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HKEX
香港交易所

Analysis of Environmental, Social and Governance Practice Disclosure in 2018

CONTENTS

EXECUTIVE SUMMARY

1 The Stock Exchange of Hong Kong Limited (the “**Exchange**”) has recently completed its second review (the “**ESG Review**”) of issuers’ reporting in accordance with the Environmental, Social and Governance Reporting Guide (the “**Guide**”).

2 The Listing Rules requires issuers to publish Environmental, Social and Governance (“**ESG**”) reports under the Guide. The Guide consists of 11 aspects (“**Aspects**”), with three Aspects under “Environmental” subject areas and eight Aspects under “Social” subject areas. Each Aspect requires general disclosures (“**General Disclosures**”) and key performance indicators (“**KPIs**”). General Disclosures include the issuer’s policies (“**Policies**”) and, in some Aspects, information on compliance with the relevant laws and regulations that have a significant impact on the issuer (“**Laws and Regulations**”). General Disclosures in all Aspects and KPIs in Environmental Aspects are subject to “comply or explain”, while KPIs in Social Aspects are voluntary disclosures. The Guide also sets out four Reporting Principles underpinning the preparation of an ESG report and the presentation of information.

3 The ESG Review analysed the ESG reports for the financial year ended 31 March, 30 June and 31 December 2018 published by a sample of 400 issuers (“**Sample Issuers**”). Sample Issuers were selected randomly with a weighting reflective of the industry distribution of all listed issuers as at 31 December 2018.

4 The ESG Review was conducted in respect of each Sample Issuer, focusing on:

- whether the issuer had published an ESG report;
- when the ESG report had been published;
- the issuer’s disclosure in respect of any assessment of materiality;
- disclosure of general disclosures and key performance indicators; and
- the overall approach to ESG reporting and the level of detail disclosed.

5 All Sample Issuers published an ESG report and did so within the three-month time limit. We observed that the majority of Sample Issuers published their ESG report either on the same day as their annual report (63%), or shortly before the three-month deadline (26%). There remains a significant variance in the quality of ESG reporting - in particular, it appears that whilst some companies publish detailed and meaningful reports, other companies appear to have approached ESG reporting with a “box-ticking” mentality.

6 The focus of our recommendations has been on four interlinked areas: (a) board-level engagement; (b) materiality assessments; (c) ensuring that each and every of the required disclosures are addressed; and (d) use of the option to “explain” a provision for which “comply or explain” is required.

7 In relation to board-level engagement, many reports contained little or no description of board involvement. Whilst there is no requirement that the reports should provide details of this, it is not necessarily clear in some cases to what extent boards are engaged. We have therefore sought to reiterate the importance of boards being meaningfully involved in assessing and addressing ESG-related risks.

8 In relation to materiality assessments, we noted that two-thirds of issuers in the sample disclosed that an assessment had been undertaken (again there is no strict requirement for disclosure of this), with more or less detail as to how it had been performed. We have sought to emphasise the importance of undertaking a materiality assessment – not for the purposes of satisfying the Exchange, but because it is a fundamental element in a company assessing the ESG-related risks it faces.

9 In relation to ensuring every required disclosure is addressed, we noted that in some cases, even in reports which appeared to be presented with a very high overall quality, there had been an omission or failure to address one or more of the "comply or explain" provisions. In some cases, it could be that a provision was not addressed because it was deemed immaterial. However, this is technically a breach of the Listing Rules – if the provision was immaterial then technically the issuer is required to say so. We have therefore sought to encourage issuers to ensure that their reports do not miss a single required disclosure.

10 In relation to the use of the option to "explain", we note that of all provisions reported by Sample Issuers, only 3% were "explained". This seemed very low. The most common explanation is that a provision is not material to the issuer. Given that provisions prescribed by the ESG Guide cover a wide range of ESG matters, and every issuer's business is different, we expected that a greater proportion of provisions would be considered immaterial by individual issuers, and so would be perfectly suited to be "explained" in the report. The high proportion of provisions for which issuers chose to "comply" may suggest that issuers have not properly determined whether a provision is material to them or not, or that issuers believe that the "explain" option is somehow a less-preferable option.

11 These findings and recommendations are in line with the results and the conclusions of our ESG consultation (the "**Consultation Conclusions**") which seeks to improve our ESG reporting framework and the board's governance on ESG matters. We encourage issuers to take into account the recommendations set out in this report in preparing their ESG reporting under the new requirements set out in the Consultation Conclusions[1].

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[1] The implementation date for the new requirements set out in the Consultation Conclusions is for financial years commencing on or after 1 July 2020.

