



## HKEX Consults on Mandatory Climate Disclosures in ESG Reports

On 14 April 2023, the Stock Exchange of Hong Kong Limited (**HKEX**) published a [Consultation Paper](#) proposing to mandate all listed issuers to make climate-related disclosures in their annual Environmental, Social and Governance (**ESG**) reports and introduce additional climate-related disclosures based on the International Sustainability Standards Board (**ISSB**) Climate Standard<sup>1</sup> in a new Part D of Appendix 27 to the Main Board Listing Rules and Appendix 20 of the GEM Listing Rules. Both appendices will be renamed the “Environmental, Social and Governance Reporting Code”.

The proposed new climate-related disclosures cover four key areas: Governance, Strategy, Risk Management and Metrics and targets. The key proposals include:

- **Governance:** A requirement for issuers to disclose their governance process, controls and procedures for overseeing and managing climate-related risks and opportunities;
- **Strategy:** Requirements for:
  - disclosure of material climate-related risks and opportunities (if applicable) and their impact on issuers’ business operations, business model and strategy;
  - disclosure of issuers’ response to climate-related risks and opportunities identified, including changes to their business models and strategies, any adaptation and mitigation efforts, and climate-related targets set;
  - disclosure of the resilience of issuers’ strategies and operations to climate-related changes, developments or uncertainties; and
  - disclosure of the current and anticipated financial effects of climate-related risks and opportunities (if any);
- **Risk Management:** Issuers will be required to disclose their process for identifying, assessing and managing climate-related risks and, where applicable, opportunities; and
- **Metrics and Targets:** Issuers should disclose the metrics and targets they use to measure, monitor and manage material climate-related risks and opportunities, and how they assess the performance. These include greenhouse gases (**GHG**) emissions, other cross-industry metrics and internal carbon price.

The proposed amendments to the Listing Rules are expected to come into effect on 1 January 2024. Acknowledging that issuers may need more time to comply with certain disclosure requirements (e.g. the financial effects of climate-related risks and opportunities, scope 3 emissions, and other cross-industry metrics), the HKEX is proposing interim provisions for these disclosures during the first two reporting years. Full compliance will be required in financial years commencing on or after 1 January 2026.

The deadline for responding to the Consultation Paper is 14 July 2023.

## Development of Hong Kong's ESG Reporting Requirements

Under the existing reporting framework, there are two levels of reporting requirements: mandatory disclosure requirements and "comply or explain" provisions. The "comply or explain" provisions currently cover four aspects under the "Environmental" subject area<sup>2</sup> and eight aspects under the "Social" subject area.<sup>3</sup>

To keep pace with the international development of climate-related disclosures standards, the HKEX has made several enhancements to its ESG reporting framework in recent years. These included incorporation of certain key elements of the Task Force on Climate-related Financial Disclosures (TCFD) Recommendations in its ESG reporting framework in July 2020. The Hong Kong Green and Sustainable Finance Cross-Agency Steering Group (Steering Group) has also announced an objective for the financial sector to achieve mandatory TCFD-aligned climate-related disclosures by 2025.

In March 2022, the International Sustainability Standards Board (ISSB) published [exposure drafts](#) of the ISSB Climate Standard and ISSB General Standard. Built on the principles of the TCFD Recommendations, the ISSB Climate Standard will become the global baseline for sustainability-related disclosures to address the rising need for transparent, consistent and comparable data by companies on climate and other ESG issues. After considering the feedback and holding a series of deliberations, the final standards are expected to be published by the end of the second quarter of 2023. The HKEX's latest proposed amendments to the HKEX Listing Rules, which largely adopt the ISSB Climate Standard, are aimed at facilitating a smooth transition to mandatory climate-related disclosures by 2025.

## Governance

Under the current ESG disclosure framework, issuers are required to disclose the board's oversight and governance of ESG issues, the board's ESG management approach and strategy, and how the board reviews progress made against ESG-related goals and targets.

Recognising the importance of the board's role in driving sustainability practices and overseeing climate-related risks and opportunities, the HKEX proposes to incorporate the more detailed governance disclosures under the ISSB Climate Standard into its ESG disclosure framework. The existing ESG governance disclosures will remain in place.

