Integrating ESG into your business

A step-by-step ESG guide for Hong Kong-listed issuers

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Foreword

Environmental, social and governance (ESG) issues are of increasing concern to the investor community. Companies are also facing rising expectations from different stakeholders to take a proactive approach to manage ESG risks and opportunities as part of their business strategies. In fact, the global investment community’s interest in ESG issues has reached a tipping point. Investors are now demanding corporate leaders improve sustainability practices that both benefit their firms’ bottom line and create greater impact on the wider community.

The investors’ demands are in line with multiple studies suggesting that ESG and corporate performance are intrinsically intertwined. Companies with higher ESG performance are likely to have better financial performance, talent retention, and long-term value creation. As investments dedicated to ESG and sustainability are now escalating, companies need to hasten their response to institutional investors’ demands for transparent and detailed ESG disclosures.

Companies also need to respond on the regulatory front. To date, over 35 stock exchanges around the world have issued or are committed to issuing ESG reporting guidance to regulate their listed companies.1 For example, in Hong Kong, we are seeing more stringent ESG disclosure requirements for listed companies, following the release of the revised ESG Reporting Guide by The Stock Exchange of Hong Kong Limited (HKEX) in December 2019, which will become effective for financial years commencing on or after 1 July 2020.

All of these factors have changed ESG integration from simply nice-to-have to essential-to-have. However, are companies ready to integrate ESG concerns into their core business and embrace their true benefits?

Our survey conducted in 2018 found that only 37 percent of business leaders of Hong Kong-listed companies had integrated ESG issues into their strategic planning, meaning that the majority of companies still regarded ESG as ancillary, and did not integrate it as a key concern in actual company business. One of the key challenges is associated with limited knowledge and expertise of ESG issues. This hinders companies from integrating ESG into their business models and understanding its values.2

To help companies better understand and integrate ESG issues into their business strategies, KPMG China has once again collaborated with CLP Holdings Limited (CLP) and The Hong Kong Institute of Chartered Secretaries (HKICS) to jointly produce this publication. This publication aims to provide step-by-step guidance and recommendations, together with insights from interviews with leading companies. These should help corporates address the central issue of integrating ESG value drivers into sustainable business models.

We would like to express our gratitude to the interviewees contributing to this guide, namely BlackRock, CLP, HKICS, Lenovo and MTR for sharing with us their valuable views on how companies can better integrate ESG into their business.

We hope this guide will encourage companies to go beyond ESG regulatory compliance and take a systematic approach addressing the ESG issues that are critical to their business. We also hope it establishes forward-looking business strategies for long-term value creation.

We welcome the opportunity to inspire discussions, and hope you find this publication useful in your company’s sustainability journey.
Executive summary -
ESG Integration Guide

Amid rapid developments in the environmental, social and governance (ESG) space and rising stakeholder demand for improved sustainability performance, it is essential for business leaders to adopt a proactive approach to holistically integrate ESG into their business. This effort should encompass corporate governance, risk management, strategies, reporting and more.

Integrating ESG concerns into business strategies allows companies to capture the trends on this front as well as helps them stay alert to ESG risks in both operations and their value chains.

Our step-by-step guide helps companies integrate ESG into their business through three key phases. In each phase, we pinpoint specific aspects that companies need to be aware of and address.

Since ESG has entered the mainstream, it has been proven that strong ESG performance creates a variety of competitive advantages for companies. With more stringent ESG reporting requirements coming into effect, it is time for companies to review both their ESG reporting and performance in a holistic manner.

Establishing a systematic approach to managing such issues would help the board understand the implications of the accompanying risks, and cash in on the opportunities brought by various ESG topics.

David Ko
Vice Chairman and Head of Audit
KPMG China
Global sustainable investing assets rose from USD 13 trillion in 2012 to USD 31 trillion in 2018. UN Principles for Responsible Investment (PRI) now has 2,372 signatories in 2019, so over past 5 years, up by 71%. Companies with the highest ESG ratings outperformed the lowest-rated firms by as much as 40%. Bloomberg’s research showed 43% of respondents across the buy side, sell side and corporations feel that ESG is more important today (in 2019) than it was 3 years ago.

China:
Internationally-aligned green bond issuance from China reached USD 31.2 billion (RMB 210.3bn) in 2018, representing a 33% increase from USD 23.5 billion (RMB 157.8bn) in 2017. China’s imperative to control air pollution is forecast to create RMB 20 trillion (USD 3.2 trillion) in investment opportunities through 2030. Potential value of sustainable business opportunities almost 7 times the cost of realising them (USD 311 billion in costs, USD 2.1 trillion in opportunities).

Risks/challenges:
Top 3 global risks: (in terms of likelihood)
1. Extreme weather events
2. Failure of climate-change mitigation and adaptation
3. Natural disasters

Tightening regulatory requirements for ESG disclosure by HKEX

Hong Kong:
Hong Kong Monetary Authority (HKMA) has incorporated ESG investment principles in its HKD 4 trillion Exchange Fund under management. HKSAR Government launched HKD 100 billion green bond plan to establish Hong Kong as an international green finance hub.
On 18 December 2019, The Stock Exchange of Hong Kong Limited (HKEX) published new requirements in its Consultation Conclusions on Review of the Environmental, Social and Governance (ESG) Reporting Guide and Related Listing Rules. The new requirements will apply to financial years commencing on or after 1 July 2020.

