



25 July 2019

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By post and email to: [response@hkex.com.hk](mailto:response@hkex.com.hk)

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

Dear Sir,

The Asian Corporate Governance Association (ACGA) is a not-for-profit membership association chartered under the laws of Hong Kong and founded in 1999. The Association is dedicated to working in a constructive manner with regulators, listed companies, investors and other key stakeholders across Asia to improve corporate governance standards and practices, which we believe are a foundation for long-term economic development. We are guided by a practical, long-term approach that is relevant to each individual market. Our operations are supported by a membership base of institutional investors, Asian listed companies, insurance and accounting firms, and universities. ACGA has more than 110 corporate members, two thirds of which are institutional investors with more than US\$30 trillion in assets under management globally. They are also significant investors in the Hong Kong market.

We appreciate the opportunity to comment on the revised ESG Reporting Guide for Hong Kong and would like to start with some high-level comments, followed by our answers to each of the specific questions.

**High-level comments**

We support the direction that the Exchange is taking in updating this Guide and agree with the spirit of many of its proposals, in particular:

- An enhanced statement on the role of the board in setting ESG/sustainability strategy;
- The introduction of new “mandatory disclosure requirements” on the board’s role and other issues, such as how it determines materiality, sets goals and targets, and ensures consistent reporting.
- The inclusion of a section on climate change under the Environmental KPIs;
- Transferring all Social KPIs from “recommended disclosures” to “comply or explain”.

In general, however, we believe that the proposed amendments do not go far enough and will leave Hong Kong well behind leading practice in other regional markets and globally. Standards and expectations have moved quickly on ESG/sustainability reporting over the past four years, yet Hong Kong's approach is incremental in key areas and highly "path dependent" (ie, constrained by the framework and content of the original Guide). Something more innovative and internationally minded is needed for an international financial centre such as Hong Kong.

Areas where the Guide could provide additional guidance include, for example:

1. **The board statement:** Include additional language on how it could be made more meaningful to investors and other stakeholders (ie, company specific) and how to avoid boilerplate.
2. **Climate change impact:** The wording of the new general disclosure obligation and KPI is extremely brief and will probably result in boilerplate statements from companies. A more helpful approach would be to reference the logical framework provided by the Task Force on Climate-related Financial Disclosures (TCFD) and encourage companies to report in line with it.
3. **International ESG reporting standards:** While the Guide mentions that issuers can opt to follow various international standards in ESG reporting, it does not incorporate practical guidance on these. For example, standards developed by the Sustainability Accounting Standards Board (SASB) in the United States can be used for reporting on ESG risks that are likely to have a direct financial impact on company performance. (Note: SASB standards have broader application than just the US). Or companies could adopt the "integrated thinking" approach suggested by the UK's Integrated Reporting <IR> model that provides a helpful framework for directors, senior executives and divisional heads to discuss the most significant (ie, strategic) sustainability challenges facing their company. This is a useful exercise whatever the form your ESG report takes.

It is important to emphasise that we are talking above about additional guidance to help companies think through the best approach to ESG reporting. We are not suggesting that TCFD, SASB and <IR> reporting must become mandatory in Hong Kong.

### Policy considerations

A number of policy issues are implicit in the Guide and we would like to comment as follows:

1. **Comply or explain:** The presentation of the Environmental and Social KPIs could be read as implying that companies must gather and report on all these metrics, despite the fact that they fall under the "comply or explain" part of the Guide. A more explicit statement emphasising that companies should apply a materiality threshold to each KPI would be helpful.
2. **Anti-corruption:** The reference to disclosure of training on anti-corruption is positive, yet this whole aspect is not properly supported by the Hong Kong CG Code which still leaves

whistleblowing policy as only a “recommended best practice” (ie, not subject to comply or explain”). This is an area where the CG Code needs to be amended soon.

3. **Assurance:** Since assurance is voluntary, there is an understandable concern that any ESG data that is not assured could lack integrity. If companies choose not to seek assurance, perhaps they should be required to provide a detailed explanation of their data gathering and analysis processes? This is covered to some extent by the Guide, but could be made more explicit.

