



Ceres

*Mobilizing Business Leadership
for a Sustainable World*

September 17, 2015

Dear Hong Kong Stock Exchange,

Ceres welcomes Hong Kong Stock Exchange's (HKEx) proposal to implement a "comply or explain" environmental, social, and governance (ESG) disclosure regime. We agree that this strengthening of the exchange's ESG disclosure expectations will improve its listed issuers' sustainability reporting and performance, thus serve to better enable investors to more accurately perform due diligence and conduct ongoing monitoring of their holdings.

As you may or may not know, Ceres' Investor Initiative for Sustainable Exchanges (IISE) is a project focused on supporting exchanges in their efforts to implement ESG disclosure listing rules and guidance. We also facilitate investors' efforts to voice their demand for ESG data to regulators and exchanges. We believe that ultimately, the benefits of mandated, system-wide ESG disclosure will accrue to:

- Investors, through enhanced ability to conduct due diligence and ongoing engagement and monitoring of issuers;
- Issuers, through better quality risk management, revenue growth identification, and improved resource efficiency stemming from heightened ESG performance;
- Nonprofits, through increased ability to identify corporate sustainability leaders and laggards;
- Society, through improved environmental and social outcomes, resulting from less resource intensive corporate operations, products, and services.

In order to alert exchanges to the market-wide need for ESG data from listed issuers, Ceres worked with over 100 Institutional Investors representing 12 countries with over US \$9 trillion in AUM to develop an ESG disclosure listing requirement proposal to stock exchanges. Our responses to HKEx's questions are based on the consultation held for this proposal and ongoing collaborative efforts with our Stock Exchange Working Group.

Following our responses, we've submitted comments on a few specific ESG disclosure items that were not addressed by the questions posed, but which investors have made clear that they want included in an ESG reporting listing requirement exercise.

The following 15 questions refer to those posed on pages 21 - 29 in HKEx's, "Consultation Paper: Review of the Environmental, Social, and Governance Guide."

[1. Do you agree with our proposal to amend Rule 13.91 to require issuers to disclose in their annual reports or ESG reports whether they have complied with the "comply or explain" provisions in the ESG Guide and if they have not, they must give considered reasons in the ESG reports?](#)

Yes, but disclosures should be made in both the annual report and ESG report (if a company provides such a stand-alone report).

Providing investors with upfront knowledge regarding whether or not the issuer has complied with the listing rule and if not, the reason(s) why, will be helpful in general during due diligence processes and in guiding any subsequent engagements with the issuer regarding the reasons offered for non-compliance.



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2. Do you agree with our proposal to amend Rule 13.91 to require the issuer to report on ESG annually and regarding the same period covered in its annual report as discussed in paragraphs 86 and 90?

Yes.

Requiring companies to synchronize the financial reporting and ESG reporting timeframes is essential to enabling investors' to accurately compare companies over the same period as well as consider an individual company's ESG performance in relation to its financial performance.

We do not agree, however, with paragraph 87. Analysts are forced to spend a lot of time trying to find relevant ESG information because there is no way to know where relevant data is located. An elegant solution to this problem is requiring listed issuers to publish an ESG Content Index, such as GRI's Content Index or similar, which provides hyperlinks to all of an issuer's publically available sustainability information in one document. This provision would strongly supplement the data found in the Annual Report, and make it much easier for investors to locate business-relevant ESG information.

3. Do you agree with our proposal to include a Note under Rule 13.91 to clarify that: (i) an ESG report may be presented as information in its annual report, in a separate report, or on the issuer's website as discussed in paragraph 91; and (ii) the issuer should publish the ESG report as close as possible to, and in any event no later than three months after, the publication of the issuer's annual report as discussed in paragraph 92?

No.

Ceres recommends that the exchange require all required ESG disclosures to be in the Annual Report. Additional ESG information, such as those items covered in the Recommended Disclosures column (those that we did not advise being moved to the mandated column) and any other ESG information an issuer chooses to disclose, can be placed in an appendix to an Annual Report, hyperlinked from the annual report, included in a stand-alone Sustainability Report or Integrated Report, included on the issuers website, or located in another vehicle, as long as instructions are provided on where to find the information in the Annual Report.

Ceres recommends that the Exchange require companies to synchronize the financial reporting and ESG reporting timeframes, and the issuance of both reports. As such, an allowance of any grace period for the ESG report following issuance of the financial report is not recommended. Investors felt quite strongly during our consult that integrated reporting was very difficult without such synchronicity, and that syncing the reporting timeframes and data collection cycles would be helpful to issuers in figuring out the financial implications and benefits of various ESG performance metrics. We had almost unanimous consent on this point.