CHAPTER 1: PURPOSE AND METHODOLOGY

Purpose of ESG Review

12 ESG has never been more topical for businesses and investors. There are growing calls globally for companies to consider ESG-related issues and risks in determining their business practices and direction and as part of their medium to long-term strategy, and for issuers to disclose information relating to ESG for the benefit of investors and other stakeholders.

13 The Exchange introduced the Guide in 2012.[2] From the financial year starting 1 January 2016, issuers have been required under the Listing Rules to publish reports on certain ESG matters.

14 The Guide requires reporting in respect of 11 Aspects, comprising three Aspects in Environmental subject area and eight Aspects in Social subject area.

15 The information requested in respect of each Aspect is broken down into individual provisions, comprising: (a) General Disclosures, including an issuer's Policies and, in some Aspects, compliance with Laws and Regulations; and (b) information on certain specific matters in the form of KPIs.

16 Reporting of (i) General Disclosures under both the Environmental and Social Subject Areas, and (ii) KPIs under the Environmental Subject Area, is on a "comply or explain" basis. This means that an issuer should either report the requested information under the "comply or explain" provision, or explain why information is not disclosed (e.g. because it is not material for that particular issuer's business and operations). KPIs in respect of the Social Subject Area are currently recommended, rather than "comply or explain", disclosures.

17 With a view to provide guidance to issuers and improve the quality of future reports, the Exchange has undertaken periodic reviews of issuers' ESG reports, including practices adopted and compliance with requirements of the Listing Rules. In May 2018, the Exchange published its first Analysis of Environmental, Social and Governance Practice Disclosure, covering information disclosed in 2016-2017.

18 The Exchange has recently completed its second periodic review. This report summarises the main findings of that second review.

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[2] The Guide can be found in rule 13.91 and Appendix 27 of the Main Board Listing Rules, and rule 17.103 and Appendix 20 of the GEM Listing Rules.

Methodology

19 A sample was selected comprising 400 Sample Issuers[3] with financial year-end in March, June and December 2018. The selections were a random sample for a weighting to achieve an industry distribution reflective of all listed issuers in Hong Kong, and a cross-section of financial year-ends. The industrial distribution of Sample Issuers could be referred to the table below:

Table 1: Industrial distribution of Sample Issuers[4]		
	Number of Issuers	**% of Sample Issuers**
Conglomerates	4	1.0%
Consumer Goods	91	22.8%
Consumer Services	55	13.8%
Energy	14	3.5%
Financials	39	9.8%
Industrials	46	11.5%
Information Technology	38	9.5%
Materials	26	6.5%
Properties & Construction	71	17.8%
Telecommunications	3	0.8%
Utilities	13	3.3%
Total	**400**	**100%[5]**

20 A review was then conducted in respect of each issuer in the sample. The review focused on:

(a) whether the issuer had published an ESG report;
(b) when the ESG report had been published;
(c) the issuer's disclosure in respect of any assessment of materiality;
(d) disclosure of General Disclosures for each Aspect;
(e) disclosure of KPIs for each Aspect; and
(f) the overall approach to ESG reporting and the level of detail disclosed.

21 Whilst the ESG Review has sought to illustrate some of our findings by reference to statistical data gathered from our review, it is important to note that our review also looked at ESG

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[3] Among the Sample Issuers, 336 (84%) are Main Board issuers and 64 (16%) are GEM issuers.

[4] Since the ESG Review is based on the data in 2018, the Hang Seng Industry Classification System prior to its 2019 update is used. The 2018 system categorise all companies into 11 industries, including Conglomerates, Consumer Goods, Consumer Services, Energy, Financials, Industrials, Information Technology, Materials, Properties and Construction, Telecommunications, and Utilities. With effect from 9 September 2019, "Consumer Goods" and "Consumer Services" industries have been reorganised into 'Consumer Discretionary', 'Consumer Staples' and 'Healthcare' industries.

[5] Numbers does not add up to 100% due to rounding.

reporting from a qualitative perspective. Some of our key findings on the matters above are therefore based on our overall impression from the review. So whilst we have included some data which we believe may be helpful, we do not attempt to use statistical data as the basis of determination of all the matters listed in paragraph 20 above.

