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ESG UPDATES
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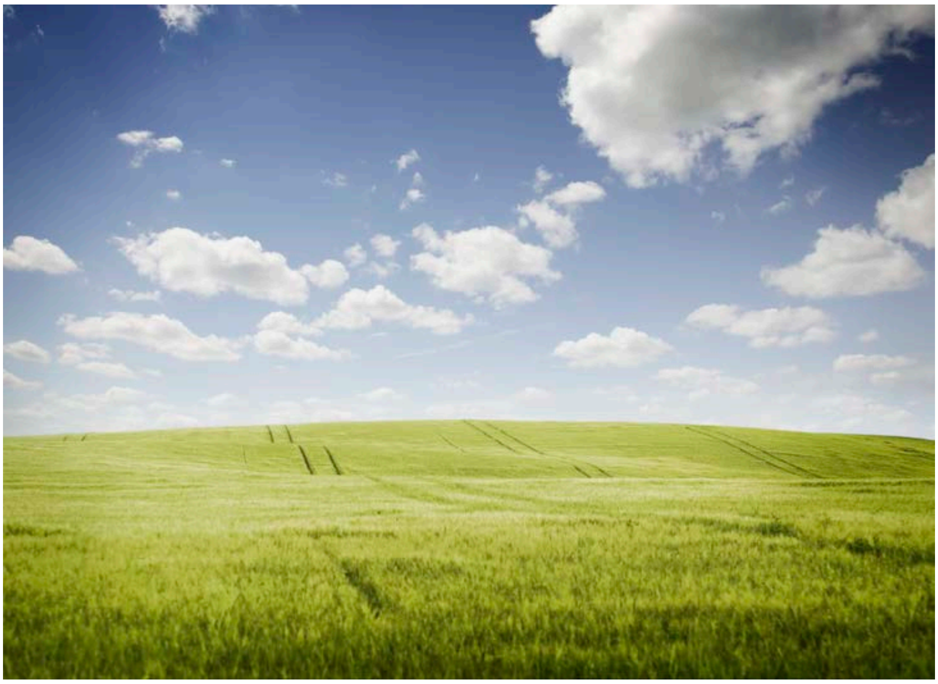

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To achieve corporate sustainability and generate long-term benefits, the integration of environmental, social and governance (ESG) factors into one company's business strategies, management and operation are the key to success. In every monthly issue of our 'ESG Updates', it will include the latest updates from various aspects in ESG.

ESG equity index futures: Meeting the increasing needs for ESG investment

On 12 April 2021, the Hong Kong Exchanges and Clearing Limited (HKEx) published a research paper titled 'ESG equity index futures: Meeting the increasing needs for ESG investment' highlighting the significance of ESG indices in ESG investment, and sharing its implications for Hong Kong.

As the investors become increasingly conscious about long-term sustainable development, ESG investment is on the rise in the global market. Following the global trend of ESG investment, the potential demand for product innovation of ESG investment in Hong Kong, such as ESG equity indices and ETFs, is expected to increase. This will be further motivated by the strong institutional support from the public and private sectors. ESG equity investment, facilitated by the development of related ESG indices, is a good starting point to drive further growth. In Hong Kong, the ESG versions of Hang Seng Index (HSI), Hang Seng Chinese Enterprises Index (HSCEI) and a few ESG indices tracking Hong Kong-listed stocks have been developed in this home market where there is a deep and liquid market in the underlying stocks.

In addition to serving the home market, Hong Kong as an international capital market also serves global investors in managing their regional and global investment portfolios, as well as Mainland investors in their global asset allocation. As ESG investment continues to grow in Hong Kong, ESG risk management tools, including ESG index futures, should be launched to meet investors' needs. The potential launch of futures and other derivatives on local, regional or global ESG indices, in particular with stocks in the Mainland and Hong Kong markets, is expected to serve the purpose.

The development of ESG products, including indices and related derivatives such as futures and options, contributes to the formation of an ESG investment ecosystem in Hong Kong. This would facilitate the further growth of green and sustainable finance and ESG investment in the Hong Kong market and the world.

The thematic insight HKEx concluded on the implications learned from global experience for the development of ESG finance and investment in Hong Kong includes:

- Starting with ESG equity investment - The integration of ESG criteria into investment analyses has been more developed for equity investment in the global market. Compared to the bond market, the Hong Kong listed equity market has very active participation from local and overseas retail and institutional investors, and would therefore provide a good nursing ground for ESG investment.
- ESG indices would be good investment vehicles – These will provide ESG investment benchmarks and facilitate the development of index-tracking ESG products.
- Exploring suitable ESG equity indices – Home-market ESG equity indices on parent indices with actively traded underlying securities and related index products such as ETFs would expectedly be appealing to investors. As Hong Kong is an international capital market, popular regional and global ESG equity indices should also be explored.
- The availability of related risk management tools is important – As the ecosystem of ESG investment products progressively develops in Hong Kong, related risk management tools need to be made available to meet the needs of issuers and investors for hedging and portfolio management.

