DENTONS

Key ESG Issues in Focus for 2022 - Identifying Risks and Opportunities for the Future

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- more than 20 years experience as corporate and commercial lawyer, with focus in the financial institutions and financial services sectors;
- deep and broad focus in the areas of asset management, diverse forms of investment funds across asset classes and structures, retail funds and privately placed funds, investments in public markets, private equity, real estate and alternative investments;
- market-leading in having developed a unique focus on corporate and regulatory issues around environmental, social and governance (ESG) areas, sustainable finance, responsible investment, impact investing and social finance
- broader practice experience includes advising on trusts and tax matters, international tax issues, wealth management and private client matters, pre-IPO trust structures and employee incentive schemes, and also advising on establishing or structuring of charities, foundations, philanthropic giving or social enterprise
- *Asialaw* leading lawyer for investment funds and corporate M&A (2018 to 2020); *China Business Law Journal* A-List Elite 100 foreign lawyers for China practice (2020 & 2021)

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Is ESG not the same as CSR (Corporate Social Responsibility)?

We get asked this question all the time. Corporate Social Responsibility (CSR), Corporate Sustainability, and Environmental and Social Governance (ESG) all cover broadly the same subject matter, but society appears to be morphing from a narrative of 'CSR' to 'ESG'. So what's the difference? The real question, is not whether this process is 'ESG' or 'CSR', but whether there is a shift in the way a business evaluates and embeds the environmental and social impacts of its enterprise into every day performance and strategy.

Why is ESG increasingly an issue for the legal team?

Increasingly we are seeing legal teams own their organization's ESG agenda (or at least its implementation) because:

1. The ESG agenda is being driven by law – class actions, consumer claims, investor activism and, increasingly, regulation. Who better to anticipate forthcoming changes and provide your organization with a view of the legal baseline globally than your legal team?

2. Implementation of an ESG strategy requires legal input. For example, drafting contracts that ensure your supply chain upholds labour practices that meet your standards and M&A due diligence to establish what work needs to be done to on-board an acquired asset so that it meets your organization's ESG standards.

3. The risks associated with ESG claims and statements your organization may wish to make or are required to make by regulation and how to validate and evidence those claims, especially in the context of a significant dispute, is the domain of lawyers.

4. General Counsel are often the governance leader in their organization and the advisor to the Board on governance related issues.

5. Lawyers understand the value of, and need for, attorney client privilege/legal advice privilege.

6. Ultimately law will be used to hold organizations to account whether by criminal or civil liability and sanctions.

ESG. What does it stand for?

Environmental – This includes contributions made to climate change through emissions and carbon footprint, the impact the business has on natural resources, pollution, waste, land contamination, biodiversity, energy use etc.

Social – Social factors can include modern slavery, human rights, pay equity, labour standards across the supply chain, and adherence to workplace and industry health and safety standards.

Governance – Governance refers to themes surrounding corporate governance and behaviour, including ethics, corruption, political donations, transparency, anti-competitive practices and corporate sustainability.

ESG is a means of measuring the environmental, social and ethical expectations of all stakeholders in a business

If a business does not understand its stakeholders and their expectations it cannot begin to set measurable targets that will enhance performance

The same stakeholders are pushing governments to regulate as businesses do not respond in a uniform way, and so there is a gathering pace of new law that necessitates certain responses

If a business does not understand the new law and the foreseeable development of law it cannot make decisions in full confidence that they will enhance enterprise value

A view of the ESG landscape (source: MSCI ESG Universe)

Environmental pillar

Climate change
- Carbon emissions
- Product carbon footprint
- Financing environmental impact
- Climate change vulnerability

Natural resource
- Water stress
- Biodiversity & land use
- Raw material sourcing

Pollution & waste
- Toxic emissions & waste
- Packaging materials & waste
- Electronic waste

Environment opportunity
- Opportunities in clean tech
- Opportunities in green building
- Opportunities in renewable energy

Social pillar

Human Capital
- Labor Management
- Health & safety
- Human capital development
- Supply chain labor standards

Product liability
- Product safety & quality
- Chemical safety
- Financial product safety
- Privacy & data security
- Responsible investment
- Health & demo. risk

Stakeholder opposition
- Controversial sourcing

Social Opportunity
- Access to communication
- Access for finance
- Access to health care
- Opportunities in nutrition & health

Governance pillar

Corporate governance
- Board diversity
- Executive pay
- Ownership
- Accounting

Corporate behaviour
- Business ethics
- Anti-competitive practice
- Corruption & instability
- Financial system instability
- Tax transparency

The evolution of ESG

Framework, Principles & Standards

- Beyond Corporate Social Responsibility
- Responsible Business, Stakeholder Capitalism, Triple Bottom Line (Profits, People, Planet)
- Purpose of a Corporation – Business Roundtable

2015 Paris Agreement on Climate

Task Force on Climate Related Financial Disclosure （TCFD）

2030 Sustainable Development Goals

Global Reporting Initiative

Sustainability Accounting Standards Board

ISO / ISO26000

B Lab – B Corps
B Impact Assessment

Others…

United Nations Global Compact

United Nations Guiding Principles on Business & Human Rights

OECD Guidelines for Multinational Enterprises

UNEP-FI
PRB / PSI / UNPRI

GLASGOW CLIMATE CHANGE CONFERENCE 2021 (COP26)

Net zero pledges by 90% of the world economy

Glasgow Breakthrough Agenda

Over 40 leaders commit to work together to accelerate development and deployment of clean technologies and sustainable solutions needed to meet COP21 Paris Agreement goals.

Glasgow Financial Alliance for Net Zero (GFANZ)

Over 20 countries committed to halting all financing for fossil fuel developments overseas and diverting it to spending on green energy from next year (excludes existing projects and fossil fuel projects 'at home').