Board’s responsibility
- Enhanced board’s responsibility for overseeing ESG issues
- Introduced the Mandatory Disclosure Requirement (MDR) on board’s statement covering:
  - Board’s oversight of ESG issues
  - Board’s ESG management approach and strategy, including the process used to evaluate, prioritise and manage material ESG-related issues and risks
  - How the board reviews progress towards ESG-related goals and targets and relevance to the business

Disclosure of climate-related issues
- Introduce a new Aspect relating to climate change (“comply or explain”) comprising:
  - Policies on identification and mitigation of significant climate-related issues that have impacted and may impact the issuer; and
  - A KPI description of the significant climate-related issues that have impacted and may impact the issuer, and the actions taken to manage them

Targets for environmental key performance indicators (KPIs)
- Require disclosure of a description of targets set regarding emissions, energy use and water efficiency, waste reduction and the like, and steps taken to achieve them

New ESG Reporting Guide calling for greater ESG integration

The amendments to the existing guide represent a shift away from “reporting” to “management”, with an emphasis on the board’s role in the governance structure for ESG matters. The following section summarises the key amendments and our guidance for understanding how to comply with them.

Shortened timeframe for ESG reporting
- Shortened the deadline for publication of ESG reports with a revised timeframe of no later than five months after the year-end date

Reporting boundary
- Mandatory to disclose the process used to identify the specific entities or operations that are included in the ESG report, and explain any change in scope.

Social KPIs
- Upgrade the disclosure obligation of all social KPIs to “comply or explain”
- Introduced new social KPIs relating to supply chain management and anti-corruption training

Independent assurance
- Encourage the issuers to seek independent assurance to strengthen the credibility of disclosed ESG information
- Require to clearly describe the level, scope and processes adopted for assurance in the ESG report where independent assurance is obtained

Consultation Conclusions
- Review of the Environmental, Social and Governance (ESG) Reporting Guide and Related Listing Rules

Assessment questionnaire
- To assess your company’s preparedness for complying with the new requirements
Because your stakeholders care. Here are some of their views

Institutional investors have growing expectations for integrating ESG across different asset classes, regions and fund sizes. A global survey conducted by BNP Paribas showed the percentage of surveyed asset owners who put more than a quarter of their funds towards ESG increased from 48 percent in 2017 to 75 percent in 2019. The survey also showed that long-term returns, brand and decreased investment risk feature among investors are the top three drivers for incorporating ESG into their investment decision-making.

The Securities and Futures Commission (SFC) stated that Hong Kong is uniquely positioned to become an international green finance hub. As a market regulator, it will take actions to expedite green finance development in Hong Kong. Its priority is to enhance listed companies’ reporting of environmental information, emphasising climate-related disclosure, taking into account the Mainland’s policy direction to target mandatory environmental disclosure by 2020, and aiming to align with the TCFD Recommendations.

Led by the China Securities Regulatory Commission, the Stock Exchanges in Shanghai and Shenzhen have been pushing CSR or ESG-related disclosure since 2006. The ESG reporting disclosure guide for A-share listed companies will be released in 2020 as a step towards aligning with global practices.

Changes in consumer demand are beginning to affect the corporate bottom line as consumers are increasingly aware of ESG practices. They have higher expectations of the companies behind the products to operate their businesses ethically and responsibly, and demand greater transparency about how they conduct their business.

Millennials are willing to pay more for products and services regarded as sustainable or coming from socially and environmentally responsible companies.

Reputation could be put at risk if a company does not perform well in the ESG space, such as the hiring of child labour by the company or its suppliers. This may lead to negative publicity, and boycotts by the media as well as customers, given that we are in an era where social media connects the world and spreads information at an unprecedented pace.

Companies that pursue sustainability are more likely to gain the benefits of having better employee attraction, retention, engagement and productivity.

By 2025, millennials will comprise 75 percent of the workforce. They have high expectations about social purpose and expect accountability in the companies they work for. They seek to work for companies that uphold these values and align with their own. In fact, 78 percent of millennials consider a company’s social and environmental commitments before deciding to work there.

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The first step in integrating ESG into business is to set a common ground where the company and its key stakeholders can agree on the definition of ESG and its importance to the company. This common ground is essentially composed of different elements which provide the environment to nurture a company’s ESG development.

- A top-down approach can greatly facilitate the ESG integration process of a company. The tone at the top sets forth a company’s guiding principles, values and ethical climate.
- To do so, the board and senior management should first understand the values and relevance of ESG to their business. Having their buy-in and support is fundamental to nurturing a supportive culture for driving the ESG agenda or initiating ESG-related discussions across a company.

- Finding a common language to communicate a company’s approach to ESG is essential because there are different terms about ESG which could refer to the same or similar meaning, such as corporate social responsibility (CSR), shared values and sustainability.
- It is necessary to make sure all key stakeholders are clear on what the company refers to and interprets when it comes to ESG integration.

Multiple business leaders have emphasised the role of purpose in business. BlackRock’s CEO Laurence Fink opined: “Society is demanding that companies, both public and private, serve a social purpose...Without a sense of purpose, no company, either public or private, can achieve its full potential.”

- To create a sense of social purpose, the board has a key role to play. This can be done by integrating the “purpose” into the board’s conversations and agenda as well as the firm’s decision-making process, and linking tightly with strategy and risk management.
- The board should also make sure it takes on the responsibility for cultural oversight, shape the tone correctly and monitor performance and employee behaviour.
- In addition, the board needs to ensure the culture encourages employees to align with the firm’s ESG priorities and critical concerns.

Apart from getting senior management and the board’s buy-in for ESG, stakeholder support and engagement are also essential in making ESG integration possible.

- Companies should articulate and constantly communicate their direction, goals, vision and strategies with regard to ESG issues through various communications channels such as the intranet, posters, meetings, social media, emails.
- Does your company have an agreed definition of ESG? Is the term “ESG” well understood and communicated across the company?
- Does the board understand the values of ESG and strive to drive sustainable changes from the top?
- How does your company nurture a culture where your key stakeholders (e.g. employees) can find the purpose for driving ESG integration and are willing to collaborate to make positive changes?

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Founded in Hong Kong in 1901, CLP provides power to millions of homes and businesses across Asia Pacific. As part of its efforts to become the “Utility of the Future”, CLP has placed sustainability at the centre of its operations and future planning, from decarbonisation to climate resilience to talent attraction.

