Deloitte.

德勤

HKEX Climate Risk Reporting Proposals– Challenges and Opportunities

31 May 2023

Contents

Introduction

On 14 April the Hong Kong Stock Exchange (HKEX) released a Consultation Paper[1] which aims to substantially enhance reporting requirements related to climate risk and greenhouse gas emissions. The proposed new requirements cover specific disclosure requirements across the four areas of: governance, strategy, risk management, metrics & targets.

The proposed regulations will move climate risk reporting from a “comply and explain” approach into the realms of mandatory reporting. To make this clear, Appendix 27 of the Listing Rules is proposed to be renamed the “Environmental, Social and Governance Reporting Code” from the previous “Environmental, Social and Governance Reporting Guide”. The new guidance and consequential amendments to existing guidance is proposed to apply to financial years commencing on or after 1 January 2024 with certain requirements however not being required in the first two reporting periods as part of Interim Provisions. The proposed amendments would apply to both the Main Board Listing Rules and the GEM Listing Rules.

The Stock Exchange is aligning its new climate risk reporting requirements with the IFRS S2 Climate-related Disclosures standards set for a June release by the International Sustainability Standards Board (ISSB). The ISSB standards are set to become the international standard for sustainability reporting. They form part of a broad effort by the ISSB, which operates under the auspices of the International Financial Reporting Standards Foundation (IFRSF), to create a global baseline on ESG disclosure with the first priority assigned to climate risk.

In Hong Kong, regulatory bodies such as the Hong Kong Institute of Certified Public Accountants, the Hong Kong Monetary Authority and the Securities and Futures Commission have provided feedback to the ISSB on shaping the standards, as have the People’s Bank of China and the China Securities Regulatory Commission. In December 2022 China’s Ministry of Finance and the ISSB signed a MoU enabling ISSB to open a regional office in Beijing. Several regulatory officials in China have made it clear that common international sustainability reporting standards will be a positive step forward.

[1] Hong Kong Exchanges and Clearing Limited. Consultation Paper: Enhancement of Climate-related Disclosures Under the Environmental, Social and Governance Framework. April 2023.

New requirements on climate risk reporting

The most significant changes proposed under the Consultation Paper include:

- A new "Part D" of Appendix 27 of the Listing Rules will set out the detailed new disclosure requirements across the four core pillars used in the ISSB standards: governance; strategy; risk management; and metrics and targets.

- In respect of governance the disclosures cover the identity of board committees or board members responsible for oversight of climate related risks and opportunities, as well as a number of detailed requirements regarding frequency of those individuals/bodies being informed, how they ensure appropriate skills and competencies are available to oversee related strategies, consideration of the climate related risk and opportunities, oversight over setting and reviewing progress towards related targets as well a description of management's role in assessing and managing climate related risks.

- In respect of strategy the proposed disclosures cover climate related risk and opportunities, transition plans, climate resilience (including scenario analysis) as well as financial effects of climate related risks and opportunities both in terms of current financial effect and anticipated financial effect in future over short, medium and long term including quantification.

- In respect of risk management the proposed disclosures have detailed requirements regarding the process the issuer uses to identify and manage the climate related risks.

- With respect to metrics and targets reporting of scope 3 green house gas (GHG) emissions (defined as indirect emissions outside of scope 2 emissions that occur in the value chain of the issuer, including both upstream and downstream emissions) will be required in addition to scope 1 and 2 emissions; specific disclosures in respect of transition risks, physical risks, climate related opportunities, capital deployment, internal carbon prices and remuneration are also required.

Interim Provisions provide more time to prepare hard-to-get numbers

The HKEX accepts that some issuers will face initial difficulties in responding to these more rigorous reporting requirements in certain areas:

- Data availability, especially for assessing scope 3 emissions;
- Absence of standardized methodologies for scenario analysis and financial impact quantification; and
- A lack of internal and external technical knowledge and expertise.

Acknowledging specific challenges issuers may face, the HKEX is setting “Interim Provisions” for the first two years of an entity’s reporting (Interim Period) during which issuers can report as follows:

- With respect to current financial effect of climate related risks and opportunities issuers who have yet to provide quantitative information (in terms of effect on financial position, financial performance and cash flows for the most recent reporting period) should provide qualitative disclosures.

- With respect to anticipated financial effect of climate related risks and opportunities issuers who have yet to provide the required disclosure should provide information, to the extent reasonably available, that may enable investors to understand the aspects of the financial statements that are most affected.