New pacts –

- *Glasgow Climate Pact – phase down coal and fo fuel subsidies*
- *Global Methane Pledge – slash methane emissi by 30% by 2020*
- *Glasgow Leaders' Declaration on Forest and La Use – pledge to halt and reverse forest loss and degradation by 2030*
- *Global Coal to Clean Power – commit to scale u clean power and ensuring just transition away f coal*
- *Zero Emissions Vehicle Pact – 100% of sales of cars and vans will be zero emission by 2040 (20 leading markets)*

Net-Zero Alliances – COP26

Glasgow Financial Alliance for Net Zero (GFANZ)

- Sector-wide strategic alliance and global coalition of leading financial institutions in the UN's Race to Zero committed to accelerating and mainstreaming de-carbonisation of the world economy and reaching net-zero emissions by 2050
- Commitment from over 450 financial firms across 45 countries responsible for assets of over $130 trillion (as of Nov 2021) to transform the economy for net zero
- Brings together leading net-zero initiatives from across the financial system
  - *Net-Zero Asset Owner Alliance (NZAOA)*
  - *Net Zero Asset Managers initiative (NZAM)*
  - *Paris Aligned Investment Initiative (PAII)*
  - *Net-Zero Banking Alliance (NZBA)*
  - *Net-Zero Insurance Alliance (NZIA)*
  - *Net Zero Financial Service Providers Alliance (NZFSPA)*
  - *Net Zero Investment Consultants Initiative (NZICI)*
- Members set science-aligned interim and long-term goals to reach net zero no later than 2050 in line with the criteria of the UN Race to Zero campaign

Taxonomies – COP26 update

International Platform for Sustainable Finance (IPSF) ***Common Ground Taxonomy*** – an analysis and comparison of EU Taxonomy & China Taxonomy with a view to alignment – published 4 November 2021 initial package including activity-by-activity mapping, technical screening criteria, for industry feedback

HKMA Chief Executive:
Hong Kong will adopt Common Ground Taxonomy

10 November 2021
ASEAN Taxonomy for Sustainable Finance *– Version 1*
Foundation Framework & Plus Standard
4 environmental objectives:

- climate change mitigation
- climate change adaptation
- protection of healthy ecosystem & biodiversity
- promote resource resilience and transition to circular economy

DNSH to other environmental objectives, remedial efforts to transition
Plus Standard on activity-level criteria to be further developed

Increasing needs and expectation for due diligence on taxonomy-alignment

Taxonomy as basis for financing – green loans, green bonds, sustainable financing, sustainable investments

Green or sustainable investment principles, taxonomy-aligned investments and development will be the future

Global alignment – aligning respective standards in issuer's market & investors' markets

Sustainability Reporting – COP26

3 November 2021, IFRS Foundation announces new International Sustainability Standards Board (ISSB) with a view to establishing
global baseline for
Sustainability (**Financial**) Disclosure Standards

Consolidating:
Climate Disclosure Standards Board
Value Reporting Foundation
(Integrated Reporting Framework &
Sustainability Accounting Standards Board (SASB))

Prototype disclosure requirements – along IASB, **TCFD** & WEF, supported by IOSCO

Intended for compatibility with EU CSRD and other jurisdictional requirements

Baseline to be available before end of 2022 – initially on Climate, subsequently other environment objectives and social considerations
"Hong Kong should be an early adopter. – Ashley Alder, SFC CEO"

Separately, consider:

Global Reporting Initiative –
Non-financial Sustainability Reporting
Universal Standards
- GRI 1: Foundation 2021
- GRI 2: General Disclosures 2021
- GRI 3: Material Topics 2021

First Sector Standard – GRI 11: Oil & Ga

DOUBLE MATERIALITY

IMPACT REPORTING
Integrating UNSDGs into GRI
GRI and B Lab's Business Impact Assessme

UN Sustainable Development Goals 2030

“”Decade of Action”

Source: UN SDG Website

Taxonomies for Sustainable Finance

Encourage capital and investments towards green and sustainable business activities

EC 2018 Action Plan: Financing Sustainable Growth

Renewed Sustainable Finance Strategy July 2021

"Green Assets" Green Loans / Green Bonds / Sustainability-linked Bonds

On balance sheet vs Off balance sheet

EU Taxonomy Regulation

Obligations to disclose the proportion of ***turnover*** derived from ***products or services associated with environmentally sustainable economic activities*** and the proportion of ***capex and opex expenditure*** related to ***assets or processes associated with environmentally sustainable economic activities***.

=> **Green Asset Ratio (GAR)** for Banks (Delegated Act, July 2021)

IPSF - Common Ground Taxonomy

China Green Bond Project Endorsed Catalogue (2015/2021)

China Green Industry Guiding Catologue (2019)

China Green Finance Performance Evaluation of Banks/Depository FIs (Effective July 2021)

– quantitative indicators on green finance – green loans and green bonds; qualitative assessment by regulator on banks' green finance policies and strategies, support for green industries

HKMA Common Assessment Framework on Green and Sustainable Banking

EU Sustainable Finance Disclosure Regulation – Investment Managers/Funds

Entity level vs product level

Entity level requirements - Managing & Reporting on Sustainability Risks

- *UCITS ManCos & AIFMs*
- *Requirements to assess and disclose sustainability risks under SFDR*
- *Group/Entity Sustainability Investment Policies and Strategies; Risk Management; Remuneration Policies*
- *Taxonomy-aligned sustainable investments*
- *Principal Adverse Impact (PAI) Statements – reporting on sustainability matters (2022 / 2023) – due diligence on adverse impact indicators*

Product Disclosures & Reporting

– Marketing an "ESG fund" or "green fund"?

