



Hong Kong

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HKEX CONSULTS ON INTRODUCTION OF “COMPLY OR EXPLAIN” ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORTING

Introduction

The Stock Exchange of Hong Kong Limited (the **Exchange**) has published a **Consultation Paper** on proposed changes to its Environmental, Social and Governance (**ESG**) Reporting Guide (the **ESG Guide** or **Guide**) which is set out in Appendix 27 to the Main Board Listing Rules and Appendix 20 to the GEM Listing Rules. The ESG Guide was introduced in 2012 to apply to listed issuers with financial years ending after 31 December 2012. However ESG reporting is currently voluntary: issuers are “encouraged to include” the information set out in the ESG Guide in their annual reports, or as a separate report, by Main Board Listing Rule 13.91 (GEM Listing Rule 17.103). When the ESG Guide was originally introduced, the Exchange stated its intention to raise the voluntary obligation to a “comply or explain” mechanism in 2015 which would be the subject of a public consultation.

The key change proposed by the Consultation Paper is to amend the Listing Rules to require issuers to state in their annual report or ESG report whether they have complied with the “comply or explain” provisions of the ESG Guide for the relevant financial year. If they have not, they must give considered reasons for not complying. The other major changes proposed are to:

- Revise the Guide’s introductory section to give more guidance on reporting and bring it more in line with international standards;

- Re-arrange the Guide into two subject areas: Environmental and Social, from four in the current Guide;
- Upgrade the general disclosure under each aspect of the Guide to “comply or explain” and align the wording with the directors’ report requirements under the Companies Ordinance (Cap 622) (incorporated in Appendix 16 to the Main Board Listing Rules);
- Upgrade the key performance indicators under the “Environmental” subject area to “comply or explain”; and
- Revise the wording of the recommended disclosure to bring it more in line with international standards by incorporating disclosure of gender diversity.

Subject to responses to the consultation, the Exchange aims to implement the amended Listing Rules and the revised Guide for financial years commencing on or after 1 January 2016 whereupon issuers would need to start gathering the necessary information for the purpose of publishing their ESG reports under the new ESG Guide in 2017.

Parties interested in responding to the consultation should complete the Questionnaire which is available at <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201507.pdf> and submit it to the Exchange no later than **18 September 2015**.

The Consultation Paper emphasises the importance of guarding against imposing undue regulatory burden on issuers. It fears that setting the reporting bar too high prematurely may have an adverse effect on the overall quality of ESG reporting by issuers, e.g. by encouraging box-ticking or treating non-compliance as a norm.

Background

The Current ESG Guide

The Guide is currently a recommended practice, and so reporting in accordance with the Guide is voluntary. It is organised into four ESG Subject Areas, with each Subject Area containing various Aspects. For each relevant Aspect, an issuer may report on the General Disclosures and key performance indicators (**KPIs**) that demonstrate its performance.

The issuer is encouraged to identify and report on relevant ESG Subject Areas, Aspects and KPIs that have material environmental and social impacts, both in terms of the impacts that the issuer's operations have on the environment and society, and vice versa.

The Guide clearly states that it does not provide a definition for each KPI. Instead, the issuer is encouraged to explain how it calculates the KPIs and include information that is necessary for interpreting the KPIs. The Guide provides a basic framework to facilitate ESG disclosure so that investors and stakeholders can understand the issuer's ESG performance and practices, and respond accordingly.

The Exchange believes that although surveys indicate that just under half of issuers are reporting, with the changing regulatory landscape, and as more issuers begin to see the positive effects of ESG reporting, the level and standard of reporting will improve.

Previous Consultation Paper (August 2012)

In the original consultation proposing introduction of ESG reporting, the Exchange stated that the Guide (compliance with which is currently voluntary) was intended for issuers looking for a starting point from which to begin work on ESG reporting. It was also indicated that, subject to consultation, the level of obligation of some recommended disclosures would later be raised to "comply or explain".

