

Response to Hong Kong Exchange consultation on the Environmental, Social and Governance Reporting Guide

The Local Authority Pension Fund Forum was set up in 1991 and is a voluntary association of 65 local authority pension funds based in the UK with combined assets of approximately £175 billion. It exists to promote the investment interests of the funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest. The Forum has taken the opportunity below to provide our view on those issues which we consider relevant to our activities.

Summary

LAPFF welcomes and endorses the move towards a 'comply or explain' approach for Environmental Social and Governance (ESG) reporting in Hong-Kong and considers this may set a model for other exchanges and the encouragement of reporting on the governance of material environmental and social issues.

LAPFF recommends that Hong Kong Exchanges and Clearing Ltd (HKE) mandates the reporting of carbon emissions. LAPFF considers that a single global reporting framework is essential in the context of initiatives seeking a consensus on global action required to tackle climate change.

It is noted that certain disclosure recommendations in the ESG guide will not be subject to the 'comply or explain' requirement and that the key performance indicators (KPIs) addressing social issues are set out as 'recommended disclosure' LAPFF considers that certain of these requirements could be upgraded to 'comply or explain', in particular those on gender breakdown, employee turnover and health and safety metrics as this information should be readily accessible by companies.

A reorganisation of the structure of the reporting requirement has been recommended, in line with practices across other markets. We believe this will help companies reporting to be more consistent across the market and will provide greater clarity to both issuers and investors.

Question 1: *Do you agree with our proposal to amend Rule 13.91 to require issuers to disclose in their annual reports or ESG reports whether they have complied with the “comply or explain” provisions in the ESG Guide and if they have not, they must give considered reasons in the ESG reports?*

LAPFF supports the request for reporting on use of the ‘comply or explain’ methodology. This methodology has proven to be useful to investors to better understand companies’ ESG strategy while giving the issuer the opportunity to explain their methodologies or stance in cases of non-compliance with the rules. Therefore, an explanation of why an issuer has chosen not to use this approach would be useful information for investors in assessing whether issuers are accounting adequately for ESG impacts and materiality of investment risk.

Question 2: *Do you agree with our proposal to amend Rule 13.91 to require the issuer to report on ESG annually and regarding the same period covered in its annual report as discussed in paragraphs 86 and 90?*

Q2: LAPFF is supportive of this proposal as it considers that issuers should report on ESG on an annual basis aligned with the Annual report. This alignment will assist issuers as models of integrated reporting become more prevalent.

Question 3: *Do you agree with our proposal to include a Note under Rule 13.91 to clarify that:*

(i) an ESG report may be presented as information in its annual report, in a separate report, or on the issuer’s website as discussed in paragraph 91; and (ii) the issuer should publish the ESG report as close as possible to, and in any event no later than three months after, the publication of the issuer’s annual report as discussed in paragraph 92?

Q3: Following the amendments of the Appendix 16 (Main Board Listing Rules Hong Kong companies are now required to disclose in their annual report; environmental policies, legal compliance and an account of relationships with employees, customers and suppliers and others that have a significant impact on them and on which their success depends. While this is welcomed, LAPFF is of the view that Companies should aim for a more rigorous determination of material ESG issues to be reported on in the annual report. LAPFF believes the Guide should aim to strengthen its requirements in terms of mandatory ESG disclosure in the annual report, in particular through the application of the ‘comply or explain’ approach. This would encourage companies to integrate reporting on material ESG matters in relevant sections of the report, and avoid having ESG matters treated in a peripheral manner.

If the Company reports on ESG matters over a different time frame from the annual report, the reason for this should be explained.

Question 4: *Do you agree with our proposal to revise the introductory section of the Guide into four areas as discussed in paragraphs 94 and 95, and with the wording set out in Appendix II?*

LAPFF supports the proposed structured approach of the new Guide which, as noted in paragraph 95, will provide clarity and guidance to the Issuer, the Board, and also to investors reviewing the company’s disclosure on ESG matters. This approach should also clarify how

issuers should comply with the new Rule in Main Board Appendix 16, which requires issuers to discuss ESG in their director reports.

Question 5: *Do you agree with the proposed wording of the Reporting Principles in the introductory section of the Guide as discussed in paragraphs 96 and 97, and with the wording set out in Appendix II?*

LAPFF supports paragraph 96 which aligns with international practices to provide consistency and clarity to the reporting process. The new four principles structure should further encourage companies to avoid making an annual restatement of boilerplate text relating to generic, rather than company-specific ESG risks, opportunities, and activities.

Para 97 states that 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. LAPFF notes this is the case, but considers that some of the ‘recommended’ principles could be upgraded to a ‘comply or explain’ basis. .

Question 6: *Do you agree with the proposed wording in the Guide linking it to Appendix 16 as discussed in paragraph 98, and with the wording set out in Appendix II?*

LAPFF believes it is essential for the Company to link its ESG practices and disclosure with its strategy and performance. Therefore, LAPFF supports the proposed wording in paragraph 98 linking the Guide to Appendix 16. Companies should explain how account is taken of material ESG concerns and if/how this influences strategic decision making. As noted in paragraph 98, the ESG report should support and develop the information disclosed in the Business Review section of the Annual Report rather than repeat it.