"Light Green"
(SFDR Art 8 Funds)

"Dark Green"
(SFDR Art 9 Funds)

Methodology
Data source
Screening criteria

Sustainability & Impact

Net Zero Carbon Commitments

TCFD

Pre-Contractual & Periodic Disclosures

EU Sustainable Finance Regulation

Encourage capital and investments towards climate goals and sustainable business activities

Environmentally sustainable

under EU Taxonomy Regulation

To be environmentally sustainable according to the taxonomy, activities must:

- **contribute substantially** to at least one of the environmental objectives;
- "**do no significant harm**" to any of the other environmental objectives;
- be carried out in compliance with **minimum social and governance safeguards**; and
- comply with technical screening criteria to be adopted under the Regulation

Environmental objectives:

- climate change mitigation;
- climate change adaptation;
- water;
- circular economy;
- pollution control; and
- biodiversity

EU is also proposing to develop a Social Taxonomy

Tackling “S” Factors

Business & Human Rights

Under **EU NFRD / CSRD**, ***non-financial reporting*** *on environmental and social matters, employees, human rights, anti-corruption, bribery, board diversity, related policies, risks/risk management, KPIs*.

Growing consumer and investors’ expectations
Potential reputation risks, with potential financial risks

UN Guiding Principles on Business & Human Rights – human rights due diligence principles
OECD Guidelines for Responsible Business Conduct
Due Diligence in international supply chain

International Bill of Human Rights
ILO’s Declaration on Fundamental Principles and Rights at Work

“Businesses can affect the human rights of their employees, customers, workers in supply chains or communities around where they operate”

EU law on mandatory human rights due diligence

EU Whistleblowing Directive and other laws on whistleblowers protection

Tackling “S” Factors

Business & Human Rights

EU Human Rights Due Diligence Law
French Duty of Vigilance Act
German Supply Chain Due Diligence Act
Legal responsibility of EU companies for supply-chain under domestic law
Requires first level direct supplier by contract to comply with law
Supply chain obligations and monitoring down the chain of suppliers

Human Rights & Environmental Policies
Responsible Purchasing Code of Conduct
Supply Chain Contracts

- Human rights risks not just addressed by reps and warranties
- Require taking appropriate steps to identify and mitigate human rights risks
- Address adverse human rights impacts and remediation
- Responsibilities of the buyer and the supplier
- Supply chain governance and management framework
- Training and awareness of expected standards – throughout procurement process, employees and suppliers, also monitoring and reporting
- Potential rights of third party beneficiaries to enforce

Mainland China Policy initiatives* *not exhaustive

Signatory to 2015 Paris Agreement – Big push for Green Finance

Guiding Principles for Establishing the Green Financial System issued in 2016 by 7 regulatory agencies

People's Bank of China, one of the key founders of **Network for Greening Financial System (NGFS)**

Green Bond Endorsed Project Catalogue (2015)/(**2021** update); **Green Industry Catalogue** (2019)

Green Credit Performance Evaluation of Banking Depository Institutions (since 2018) – now expanded and updated to cover green loans and green bonds

Asset Management Association of China (AMAC) formally released in 2018: ***Research Report on ESG Evaluation System of China's Listed Companies and the Green Investment Guide***

Listed Companies' Corporate Governance Code published in September 2018: general obligation for listed companies to disclose environmental and social information; **Draft rules on disclosure requirements for listed companies on environmental and social responsibility** issued May 2021 for consultation

CBIRC Guiding Opinion (Dec 2019) to Banks/Insurance Companies: Green finance, "ESG and stakeholder interests in credit decisions"

Shenzhen Special Economic Zone Green Finance Regulations

National Carbon Emissions Trading Scheme (debut in July 2021) – Power generators and carbon intensive industries mandated to be included in the scheme in phases 2021 & 2022

Hong Kong's Initiatives and Climate Action Plan 2050

- *Cross-Agency Steering Group on Green & Sustainable Finance – HKMA, SFC, FSTB, Environment Bureau, Insurance Authority, MPFA*
- *Government pledged to achieve **carbon neutrality by 2050**, committing to **reduce total carbon emissions by half against 2005 level before 2035***
- *Medium-term targets in CAP 2050 include:*
  - ***Phase out coal** for electricity generation by 2035*
  - ***Replace coal with natural gas** and zero-carbon energy (renewable energy and nuclear energy) by 2035*
  - ***Increase share of renewable energy in fuel mix** for electricity generation from less than 1% to 10% by 2035*
  - ***Reduce the electricity consumption** of commercial buildings by 15% to 20%, and that of residential buildings by 10% to 15% by 2035*
  - ***Cease new registration of fuel-propelled and hybrid private cars** in 2035 or earlier and setting strategies and targets for providing charging facilities and developing new energy transport*
- *Imminent expiration of city-level Biodiversity Strategy and Action Plan (BSAP) 2016-2021 in support of Hong Kong's efforts on biodiversity conservation*

4 major de-carbonisation strategies and measures:

1. ***Net-zero electricity generation***
2. ***Energy saving and green buildings***
3. ***Green transport***
4. ***Waste reduction***

Hong Kong's Role in Carbon trading market?

