ESG NEW ERA: CORPORATE INSIGHTS AND FACTS IN CHINA MARKET

A Research on Corporate Environmental, Social and Governance (ESG) Issues
By HKGFA and CECEPEC

2019
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Message from Dr Ma Jun

Our planet is endangered by mounting environmental challenges including accelerating global warming. It is now a global consensus that sustainability and ESG factors must be integrated into corporate governance. As the largest developing country, China has identified pollution prevention and control as one of its “Three Tough Battles”, incorporated green development into its development philosophy, and placed green finance on the top of its financial development agenda.

China’s green finance industry has grown rapidly, leading the world in areas such as incentive measures, local pilot projects, green bonds, green industrial funds, environmental stress tests, as well as green assessment and certification. However, participation by corporations and market investors lags behind. One main reason is the lack of ESG disclosure and the misconception that a company’s ESG performance doesn’t correlate with its financial performance. In reality, studies have shown that in general, a company’s financial performance — in terms of the probability of loan defaults and its share price performance — has a positive correlation with its ESG performance. For example, from 2013 to 2017, twenty-one major banks in China reported that their green loans’ NPL (non-performing loan) ratio averaged merely 0.37%, substantially lower than the 1.69% ratio of these banks’ entire loan portfolio. Further, the fund industry’s perspective, several studies around the world have shown higher long-term returns on ESG indices compared with general market equity indices.

The key approach for companies to disclose ESG information is through the publication of ESG reports, sustainability reports, or corporate social responsibility (CSR) reports. These reports provide stakeholders, including investors, with information on companies’ performance in social, environmental, economic and governance. They underscore their corporate values, governance models and serve as an instrument to link to the specific strategies and the ways toward regional and global sustainable development.

I believe that enhancing the transparency of corporate ESG governance and ESG information disclosure can contribute significantly to further development of green finance. The use of ESG analytical methods and models based on corporate-related information and material will also help banks and investors identify potential positive environmental and social impact on their portfolios and encourage financiers to allocate more resources to green investment.

Against this backdrop, the Hong Kong Green Finance Association (HKGFA) and CECEP Environmental Consulting Group Limited (CECEP) jointly initiated this study-taking survey based on a survey of 50 listed companies in the China market, a review of governance information from ESG disclosures by the 50 Hong Kong Index (HSI) Constituents, and an analysis on the latest ESG reports of 374 companies listed in Hong Kong.

We believe that this study will help market participants and regulators understand the status quo of companies’ ESG disclosure and identify the barriers to further improvement in disclosure. Further work based on this study will be needed to develop more concrete options for enhancing ESG disclosure among listed companies and the corporate world in general.

Dr. Ma Jun
Chairman of Green Finance Committee, China Society for Finance & Banking
Chairman and President of HKGFA

Foreword

In response to today’s severe economic, social, and governance challenges, the UN member states at the 2020 Agenda for Sustainable Development Goal and its 17 Sustainable Development Goals, that drive the global vision and promise for sustainable development by 2030, and mobilizing forces from governments, businesses, and civil society to achieve those common goals.

For companies, as investors are becoming increasingly aware that corporate financial statements alone may not necessarily suffice in helping them to understand companies’ access to capital, cost of capital, potential risks, and the ways in which these risks are managed, an increasing number of investors and rating agencies are now taking actions to demand companies to integrate ESG into corporate governance and business operations. Meanwhile, regulators such as stock exchanges have also played a key role in enhancing market confidence and promoting ESG governance and disclosure. Listed companies are becoming more and more familiar with disclosing their ESG performance and related performance through ESG reporting.

With the accumulation of ESG integration experiences by investors, the enhancement of ESG regulatory requirements, and the extensive practice of corporate ESG reporting, listed companies are embracing various opportunities and challenges in the process of sustainable development at different stages. This report aims to help to enhance industry consensus among regulators, investors, and companies, to establish a solid foundation for better communication, and ultimately to better reflect companies’ needs to the market and regulators, thereby further promoting green finance development in the region and facilitating ESG policy upgrading.

HKGFA and CECEP
Executive Summary

In addition to disclosure of traditional financial information, it has become an inevitable global trend for companies to disclose non-financial information, including ESG or CSR (corporate social responsibility) information, in response to the needs of various stakeholders. We have been continuously paying close attention to companies' performance and development in ESG issues. To gain a deeper understanding of companies' current views on ESG issues, we surveyed the leading companies and conducted a questionnaire survey and in-depth interviews with management personnel of 90 listed companies in the China Market between August and September 2019. Concurrently, to understand companies' current ESG management practices and ESG disclosures, we reviewed the governance information from ESG disclosures by the HK EXCH in HKG, 106 companies, and conducted an analysis on the latest ESG reports of 374 companies listed in Hong Kong.

The results of our survey and interviews reveal that over half of the companies' management gave a positive evaluation of ESG's significance in their companies. ESG factors can affect intangible assets of an enterprise, such as reputation and relationships with key stakeholders, and therefore affect valuation and performance of companies. At the same time, some of the management personnel believe that overall ESG performance will have no impact on corporate positioning within an industry, and there is no significant correlation between ESG and corporate capital flows. This is likely attributed to the fact that ESG performance are often difficult to be monetised. Compared with the financial income and expenditure of ESG, investment and return of ESG are difficult to be quantified. Effectively integrating ESG into corporate governance present a challenge to most companies.

The Insights
Survey and Interview

01 70% of respondents believed that companies that attach importance to ESG should have greater comparative advantages and are more competitive in the marketplace as compared with their peers.

02 69% of respondents expressed that climate change has an impact on their daily operations, among which more than half believed that they had already been affected by climate change at present.

03 More than 90% of respondents expressed that they had already incorporated ESG into their corporate governance and considered to do so over the next three years. However, most respondents believed that the lack of standardization in terms of a tasking with ESG issues could be a major obstacle for companies to incorporating ESG into their corporate governance.

