

Civic Exchange's Written Submission to the Hong Kong Exchange and Clearing Limited regarding the Public Consultation on the Review of the Environmental, Social and Governance Reporting Guide

31 August, 2015

1. INTRODUCTION

1.1. The Consultation Document

- 1.1.1. Hong Kong Exchanges and Clearing Limited (HKEx) launched a document entitled *Consultation Paper on Review of the Environmental, Social and Governance Reporting Guide* (Consultation Paper)¹. This Consultation Paper aims to urge the issuers in Hong Kong disclosing environmental, social and governance (ESG) information, upgrade some of the recommended disclosures to “comply or explain”, and encourage a more standardised format of ESG disclosure. The consultation lasts until 18 September 2015.
- 1.1.2. Civic Exchange acknowledges and commends HKEx's effort in consulting the issuers and other key stakeholders on the disclosure of ESG performance. The first consultation document *Consultation Paper on Environmental, Social and Governance Reporting Guide*² was launched in December 2011. After consolidating the issuers' comments, *Consultation Conclusions on Environmental, Social and Governance Reporting Guide*³ was published in August 2012. Since then, the issuers were encouraged to start working on ESG reporting.
- 1.1.3. Civic Exchange also acknowledges and commends HKEx's effort in providing substantial amount of training to the issuers to disclose their ESG performance, which is voluntary in the current *ESG Reporting Guide* (the Guide).
- 1.1.4. In view of the greater demand and expectation for both financial and non-financial information from the investors and other key stakeholders, HKEx has proposed to upgrade many of the disclosure requirements, a step which Civic Exchange fully approves of and supports, as described below.

¹ Hong Kong Exchanges and Clearing Limited, *Consultation Paper on Review of the Environmental, Social and Governance Reporting Guide*, July 2015, <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201507.pdf> (accessed 17 July 2015).

² Hong Kong Exchanges and Clearing Limited, *Consultation Paper on Environmental, Social and Governance Reporting Guide*, December 2011, <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201112.pdf> (accessed 17 July 2015).

³ Hong Kong Exchanges and Clearing Limited, *Consultation Conclusions on Environmental, Social and Governance Reporting Guide*, August 2012, <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201112cc.pdf> (accessed 17 July 2015).

2. COMMENTS ON THE NEWLY PROPOSED GUIDE

2.1. Reporting Approach and Principles

- 2.1.1. Civic Exchange acknowledges and supports the need for the issuers to disclose ESG data. HKEx proposed to upgrade the General Disclosures for each aspect and the proposed key performance indicators (KPIs) for “Environmental” subject area to “comply or explain”.
- 2.1.2. In general, the “comply or explain” approach is in line with the Corporate Governance Code and promotes good governance of the issuers. However, in order for this approach to work and to be sustainable, the issuers’ disclosures have to be transparent, continuously improve their quality and build trust with shareholders or stakeholders⁴. In order to allow the successful execution of this commendable change, HKEx should continue to provide further support, such as ESG reporting toolkit, to ensure that the “comply and explain” approach will be conducted in a rigorous way.
- 2.1.3. The Reporting Principles of the newly proposed Guide are categorised into four major areas: materiality, quantification, balance and consistency. Civic Exchange welcomes the rewording of the principles which makes it clearer for the issuers and stakeholders. Those terms are now comparable to the international ESG reporting guidelines.

2.2. Reporting Level and Formality

- 2.2.1. In order to converge with the New Companies Ordinance (Cap 622) and the Hong Kong Financial Reporting Standards, Civic Exchange welcomes the rearrangement of the Guide into two subject areas: “Environmental” and “Social”. This will simplify and clarify the reporting level of the ESG report to the stakeholders.
- 2.2.2. Civic Exchange endorses the revised KPIs for the “Social” subject area. Although Civic Exchange understands the need to simplify the disclosure requirements of the reporting guide for the purpose of smoother implementation, HKEx should nonetheless set a clear timeline on when it intends to raise the reporting level of the KPIs under the “Social” subject area to “comply or explain”. Should the administrative burden of making all its KPIs “comply or explain” be considered too large to ensure issuers’ readiness, HKEx might consider sub-categorising the aspects to prioritise those which have the highest importance or urgency to stakeholders and set timeframes accordingly.
- 2.2.3. Civic Exchange welcomes HKEx proposal to amend Rule 13.91, under which issuers will have the option to disclose the ESG information in an ESG report, a sustainability report or combined into their annual report. Civic Exchange also acknowledges the necessity of timely publishing of the ESG reports and agrees that the issuers should publish the ESG report no more than three months after the publication of the issuers’ annual report.
- 2.2.4. According to both the original and the newly proposed Guide, Corporate Governance reporting is addressed separately based on Appendix 14 of the Main Board Listing Rules,

⁴ ICAEW, *When is comply or explain the right approach? What we think: a dialogue in corporate governance*, December 2013, <http://www.icaew.com/~media/corporate/files/technical/corporate%20governance/dialogue%20in%20corporate%20governance/icaew%20tl%20q3%20web.ashx> (accessed 21 July 2015).