The proposed governance requirements require issuers to disclose:

- the identity of any board committee or board members responsible for oversight of climate-related risks and opportunities;
- how the board ensures that the appropriate skills and competencies are available to oversee strategies designed to respond to climate-related risks and opportunities;
- how and how often the board and its committees are informed about climate-related risks and opportunities;
- how the board and its committees consider climate-related risks and opportunities when overseeing the issuer's strategy, its decisions on major transactions, and its risk management policies;
- how the board and its committees oversee the setting of, and monitor and review progress towards, targets related to significant climate-related risks and opportunities, including whether and how related performance metrics are included in remuneration policies; and
- a description of management's role in assessing and managing climate-related risks and opportunities, including:
  - o the scope of climate-related responsibilities and duties performed by management-level position(s) or committee(s);
  - o how the board's oversight is exercised over such management-level position(s) or

committee(s); and

- o whether dedicated controls and procedures are applied to the issuer's management of climate-related risks and opportunities.

## Strategy

### Climate-related risks and opportunities

The HKEX notes that climate-related risks vary among issuers, depending on their industry sector and the location of their operations. It expects issuers to identify the material climate-related risks they face and assess their actual or potential impact on their business model, strategy, cash flows, access to finance and cost of capital over the short, medium or long term.

In addition to risks, climate-related opportunities may arise from efforts to mitigate or adapt to climate-related effects and events, such as cost savings due to greater use of renewable energy, enhanced resource efficiency and access to new markets due to the company's transition to a lower carbon economy.

The HKEX proposes to primarily adopt the Strategy part of the ISSB Climate Standard requirements into Appendix 27 of the Listing Rules. However, issuers will be able to opt to disclose the actual and potential effects of climate-related opportunities they have identified in response to climate-related risks they disclose. When preparing disclosures, issuers will be required to consider the applicability of cross-industry metrics and industry-based metrics discussed in the "Metrics and Targets" section. Additionally, they will be able to explain the connections between climate-related risks and opportunities and disclosures in other sections of their annual reports.

The proposed disclosures include:

- a description of climate-related risks identified and the time horizon over which each could reasonably be expected to have a material effect on the issuer;
- an explanation of the issuer's definitions for short, medium, and long term, and how these timeframes are associated with their strategic planning and capital allocation plans;
- a classification of the identified risks as either physical or transition risks;
- whether the risks identified are acute or chronic; and
- current and anticipated effects of any climate-related risks identified on the issuer's:
  - o business operations (including types and locations), business model, and strategy;
  - o products or services offered; and/or
  - o suppliers and other stakeholders in the value chain.

### Transition plans

A transition plan is part of a company's general business strategy that outlines its targets and action plans to move towards a lower carbon and eventually a net zero economy. The HKEX proposes substantial adoption of relevant ISSB Climate Standard requirements into Appendix 27 of the Listing Rules, including the requirement for issuers to disclose any climate-related targets they have set and any emission targets they are required to meet by local legislation.

Under the proposed changes, issuers would be required to describe their response to climate-related risks and opportunities by providing information on:

- any current or anticipated changes to the issuer's business model, strategy and resource allocation to address climate-related risks and opportunities;
- any adaptation and mitigation efforts (both direct and indirect) undertaken or to be undertaken by the issuer; and
- resources allocated for implementing these plans.

Issuers would also be required to disclose information on any climate-related targets they set and any greenhouse

gas (GHG) emission targets required by local legislation, covering:

- whether the target is an absolute target or an intensity target;
- objective of the target (e.g. mitigation, adaptation or conformance with sector or science-based initiatives);
- scope of the target (e.g. whether the target applies to the entire group or only a specific business unit or geographic region);
- period over which the target applies;
- base period from which progress is measured;
- milestones or interim targets (if any); and
- for GHG emission targets, the extent to which the target relies on carbon credits, including separate disclosure of gross emission targets, intended use of carbon credits, and net emission targets, as well as the type of carbon credit and whether the credits are subject to third-party verification or certification.

