13 July 2023

By email: response@hkex.com.hk

Re: Consultation on the Enhancement of Climate-related Disclosures Under the ESG Framework

Dear Sir or Madam,

The Asian Corporate Governance Association (ACGA) is a non-profit membership association founded in 1999. We conduct research on corporate governance and ESG in 12 markets in Asia-Pacific and advocate at the regulatory and corporate level across the region to improve standards and practices. ACGA is entirely funded by a network of 113 member firms from 20 markets, of which 70% are institutional investors with more than US$40 trillion in assets under management globally.

We welcome the opportunity to respond to the consultation paper on the Enhancement of Climate-related Disclosures Under the Environmental, Social and Governance Framework (Appendix 27 of the Listing Rules). ACGA has both high-level and specific comments.

High-Level Comments

We would like to emphasise that we are supportive of the plan of Hong Kong Exchanges and Clearing (HKEX) to make climate reporting mandatory in Hong Kong and to prepare issuers to get ready for such reporting based on the IFRS S2 standard recently published by the International Sustainability Standards Board (ISSB).

We also believe the Exchange has struck a reasonable balance between items that need to be disclosed from the time the new Appendix 27 takes effect (ie, for financial years starting on or after 1 January 2024) compared to those that could be phased in. Introducing the more difficult reporting requirements over a two-year "interim period" also seems reasonable, especially for larger listed companies. One question worth considering is whether listed SMEs will require a slightly longer interim period to report on the complex items such as current/anticipated financial effects, Scope 3 emissions and certain cross-industry metrics? We would note that allowing a degree of flexibility here for SMEs would not exempt them from reporting on most items in the new "ESG Reporting Code" in Appendix 27, including Scope 1 and 2 emissions.

One area of concern in the consultation process, however, is the apparent lack of coordination with the Hong Kong Institute of Certified Public Accountants (HKICPA), which is the accounting and auditing standard setter for Hong Kong and the entity formally charged with introducing ISSB standards into the territory. We understand that HKICPA will be undertaking its own consultation on ISSB in the coming months, with a view to releasing standards as soon as possible thereafter. Any differences between the HKEX and HKICPA requirements could create a degree of confusion in the market and reporting challenges for locally incorporated HK-listed companies that follow HKFRS. We trust that HKEX, the Securities and Futures Commission, and the Hong Kong Government will clarify the relationship between these two sets of standards and the degree to which the new HKICPA standards are mandatory or voluntary.

It is also worth highlighting that HKEX's new "ESG Reporting Code" is not yet aligned with IFRS S1 on General Requirements for Disclosure of Sustainability-related Financial Information. While the focus on climate disclosure is a strong step forward and will require considerable effort and investment by issuers, international investors are looking to jurisdictions in Asia-Pacific and developed markets to adopt both IFRS S1 and S2 as soon as possible. We look forward to commenting on a further amendment of the ESG Reporting Code in future.

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Specific comments
Our specific comments are as follows:

ESG discussions in the Business Review Section of the Directors' Report
We welcome the addition of climate in the requirement for "a discussion of the issuer's environmental (including climate-related) policies and performance" in the business review section of Directors' Reports.

We recommend that companies be encouraged to also include an explicit statement regarding the extent to which the board considers climate-related risks or opportunities to be material in the context of the current financial statements and, if so, where these statements have been adjusted.

We understand that most companies today, possibly a majority, do not yet consider climate matters to be material for their current financial position or performance. Nevertheless, since IFRS accounting standards already require companies to consider the impact of all material risks on their financial, a statement to the effect that the board is aware of this requirement and has actively considered climate as a material matter would provide transparency to the market and reassurance to investors that the company is on top of these issues.

Governance
We believe the expanded guidance on governance matters will provide readers with more granularity and an improved overview of how boards are addressing climate matters. It is important that investors receive meaningful narrative in this section, not generic statements that recycle the language of the Code, such as "the board ensures that the appropriate skills and competencies are available to oversee strategies designed to respond to climate-related risks and opportunities".

