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September 25, 2015

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By email (response@hkex.com.hk) and post

Dear Sirs,

ACGA's Response to the Consultation Paper on Review of the Environmental, Social and Governance Reporting Guide ("the Consultation")

We welcome the opportunity to respond to the Consultation.

The Asian Corporate Governance Association (ACGA) is a not-for-profit association chartered under the laws of Hong Kong. The association is dedicated to assisting companies and markets across Asia in their effort to improve corporate governance practices. In our educational outreach, we are guided by a practical, long-term approach. ACGA's operations are supported by a membership base of institutional investors, such as public pension funds and fund managers, as well as listed Asian companies, law and accounting firms, and universities. ACGA now has over 100 corporate members, two thirds of which are institutional investors with more than US$20 trillion in assets under management globally. They are also significant investors in the Hong Kong market.

Before we address the specific Consultation Questions, we would like to highlight six issues that frame ACGA's response to the Consultation.

High Level Issues

Fair Markets Require Material ESG Reporting

We endorse the view that "non-financial" issues are material and that improved transparency is crucial to ensuring that investors can exercise their stewardship obligations and engage in more active price discovery related to environmental, social, and governance (ESG) performance. As a result, ACGA strongly supports the introduction of clear mandatory obligations to shape the content of listed company ESG disclosure and associated governance processes. This should provide much-needed structure and coherence to the growing body of ESG disclosure already found in most Stock Exchange of Hong Kong (SEHK) IPO prospectuses and material ESG event-related disclosures.

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We view the proposed combination of comply-or-explain general disclosure obligations and an initial set of required environmental KPIs as a positive step for market efficiency and transparency. This aligns SEHK with its global peers and ensures that the same level of diligence that investors, intermediaries, and issuers bring to other markets will have an appropriate and disciplined context in Hong Kong. Stewardship-focused investors have often engaged with Hong Kong listed companies on issues related to operating practices. This is a trend that we expect to continue. As a result, to prepare the market, we believe that SEHK would be well advised to consider accelerated efforts to address enhanced reporting norms for the most material operating practice issues.

A More Integrated ESG Roadmap Supports Hong Kong's Market Evolution

SEHK's policy of gradually raising ESG obligations and standards, when paired with capacity building and clearly articulated long-term disclosure policy goals, has served the Hong Kong market well. As we have observed with the phased implementation of Appendix 14 (Corporate Governance Code), a well-managed, evolutionary process gives issuers the incentives they require and investors the tools they need to engage more actively with companies and their boards concerning ESG performance. By identifying the policy drivers that will shape SEHK's long-term approach to ESG disclosure, it permits investors to identify those companies that have a strategic commitment to ESG integration as opposed to tick-the-box compliance. This race-to-the-top approach is well aligned with the standards discussed in the recent Securities and Futures Commission's Principles of Responsible Ownership consultation paper and endorsed by ACGA's membership.

In addition, we believe that SEHK's ESG evolution would benefit from more explicit integration of issuers' obligations under both Appendix 14 (Corporate Governance Code) and Appendix 27 (ESG Guide). It is important that issuers and other stakeholders realise that governance is not only limited to complying with corporate governance codes, but also practiced in wider interests such as environmental and social concerns to address risk management and strategy requirements. We believe that the link between Appendices 14 and 27 could be better defined to elaborate, for example, on the role of the board and board committees in the oversight of reporting on material environmental and social issues.

ACGA Endorses the Stronger Governance Context for ESG Reporting

With these governance considerations in mind, we would like to specifically endorse two aspects of the proposed changes to the ESG Guide:

1) SEHK's focus on the governance context of E&S reporting and the use of general obligations to establish durable disclosure obligations is a welcome step. By framing listed company ESG disclosure obligations in the context of the Business Review Section of the annual Director's Report (codified in Appendix 16 of the Listing Rules) a meaningful nexus is established that ensures that material ESG issues have a clear business context. It is our expectation that this will be a catalyst for companies, regardless of their maturity as ESG reporters, to inform the market pro-actively about material ESG developments that shape their operations.