The HKEX clarifies that climate-related targets are not limited to those in Part B of Appendix 27, and issuers are still required to disclose targets under KPIs A1.5, A1.6, A2.3, and A2.4 on a “comply or explain” basis.<sup>4</sup>

Acknowledging that issuers are at different stages of their sustainability journey, the HKEX proposes alternative disclosure options for those who need more time to determine meaningful and achievable climate-related targets. Issuers not providing the information will be required to disclose their work plan, progress and timetable for setting and disclosing climate-related targets.

In addition, issuers are expected to report the progress made in the most recent reporting year in relation to the plans and targets, except for ESG reports covering the first reporting period following the effective date (i.e. 1 January 2024).

#### Climate resilience

The HKEX proposes that issuers disclose their climate resilience, which is the ability to anticipate, prepare for, and respond to climate-related hazardous events, trends, or changes. The proposed amendments will integrate relevant ISSB Climate Standard requirements into Appendix 27 of the HKEX Listing Rules. Specifically, the disclosures include:

- the extent to which assets and business activities at risk are addressed by the issuer’s strategy, its current and planned mitigation actions and/or investments;
- any implications of the issuer’s findings for its strategy, such as how it may need to respond to anticipated effects during its transition to a lower-carbon economy;
- the significant areas of uncertainty considered in the climate resilience analysis; and
- the ability of the issuer to adjust, or adapt its business model, in the future in terms of, for example, access to finance and cost of capital, product and services portfolio shift or reskilling of workforce.

Additionally, issuers should disclose the climate-related scenario analysis used to assess the impact of climate-related risks and, if applicable, opportunities on their business model, strategy, cash flows, access to finance and cost of capital.<sup>5</sup> The resilience of their strategy and business model should also be addressed. The method of climate-related scenario analysis should be appropriate to each issuer’s circumstance, and at a minimum, the disclosure should include:

Inputs used in the analysis:

- scope of risks (e.g. physical risks) and operations (e.g. business segment, location, sites, or assets) covered;
- details of the assumptions; and
- upstream and/or downstream activities in the value chain, if applicable.

How the analysis was conducted:

- scenarios used for the assessment and their sources;<sup>6</sup>
- whether the scenarios used are associated with transition risks or increased physical risks;
- the relevance of chosen scenarios for assessing the issuer’s resilience;
- critical assumptions about the impact of transition to a lower-carbon economy on the issuer; and
- time horizons used in the analysis.

Recognising that issuers might need time to develop expertise in comprehensive climate-related scenario analysis, the HKEX suggests issuers could begin with qualitative narratives before progressing to quantitative methods to explore the potential range of climate change implications.

#### Financial effects of climate-related risks and opportunities

The amendments focus on disclosing the financial effects of a company’s exposure to climate-related risks and opportunities, and its strategic decisions to seize those opportunities and manage those risks.

In response to some issuers’ concerns about the challenges of quantifying the current financial effects of climate-related risks due to their limited knowledge and experience in the area, the HKEX notes that the International Financial Reporting Standards (**IFRS**) already mandate companies to quantify and account for material financial effects arising from climate-related matters in their financial statements. The IFRS has also issued guidance on the way to disclose the effects of climate-related matters on financial statements.

The HKEX also cites issuers’ concerns about the difficulties in disclosing the anticipated effects of climate-related risks, which is highly dependent on the assumption and projection model used.

In light of the above, the HKEX will incorporate the ISSB Climate Standard on the current and anticipated financial effects of climate-related risks and opportunities into Appendix 27 of the Listing Rules, with certain modifications:

Aspect	Requirements	Interim Provisions
Current Financial Effect	<p>Describe and, where material, quantify the effect of climate-related risks and opportunities on the issuer’s financial position, financial performance, and cash flows for the most recent reporting period;<sup>7</sup> and</p> <p>Describe whether and how such risks and opportunities may result in a material adjustment to the carrying amounts of assets and liabilities reported in the financial statements within the next financial year.</p>	<p>During the Interim Period, issuers who have yet to provide quantitative information should provide qualitative disclosures.</p>
Anticipated Financial Effect	<p>Describe the anticipated effects of climate-related risks and opportunities identified on the issuer’s financial position, financial performance and cash flows over the short, medium and long term. This envisages disclosures on:</p> <ul style="list-style-type: none"> <li>• how the issuer expects its financial performance to change over the short, medium and long term, considering its strategy to address significant climate-related risks and opportunities; and</li> <li>• how the issuer expects its financial position to change over the short, medium and long term, considering funds (e.g. capital expenditure, R&amp;D expenditure) required to pursue: <ul style="list-style-type: none"> <li>- its current and committed plans; and</li> <li>- its planned sources of funding to implement its strategy to address significant climate-related risks and opportunities; and</li> </ul> </li> <li>• how the issuer defines the short, medium and long term.</li> </ul>	<p>During the Interim Period, issuers who have yet to provide the information relating to the anticipated financial effect should disclose:</p> <ul style="list-style-type: none"> <li>• information, to the extent reasonably available, that may enable investors to understand the aspects of the financial statements that are most affected; and</li> <li>• the work plan, progress, and timetable for making the required disclosure.</li> </ul>

## Risk Management

Under the current HKEX Listing Rules, issuers are required to disclose the process used to evaluate, prioritise and manage material ESG-related issues, and the effectiveness of their risk management and internal control systems. There is no specific requirement, however, to disclose the risk assessment process.

The proposed amendments to the HKEX Listing Rules, which largely incorporate the ISSB Climate Standard, aim to enable investors to better understand and assess how a company identifies, evaluates, and addresses climate-related risks that may materially impact its business. The disclosures would include:

- how the issuer assesses the likelihood and effects associated with such risks;
- how the issuer prioritises climate-related risks relative to other types of risks, including the use of risk-assessment tools;
- how the issuer monitors and manages its climate-related risks;
- how the process is integrated into the issuer’s overall risk management process; and
- any changes in the processes compared to the prior reporting period.

Issuers may also choose to describe any process used to identify, assess, and manage climate-related opportunities in respect of the provisions mentioned above.

## Metrics and targets

Under the current HKEX Listing Rules, issuers are required to disclose certain environmental KPIs on a “comply or explain” basis. However, the HKEX recognises the need for more comprehensive information for investors to evaluate the carbon footprint and transition risks faced by companies. Therefore, the HKEX proposes upgrading the reporting obligation for scope 1 and 2 emissions to mandatory and including the disclosure standards for scope 3 emissions.<sup>8</sup>

For scope 3 emissions, the HKEX acknowledges the practical challenges faced by issuers in collecting data from upstream and downstream stakeholders which they have no control over. The HKEX also considers that more time may be required for issuers to analyse their value chain, identify significant scope 3 activities, collect data, and build appropriate calculation models.

In light of the above considerations, the HKEX is proposing the following amendments:

Aspect	Requirements	Interim Provisions
GHG emissions	<p>Disclose absolute gross GHG emissions generated during the reporting period, expressed as metric tons of CO2 equivalent, classified as:</p> <ul style="list-style-type: none"> <li>• scope 1 emissions;</li> <li>• scope 2 emissions; and</li> <li>• scope 3 emissions.</li> </ul> <p>Disclose the following information in relation to GHG emissions:</p> <ol style="list-style-type: none"> <li>a statement describing the standard in accordance with which the issuer’s GHG emissions have been measured, which must be either (i) the GHG Protocol; or (ii) the protocol that the issuer is required to use by local legislation for measuring GHG emissions;</li> <li>the GHG emissions consolidation approach used: equity share, financial control, or operational control; and</li> <li>a summary of specific exclusion of sources, facilities and/or operations with a justification for their exclusion.</li> </ol>	<p>During the Interim Period, issuers who have yet to disclose all information in relation to scope 3 emissions should disclose:</p> <p>information, to the extent reasonably available, that may enable investors to understand the issuers’ relevant upstream or downstream activities along the value chain; and</p> <p>the work plan, progress and timetable for making the required disclosure.</p>