- ***Integrating with Guangdong carbon market – a unified GBA market?***
- ***Carbon Connect?***
- ***International voluntary market?***
- ***SFC & HKEX Carbon Market Workstream – feasibility study expected by end 2021***

Hong Kong Monetary Authority “Green-ness Assessment” on AIs

Common Assessment Framework

	Key elements		Sub-elements
1	Governance	1	Board and senior management oversight
		2	Roles and responsibilities
2	Corporate planning and tools	3	Strategic plan
		4	Business plan
		5	Financial plan
		6	Scenario analysis
		7	Stress testing
3	Risk management process	8	Identification
		9	Measurement
		10	Monitoring
		11	Reporting
		12	Control and mitigation
4	Business policies, products and services	13	Lending
		14	Investment
5	Performance and resources	15	Indicators
		16	Targets
		17	Staff capacity
		18	Data collection and processing
6	Disclosure and communication	19	Disclosure
		20	Communication

- HKMA released industry consultation on the draft Supervisory Policy Manual GS-1 on climate risk management in July 2021
- Under the draft GS-1, proposed requirements are in relation to AIs’ governance, strategy, risk management and disclosure in building climate resilience.
- The board has primary responsibility for an AI’s climate resilience and the senior management is responsible for the proper functioning of the AI’s risk management framework and for driving necessary changes in addressing climate-related issues. The board should play an active role in overseeing the development and implementation of the AI’s climate strategy and is responsible for setting the AI’s overall risk appetite.
- Highlighted in the paper that the Banking Ordinance requires AIs to conduct their business with integrity, prudence and professional competence and in a manner that is not detrimental to the interests of depositors or potential depositors, and in this connection, the HKMA will take account of, among other things, AIs’ approach to managing climate-related financial risks and building climate resilience.
- AIs should embed climate considerations throughout the current strategy formulation process, from strategic assessment to action plan development. To conduct a comprehensive strategic assessment, the draft GS-1 suggests stakeholder engagement, to enable the AI to better understand the key concerns and expectations of various stakeholders (including regulators, the government, investors, depositors, clients, counterparties, industry associations, standard-setting bodies, suppliers, employees and the general public), and also to inform them about how the AI is positioning itself in light of climate-related risks and opportunities.

The Management and Disclosure of Climate-related Risks by Fund Managers

- In August 2021, the SFC issued the Consultation Conclusions on the Management and Disclosure of Climate-related Risks by Fund Managers (“Consultation Conclusions”).
- The Fund Manager Code of Conduct (“FMCC”) amended to require Fund Managers managing collective investment schemes (CIS) to take climate-related risks into consideration in their investment and risk management processes and make appropriate disclosures
- The **governance, investment management and risk management** requirements apply if the fund manager has **investment management discretion**
  → Requirements are applicable based on the relevance and materiality of climate-related risks
- The **disclosure** requirements only apply if the fund manager is responsible for **overall operation of the fund** (**ROOF**).
- A Circular was issued to set out the expected standards for complying with the amended FMCC, including:
  - **Baseline requirements** for all Fund Managers managing CIS
  - **Enhanced standards** for Large Fund Managers with CIS ≥ AUM HK$8 billion for any three months in previous reporting year
    → **Reporting on portfolio carbon footprint (Scope 1 & Scope 2) (Scope 3 if data available)**
- The SFC also published FAQs to provide guidance on the implementation of the requirements
- Scope: The requirements **only apply to managers managing CIS with investment discretion**
  - Discretionary account management is *out of scope*

Implementation timeline

Aug 2022

- LFM to comply with baseline requirements

Nov 2022

- Other fund managers to comply with baseline requirements
- LFM to comply with enhanced standards
- Disclosures relating to baseline requirements and enhanced standards

From Nov 2022

- If FYE after Nov 2022, LFM required to disclose portfolio carbon footprints calculated based on positions as of FYE
- Disclosure made no later than due date of funds' audited accounts or annual reports

ESG Investment Product Labelling

"

"Dark Green"
(SFDR Art 9 Funds)

funds with sustainable investment objectives

"Light Green"
(SFDR Art 8 Funds)

"promote environmental or social characteristics or a combination of those characteristics"

Hong Kong Retail "ESG Funds"

*"incorporate **ESG factors** as key investment focus and reflect such in the investment objective and/or strategy"*
(not just funds with "certain ESG features")

"ESG factors":
- Those aligned with one or more ESG criteria recognized globally or nationally
United Nations Global Compact Principles
United Nations Sustainable Development Goals
Common Principles for Climate Migration-Finance Tracking, Green Bond Principles, etc...
"any other ESG or sustainability criteria or principles or taxonomies"

Disclosure on ESG investment strategy and process

Hong Kong SFC requirements on authorized funds:

Description of ESG focus - list of ESG criteria used to measure the attainment of the ESG focus

Description of the ESG strategy(ies), the binding elements and significance of the strategy(ies) in the investment process

How such strategy(ies) are implemented in the investment process on a continuous basis

Summary of the process of considering ESG criteria (whether an exclusion policy is adopted by the ESG Fund)

Asset allocation – the expected or minimum proportion of securities or other investments of the ESG Fund (in terms of net asset value) that are commensurate with the ESG focus;

How ESG focus is measured and monitored through the lifecycle of the ESG Fund, methodologies adopted, engagement policies (if any), description of the sources and processing of ESG data, or applicable assumptions

Annual assessment and reporting

Harmonisation of Requirements?

Where UCITS funds meet SFDR disclosure and reporting requirements under Article 8 and 9 of the SFDR, such funds will be deemed to have generally complied with the disclosure and reporting requirements under the SFC 2021 ESG Circular

Responsible Investment

"Spectrum of investment strategy and impact intentionality"

Negative Screening / Exclusions

Best in Class

Thematic
(eg. clean energy, energy efficiency, water, agriculture, biodiversity)

Values Purpose Strategy

Impact Investing

ESG integration

Stewardship

Sustainable Investments

Future-proofing

Community investing / Social Finance

Note:
TCFD
Governance
Strategy
Risk Management
Metrics & Targets

Sustainability Journey

"No organization is alike"

Compliance / baseline requirements

Applying Due Diligence

Risk awareness / assessment

De-risking

Stakeholder Engagement

Values Purpose Strategy

Managing change and transition

Future-proofing

Investing in Impact

Serving community / Giving back

Note:
TCFD
Governance
Strategy
Risk Management
Metrics & Targets

ESG & Sustainability

Corporate ESG Reporting & Disclosures

"You will be measured whether you like it or not!"

