

The future of climate reporting

A deep dive into first global sustainability reporting standards and the Hong Kong bourse's proposal

By CFA Institute and CFA Society Hong Kong



The International Sustainability Standards Board (ISSB) issued its inaugural global sustainability disclosure standards on June 26, aimed at meeting investors' information needs and demand for a harmonised reporting framework. The IFRS S1 and S2 serve as a global baseline on climate-related disclosure.

Following the issuance of the exposure draft of the standards, the Hong Kong stock exchange proposed to upgrade Appendix 27 of its environmental, social and governance reporting guide. It will become effective on January 1, 2024. Interim provisions will last for two reporting years.

Elsewhere in Asia Pacific, Singapore upped the ante by advancing climate-related disclosures to align with the ISSB starting from the financial year 2025. This timeline evokes a sense of urgency and accountability.

The CFA Institute and CFA Society Hong Kong jointly responded to the Hong Kong Exchanges and Clearing's (HKEX) consultation paper on enhancing disclosure rules under its ESG framework.

The proposed move will give Hong Kong the opportunity to be an early adopter and adapter of ISSB-aligned disclosures. It marks a milestone in the realm of climate reporting.

For investors, the ESG reporting code will improve their understanding of how to integrate climate-related risks and opportunities into their investment decisions. On the issuer side, adherence to the code strengthens their resilience and adaptation capabilities, which are essential for businesses to remain competitive in the face of climate change.

Balanced approach

The HKEX has adopted a market-focused

approach coupled with standard-setter thinking and technical methodology, considering the maturity and ESG literacy of issuers and the bourse's own long-standing practice. This allows flexibility for issuers in more challenging areas, such as climate-related targets, industry-based metrics, and alternative disclosure during interim periods.

Meanwhile, issuers are subject to a higher level of reporting obligation based on the G-20's Task Force on Climate-related Financial Disclosures (TCFD), enhanced from 'comply or explain' to a mandatory regime. With that, the HKEX has localised ISSB in certain areas to incorporate locally-relevant nuances.

The proposed requirements

Below is a summary of the proposed climate-related disclosure requirements across the four pillars of the TCFD.

• Governance

Current: Board's oversight and governance on ESG issues, management approach, and strategies.

Proposed: Governance process, controls, and procedures used to monitor and manage climate-related risks and opportunities.

The proposed disclosures will better communicate the issuer's oversight and control of climate-related issues. An added benefit is that issuers will be encouraged to develop a robust corporate governance framework, including the extent of the board's and management's involvement, skills and competency, accountability, and remuneration policy. Here, we suggest issuers disclose the identity of the designated key individual or chairman of the committee responsible for climate-related matters.

• Strategy

Current: Significant climate-related issues, management policies and strategies.

Proposed: Material climate-related risks and opportunities, transition plans, setting of targets, climate resilience strategy, scenario analysis, financial impacts (current and anticipated).

The concept of 'materiality' is emphasised here when issuers are required to disclose material climate-related issues and their corresponding impacts. Materiality can be interpreted in different ways, such as financial materiality, double materiality or dynamic materiality.

We seek to clarify the definition of materiality in the ESG code. As an investor organisation, we have long advocated for quality and science-based information reporting and assessment of climate resilience based on scenario analysis commensurate with an issuer's circumstances.

• Risk management

Current: Processes of evaluating, prioritising and managing material ESG related issues and their effectiveness.

Proposed: Process to identify, assess and manage climate-related risks and opportunities, and integration with overall risk management framework.

We are happy to see a more comprehensive list of disclosure requirements, in particular the basis for risk prioritisation, and the interaction between climate and the overall risk management framework.

Meanwhile, the HKEX itself may also need to demonstrate the proportionality of the requirements and the need to prioritise climate-related risks over other types of risks.

• Metrics and targets

Current: Environmental key performance indicators such as Scope 1 and 2 greenhouse gas emissions, on a 'comply or explain' basis.

Proposed: Scope 1, 2 and 3 emissions with cross-industry metrics on physical and transition risks, climate-related opportunities, and capital deployment. Other metrics include linkage to internal carbon price, remuneration, and industry-based metrics (optional).

Carbon footprint, especially Scope 3 emissions, will be an effective metric to convey the transition risk faced by an issuer. The location of information also matters as it will determine the subsequent level of assurance.

The CFA Institute and CFA Society Hong Kong appreciate taxonomy-based and quantifiable metrics as comparability is the lifeblood of investment analysis. We also appreciate the higher transparency on an issuer's mitigation and adaptation responses, i.e., capital deployment, linkage to remuneration and internal carbon price.

A proportionate approach

The proposed enhancement of Appendix 27 of the listing rules has made Hong Kong an early mover in climate reporting. The quality and relevance of the disclosures, however, will be highly dependent on the issuers' oversight. The TCFD's own study of the application of its guidance also suggested weak compliance.

With the HKEX's enhanced requirements, this will naturally improve given the liability concerns that should be commensurate with the evolving nature of climate-related disclosure. However, to be decision-useful, the compliance

element of the proposal will require persistent monitoring from HKEX and relevant authorities.

As a step forward or as an interim measure, we also suggest that the HKEX leverage the existing financial reporting mechanism and regulatory framework to require issuers to disclose material climate-related risks and opportunities and related material information contained in the ESG report in their audited financial statements. This can impose a healthy level of assurance for the quality of relevant disclosures and enhance stakeholder confidence.

It is vital to balance climate ambitions with practicality. More guidance and clarification on details will help secure buy-in from a range of stakeholders. In particular, a proportionate approach to climate disclosure with differentiated requirements is needed for issuers in the GEM market, who are facing proportionality challenges.

Long journey ahead

The CFA Institute and CFA Society Hong Kong support disclosures based on the ISSB and TCFD global baselines. IFRS S1 and S2 are important frameworks going in parallel for multi-period and multi-jurisdictional efforts towards improving the quality of climate-related disclosures. Therefore, we encourage the HKEX to place priority on aligning with IFRS S1, following the integration of S2 into Appendix 27 of the listing rules.

We also advocate for the HKEX to continue its efforts in broader engagement and assist issuers with capacity building. Apart from engaging with issuers to raise awareness and collect their feedback on implementation leanings, investor engagement is also important given that they are the audience for the reports and users of the proposed code with respect to stewardship.

Lastly, we encourage the HKEX to continue offering capacity-building support, transitional relief and incentives for upskilling on climate-related matters, while connecting with other markets in the region to participate in the global conversation and transition journey.