4. Do you agree with our proposal to revise the introductory section of the Guide into four areas as discussed in paragraphs 94 and 95, and with the wording set out in Appendix II?

Yes.

The revisions to the introductory section are logical, thus will be helpful to listed issuers in understanding the Guide and planning and organizing their sustainability report and annual report disclosures. In general, providing links to relevant information is always useful.



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5. Do you agree with the proposed wording of the Reporting Principles in the introductory section of the Guide as discussed in paragraphs 96 and 97, and with the wording set out in Appendix II?

Yes.

Although Ceres agrees with prioritizing these four principles and their broad definitions, materiality was more pronounced in the old guide and should retain this level of importance in the new guide. Investors have made it very clear that the most important item in an ESG disclosure listing rule is an in-depth discussion of the materiality process, and for issuers to make a clear connection between ESG factors and financial outcomes (both positive and negative). Ceres thus recommends HKEx add a section after item 11 stipulating that issuers must disclose their materiality assessment, including the process undertaken, its outcomes, how a company engages stakeholders, how stakeholder feedback informs the materiality process, and how material issues connect back to business and financial performance.

The principles are in keeping with ESG performance reporting standards. Aligning Reporting Principles with international guidelines will be helpful to both issuers and investors in establishing a widely recognized ESG reporting standard, thus facilitating reporting and the consumption of ESG data across jurisdictions.

There are, however, edits we'd like to see made to three of the four principles.

In item one, we've replaced HKEx's definition of materiality with the definition agreed upon by a majority of the investor participants in our consultation:

(1) Material topics for a reporting organization should include those topics that have a direct or indirect impact on an organization's ability to create, preserve, or erode economic, environmental, and social value for itself, its stakeholders, and society at large.

In items 3 and 4, we suggest rendering the language to a requirement rather than a recommendation.

(3) Replace all instances of "should" with "must."

(4) Replace all instances of "should" with "must."

6. Do you agree with the proposed wording in the Guide linking it to Appendix 16 as discussed in paragraph 98, and with the wording set out in Appendix II?

Yes.

Appendix 16:

The simple wording is fine as long as changes are made to Appendix 27 to strengthen the reporting obligations and make the reporting of all Social KPIs on a "comply or explain" basis.

Appendix II:

The distinctions made are logical and will prove useful in clarifying the distinction between the environment and social disclosures required, and Directors' opportunity to discuss their involvement in the process; the latter being of vital importance to investors in demonstrating an issuer's level of commitment to sustainability.



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There are however, edits we'd like to see made to each of the three business areas.

In item i, we've suggested an expansion of the requirement:

(i) a discussion of issuers' environmental and social policies and performance. Included in the latter: goals set and reached, notable risks and opportunities, and potential barriers to success.

In items ii and iii, we suggest integrating the concept of materiality:

(ii) a discussion of the issuer's compliance and material non-compliance with relevant standards, rules, and regulations, including the overall effect on the company of any violations and/or lawsuits.

(iii) Replace "significant" with "material."

7. Do you agree with the proposal to re-arrange the Guide into two Subject Areas (A. Environmental and B. Social) and re-categorise "Workplace Quality", "Operating Practices" and "Community Involvement" under Subject Area B as discussed in paragraph 99?

Yes.

8. Do you agree with the proposal to change the heading "Workplace Quality" to "Employment and Labour Standards" as discussed in paragraphs 100 and 101?

Yes.

9. Do you agree with our proposal to upgrade the General Disclosure for each Aspect of the ESG Guide to "comply or explain"?

Yes. The reasoning for doing so is well phrased in paragraphs 77 - 79.

However, we recommend the following general additions to the KPIs:

1. All "Recommended Disclosures" under the Social category should be on a "comply or explain" basis. The social indicators are very basic, thus not difficult to report and they accord with the data investors seek.
2. Clarify the meaning of "information," "activities," and "significant" for all KPIs.
3. Require hyperlinks to all requested policies, where available.

Finally, Ceres recommends that the proposed KPIs be strengthened with the following edits:

KPI B1 - This indicator should cover freedom of association and the right to collective bargaining as a global norm, and be aligned with the core International Labor Organization (ILO) conventions. A footnote can be made about the core ILO conventions and mention that this is global best practice and a well-established norm, to educate issuers. Various other reporting standards also broadly refer to the core ILO Conventions, including the UN Global Compact and the GRI, thus showing issuers how consistent the standard is. Perhaps a detailed footnote for issuers on this matter would be helpful highlighting the overlap.



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KPI B1(b) - Revert to the previous draft of covering compliance and non-compliance to make sure issuers have balanced disclosure in this category. Most issuers are hesitant to discuss labor controversies with investors. Conversations on this topic must be encouraged in order to judge risk management and human resource management quality.