22 For the purposes of understanding the statistical data in this ESG Review, readers should note that an Aspect is described as “reported” if the issuer’s report contained disclosure (whether by compliance or explanation) in respect of *each and every* “comply or explain” provision (whether a General Disclosure or KPI) set out under that Aspect. An Aspect would be deemed as not having been reported if there was no disclosure on one or more “comply or explain” provisions (whether a General Disclosure or KPI) under an Aspect. By way of example, if an issuer’s report omitted disclosure in respect of a single provision within an Aspect, without including an explanation of why disclosure was omitted, then for the purposes of the statistics, the whole Aspect would be deemed “not reported”, irrespective of the fullness and quality of the disclosure in respect of the other provisions under that Aspect. This is accordingly a high threshold and the statistics should be read in this light.

CHAPTER 2: COMMENTARY AND RECOMMENDATIONS

23 It is encouraging to see that there has been an overall trend of improvement in ESG reporting since our first review in 2016. [6] All Sample Issuers produced an ESG report and did so on time.[7] A majority published their ESG reports on the same day as their annual reports, allowing timely access to both financial and ESG information. Many issuers are producing comprehensive and informative reports which go beyond the minimum requirements under the Listing Rules. However, there are areas for further improvement for some companies, and there remains a significant variance in the quality and detail of the reporting.

24 In this section, we comment on the findings from our review, and make suggestions as to how issuers can continue to enhance their reports in the future. We focus on the following four matters:

- Board-level engagement
- Materiality assessments
- Considering every provision
- “Comply or explain” – both are acceptable options

25 There is considerable overlap between these four areas. The key common thread is the desirability of meaningful engagement by the issuer with ESG matters, and a correspondingly meaningful and quality disclosure output in the report.

26 Put another way, it is not particularly helpful for an issuer to work through the Guide in a mechanical, “box-ticking” manner. Adopting such an approach will not help the issuer to understand its own business and any relevant ESG risks or opportunities. It will also be apparent to readers, including investors and stakeholders, when an issuer has adopted an approach to ESG which lacks a desirable level of quality and depth of detail.

Board-level engagement

27 Proper consideration of ESG matters is essential for the understanding and management of ESG-related risks. The evaluation of those risks, and an issuer’s strategy in relation to them, therefore inevitably fall within the responsibility of the board. There are express provisions in the Listing Rules regarding board-involvement in ESG. [8] Any board performing proper oversight would in any event be expected (not least by investors) to be meaningfully engaged in ESG so that it can understand and react to the related risks and opportunities, and ensure

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[6] See “Analysis of Environmental, Social and Governance Practice Disclosure in 2016/2017”.

[7] An issuer should publish its ESG report as close as possible in time to, and in any event no later than three months after, the publication of its annual report – see paragraph 3 of the Guide.

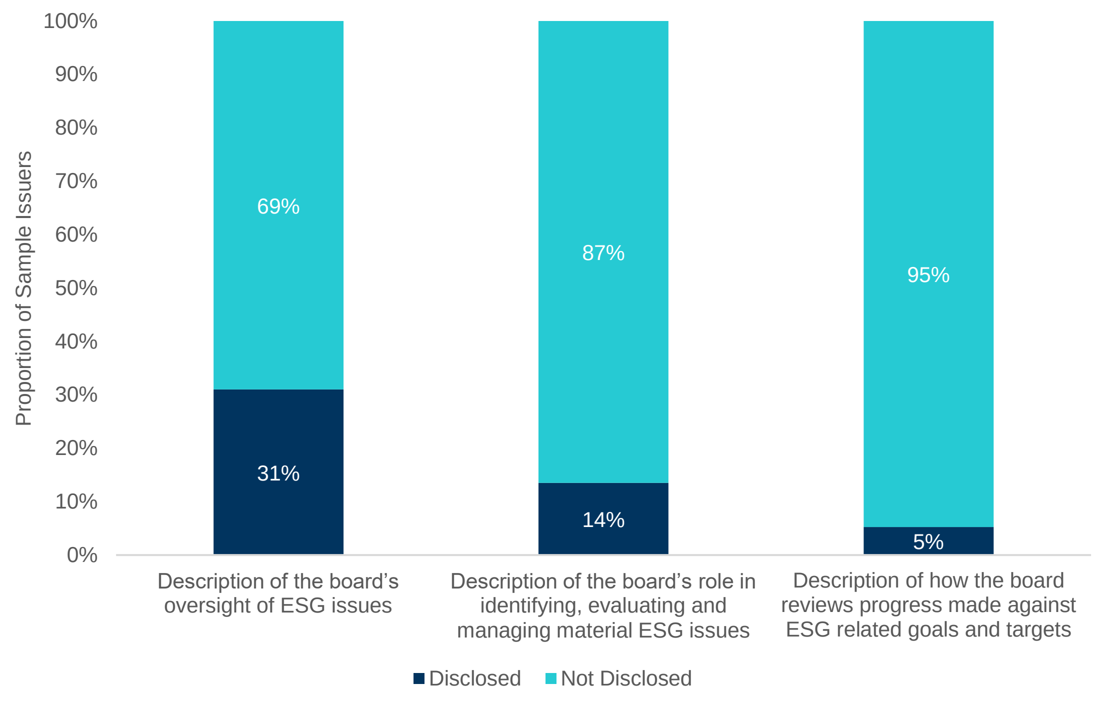
[8] See in particular paragraphs 8 and 9 of the Guide.

that appropriate management and control systems are in place to address them.