Question 7: *Do you agree with the proposal to re-arrange the Guide into two Subject Areas (A. Environmental and B. Social) and re-categorise “Workplace Quality”, “Operating Practices” and “Community Involvement” under Subject Area B as discussed in paragraph 99?*

The proposed re-arrangement does not raise significant concerns as all existing categories are regrouped under each Subject Areas. This will allow companies to align the reporting framework with international standards.

However, it is important to make sure that such re-categorisation does not reduce the quality of disclosure. This framework must provide companies with a certain flexibility and the Guide should make clear that certain issues are not mutually exclusive (specific to one area only). For instance, moving ‘Operating Practices’ under the ‘Social’ Area may be questionable as these issues could, in certain circumstances, fall under an environmental heading.

Question 8: *Do you agree with the proposal to change the heading “Workplace Quality” to “Employment and Labour Standards” as discussed in paragraphs 100 and 101?*

This reorganisation is welcomed. This structure provides harmonisation with international standards. It simplifies the report structure and makes it clearer for both Issuers and Investors.

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

LAPFF supports the ‘comply or explain’ approach. It is understandable that certain companies, for various reasons, may not be able to fully comply with all the recommendations of the Guide. However, it is important for transparency purposes that the Issuers provide clear reasons for non-compliance and avoid boiler plate statements.

Also, it is noted that the guide comprises two levels of disclosure obligations: (a) ‘comply or explain’ provisions; and (b) recommended disclosures. While it is welcome that the General Disclosures of each ESG aspect follow the ‘comply or explain’ methodology, LAPFF would like to see particular provisions in the ESG guide follow this approach, and receive discussion in the report, when compliance by the Company is not evident.

As stated in the proposed guide, ‘many issuers are waiting for the recommended disclosures of the ESG Guide to be upgraded to ‘comply or explain’ before they begin to report.’ LAPFF believes that the ‘comply or explain’ approach allows sufficient flexibility to issuers to explain why they were not able to, or did not consider necessary to, report on certain ESG matters. We do not support the argument that the ‘comply or explain’ approach is too restrictive/complex for certain companies. Companies lacking experience or initiating reporting on these matters are able to explain their particular situation. Furthermore, LAPFF takes the view that the benefits of employing the ‘comply or explain’ approach will outweigh the costs by allowing issuers to identify ESG risks early and prepare for the range of ESG reporting regulations emerging globally.

Question 10: *Do you agree with the proposed amendments to the wording of paragraph (b) under current Aspects A1, A2, A4, B1, C2 and C3, re-numbered Aspects A1, B1, B2, B4, B6 and B7, as discussed in paragraphs 103 to 104?*

In LAPFF’s view, the proposed amendments incorporating materiality and determination of significant impact provide clarity and are supported. For reporting environmental KPIs, LAPFF welcomes that companies will be required to explain and describe how they handle wastes and emissions and the different initiatives used to mitigate these risks.

However, LAPFF recommends that HKE mandate the reporting of carbon emissions. LAPFF considers that a single global reporting framework is essential in the context of initiatives seeking a consensus on global action required to tackle climate change.

Question 11: *Do you agree with our proposal to revise Aspect A1 by upgrading to “comply or explain” the current KPIs B1.1, B1.2, B1.4 and B1.5, re-numbered KPIs A1.1, A1.2, A1.4 and A1.5, as discussed in paragraphs 109 to 114, and 117 to 118?*

LAPFF agrees with this proposal. LAPFF has been a long-term advocate of mandatory carbon emission reporting and UK listed companies now have to provide this disclosure in annual reporting to shareholders. LAPFF further agrees that disclosure on waste should be on a ‘comply or explain’ basis, not least due to the link to carbon emissions. Clearly the materiality of this factor will be sector dependent.

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

Given that the handling of hazardous waste will be a material risk management factor in certain sectors, LAPFF considers this should be upgraded to ‘comply or explain’ and therefore supports the proposal.

Question 13: *Do you agree with our proposal to upgrade to “comply or explain” the KPIs under the current Aspect B2, re-numbered Aspect A2 as discussed in paragraphs 120 to 122?*

LAPFF agrees with the proposal to upgrade resource use/depletion (energy, water and other raw materials) to a ‘comply or explain’ basis, given the link to carbon emissions, the fact that companies in certain jurisdictions are already required to produce this information and that, for certain sectors, this would clearly be a material reporting issue.

Question 14: *Do you agree with our proposal to upgrade to “comply or explain” the current KPI B3.1, re-numbered KPI A3.1, as discussed in paragraphs 123 to 125?*

LAPFF considers this is the most important of the KPIs to be upgraded in this section, requiring a narrative statement to provide information on the environmental quantitative disclosures. Companies can therefore set out the relevance and materiality of this information in terms of their sector and the risks and opportunities this provides for the business.

LAPFF supports the proposals set out in paragraphs 115 and 116 which sets out that companies should use international accounting tools for clarity and comparability in reporting carbon emissions, specifically the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard. Further, LAPFF considers that companies should be able to report scope 1 and 2 emissions as a minimum, but be work towards assessing scope 3 emissions.

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

LAPFF, in line with the recent disclosure requirements in the UK, supports the mandatory disclosure of gender diversity in terms of the number of men and women on company boards, in senior management positions and in the company as a whole. LAPFF would promote mandatory reporting in this area, and as a minimum would support this being moved to the ‘comply or explain’ heading. LAPFF would also promote a recommendation on the publication of gender pay information throughout the organisation.

PIRC Contact: Vincent Latour (vincent.latour@pirc.co.uk)