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Interpretation of "Consultation Conclusions: Enhancement of Climate-related Disclosures under the Environmental, Social and Governance Framework"

On 14 April 2023, the Stock Exchange of Hong Kong Limited (the "**Exchange**") published a Consultation Paper on amending its ESG reporting framework, and published the corresponding Consultation Conclusion on 19 April 2024, setting out the new ESG Code and the New Climate Requirements. While the disclosure requirements as stated in Part A to Part C of the ESG Code do not have significant changes as compared to the currently effective requirements, the newly incorporated Part D: New Climate Requirements aligns more closely with International Financial Reporting Standards S2 ("**IFRS S2**"), which will be effective starting from 2025 reporting year in phases.

Key dates

	Disclosure of scope 1 and scope 2 GHG emissions	Other disclosures
LargeCap Issuers[1]	**Mandatory disclosure starting FY2025**[2]	❖ Disclose under "**Comply or explain**" provision starting FY2025 ❖ Mandatory disclosure starting FY2026[3]
Main Board Issuers[4]		Disclose under "**Comply or explain**" provision starting FY2025
GEM Issuers		**Voluntary disclosure** starting FY2025

*** GEM issuers shall continue to make climate-related disclosures pursuant to Aspect A4: Climate change of Part C of the ESG Code on a "comply or explain" basis.*

Implementation reliefs

To address concerns over the reporting challenges that some issuers may face, the Exchange has provided the following implementation reliefs:

Reasonable Information Relief	Allow disclosure based on "**reasonable and supportable** information that is available at the reporting date **without undue cost or effort**"
Capabilities Relief	Allow to use an approach "that is informed by or **commensurate with their available skills, capabilities and resources** at a particular point in time in preparing disclosures on **climate-related scenario analysis and anticipated financial effects**"
Commercial Sensitivity Relief	When "information about the climate-related opportunity is **not already publicly available**, disclosure of such information could **seriously prejudice the economic benefits**, and it is **not possible** to disclose such information in a manner that **meet disclosure disclosure objectives without prejudicing the economic benefits**", allow not to disclosure such information but "disclose the fact that it has used the exemption" and "reassess, at each reporting date, whether the information qualifies for the exemption"
Financial Effects Relief	When "the financial effects are **not separately identifiable**, or the **level of uncertainty** involved in estimating those effects **is so high** that the resulting quantitative information would not be useful", allow to use **qualitative** information as alternative disclosure

Where the company opted to "explain" why it has not made a particular disclosure under the "comply or explain" regime, or chosen to apply an implementation relief, it is encouraged to provide information on the **work plan, progress and timetable** for making the required disclosure.

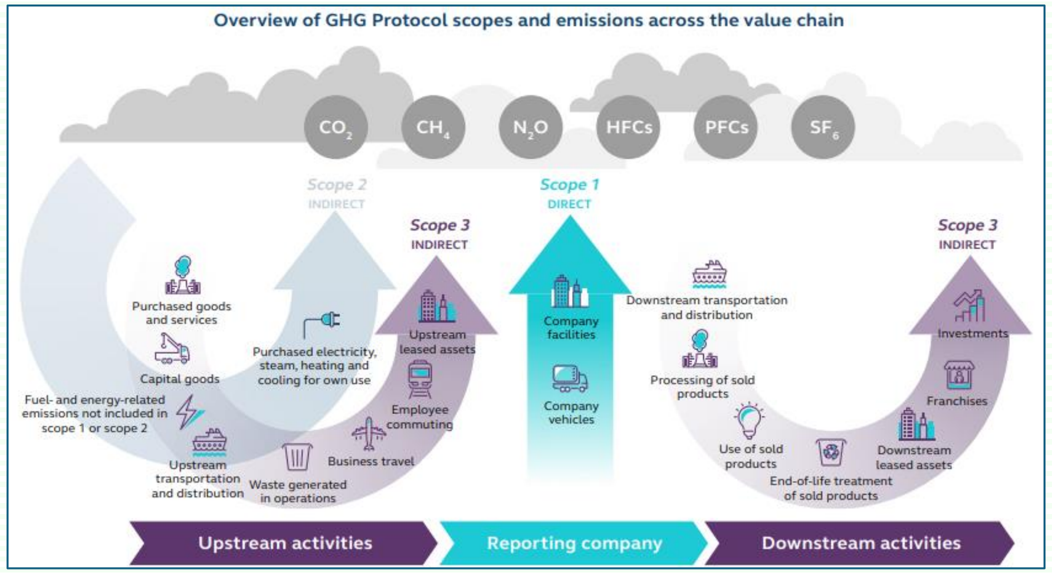
[1] Issuers that are Hang Seng Composite LargeCap Index ("**HSCLI**") constituents: https://www.hsi.com.hk/eng/indexes/all-indexes/sizeindexes (Issuer must continue to disclose information according to the New Climate Requirements even if it subsequently ceases to be a HSCLI constituent)
[2] Financial years commencing on or after 1 January 2025
[3] Financial years commencing on or after 1 January 2026
[4] Excluding LargeCap Issuers