28 As stated in paragraph 10 of the Guide, an ESG report should describe the issuer's ESG management approach and strategy (amongst other things). There is neither a prescribed way to do so this, nor a prescribed level of detail to be contained in such a description. When conducting our review, we sought to identify whether issuers were describing: (1) their board's oversight of ESG issues; (2) the board's role in identifying, evaluating and managing material ESG issues; and (3) how the board reviews progress on ESG issues.

29 As shown in Figure 1 below, the ESG Review found that less than one-third of Sample Issuers described their board's oversight of ESG issues, and only a small percentage of Sample Issuers described the board's role in identifying, evaluating and managing material ESG issues, or how the board reviews progress on ESG issues. It is of course possible that boards were involved in and overseeing ESG issues but this was not described in the report.

Figure 1: Disclosure on ESG governance



30 Disclosures on the three areas referenced in paragraph 28 and Figure 1 would assist readers of issuers' ESG reports to understand board-level engagement generally. Issuers should also note that, with reference to the Consultation Conclusions, we will introduce a mandatory disclosure requirement on a statement from the board setting out the board's consideration of ESG issues.

Materiality assessments[9]

31 A considered materiality assessment is a fundamental and indispensable element in a proper analysis of ESG-related risks. It shows report readers how the board assesses and prioritises ESG-related risks. Issuers who have not conducted a materiality assessment before should do so. If a materiality assessment has been done, then issuers are encouraged to include details of the assessment in the ESG report to demonstrate both the existence and thoroughness of the exercise carried out. There is no strict requirement for this disclosure in the Guide, but materiality is one of the reporting principles referred to in paragraph 11 of the Guide, and information relating to materiality assessments is helpful to the reader. Issuers may wish to refer to our step-by-step guide as a reference for expectations in this regard.[10] Moreover, if there is no disclosure of a materiality assessment, then the following question inevitably arises: how was the issuer able to ascertain satisfactorily the ESG risks it faces?

32 In our first ESG review,[11] only 57% of issuers sampled reported that they had conducted a materiality assessment. We are pleased to note a statistically significant improvement in this ESG Review, with 66% of Sample Issuers reporting on their materiality assessment exercise.

33 Certain industries in particular were "off the pace" in this regard: for example, Industrials had the lowest percentage of disclosures by some margin at 46%. Further information appears in the table below. The industries have been classified in line with the Hang Seng Industry Classification System in effect in 2018.