- Issuers who have yet to disclose all information in relation to scope 3 emissions should disclose information, to the extent reasonably available, that may enable investors to understand the issuers’ relevant upstream or downstream activities.

- With respect to the required disclosures on transition risks, physical risks, climate related opportunities, capital deployment issuers who have yet to provide the quantitative disclosures required should instead provide specific descriptive disclosures.

However in each case except for the current financial effect of climate related risks and opportunities, the HKEX is also proposing that issuers disclose the workplan, progress and timetable for making the required disclosure.

A full description of the proposed new mandatory requirements and the Interim Provisions can be found in Part D of the proposals for Amendments to Appendix 27 of the Listing Rules within the Consultation Paper.

Comparison to ISSB S2 Exposure Draft and subsequent ISSB decisions

Appendix III of the Consultation Paper contains a table which compares in detail the proposed requirements of Part D of Appendix 27 of the Listing Rules with the equivalent requirements of the ISSB Climate Standard Exposure Draft along with HKEX commentary on the degree of alignment. This shows a high degree of alignment between the two. However it should be noted that the ISSB has made decisions in Board meetings after issuance of the ED to make certain changes to the proposals in the ED in response to feedback received in addition to agreeing on an effective date of periods beginning on or after 1 January 2024 (this being aligned with the proposed effective date of the new requirements in the Consultation Paper). The most prominent change agreed by the ISSB with respect to climate risk disclosure was to make available in the first annual reporting period in which an entity applies the requirements:

- relief from the requirement to measure Scope 1, Scope 2 and Scope 3 GHG emissions in accordance with the Greenhouse Gas Protocol if the entity uses a different measurement basis in the annual reporting period immediately preceding its initial application of the climate risk disclosure standard; and
- relief from the requirement to disclose Scope 3 GHG emissions.

In light of this if the ISSB were to issue the final standard on this basis and if the HKEX were to proceed with changes to the Listing Rules as proposed in the Consultation Paper this would mean that HKEX reporters would have an additional one year (as compared to the ISSB requirements) of relief from reporting scope 3 emissions along with two years of relief from certain other reporting requirements (as detailed above) during the Interim Period where the ISSB decided not to give equivalent relief.

Also, the HKEX does not mandate certain ISSB requirements at this stage, including but not limited to (i) providing options for issuers to disclose the actual and potential effects of any climate-related opportunities they may have identified, (ii) not requiring a description on how the target compares with those created in latest international agreements and whether it has been validated by a third party or was derived using a sectoral decarbonization approach, (iii) encouraging but not mandating issuers to consider the industry-based disclosure requirements, maintain an internal carbon price and disclose the percentage of remuneration linked to climate-related consideration.

Differences to European proposals

The HKEX existing and proposed reporting standards follow the ISSB sustainability standards in a focus on investor-facing sustainability information with material impact on value.

European sustainability reporting standards, however, go further. In addition to investor-facing information reporting the financial impact of climate change on the enterprise, the European Corporate Sustainability Reporting Directive (CSRD) also requires reporting on the impact of the enterprise on the environment, on society and on the overall economy – a concept known as 'double materiality'.

It will be important to know from the regulatory bodies in the Green and Sustainable Finance Cross-Agency Steering Group – which includes among its members the HKEX , the Hong Kong Monetary Authority, the Securities and Futures Commission as well as the Environment and Ecology Bureau – whether members believe requiring business and finance to report on the principle of double materiality would benefit Hong Kong's ambition to become a green finance hub, Hong Kong's achievement of its carbon neutral targets, as well as national ambition to build an ecological society.

Targets

The Consultation Document does not stipulate any targets for greenhouse gas emissions reductions in line with scientific assessments or international agreements. It does however require disclosure of any climate-related targets an issuer has itself set as well as any GHG emission targets it is required to meet by local legislation.

Assurance

Despite requiring a good deal more quantitative detail on climate risk the Consultation Paper has nothing new to say with regard to assurance. The document retains the previous Appendix 27 statement that issuers “may seek independent assurance to strengthen the credibility of the ESG information disclosed” in which case, details of the level, scope and process should be given.

Meeting the challenge of our times

Deloitte's report "Work Towards Net Zero: The rise of the green collar workforce in a just transition"[2] makes it clear that the journey to a net zero economy is full of opportunities. The Deloitte Economics Institute calculates that a well-managed transformation could increase the size of the world economy by US$43 trillion between 2021 and 2070.[3] Unmitigated climate change, on the other hand, would cost the global economy US$173 trillion. With climate strategies that apply the principle of a just transition, Deloitte believes some 300 million green collar jobs can be created as we move to a net zero future.

