香港董事學會
The Hong Kong Institute of Directors

18 September 2015

Corporate Communications Department
Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Dear Sirs

HKIoD's Response to HKEx's Consultation Paper on Review of the Environmental, Social and Governance Reporting Guide (July 2015)

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our response to the captioned paper.

HKIoD is Hong Kong's premier body representing directors to foster the long-term success of companies through advocacy and standards-setting in corporate governance and professional development for directors. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In developing the response, we have consulted our members and organised focused discussions.

Should you require further information regarding our response, please do not hesitate to contact me on tel no. 2889 9986.

With best regards

Yours sincerely
The Hong Kong Institute of Directors

Dr Carlye Tsui
Chief Executive Officer

cc: Mr Henry Lai, Chairman of Council, HKIoD & Chairman, Corporate Governance Policies Committee

香港董事學會有限公司
The Hong Kong Institute of Directors Ltd
香港灣仔軒尼詩道48號上海實業大廈2104
2104 Shanghai Industrial Investment Building, 48 Hennessy Road, Wan Chai, Hong Kong
電話 Tel: (852) 2889 9986 傳真 Fax: (852) 2889 9982 電郵 E-mail: executive@hkiod.com 網址 Web-site: www.hkiod.com

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The Exchange's Consultation Paper on Review of the Environmental, Social and Governance Reporting Guide (July 2015)

In relation to the captioned Consultation Paper, The Hong Kong Institute of Directors is pleased to present its views and comments.

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General comments

HKIoD appreciates the Exchange's continuing efforts to raise the awareness of ESG reporting among issuers. The current proposal is to upgrade the recommended disclosures in the ESG Guide, which was introduced following the 2011 consultation paper and the resulting consultation conclusions.

As we stated in our submission in response to the 2011 consultation paper, issuers should not be left to feel ESG reporting as yet another compliance exercise to add to their burden.

Some issuers will be concerned about the "comply or explain" requirement. We think it acceptable, as issuers are free to give considered reasons, but the more important premise is that readers should assess the reasons given according to the circumstances of the particular issuer, not measure them mechanically against some cookie-cutter standards.

One aim of the proposed upgrade is to provide clarity and guidance on, among other things, the role of the board in ESG reporting, including its responsibility to ensure that the issuer has effective ESG risk management and internal control systems in place. Consultation Paper para 95 refers. Directors' roles in ESG reporting do need to be put into proper context.

ESG reporting, if it is to truly showcase its merits, must be understood in the context of the overriding corporate objective at maximising long-term firm value. The board's role in the process is paramount. If done in the proper context, company boards should realise the business sense that ESG reporting can make. Just as important as it is for company boards to tap into the benefits of ESG reporting, boards (and the users of those reports) must also understand the pitfalls.

ESG reporting and the board's role

The widely-occurring shift towards information and service economy does suggest the increasing weight of "intangibles" in representing company value. Those intangible, extra-financial aspects, if not managed well, can become a liability for the company, knocking down company value. While traditional financial accounting and reporting can still be held out as acceptably adequate to account for tangible assets, it does fall short of capturing the value of intangibles. We can accede to the notion that there is more to business valuation than can be revealed by traditional financial reporting alone. ESG reporting is seen as one mechanism to capture and reveal some of those extra-financial aspects that may affect corporate performance and firm value.

As yet there is not enough evidence that links ESG reporting to financial performance, but it is prejudice to dismiss ESG matters as having no place at creating and adding to firm value. Whether in the older industrial-based or the newer knowledge-based economy, a firm is not likely to truly create value if it has no regard to the interests and does not enlist the support of stakeholders. ESG reporting does have the utility of facilitating a fuller and more differentiated assessment of the risks and opportunities brought on by ESG factors. The ability of a company board to identify those risks and manage them, and the ability to seize opportunities in anticipation of emerging trends to keep and create competitive edge, can be a strong reflection of management quality.

But while ESG reporting can serve as a surrogate of management quality, calculating metrics and ultimately KPIs does not replace the need for risk assessments. KPIs do not tell you how ESG issues interact, and they do not tell you the tradeoffs between and among issues. Having KPIs do not replace, and in fact requires more, the exercise of judgment in developing company strategy in light of those risks and opportunities.

The company's board has the task of making appropriate assessments on the relative weights of the various ESG factors confronting the company, devise a strategy to tackle those issues, and communicate that strategy. The aim of creating long-term value provides the necessary criteria for weighing the competing interests in setting corporate strategy. The success or not of value creation in turn becomes a check on the performance on the company's board and management, holding them accountable.