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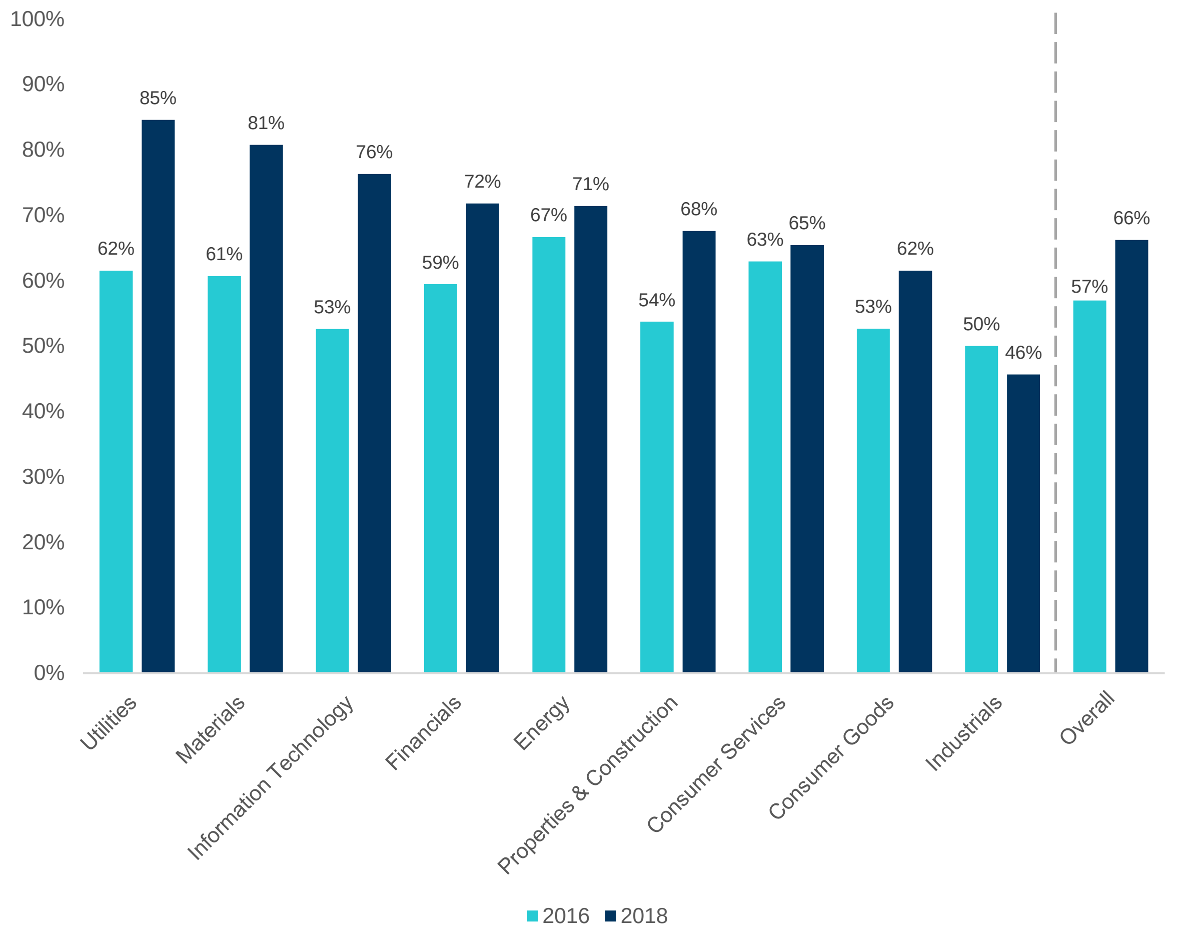
[9] Due to insignificant sample sizes in the industries, Conglomerates and Telecommunications, these two industries are excluded from the analyses by industry in this report.

[10] See "How to Prepare an ESG Report: A Step-by-step Guide to ESG Reporting".

[11] The review analysed the ESG information disclosed by 400 Sample Issuers with financial year end date of 31 December 2016, 31 March 2017 and 30 June 2017.

Figure 2: Statistics on disclosure of materiality assessment by industry



34 Materiality assessment is arguably one of the most important parts of the ESG assessment and reporting process, as they are instrumental in setting the tone of a company's overall thinking about and approach to ESG issues. Issuers should describe the process of identifying and engaging with key stakeholders, and the criteria used to ascertain the materiality of each Aspect or provision. However, our review found that less than one-third of ESG reports disclosed the criteria adopted for selection of material ESG factors.

35 Issuers should disclose ESG information for the Aspects that are deemed material to their businesses. If certain Aspects or provisions are identified as being immaterial, the disclosure should explain why, by reference to the assessment process.

36 Issuers are reminded that there are useful resources available to help them map out and prioritise ESG issues. Apart from guidance materials available on our website,[12] issuers may refer to guidance available from other organisations which have developed ESG reporting standards and systems. For example, the Sustainability Accounting Standards Board (**SASB**)

[12] Resources in relation to ESG reporting on our website.

publishes a "Materiality Map" which is intended to help companies in certain industries and sectors identify ESG areas which are most likely to be relevant to those industries and sectors.[13]

Considering every provision

37 ESG reports must cover each and every "comply or explain" provision in the Guide. Each provision is either considered material, in which case the issuer should provide the necessary disclosures, or it is considered immaterial, in which case the issuer should make a statement to that effect with sufficient explanation of its determination of immateriality.

38 Our review found that some reports lacked the requisite attention to detail and precision to ensure that each and every "comply or explain" provision had been addressed. This was sometimes the case even in reports which appeared otherwise to evidence a high-level of meaningful engagement and quality of reporting, and/or which attempted to address all ESG-related issues.

39 For example, it appeared from the review that issuers had little difficulty providing the necessary General Disclosures relating to policies (with a reporting rate of about 99%). However, reporting in respect of General Disclosures of laws and regulations was only 91%.

40 Issuers are reminded that a failure to address each and every "comply or explain" provision is a breach of the Listing Rules, and accordingly appropriate care should be taken to ensure that no provisions are missed, even if they may potentially require more work to be properly addressed.