*Corporate Governance Code and Corporate Governance Report*⁵, indicating that issuers must include a Corporate Governance Report prepared by the board of directors in their summary financial reports on the “comply or explain” basis. Given that the target audience of an issuer’s financial report and ESG disclosures may be different, it is highly recommended that the Corporate Governance Report (or at least its summary) be provided in the same report as the “Environmental” and “Social” elements considered in the Guide. However, HKEx should minimise the number of separate reports required in order to provide a single comprehensive overview of ESG matters to the stakeholders concerned and to alleviate the administrative burden on issuers.

- 2.2.5. Civic Exchange supports the clear confirmation of the “overall responsibility for ESG strategy and reporting” falling to the issuers’ Board within the Guide and the new Cap 622. The Board will be required to review the company’s environmental policies and performance, and include these in the Directors’ Report starting in 2016. HKEx may consider adopting an accountability system so that directors will be strictly responsible, or even disqualified, for any non-compliance, errors or frauds discovered in the process of ESG reporting, based on *A Guide on Directors’ Duties*⁶.

2.3. Quality Control and Further Actions

- 2.3.1. The role of HKEx in providing assurance for ESG reports should be clarified. Quality control should be provided by either the authority or recognised third parties in order to avoid any ‘box-ticking’ practices for compiling the ESG report, and HKEx should make its expectations clear in the Guide when issuers should achieve this level, including any extenuating circumstances or “grace period” that it may accept. Civic Exchange also recommends HKEx to review the Guide regularly and modify its contents in alignment with internationally reporting.
- 2.3.2. Civic Exchange acknowledges there is a need to judge or assess ESG reports’ quality to ensure effective implementation of the Guide’s principles. Issuers are required to provide reasons in their ESG report when they deviate from the “comply or explain” provisions, however, the consultation paper does not lay out the requirements or standard of “explanations”. Civic Exchange recommends HKEx to provide examples of “best in class” explanations on an ongoing basis as a means for issuers to benchmark and refine their reporting. Furthermore, HKEx should set out a framework, including clear and rigorous penalties for non-compliance and a timeframe for any “grace period” that might be applied, in order to urge issuers to disclose ESG data appropriately and to demonstrate the consequences for issuers failing to disclose these ESG data. This will provide an incentive for issuers to respond to and act upon the proposed changes promptly in avoidance of potential future penalties and therefore raise the standard of their reporting in a timely fashion.

⁵ Hong Kong Exchanges and Clearing Limited, *Corporate Governance Code and Corporate Governance Report*, December 2014, https://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/appendix_14.pdf (accessed 28 July 2015).

⁶ Companies Registry, *A Guide on Directors’ Duties*, March 2014, https://www.hkex.com.hk/eng/rulesreg/listrules/guidref/Documents/director_guide_e.pdf (accessed 28 July 2015).

- 2.3.3. In the Consultation Paper, only the “Environmental” KPIs are subject to the “comply or explain” requirement. All the KPIs under the “Social” subject area are designated as “Recommended Disclosures” only, meaning the issuers can choose to disclose these matters on voluntary basis. However, Civic Exchange suggests that HKEx should, as the regulating body, propose a clear timeframe within the consultation paper for adopting “comply or explain” across all areas. This will provide an incentive for issuers to prepare for and act upon the proposed changes in anticipation of further, more onerous changes to come and therefore raise the standard of their reporting in a timely fashion.
- 2.3.4. HKEx encourages issuers to employ international accounting tools for reporting on greenhouse gas emissions. However, according to the reporting toolkit provided by HKEx, issuers can calculate the greenhouse gas emissions as they see fit. Civic Exchange urges HKEx to provide guidance and support to the issuers, for example by means of the current toolkit, so that the issuers can easily discover and implement alternative means to improve disclosures of their emission data.
- 2.3.5. According to the Bloomberg statistics on issuers’ ESG reporting, slightly less than a half of the sample issuers had reported on ESG matters. From the detailed breakdown, it was obvious that small and mid-cap issuers were more reluctant to report ESG matters on a voluntary basis. Civic Exchange sees the importance of offering extra support to these issuers in compiling their ESG reports. To this end, HKEx may play an important role in amplifying the impact of ESG reporting by encouraging a matching platform between issuers and the ESG community, such as green groups and social enterprises.

3. CONCLUSIONS

- 3.1.1. Civic Exchange acknowledges the pressing need for issuers to disclose ESG data in order to improve the competitiveness of Hong Kong’s market. However, many issuers are waiting for an update to the Guide which makes such reporting mandatory before they start to report. Therefore, Civic Exchange agrees with the need to raise the standard of ESG reporting to “comply or explain” in order to compel issuers to start compiling ESG reports, and to create an environment beneficial to the vibrant growth of Hong Kong’s economy.
- 3.1.2. In principle, Civic Exchange supports the changes proposed in the Consultation Paper. However, Civic Exchange urges HKEx to expend more efforts in ensuring and raising the quality of the ESG reports submitted by the issuers. Furthermore, HKEx should demonstrate a clearer vision and timeline for the long-term development of sustainability reporting standards in Hong Kong in order that issuers can see the need to integrate the proposed changes into their longer-term business planning.

— End of submission —