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2) Paragraphs 8 and 9 of the revised Guide clearly establish the Board's responsibility for an issuers' ESG strategy and related management and reporting disciplines. By articulating the Board's governance responsibilities related to the determination of a company's ESG-related risks and the development of suitable risk management and internal control systems, the Board's oversight obligations are put in a practical context that should lend urgency to Board awareness of relevant ESG issues. Improved disclosure concerning risk management systems is one of the highest priorities for ACGA's members and we strongly endorse SEHK's focus on progress in this area.

We note that many larger companies delegate responsibility for ESG reporting to a board committee, rather than involving the full Board in all the relevant, detailed discussions. It seems reasonable that companies be allowed the flexibility to manage this process in the way they see fit, with the Board retaining overall responsibility for the information disclosed.

Recommendations for the Next Steps in Reporting

We would also like to encourage SEHK to address three aspects of the proposed Guide:

1) We believe that the somewhat artificial distinction between the concerns of the Appendix 14 (Corporate Governance Code) and Appendix 27 (ESG Guide) should be taken into consideration as SEHK considers the way forward for future corporate governance and ESG reporting changes. In particular, ACGA would suggest that SEHK issuers be encouraged to publish their Corporate Governance and ESG reports together in one medium after a reasonable transition period. This could contribute to achieving better standards of reporting as all three areas will be addressed together, without neglecting the corporate governance aspect, and will be to the issuers' and SEHK's convenience. In addition to ensuring greater coherence, we believe that creating a fundamental link between the disclosure of ESG risks and the effectiveness of risk management systems will support the type of focused disclosure that investors value most. Over the longer term, we also believe that this will encourage more capable reporters to play a leadership role in defining higher standards suitable to the Hong Kong market. If reporting moves in this direction in future and some issuers prefer to continue publishing separate reports, it would be helpful for them to explain their rationale for doing so.

2) The proposed ESG Guide takes an important step forward by making a core set of environmental KPIs subject to comply-or-explain standards. Listed companies across a broad range of markets have demonstrated their ability to disclose emissions and natural resource usage in a transparent and cost-effective way. We are confident that Hong Kong-listed companies can match their global peers in this regard. Nevertheless, we would stress that the decision to formalise this new requirement should not distract from the importance of more strategic and potentially material disclosures. Indeed, many Hong Kong listed companies face hard-to-manage operational challenges with linked ESG risks. Examples that include instances of community-level groundwater contamination, regional air pollution, seasonal flooding and hazardous waste management issues and companies with significant ESG risks in their supply chains. The general disclosure obligations should serve as a catalyst for a diverse range of disclosures, but we believe that guidance may be required to ensure that the new Guide and the identified KPIs are not interpreted as a safe-harbour to avoid disclosure in more detail in annual reports or as a matter of continuous disclosure.

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3) We believe that HKEx should consider more explicit steps to shape the next stage of evolution in ESG reporting. Specifically, we believe that a timeline should be established to formalise the time period between the implementation of the new Guide and the next round of consultation on the extension of mandatory comply-or-explain disclosure to additional categories of ESG risk. A second important catalyst for improved disclosure would be designation of the next target set of disclosures and possible indicators. In light of the composition of the Hong Kong market, we believe that more rigorous disclosure of issues related to operating practices – supply chain management, product responsibility, and anti-corruption – deserve more urgent consideration. These are complex issues that already have market impact on a regular basis and the market would benefit from more energetic work by investors, companies, regulators, and service providers to define workable approaches to effective ESG disclosure.

One component of effective disclosure would be a requirement that ESG reports in future be audited, as some leading companies in Hong Kong are already doing. Such assurance would lend credibility to the information provided and allow for more meaningful comparability between companies.

Specific Consultation Questions

Question 1: General comply or explain obligation *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.

We support the proposed amendments to Rule 13.91 and believe that the introduction of mandatory comply-or-explain provisions can be used effectively to raise ESG reporting standards in Hong Kong. The general obligations have the potential to be a powerful driver of improved ESG reporting. Indeed, it would be our expectation that proper implementation of Rule 13.91, with regulatory oversight, should result in a significant increase in the percentage of Hong Kong listed companies that disclose regularly and in a disciplined way on ESG issues.