“The notion of sustainability comes pretty naturally to CLP,” says David Simmonds, Group General Counsel, CLP. He explains that CLP’s business philosophy emphasises value creation over the long term rather than the short term; given its relatively long asset life of more than 30 years, the business tends to take a long-term view. In addition, purpose is part of the business philosophy of CLP’s largest shareholder, the Kadoorie family, which is focused on doing business in a way that also helps serve the community. “We do not have a standalone strategy; we have a business strategy that sustainability is built into,” adds Hendrik Rosenthal, Director - Group Sustainability, CLP. This mindset cultivates a culture that is set from the top and is conducive to creating a supportive environment to drive sustainability.

Communicating the vision and long-term strategy with key stakeholders such as employees is a key driver of sustainability for CLP Simmonds explains, “It’s all about how you articulate that view for the long term to bring people along with you on that journey.” By sharing what actions CLP is taking to sustain its business over the long term, the company is able to attract investors and shareholders who align with its vision and strategies and who also take a long-term view. Communication about the company’s purpose and values is also critical to attract younger generation to join the workforce as they tend to think beyond basic needs and look for an organisation that aligns with their personal values.

Target setting is vital for achieving the long-term vision. It is also a learning process that needs constant review. CLP has reviewed its 2007 climate vision for 2050 and tightened its targets by conducting a number of scenario analyses around the speed of transition away from fossil fuel-based power generation using existing technologies in the countries where it operates. Furthermore, CLP plans to strengthen its targets every five years. This will enable the company to take into account technological improvements, policy and market changes over time, thereby adequately managing business risks and reinforcing its strong commitment to sustainability.

Simmonds highlights that the investment community is now facing a big challenge associated with the lack of comparability of information on sustainability. To overcome this challenge, some investment companies such as BlackRock are advocating the streamlining of reporting standards around the standards set up by the Sustainability Accounting Standards Board (SASB) and Task Force on Climate-related Financial Disclosures (TCFD). These standards aim to enable investors to make informed investment decisions as SASB provides standardisation of information that allows investors to compare one company with another in terms of their ESG performance, whereas TCFD recommendations are about quantification of the risk and opportunity of climate change through scenario analysis.

Talking about how CLP addresses its climate impact, Rosenthal states that the company has been assessing both its physical and transition risks of climate change. For physical risks, CLP assesses potential impacts on its physical assets and investments to help ensure they are safe and protected during hazardous extreme weather events. For transition risks, CLP has identified regulatory changes as one of their biggest risks along the decarbonisation pathway. CLP has been following the TCFD recommendations and seeks to strengthen its scenario analysis to quantify the risks and opportunities that will arise from climate change, consequently delivering more constructive information to the company and its stakeholders.

Sustainability is a very broad topic. Simmonds suggests companies focus on what matters most to an organisation by selecting one or two core long-term issues and demonstrating the value in addressing those issues to the company and investors. Rosenthal adds, “ESG is not just about risks. It’s also about finding new business opportunities. It’s about something even smaller organisations should continue looking for.” He suggests companies think out of the box and understand how the market changes and how that would affect their business in order to grasp the opportunities of the future.
Materiality is the principle of defining the ESG topics that matter most to your business and your stakeholders. Given limited resources and time, companies should focus on the most important ESG issues with the greatest impact on their business and stakeholders.

There is not a standard number of material topics that a company should address. But our research has suggested that the board should identify and concentrate on two or three strategically important issues out of the broad inventory of material ESG issues. By strategically focusing on the key issues, this fundamentally affects the company’s competitive advantage.

Materiality assessment should be used as a strategic business tool, with implications beyond ESG reporting. The steps to conduct a materiality assessment are typically as follows.21

### Steps to conduct a materiality assessment

<table>
<thead>
<tr>
<th>Phase 1 Define purpose and scope</th>
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<tr>
<td>• Define the objectives of the materiality assessment</td>
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<td>• Define what materiality means for your organisation</td>
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<tr>
<td>• Define the parts of the business/operations that the assessment will cover</td>
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<tr>
<td>• Define where the significant impact of a material topic occurs, either within or outside the company</td>
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<th>Phase 2 Identify potential topics</th>
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<tr>
<td>• Create a comprehensive list of potential material topics by reviewing different sources e.g. annual/ESG reports, peer review, ratings and rankings, research on wider ESG trends, standards and tools, such as Global Reporting Initiative (GRI) Standards and Sustainability Accounting Standards Board (SASB) Materiality Map</td>
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<tr>
<td>• Discuss with key stakeholders and other business functions beyond the ESG team to gain a wider perspective about the ESG issues that are of concern and have an impact on business</td>
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<th>Phase 3 Categorise</th>
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<td>• Refine the long list of potential material topics by grouping them into a limited number of higher-level categories</td>
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<td>• Align topic names with the existing terminology, strategy and policy used by the company</td>
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<th>Phase 4 Engage stakeholders</th>
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<tr>
<td>• Collect views from key stakeholders about the impact and importance of topics through a variety of ways such as focus groups, interviews and surveys</td>
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<tr>
<td>• Identify the key internal and external stakeholders that should take part in rating the material topics</td>
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<td>• Define the methodology for scoring and rating each topic</td>
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<th>Phase 5 Assess and prioritise</th>
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<td>• Prioritise material topics by</td>
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<tr>
<td>» Identifying the internal stakeholders of relevant business functions that should be involved in prioritising the final topic list</td>
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<tr>
<td>» Assessing and prioritising their views or scores based on certain criteria such as the significance of the topics to stakeholders or their business impact on the company</td>
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<tr>
<td>» Setting a threshold or cut-off point for defining which topics will be considered as material (if possible, use the same threshold used by enterprise risk management)</td>
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<th>Phase 6 Validate and report</th>
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<tr>
<td>• Engage key internal stakeholders (usually senior management) to validate the materiality assessment results to make sure those topics are in line with the sustainability direction that the company seeks to head towards</td>
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<tr>
<td>• Present the outcome of the materiality assessment to the board of directors and C-suite for approval, recommend what actions should be taken, then disclose the results in the ESG reports</td>
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### Materiality matrix sample