Companies should get ready to explore appropriate approaches to enable them to stick with the global trend of ESG investment, and stay effective and efficient in the light of evolving risks. If you are interested to explore more, please do not hesitate to contact BDO Risk Advisory for further assistance.

Read more from the source:
https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2021/CCEO_ESGIdxFutures_202104_e.pdf?la=en

Harvest launches a Hong Kong-listed China sustainable ETF

Harvest Global Investments has launched an exchange traded fund in Hong Kong targeting demand from global institutional investors for sustainable Chinese investments.

The Harvest CSI 300 ESG Leaders Index ETF was launched on the HKEx on 10 March 2021. The ETF tracks the index the fund house has developed that incorporates 100 A-share companies it rates highest in terms of compliance to ESG standards.

The scoring system gives an equal weighting of 33% to the three factors that comprise ESG and uses 110 data points covering 'green revenues', environmental penalties, human resources management and employee benefits, as well as executive pay and accounting governance.

The issuer is reportedly using artificial intelligence to extract data from other channels to assess local news updates on nearly 90% of the A-shares and primarily look for controversial news.

Upon the product launch, the issuer would primarily target institutional investors, including those from the Asia-Pacific region, Europe and the US, and would try to demonstrate that ESG investing can generate alpha in China, amid China's pledge to focus on sustainable growth in the upcoming five-year plan and its commitment to creating a carbon-neutral economy by 2030.

Read more from the source:
https://www.ft.com/content/25b941c1-6343-4421-9844-06652ae07227

China collaborates with the EU on green investment standards

Yi Gang, the governor of the People's Bank of China (PBoC), said at the China Development Forum in March 2021 that the primary goal of the central bank over the next five years was to implement and standardise a green finance system in the country in co-ordination with global partners in order to fulfil the national goals of having domestic carbon emissions peak before 2030 and turning carbon neutral by 2060.

To attain those goals, the head of PBoC said China was working with the EU to push for greater convergence of taxonomies of green finance and investments across the two markets, aiming to implement a jointly recognised classification system for the environmental credentials for businesses by the end of 2021.

The China's commitment to co-operation on establishing universal approaches to green investment came just days after the EU's Sustainable Finance Disclosure Regulation came into force on 10 March 2021 for fund houses operating or selling products in Europe. The SFDR rules require asset managers to disclose any negative environmental and social impacts of their investments, and categorise their products accordingly, but many asset managers in Asia have been left unsure over the extent to which they need to comply.

The EU's long-term goal is to be carbon neutral by 2050, in line with commitments under the Paris Agreement on climate action. Within the ESG universe, a framework for environmentally focused investment standards is likely to be one area where Chinese and European authorities are most easily able to find common ground to help advance a mutual cause.

The China-EU initiatives, however, is not the first instance of China's cooperation with global partners. In 2018, a China-UK pilot scheme to encourage climate and environmental information disclosure was mutually launched by PBoC and the Bank of England.

Read more from the source:
https://www.ft.com/content/cddd464f-9a37-41a0-8f35-62d98fa0cca0

Proposed new EU rules on sustainability reporting and assurance: what's covered?

As widely anticipated, the European Commission (EC) has presented comprehensive legal proposals paving the way towards enhanced sustainability disclosures for a large swathe of companies operating in Europe. It comes at the same time as growing global attention to sustainability reporting in the run-up to COP26.

EU rules have required large entities to include a non-financial statement as part of their annual reporting obligations since 2018. Responding to growing demands for enhanced non-financial information from multiple quarters – and following a large stakeholder consultation – EC has now adopted far-reaching legislative proposals to review its existing Non-Financial Reporting Directive (NFRD) and improve the flow, comparability and reliability of sustainability information.

The proposed Corporate Sustainability Reporting Directive (CSRD) seeks to mandate sustainability reporting and assurance by amending several EU laws, including the Accounting Directive, Transparency Directive, and Audit Directive. As EC puts it, the ultimate aim is over time to 'bring sustainability reporting on a par with financial reporting'.