The HKEX's proposed reporting code on climate risk and opportunities raises the bar for issuers at a time when international and national leaders are signaling the urgent need for positive action. The proposed new rules enable Hong Kong to substantially align with international standards in the area of sustainability reporting which will certainly benefit Hong Kong's status as a global centre for green finance.

The proposed requirements would help companies identify high-carbon aspects of their business and identify targets for lowering their emissions in a more comprehensive manner. This will enable Hong Kong's listed companies to play a vital part in achieving the targets for carbon neutrality set by the governments of China and Hong Kong.

[2] Deloitte Global. 2022. Work Towards Net Zero: The rise of the green collar workforce in a just transition. November 2022.
[3] Deloitte Global. 2022. The Turning Point: A Global Summary. May 2022.

HKEX timetable & next steps

The consultation period will run until 14 July 2023. The HKEX is publishing this consultation paper ahead of the finalisation of the ISSB Standards because issuers, in order to provide meaningful responses to proposals in this paper, may need more time to review their internal systems and coordinate among different divisions to identify information gaps and assess their readiness in complying with the proposed climate-related disclosures. This will also give issuers more time to get familiar with the concepts and climate-related reporting requirements. The consultation period of 3 months is therefore envisaged so respondents will have (i) the opportunity to consider the final ISSB Climate Standard expected to be published by ISSB by mid-2023; and (ii) more time for internal coordination and assessment of the proposals in this paper.

The HKEX will take into account the final version of the ISSB standards in finalizing these Listing Rules, but the proposed requirements are slated to come into effect on 1 January 2024 and apply to ESG reports in respect of the financial years commencing on or after that effective date.

The Interim Provisions as outlined above will end after two years per the proposals, and full compliance would therefore be expected for reporting periods beginning on or after 1 January 2026 so that the first fully compliant reports with all aspects of the new Listing Rules would be produced in 2027. The Consultation Paper states that it is important that issuers should start reviewing their internal procedures and put in place any measures necessary for complying with the enhanced requirements. IPO applicants are expected to disclose material ESG risks and information in their prospectuses under existing requirements, and have mechanisms in place that enable them to meet the Exchange's ESG requirements upon listing. The HKEX therefore notes in the document that IPO applicants should therefore be mindful of the new climate-related disclosure requirements and commence necessary preparatory work to ensure compliance after listing once the proposed requirements take effect.

To assist issuers in understanding and complying with the new requirements the HKEX states in the Consultation Paper that they will issue Implementation Guidance together with the consultation conclusions to:

a) set out principles, guidelines and illustrative examples for the implementation of the new Rules;

b) refer issuers to external frameworks, tools and guidelines helpful for disclosures; and

c) set out a glossary of technical terms/acronyms commonly used in international ESG reporting frameworks (such as the ISSB Climate Standard).

Going forward, they plan to continue to monitor issuers' compliance and provide further guidance or training as appropriate. Issuers are also encouraged to visit the HKEX's ESG educational platform, ESG Academy, for guidance materials, e-learning, webinars and other resources to explore the trends that define the future of ESG and to develop a roadmap to integrate ESG considerations into their business strategies.

Need for action by listed entities

The HKEX's proposed new requirements are both an opportunity and a challenge for reporters. Tackling climate change and material sustainability issues will deliver significant economic benefits, but this cannot be realized without significant re-allocation of capital and new investment. Rigorous climate risk disclosures as proposed by the HKEX (modelled on the ISSB's proposals) would provide more consistent and comparable information to better facilitate this shift and future investment. It also provides reporting entities the opportunity to explain to investors (focused on assessing value) how considerations regarding climate related risks and opportunities are integrated into existing governance and risk management mechanisms as well as capital allocation decisions.

However, providing the required disclosures will require a commensurate investment in systems, processes and appropriate expertise needed for better and more timely access to climate risk data with an appropriate level of confidence in its reliability built on an appropriate internal control environment. The investment of time and management focus and the need for external assistance and advice necessary for an entity to reach the position of being ready to report in line with the proposed requirements should not be underestimated. This is especially the case with regard to the particularly challenging requirements with regard to areas such as reporting the current and anticipated financial effects of climate-related risks and opportunities, scenario analysis and GHG emissions.