Question 2: Annual ESG reporting *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.

The goal for the Hong Kong market should be integrated and timely reporting of all material ESG factors. With this goal in mind, we support the view that the information reported will be consistent if the Annual Report and ESG reporting cover the same time period, thus making it easier for investors and other stakeholders to draw correlation from the information reported. This approach would satisfy the link to the governance practice of the Guide from risk-management and strategic standpoints by ensuring that the content reported is still applicable and not outdated. In addition, we would note that the annual report should notify investors where and when they can find relevant ESG reporting.

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Question 3: Flexibility on ESG report modalities with maximum three-month lag following annual reports *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.

We believe that the issues addressed by the proposed note should be re-assessed and that a less permissive set of norms should be implemented as part of the rule rather than as an appended note. As noted above, the context of ESG reporting is no different than the context of regular annual financial reporting. Although we believe that SEHK's goal of providing issuers flexibility in addressing new obligations for the next phase of ESG reporting obligations has merit, we believe the market would benefit from greater clarity on the issue of how and when this reporting should take place.

Specifically, we would urge that the rule establish a credible baseline of performance to ensure that annual ESG disclosure is not only released on a timely basis, but is also easy to compare year on year. The proposed language for the timing of ESG reporting strikes too lenient a posture however. We maintain this stance for the benefit of issuers. From an investor's point of view, the information would in many instances lack relevance if ESG reports are published three months after the release of the annual report. In Hong Kong, annual reports are often published four months after the fiscal year ends. It is highly likely that ESG reports delivered as much as seven months after fiscal year-end will be outdated and unreliable. This would frustrate the goal of improved ESG disclosure and raise the possibility that ESG reporting would not be subject to the same level of board oversight that is common to traditional annual reporting.

Question 4: Restructuring of introductory section of the Guide *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? [1) The Guide; 2) Overall Approach; 3) Reporting Principles; and 4) Complementing ESG discussions in the Business Review Section of the Directors' Report.]*

Yes.

As noted above, ACGA strongly endorses the spirit of paragraphs 8 through 10 in the *ESG strategy and reporting* section that clarify the role of the board in providing oversight on ESG management and disclosure. However, we believe that the link between Appendices 14 and 27 should be better defined under the Overall Approach in Appendix II to further ensure that issuers address the oversight role of the board and board committees on ESG reporting. Currently, the relationship has not been established in enough detail; as a consequence, the quality of reporting can be significantly affected by neglecting critical aspects of governance such as risk management and strategy which are essential to the Guide and its reporting.

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Question 5: Reporting principles *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? [(i) Materiality; (ii) Quantitative; (iii) Balance; and (iv) Consistency]*

Broadly yes.

The Reporting Principles correctly align the structure of the guide with internationally accepted guidelines, forming a simple approach for issuers to observe, giving them flexibility to "comply or explain" and to carve out their own distinct policies on ESG.

One additional principle worth considering would be "reliability". Companies should have robust processes in place so that the ESG information they provide to investors can be relied upon.

Question 6: New requirements on factual basis for ESG statements and link to Directors' Report *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.

We expect that the proposed wording provides sufficient guidance to issuers.

Question 7: Reorganisation of reporting categories to Environmental and Social *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.

Rearranging the Guide grants it a direct structure. As noted above, however, we are concerned that steps to link the Guide to Appendix 14 Corporate Governance Code have not been clearly highlighted in the Guide. Defining the link will help build the issuers' understanding on the element of governance in the Guide, which will contribute towards incorporating their ESG reporting in their good governance activity, and integrating it with their stewardship responsibilities as well.

As noted above, while we endorse alignment with the Companies Ordinance and international guidelines, we would believe that "operating practices" (aspects B5-B7) are a particularly material area for complex ESG issues facing many Hong Kong listed companies. Stewardship focused investors have often engaged with Hong Kong listed companies on issues related to operating practices. This is not a trend that we expect to change. As a result, to prepare the market, we believe that SEHK would be well advised to consider accelerated efforts to address enhanced reporting norms for the most material operating practice issues.