### **Corporate reporting considerations**

One of our biggest fears about enhanced ESG reporting in Hong Kong is that the city could suffer the same fate as many other Asian markets, namely increasingly sophisticated ESG/sustainability reports standing alongside mediocre and unchanging financial and corporate governance reports. This is a worsening issue in many places, in our view, and is readily apparent from the 100-page GRI-style reports published by some companies (often large caps) alongside annual reports that contain limited narrative to their financial statements and CG reports that are cut-and-pasted from one year to the next. The drive for higher standards in ESG reporting should not result in a weakening in other areas of disclosure.

One way in which financial regulators could address this issue is not only to ensure balanced guidance to companies on financial, CG and ESG reporting, but to make clear a regulatory expectation for high-quality reporting across the board. In this context, we note and welcome HKEX’s regular [review](#) of annual reports in Hong Kong, the most recent of which was published on 31 January 2019. The report described disclosure in annual reports as “generally satisfactory”, but highlighted four areas for improvement: the business review in MD&As; financial statements with modified opinions by auditors; disclosure of material other expenses; and material intangible assets.

Yours truly,

A handwritten signature in black ink, appearing to read 'JA', is placed above the name and title of the signatory.

Jamie Allen  
Secretary General

- Appendix: ACGA Responses to the ESG Reporting Guide Consultation Paper

## **Appendix: HKEX ESG Reporting Guide, Consultation Questions**

### Timeframe for Publication of ESG Reports

**Question 1:** *Do you agree with our proposal to amend MB Rule 13.91 and GEM Rule 17.103 to shorten the time required to publish an 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?*

**Answer: Yes**

We agree with the shorter reporting timeframe proposed, as it would bring ESG reporting in Hong Kong into line with the publication of annual reports and encourage or require companies to discuss material ESG risks (and potentially opportunities) in the context of their broader business strategy and operations. ESG and sustainability should not be seen by issuers as an "add on" to their other reporting, nor should these factors be put into a separate silo away from the rest of their operations. Investors are likely to take ESG reporting more seriously when a company coherently states the issues that are a strategic priority and what they are doing or planning to do. This at least gives investors a clear basis for engaging.

Moreover, as we noted in our September 2015 submission on the first major revision of the ESG Reporting Guide, a delay in the release of critical ESG information would likely result in it being viewed by investors as out of date and unreliable.

The logic of this argument appears to have been accepted by many issuers. As HKEX reported in May 2018, more than 60% of the companies that it sampled published their ESG reports at the same time as their annual reports (see footnote 57, page 13 of the HKEX consultation paper).

We would add one qualification: if companies include a substantive discussion of strategic ESG factors in their annual report, yet still wish to publish a longer ESG or sustainability report with more data and to have such a report assured, then these issuers could be permitted another two months to release the latter reports.

**Question 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?*

**Answer: Yes**

Issuers should, however, be required to inform shareholders that a printed copy is an option, not simply wait for requests to come in.

### **General**

**Question 3:** *Do you agree with our proposal to amend the Guide to introduce Mandatory Disclosure Requirements?*

**Answer: Yes**

The evolution of the Guide from a document based on "comply or explain" and "recommended disclosures" to one structured around "mandatory disclosure requirements" and "comply or explain" for both environmental and social KPIs is a step in the right direction. This not only better aligns the Guide with international trends in ESG reporting, but brings it closer in form and spirit to Hong Kong's CG Code: while mostly based on "comply or explain", the Code also concludes with a set of mandatory disclosure requirements.

### **Governance Structure**

**Question 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?*

**Answer: Yes**

We strongly endorse the need for an enhanced statement on the board's oversight of ESG and sustainability strategy setting and reporting. A glaring omission we found in most sustainability reports in Asia during our research for "CG Watch 2018" was the lack of any reference to the role of the board in this process. Indeed, it is apparent that many boards are not reading their own sustainability reports, nor discussing material ESG risks and opportunities in any detail.