International Practice

The Consultation Paper summarises the practice in Mainland China, the European Union, the United Kingdom, Australia, the United States, South Africa, and other Asian countries. There has been a marked increase in recent years in the amount of policy and regulation calling for ESG reporting. Most countries with policies in this area adopt a combination of laws, listing rules, "comply or explain" and/or voluntary guidelines to regulate the disclosure of ESG information. However, these policies are increasingly subject to higher levels of obligation (i.e. "comply or explain" and/or mandatory).

Standpoint of the Exchange

The Exchange believes that, on balance, the long term benefits that ESG reporting can bring to issuers, as well as to the quality, sustainability and reputation of the Hong Kong market, outweigh the disadvantages which include increased costs and a greater administrative burden, particularly for smaller issuers. The Exchange also considers it important for Hong Kong to align itself with international best practice in this area.

The low response rate of the ESG survey is acknowledged but the Exchange insists that market feedback indicates that many issuers are waiting for the recommended disclosures of the ESG Guide to be upgraded to "comply or explain" before they begin to report.

It thus considers that it is now appropriate to consider imposing a higher level of reporting obligation on issuers. This is further supported by recent developments in Hong Kong and other jurisdictions with regard to ESG disclosure.

Aims of the Consultation Paper

- a) To strengthen environmental, social and governance disclosure requirements and enable issuers to formulate policies, measure relevant data, monitor progress and report to investors and other stakeholders on their work in this area.
- b) The proposals seek to encourage more widespread and standardised ESG reporting amongst issuers, and to help issuers meet greater demand and expectations for non-financial information from investors and other stakeholders.

Proposals

The proposed new Guide will continue to give issuers flexibility due to the nature of the “comply or explain” provisions. An ESG report may be presented as information in the issuer’s annual report, in a separate report, or on the issuer’s website. Issuers may also use international standards or guidelines that they consider appropriate. Furthermore, disclosures may be provided at the group level, rather than by each subsidiary within a group. Issuers should carefully consider the practice that best suits them and explain their choice in their ESG reports.

Proposed Amendments to Main Board Rule 13.91

The Consultation Paper proposes amending Main Board Rule 13.91 (which encourages issuers to disclose information set out in the ESG Guide either in the annual report or in a separate report) to state that the issuer must disclose in its annual report or ESG report whether it has complied with the “comply or explain” provisions in the ESG Guide for the relevant financial year. Where the issuer deviates from the “comply or explain” provisions, it must give considered reasons in its ESG report. Issuers will be encouraged, but not required, to report on the recommended disclosures of the ESG Guide.

It is also proposed that issuers must disclose ESG information set out in the ESG Guide on an annual basis regarding the same period covered in their annual reports.

An ESG report may be presented as information in an issuer’s annual report, in a separate report, or on the issuer’s website. Issuers will be required to publish the ESG report as close as possible to, but in any event no later than three months after, the publication of the issuer’s annual report.

Proposed Amendments to the Guide

1. Revamping the introductory section of the Guide

The Consultation Paper proposes to divide the introductory section of the Guide into four areas:

- a) The Guide;
- b) Overall Approach;
- c) Reporting Principles; and

- d) Complementing ESG discussions in the Business Review Section of the Directors’ Report.

The revised introduction will:

- i) give guidance on the format, timing and frequency of ESG reporting and will encourage issuers to publish the ESG report on the websites of the issuer and the Exchange;
- ii) stipulate that issuers’ boards bear responsibility for ensuring that effective ESG risk management and internal control systems are in place;
- iii) reword the “Reporting Principles” (which will relate to Materiality, Quantitative, Balance and Consistency) to provide greater clarity and align them with international guidelines. Issuers are not required to “comply or explain” each of the individual principles, but should demonstrate in their ESG reports that due consideration has been given to the principles; and
- iv) link the Guide to the new rule in Main Board Appendix 16 which will require issuers to discuss ESG matters in their directors’ reports. Paragraph 28(2)(d) of Appendix 16 requires an issuer’s directors’ report for a financial year to contain a business review in accordance with Schedule 5 to the Companies Ordinance. The business review must include, to the extent necessary for understanding the development, performance or position of the issuer’s business: (a) a discussion of the issuer’s environmental policies and performance; (b) discussion of the issuer’s compliance with relevant laws and regulations that have a significant impact on the issuer; and (c) an account of the issuer’s key relationships with its employees, customers and suppliers and others having a significant impact on the issuer and its success. The introduction will clarify that the Guide calls for a greater level of detail, including data relating to the company’s environmental and social performance, whereas Appendix 16 requires a high level discussion in the business review section of the directors’ report. Thus disclosure under the Guide should complement rather than duplicate the information contained in the business review.