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<th>Significance of economic, environmental, &amp; social impact on the organisation</th>
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<tr>
<td>LOW</td>
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<tr>
<td>Low impact on business Low influence on stakeholders</td>
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<tr>
<td>High impact on business High influence on stakeholders</td>
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<tr>
<th>Influence on stakeholder assessments &amp; decisions</th>
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<tbody>
<tr>
<td>LOW</td>
</tr>
<tr>
<td>Low impact on business Low influence on stakeholders</td>
</tr>
<tr>
<td>High impact on business High influence on stakeholders</td>
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### Checklist questions

- Which ESG issues are truly core to the business strategy and key to the long-term sustainability of the company?
- Are the internal stakeholders involved in assessing and prioritising topics sufficiently senior and knowledgeable to provide meaningful insight?
- What kind of criteria are used in assessing and prioritising the topics, e.g. level of interest to stakeholders and potential impact on business?

ESG considerations are increasingly important for investors. BlackRock, the world’s largest asset manager, is increasingly focused on ESG in its investment strategy. Founded in 1988, BlackRock has grown to approximately USD 7 trillion in assets under management.23

BlackRock’s CEO Larry Fink highlighted the importance of ESG in an annual letter to chief executives24 in which he stressed that stakeholders are demanding companies exercise leadership in ESG matters, which are essential to sustainable growth and profitability. BlackRock has worked to further integrate ESG into its investment process.

Investors and asset owners alike are increasingly demanding more ESG-focused investing, says BlackRock Associate Zoe Lau, who is part of the company’s Investment Stewardship team. This is particularly true of European or American investors.

The demand is particularly noticeable among “insurance companies or pension funds, which have a long time horizon and would naturally think more about the long term,” Lau says. “Increasingly, we see Asian institutional investors looking at this as well.”

BlackRock believes that incorporating considerations of business-relevant sustainability issues into the investment research, portfolio construction, and stewardship process can enhance long-term risk-adjusted returns. As of September 2019, BlackRock manages around USD 68 billion in dedicated sustainable investing strategies, which span across four main segments:

1. Screens: strategies that avoid specific companies or industries associated with objectionable activities such as controversial weapons and tobacco;

2. ESG: strategies that align capital with higher ESG performance such as ESG best-in-class index products and ESG optimised index products;

3. Thematic: strategies focusing on specific E, S, or G themes such as sustainable energy, and

4. Impact: strategies targeting specific environmental or societal outcomes.

ESG reporting also plays an important role in how investors make their decisions. This means that companies should elevate the quality of their ESG reporting.

To make ESG reports more relevant and useful for investors, Lau suggests companies look into two reporting frameworks: the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD).

The SASB framework covers 77 different sectors and identifies the more relevant metrics that should be included in ESG reports. TCFD provides a framework for disclosing financially material issues with a strong climate focus while encouraging companies to set up governance frameworks.

“Frameworks are starting points,” Lau notes. “The benefits lie in the review process of the entire supply chain or value creation system.” These frameworks should not just be used for reports but as useful perspectives for companies to manage risks and tackle business challenges.

To improve ESG disclosures, Lau suggested companies consider three key areas:

Materiality – Companies can evaluate the materiality of different environmental or social issues and prioritise them according to their impact on the business. “Instead of providing a laundry list of ESG factors and explaining how the company is handling each of them, it would demonstrate more thoughtfulness if the company can prioritise the key risks and focus on the E, S and G issues that are relevant to its business as potential drivers of long-term financial performance,” Lau says.

Target and metrics setting – “What makes numbers useful is the ability to put them in context,” says Lau. While most companies are still at an early stage gathering the relevant data, it is important for them to set certain ESG targets to clearly define what the company strives to achieve within a certain time frame, closely monitor performance, and disclose the relevant performance metrics.

Comparability – Companies will benefit from adopting commonly used reporting frameworks such as TCFD and SASB to enhance the comparability of ESG reports from year to year, among their peers in their respective industries. Creating comparable reports makes it easier for investors to evaluate a company. “A common framework allows investors to better compare companies within the same industry over time,” Lau adds.

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Mandating ESG governance and its disclosure is regarded as the most important change in the HKEX’s new ESG Guide. The mandatory disclosure requirement (MDR) stipulates that all listed companies disclose the board’s oversight of and management approach for ESG issues, including identifying material ESG-related risks to their business. While “tone at the top” plays an important role in incorporating a sense of social purpose into the company, having sound ESG governance offers a solid foundation for functional board oversight, proactive management and ongoing dialogue on ESG topics.

**Governance**

Getting the basics right  Strengthening the core  Communicating the efforts

**Guide to strengthening ESG governance**

- Ensure the board comprises directors with relevant ESG expertise and experience (e.g. “climate competent” and future-looking board members) to minimise/avoid the potential ESG-related risks and crises from happening, and to avoid missing opportunities in the marketplace due to a lack of attention to ESG issues
- Include ESG as one of the criteria for selecting future candidates for the board
- Engage a third-party consultant to help enhance the board’s capabilities in ESG

- Ensure the board has a good understanding of the mandatory or voluntary ESG-related requirements of organisations
- Determine which activities should have the full board involved, and which should just involve a specific committee (e.g. level setting is best done by the full board, but assessment of specific ESG risks may be best addressed and dealt with by a specific committee)
- Determine whether these responsibilities should be added to the agenda of an existing committee or housed in a more targeted and newly established committee. This can be done by considering:
  - Type and magnitude of issues
  - Available bandwidth of existing committee
  - Culture of the board
- Set clear roles and responsibilities of the board members as well as committees in order to make the personnel/committees accountable and thus facilitate the overall development of ESG
- Appoint a C-suite or board member to chair the ESG committee as he/she has strong influence and control of the business

**Checklist questions**

- Does the board understand its full responsibility for managing ESG issues?
- Has the company established any formal ESG governance framework, e.g. setting up a separate ESG committee or an existing committee with ESG agenda?
- Does the board contain any personnel who have knowledge and experience in ESG issues?
- Are there any ESG-related criteria (e.g. relevant ESG experience) when selecting the board members?
Established in 1975, MTR Corporation is one of the world’s leading railway operators, focusing on safety, reliability, customer service and cost efficiency. MTR is unique from a governance perspective: the company is not only a listed company with a wide range of stakeholders but also majority government-owned, which gives it a strong public service obligation. This is the reason why Gillian Meller, the corporation’s Legal and European Business Director, says, “MTR has two birth certificates.”

