firm implements an Environmental Risk Management Program. This can include details on the Program, and the risk transfer and mitigation measures that they have taken to reduce the possibility and impact of environmental damage from their business operations. This should also allow the issuers to show how they would fund an environmental cleanup and their preparedness in the event of such an incident.

The Report should also disclose the insurance that issurers have purchased to cover pollution risks and other environmental risks. Also, it should show the limits of liability of their Environmental Liability Insurance Policy and evidence the Board has considered these adequate to cover the firm's environmental risks.

Additionally it would be helpful to show how the issuers assess the ESG credentials of their insurance counterparts (e.g. whether insurance providers meet minimum ESG standards, such as exposure to investments; and clients that produce gas emissions and contribute to deforestatin and other environmental damaging practices.)

End -