04 The use of resources, the conservation of raw materials, environmental protection, energy management, and social responsibility management is supply chain and product or service quality and ESG topics considered to have a substantial impact on corporate development at present, and in the medium and long term. With the changes in environment and society, greenhouse gas emissions and climate change adoption (66% at present; 66% in the medium and long term), as well as information acquisition and artificial intelligence (26% at present; 36% in the medium and long term) are considered to have increasing impacts on companies in the medium and long term.

05 Continuous tracking and improving performance on ESG topics, setting relevant management objectives, and reviewing their progress regularly, have been considered as the main strategies for companies to integrate ESG into their corporate governance at present and in the next 15 years (80%), and as the major direction of ESG investment for companies over the next 3 years (74%).

The Facts
Review of Disclosed Information

01 89% of HSCI constituents have disclosed information about their responsible units (committees or working groups, departments, etc.) within the companies for ESG issues, while 90% of HSCI constituents have not disclosed any relevant information.

02 85% of the Hong Kong listed companies are found to have disclosed their information in line with the "comply or explain" provisions of the current ESG Reporting Guidance regarding the "comply or explain" provisions of the proposed amendments to the ESG Reporting Guidance issued in May 2019 (the "Proposed Amendments"). The percentage of companies disclosing such information remains relatively the same as those for previous years, with some companies showing that they are already well-prepared to respond to requirements of the Proposed Amendments.

03 The HK EXCH in HKG has developed a disclosure framework for companies in the market to understand the requirements of the Proposed Amendments to the ESG Reporting Guidance. The framework includes a self-assessment tool, which helps companies to identify gaps in their disclosure and develop strategies to address them. The framework also includes guidance on how to improve the quality of disclosure and enhance its relevance to stakeholders.

04 The HK EXCH in HKG has established a set of metrics to assess the performance of companies on their ESG disclosure, such as the percentage of companies that have disclosed specific ESG indicators, the quality of the disclosure, and the consistency of the disclosure with the HK EXCH's sustainability reporting guidelines.

05 The HK EXCH in HKG has also provided training and workshops for companies to help them understand the requirements of the Proposed Amendments and how to improve their ESG disclosure.

06 The HK EXCH in HKG has created a dedicated website to provide companies with information on the Proposed Amendments, including the draft guidance, the timeline for implementation, and the contact information for the HK EXCH's sustainability team.

07 The HK EXCH in HKG has also established a Sustainability Committee to oversee the implementation of the Proposed Amendments and to ensure that companies are meeting the requirements.

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About the Research: Survey and Interview

Composition of Respondents

- 46% C-suite
- 54% Other Management

This report covers a total of 50 Hong Kong listed companies surveyed and interviewed between August and September 2019. C-suite executives and other management personnel of these companies were invited to participate in the survey and interview.

Source: CECEPEC

Sectoral Distribution of Companies Surveyed and Interviewed

- Consumer Discretionary: 14%
- Financials: 6%
- Health Care: 2%
- Communication Services: 6%
- Energy: 2%
- Consumer Staples: 8%
- Real Estate: 14%
- Industrials: 14%
- Materials: 14%
- Utilities: 16%
- Information Technology: 4%

Source: CECEPEC

Market Capitalisation Distribution of Companies Surveyed and Interviewed

- 38% Below HKD 10 billion
- 14% HKD 10 billion to HKD 1,000 billion
- 4% Over HKD 1,000 billion
- 44% HKD 10 billion to less than HKD 100 billion

Source: CECEPEC

Geographical Region of Companies Surveyed and Interviewed

- 88% Mainland China
- 6% Hong Kong, China
- 6% Overseas (Others countries or regions)

Source: CECEPEC

Non Central SOEs/SOEi

- 32%

Central SOEs/SOEi

- 68%

Source: CECEPEC
About the Research:
Review of Disclosed Information

To understand companies’ current performance regarding their ESG governance and disclosure of ESG information, we have reviewed the governance information from ESG disclosures by all of the current 90 HSI constituents, and have analyzed the latest ESG disclosures of a total of 374 companies listed in Hong Kong.

Furthermore, we held an online seminar regarding the Proposed Amendments of the ESG Reporting Guide and the Listing Rules in May 2019, with a total of 63 Hong Kong listed companies participating in the seminar. We have collected and analyzed the participating companies’ views on the Proposed Amendments. For more information, please refer to the “II. The Facts” section of this report.

Current status of HSI constituents on ESG governance disclosures

The review of governance information from ESG disclosures focuses on HSI constituents’ ESG governance structure, their ESG-related roles and duties, and ESG governance practices through examination of annual reports, ESG reports, company websites, terms of reference (TOR) documents, and other publicly available information.

<table>
<thead>
<tr>
<th>Aspects of ESG Governance Disclosure</th>
<th>Description</th>
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<tbody>
<tr>
<td>ESG governance structure</td>
<td>Refers to whether a company discloses the establishment of responsible units for ESG in its corporate governance structure, such as committees, working groups and departments, and, where applicable, the position of the head of the responsible units.</td>
</tr>
<tr>
<td>Duties of the responsible unit for ESG</td>
<td>Refers to whether a company discloses the specific governance duties of the responsible units for ESG.</td>
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<tr>
<td>• Identification of ESG topics</td>
<td></td>
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<tr>
<td>• Management of ESG topics</td>
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<tr>
<td>• Setting targets for ESG topics</td>
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<tr>
<td>ESG governance practices</td>
<td>Refers to whether a company discloses the implementation of a specific ESG governance practice, for example, whether the compensation/bonus of board members/C-suite executives are tied in with the current ESG performance of the company, etc.</td>
</tr>
</tbody>
</table>

Overall status of ESG information disclosures of listed companies in Hong Kong

The review of ESG information disclosure in this report was based on the requirements of the HKEX’s current ESG Reporting Guide and the Proposed Amendments. We analyzed companies’ latest ESG reports, sustainability reports or CSR reports to keep track of their ESG disclosure as well as to understand their readiness for the Proposed Amendments.