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Question 8: Replacing Workplace Quality with Employment and Labour Standards *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.

Question 9: Upgrading General Disclosures to comply or explain *Do you agree with our proposal to upgrade the General Disclosures for each Aspect of the ESG Guide to "comply or explain"?*

Yes.

We agree with the proposal and believe that with proper guidance that it has the potential to create a robust initial baseline of reporting.

Question 10: Wording of Aspects *Do you agree with the proposed amendments to the wording of paragraph (b) [relevant laws and regulations that have a significant impact on the issuer] 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 to 104?*

Yes.

We support the narrative disclosure for the General Disclosures that is envisioned by the proposed amendments. Nevertheless, we would offer a cautionary note that IPO disclosure on related topics has occasionally resulted in a form of cut-and-paste reporting that may not serve the interests of investors. By contrast, properly governanced narrative disclosure on "compliance with relevant laws and regulations" should support constructive inquiry and engagement with motivated investors. For example, ACGA members place a high priority on narrative disclosure that highlights a company's goals and targets, as well as their approach to developing compliance capabilities.

Question 11: Revision of Aspect A1 and upgrading KPIs to comply or explain *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 to 118?*

Yes.

The renumbering helps with the re-organisation of the Guide, making it clearer and more structured. We appreciate the SEHK's decision to begin with upgrading the KPIs from only Section A, as it represents a gradual transition in raising the obligation level to comply-or-explain by not giving the issuers undue pressure to conform to "comply or explain" to all KPIs at once. We are sympathetic to the goal of building market capacity and the belief that best practice reporting of ESG indicators should be addressed gradually to ensure meaningful disclosure without the risk of herd adoption of low standards. In addition, we strongly endorse SEHK's goal of encouraging reporting requirements that result in greater harmonization with existing Mainland requirements as outlined in paragraph 113.

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Question 12: Upgrading KPIs to comply or explain *Do you agree with our proposal to upgrade to "comply or explain" the current KPIs B1.3 and B1.6, re-numbered KPIs A1.3 and A1.6, as discussed in paragraph 119 [hazardous waste]?*

Yes.

Problems associated with the handling and management of hazardous waste are often material and investors have often been subject to un-managed and unreported risks. We believe that boards should be expected to governance these risks more actively and that elevation to comply-or-explain will be a valuable catalyst for better disclosure of relevant risks.

Question 13: Upgrading KPIs to comply or explain *Do you agree with our proposal to upgrade to "comply or explain" the KPIs under the current Aspect B2 [use of resources], re-numbered Aspect A2 as discussed in paragraphs 120 to 122?*

Yes.

Question 14: Upgrading KPIs to comply or explain *Do you agree with our proposal to upgrade to "comply or explain" the current KPI B3.1 [narrative statement on activities related to resource management], re-numbered KPI A3.1, as discussed in paragraphs 123 to 125?*

Yes.

Elevation of this KPI to comply-or-explain and the introduction of a narrative statement should result in meaningful disclosures, particularly by best practice ESG disclosure companies. It should serve as a catalyst for more engaged discussion with boards and the development of appropriate internal systems. We also believe that the proposed KPI and the narrative format has the potential to be a closely watched litmus test of the ability of issuers to meet market expectations in a narrative disclosure format.

Question 15: Inclusion of gender disclosure *Do you agree with our proposal to incorporate gender disclosure in Subject Area B under the sub-heading "Employment and Labour Standards"?*

Yes.

We support the goal of aligning SEHK's reporting targets with global norms that typically include disclosure on gender. The importance of gender disclosures in a governance context related to the composition of senior management and boards is well understood. We would add, however, that disclosures related to gender on its own might not necessarily result in material disclosures where the important consideration may be workforce composition, seniority trends, or workforce turnover. These would be suitable areas to address in future development of the Guide.

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Thank you for your attention. We would be pleased to discuss the above issues in further detail.

Yours truly,



Jamie Allen
Secretary General

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