We have concerns, however, that the language of the Guide as currently worded could result in boilerplate statements from issuers. (See next comment)

**Question 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?*

**Answer: Yes**

We agree that the board statement should cover, at the very least, the points listed in the note. As currently drafted, however, the note provides insufficient guidance to issuers on what a meaningful board statement might look like. For example, a useful board statement could contain:

1. A description of the level of expertise within the board supporting detailed discussion of ESG/sustainability issues--and what is being done either to enhance director skills (if they are inadequate) or to bring in outside consulting expertise to advise the board.
2. Details on how and when the board discusses ESG issues, and for how long, each year.
3. A description of the working relationship between the board and management in developing sustainability strategy and setting goals/targets, including the structures that exist within management to organise this process. Is there, for example, a senior manager, management committee, or department in charge of ESG?
4. Quantitative and qualitative information on sustainability strategy, priorities and goals/targets that is specifically relevant to the company during the year in question. It should not be generic and formulaic (ie, written in a way that could apply to any company).
5. A description of the extent to which the board believes material ESG risks could have an impact on the financial performance of the company's operating divisions over the short, medium and long term.
6. Any strategic decisions taken by the board over the past year to rethink the company's business model in light of material ESG risks.

### **Reporting Principles**

**Question 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?*

**Answer: Yes**

The suggested MDR on Reporting Principles makes mandatory what was previously described in the Guide as good reporting practice. Requiring issuers to explain in some detail their process for determining material ESG risks and setting quantitative targets, while ensuring they take a balanced and consistent approach to reporting, seems sensible. However, our concerns in relation to this section of the Guide are as follows:

- **Materiality:** While we agree that stakeholder engagement is useful for determining whether an issue is material, the Guide seems to imply that materiality is largely determined in response to such a process. It defines materiality as the "threshold at which ESG issues determined by the Board are sufficiently important to shareholders and other stakeholders that they should be reported". What about issues which the board and management decide are material through internal analysis and discussion?

Secondly, many "materiality mapping" exercises carried out by companies result in a list of priority issues or a "materiality matrix" that is vague and pseudo-scientific. A typical example is the ubiquitous graph with 12-14 key issues ranked according to importance to stakeholders vs importance to the company. Often there is no detailed explanation as to what the measuring process involves or why one factor, such as "safe production", is more important to a company than a related issue such as "occupational health"; or why "charity" is more important to the company than "remuneration and benefits" (real example from a China coal company). Indeed, in this same case, the issue of carbon emissions was completely excluded from the materiality matrix--a significant absence that should require explanation.

- **Quantitative:** The Guide envisages that companies can set targets that are either numerical or utilise "directional, forward-looking statements". Yet it is difficult to see how qualitative statements could be properly measured; and such a proposal is likely to encourage companies to set vague and unambitious goals.

Secondly, the Guide merely states that targets should be set to "reduce a particular impact", without reference to any goal or benchmark. But surely any reduction should be meaningful to a company's emissions load or energy usage, its impact on the immediate environment and/or the broader issue of climate change? Setting minimal targets that are fairly easily achieved and have little impact on externalities is probably pointless. We recommend that the Guide be more purposeful in its guidance on this point.

In particular, it could reference the growing use of "science-based targets" by leading companies around the world to commit to reductions in greenhouse gas (GHG) emissions in line with climate science recommendations and the goals of the Paris Agreement. Such targets involve reducing not only Scope 1 (direct) and 2 (indirect) emissions, but Scope 3 (value chain) as well. While this may be too ambitious for Hong Kong at this stage--since the Guide is only just now amending the GHG KPI from "total" emissions to Scope 1 and 2--it would be helpful for companies here to have a deeper understanding of international thinking and emerging corporate practice on this issue.



**Question 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?*

**Answer: --**

It is difficult to answer this question in a binary way because it bundles several ideas.

As we noted in our answer to Q1, one of the first steps in ESG and sustainability management is for the board and management to discuss what the strategic issues are and how they intend to deal with them.