The review of ESG information disclosure examined the 2018 ESG reports, sustainability reports or CSR reports (published on or before 31 December 2019) of a total of 374 companies listed in Hong Kong. ESG information on the environmental and social subject areas of the “socially responsible” provisions of the current ESG Reporting Guide and the Proposed Amendments was collected and analyzed based on the disclosure requirements of these two guides. The ESG information disclosure was categorized under the following two situations:

<table>
<thead>
<tr>
<th>ESG Information Disclosure Situation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contained relevant disclosures</td>
<td>Disclosed relevant information required by the “socially responsible” provisions in the current ESG Reporting Guide and the Proposed Amendments</td>
</tr>
<tr>
<td>Did not contain relevant disclosures</td>
<td>Did not disclose relevant information required by the “socially responsible” provisions in the current ESG Reporting Guide and the Proposed Amendments (regardless of whether the company provided an explanation)</td>
</tr>
</tbody>
</table>

The Industry Distribution of the Companies with ESG Information Disclosures Reviewed

- Consumer Discretionary: 12%
- Financials: 16%
- Health Care: 5%
- Communication Services: 3%
- Energy: 4%
- Consumer Staples: 5%
- Real Estate: 12%
- Industrials: 21%
- Materials: 8%
- Utilities: 7%
- Information Technology: 6%
## Highlights

### The Insights — Survey and Interview

**Time consideration for the incorporation of ESG into corporate governance:**

- 66% of the respondents have incorporated ESG into their corporate governance.

**The function of ESG in companies:**

- 44% of companies see ESG as an important part of business operations, and can provide intangible assets for corporate development across environmental and social aspects.

### About companies’ market competitiveness:

- 70% of companies that attach importance to ESG have greater competitiveness advantages and are more competitive in the marketplace as compared with their peers. Only 8% respondents considered that due to relevant restraints, companies attaching importance to ESG have no obvious market competitive advantages over their peers.

### At present/in the next 10 years:

**Integrating ESG into corporate governance:**

- 82% identify ESG topics closely related to corporate sustainability development and keep track of relevant progress.
- 74% ESG issues are updated promptly in board members' annual reports.
- 60% Lack of executive awareness in tackling ESG issues.

### The major ESG investment direction in the next three years:

- 74% Improve the company's ability to keep track of ESG topics, set up relevant management objectives, and review progress regularly.
- 36% Define responsibilities of the board/committee to oversee ESG issues. Only 6% respondents expect no investment in ESG in the next three years.
- 36% Facilitate communications between the board and shareholders/investors on ESG issues.

### Improving ESG Governance Level:

- 82% Enhancing corporate reputation and improving brand image.
- 80% Improving the company’s ability to address regulatory risks.

### Stakeholders of relatively higher importance in current corporate development:

- 80% Shareholders / Investors
- 76% Governments / Regulators
- 70% Clients / Consumers
- 62% Use of resources
- 52% The conservation of nature and environmental protection
- 52% Occupational health and safety

### Climate change:

- 62% respondents believe their businesses will be affected by climate change, in which, 48% has already been affected.
- 58% Transitional risks
- 55% Physical risks
- 45% New market opportunities

### The Facts — Review of Disclosed Information

- 88% disclosed information about responsibilities units for ESG.
- 60% set up internal committees (departmental or company) to fully implement ESG responsibilities to other Board committees.
- 52% disclosed ESG-related responsibility management system or policy.
- 89% disclosed relevant information as required by the "comply or explain" provisions of the current ESG Reporting Guide.
- 54% disclosed relevant information required by the "comply or explain" provisions of the Proposed Amendments
- 30% disclosed relevant information required by the "comply or explain" provisions of the Proposed Amendments

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*Note: As of November 2019, referring to the 334 Hong Kong listed companies reviewed.*
I The Insights:

Current Corporate Views on ESG

To understand the current and future view of ESG from a corporate perspective, we surveyed and interviewed 56 Hong Kong listed companies between August to September 2019, covering 31 sectors under the ESG industry classification. The survey and interviews targeted C-suite and other management personnel. Among the surveyed and interviewed companies, nearly 70% are listed SOEs/SECOs.

Recently, the International Investment community has shifted its criteria for allocating capital to businesses that can demonstrate a sustainable and responsible approach to business management. This trend has led to an increase in the demand for companies to incorporate sustainability into their business strategies and operations. The survey revealed that companies are increasingly focusing on ESG issues and are adopting practices to address environmental, social, and governance (ESG) risks.

01 ESG as the key to corporate success?

The survey results show that nearly 70% of the respondents believe that ESG can bring about positive impacts to companies, among which, 44% of the respondents consider ESG as an important part of business operations, and could provide an impetus for corporate development across environmental and social aspects. In the meantime, with the wide adoption of ESG investment approaches in the capital market, 36% of the respondents agreed that ESG could help companies attract potential investors and demonstrate the long-term sustainable value of the company. It is evident that ESG has become a growth strategy for companies. The implications of the survey are that companies need to develop and form a long-term development strategy and also need to pay more attention to social and environmental aspects in their operations.

02 The importance of ESG to companies

The importance of ESG to companies can be further illustrated by the results of the survey. Companies that are committed to sustainable development can benefit from a better reputation and increased competitiveness. The survey indicates that companies that attach importance to ESG have a competitive advantage in the marketplace and are more likely to attract potential investors and demonstrate the long-term value of the company. ESG also helps the company improve its market reputation. SGI

03 ESG topics that significantly affect current corporate development

A company's success depends on maintaining an effective communication with its stakeholders. Alongside traditional financial and corporate governance reports, ESG report has been seen as another crucial communication channel for companies to engage with their investors and other stakeholders. The survey shows that companies generally consider ESG issues as important as financial performance, as well as other aspects of a company's operations.

04 Key stakeholders in current corporate development

Compared to the general trend, central SOEs/SECOs attach a higher importance to ESG issues. This could be attributed to their focus on social and environmental aspects. SOEs/SECOs have a larger role in public affairs and social issues, which means that they need to pay more attention to ESG issues. They need to ensure that their operations are in line with the needs of the society and the environment. Therefore, SOEs/SECOs need to focus on social and environmental aspects. They also need to pay attention to the expectations of stakeholders, such as the government, regulators, and local communities.
The Insights: Incorporating ESG into Corporate Governance

ESG has become an international hot topic in recent years. The improvement and advancement of corporate governance should give insight into how to avoid any related risks and to seek greater development opportunities. To meet the requirements of different stakeholders both domestically and internationally, companies are increasingly adopting ESG integration in their strategies.

