FSDC Response to SEHK Consultation on Review of the Environmental, Social and Governance Reporting Guide and related Listing Rules

Introduction

The Financial Services Development Council (the “FSDC”) welcomes the Stock Exchange of Hong Kong Limited (“SEHK”)’s publication of the captioned consultation paper (the “Consultation Paper”) in May 2019.

The FSDC agrees that the Environmental, Social and Governance (“ESG”) Reporting Guide and related listing rules is a matter which merits review. In November 2018, the FSDC issued a paper entitled “Environmental, Social and Governance (ESG) Strategy for Hong Kong” (“FSDC ESG Paper”), which recommended, amongst others, the SEHK to strengthen the emphasis on ESG for both listing applicants and listed issuers.

The FSDC is encouraged to note that numerous proposals set out in the Consultation Paper are in alignment with the recommendations in the FSDC paper. In particular, the FSDC appreciates SEHK’s proposal to require issuers to set out their board’s consideration of ESG-related issues, including the board’s oversight, the mechanisms involved in identifying, evaluating and managing relevant matters, as well as the review process. We believe, together with other constructive developments since the publication of the FSDC ESG Paper, the SEHK’s proposals will have positive impacts on the reporting quality of companies and bring about beneficial changes in investment behaviour.

Agreeing that the recommendation package set out in the Consultation Paper is a step in the right direction, the FSDC appreciates the opportunity to share the following observations, which will further enhance the SEHK’s proposals in our view:

1. Timeframe for Publication of ESG Report

In principle, the FSDC is in support of shortening the timeframe for ESG report publication, which will require Main Board and GEM issuers to publish an ESG report within four months and three months after the financial year-end date, respectively.

In this context, the time required to publish an ESG report would align with the publication timeframe of the annual report. Such alignment of the publication timeframes would highlight the interdependency between financial and non-financial matters, thereby enabling the board of an issuer to assess how the business performs in a more holistic and balanced manner. Given the aligned timeframes, it is more likely that the contents of the annual report and the ESG report will be considered and addressed collectively and comprehensively by the board, which would be conducive to the development of more coherent strategies and execution plans on relevant matters. Investors would, at the same time, benefit from being presented with a more comprehensive picture of the company's performance with more current data.

While this direction in principle echoes the FSDC's view, the link between the Corporate Governance Code and the ESG Guide remains rather implicit. That is, whilst the SEHK has proposed changes to be made in the Listing Rules with regard to the publication timeframe of ESG reports, corporate governance-related issues would still be addressed in the Corporate Governance Code *separately*.

As the FSDC ESG paper suggested, we believe it would be beneficial if the link between the Corporate Governance Code and the ESG Guide could be more clearly elaborated, perhaps in the form of guidance letters and/or FAQs. The SEHK may also consider encouraging issuers to combine their corporate governance reporting and ESG reporting into one single document at an appropriate stage. In our view, this will improve the interconnectedness of the three factors (namely E, S and G) and, at the same time, facilitate stakeholders' comprehensive understanding of the company's performance.

Notwithstanding benefits reaped from aligning the reporting timeframes, the SEHK should not neglect that *only* 61% of the sample reviewed issuers had published their ESG reports at the same time as their annual report for the 2016/2017 financial year.[1] In other words, with a meaningful portion of issuers who had not committed to publishing their annual report and ESG report concomitantly, a reallocation of internal

[1] Paragraph 25, Consultation Paper.

resources would be needed for these issuers if the publication timeframe for ESG report is to be shortened. In this regard, the SEHK should continue to provide adequate guidance and training to assist issuers meeting the updated reporting requirement.

2. ESG Disclosures for Listing Applicants

The primary focus of the SEHK's Consultation Paper is on listed issuers' ESG disclosure. While these proposals will bring about betterment of the disclosure mechanism, as promulgated in the FSDC ESG Paper, we believe the SEHK should also consider designing bespoke ESG disclosure guidance for listing applicants, who can benefit from being habituated to the post-listing disclosure requirements at an earlier stage.[2]

In the Consultation Paper, the SEHK mentioned that it has adopted this recommendation in an updated HKEX Guidance Letter HKEX-GL86-16.[3] While the FSDC appreciates that the SEHK has considered and responded to our recommendation, we believe ESG matters should be given greater prominence instead of being included as a couple of paragraphs in the 81-page long Guidance Letter among the many issues it attempted to address with respect to producing simplified listing documents.

Embarking on an initial public offering ("IPO"), a private company has to carry out thorough risk management – in some cases, for the very first time – and has the opportunity to reassess its overall business structure. During this process, guidance on ESG reporting/disclosure would be an instrumental component of risk management, for that it could guide the company through assessing and reflecting on its ESG-related risks effectively, and thereafter prepare it to better manage these risks. Therefore, we believe that it is crucial for an issuer to turn its mind to these ESG-related risks at the outset and get itself ready to tackle these risks once it is listed, instead of treating them as an after-thought when it gets to the time of preparing its first annual report. To this end, the SEHK should be more specific in recommending ESG disclosure on the listing applicant level, for example through the issuance of a dedicated guidance letter for the purposes of ESG disclosure in the listing application stage.

[2] Paragraph 67, FSDC ESG Paper.
[3] Footnote 18, Consultation Paper.

3. Quality of Assurance

As investors are increasingly reliant on the quality of ESG data disclosed to make informed investment decisions, more issuers may explore independent assurance to further ensure the quality of their disclosure. While the FSDC agrees with the intent behind SEHK's proposal that issuers *may* seek independent assurance to strengthen the credibility of the ESG information disclosed, there are some reservations about the associated implications to such a proposal. Particularly, the FSDC wishes to highlight that the quality of general assurance services varies among service providers in the market. Issuers, especially those that are yet to become experienced in ESG reporting, may need some guidance on what they should expect from an assurer. If the SEHK is considering the introduction of an *obligatory* level of independent ESG disclosure assurance in the future, it should also consider providing issuers with more guidance in such areas. This can be achieved by, for example, making specific references to some globally recognised assurance standards in the form of guidance letters and/or FAQs.

Conclusion and Way Forward

Following the publication of the ESG paper in November last year, we are encouraged to note that the SEHK and other regulators concerned have taken decisive steps to consider and, in some cases, implement FSDC's recommendations. With regard to the SEHK's Consultation Paper, we express our general support and envisage the SEHK will take into consideration the several issues highlighted in this response, endeavouring to contribute to the further development of Hong Kong's ESG investment ecosystem.

We look forward to the implementation of an effective ESG reporting scheme that can help issuers and financial investors consider and incorporate ESG factors, and hence collectively develop a robust ESG investment ecosystem for Hong Kong.

Financial Services Development Council

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