Corporate Values, Purpose & Strategy

"Social Licence to Operate"

Mainstreaming of ESG Practice & Expectations – Global trends

Race to the Top?

Need for "decision-useful" information, concrete actions – especially urgent around climate

ESG Reporting Requirements for HK Listed Companies

Updated ESG Reporting Guide issued in late 2019 (July 2020)

Expanded "Comply or Explain" Disclosure Requirements

Expected disclosure on **(i) policy and (ii) compliance with relevant laws and regulations** on different environmental or social aspects that have a significant impact on the issuer

Reporting on the relevant laws and regulations in respect of an Aspect with significant impact, disclosure on the potential impact, disclose ways in which issuer has ensured compliance with such laws and regulations

Qualitative & Quantitative Disclosures

Materiality Assessment

Issuer assesses material ESG issues

Disclosure and reporting on material ESG Aspects

Reporting on Key Performance Indicators (KPIs)

For ESG Aspects considered to be not material to an issuer, disclosure on why

No further disclosure required

Governance - Board Engagement

Mandatory disclosure

- Board's ESG management approach and strategy, including the process used to evaluate, prioritise and manage material ESG-related issues (including risks to the issuer's businesses)
- How the board reviews progress made against ESG-related goals and targets with an explanation of how they relate to the issuer's businesses
- The process to identify and the criteria for the selection of material ESG factors
- If stakeholder engagement is conducted, a description of significant stakeholders identified, and the process and results of the issuer's stakeholder engagement.

Materiality

determined by board to be sufficiently important to investors and stakeholders

"Whether a particular ESG issue is material is a matter of judgment that depends on the facts involved, the circumstances of the specific issuer with reference to the views of its key stakeholders. The issuer's board is responsible for evaluating and determining the issuer's ESG-related risks and opportunities in the context of its business strategy.

Issuers should bear in mind that materiality can have different meanings for different stakeholder groups, and should disclose the board's involvement, the identification process and the criteria for the selection of material ESG factors in the ESG report."

ESG Reporting Requirements for HK Listed Companies

Environmental Aspects

Emissions

- Air pollutants
- Greenhouse gas emissions
- Hazardous waste
- Non-hazardous waste
- Emissions reduction
- Waste management

Use of Resources

- Efficient use of resources
- Energy consumption
- Renewable and non-renewable energy
- Water consumption
- Packaging materials

Environment & Natural Resources

- Impact on environment
- Environmental management system
- Use of natural resources
- Impact on biodiversity

Climate Change

- Identifying and mitigating climate-related issues with impact or potential impact
- Physical risks
- Transition risks
- **TCFD recommendations**

ESG Reporting Requirements for HK Listed Companies

Social Aspects – Employment related

Employment

- Compensation and dismissal
- Recruitment and promotion
- Equal opportunity & anti-discrimination
- Benefits and welfare
- Workforce gender, employment type, age and geography

Health & Safety

- Healthy and safe working conditions
- Protecting employees from occupational hazards
- Work injuries or fatalities
- Promoting physical and mental health of employees

Development & Training

- Improving employees' knowledge and skills for discharging duties
- Training statistics by gender and employee category – percentage and training hours

Labour Standards

- Avoiding child and forced labour
- Respect, protect and promote fundamental human rights
- Employment practices and measures to eliminate all forms of child or forced labour

ESG Reporting Requirements for HK Listed Companies

Social Aspects – Other Stakeholders

Supply Chain Management

- Disclosures on suppliers by geography
- Supply chain management strategy and practices
- Supply chain environmental and social risk assessment
- Green procurement

Product Responsibility

- Health & safety impact of products and services
- Labelling practices and quality assurance
- Consumer protection
- Consumer privacy and data
- Respect, protect and promote intellectual property rights

Anti-Corruption

- Anti-corruption policies
- Anti-bribery, extortion, fraud
- Anti-money-laundering
- Preventive measures and training
- Whistle-blowing procedures

Community Investment

- Community engagement to understand needs of communities where issuer operates
- Ensure activities take into consideration communities' interests
- Contributing to development of local communities

Review of Corporate Governance Code

Proposed amendments to the CGC

Corporate Values, Purpose & Strategy

Proposes to require an issuer's board to align the company's culture with its **purpose, value and strategy**:

"Establishing a company's overall purpose is crucial in supporting the correct behaviours. The strategy to achieve a company's purpose should reflect the company's values and culture… An effective board should set the tone and define the company's purpose and strategy"

"Corporate culture [should be] appropriate for the context in which the issuer is operating, alignment between its **purpose, values, strategy and business model(s)**"

Proposed disclosure requirement: "description of the vision, value and strategy of the company, alongside with the company's culture and how these affect the business model…. "

Review of the CGC and proposed amendments published in April 2021 for market consultation

Made explicit in the Review that the board should be responsible for governance of ESG matters to ensure oversight, as well as assessment and management of material environmental and social risks

Diversity

- Requires listed companies to adopt a diversity policy and to disclose this policy or a summary in its corporate governance reports
- Diversity not considered to be achieved for single gender boards
- Requires all listed companies to set and disclosure numerical targets and timelines for achieving gender diversity at both board level and across the workforce (including senior management)

HKEx’s analysis of IPO applicants’ corporate governance and ESG disclosure in 20/21

November 2021

***Compliance culture -** IPO applicants should instil strong corporate culture that fully adopts and prioritises compliance and governance measures of integrity, and embed the compliance culture into their everyday workflows.*

***ESG matters -** Most applicants made disclosures on environmental and social issues at IPO. Nonetheless, IPO applicants should conduct a thorough analysis and assessment to identify material ESG risks, and consider making appropriate disclosure on climate-related issues and initiatives to reduce carbon emissions, to facilitate the transition to a low-carbon economy. ESG risk management starts before listing, and it is important for IPO applicants to plan ahead to implement the necessary measures to ensure future compliance.*