"Comply or explain" – both acceptable options

41 "Comply or explain" means that issuers can choose to disclose the requested ESG information (i.e. "comply") or explain why relevant information is not disclosed (i.e. "explain"). However, we noted that substantially all of the "comply or explain" provisions were "complied" with, i.e. disclosing the relevant substantive data required, and that very few of the "comply or explain" provisions were "explained". Of all the "comply or explain" provisions reported by Sample Issuers, only 3% were reported by way of "explanation".

42 For those provisions that were explained, the most common explanation was that the provision was not material or applicable to the issuer's business. For example, many Sample Issuers in the Financials industry explained that there is no need for information to be disclosed in respect of KPI A1.3 (hazardous waste produced) or KPI A2.5 (packaging material used), as the financial services industry does not produce much hazardous waste, or products which require packaging material, and so these KPIs are not material to their business. These are relatively

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[13] SASB, Materiality Map.

obvious examples, but the very low percentage of “explanations” may suggest that issuers are not necessarily differentiating their approach to reports (i.e. whether to comply or explain) even where it may be reasonably clear that a “comply or explain” provision is not material.

43 It was similarly noted in the review that a high proportion of Sample Issuers are disclosing substantive ESG information on almost every Aspect. However, every business is different, and will face different risks. While the Guide sets out provisions relating to 11 different Aspects, not all of these Aspects are expected to be material to each and every business.

44 A possible explanation for the unexpectedly high level of “compliance” rather than “explanation” and number of Aspects and provisions considered by issuers to be material to their business, is that some issuers are choosing to report on each provision, rather than engaging in a thorough process to determine whether these “comply or explain” provisions are truly material.

45 It is of course possible, in individual cases, that each and every provision is material for an issuer. However, issuers should not fall into a “box-ticking” approach whereby attempts are made to populate each provision with data without conducting a suitable assessment of each provision’s materiality and relevance. On a holistic view, the reports which appeared to be of higher quality in terms of demonstrating meaningful engagement and disclosing meaningful detail tended to be able to differentiate between each “comply or explain” provision on a materiality scale and focus on those of greatest relevance and priority.

46 Issuers are reminded that “explanation” is not a less preferred or secondary option. Indeed if a “comply or explain” provision is not material to an issuer, it is better to say so, and for the issuer to demonstrate that it has fully thought through what applies to them in a material way, and what does not.

Other recommendations

47 As described more fully in the following section of this report, issuers are also recommended to seek to publish their ESG reports at the same time as, or as close as possible in time to, their annual reports.

CHAPTER 3: RESULTS AND STATISTICAL DATA

48 This section summarises some of the key findings of the review.

Publication of ESG report / timing

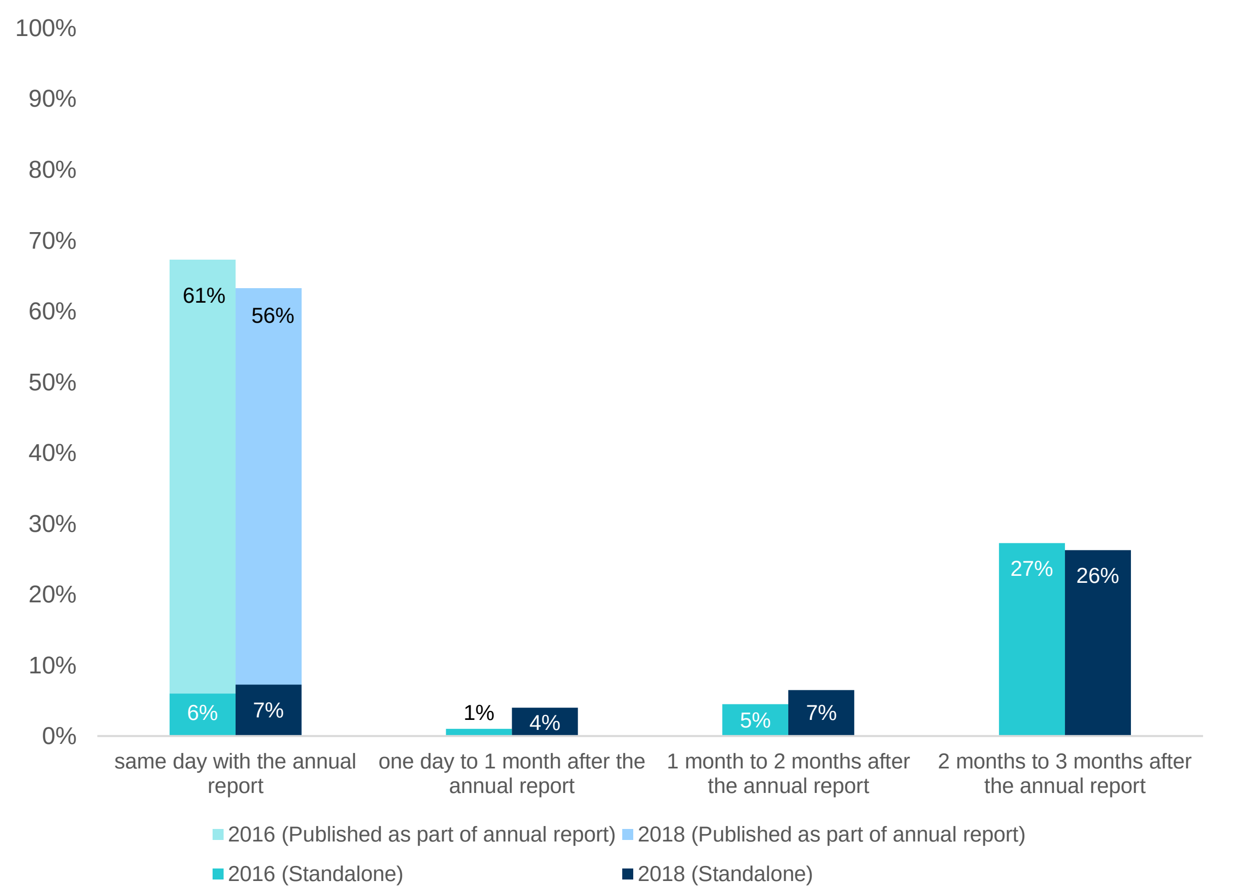
49 All Sample Issuers published an ESG report, and did so within three months of their annual report (being the deadline in the Guide).