KPI B1.2 and 1.2 - Add ethnicity to the criteria and require issuers to provide a breakdown of gender diversity at director and senior manager levels. See "Closing the Gender Pay Gap" from July 2014, by the UK Government Equalities Office for more information on this topic.

In addition, augment these KPIs to cover different tiers of employment, such as entry-level, manager, senior manager, executive, etc. for both total numbers and turnover. Employment type should be clarified in all categories including full-time, part-time, contract, etc. if that is what is meant by this term.

KPI B2 - Require issuers to link their discussion to relevant policies where possible and applicable. Also, reporting on compliance and material non-compliance should be added.

KPI B2.1 - Specify fatality rates for full-time, part-time and contract employees. Encourage issuers to provide year-over-year numbers so that investors can gauge performance in this category.

KPI B2.2 - Revise/clarify the meaning of "lost days" to a more specific standard so that issuers can report more consistently across the market.

KPI B2.3 - Discuss how material safety issues are reported and resolved in the mandated disclosures column. We strongly recommend that issuers discuss their programs, initiatives, training, and compensation schemes that aim to reduce fatalities and lost-time injury rates across these employees. HKEx should provide examples to clarify the expectation.

KPI B3 - Please detail what is to be included in the description of training activities.

KPI B3.1 - Be more specific about including all employee categories.

KPI B4 - Make sure all KPIs and Recommended Disclosures cover supply chain, subcontractors, and identified joint ventures where possible to do so.

Add KPI B4.3 - In the Recommended Disclosures column: recommend assurance or spot audits of key facilities and subcontracted factories in high-risk regions. This type of oversight goes hand-in-hand with safety due diligence.

KPI B5.1 - Specify material risk factors that suppliers pose in a given region as a Recommended Disclosure.

KPI B5.2 - Ask specifically if audits are being done and any standards imposed on suppliers, and specify what is to be done if they are not met.

KPI B6 - Ask for the policies to be hyperlinked where possible. Recommend that issuers break down by geographic area when possible, to the product quality issues being reported.

KPI B6.1 – KPI B6.5 – A very good list to start with, and in alignment with concerns investors had in the *Investor Listing Standards Proposal*. All of these items should be mandatory, and historical data should be provided for assessment when possible, to give investors context on improving or declining performance. All items in B6 are clearly important for all issuers to report where this



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topic is relevant. The Exchange should be as specific as possible here so investors do not get boilerplate discussions for these KPIs.

KPI B7 - Specify exact laws where relevant, such as the FCPA, or best practice norms.

KPI B7.1 - Add how the outcome of cases affected operations, e.g. fines levied, employee dismissals, changes to policy, etc. in the Recommended Disclosures column.

KPI B7.1 - Add total fines or settlements paid to governments, regulators or individuals during the reporting period.

KPI B7.2 - Ask for the specific policy on whistleblowing to be hyperlinked.

KPI B7.3 - "Payments to governments" figures should be included as a category of disclosure to report against in the Recommended Disclosures category.

KPI B8 - Add information about programs and discussion of issuers' processes for identifying any operations and activities that generate negative externalities that affect a community. Issuer should discuss mitigation and compensation policies where negative effects on communities are identified. Issuer should discuss regular engagement protocols with affected stakeholders, and how risks or opportunities are included in the ESG materiality process.

KPI B8.1 - Detail what is being done and how it helps the community.

KPI B8.2 - Report on both monetary and time commitment, as well as level of staff involvement.

10. Do you agree with the proposed amendments to the wording of paragraph (b) under current Aspects A1, A2, A4, B1, C2 and C3, re-numbered Aspects A1, B1, B2, B4, B6 and B7, as discussed in paragraphs 103 and 104?

No.

Ceres recommends issuers be required to provide a hyperlink(s) to all requested policies. Also, the proposed wording change reduces the strength of the requirement. We recommend keeping the original wording, as the use of the term "significant impact" is vague and "compliance and material non-compliance with relevant standards, rules and regulations" is more specific, thus reducing potential confusion regarding what to report.

11. Do you agree with our proposal to revise Aspect A1 by upgrading to "comply or explain" the current KPIs B1.1, B1.2, B1.4 and B1.5, re-numbered KPIs A1.1, A1.2, A1.4 and A1.5, as discussed in paragraphs 109 to 114, and 117 and 118?

Yes.

However, as the phrasing, for example, "types of emissions and respective emissions data" is vague enough that it may be interpreted in more than one way, thus resulting in potentially material and/or irrelevant data, issuers should be referred to a recognized standard for reporting CO₂e emissions, such as the GHG Protocol's [Corporate Standard](#).