***Board diversity -** Board gender diversity of new applicants has improved significantly, with the percentage of single gender board applicants dropping from 30 per cent in 2019 to 21 per cent in 2020, and down further to 12 per cent in the first half of 2021. IPO applicants are expected to not have single gender boards and should prioritise on achieving board gender diversity.*

Guidance to Listed Issuers on Climate Disclosures

- HKEx's ESG reporting requirements have incorporated certain key recommendations of TCFD and Green and Sustainable Finance Cross-Agency Steering Group has announced plans for mandatory TCFD-aligned climate-related disclosures by 2025.
- HKEx published ***Guidance on Climate Disclosures*** in November 2021
  - To help companies assess their response to risks arising from climate change
  - Provides practical tips and step-by-step guidance to assist issuers in preparing TCFD-aligned climate change reporting
- The way forward for HKEx:
  - Review ESG reporting framework to **further align with TCFD recommendations**
  - Collaborate with other regulators to work on a roadmap to evaluate and potentially adopt the new standard(s) to be developed by the International Sustainability Standards Board under the IFRS Foundation

Recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD)

Figure 2

Core Elements of Recommended Climate-Related Financial Disclosures

Governance
The organization's governance around climate-related risks and opportunities

Strategy
The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning

Risk Management
The processes used by the organization to identify, assess, and manage climate-related risks

Metrics and Targets
The metrics and targets used to assess and manage relevant climate-related risks and opportunities

Source: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017)

TCFD Recommendations

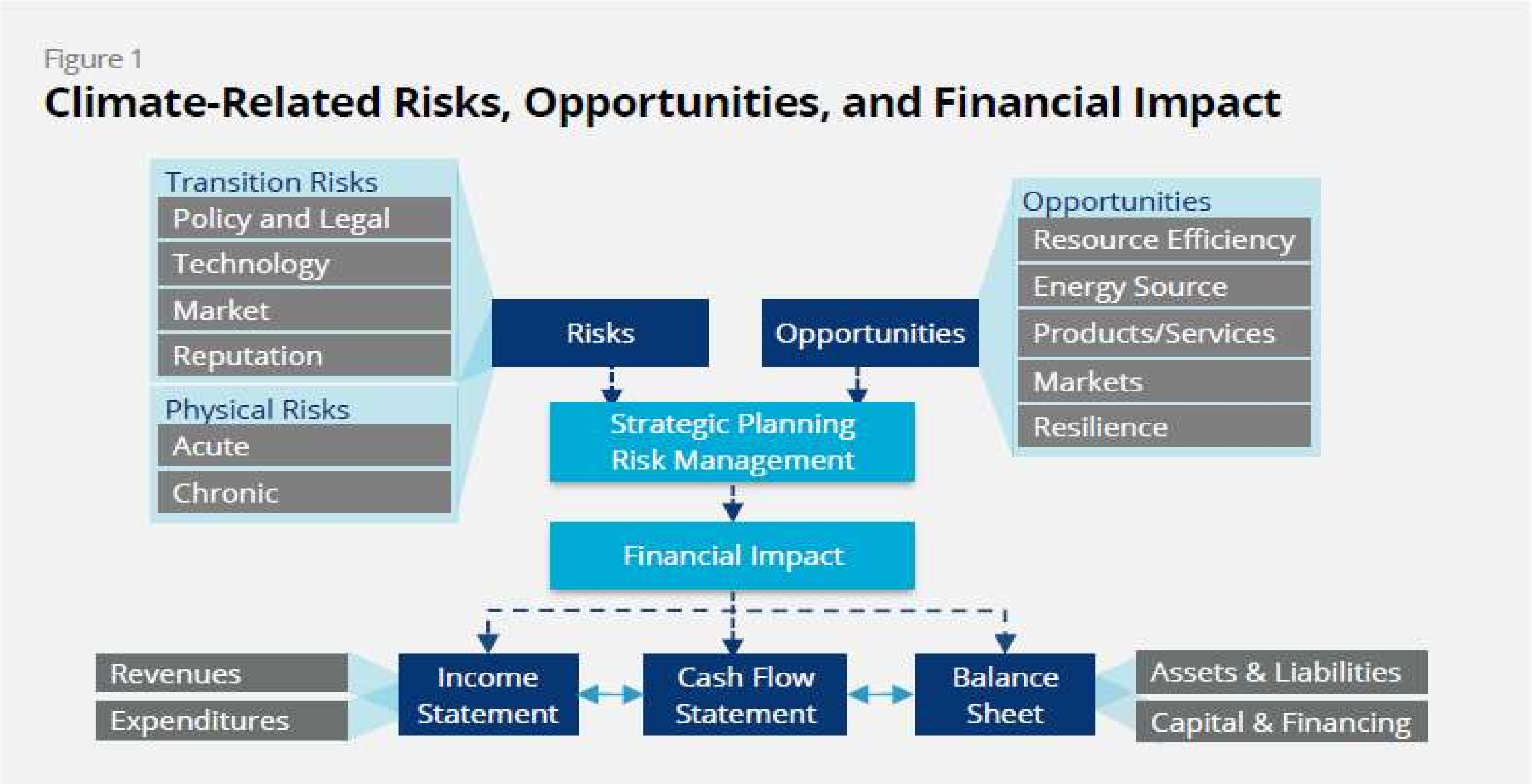
Figure 4

Recommendations and Supporting Recommended Disclosures

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures	**Recommended Disclosures**	**Recommended Disclosures**	**Recommended Disclosures**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

Source: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017)

Risks, Opportunities and Financial Impact



Source: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017)

Hong Kong Listed Companies – HKEX ESG Reporting Guide

Aspect 4: Climate Change	**General Disclosure** **Policies on identification and mitigation of significant climate-related issues which have impacted, and those which may impact, the issuer.**	
	KPI A4.1	Description of the significant climate-related issues which have impacted, and those which may impact, the issuer, and the actions taken to manage them.