With an average weekday patronage of about 5.9 million passengers,26 MTR interacts with the majority of stakeholders but also majority government-owned, which gives it a strong public service obligation. This is the reason why Gillian Meller, the corporation’s Legal and European Business Director, says, “MTR has two birth certificates.”

However, while ESG practices are now becoming more common, Meller admits that it remains challenging to engage businesses that are not already in the sustainability community in Hong Kong, often preaching to the converted instead of reaching the broader community. Nevertheless, MTR has been striving to influence the suppliers, especially small-to-medium enterprises (SMEs), along its value chain through its supplier code of practice and a series of events designed to help them improve their ESG performance and hence MTR’s performance.

Meller suggests that companies find a common language to internally discuss sustainability. “There are so many terms including corporate responsibility, CSR, sustainability and shared value, which are broadly trying to address the same issues,” she explains. “Having a common language makes things far easier.” This also helps MTR communicate with its stakeholders on its two key pillars of corporate responsibility: responsible operations and community investment.

Meller stresses the importance of figuring out ESG business drivers (whether opportunities or risks) that are important to the company. Formulating initiatives that address these unique factors can help a company better integrate ESG into its business. These business drivers are usually associated with the particular nature of a company’s business and different stakeholders’ demands. “There is an increasing interest in ESG primarily from European and American investors, who are demanding detailed information on ESG issues,” Meller says as an example. “This increasing demand for ESG is now noticeable on all fronts. In addition, employees, particularly the younger generation, seek to know what is being done by their employer in areas such as corporate responsibility, community investment, and diversity and inclusion.”

Key advice from MTR

At its core, ESG is simply part of good corporate governance, Meller explains. “Working out your business drivers by talking to your key stakeholders and agreeing on some common language are the keys to integrating ESG into the business and building a sustainable business in the long run.”
Identify risks
- Analyse the company’s risk inventory to identify ESG-related risks
- Engage ESG risk owners and sustainability practitioners in the risk identification process to leverage subject-matter expertise
- Identify the ESG-related risks that may affect the corporate strategic and operational plans and precisely determine their impact on the company
- Use root cause analysis to understand drivers of the ESG-related risks

Assess and prioritise ESG-related risks
- Understand the company’s criteria for prioritising risks, e.g. based on the levels of impact and likelihood
- Understand the quantitative and qualitative metrics used for expressing risks
- Select appropriate assessment approaches (e.g. expert input, forecasting and valuation, scenario analysis or ESG-specific tools) to measure risk severity
- Consider and select the data, parameters and assumptions used for calculating risk severity
- Leverage subject-matter expertise to prioritise ESG-related risks
- Identify and challenge organisational bias against ESG issues for better decision making (e.g. groupthink bias, overconfidence effect)

Implement risk responses
- Select an appropriate risk response based on the company-specific factors (e.g. costs and benefits and risk appetite)
- Build the business case for the response and obtain buy-in
- Implement the risk response to manage the risk (e.g. assign a risk owner, integrate risk responses into decision making)
- Evaluate risk responses at the organisational level to understand the overall impact on the risk profile

Review and revision for ESG-related risks
- Identify and assess internal and external changes that may considerably affect the strategy or business objectives
- Review ERM activities to identify revisions to ERM processes and capabilities
- Improve how ESG-related risks are managed by ERM

Information, communication and reporting for ESG-related risks
- Identify relevant information and communication channels for internal and external communication and reporting
- Communicate and report relevant ESG-related risk information internally and externally for better decision-making and regulatory compliance purposes
- Identify opportunities for improving the quality of ESG-related data reported internally and externally

Source: COSO and WBCSD

Checklist questions
- Is the board aware of the ESG-related risks that could affect corporate strategy and business objectives?
- Are ESG-related risks being considered as part of your company’s risk management process?
- Has your company adopted the ERM framework in identifying and managing the ESG-related risks? If not, what kind of approach is being adopted?
- How does your company choose and implement the risk responses to the identified ESG-related risks?
Multinational technology company Lenovo — the world’s largest personal computer vendor by unit sales28 — continues to make efforts to improve its ESG programmes and performance. John Cerretani, Vice President, Deputy General Counsel, and Chief Corporate Responsibility Officer, Lenovo, says, “At Lenovo, we believe excellence in sustainability and excellence in business go hand in hand.”

Cerretani adds, “In recent years, we see a growing concern from both individual consumers and large enterprise customers over climate change mitigation, material selection and corporate social responsibility.” This motivates Lenovo to manage its business more responsibly while putting forward a strong corporate sustainability agenda within its development and supply chain operations. “We participate in many voluntary eco-label programmes such as ENERGY STAR, TCO30 and EPEAT31 which have recently been updated to include higher performance requirements in many areas of ESG,” says Cerretani. The focus of these programmes has been expanded from mainly the environmental impact of products to include more supply chain and social responsibility requirements, such as factory audits through organisations like the Responsible Business Alliance (RBA).

“On a governance structure, including board involvement and a formal enterprise risk management process, is key to efficient ESG integration. Lenovo leverages this process to address ESG-related risks within its own operations and those of its global supply chain,” Cerretani says. “To help address these risks, we have implemented the RBA Code of Conduct at our own operations and with our suppliers.”