50 As shown in Figure 3, in respect of timing of publication, most Sample Issuers fell into one of two distinct groups – publishing either at about the same time as their annual report, or nearly three months later. A very similar pattern was observed in 2016. In particular:

- A total of about 63% of Sample Issuers published their ESG information on the same day as they published their annual report (either incorporated within the annual report, or in a standalone report). This is broadly the same as the 2016 review (67%).

- About 26% of Sample Issuers published their ESG report over two months after the annual report (2016 review: 27%).

Figure 3: Time difference between publishing ESG reports and annual reports



51 A narrow majority (56%) of Sample Issuers incorporated their ESG reports into their annual reports (2016 review: 61%). The remainder published standalone reports.

52 An issuer should publish its ESG report as close as possible in time to, and in any event no later than three months after, the publication of its annual report.[14] It is clear from the ESG Review that a significant proportion of issuers continue to publish their ESG reports shortly before the expiry of this three-month time limit. Issuers are encouraged to make the necessary adjustments to harmonise the timing of the publication of their ESG reports with their annual reports.

Breakdown by nature of provision

53 A distinct pattern was detected in respect of reporting by Sample Issuers by reference to the nature of provision[15] under which a disclosure was required. This is summarised in the table below:

Table 2: Statistics by nature of disclosure required	
Nature of disclosure required	**%**
General Disclosures – Policies	99
KPIs (Environmental Area only)	95
General Disclosures – Laws and Regulations	91

54 About 99% of provisions relating to policies (across both the Environmental subject area and Social subject area) were reported. However, reporting of Laws and Regulations was distinctly lower at about 91% of provisions. As in 2016, Emissions (A1), Health and Safety (B2), and Product Responsibility (B6) were again the three Aspects in which most instances of non-reporting of Laws and Regulations provisions were detected. There was nevertheless a substantial improvement in reporting of these three Aspects in 2018 (89%) when compared with 2016 (77%).[16]

55 In relation to KPIs in the Environmental subject area, the overall reporting rate was high, and the majority of Sample Issuers complied or explained every provision. Some Sample Issuers did not comply or explain *each and every* KPI provision. For example, only about 60% of Sample Issuers from the Consumer Services, Financials, and Energy industries reported on each and every Environmental KPI.

56 Although Social KPIs are only recommended disclosures, our review noted that many Sample Issuers were reporting them. Particular strength was shown in respect of the Aspects of Anti-

[14] Paragraph 3 of the Guide.

[15] As noted in paragraph 15 above, information requested in respect of each Aspect is broken down into individual provisions.

[16] Average value across the three Aspects.

