Re: Responses to HKEX Consultation Paper – Enhancement of Climate-related Disclosures Under the Environmental, Social and Governance Framework

The Chamber of Hong Kong Listed Companies is pleased to submit our response to the HKEX Consultation Paper on Enhancement of Climate-related Disclosures Under the ESG Framework ("HKEX CP").

The Chamber appreciates the good intention of the enhancements in aligning with international standards and in seeking to provide higher transparency to investors about listed issuers' ability to deal with climate change risks and opportunities.

The Chamber has always been a strong advocate of ESG, sharing best practices through annual forums, various seminars and workshops. However, we also realise the challenges for some listed companies from the proposed enhancements, if adopted in their present format and timetable.

In this submission, we will outline our observations about the proposed enhancements and their respective challenges in compliance, and our recommendations based on those observations.

Overview

The HKEX's proposed enhancements of climate-related disclosure are largely aligned with the International Sustainability Standards Board (ISSB) Climate Standard. The proposed disclosure enhancements are grouped under four core pillars: Governance, Strategy, Risk Management, and Metrics and Targets.

We attempted to categorise the proposed enhancements into 3 different levels of disclosures, namely: ***I. "Qualitative disclosure", II. "Quantitative disclosure" and III. "Financial impact disclosure"***. We would analyse their respective level of complexity and difficulty in compliance.

I. Qualitative disclosure

Climate governance, management approaches on climate strategies and risk management	HKEX CP: Question 2-6, 10-11, 16-17 & 25
Governance structure of climate change	HKEX CP: Question 2 & 25
Management approaches and processes on developing climate strategy	HKEX CP: Question 6 & 10-11
Climate transition plans in response to identified climate-related risks	HKEX CP: Question 6
Climate resilience plans	HKEX CP: Question 6
Method(s) and result(s) of scenario analysis	HKEX CP: Question 10-11
Management approaches and processes on climate risk management (climate risks and opportunities identification, prioritisation, control and review)	HKEX CP: Question 3-5 & 16-17

The above qualitative disclosures are similar to the TCFD-aligned climate-related financial disclosures with which listed companies are expected to be in compliance by 2025, as previously proposed by The Green and Sustainable Finance Cross-Agency Steering Group. As such, quite a number of listed companies would have already kick-started the related preparation work. The new proposed requirements on the qualitative disclosures appear to be largely achievable for general listed companies in Hong Kong under the proposed timeline.

II Quantitative disclosure

GHG emissions and reduction target(s)	HKEX CP: Question 7-9 & 18-19
Measurement of GHG emissions (Scope 1 &2 emissions)	HKEX CP: Question 18
Measurement of GHG emissions (Scope 3 emissions)	HKEX CP: Question 18-19
Description of the methodologies on target setting (e.g. base year, type of targets, progress review)	HKEX CP: Question 7-9

The recommendations of TCFD require the companies to report the measurement of greenhouse gas (GHG) emissions (Scope 1 &2) and *if appropriate* Scope 3 emissions. Generally, we consider that many listed companies would be able to fulfil the proposed disclosure requirement on Scope 1 & 2 emissions with corresponding reduction target setting, as such requirements already exist in the current ESG Reporting Guide of Appendix 27 - A4: Climate Change & KPI A1.2.

However, the proposed timelines of interim and full compliance of ***some quantitative disclosures especially for the Scope 3 emissions do appear to be challenging*** to many listed companies. Meaningful and accurate disclosure of Scope 3 emissions along the supply chains of a company require a comprehensive dataset which is difficult to obtain and the process of collecting it could be time- and resource-intensive.

Even with the intention to collect Scope 3 data, the lack of accurate and comprehensive dataset from the value chain adds to the challenge. The data collection work may not be straightforward and we believe businesses along the upstream and downstream value chain, especially the SMEs, are not ready to provide such data to the listed companies. Rushing for adoption of Scope 3 reporting for listed companies may result in inaccurate or misleading information.

For the average listed companies, it would also require them to review the entire upstream and downstream value chain and seek professional advice from compliance experts. But with the expected surge in demand for professional advisory services, whether there will be sufficient resources in the market is still in question.