Some simple questions companies could consider addressing in this section include:

- What is the board's value-added in terms of climate strategy?
- What specific decisions has the board made that management could not have made?
- Is the board fit for purpose to address complex climate issues (considering the age, expertise, and professional background of directors)?
- How is the board nomination process being refreshed to ensure that "the appropriate skills and competencies are available", to quote the Code.
- What is the company doing to raise director awareness of the critical physical or transitions risks that the company may face in the short, medium, and long term?
- If the board adds climate strategy to the remit of an existing committee, such as audit or risk, how does it ensure that these committees are not overloaded?

In December 2022, ACGA co-published a report with CLSA on climate governance in Asia, called "Down to Earth: Climate governance case studies in Asia-Pacific". While our sample size was small, we found limited climate expertise on boards, with management in the driving seat. On the one hand, it was reassuring that management teams had the expertise to respond to these complex challenges. At the same time, it raised doubts as to the value boards were providing to their companies on climate strategy and their ability to act as a check and balance mechanism.

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Strategy

Current financial effects
The new ESG Reporting Guide hews closely to the text of IFRS S2 on the issue of "current" and "anticipated" financial effects. On current financial effects, it states:

> 10.(a) Describe and, where material, quantify the effect of climate-related risks and, where applicable, climate related opportunities identified on the issuer's financial position, financial performance and cash flows for the most recent reporting period; *(underlining added)* and
> (b) describe whether and how such risks and, where applicable, opportunities may result in a material adjustment to the carrying amounts of assets and liabilities reported in the financial statements within the next financial year."

We are concerned that this framing could be somewhat confusing for issuers and others, since neither Appendix 27 nor IFRS S2 is a set of accounting standards.

As noted, IFRS accounting standards already require firms to take material matters into account in their audited financial statements and this should include climate if it is material. While HKEX includes a note to this affect after paragraph 10, we believe this this point could be emphasised more strongly, perhaps in a preamble to this part of the Code.

Interim provision
The interim provision under "Current financial effects" states that:

> "During the Interim Period, issuers who have yet to provide quantitative information pursuant to paragraph 10(a) above should provide qualitative disclosures."

We have doubts as to the merits of allowing issuers to provide qualitative descriptions of current financial effects if they cannot provide quantitative information. If something is currently material, it should have been accounted for in the financials in line with accounting standards. Providing only qualitative information might cause some confusion or mislead users of financial statements.

Uncertainty
We also note that IFRS S2 has some helpful language on uncertainty that is lacking in the new Appendix 27. For example, IFRS S2 states:

> 19. An entity need not provide quantitative information about the current or anticipated financial effects of a climate-related risk or opportunity if the entity determines that:
> (a) those effects are not separately identifiable; or
> (b) the level of measurement uncertainty involved in estimating those effects is so high that the resulting quantitative information would not be useful.

While this text may provide some companies with a reason not to disclose detailed information, it also offers a useful safety value to those struggling to quantify the financial impacts of climate change. This text is lacking in the new ESG Reporting Code and we recommend similar wording be included.

Assurance

We note that the HKEX proposals do not update the section on the assurance of ESG reports. The relevant paragraph (9) states:

> "The issuer may seek independent assurance to strengthen the credibility of the ESG information disclosed. Where independent assurance is obtained, the issuer should describe the level, scope and processes adopted for the assurance given clearly in the ESG report."

Given the rapidly increasing focus on the importance of assurance, and its inclusion in either the regulatory frameworks or other ISSB-related consultations taking place around the region, this feels like an opportunity missed. We would recommend that HKEX strengthen this part of the new Appendix 27 and require, at a minimum, that issuers ensure their ESG reports receive at least limited assurance within the next two to three years. Given the well-known capacity constraints in the assurance industry, such a provision could be phased in according to company size (ie, with the larger issuers and bigger emitters going first). Requiring assurance would also provide comfort that any exemptions sought on the grounds of uncertainty have a basis in fact.

Climate lobbying

Although not addressed in either the new HKEX proposals or IFRS S2, climate lobbying by some companies is becoming an issue of increasing concern to global institutional investors. One way forward would be for companies to include a description in their ESG reports of any climate-related lobbying they have undertaken over the previous year and how this is aligned with their carbon-reduction commitments.

Thank you for your attention. We would be pleased to answer any questions that you may have.

Yours truly,

Jamie Allen
Secretary General