1. Whether companies incorporate ESG into their corporate governance considerations

In 2020, the China Securities Regulatory Commission issued the revised Code of Corporate Governance for Listed Companies, which requires companies to disclose ESG information. The standards are being revised to ensure that companies clearly understand the importance of ESG. The survey found that 50% of companies have incorporated ESG into their governance framework. Of these, 60% currently incorporate ESG into their governance framework, while 30% consider incorporating ESG into their governance framework over the next 10 years. Only 5% of respondents consider incorporating ESG into their governance framework. The reasons given are as follows:

- Timeframe for the incorporation of ESG into corporate governance
  - Consider incorporating ESG into corporate governance in the next three years: 20%
  - Consider incorporating ESG into corporate governance over the next three to ten years: 26%
  - Consider incorporating ESG into corporate governance over the next ten years: 16%

2. How companies see the benefits of improving ESG governance

As ESG regulatory requirements become increasingly stringent, companies are concerned about the relationship between ESG and the returns yielded. In view of the benefits of improving ESG governance, respondents have provided different points of view, among which enhancing corporate reputation and improving brand image (62%), improving the company's ability to tackle and monitor risks (58%), and strengthening corporate sustainability in the industry (57%) are the three most significant benefits.

The Benefits of Improving ESG Governance

- Enhance corporate reputation and improve brand image: 82%
- Improve the company's ability to tackle and monitor risks: 62%
- Strengthen the company's competitive advantage in the industry: 66%
- Improve the sustainability disclosure of the company: 61%
- Improve operation efficiency and reduce long-term cost: 54%
- Provide innovative development opportunities for the future: 44%
- Promote the sustainable development and sustainability of the company: 38%
- Attract and retain talent: 33%
- Enhance the company's leadership and social responsibility: 33%
- Enhance the company's corporate governance: 24%

3. How companies improve their ESG governance

It is a step-by-step process for companies to incorporate ESG into their governance. The ESG governance of a company is only effective if it is the basis of ESG governance. Investors and stakeholders play a crucial role in improving ESG governance. Survey results show that respondents have responded to the ESG governance framework, which is supported by the company's leadership (74%) and returns yielded (62%)

- ESG issues are updated periodically to board members (C-suite executives) and internal procedures (74%)
- ESG governance is incorporated into the company's strategy (52%)
- ESG governance is incorporated into the company's strategy (46%)
- ESG governance is incorporated into the company's strategy (16%)

4. Major obstacles that companies face when dealing with ESG issues

Although more than 60% of the respondents expressed that they had already incorporated or would incorporate ESG into their corporate governance framework, the respondents still face a number of obstacles during this process. The most common obstacles are:

- Lack of expertise or experience: 61%
- ESG issues are not considered to be significant: 70%
- ESG is often regarded as a marketing tool: 66%
- The board of directors or management does not participate in ESG issues: 54%

Wang Xiaoling, Datang Environment Industry Group Co., Ltd.

Datang Environment Industry Group Co., Ltd. has been recognized as a leading player in environmental protection and corporate social responsibility. The company has the ability to take on ESG governance risks. Although regulatory authorities have strengthened ESG governance, companies are still facing a number of obstacles in maintaining an effective ESG governance framework.
The Insights: Companies' Future Investment and Views on ESG

In the long run, the traditional criteria and considerations used to measure corporate value will gradually be replaced by more comprehensive ESG (Environmental, Social, and Governance) analysis as society and technology evolve rapidly. The integration of ESG can be seen as a systematic reflection of sustainable investment behaviour. Although companies are still facing various challenges when incorporating ESG issues into corporate governance, with the rising awareness of the sustainability in the market, it is already a consensus for companies to strengthen their ESG competence.

The Major Direction of the Companies' Future Engagement in ESG Issues

The incorporation of ESG into corporate governance will not only help to enhance the management's involvement in the formulation of ESG strategies but will also help companies to identify potential non-financial risks in the operation process in advance, which enables them to address related issues in a timely manner and ultimately realize companies' sustainable development. According to the survey results, 74% of the respondents considered that they would improve their ESG management capacity, set up relevant management objectives, and conduct regular progress review in the next three years.

The survey also finds that 40% of respondents said they would set up a professional third-party ESG management consulting agency for ESG advisory over the next three years. This coincides with our findings in the previous section that most respondents saw the lack of expertise or experience in dealing with ESG issues as a major obstacle when incorporating ESG into corporate governance. Only 6% of the respondents expressed that they would not expect more investment in ESG issues in the next three years. In sum, companies generally take a positive attitude towards a more in-depth engagement in ESG issues.

Since the 19th National Congress of the Communist Party of China, China has actively promoted the integrated layout of "Five-Pillared Overall Plan". The national financial system has earnestly implemented the central concept of ecological civilization construction, adopted the green development concept of "Land use and water bodies are inviolable assets", constantly improved the construction and basic institutional arrangements of the green financial system, expanded green investment and financing channels, and transformed green projects and innovative financial tools. During its presidency of the G20 in 2019, China has taken a proactive role in building global consensus and promoting green finance development. According to the estimates made by the People's Bank of China, Mainland China needs at least three to four trillion yuan of annual green investment. Such a huge financing demand creates plenty of investment opportunities for domestic and foreign investors. As a national financial centre and a leading international financial centre in the world, Hong Kong has long been a gateway connecting Mainland China with the international market, which can effectively match the needs of both sides for green investment and financing, creating a win-win situation. Listed companies play a crucial role in strengthening the development of regional and international green finance. As the central system of business operation and management, the board and the management team implementing and strengthening the impacts of ESG in a top-down approach would be vital for the healthy development of green finance.