III. Financial impact disclosure

• Company's business activities related to climate-related risks and opportunities	HKEX CP: Question 12-15, 20-24 & 26
• Current financial effect (quantitative where material) and anticipated (qualitative) financial effect in future (short, medium and long term) including quantification	HKEX CP: Question 12-15

• Cross-industry climate-related metrics for understanding company's financial vulnerability ✓ the amount and percentage of assets or business activities (i) vulnerable to transition/physical risks and (ii) aligned with climate-related opportunities ✓ the amount of capital expenditure, financing or investment deployed towards climate-related risks and opportunities ✓ Internal carbon price (if issuers maintained) ✓ Disclosure of how climate-related considerations are factored into remuneration policy	HKEX CP: Question 20-21 HKEX CP: Question 22-23,26 HKEX CP: Question 24 HKEX CP: Question 25

For those requirements related to financial impact disclosure, the Chamber is of the strong view that that listed companies may face huge challenges, especially on those disclosures linked to financial impacts for the company. The main reasons are:

- There is no standardised internationally recognised valuation methodologies, tools and guidelines in the current market to evaluate the financial effects linked to climate-related risks and opportunities, hence the definition and the financial implications of the quantitative data are of much uncertainties.
- The mapping of affected assets and business activities may involve high degree of assumptions, interpretations and other subjectivities made by the management, consultants or other advisors. As a result, estimated financial numbers could be highly incomparable among industry peers since they are dependent on the selection of assumptions and other subjectivities, even under the same climate scenarios.
- Currently, TCFD recommendations suggest using a 2°C or lower scenario in addition to other scenarios to measure climate-related risks and opportunities. Companies which voluntarily use more severe scenarios (e.g. 4°C or above) may report more significant financial impacts than using milder scenarios. There would not be a level playing field for comparison and assessing impact on business.
- For those listed companies which are operating in different and/or multiple geographical locations and with diverse industry sectors, they are required to follow their own national schemes or preferred framework in different sectors for measuring the financial effects. Such data may not be easily compatible to perform data analysis and presentation.
- Many listed companies would have concerns on disclosing financially-related data, and the interpretation of such data by investors using inaccurate interpretation may result in significant impact on stock price, capital raising capacity and even company reputation.
- Disclosure of anticipated financial effects may also amount to forward-looking statements which would require careful consideration.

Overall, the management and business particulars of companies differ. Issuers in the same industry and similar geographic focus will not share the same views on risks, opportunities, materiality and forecasts. Therefore, there may be significant differences in disclosures for companies in the same industry, especially in relation to basis and assumptions in arriving at financial impacts. In addition, the required financial information and forecasts may not be entirely accurate as they are not audited or verified as the case may be.

Summary

1. For the proposed qualitative disclosures including climate governance, risk management and strategic plans and actions, and approaches on GHG reduction target setting, we consider that they may be largely achievable by many listed companies;
2. For the proposed quantitative disclosures, Scope 3 emissions disclosure may not be feasible for many listed companies;
3. For financial impact disclosure, it is likely that many listed companies would have strong difficulty in complying.

CHKLC Recommendations

Given the diverse degree of readiness between different types of disclosure and between listed companies, we believe it would not be prudent to upgrade the proposed enhancements to "mandatory" in one go. A more gradual and selective approach would be more advisable.

➢ For **qualitative disclosures**, while we support information of a qualitative nature can be made mandatory, a longer lead time would be beneficial, especially for smaller size companies. Afterall the ISSB IFRS S2 finalised standards were only released in the end of June 2023, more time might be needed for smaller companies to fully grasp the essence of the requirements and organise necessary resources. We therefore recommend extending the implementation for mandatory disclosure of qualitative nature for another year, i.e. effective for financial year beginning January 1, 2025. And from financial year beginning January 1, 2024, it will be on a "comply-or-explain" basis. Companies who are ready may disclose while letting smaller companies more time to prepare so that they can engage the market with disclosures of high standard.

➢ For disclosure of a **quantitative nature**, we believe that mandatory disclosure of targets and Scope 1 and 2 emissions should also only start from financial year 2025 while "comply-or-explain" may start from financial year 2024. However, we have reservations about making Scope 3 data disclosure mandatory in a blanket manner per se. We recommend HKEX considers mandatory for some industries, and "comply-or-explain" for others, e.g. industries with light pollution, or companies of smaller-sized or with immaterial Scope 3 emissions. For Scope 3 disclosures, HKEX may consider providing safe harbour from certain forms of liability for inaccurate data, e.g. deemed not be a fraudulent statement, unless it is disclosed other than in good faith. In fact, as referred to in Appendix I of the Consultation Paper, some jurisdictions do provide safe harbour or make it "comply-or-explain". For industries subject to mandatory disclosure of Scope 3 emissions, the two year interim arrangements shall apply.

➢ As for **financial impact disclosure**, we are concerned that many companies are not ready for or incapable of, given the complexities we mentioned, therefore the implementation of it should be subject to more market discussion, and only with more assistance given. Even if implemented, it should only be on a "comply-and-explain" basis in the foreseeable future. Companies who are able and willing to make the efforts may do so, for example in abiding by industry regulations or in response to keen investors demand.