Lenovo is also committed to addressing climate change by setting up its climate and energy policy as well as its own environmental and energy management systems. “Our risk management process also addresses both climate-related physical risks and transitional risks, for example, through the implementation of effective mitigation plans in climate-challenged areas, and the use of Lenovo’s own energy efficiency tool, Lenovo Power Manager32, to manage climate-related opportunities,” adds Cerretani. Through these intensive ESG integration measures, Lenovo manages to incorporate ESG strategies into its long-term value creation.

“The principles of ESG integration must be recognised, supported from the top down, and must be ingrained in the DNA of the corporation,” Cerretani emphasises. Instead of regarding ESG as merely a box-ticking reporting duty, ESG should be part of the day-to-day business operations. “Sustainability and ESG can no longer be an afterthought. They must be a central part of the operations and thinking of every organisation.”

Why does climate change matter?

KPMG’s Global CEO Survey32 suggested that climate change is rising up the risk agenda, from fourth in 2018 to the number one position in 2019. The findings show that climate risks are no longer remote, which is why HKEX introduced new rules requiring issuers to make climate-related disclosures on a “comply or explain” basis.
TCFD Recommendations

The Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD) has developed a set of recommendations for voluntary and consistent climate-related financial risk disclosures in mainstream filings. In the final report published in 2017, the TCFD Recommendations provide guidance for companies to disclose information to investors and other stakeholders. This provides a foundation to improve investors’ and others’ ability to appropriately assess and price climate-related risks and opportunities.

The TCFD Recommendations are built around four thematic areas that represent core elements of how organisations operate: governance, strategy, risk management, and metrics and targets.

Climate-related risks

Two types of climate change-related risks have been identified by the TCFD:

- Physical risks
- Transition risks

### Definitions

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| **Physical risks** | • Physical risks caused by climate change can be categorised into two types: (i) event-driven (acute) and (ii) longer-term shifts (chronic) in climate patterns.  
  • Physical risks may have financial implications for the organisation, such as direct damage to assets and indirect impact from supply chain disruption.  
  • Other issues such as water availability, food security, extreme temperature change and supply chain instability as a consequence of climate change may also have an impact on the financial performance of the organisation. |
| **Transition risks** | • Transition risks may arise as a consequence of the extensive changes in policy, legal, technology, and market during the transition to a lower-carbon economy. These changes are aimed to address mitigation and adaptation requirements related to climate change.  
  • Transition risks may pose different levels of financial and reputational risk to organisations, depending on the nature, speed, and focus of these changes. |


As climate change is no longer something in the distant future, related risk disclosures will be essential for companies to deal with increasing expectations from regulators, investors and other stakeholders.

Report issuers will need to provide more consistent information within their sectors and, in particular, reference international guidance such as the TCFD recommendations.

For sectors that have significant exposure to physical and transitional risks, conducting scenario analysis would help identify the potential impact of climate change on their business and help companies prepare for the potential costs.

Patrick Chu
Partner, Head of Business Reporting and Sustainability
KPMG China
A sustainability strategy is important to prioritise a company’s actions. It provides a framework to guide investment, drive performance and engage stakeholders. Successful implementation lies in how the company integrates ESG into its overall business strategy, such that it builds onto the company’s vision and contributes to business growth.

**Strategy**

A growing number of studies have shown that a sound sustainability strategy minimises the reputational risks of a company and protects the brand. Executives and stakeholders recognise that results-focused strategies are evidence of sound management, resulting in greater readiness to adapt to changing markets and respond to customer needs. A clear sustainability strategy helps to provide confidence and reassurance that a company has a solid foundation for future success.

**Checklist questions**

- Has your company established any corporate vision that drives sustainability within the organisation?
- Have the board and senior executives developed any strategies for addressing sustainability/ESG issues?
- How does your company improve the performance of various sustainability/ESG aspects to achieve your vision? Has your company set any goals and targets for those key aspects?

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ESG Viewpoint

David Fu FCIS FCS(PE)
Immediate Past President, HKICS

Founded in 1949, HKICS is an independent professional institute that represents Chartered Secretaries and Chartered Governance Professionals as governance professionals in Hong Kong and mainland China. HKICS appreciates the value proposition of preference for long-term sustainability over short-term profit for a business and the balancing that ensues. It has been playing an important role in driving ESG integration mainly through continuing professional development.

Over the past few years, ESG has been absorbing more attention from both customers and enterprises, with several key drivers. David Fu, Immediate Past President of HKICS, explains, “A very important key driver is the international agreements, especially following the issuance by the United Nations’ 17 Sustainable Development Goals and the adoption of Paris Climate Agreement in 2015.” These global standards motivate the enterprises to shoulder their responsibility to respond to the climate change. Fu adds, “Laws and regulations also contribute to companies’ growing focus on ESG issues and recognition of the importance of being responsible companies.” What is more, the increasing numbers of younger generations entering the workforce expect their employers to act responsibly in ESG issues. It is no wonder that more and more enterprises take account of ESG issues when making decisions nowadays.

But ESG is not only about protecting the environment and treating employees fairly. It is also about the enterprises’ responsibility to respond to the climate change. Fu adds, “Laws and regulations also contribute to companies’ growing focus on ESG issues and recognition of the importance of being responsible companies.” What is more, the increasing numbers of younger generations entering the workforce expect their employers to act responsibly in ESG issues. It is no wonder that more and more enterprises take account of ESG issues when making decisions nowadays.

However, the road to ESG is not always easy. Fu points out that issuers may seek to synchronize the publication time frame of their ESG reports with that of annual reports because the non-financial ESG data may pertain to financial disclosures. “Some members thus regard it as a practical governance challenge to comply with the shortened time frame to provide the non-financial independent assurance, which is relatively new to the marketplace,” he notes. Therefore, the HKICS suggests that the HKEX could provide some flexibility on the issue, with encouragement for synchronised reporting, and the provision of guidance as to how to address the material issues. As ESG reporting matures, this matter could be reviewed from time to time.