Major Direction of the Companies' Future ESG Engagement in ESG Issues

- Improve the company's capability to keep track of ESG issues, set up relevant management objectives, and implement regulations: 40%
- Enhance communication between the board of directors and shareholders/employees on ESG issues: 36%
- Set up a professional third-party ESG management consulting agency for ESG advisory over the next three years: 30%
- Establish an ESG management position/working group committee to be responsible for ESG: 34%
- Request the boards of directors to make ESG a strategic focus of business operations and development: 22%
- Add senior managers with ESG leadership experience: 19%
- Increase the number of Board members with ESG knowledge and experience: 10%
- It is predicted that there will be no investment in ESG in the next three years: 8%
- Other: 4%

Huanian Fush Energy Corporation Limited

As a listed company actively engaged in clean energy development, Huanian Fush energetically combines its business with green investment and financing in order to increase investment in the business of clean energy development and achieve the path of diversified, clean and efficient energy development. Through green investment and financing, Huanian Fush not only provides a social guarantee for its development but also improves its brand value as well as obtaining long-term recognition from investors.

02 ESG topics that affect corporate development to a larger degree in the future

Amendments to the ESG Reporting Guide and the related Listing Rules are expected to take effect in 2020. From the domestic perspective, the China Securities Regulatory Commission (CSRC) and the Shanghai Stock Exchange (SSE) formulated a Guidance on Building a Green Financial System (draft征求意见稿). This proposed to promote the mandatory environmental information disclosure of listed companies. Subsequently, regulators clarified the Three-step Path of China's environmental information disclosure. By 2020, all listed companies will be required to disclose environmental information. Currently, regulators in Mainland China have begun to study and formulate ESG information disclosure standards, including environmental information disclosure. Disclosing corporate ESG information in Mainland China has become an inevitable trend, and mandatory ESG information disclosure policies are expected to be released in the future. The disclosure of ESG information by listed companies in Mainland China and Hong Kong will further subject to supervision and control by the regulatory bodies, and the requirement of ESG information disclosure will be increasingly stringent.

As compared to the ESG topics that are currently considered to affect corporate development considerably, similarly the top five ESG topics that are considered to affect corporate development in the medium- and long-term also include use of resources (48%), conservation of the natural and natural environment (46%), environmental and social risk management in the supply chain (46%), and product or service quality (42%). It is worth noting that respondents believe that the impact of greenhouse gas emissions and climate change (previously 48%) and informatization and artificial intelligence (previously 20%) would increase significantly, which mean these ESG issues are considered to affect corporate development to a larger degree in the medium- and long-term.

Countries all over the world are increasingly concerned about climate change. In recent years, since China has ratified the 20th Paris Agreement, significant progress has been attached to building resilience and adapting to climate change. China has been proactively controlling carbon emissions, fulfilling its pledge on combating climate change and enhancing its climate resilience. By developing and implementing plans such as the Work Plan for Greenhouse Gas Emission Control during the 13th Five-Year Plan Period, China has been contributing significantly to the global response to climate change.

In the context of countries' proactive efforts in tackling climate change, the SEHK strengthened the disclosure requirements on climate change in its amendments to the ESG Reporting Guide, which could be seen as an evidence to support the higher number of respondents taking greenhouse gas emissions and climate change as their priority ESG topic in the medium and long-term.

In addition, through systematic analysis and ESG data management, investors can evaluate companies from a more comprehensive perspective. By means of informatisation and artificial intelligence, real-time tracking of ESG-related performance indicators and gathering the insights over market trend will enable companies to avoid risk losses in advance and also to capture rare/early earnings opportunities. The current development of artificial intelligence and big data-related technologies further strengthens investors' application of non-financial information when evaluating corporate investment risks and analysing the stability of investment returns.

- Greenhouse gas emissions and climate change: 50%
- Use of resources: 48%
- Conservation of the natural environment: 46%
- Environmental and social risk management in the supply chain: 46%
- Product or service quality: 42%
- Informatization and artificial intelligence: 34%
- Occupational health and safety: 32%
- Human resource management: 26%
- Poverty alleviation and community involvement: 20%
- Anti-corruption and promotion of integrity: 16%
- Labour rights, diversity and equality: 10%
- Consumer protection: 10%
- Intellectual property rights protection: 6%

Source: ESGPIE
I. The Insights: Companies’ Views on Impacts of Climate Change

With the increased frequency of extreme weather and climate change over the years, there has been an escalating demand for corporate climate-related information. Understanding the impacts of climate change and making informed decisions on business strategies and risk management are crucial for companies.

1. How do companies see the impact of climate change on their businesses?

Results show that 92% of the respondents agreed that climate change has an impact on their daily operations, while 39% of the respondents considered their daily operations unaffected by climate change. At the same time, nearly 70% of the respondents, who believed climate change has an impact on their daily business operations, stated that their business operations have already been affected. The percentage of respondents who expressed that climate change will affect their business at different times in the future ranges from 30% to 32%, while a total of 32% of respondents believed that the business impact of climate change would be realized within the next ten years.

It is worth noting that more than half of the respondents that regarded their business operations have already been impacted by climate change considered the impact a negative one to their businesses. 80% and 85% of the respondents believed that they are exposed to financial shocks and physical risks due to climate change, respectively. Common transitional risks include climate change and natural disasters, which can lead to business disruptions, increased costs, and reduced profits. Companies that are better prepared for these risks can better respond to the challenges posed by climate change.

2. Are Businesses Affected by Climate Change?

38% NO
62% YES

The Expected Time Nodes that Companies will be under the Influence of Climate Change

- At present: 60%
- In the next 1-3 years: 10%
- In the next 3-5 years: 10%
- In the next 5-10 years: 10%
- In the next 10 years from now: 10%

Impacts of Climate Change on Companies’ Current Operations or Future Development

- Due to climate change, companies will be exposed to transition risks, and the company will bear additional transition costs.
- Due to climate change, companies will be exposed to physical risks, and the company will bear additional operating costs.
- Climate change creates new market opportunities for the companies and leads them into new areas of development.