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12. Do you agree with our proposal to upgrade to “comply and explain” the current KPIs B1.3 and B1.6, re-numbered KPIs A1.3 and A1.6, as discussed in paragraph 119?

Yes.

The latitude a “comply or explain” requirement allows is appropriate for this KPI, as hazardous waste does not apply to all sectors.

The opponent’s argument put forth in paragraph 119 is a not valid because there are laws in place that identify what comprises hazardous waste and there are systems and services that can be purchased to properly separate, contain, and dispose of all waste types. In addition, it being the case that there are regulatory, safety, reputational, and litigation risks associated with improper handling of hazardous waste that can have a material financial impact, it is in issuers’ best interest to be managing all waste production, separation, containment, and disposal at least according to what is legally required.

Finally, either a separate KPI should be added to account for the amount of e-waste produced and how it is disposed or specific mention of it should be made in KPI A1.3 or KPI A1.4.

13. Do you agree with our proposal to upgrade to “comply or explain” the KPIs under the current Aspect B2, re-numbered Aspect A2 as discussed in paragraphs 120 to 122.

Yes. HKEx’s reasoning for this upgrade is sound.

However, “other raw materials” in KPI A2 should be specified, e.g. wood, fuels, ores, metals, etc. And actions an issuer is taking to resolve the issue over the short-term and long-term should be added to KPI A2.4.

14. Do you agree with our proposal to upgrade to “comply or explain” the current KPI B3.1, re-numbered KPI A3.1, as discussed in paragraphs 123 to 125?

Yes. HKEx’s reasoning for this upgrade is sound.

However, what is meant by “description of significant impacts” should be better defined, e.g. loss of biodiversity, mountaintop removal, pollution by type, etc. In addition, an indicator that describes how stakeholders are affected by the “significant impacts” should be added, thus providing investors with more context in determining how significant those impacts are or might become.

Finally, in addition to how issuers’ operations affect the environment, HKEx should require issuers to explain any consideration they give in their strategic business planning to future availability of natural capital required for their operations.

15. Do you agree with our proposal to incorporate gender disclosure in Subject Area B under the sub-heading “Employment and Labour Standards”?

Yes.

Additional Comments:

The following comments address specific disclosure issues that were not addressed by the questions posed, which investors have made clear that they want included in any ESG disclosure listing requirement exercise.

Issue 1: Company Education and Capacity Building - Although HKEx's efforts with respect to <IR> are mentioned in paragraph 49, HKEx can likely be doing more to encourage issuers to familiarize themselves with the concepts and framework of Integrated Reporting (published by the International Integrated Reporting Council). Ceres encourages HKEx to commit to working with issuers to improve their understanding and application of <IR> in your market.

Issue 2: Assurance - HKEx's comments are aligned with what we've heard from investors, who are still reticent to force standards of assurance across the board until the market matures further. We recommend advocating assurance where feasible (such as the mandated disclosures), and providing tools to issuers on an ongoing basis on how to develop assurance across critical data points of the ESG disclosures that are mandated or recommended. Also, the Exchange is well placed to convene experts on assurance to focus on the obstacles to the market's maturity in the region and identify solutions and paths forward. The World Federation of Exchanges likely has a role to play here in furthering this discussion.

Some key questions are:

1. If assurance is not provided for in the rules, how does the Exchange plan to verify submitted data in future years?
2. Given the current state of the assurance market, what can HKEx further do to bring some transparency and standardization?
3. As HKEx is calling for ESG disclosures to be included in the Annual Report, an auditor must assure the veracity and accuracy of disclosure. How does the exchange plan to explain this requirement to issuers?

Issue 3: Stakeholder engagement - The consultation would benefit from focusing more on the importance of stakeholder engagement, and how such interaction feeds into ESG reporting and risk management processes. Specifically, investors want the stakeholder engagement process explained and to know how stakeholder feedback informs an issuers' materiality process.

Issue 4: Human Rights - With the launch of the UN Guiding Principles Reporting Framework this past February, and the human rights controversies that exist in many Asian (and other) markets, it would be helpful for HKEx to clarify its language regarding the importance of issuers completing regular human rights risk assessments to communities, not just assessing risk to the company itself. The UNGPRF clarifies well what internal questions companies can ask of themselves to complete this.

If you have any questions about our responses, please don't hesitate to email or call. My information is provided below. I have also attached a summary of our investor consultation on ESG listing rules by exchanges--known as the *Investor Listing Standards Proposal*, which was first submitted to Nasdaq OMX in 2013 and finalized and submitted to the World Federation of Exchanges membership in March 2014.



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Sincerely,

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