2. Re-arranging the Guide

The proposal is to re-arrange the Guide into two Subject Areas: Subject Area **A. Environmental** and Subject Area **B. Social**. The current Subject Areas “Workplace Quality”, “Operating Practices” and “Community Involvement” will, with some modifications, come under Subject Area B.

The Consultation Paper proposes to change the heading “Workplace Quality” to “Employment and Labour Standards”.

3. Upgrading the General Disclosures

The Consultation Paper proposes to upgrade to “comply or explain” the General Disclosures for each Aspect of the ESG Guide. Each General Disclosure requires issuers to set out their policies or information on their policies in respect of the relevant Aspect. Some General Disclosures additionally require information on “compliance and material non-compliance with standards, rules and regulations ...” relating to the relevant Aspect. Some language in the General Disclosures will be modified to align with the recent changes to the CO and related amendments to the Rules.

Issuers should explain in their ESG report if any particular General Disclosure is not relevant to them. General Disclosures are narrative in nature and do not require any collection or analysis of data.

4. Upgrading the KPIs in Subject Area A. Environmental

Subject Area B (Environmental Protection) is proposed to be moved to Subject Area A and the heading will be revised to “Environmental”. The Consultation Paper proposes to upgrade to “comply or explain” the proposed new Subject Area A, including all of the KPIs.

Proposed Subject Area A comprises three Aspects:

- a) Emissions (current Aspect B1, renumbered Aspect A1) - This will contain recommendations for disclosure concerning emissions and wastes. Issuers will be encouraged to use international accounting tools for reporting greenhouse gas emissions (i.e. the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard developed by the World Resources Institute and World Business Council for Sustainable Development).
- b) Use of Resources (current Aspect B2, renumbered Aspects A2); and

- c) The Environment and Natural Resources (current Aspect B3, renumbered Aspect A3) – there will be only one KPI, asking for description of the significant impacts of activities on the environment and natural resources and actions taken to manage them.

5. Gender Disclosure

The Consultation Paper proposes to amend the wording of the existing ESG Guide to incorporate gender disclosure in proposed Subject Area B, under the sub-heading “Employment and Labour Standards”. These proposed amendments relate only to the voluntary provisions of the Guide (i.e. the recommended disclosures) that are not proposed to be upgraded to “comply or explain”.

The “Comply or Explain” and recommended disclosures for each Subject Area are summarised in the table below.

	Comply or Explain	Recommended Disclosures	
Subject Area A: Environmental			
Aspect A1: Emissions	General Disclosure Information on: a) the policies: and b) compliance with relevant laws and regulations that have a significant impact on the issuer relating to air and greenhouse gas emissions, discharges into water and land, and generation of hazardous and non-hazardous waste.		
	KP1 A1.1	Types of emissions and respective emissions data.	
	KP1 A1.2	Total greenhouse gas emissions (in tonnes) and where appropriate, intensity (e.g. per unit of production volume, per facility).	
	KP1 A1.3	Total hazardous waste produced (in tonnes) and where appropriate, intensity (e.g. per unit of production volume, per facility).	
	KP1 A1.4	Total non-hazardous waste produced (in tonnes) and where appropriate, intensity (e.g. per unit of production volume, per facility).	
	KP1 A1.5	Description of measures to mitigate emissions and results achieved.	
	KP1 A1.6	Description of how hazardous and non-hazardous wastes are handled, reduction initiatives and results achieved.	