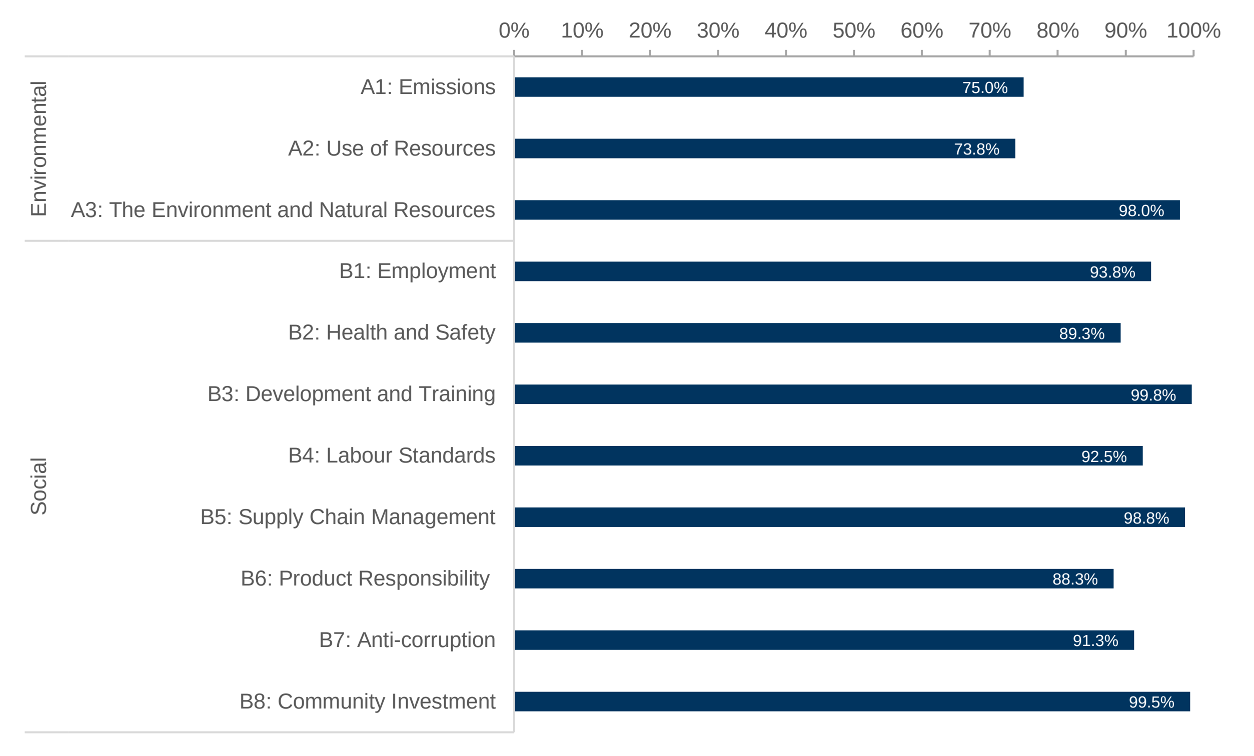
corruption (B7) and Community Investment (B8). However, few reports were observed in respect of Labour Standards (B4), and Product Responsibility (B6).

Breakdown by Aspect

57 As explained in paragraph 22 above, the reporting rate of an Aspect is defined as the proportion of Sample Issuers who complied or explained each and every "comply or explain" provisions under the relevant Aspect.

58 As shown in Figure 4, apart from Emissions (A1) and Use of Resources (A2), all the other Aspects have a reporting rate of at least 88%. Aspects such as The Environment and Natural Resources (A3), Development and Training (B3), Supply Chain Management (B5) and Community Investment (B8) were reported by almost all Sample Issuers.

Figure 4: Reporting rate by Aspect in 2018



59 The below-average reporting rates for Emissions (A1) and Use of Resources (A2) can likely be attributed to the change of Environmental KPIs from recommended disclosures to "comply or explain" provisions for financial years beginning on or after 1 January 2017. Following the change, there are eight[17] and six[18] "comply or explain" provisions under Emissions (A1) and Use of Resources (A2) respectively, while The Environment and Natural Resources (A3) and

[17] Emissions (A1) consists of two General Disclosures and six KPIs.

[18] Use of Resources (A2) consists of one General Disclosure and five KPIs.

other Aspects in Social subject area only consist of one to two “comply or explain” provisions.[19] Some Sample Issuers may not have applied sufficient rigour to check that all of the “comply or explain” provisions have been reported on.

[19] The Environment and Natural Resources (A3) consists of one General Disclosure and one KPI provision, while Aspects in Social subject area consist of one or two General Disclosures with no KPIs subject to “comply or explain”.