Key concepts

Materiality	Value chain
❖ The "materiality" reporting principle of the ESG Code will **continue** to underpin the ESG Code (including Part A to Part C) disclosure requirement ❖ For the Part D: New Climate Requirements of the ESG Code, "materiality" is determined when the Board **reasonably expects**[5] that its cash flows, its access to finance or cost of capital over the short, medium or long term is going to be affected *** Understanding the concept of "materiality" is going to help companies to identify the required information to be disclosed, allocating resources appropriately*	❖ Describes the **chain of business activities** required to create a product or service ❖ The full range of interactions, resources and relationships related to the **company's business model and the external environment** *** Understanding its own value chain is going to facilitate the company to identify and manage hotspots of climate-related risks and opportunities, as well as guiding the subsequent accounting of Scope 3 GHG emissions*

Key note 1 – GHG emissions (Scope 3)

Unless otherwise required, the Exchange requires all issuers to measure it GHG emissions in accordance with the Greenhouse Gas Protocol[6]. In addition to Scope 1 and Scope 2 emissions which are familiarised by most of the companies, Scope 3 accounting is more complicated as it requires consideration of emissions arose from all 15 categories of up-stream and down-stream activities across the whole value chain.



After determining the boundary and the identified Scope 3 categories and activities that are going to be included in the inventory, companies should measure Scope 3 emissions through the collection of primary data or secondary data (e.g. from market research), thereby preparing disclosures.

- When there is a large number of suppliers, companies should target the most relevant suppliers, such as suppliers that contribute to most of the annual spending; suppliers that have the most significant anticipated emissions impact
- When suppliers lack experience and the quality of data is in doubt, companies should request activity data for reasonableness checking and consider providing training or follow-up
- When suppliers' reporting period is different from that of the companies, as long as the length of the reporting periods is the same, companies can use the most recent data available from these suppliers

[5] Whether omitting, misstating or obscuring that information could reasonably be expected to influence the information decisions of the primary users of the report
[6] Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (2004) and Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard (2011)

Key note 2 – Climate resilience & climate scenario analysis

The ESG Code requires issuers to assess their resilience to climate-related risks and opportunities using **climate-related scenario analysis**, and disclose information about the inputs used.

Scope and boundaries determination	▪ Prioritise the previously identified material climate-related risks and opportunities ▪ Consider business nature, geography and data availability
Scenario selection	▪ Select scenarios with high contrast to provide diversity in pathways and outcomes ▪ Selected scenarios, variables and other parameters should have a reasonable and supportable basis
Scenario analysis	▪ Consider the company's exposure to climate-related risks and opportunities ▪ Consider the skills, capabilities and resources available to the company

Quantitative or qualitative analysis?

Conducting a climate-related scenario analysis is often a long journey for companies. Companies may **start with qualitative scenario narratives** to gain experience, and start using quantitative information to illustrate potential pathways and outcomes, as well as conducting **quantitative modelling** or simulations of climate-related risks over time. In the absence of robust quantitative information, qualitative information, either alone or combined with other quantitative assumptions, can also provide a **reasonable and supportable basis** for an issuer's resilience assessment.