Fu also stresses the importance of a company secretary’s role in enhancing board oversight and strengthening governance of ESG issues. To optimise his/her role and function, Fu recommends that company secretaries be more proactive in identifying a list of potential ESG issues, coordinating stakeholder engagement and arranging participation by relevant business units, as well as advising the board on issues relating to compliance with the ESG Reporting Guide set out in Appendix 27 to the Listing Rules.

When asked to comment on HKEX’s ESG consultation paper, on behalf of HKICS, Fu expresses their overall support for the proposed changes on the paper subject to certain observations from the practical governance implementation perspective. He further explains, “In relation to the implementation of the proposals in relation to a listed issuer, there could well be timing and/or resources-driven issues. At the initial stage, HKEX may desire to retain flexibility and work towards the desired outcome over time.”

Key Advice from HKICS

“ A company with poor consideration of ESG will find itself at a disadvantage to competitors that place more emphasis on these issues,” says Fu. To incorporate ESG into a company’s business successfully, it requires careful consideration of ESG implications in relation to workforce, access to and cost of capital for funding and growing the business, and building the trust of customers, suppliers and neighbours.

KPIs and targets

As one saying goes, “if you can’t measure it, you can’t manage it.” This is particularly true when it comes to measuring ESG KPIs and setting targets. Getting the right data is of paramount importance for any company that is seeking to measure, monitor and evaluate their ESG performance, and more ambitiously, set targets to advance sustainability.

Key elements of ESG data management

Maintaining a robust and reliable data collection system is highly important for data disclosure and target setting. To achieve this, the fundamentals are shown as follows:

- Ensure the personnel responsible for managing ESG data have a basic understanding of the data, such as:
  - What types of data should be collected?
  - Why are these data being collected?
  - Is it part of the regulatory requirement or target setting process?
  - Why are these data important for our company?

- Provide training for these personnel to help them better understand the data and hence facilitate the overall data collection process.

- Set clear roles and responsibilities at different stages of the ESG management process to make sure the data is accurate and reliable

- Make sure specific personnel are accountable for collecting the data and updating performance on a defined schedule

- Who is responsible for collecting, storing, tracking the ESG data?

- Are there any business functions (e.g. internal audit) involved in reviewing and verifying the data?

- How often is the data being reviewed?
Robust data management system

Companies can engage a third-party consultant to review and evaluate the operating effectiveness and efficiency of the data system and improve confidence in ESG performance data.

On the regulatory side, HKEX’s revised ESG Reporting Guide requires listed companies to disclose targets set regarding emissions, energy use and water efficiency, waste reduction etc., and the steps taken to achieve them. The new requirements will apply to financial years commencing on or after 1 July 2020.

Key steps to target setting

1. Seek buy-in from the top
   - Seeking senior management’s buy-in is essential because setting the tone at the top can help shape the company’s direction of ESG development, driving different business functions to be fully engaged in securing the resources necessary for target setting and implementation, and then achieving the targets. *(See more in “Level setting” section)*

2. Focus on material topics/metrics and specify KPIs
   - Through materiality assessment, material topics for the company are identified, prioritised and validated. *(See more in “Materiality assessment” section)*
   - Setting targets for the most material topics helps companies better utilise their limited resources more effectively than setting targets that are irrelevant or insignificant to the company and stakeholders. With reference to the materiality results, companies should determine the specific KPIs (e.g. use of electricity) selected for target setting.

3. Establish a base year
   - A base year should be set to allow meaningful and consistent tracking of ESG performance against established targets over time.
   - Three considerations for selecting a base year include:
     - Availability of verifiable data for the base year
     - Representativeness of the base year by comparing the past data record and business activity levels over time
     - Level of forward-looking ambition (i.e. Is the target ambitious enough? Does the company aim to achieve progress to go beyond its current ambition?)

4. Define scope and boundary
   - Defining clear scope and boundary of the targets is important for implementing and integrating them into the company’s overall business strategy.
     - Does the target cover the entire company or certain operations or regions?
     - In terms of greenhouse gas emissions, which scope of emission does the target cover (e.g. Scope 1, 2 or 3)?

5. Establish a time frame
   - Depending on the company’s ambitions for ESG development, a time frame should be established when setting a target, be it short-term, middle-term or long-term.
   - Short-term targets can be set for initiatives that are regarded as low-hanging fruit or quick wins. They can also serve as the interim milestones of a longer-term target.

6. Plan
   - Setting a target requires a company to carefully examine the attainability of the targets which should be weighed against the company’s ambitions and goals.
   - Specifying whether the target is to be set on an absolute basis or intensity basis is essential for target setting.

7. Set targets
   - The progress of target implementation and the performance of the KPIs should be closely monitored from time to time. Rectification may be needed if the progress falls short of expectation.
   - Effective communication about the goals and target progress with key stakeholders such as employees is essential, as this enables them to be engaged in the implementation process, and to feel they are part of the change that the company aspires to make.

8. Monitor and communicate progress
   - Obtaining validation and endorsement from senior management will facilitate the target implementation process.

Checklist questions

- Do you know what targets and goals have been set by your industry peers/competitors?
- Has your company set targets for material ESG issues?
- Is your data collection system robust and reliable enough to establish an appropriate base year for target setting?
- What controls or processes are in place to ensure data quality (e.g., internal controls over data, external assurance)?
With all the efforts made in advancing sustainability, reporting should go beyond compliance, and instead be seen as a value-adding way for companies to communicate directly with their stakeholders on their contribution to the business and community.

Effective, open and regular channels of communication should be established to reach out to both internal and external stakeholders and keep them informed of all the sustainability visions, direction and progress.

As a compliance requirement by HKEX, all Hong Kong-listed companies have been required to disclose their ESG performance and publish their ESG reports annually since 2016. For the financial year commencing on or after 1 July 2020, all these companies need to abide by the newly published ESG Guide with the heightened requirements described earlier.