Because ESG reporting has much value in analysing long-term performance and risk evaluation, it should have a significant role not just in the context for responsible investment but also in the more mainstream business valuation and investment decision-making. But if the context is lost, ESG reporting could quickly become an exercise to report for reporting's sake, rather than a process for a company to report on issues that are truly relevant to its business and for its directors to apply their collective expertise in overseeing its strategic objectives.

About KPIs
Key Performance Indicators, or KPIs, should be quantifiable measurements that reflect the critical success factors of an organisation. They should be quantifiable measurements reflecting an organisation's goals and for which targets can be set.

The current proposal is to upgrade to "comply or explain" the KPIs in the ESG Guide. As we stated in our response to the 2011 consultation paper, some of the KPIs which were put forth and did become part of the ESG Guide are calling for information that could more properly (and reasonably so) be included in the general disclosure. Some others could be useful metrics in their own right, but do not necessarily amount to be company-specific "KPIs". Wanting to have better comparability across companies may be a consideration. But as the 2011 consultation paper states, there is no definitive list of ESG issues, ESG issues vary by industry and vary by region, and ESG priorities shift over time.

It should be for the issuers to identify, with reference to the industries and production processes they engage in, or the geographical region or locale they operate in, those ESG issues that are important to them and report accordingly. Likewise, it should be for issuers to identify and report on metrics and ultimate KPIs that are material to their business. This is a check on the ability of the issuer's board to identify risks and manage those risks, to understand the broader trends affecting the issuer's business and devise strategies to seize opportunities in anticipation of those trends. We surmise stakeholder groups' expectations will have effect in making issuers recognise the type of information and range of metrics and indicators relevant to them.

About gender disclosure
One current proposal is to incorporate gender disclosure in proposed Subject Area B Social, under the sub-heading “Employment and Labour Standards”. Consultation Paper para 126 refers.

We do not have strong views on this proposal. We do emphasise that the key criteria to hire any member of the workforce must be on the merits of a candidate’s likely contribution to the organisation, not about recruiting tokens or names against some quotas or targets, nor to appear to be catering to some social objectives.

The Consultation Paper cites the Code provision on disclosure of policy on board diversity as part of the reasoning to add gender disclosure to the ESG Guide. HKIoD is firm on the principle that board diversity is about composing and maintaining a board with the right mix of skill sets that will increase board effectiveness and bring long-term shareholder value. This would entail an assessment of whether certain elements of diversity or attributes could enhance boardroom discussions and decision-making but were missing. Individual skills and exposure relevant to devising and attaining a company’s strategy and objectives are elements of diversity or attributes that are just as – probably more – important than identity such as age, gender or ethnicity. For a full discussion of HKIoD’s views on board diversity, see our response to the Exchange’s Consultation Paper on Board Diversity (September 2012).

ESG reporting in context
We will not be the first to make this observation: not everything that counts can be measured, and not everything that can be measured counts. Keeping track of metrics, for one, involves considerable time and costs. The aim for doing all that must be put in the perspective of the long-term value of the firm, not to give the investment community or stakeholder groups some convenient and ostensibly standardised scorecards for ranking one issuer over another.

We need to guard against ESG reporting done in a manner that mistakes the context. The 2011 consultation paper takes the view that “a company is responsible for its impact on society and the environment, and that a company should operate in a sustainable manner and create long-term value for shareholders and other stakeholders by integrating sustainability practices into its operation.” We are for company boards to take into consideration of ESG matters in the context of creating long-term value. Sustainability, however, is a societal and ecological concept. We remain in doubt whether it can actually be understood at the corporate level. It is quite possible to imagine a world that no one entity needs to be “sustainable” in its own right. And there is conceivably not just one “sustainable” position; what is supposed to be a better state, a more sustainable way of being, is fraught with personal value judgment.

We assert again, that the purpose of a firm’s ESG reporting should be to facilitate the identification of risks and opportunities, especially the more obscured risks, in the process of creating long-term value for the firm, to let the firm fulfil its fundamental objective function. If the aim becomes slanted towards suiting some reporting guide’s prescription to achieve good scorecards, the focus on risks and opportunities blurs. We could end up in a trap where boards and management pursue with corporate resources their own personal favourite social causes in the name of corporate social responsibility, leading only to firms engaging in behaviour in the name of increasing social welfare but that in fact undermines the value-seeking objective.

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Response to questions for consultation

Subject to our general comments above, we state our responses to specific questions as set out in the Consultation Paper as follows:-

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?

HKIoD Response:

- AGREE
- Issuers are free to give considered reasons, but the more important premise is that readers of the information should seek to assess the reasons given according to the circumstances of the particular issuer.

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?