HKEX ESG Reporting Guide - Emissions

A. Environmental	
Aspect A1: Emissions	General Disclosure Information on: (a) the policies; and (b) compliance with relevant laws and regulations that have a significant impact on the issuer relating to air and greenhouse gas emissions, discharges into water and land, and generation of hazardous and non-hazardous waste. *Note: Air emissions include No_x, So_x, and other pollutants regulated under national laws and regulations.* *Greenhouse gases include carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and Sulphur hexafluoride.* *Hazardous wastes are those defined by national regulations.*

HKEX ESG Reporting Guide - Emissions

A. Environmental		
Aspect A1: Emissions	KPI A1.1	The types of emissions and respective emissions data
	KPI A1.2	Direct (Scope 1) and energy indirect (Scope 2) greenhouse gas emissions (in tonnes) and, where appropriate, intensity (e.g. per unit of production volume, per facility)
	KPI A1.3	Total hazardous waste produced (in tonnes) and, where appropriate, intensity (e.g. per unit of production volume, per facility)
	KPI A1.4	Total non-hazardous waste produced (in tonnes) and, where appropriate, intensity (e.g. per unit of production volume, per facility)
	KPI A1.5	Description of emission target(s) set and steps taken to achieve them
	KPI A1.6	Description of how hazardous and non-hazardous wastes are handled, and a description of reduction target(s) set and steps taken to achieve them

Issuers are required to report on Scope 1 & Scope 2 emissions on a “comply or explain” basis, and encouraged to report on Scope 3 GHG emissions

DENTONS

BOX 1. Business goals served by GHG inventories

Managing GHG risks and identifying reduction opportunities
- Identifying risks associated with GHG constraints in the future
- Identifying cost effective reduction opportunities
- Setting GHG targets, measuring and reporting progress

Public reporting and participation in voluntary GHG programs
- Voluntary stakeholder reporting of GHG emissions and progress towards GHG targets
- Reporting to government and NGO reporting programs, including GHG registries
- Eco-labelling and GHG certification

Participating in mandatory reporting programs
- Participating in government reporting programs at the national, regional, or local level

Participating in GHG markets
- Supporting internal GHG trading programs
- Participating in external cap and trade allowance trading programs
- Calculating carbon/GHG taxes

Recognition for early voluntary action
- Providing information to support "baseline protection" and/or credit for early action

Scope 1
Direct emissions from owned or controlled sources

Scope 2
Indirect emissions from purchased electricity, heating and cooling

Scope 3
All indirect emissions in a company's value chain

The Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard

Guidelines to Account for and Report on Greenhouse Gas Emissions and Removals for Buildings (Commercial, Residential or Institutional Purposes) in Hong Kong

Why should an organisation measure its Scope 3 emissions?

There are a number of benefits associated with measuring Scope 3 emissions. For many companies, the majority of their greenhouse gas (GHG) emissions and cost reduction opportunities lie outside their own operations. By measuring Scope 3 emissions, organisations can:

- Assess where the emission hotspots are in their supply chain;
- Identify resource and energy risks in their supply chain;
- Identify which suppliers are leaders and which are laggards in terms of their sustainability performance;
- Identify energy efficiency and cost reduction opportunities in their supply chain;
- Engage suppliers and assist them to implement sustainability initiatives
- Improve the energy efficiency of their products
- Positively engage with employees to reduce emissions from business travel and employee commuting.

Carbon Trust

Disclosure of false or misleading information or misstatements

Securities & Futures Ordinance

***277.** Civil liability if the person knows that, or is reckless **or negligent** as to whether, the information is false or misleading as to a material fact or through the omission of a material fact…*

298. Offence of disclosure of false or misleading information inducing transactions

(1) A person shall not, in Hong Kong or elsewhere, disclose, circulate or disseminate, or authorize or be concerned in the disclosure, circulation or dissemination of, information that is likely—

(a) to induce another person to subscribe for securities, or deal in futures contracts, in Hong Kong;

(b) to induce the sale or purchase in Hong Kong of securities by another person; or

(c) to maintain, increase, reduce or stabilize the price of securities, or the price for dealings in futures contracts, in Hong Kong,

if—

(i) the information is false or misleading as to a material fact, or is false or misleading through the omission of a material fact; and

*(ii) the person **knows that, or is reckless as to whether**, the information is false or misleading as to a material fact, or is false or misleading through the omission of a material fact.*

303. Penalties

(1) A person who commits an offence under this Part is liable—

(a) on conviction on indictment to a fine of $10,000,000 and to imprisonment for 10 years; or

(b)on summary conviction to a fine of $1,000,000 and to imprisonment for 3 years.

CWUMPO

40A. Criminal liability for misstatements in prospectus

*(1) Where a prospectus issued after the commencement of the Companies (Amendment) Ordinance 1972 (78 of 1972) includes any untrue statements, any person who authorized the issue of the prospectus shall be liable to **imprisonment and a fine**, unless he proves either that the statement was immaterial or that he had reasonable grounds to believe and did up to the time of the issue of the prospectus believe that the statement was true.*

A person who commits an offence under subsection (1) is liable—

(a) on conviction on indictment to a fine of $700,000 and to imprisonment for 3 years; or

(b) on summary conviction to a fine of $150,000 and to imprisonment for 1 year.

(Section 40 imposes a civil liability to pay compensation for losses suffered by those who subscribed to shares or debentures after relying on untrue statements included in a prospectus.)