Going beyond regulatory compliance, many companies have been aligning or referencing various international reporting standards and frameworks in the development of their ESG or sustainability reports.

The HKEX’s newly published EGS Guide encourages listed companies to seek independent assurance to strengthen the credibility of EGS information disclosed in their relevant reports. The listed companies should describe the level, scope and processes adopted for the assurance.

**Checklist questions**

**Reporting**
- Has your ESG report adopted any international reporting standards and frameworks?
- Is your company ready to publish the ESG report in conjunction with the annual report? Have you assessed the resources and manpower needed to achieve this?

**Assurance**
- Is your company aware of any peers that have sought independent assurance?
- Does your company know whether the assurance should cover the entire report or some of the key performance indicators?
- Does your company have any knowledge of ESG report assurance (e.g., types of assurance, assurance service providers, assurance standards, procedures)?
- Are the necessary data management systems and internal control practices in place for obtaining external assurance?
Looking ahead

To move EGS from a peripheral issue and truly integrate it into business practices, it takes not only ongoing support from top management, but also needs a holistic system to make sure all ESG requirements are effectively in place. In summary, ESG integration into businesses is most attainable by having all the key ingredients ready:

Getting the basics right

- Create a sense of purpose for business that fosters ESG development with top management’s buy-in
- Focus on the top priority issues that make the greatest impact on the business and stakeholders

Strengthening the core

- Build proactive ESG governance with sufficient board oversight
- Identify and address ESG-related risks
- Develop vision-led and goal-driven sustainability strategies
- Develop a robust data management system for progress tracking and target setting

Communicating the efforts

- Communicate the sustainability report vision and performance with your stakeholders regularly
- Develop and publish a sustainability/ESG report annually in line with local and international reporting standards
- Engage a third party to conduct independent assurance on the sustainability/ESG report and data

As ESG is an evolving topic globally, companies should stay abreast of the latest ESG developments, be they regulatory or voluntary, such as TCFD recommendations. This is part of an ongoing journey to minimise any emerging risks and, more importantly, grasp the opportunities for long-term growth and profitability.

Acknowledgments

We would like to express our gratitude to the following contributors to this report:

**BlackRock**
- Mr Amar Gill, Managing Director and APAC Head of Investment Stewardship, BlackRock
- Ms Zoe Lau, Associate, BlackRock

**CLP**
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**HKICS**
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**Lenovo**
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About KPMG China

KPMG China is based in 23 offices across 21 cities with around 12,000 partners and staff in Beijing, Chengsha, Chengdu, Chongqing, Foshan, Fuzhou, Guangzhou, Haikou, Hangzhou, Nanjing, Qingdao, Shanghai, Shenyang, Shenzhen, Tianjin, Wuhan, Xiamen, Xi’an, Zhengzhou, Hong Kong SAR and Macau SAR. Working collaboratively across all these offices, KPMG China can deploy experienced professionals efficiently, wherever our client is located.

KPMG is a global network of professional services firms providing audit, tax and advisory services. We operate in 147 countries and territories and have more than 219,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

In 1992, KPMG became the first international accounting network to be granted a joint venture licence in mainland China. KPMG was also the first among the Big Four in mainland China to convert from a joint venture to a special general partnership, as of 1 August 2012. Additionally, the Hong Kong firm can trace its origins to 1945. This early commitment to this market, together with an unwavering focus on quality, has been the foundation for accumulated industry experience, and is reflected in KPMG’s appointment for multi-disciplinary services (including audit, tax and advisory) by some of China’s most prestigious companies.

About CLP

CLP Holdings Limited, a company listed on the Stock Exchange of Hong Kong, is the holding company for the CLP Group, one of the largest investor-owned power businesses in Asia Pacific. Through CLP Power Hong Kong Limited, it operates a vertically-integrated electricity supply business providing a highly-reliable supply of electricity to 80% of Hong Kong’s population.

Outside Hong Kong, CLP holds investments in the energy sector in Mainland China, India, Southeast Asia, Taiwan and Australia. Its diversified portfolio of generating assets uses a wide range of fuels including coal, gas, nuclear and renewable sources. CLP is one of the largest external investors in the Mainland’s renewable energy sector. In India, it is one of the biggest renewable energy producers and among the largest foreign investors in the electricity sector. In Australia, its wholly-owned subsidiary EnergyAustralia is one of the largest integrated energy companies, providing gas and electricity to about 2.5 million households and businesses.

CLP is included in the Global Dow – a 150-stock index of the world’s leading blue-chips, the Dow Jones Sustainability Asia Pacific Index (DJSI Asia Pacific), the Dow Jones Sustainability Asia Pacific 40 Index (DJSI Asia Pacific 40), Hang Seng Corporate Sustainability Index Series and MSCI ESG Leaders Indexes.

About HKICS

HKICS was first established in 1949 as an association of Hong Kong members of The Chartered Governance Institute, formerly known as The Institute of Chartered Secretaries and Administrators (ICSA) of London. It was a branch of The Chartered Governance Institute in 1990 before gaining local status in 1994 and has also been The Chartered Governance Institute’s China Division since 2005.

HKICS has established The Hong Kong Institute of Chartered Secretaries Foundation Limited (the Foundation) on 5 January 2012 with the main objective to promoting good secretarialship and corporate governance to the general public. The Foundation is a registered charity under Section 88 of the Hong Kong Inland Revenue Ordinance (Charity reference 91/11348).

HKICS is also a member of Corporate Secretaries International Association Limited (ICSA), which was established in March 2010 in Geneva, Switzerland. In 2017, CSIA was relocated to Hong Kong where it operates as a company limited by guarantee. CSIA aims to give a global voice to corporate secretaries and governance professionals.

HKICS has more than 6,000 members and 3,200 students. For more information, please visit www.hkics.org.hk.

About us

Contact us