Further, we believe that meaningful and comparable disclosures may only be able to achieve if:

- A comprehensive implementation guidance with well-defined methodologies and compliance instructions is prepared by the regulators;
- Designated standard and methodology in projecting affected business areas shall be advised.
- Sufficient training for the compliance of proposed disclosure requirements is provided to the listed companies as well as the related stakeholders along their upstream and downstream value chains;
- A reasonable grace period is allowed for the trial run of the implementation guidance;

- The regulators should explain how they will judge compliance of required reporting as there is a large degree of subjectivity in preparing the disclosures. The regulators should also provide detail guidance on the standard expected and the consequences of any inadvertent inaccurate disclosures.
- The regulators consolidate the relevant experience obtained during the grace period and make necessary further amendments before considering full implementation.

In addition to our overall comments cited above, we noted in the ISSB IFRS S2 finalised standards published on 26 June that in certain areas, the finalised standards are less demanding in the reporting contents and scope than what are proposed in the HKEX Consultation Paper, and allow more flexibility to issuers. As the ISSB finalised standards set out to be the principle recommended reporting standards, it should be regarded as the highest achievable standards. There is no compelling reason the Hong Kong reporting guidelines should be more stringent. We therefore recommend HKEX removes requirements in its Consultation Paper that are higher than the ISSB finalised standards, or provide the same flexibility as the ISSB finalised standards. We summarise those areas in question below:

<u>Key differences between the New ESG Code in HKEX Consultation and the ISSB IFRS S2 finalised standards</u>

ISSB IFRS S2 finalised standards	**New ESG Code in HKEX Consultation**	**CHKLC comments**
10(d) explain how the entity defines 'short term', 'medium term' and 'long term' and how these definitions are linked to the planning horizons used by the entity for strategic decision-making.	2(b) how the issuer defines short, medium and long term and how these definitions are linked to the issuer's strategic planning horizons and <u>capital allocation plans</u>;	The finalised ISSB standards do not require explanation of the linkage between the definition of the "term" and the capital allocation plans. HKEX should consider removing such requirement.
-	2(d) whether the risks identified are acute or chronic; and	The finalised ISSB standards do not require such risk identification. HKEX should consider removing such requirement.
16. Specifically, an entity shall disclose quantitative and qualitative information about: (a) how climate-related risks and opportunities have affected its financial position, financial performance and cash flows for the reporting period; (b) the climate-related risks and opportunities identified in paragraph 16(a) for which there is a	10(a) Describe and, where material, quantify the effect of climate-related risks and, where applicable, climate-related opportunities identified on the issuer's financial position, financial performance and cash flows for the most recent reporting period; and 10(b) describe whether and how such risks and, where applicable, opportunities may result in a material adjustment to the carrying	<u>**Para. 19-21**</u> of the finalised ISSB standards provide exceptions to the disclosure of quantitative information, and do not specify a specific duration to which such exceptions apply. Broadly speaking, listed companies are not required to make quantitative information about the current or anticipated financial effects of a climate-related risk or opportunity under the following circumstances: (a) those effects are not separately identifiable;

significant risk of a material adjustment within the next annual reporting period to the carrying amounts of assets and liabilities reported in the related financial statements;	amounts of assets and liabilities reported in the financial statements within the next financial year.	(b) high level of uncertainty involved in estimation resulting in quantitative information not useful; (c) listed companies do not have the skills, capabilities or resources to provide the quantitative information; listed companies can provide qualitative information about those effects instead. HKEX Consultation did not include such exceptions.
17. In providing quantitative information, an entity may disclose a single amount or a range.	-	The finalised ISSB standards provide the flexibility of disclosing a single amount or a range for quantitative information. HKEX Consultation did not include such flexibility.
-	8(a) the extent assets and business activities at risk are covered by the issuer's strategy, its current and planned mitigation actions and/or investments;	The finalised ISSB standards do not require the disclosure on such extent. HKEX should consider removing such requirement.
-	9(c) where applicable, upstream and/or downstream activities in the value chain covered in the analysis; 9(g) critical assumptions about the way the transition to a lower-carbon economy will affect the issuer; and	The finalised ISSB standards do not require disclosure on these areas. HKEX should consider removing such requirement.
25(iv) whether and how the entity prioritises climate-related risks relative to other types of risk;	12(a)(ii) how the issuer prioritises climate-related risks relative to other types of risks, <u>including its use of risk-assessment tools (for example, science-based risk-assessment tools)</u>;	The finalised ISSB standards do not require disclosure on the risk-assessment tools used. HKEX should consider removing such requirement.
-	14(c) a summary of specific exclusion of sources, facilities and/or operations with a justification for their exclusion.	The finalised ISSB standards do not require disclosure of such summary. HKEX should consider removing such requirement.