

# Nov/Dec 19 Legal and Regulatory Update

## Top stories

### ESG: HKEX consultation conclusions; reports review; investor trends

(i) **HKEX published consultation conclusions on “Review of ESG Reporting Guide and related Listing Rules”**. (Click: [Press release](#); [full report](#); [Listing Rule amendments](#))

It is important to note that the proposals focus on **the board’s governance and roles**, beyond “technical reporting”. They are broadly the same as the original proposals, but will become effective for **financial years commencing on or after 1 July 2020** (instead of Jan).

Key areas that may involve further work include the **board’s roles in specified areas**; target-setting for **“environmental” KPIs**; **“social” KPIs**; and **“climate change”** disclosure.

While the actual reporting will be done at a later stage, companies need to set up their **governance structure, refine relevant policies/systems/processes as soon as possible**, enabling the eventual reporting process.

We must not lose sight of the board’s general roles in ESG, under **current requirements** (e.g. in **risk management**). ([HKEX updated FAQs series 17 and 18](#): summary in our [May 19 legal update](#)).

### *What you should know:*

#### Summary of changes

- **Mandatory disclosure of board statement on ESG**
  - **Board oversight** of ESG issues
  - Board’s ESG management approach and strategy; process used **to evaluate, prioritise and manage ESG issues** (including risks)
  - **Board review of progress** made against **ESG targets**; how they relate to the **business**
- **New mandatory disclosure, to explain**
  - **“Reporting principles”**: e.g. **“materiality”**; how are material ESG factors selected?
  - **“Reporting boundary”**: process used to identify entities
- **“Environmental” KPIs revised**
  - E.g. disclosure on **targets**, and **action steps**

- (New “Aspect” added) “**climate change**” disclosure
  - **Significant climate-related issues that have impacted/may impact issuer**
  - **Mitigation actions**
- “**Social**”
  - **KPIs** upgraded to “**comply or explain**”
  - (New) **supply chain management KPIs**
  - (New) **anti-corruption KPI** (training to directors and staff)
- **Shortened timeframe for ESG reporting**
  - Within **5** (*not 4 as originally proposed*) months of year-end
- **No printed form of ESG reports**
  - Where separate ESG report
  - Save per shareholder special request
- **Encourage independence assurance**

*What you should do:*

**Your first action steps include**

- Management to perform a **gap analysis**
- Organize **board training**, re: rule changes, impact on the company, and investor trends generally (*see (iii) below: SFC’s asset managers survey*)
- Review **governance structure**: whether help of board committee needed (e.g. for review of targets)
- Review **investor feedback** on ESG

HKEX will provide further guidance and FAQs on implementation.

(ii) **HKEX** also published a **report** on its **review of issuers’ ESG reporting** (Click: [press release](#), [full report](#)). There are noteworthy HKEX observations, for preparing your next report.

*What you should to know/do:*

In line with the consultation conclusions, HKEX highlighted:

- The need for **board-level engagement**

- Significance of undertaking a “**materiality assessment**”

In addition, the followings are noteworthy:

- **Every “comply or explain” provision must be addressed:** some have omitted to explain, where some provisions are inapplicable to their circumstances
  - Non-compliance without giving considered reasons is **a breach of the Listing Rule**
- **Properly determined whether to “comply” or “explain”?**
  - Some companies chose to “comply” with provisions which do not appear to be relevant to their industries

**(iii) SFC published its Survey on Integrating Environmental, Social and Governance (ESG) Factors and Climate Risks in Asset Management.** (Click: [Press release](#); [full report](#))

This is a useful survey on investor trends regarding ESG. **A strong interest in ESG among asset management firms** surveyed is noted. The findings, summarized below, are **useful for your ESG board training.**

### *What you should to know:*

#### **Summary of key findings**

- A **strong interest** in ESG matters noted, among **firms currently active in asset management** surveyed
  - **(83%) considered at least one ESG factor** when evaluating a company’s investment potential
  - **68%** (of the above sub-group) saw ESG factors as a source of **financial risk**
  - Only **35% consistently integrated**, instead of on ad hoc basis, ESG factors in investment/ risk management
- But **64%** of firms **currently active in asset management** surveyed **plan to strengthen ESG practices** in the next two years
- Management of **climate risks** – SFC will promote this including by developing standards and providing practical guidance

## Also in this issue

### Regulators

(i) **HKEX issued a new semi-annual [Listed Issuer Regulation Newsletter](#).**

This issue addresses HKEX efforts in combatting “shell companies”, and observations on the new de-listing regime. These do not fall in our focus areas.

However, it also contains useful **guidance on disclosure of counterparties and their beneficial owners**.

(Effective Oct 19) amended Listing Rules require disclosure of identity of counterparties in “notifiable transactions”.

**In addition**, HKEX would “**highly encourage**” disclosure of the identity of the **beneficial owners**, particularly where the counterparties are **investment holding vehicles**. This is because information in companies’ documents must be **meaningful, accurate and complete** in all material respects.

HKEX also reminds issuers of **other new disclosure** requirements in **annual reports**.

#### *What you should to know/do:*

- **Examples: should disclose beneficial owners**
  - Continuing relationships with counterparties (e.g. joint venture partners)
  - Subscribers of securities, who would hold a material interest in the listed issuer
- **Reminder: new disclosure in annual reports**
  - Where **securities investment** represents **5%** or above of a company’s total assets
  - Outcome of a **performance guarantee** of an acquisition target
  - Detailed summary of rule changes: items 15-20, Appendix 1, [HKEX Consultation Conclusions on backdoor listing, continuing listing criteria and other rule amendments](#)

(ii) **SFC issued a statement reminding listed issuers** as to **disclosure** obligations, focusing on information about **counterparties and**, (where appropriate) their controllers or **beneficial owners**. (Click: [Press release](#), [full statement](#))

The underlying principle is to ensure investors have the necessary information to make an **informed assessment** of the issuer's activities.

In particular, SFC is concerned as to the use of **special purpose vehicles** to conceal identities as part of wider schemes to engage in market misconduct.

In parallel, it also issued a circular to asset managers on the expected conduct, in the context of dubious arrangements.

These echo **recurring regulator concerns** in this area (including HKEX, addressed above).

SFC gave **useful examples** where the identity of beneficial owners should be disclosed.

*What you should to know/do:*

**Examples: beneficial owners should be disclosed**

- **Acquisitions/disposals; capital injection in targets; joint ventures**
- Identity of **borrower**
  - company is lending money of a material amount
- Identity of **allottees**
  - company issuing shares/convertible bonds
- Information on **grantees of share options**
  - NOT generic disclosure as “eligible grantees”
- Use of **private fund structures**
  - No commercial rationale

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