	<p>In relation to scope 3 emissions, disclose:</p> <p>i. the categories of significant upstream or downstream activities along the value chain that have been included in the calculation;</p> <p>ii. the basis for selecting such upstream or downstream activities;</p> <p>iii. the basis for its measurement of scope 3 emissions when it includes information provided by entities in its value chain; and</p> <p>iv. the reasons for omission if it excludes those GHG emissions in (iv) above.</p>	
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### Other cross-industry metrics

The HKEX also proposes disclosure of the following cross-industry metrics, subject to an interim provision:

Aspect	Requirements
Transition risks	Disclose the amount and percentage of assets or business activities vulnerable to transition risk.
Physical risks	Disclose the amount and percentage of assets or business activities vulnerable to physical risk.
Climate-related opportunities	Disclose the amount and percentage of assets or business activities aligned with climate-related opportunities.
Capital deployment	Disclose the amount of capital expenditure, financing or investment deployed towards climate-related risks and opportunities.

During an Interim Period, an issuer who has yet to make quantitative disclosures in respect of the above metrics is required to disclose:

- (a) a description of: (i) the assets or business activities identified to be vulnerable to transition risks/ physical risks or aligned with climate-related opportunities; or (ii) the types of activities requiring capital expenditure, financing or investment towards climate-related risks and opportunities; and
- (b) the work plan, progress and timetable for making the required disclosure.

### Internal carbon price

Internal carbon pricing is a planning tool used by companies to assess the financial implications of climate-related risks and opportunities. Given the absence of a mature carbon market, establishing an internal carbon price can be challenging. Therefore, the HKEX has decided not to mandate issuers to maintain an internal carbon price at this stage.

In respect of issuers who maintain an internal carbon price, the HKEX requires them to disclose:

- the price for each metric tonne of GHG emissions that the issuer uses to assess the costs of its emissions; and
- an explanation of how the issuer is applying the carbon price in decision-making (for example, investment decisions, transfer pricing, and scenario analysis).

### Remuneration

The HKEX proposes to incorporate ISSB Climate Standard requirements in respect of remuneration into Appendix 27 of the Listing Rules. However, it has decided not to require issuers to disclose the percentage of remuneration linked to climate-related considerations as it may not always be practical to do so. The requirements are modified such that issuers are required to disclose how climate-related considerations are factored into their remuneration policy.

### Industry-based metrics

Due to the evolving nature of international ESG frameworks, the HKEX will not mandate industry-based metrics at this stage. Instead, it encourages issuers to use other international ESG reporting frameworks such as the SASB Standard and the GRI Standards as references for industry-specific disclosures.

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[1] The IFRS S2 Climate-related Disclosures Exposure Draft, as supplemented or modified by deliberations of the ISSB. The ISSB has indicated its intention to publish the final standards by the end of the second quarter of 2023

[2] These include Emissions, Use of Resources, The Environment and Natural Resources and Climate Change

[3] These include Employment, Health and Safety, Development and Training, Labour Standards, Supply Chain Management, Product Responsibility, Anti-corruption and Community Investment

[4] KPIs A1.5 (emission targets), A1.6 (waste reduction targets), A2.3 (energy use efficiency targets) and A2.4 (water efficiency targets)

[5] Scenario analysis is a tool used to identify and evaluate a range of hypothetical climate-related outcomes in the future under conditions of uncertainty

[6] Scenarios may include a 1.5 degree Celsius climate-related scenario and a 2 degree Celsius or greater climate-related scenario. The HKEX will include suggestions in the Implementation Guidance to be issued in due course

[7] Issuers should account for climate-related matters in their financial statements in accordance with HKFRS, IFRS, CASBE, or an alternative overseas financial reporting standard acceptable to the HKEX. If the quantitative information is not expressed as a standalone item in the financial statements, the issuer must explain how such information is reflected in its financial statements

[8] Scope 1 emissions cover direct GHG emissions that occur from sources that are controlled or owned by a company. Scope 2 emissions cover indirect emissions from purchased electricity, heat, steam and cooling. Scope 3 emissions include all other indirect emissions that occur in a company's value chain such as business travel, purchased goods and services, waste disposal and employee commuting.



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