HKIoD Response:

- Issuers should be free to determine the temporal periods or cycles in which they report on ESG matters. We can imagine that many issuers will find it convenient to report on ESG annually and regarding the same period covered in its annual report, but we can also imagine that some issuers may find it convenient (and more helpful to investors/readers) to report on ESG matters (or certain aspects of such) on a time cycle different than annual financial reporting. ESG reporting should not be made to seem compliance-driven, and we note that the Consultation Paper does mention the desire to give issuers flexibility.

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; 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?

HKIoD Response:

- As to (i), AGREE
- As to (ii), we believe issuers should be free to decide when to publish information called for in ESG reporting. See also our response to Question 2.

Question 4. Do you agree with our proposal to revise the introductory section of the Guide into four areas (i.e. "The Guide", "Overall Approach", "Reporting Principles" and "Complementing ESG Discussions in the Business Review Section of the Directors' Report"), and with the wording set out in Appendix II to the Consultation Paper?

HKIoD Response:

- As to the four areas in the introductory section of the Guide, AGREE.
- As to the role of the board to have overall responsibility of an issuer's ESG strategy and reporting, AGREE. The Exchange may want to reiterate the understanding that the board is still free to delegate tasks to employees or a committee that reports to the board.
    - The proposed new guide will state that, in line with the Corporate Governance Code, the board is responsible for evaluating and determining the issuer's ESG-related risks, and ensuring that appropriate and effective ESG risk management and internal control system are in place, and that the management should provide a confirmation to the board on the effectiveness of these systems. We AGREE.

Question 5. Do you agree with the proposed wording of the Reporting Principles (i.e. "Materiality", "Quantitative", "Balance" and "Consistency") in the introductory section of the Guide, as set out in Appendix II to the Consultation Paper?

HKIoD Response:

- AGREE generally
    - We do not have specific comments on the wordings at this time.

Question 6. Do you agree with the proposed wording in the Guide linking it to Appendix 16 to the Main Board Listing Rules (in relation to the requirement for ESG discussions in the business review section of the directors' report), as set out in Appendix II to the Consultation Paper?

HKIoD Response:

- As to the linkage to the Business Review Section of the Directors' Report, AGREE. We understand this linkage stems from the practical need to align the requirements under the Listing Rules as a consequence to the implementation of the new Companies Ordinance. (Consultation Paper para 5 and 8 refers.)
    - We do not have specific comments on the wordings at this time.

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?

HKIoD Response:

- We have no objections.

Question 8. Do you agree with the proposal to change the heading "Workplace Quality" to "Employment and Labour Standards"?

HKIoD Response:

- We have no objections.

Question 9. Do you agree with our proposal to upgrade the General Disclosures for each Aspect of the ESG Guide to "comply or explain"?

HKIoD Response:

- We have no objections.
  - Issuers are free to give considered reasons, but the more important premise is that readers of the information should seek to assess the reasons given according to the circumstances of the particular issuer.

Question 10. Do you agree with our proposal to amend 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, to "compliance with relevant laws and regulations that have a significant impact on the issuer…" in order to align it with the language of the relevant provisions of the Companies Ordinance?

HKIoD Response:

- We have no objections.
  - We understand the re-numbering stems from re-arranging the Guide into two Subject Areas, per Question 7.
  - We understand the new wording is to align with the language of the relevant provisions of the new Companies Ordinance.

Question 11. Do you agree with our proposal to revise proposed Aspect A1 ("Emissions") 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, concerning disclosure of emissions and non-hazardous waste?

HKIoD Response:

- We have no objections.
  - See our general comments on KPIs.

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, concerning disclosure of hazardous waste?

HKIoD Response:

- We have no objections.
  - See our general comments on KPIs.

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, under "Use of Resources"?

HKIoD Response:

- We have no objections.
  - See our general comments on KPIs.

Question 14. Do you agree with our proposal to upgrade to "comply or explain" the current KPI B3.1, re-numbered KPI A3.1, concerning disclosure of the significant impacts of activities on the environment and natural resources?

HKIoD Response:

- We have no objections.
  - See our general comments on KPIs.

Question 15. Do you agree with our proposal to incorporate gender disclosure in proposed Subject Area B. Social, under the sub-heading "Employment and Labour Standards"?

HKIoD Response:

- We do not have strong views.
  - The key criteria to hire any member of the workforce must be on the merits of a candidate's likely contribution to the organisation, not about recruiting tokens or names against some quotas or targets, nor to appear to be catering to some social objectives.
- For HKIoD's views on board diversity, see our response to the Exchange's Consultation Paper on Board Diversity (September 2012).

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