While stakeholder engagement is a useful exercise for prioritising issues, as we noted in our answer to Q6, it should not be a substitute for strategic thinking by the board and management on sustainability. It is entirely possible that a company may already know enough about its key ESG risks and the concerns of stakeholders to remove the necessity for such an exercise (or reduce the frequency). While the Guide does not say that each issuer must do a stakeholder engagement exercise annually, it seems to imply that this is the regulatory expectation. We recommend that additional wording be included to clarify this point.

**Question 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 KPIs for historical data must be measurable, targets may be expressed by way of directional statements or quantitative descriptions?*

**Answer: Yes and No.**

Yes to 8a. No to 8b (for the reasons given above).

We caution that the liberty of using directional statements is likely to give companies opportunities to be less than transparent.



### **Reporting Boundary**

**Question 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 19 report?*

**Answer: Yes**

It makes sense for an issuer to be clear as to which parts of its operations the ESG report relates to and the reasons for not including any businesses in its coverage.

### **Climate Change**

**Question 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?*

**Answer: Yes and No.**

Yes and No. We agree with the inclusion of a new KPI on climate change, but feel that the approach being taken is not commensurate with the seriousness of the issue. We appreciate that such reporting is new to Hong Kong issuers and some will argue that they need to be allowed to 'walk before they can run'. Yet this is precisely why it would be helpful if the Guide included guidance on what effective corporate climate-change policy and reporting looks like.

Hong Kong is an international financial centre in which all the world's largest asset owners and investment managers participate. Many of them have offices in the city and the more progressive have been investing in specialist teams for corporate governance and ESG. Their expectations around meaningful climate change reporting have rapidly been coalescing around the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The four components of the TCFD framework--governance, strategy, risk management, and metrics and targets--provide a clear and logical way for companies to think about and report on the impact of climate change on their businesses. Indeed, the commentary from HKEX in the introduction to the ESG Reporting consultation paper explicitly references TCFD, notes that various countries have incorporated TCFD into their ESG guidance materials, and states that the Hong Kong Securities and Futures Commission is an official supporter of this framework. Our view is that issuers would be better served if Aspect A4 of the Guide were to include an explicit reference to TCFD as an option to consider. Since this part of the Guide is subject to "comply or explain", such a change would not make TCFD disclosure mandatory. It would, however, go some way in ensuring that Hong Kong was keeping pace with international developments in climate-change reporting and would encourage companies to think more deeply and set higher goals for themselves.

## Targets

**Question 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?*

**Answer: Yes**

We agree that refining the Environmental KPIs in this way makes sense, provides a more practical focus for companies, more useful data for investors, and removes the rather vague language in the first version of the Guide around "description of measures to mitigate emissions and results achieved".

Any targets set, however, must be meaningful (ie, not tokenistic) and reference local environmental conditions and regulation. For example, a company with a manufacturing facility in an area of high air pollution may choose, or be required, to prioritise reducing air emissions.

One governance question, however, is to what extent the board of directors of a typical Hong Kong issuer would have the expertise to oversee such technical judgement calls? Again, this is an area where the Guide could provide useful guidance on how company boards could go about discussing and setting effective targets. If there is concern that such additional guidance will make the Guide too long, HKEX could publish a supplementary document, as some Asian regulators do for various aspects of corporate reporting, on best- or good-practice examples under each aspect of the Guide.

## GHG Emissions

**Question 12:** *Do you agree with our proposal to revise an Environmental KPI to require disclosure of Scope 1 and Scope 2 GHG emissions?*

**Answer: Yes and No**

Yes and No. This is a move in the right direction but, as we note in our answer to Q6, such a standard would leave Hong Kong behind practices in developed markets in Europe, Japan and the UK. Since this part of the Guide is subject to "comply or explain", the inclusion of Scope 3 emissions would serve to inform issuers how climate-change reporting is evolving internationally rather than force them to gather all the requisite data. The more advanced reporters could then choose to report on such emissions as and when they are able to do so. Providing no reference to Scope 3 will arguably hold back the development of ESG reporting in Hong Kong.