Key note 3 – Financial impact

The Exchange requires issuers to disclose qualitative and quantitative information about the effects of climate-related risks and opportunities on their **financial position, financial performance and cash flows**, so as to support stakeholders in making more informed investment decisions.

Financial position and cash flows	Financial performance and cash flows
○ Current and committed investment plans ○ Planned sources of funding to implement climate strategy ○ Costs arising from physical damage to assets from climate events	○ Impact on revenue from products and services aligned with a lower-carbon economy ○ Impact on operating costs associated with climate adaptation or mitigation

Current financial effects: Companies should account for climate-related matters in the financial statements[7]. Where the relevant quantitative information is not expressed as a line item in the financial statements, companies shall explain how such information is reflected in its financial statements.

Anticipated financial effects: Given their strategy to manage climate-related risks and opportunities, companies should disclose the potential scope and scale of anticipated financial effect, and planned sources of funding to implement the relevant strategies.

*** Even though companies may choose to adopt the Implementation reliefs, they shall still 1) explain why they have not provided quantitative information; 2) identify line items, totals and subtotals within the related financial statements that are likely to be affected; 3) provide other quantitative information about the combined financial effects.*

[7] Issuers should accounted for the relevant matters in accordance with the requirements under HKFRS, IFRS, CASBE or the alternative overseas financial reporting standard acceptable to the Exchange

Key note 4 –Refresh or re-assess

Although the New Climate Requirements are a part of the annual ESG Reporting disclosure, some specific items do not require re-implementation for every reporting year or on every reporting day.

	Unless:
Climate-related risks and opportunities	○ A significant change in the value chain ○ A significant change in the business model, business activities or corporate structure ○ A significant change in the exposure to climate-related risks and opportunities
The scope of Scope 3 categories	
Climate-related scenario analysis	○ A significant change in business model ○ A discrepancy in previous assessment and current situation ○ Previous assumption is no longer valid

Our insights

- ➢ Since the newly included Part D: New Climate Requirements is more complicated than the previously effective ESG Guide, to ensure compliance, companies are advised to allocate a larger budget to ESG-related aspects and allow ample time for preparation. It is crucial for management to recognise that climate and ESG disclosure is increasingly becoming as important as financial disclosure in the capital market. The complexity and professional requirements of ESG and climate disclosure should not be underestimated.
- ➢ While comprehensive disclosure may not be mandatory for every company, it is recommended to identify any gaps between the new regulations and current practices as early as possible. Choosing to comply with the relevant regulations early on will enhance the company's reputation as committed and transparent.
- ➢ Companies are encouraged to deepen their understanding of their business models and value chains at the earliest opportunity. This will facilitate the identification of the hotspots of climate risks and opportunities, as well as the development, measurement, and disclosure of Scope 3 GHG emissions inventories.
- ➢ Given the necessity of quantifying the climate-related impacts to assess future resilience, companies should consider investing in more effective data collection and calculation tools.
- ➢ To effectively identify, manage, and respond to the potential impacts of climate change throughout the entire enterprise, it is recommended that companies establish an effective climate management framework and procedures as soon as possible. This integration of climate management into business and financial planning will aid in formulating a detailed climate action plan and related targets.

GreenCo's recommendations for follow up actions

- ✓ Conduct internal training
- ✓ The management assigns a dedicated working group to handle the disclosure preparation process. If there is a shortage of manpower, it is recommended to consider hiring additional consultants to assist until internal resources can be allocated effectively. Companies should understand that, given the complexity of the comprehensive disclosure, relying on a single individual to complete this task is extremely challenging
- ✓ Establish relevant disclosure policies and frameworks
- ✓ Develop calculation analysis archives and models, including financial models
- ✓ Prepare the first climate disclosure report

For more information, please refer to the Consultation Conclusion and the relevant document published by the Hong Kong Stock Exchange: https://www.hkex.com.hk/News/Regulatory-Announcements/2024/240419news?sc_lang=en