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Aspect A2: Use of Resources	General Disclosure Policies on the efficient use of resources, including energy, water and other raw materials.		
	KP1 A2.1	Total direct and/or indirect energy consumption (kwh in '000s) by type (e.g. electricity, gas or oil) and intensity (e.g. per unit of production volume, per facility).	
	KP1 A2.2	Total water consumption and intensity (e.g. per unit of production volume, per facility).	
	KP1 A2.3	Description of energy use efficiency initiatives and results achieved.	
	KP1 A2.4	Description of whether there is any issue in sourcing water that is fit for purpose, water efficiency initiatives and results achieved.	
	KP1 A2.5	Total packaging material used for finished products (in tonnes), and if applicable, with reference to per unit produced.	
Aspect A3: The Environment and Natural Resources	General Disclosure : Policies on minimising the issuer's significant impact on the environment and natural resources.		
	KP1 A3.1	Description of the significant impacts of activities on the environment and natural resources and the actions taken to manage them.	

Subject Area 3: Social			
Employment and Labour Standards			
Aspect B1: Employment	General Disclosure Information on: (a) the policies; and (b) compliance with relevant laws and regulations that have a significant impact on the issuer relating to compensation and dismissal, recruitment and promotion, working hours, rest periods, equal opportunity, diversity, anti-discrimination, and other benefits and welfare	KP1 B1.1	Total workforce by gender, employment type, age group and geographical region.
		KP1 B1.2	Employee turnover rate by gender, age group and geographical region.
Aspect B2: Health and Safety	General Disclosure Information on: (a) the policies; and (b) compliance with relevant laws and regulations that have a significant impact on the issuer relating to provision of a safe working environment and protection of employees from occupational hazards.	KP1 B2.1	Number and rate of work-related fatalities.
		KP1 B2.2	Lost days due to work injury.
		KP1 B2.3	Description of occupational health and safety measures adopted, how they are implemented and monitored.
Aspect B3: Development and Training	General Disclosure Policies on improving employees' knowledge and skills for discharging duties at work. Description of training activities.	KP1 B3.1	The percentage of employees trained by gender and employee category (e.g. senior management, middle management).
		KP1 B3.2	The average training hours completed per employee by gender and employee category.
Aspect B4: Labour Standards	General Disclosure Information on: (a) the policies; and (b) compliance with relevant laws and regulations that have a significant impact on the issuer relating to preventing child and forced labour	KP1 B4.1	Description of measures to review employment practices to avoid child and forced labour.
		KP1 B4.2	Description of steps taken to eliminate such practices when discovered.

Operating Practices			
Aspect B5: Supply Chain Management	General Disclosure	KP1 B5.1	Number of suppliers by geographical region.
	Policies on managing environmental and social risks of the supply chain.	KP1 B5.2	Description of practices relating to engaging suppliers, number of suppliers where the practices are being implemented, how they are implemented and monitored.
Aspect B6: Product Responsibility	General Disclosure	KP1 B6.1	Percentage of total products sold or shipped subject to recalls for safety and health reasons.
	Information on:	KP1 B6.2	Number of products and service related complaints received and how they are dealt with.
	(a) the policies; and	KP1 B6.3	Description of practices relating to observing and protecting intellectual property rights.
	(b) compliance with relevant laws and regulations that have a significant impact on the issuer	KP1 B6.4	Description of quality assurance process and recall procedures.
	relating to health and safety, advertising, labelling and privacy matters relating to products and services provided and methods of redress.	KP1 B6.5	Description of consumer data protection and privacy policies, how they are implemented and monitored.

Aspect B7: Anti-corruption	General Disclosure	KP1 B7.1	Number of concluded legal cases regarding corrupt practices brought against the issuer or its employees during the reporting period and the outcomes of the cases.
	Information on: (a) the policies; and (b) compliance with relevant laws and regulations that have a significant impact on the issuer relating to bribery, extortion, fraud and money laundering.	KP1 B7.2	Description of preventive measures and whistle-blowing procedures, how they are implemented and monitored.
Community			
Aspect B8: Community Investment	General Disclosure	KP1 B8.1	Focus areas of contribution (e.g. education, environmental concerns, labour needs, health, culture, sport).
	Policies on community engagement to understand the needs of the communities where the issuer operates and to ensure its activities take into consideration the communities' interests.	KP1 B8.2	Resources contributed (e.g. money or time) to the focus area.

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