**Question 13:** *Do you agree with our proposal to upgrade the disclosure obligation of all Social KPIs to “comply or explain”?*

**Answer: Yes**

This proposal is reasonable both in terms of the evolution of ESG reporting in Hong Kong and to bring the city into closer alignment with international standards and investor/societal expectations. As a general principle, we again recommend that the Guide make crystal clear that "comply or explain" in this context does not mean "comply and explain". Companies have a choice as to which Social KPIs to report on and should use the principle of materiality to focus most attention on those which are significant to their operations.

Having said that, it is disappointing to see that most of the KPIs under the eight "aspects" in the Social section are copied from previous "recommended disclosures" with little change. Only the Supply Chain aspect includes new KPIs that meaningfully add to what came before. Given the increasing sophistication of reporting on social factors--in part due to standards developed by the Global Reporting Initiative (GRI)--the Social section leaves Hong Kong below international norms. It is also worth noting that such reporting can be of value to other stakeholders, such as employees, not just investors. Companies may want to think about how best to use their ESG report to communicate with staff and whether the Social KPIs cover everything they want to say.

### **Employment Types**

**Question 14:** *Do you agree with our proposal to revise a KPI to clarify “employment types” should include “full- and part-time” staff?*

**Answer: Yes**

Since some companies are increasingly using part-time staff, this distinction is a sensible one to make. It would also be interesting to know if companies hire interns on a regular basis and whether they have a policy of paying such interns. This may be one area where Hong Kong has a better record than many developed markets which allow unpaid internships--often for considerable periods of time or on a recurring basis. Such internships restrict job opportunities for students from less privileged backgrounds, as they typically cannot take unpaid work.

### **Rate of Fatalities**

**Question 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?*

**Answer: Yes**

Curiously, however, the KPIs under the Health and Safety aspect seem to assume a manufacturing or heavy industry work environment. What about the health and safety of professionals working in the services sector?

### **Supply Chain Management**

**Question 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.*

**Answer: Yes**

These are the two KPIs that meaningfully expand upon the recommended disclosures in the previous version of the Guide. They complement the initial two KPIs, which require only a description of the number of suppliers by region and, vaguely, "practices relating to engaging suppliers". Since the focus of this aspect is on how companies manage environmental and social risks along their supply chain, the new KPIs provide a more substantive framework for such reporting.

### **Anti-corruption**

**Question 17:** *Do you agree with our proposal to introduce a new KPI requiring disclosure of anti-corruption training provided to directors and staff?*

**Answer: Yes**

Encouraging such training is certainly worthwhile. It does however beg the question as to why the CG Code in Hong Kong still makes the implementation of whistleblowing policies only a "recommended best practice" (ie, not subject to "comply or explain" and therefore voluntary)? In contrast, the pre-existing KPI immediately prior to this one requires a description of "preventive measures and whistle-blowing procedures, how they are implemented and monitored". It would seem that the CG Code is now out of sync with the ESG Reporting Guide.

**Question 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?*

**Answer: Yes**

This proposal makes sense as it provides firmer guidance to issuers thinking about seeking assurance. The previous version of the Guide simply said that issuers "may also consider obtaining assurance" on their ESG reports. The new version helpfully links assurance to enhancing the credibility of their ESG information and requires some detail on the auditing processes used.

In this context, it is worth highlighting that the issue of assurance is one of the most divisive we have encountered. Some investors are not convinced of the value of assuring ESG reports, others believe strongly that CPA firms should be auditing TCFD reporting as part and parcel of their audits of financial statements. The corporate sector seems equally divided between those who feel assurance should be voluntary (especially for smaller issuers) and those who believe that without assurance you are encouraging companies to fabricate ESG data. Unlike corporate governance reporting, much of which is qualitative, ESG data is often numerical, can be tested, and can be linked to financial outcomes (though views on this latter point diverge). Among auditors, their question is: which globally accepted standards should we use to assure ESG reporting? And lastly, some wonder how many CPA firms have the expertise to carry out such assurance?

Perhaps HKEX could organise a series of public seminars or roundtable discussions to gather broader market views on this point. ESG assurance is likely to become more important in future and it would be nice to see Hong Kong taking a lead in thinking through the challenges. ACGA would be pleased to assist this process in any way we can.

End.