Therefore, entities listed on the HKEX or preparing for such listing should begin now implementation efforts in anticipation of the proposed effective date of the new disclosures regime for periods beginning on or after 1 January 2024. Whilst the HKEX will need a period of time after the closing date of the consultation period (14 July 2023) to release the resulting changes to the Listing Rules, given the tight timeline and the high likelihood that final requirements will substantively reflect the proposals (given these are themselves aligned with final decisions taken by the ISSB on its S2 requirements) entities will benefit from starting the process of preparation early.

We believe organisations should focus on investing in four priorities:

Diagnose

- Review the draft HKEX proposals
- Evaluate these against their current approach to ESG reporting and in particular climate risk reporting
- Identify key gaps and implications for systems, personnel and processes
- Seek advice from Deloitte professionals on areas of complexity in HKEX proposals (e.g. scenario analysis, reporting of financial effects, GHG emissions)

Assess

- Connect key business functions to gather necessary data to draft disclosures
- Consider implications of disclosures and how these can be integrated into future decision making processes and covered by effective internal control process
- Review the resources required and make any required changes
- Consider the need to use Deloitte tools such as GreenLight, a suite of digital solutions related to accurate measurement and reporting of a company's GHG emissions, along with tools to enable development of meaningful targets for emissions reduction

Plan

- Develop a plan to operationalise capture, measurement, review and reporting of disclosures
- Build a roadmap to support implementation of the new reporting approach
- Consider if strategic plans and roadmaps for broader climate mitigation and adaption action need to be updated as part of the disclosure process
- Plan for engagement of appropriate external expertise to help with implementation or assurance over the reported information

Communication

- Support the C-Suite, Audit Committee and Board to understand the implications of the proposed requirements
- Consider how key stakeholders are kept informed of new information and developments from reviewing, preparing and disclosing against the HKEX proposed reporting requirements and how this can support better strategic decision making and risk review

Contacts

Allan Xie
Partner, Sustainability & Climate Leader
Deloitte China
Email: allxie@deloitte.com.cn
Tel : +86 10 8520 7313

Mohit Grover
Partner, Sustainability & Climate Leader
Deloitte Hong Kong
Email : moitgrover@deloitte.com.hk
Tel: +852 2852 5606

Francesco Nagari
Partner, Sustainability & Climate – FSI
Deloitte Hong Kong
Email: frnagari@deloitte.com.hk
Tel : +852 9763 7910

Martin Hu
Partner, Sustainability & Climate
Deloitte China
Email: mhu@deloitte.com.cn
Tel: +86 10 8520 7138

Melissa Fung
Partner, Sustainability & Climate
Deloitte Hong Kong
Email: melfung@deloitte.com.hk
Tel: +852 2852 5815

Richard Yeung
Partner, Sustainability & Climate – FSI
Deloitte Hong Kong
Email : ryeung@deloitte.com.hk
Tel: +852 2852 5893

Tina Song
Partner, Sustainability & Climate – FSI
Deloitte China
Email: tinasong@deloitte.com.cn
Tel: +86 10 8512 4490

Eric Luk
Director, Sustainability & Climate
Deloitte Hong Kong
Email: eluk@deloitte.com.hk
Tel: +852 2109 5299

John Sayer
Executive Director, Deloitte
CarbonCare Asia
Deloitte Hong Kong
Email: josayer@deloitte.com.hk
Tel : +852 2852 1066

About Deloitte
Deloitte China provides integrated professional services, with our long-term commitment to be a leading contributor to China's reform, opening-up and economic development. We are a globally connected firm with deep roots locally, owned by our partners in China. With over 20,000 professionals across 30 Chinese cities, we provide our clients with a one-stop shop offering world-leading audit & assurance, consulting, financial advisory, risk advisory, tax and business advisory services.

We serve with integrity, uphold quality and strive to innovate. With our professional excellence, insight across industries, and intelligent technology solutions, we help clients and partners from many sectors seize opportunities, tackle challenges and attain world-class, high-quality development goals.

The Deloitte brand originated in 1845, and its name in Chinese (德勤) denotes integrity, diligence and excellence. Deloitte's professional network of member firms now spans more than 150 countries and territories. Through our mission to make an impact that matters, we help reinforce public trust in capital markets, enable clients to transform and thrive, empower talents to be future-ready, and lead the way toward a stronger economy, a more equitable society and a sustainable world.