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Hong Kong Capital Markets Update

ISSUE 2019-02 | May 2019

HKEX's consultation on the proposed changes to the Environmental, Social and Governance Reporting Guide and related Listing Rules

On 17 May 2019, the Stock Exchange of Hong Kong Limited (the Exchange) published a consultation paper (Consultation) seeking market views on its proposed changes to Environmental, Social and Governance Reporting Guide (ESG Guide) and related Listing Rules. The deadline for submissions is 19 July 2019.

Highlights

- The Exchange proposed introducing mandatory disclosure requirements and certain changes to the ESG Guide to improve issuers' environmental, social and governance performance and reporting.
- The proposed changes are intended to be implemented in the financial year commencing on or after 1 January 2020.

Background

The introduction of the ESG Guide in 2013 and the subsequent upgrade of the ESG Guide's reporting obligation to "comply or explain" in 2016 have significantly moved the dial for Hong Kong issuers' environmental, social and governance (ESG) reporting.

Investors are increasingly willing to allocate capital in sustainable investments which take into account climate change concerns and ESG reporting of issuers. The global regulatory landscape in this area is also changing rapidly, prompting the need for the Exchange to undertake a comprehensive review of their ESG framework. The proposed changes are aimed at ensuring the framework remains fit for purpose, continues to promote the quality of ESG performance and reporting, and stays current with investor and stakeholder expectations and international best practice.

Key proposals

Shorten the timeframe for publication of ESG report

The current time frame (up to seven months[1]) for the publication of the ESG reports has been criticised for being too long, rendering information contained in the report out-of-date and less relevant for investors. In order to present investors a more comprehensive picture and up-to-date information on the company's performance and long-term prospects, the Exchange proposed amending the Listing Rules to require the issuer to publish ESG reports within four months for Main Board issuers and three months for GEM issuers from the financial year end.

Printed form of ESG reports

The Exchange proposed amending the Listing Rules and the ESG Guide to clarify that the issuer is not required to provide the reports to shareholders in printed form if the ESG report does not form part of an issuer's annual report, unless responding to their specific requests. The issuers are required to notify shareholders of the publication of the ESG report on both the Exchange's and the issuer's websites in light of the increasing importance of ESG information.

[1] The current Listing Rules state that the issuer must publish its annual report within four months from its financial year end and must publish an ESG report within three months from the publication of its annual report.

Governance structure

Investors expect the issuers' board to have oversight of the ESG strategy and the way material ESG matters are dealt with and reported. Accordingly, the Exchange proposed introducing a mandatory disclosure requirement (MDR) requiring the disclosure of a statement from the board setting out the board's consideration of ESG issues. This must include the disclosure of (i) the board's oversight of ESG issues; (ii) the process used to identify, evaluate and manage material ESG-related risks to the issuer's businesses; and (iii) how the board reviews progress made against ESG-related goals and targets.

Reporting principles and boundary

Currently there is a lack of disclosure on how the reporting principles are implemented in issuers' ESG reports, particularly in respect of materiality and quantitative information. Moreover, since issuers are not required to disclose the process in which entities or operations are chosen to be excluded from the ESG report, investors may potentially misunderstand an issuer's overall ESG performance where poor-performing entities or operations are excluded from the ESG report without explanation. To address these issues, the Exchange proposed an MDR to enhance the disclosure requirements for materiality and quantitative principles in the preparation of the ESG report. Furthermore, the Exchange proposed introducing another MDR requiring the ESG report to contain an explanation of its reporting boundary, describing the process used to identify which entities or operations are included in the ESG report and providing reasons for its decision.

Revising and upgrading KPIs

The ESG Guide is organised into subject areas (Subject Areas). Each Subject Area has various aspects (Aspects). Each Aspect sets out general disclosures and key performance indicators (KPI), based on which issuers report material ESG matters.

Environmental KPIs

With climate change being a global concern and focus, investors expect to see efforts being made by reporting companies to tackle this important issue. The Exchange proposed to revise:

- the relevant KPIs (subject to "comply or explain") to require disclosure of a description on targets set and achieved; and
- the KPI (subject to "comply or explain") on greenhouse gas emissions to require disclosure of Scope 1 and Scope 2[2] emissions.

The Exchange also proposed introducing a new Aspect (subject to "comply or explain") requiring disclosure of the significant environmental (including climate-related) issues which have made an impact, and those which may impact the issuer, and the action taken to manage them.

Social KPIs

The Social KPIs of the current ESG Guide are recommended disclosures (i.e. voluntary disclosures). By keeping the reporting obligation of Social KPIs voluntary, the level of disclosure for Social KPIs has been relatively low. This may give the mistaken impression that they are less important than Environmental KPIs, and receive less attention from issuers. In their responses to the previous ESG consultations, investors and other stakeholders have called for an upgrade of Social KPIs. Equal treatment of environmental and social risks is also in line with the UK Stewardship Code, which refers to ESG risks as a whole without singling out environmental risks.

[2] Scope 1 covers direct emissions from operations that are owned or controlled by the issuer.
Scope 2 covers "energy indirect" emissions resulting from the generation of purchased or acquired electricity, heating, cooling and steam consumed within the issuer. Scopes of emissions are defined in accordance with the international reporting framework published by the World Resources Institute/World Business Council for Sustainable Development, as reported in *The Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard*.

The Exchange proposed to:

- upgrade all KPIs from recommended disclosures to “comply or explain” provisions;
- amend a KPI to clarify that “employment types” should include “full- and part-time” staff;
- revise a KPI to require disclosure of work-related fatalities for each of the past three years including the reporting year;
- introduce new KPIs under “supply chain management” to require disclosure of the issuer’s (a) practice to identify the environmental and social risks along the supply chain, and how they are managed and monitored; and (b) the practice used to promote environmentally preferable products and services when selecting suppliers, and how they are implemented and monitored; and
- introduce a new KPI under “anti-corruption” to require disclosure of anti-corruption training provided to directors and staff.

Encourage independent assurance

With increasing sustainable investments, ESG information is used in conjunction with financial information by management, investors, rating agencies and other analysts to help them make decisions. It is important for disclosed ESG information to be reliable. External assurance on an ESG report can help improve the credibility of information and readers’ confidence in the ESG information, making it more likely that the data will be relied on and used for decision-making.

The current ESG Guide provides that the issuer may consider obtaining assurance on its ESG report. However, there is no guidance on the information to be disclosed if assurance is obtained, or on the benefits of obtaining assurance. As a result, the Exchange proposed to encourage the issuer to seek independent assurance where appropriate, and where such assurance is obtained, the issuer should clearly describe the level, scope and processes adopted for assurance in the ESG report.

Proposed effective date

Subject to responses to the Consultation, the Exchange intends to implement the revised ESG Guide and related Listing Rules (for both Main Board and GEM) for the financial year commencing on or after 1 January 2020.

If you have any questions about the matters discussed in this publication, please feel free to contact the following capital markets partners and directors.

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