HK Green Finance Hub

Green Bonds / Loans, Social Bonds, Sustainability-Linked Bonds / Loans

Hong Kong Green Bonds Issuance

- May 2019 - Hong Kong government green bonds US$1 billion
- January 2021 – Hong Kong government green bonds US$2.5 billion
- Budget speech 2020-2021 – to raise ceiling to HK$200 billion (further HK$175.5 billion) in next 5 years

HKMA Green and Sustainable Finance Grant Scheme (from May 2021 for 3 years)

- subsidy on bond issuance expenses and external review services
- Eligible green bond or sustainable bond issuers and loan borrowers in Hong Kong

Green "Use of Proceeds" vs Sustainability Framework

Green Loan Principles by Asia Pacific Loan Market Association, Loan Market Association, Loan Syndications & Trading Association

Sustainability-Linked Loan Principles by Asia Pacific Loan Market Association, Loan Market Association, Loan Syndications & Trading Association

Climate Bonds Initiative - Climate Bonds Standard

ICMA Green Bond Principles, Social Bond Principles, Sustainability-linked Bond Principles, Sustainability Bond Guidelines

China Green Bond Endorsed Project Catalogue

China Green Industries Guidance Catalogue

Use of proceeds instruments vs. sustainability-linked instruments

Use of Proceeds bonds/loans

- Financial instruments with focus on the use of and management of proceeds under relevant international principles
- e.g. ICMA's Green Bond Principles require net bond proceeds to be dedicated to finance eligible projects that fit within the eligible categories under the Principles)

Sustainability-linked bonds/loans

- Typically for general corporate purposes
- Focus placed on issuer achieving certain predefined sustainability/ESG objectives within a predefined timeline

- Any type of bond instrument where the financial and/or structural characteristics can vary (e.g. coupon, maturity and repayment amount) depending on whether issuer achieves predefined sustainability/ESG objectives within predefined timeline.
- Issuer commits to improvements in its sustainability outcomes – may commit to KPIs reaching predetermined sustainability performance targets (SPT)
- ESG objectives are at issuer level (as opposed to project level)
- Sustainability-Linked Bond Principles:
    1. Selection of KPIs
    2. Calibration of SPTs
    3. Bond characteristics
    4. Reporting
    5. Verification

- Any type of bond instrument where proceeds are exclusively applied to finance (or re-finance), in part or in full, new and/or existing green projects and which are aligned with the Green Bond Principles.
- Green Bond Principles:
    1. Use of proceeds used for eligible Green Projects only which provide clear environmental benefits
    2. Process for project evaluation and selection
    3. Management of proceeds
    4. Reporting
- Key recommendations include devising a ***Green Bond Framework*** and to conduct external review

DENTONS

Why issue green bonds?	Gain access to additional source of capital market support
	Attract new growing class of investors
	Signal a corporation’s commitment to sustainability and climate-related goals
	‘Greenium’: pricing advantage compared to vanilla debt
Why issue sustainability-linked bonds?	More flexibility in use of proceeds
	Allows issuer to articulate their sustainability strategy while providing incentive to achieve ambitious and core KPIs and targets towards its sustainability goals
	Can be used by wide range of issuers and sectors, not necessarily capex-intensive or high emitting sectors

UN Sustainable Development Goals 2030

“”Decade of Action”

Source: UN SDG Website

Next Steps – Future Proofing your Organisation

- Identify your organization’s specific ESG challenges and opportunities
- Industry and peer benchmarking
- Develop governance framework, capacity and infrastructure for disclosing, tracking and reporting on ESG performance
- Applying TCFD, also consider TNFD (Taskforce on Nature-related Financial Disclosures)
- Supply chain management (climate risks & human rights due diligence)
- **Transition** pathways – consider for your industry, your organization & your supply chain – related risks & opportunities
- New technology & innovation for low-carbon and sustainable economic model
- Stakeholder engagement, investors diversification and financing opportunities
- Sectoral or cross-sectoral collaboration opportunities
- Staying updated on fast evolving ESG laws and regulations – global & regional
- Legal duties, responsibilities and risks in implementation
- Internal policies, compliance & training, ESG contractual terms

Conclusion

The ESG debate makes it clear that the way we do business is changing and it is going to continue to change significantly in the months and years ahead.

For some, ESG is a tactical step to attract new consumers. For others it is a defensive move to maintain the social licence to operate or compliance with evolving laws and regulations. Wherever your business sits on this spectrum, avoiding the pitfalls of over-promising requires a methodical approach to developing your position.

How Dentons supports its clients

Workshops

- Introducing the ESG agenda to Boards and teams
- Overview of the data/information you need to review
- Introduction to the legal risk exposure you need to manage
- Examining your stakeholder groups and their needs and expectations
- An overview of the key standards and frameworks and industry approaches for your sector
- Legal baseline – an overview of the key legal issues to examine from a regulatory perspective
- Linking executive compensation and employee codes of conduct and handbooks to ESG

Analysis

- Legal baseline review tailored to your organization and markets, including ESG Filter, Heat Map and ESG Framework
- Legal risk review of current ESG statements – verify or write disclosures, review prospectus for IPOs and other investor materials
- Future plans – risk screening, agility assessment and advice surrounding setting up and building governance structures
- The pros and cons of different accreditation and validation approaches for your organization
- Legal baseline – what regulatory exposures will you have across your business and markets?

Diligence Products

- Acquisition
- Financing
- Product Development

Response Products

- Incidents
- Changes of law
- Sanction response
- Litigation support

Intelligence

We have developed a number of global intelligence solutions including global trackers reviewing regulation on a country by country basis relating to:

Knowledge

Our legal teams across the world are producing legal alerts, articles and webinars. To access the latest news by country and theme, visit our Global ESG hub at **www.dentons.com**

Contractual / implementation

- Implementation of ESG into all stages of a deal
- Audit rights
- Remedies
- Implementation and ongoing audits
- Transforming plans to execution
- Employee code of conduct/handbooks/contracts

Questions?

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