China Unicorn (Hong Kong) Limited

In terms of climate risk management and overall, China Unicorn actively contributes to climate change adaptation by improving its green procurement system, establishing a monitoring and data collection system for green development, and promoting green products and solutions. The company uses green technologies, leading the development of green, technology-driven businesses, and promoting the green development of the industry, seizing the development opportunities of industrial upgrade in the new era.
## II The Facts: HSI Constituents’ Status of ESG Governance Disclosures

In November 2013, the Hong Kong Financial Services Development Council recommended the HKJC to require a listed company’s ESG report to demonstrate its company’s governance structure on ESG, with emphasis on the role of the board in the oversight of assessing and managing material environmental and social topics. In May 2015, SEHK announced the publication of Consultation Paper “Review of the Environmental, Social and Governance Reporting Rules and Related Listing Rules” (“Proposed Amendments”), in which it stated the demonstration of the company’s governance structure on ESG as the most important change of the review. To emphasise the importance of the HKJC governance structure and the role of board’s leadership and to promote accountability of the board in this regard, SEHK proposed to introduce mandatory disclosure requirements to improve issuers’ ESG performance and reporting.

Through preliminary review of the status of ESG governance disclosures of 53 HSI Constituents’ samples of this report, the specific issues and development of the corporate governance practices were analyzed and summarized. We mainly analysed the ESG governance disclosure status of HSI Constituents through the following three aspects.

<table>
<thead>
<tr>
<th>Aspects of ESG Governance Disclosure</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ESG governance structure</td>
<td>Refers to whether a company discloses the establishment of responsible units for ESG in its corporate governance structure, such as committees, working groups and departments, and, where applicable, the position of the head of the responsible units.</td>
</tr>
</tbody>
</table>
| Duties of the responsible unit for ESG | Refers to whether a company discloses the specific governance duties of the responsible units for ESG:  
  - Identification of ESG topics 
  - Management of ESG topics 
  - Setting targets for ESG topics |
| ESG governance practices            | Refers to whether a company discloses the implementation of a specific ESG governance practice, for example, whether the compensation/bonus of board members/C-suite executives are tied in with the current ESG performance (of the company, etc.) |

### 01 HSI constituents’ ESG governance structure

The review results show that overall, 88% of the HSI constituents disclosed information about responsible units for ESG, while 12% of the HSI constituents have not disclosed any information directly related to responsible units for ESG. Some HSI constituents disclosed more than one responsible unit for ESG.

- **12%**
  - No findings

**88%**

- Disclosed responsible units for ESG
II The Facts: 
HSI Constituents’ Status of ESG Governance Disclosures

**Situation of Responsible Units for ESG Disclosed by HSI Constituents**

- **Dedicated ESG Board Committee**
  - A board-level committee such as the environment, social, and governance committee, corporate social responsibility committee, and sustainable development committee, etc., set to be responsible for ESG issues.

- **Other Board Committee (ESG duties authorized)**
  - The committee was established at the board level, such as the audit committee, risk management committee, strategy committee, etc. Not only do these committees have their original functions, but also serve ESG-related functions.

- **Other units (responsible for ESG)**
  - Non-board level units responsible for ESG-related issues, including working groups, business departments, committees, etc.

**Type** | **Percentage**
--- | ---
A | Dedicated ESG Board Committee 4%
B | Other Board Committees (ESG duties authorized) 12%
C | Other Units (responsible for ESG) 28%
A & C | Dedicated ESG Board Committee 4%
B & C | Other Board Committees (ESG duties authorized) 32%
A & B & C | Other Units (responsible for ESG) 8%

**Overall situation**
The results show that among the HSI constituents, those with dedicated ESG Board committees have the highest ESG disclosure rate. There are more companies with dedicated ESG Board committees (ESG duties authorized) and other units responsible for ESG than those with a dedicated ESG Board committee.

The most common corporate governance structure is one that consists of the other Board committees (ESG duties authorized) with other units (responsible for ESG), which comprised 32% of the HSI constituents.

It is rare for companies to set up a dedicated ESG Board committee and to set up an ESG Board committee with other units (responsible for ESG), which only accounted for 4% of the HSI constituents.

**Structures and functions**

For HSI constituents with a dedicated ESG Board committee:
- All companies clearly define the responsibilities and functions of the dedicated ESG Board committee through the key performance indicators, and report the work of the committee regularly in their corporate governance reports.
- All companies have set up units responsible for the identification and management of ESG risks.
- More than 90% of companies have units responsible for ESG target setting, which is significantly higher than other ESG governance structures.

For HSI constituents that have both other board committees (ESG duties authorized) and other units (responsible for ESG):
- At the level of other board committees (ESG duties authorized), all companies grant the committee the function of ESG risk identification.
- At the level of other units (responsible for ESG), more than 80% of companies specifically set units responsible for ESG, and all companies choose to entrust Board members or senior management to take the leadership of this functional unit.
- ESG risk management and target setting functions are more often delegated to other units (responsible for ESG).

For a governance structure with only other board committees (ESG duties authorized):
- Only 30% of companies specify ESG functions in the key performance indicators of the Board committee.
- Half of the companies only grant the functional unit the responsibility of ESG report review.
- No ESG risk management function has been granted by any of the companies.
- The most common ESG functions are ESG report preparation, followed by ESG management.

For governance structures with only other units (responsible for ESG):
- Over 40% of companies are led by Board members or senior management.
- 70% of companies set up a governance framework specifically for ESG functions, and the other 30% assigned ESG functions to existing departments. Half of the companies assign the governance framework, specifically for ESG functions, to the Board of Directors, while the other half assign the responsibility to the management of the ESG functions.
- Nearly 80% of companies choose to entrust the specific responsibility scope related to ESG to their key functional units in their ESG report.
- The most common ESG functions are ESG report preparation, ESG monitoring, and ESG risk management.
II The Facts:
HSI Constituents' Status of ESG Governance Disclosures

01 The Board of directors' involvement in ESG issues of HSI constituents
Results of the review show that 60% of the HSI constituents have established dedicated ESG board committees or other board committees (ESG duties authorized) to ensure the participation of Board members in ESG issues and to fulfill their ESG-related responsibilities.

It is worth noting that 28% of the HSI constituents involved other units (responsible for ESG) in a total of 14 companies, among which 3 companies disclosed that the units were led by board members, 3 other companies disclosed that the units were led by senior management, and the remaining 8 companies did not disclose the position that is leading the units. Of these 8 companies, 3 of them indicated that their other units (responsible for ESG) would report ESG performance to the Board.

Overall, 72% of the HSI constituents have explicitly disclosed the roles of the Board members regarding ESG issues, which include ESG topic identification, management, target setting, performance reporting, etc. Among them, 12% of the companies involve their board members in ESG issues by setting up one or more units responsible for ESG and appointing the Board members as the units' leaders or requiring the units to report ESG performance to the Board.

02 ESG governance functions of HSI Constituents
The review reveals a relatively complete disclosure of functions of dedicated ESG board committees, whose ToR documents provide stakeholders with a clear understanding of how the establishment of a dedicated ESG board committee will assist the Board of directors in fulfilling their ESG-related responsibilities.

It is worth noting that although 52% of HSI constituents indicated that their other board committees (ESG duties authorized) participate in overseeing ESG issues, some of them have not yet clearly disclosed their ToR for ESG functions, implementation methods and how the committee would assist the Board of directors to fulfill their ESG-related responsibilities. The disclosure content regarding the target setting on ESG topics was typically missing.

Overall, there remains room for improvement for HSI constituents to improve their disclosure of governance units' functionality.

03 ESG Governance Practices of HSI Constituents
The results show that 80% of HSI constituents have disclosed that they are equipped with ESG/social responsibility management system/policy of ESG. 36% of HSI constituents disclosed that ESG had been incorporated into their corporate policy and risk control system, and 72% of HSI constituents disclosed that the ESG concept has been included in their strategic planning process. 62% of HSI constituents have set up targets related to ESG/climate change 40% of HSI constituents disclosed that ESG was actively used as an entry point to promote corporate investment in ESG. A relatively small number of HSI constituents' remuneration/reward of board members/senior managers is linked to corporate ESG performance, accounting for 12%.
II The Facts: Overall Status of ESG Information Disclosures of Hong Kong Listed Companies

SEHK introduced the ESG Reporting Guide in 2010 in a voluntary compliance approach, and mandated companies to report on ESG issues in accordance with corresponding requirements in 2016. The ESG Reporting Guide is divided into two main areas, environmental and social, where companies need to disclose the general disclosures and key performance indicators ("KPIs") of 11 aspects accordingly. 2018 is the third year that issuers are required to disclose ESG information in accordance with the ESG Reporting Guide. Companies’ ESG reports have been continuously improving and in general are highly compliant with the ESG Reporting Guide.

Nevertheless, there is still room for improvement in terms of ESG information disclosure. On one hand, some companies failed to provide their stakeholders with meaningful and comprehensive ESG information; on the other hand, the ESG information disclosure requirements for Hong Kong and international markets are becoming increasingly stringent to meet capital market's growing demand for ESG disclosure. In response, SEHK issued an ESG consultation paper in May 2019 and suggested Proposed Amendments to refine the disclosure requirements, thereby further improving the quality of issuers’ ESG information disclosure by regulatory means. The Proposed Amendments to environmental and social disclosure requirements include: (1) introducing a new aspect on climate change and real estate environmental KPI; (2) upgrading the disclosure obligation of social KPIs to “comply or explain”; (3) revising the social KPIs.

As we have been keeping close track of companies’ ESG reports, we not only continue to understand whether required ESG information was disclosed by reviewing companies’ ESG reports against the current ESG Reporting Guide, we also try to understand companies’ readiness for the Proposed Amendments.

61 The disclosure status of “comply or explain” provisions of the current ESG Reporting Guide and the Proposed Amendments

The results of the ESG disclosure review show that on average, 89% of respondents disclosed information as required by the “comply or explain” provisions of the current ESG Reporting Guide, and only 11% of the respondents did not meet the disclosure requirements with some of them provided an explanation for not disclosing the required disclosure information. The results are broadly in line with SEHK’s analysis results of issuers’ ESG reports in 2019/2017 (companies in general were highly compliant with the ESG Reporting Guide but the report quality was variable) as well as our analysis results of 2017 ESG reports (most companies disclosed information for the “comply or explain” provision). Companies have maintained a good level of ESG disclosure at the report of the current ESG Reporting Guide.

Regarding information required by the “comply or explain” provisions of the Proposed Amendments, an average of 56% of the companies disclosed corresponding information while 44% of the companies did not, resulting in a smaller disclosure and non-disclosure ratio which is a different disclosure situation from that of the ESG Reporting Guide. Some of the companies have already started disclosing relevant information despite the fact that disclosure requirements in the Proposed Amendments have yet become effective. Although stock exchanges have yet to impose the disclosure requirements, some companies are more proactive and have already disclosed more ESG information in line with their business development needs, and are more prepared to respond to requirements of the Proposed Amendments.

A Comparison of Disclosure Status of the "Comply or Explain" Provisions of the Current ESG Reporting Guide and the Proposed Amendments

<table>
<thead>
<tr>
<th>Provision</th>
<th>Existing ESG Reporting Guide</th>
<th>Proposed Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Climate change</td>
<td>11%</td>
<td>54%</td>
</tr>
<tr>
<td>Real estate environmental</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: CECPREC

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Swire Pacific Limited

A good corporate governance structure is a prerequisite for embedding sustainability into core business strategies. There is no one-size-fits-all in good corporate governance for sustainability, it must be tailored to meet the organisations culture and operating environment. As a diversified conglomerate, we work with our businesses to develop a sustainability framework for the Group. Each of our operating companies then has the freedom and flexibility to operate in a way that fits their unique requirements within this overarching framework.

It is important that our operating companies are prepared for, and have the capacity to withstand, the negative impacts of climate change. Businesses need to identify and manage the physical risks of climate change to their operations and supply chains, and the risks associated with changes in regulation, in particular, those related to the transition to a low-carbon economy.
II The Facts:
Overall Status of ESG Information Disclosures of Hong Kong Listed Companies

02 The disclosure status of the newly introduced climate change disclosure in the Proposed Amendments

For SEHK, the newly introduced aspect on climate change disclosure was mainly a response to investors' demand for more information on climate change's impact and potential impact on companies, and its expectation for companies to tackle this pressing issue. The results of the review show that only about 59% of the companies have already disclosed relevant information regarding A4 General Disclosure and KPI A4.1 of the Proposed Amendments, while about 70% of the companies did not disclose relevant information.

Though investors pay more attention to climate change-related information, voluntary compliance climate-related disclosure recommendations have also emerged in the market. For instance, the Dow Jones Sustainability Global Indices ("DJSI") published its recommendations in June 2017. As aforementioned in this report, although companies are aware of the importance of climate change, most companies still have not yet disclosed information about climate change in the absence of mandatory disclosure requirements, with only a small number of companies voluntarily disclosing such information.

The Climate Change Information Disclosure Situation of the Proposed Amendments

<table>
<thead>
<tr>
<th>A4 General Disclosure</th>
<th>KPI A4.1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall disclosure</td>
<td>31%</td>
</tr>
<tr>
<td>Proposed disclosure</td>
<td>69%</td>
</tr>
<tr>
<td>Overall disclosure</td>
<td>30%</td>
</tr>
<tr>
<td>Proposed disclosure</td>
<td>70%</td>
</tr>
</tbody>
</table>

Source: CEIC/PIC

03 Hong Kong listed companies' perception on the "Mandatory Disclosure Requirements" and the "comply or explain" provisions of the Proposed Amendments

Admittedly, SEHK wishes to bring ESG requirements on par with international standards by suggesting the Proposed Amendments to the ESG Reporting Guide and Listing Rules. As a matter of fact, there has been a notable liberalization in the number of countries that promulgate laws and introduce regulations on ESG reporting in recent years. Many countries adopted a multi-tiered approach comprising laws, listing rules, "comply or explain" and/or voluntary guidelines to boost ESG information disclosure. Meanwhile, it is also an international trend to continuously increasing the level of reporting obligation (i.e., "comply or explain" and/or mandatory). "The development of the ESG Reporting Guide has been, and will continue to be, an evolutionary process, with the larger-term goal of achieving better and more comprehensive ESG reporting amongst our issuers", stated by SEHK in the ESG consultation conclusions in 2016.

In May 2019, to complement with SEHK's public consultation on the Proposed Amendments, a total of 98 Hong Kong listed companies participated in our webinar on the Proposed Amendments. At the same time, we collected and analysed participating companies' views on the Proposed Amendments provisions.
Summary

Taking an overview of the global capital market, there has been a rising number of investors integrating ESG factors into investment decision-making. Market regulatory authorities have intensified efforts to narrow the gap between the overall ESG performance and disclosures of listed companies and the expectations of investors. Results of this research show that companies in the China market are increasingly paying attention to ESG issues. In addition to meeting compliance requirements, companies in the China market have taken a more serious stance towards the correlation between investments and the returns of ESG management. Notwithstanding the fact that governments, regulatory authorities, and financial markets have already taken various measures for the development of green finance, the establishment of a comprehensive green financial infrastructure and associated green financing facilities are much needed now to promote green finance, and for the seamless co-developments on ESG policy, ESG management and disclosures.

Board’s participation and sound governance are key for proper management of risks and opportunities in ESG and for seizing relevant opportunities in the long run. Results of this survey and interviews show that most companies would take action to identify ESG topics, continue to build their capabilities in the management of ESG topics, establish corresponding management targets, and conduct regular progress reviews within the next five years, as principal means to integrate ESG into their corporate governance. Based on reviewing disclosures by 108 constituents regarding their Boards’ involvement in ESG, it is found that the Boards of majority HSI constituents have already incorporated ESG-related practices as part of their corporate governance. Nevertheless, there remains significant room for improvement towards listed companies’ governance structure, their duties and execution related to ESG.

Since SOKHK upgraded disclosure requirements of the ESG Reporting Guide to “comply or explain” in December 2015, listed companies in Hong Kong have been actively fulfilling their disclosure obligations. After three reporting cycles, ESG disclosure performance among companies has been maintained at a reasonable level while some companies have even demonstrated capacity in meeting requirements of the Proposed Amendments. With increased investments in green finance and ESG in recent years, some investment institutions have begun to use ESG-related level of participation on ESG issues and climate change adaptation capacity as indicators for overall performance evaluation on companies and for non-financial KPIs assessments. This is especially prominent under influences of the capital market where companies are increasingly sensitive to impacts of these global issues on their daily operations. Only by identifying and managing risks and opportunities associated with ESG issues, companies can improve their business operations and seize these new business opportunities.

Looking forward, building good communication channels between listed companies and other stakeholders such as regulatory authorities and investors is an important safeguard to improve overall corporate ESG performance in the capital market, and to drive the continuous development of green finance. The co-development of green finance at the regional and global scales will require a closer cooperation among all parties, with regulatory authorities continuing to refine regulatory requirements based on the market’s needs, investors continuing to pay close attention to ESG and directing its flow of capital accordingly, and listed companies enhancing their internal governance on ESG and ESG disclosures.
About HKGFA and CECEPEC

The Hong Kong Green Finance Association (HKGFA) was formally established on September 21, 2015, which brings together the talent and expertise of financial institutions and green businesses in Hong Kong. The HKGFA is committed to providing policy suggestions to the HK Government and other regulators in developing green finance in the city and promote concepts of green finance and green investment. In addition, the association will lead research and development of green finance products, methodologies, and tools. The HKGFA will arrange local and international events creating a sharing platform for financial organizations participating in green finance and green investments in Hong Kong, Mainland China, and the Belt and Road initiative, positioning Hong Kong to become a major international green finance centre. The HKGFA will serve as a hub for raising green capital, promoting the development of a Hong Kong green finance market through an increase in diversified green investment products, meeting the demands of both green businesses and investors.

http://www.hkgfassoc.org/lan

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