Extended scope

The proposals significantly enhance the scope of the existing NFRD rules to cover all large undertakings as well as all those listed on EU regulated markets, with the exception of micro-entities. This includes EU subsidiaries of non-EU undertakings and any non-EU entity with transferable securities listed on a regulated market in the EU. An exemption is foreseen for those companies within groups where the parent complies with the legislation. Listed SMEs would also be granted an additional three-year phasing-in period to comply with the new requirements.

EC estimates that this would increase the number of entities required to make sustainability disclosures from around 11,600 to approximately 49,000, at an estimated price tag of €1.2bn in one-off costs and €3.6bn in annual recurring costs – although the increased standardisation may deliver €1.2bn to €2bn savings per year by eliminated other information demands on preparers.

New disclosure requirements

The CRSD sets out in far greater detail the information that entities should report, covering their whole value chain, compared to the NFRD. To be specific, EC proposes that the mandatory disclosures should provide descriptions of:

- Business model and strategy, including plans and implementation
- Sustainability targets, and progress towards achieving them
- Role of the boards
- Policies in relation to sustainability factors
- Due diligence processes for own operations and supply chain
- Principal risks and dependencies
- Indicators relevant for measuring the above
- Intangibles, including intellectual, human, social and relationship capital
- Process carried out to identify the information disclosed.

Such disclosures should be qualitative as well as quantitative, providing both forward-looking and retrospective information according to short, medium and long-term horizons, as appropriate.

While retaining the existing ‘double-materiality’ approach, the proposals seek to remove any ambiguities about the fact that entities should report information necessary to understand how sustainability factors impact them – as well as the information needed to understand their impact on society and the environment.

The legislative proposals provide for sustainability information to be published as part of the management report in a digital, machine-readable format. This will require eventual sustainability standards to be accompanied by a digital taxonomy to enable information to be tagged.

Towards European sustainability reporting standards

As widely anticipated, the proposals introduce mandated EU sustainability standards, to be prepared by the European Financial Reporting Advisory Group (EFRAG) and adopted via secondary legislation. The standards should be based on the recommendations recently made by the EFRAG Task Force on Non-Financial Reporting Standards, with a first set of standards due for adoption by 31 October 2022, followed by a second set a year later. A three-year review process is suggested.

Information required by the standards must be understandable, relevant, a faithful representation, verifiable and comparable. Three key subject matters are proposed:

- Environmental factors, including climate change mitigation, climate change adaptation, water and marine resources, resource use and circular economy, pollution, biodiversity and ecosystems.
- Social factors, including equal opportunities and access to the labour market, working conditions and human rights.
- Governance factors, including the role of management and board, business ethics and corporate culture, political engagements, relationships with business partners, internal control and risk management systems.

The development of such standards should take account of existing sustainability reporting and accounting standards and frameworks, as well as internationally recognised principles on responsible business conduct, CSR and sustainable development. Insofar as possible, the development of standards should be based on constructive, two-way cooperation with leading international initiatives.

A voluntary approach towards SMEs

While SMEs not listed on EU regulated markets are exempt from the requirements of the draft legal rules, the Commission proposes the development by October 2023 of proportionate standards for SMEs to use on a voluntary basis. It is thought that such standards, which could also be used by listed SMEs within the scope of the proposals, would enable SMEs to respond in a cost-efficient way to the requests for information received from other entities including those in their supply chain as well as banks and insurers. In a kind of ‘one-stop-shop’, this would also set a reference for other entities on the information that they could reasonably expect to ask of SMEs.

Mandatory sustainability assurance

A key pillar of the proposals is a new limited assurance requirement, to evolve towards reasonable assurance once capacity has been built up. Assurance engagements would be based on standards adopted by the Commission by delegated acts, although EU countries could apply national assurance standards if no equivalent standard has been adopted by the Commission.

The assurance should cover the period of the report, the sustainability reporting framework and standards used, the scope of assurance and the sustainability assurance standards applied. The opinion should be published together with the annual financial statements and management report.

While EU countries are given the option to accredit independent assurance service providers, there is an acknowledgement that the service is most likely to be provided by the audit profession. To enable this to happen, changes to EU audit rules are proposed to ensure that statutory auditors have the necessary level of relevant theoretical knowledge both via the examination of professional competence and ongoing professional development.

Additional changes address rules relating to the organisation of the auditors' work, fees, independence requirements, quality assurance, investigations, oversight, appointment of the auditor, role of the audit committee and registration of third-country auditors.

The draft legal text also sets out to update existing provisions relating to the collective responsibility of the administrative, management and supervisory bodies to ensure alignment with the new sustainability reporting requirements.

When to roll out?

If a final legislative text is adopted in the first half of 2022, and a first set of standards adopted by the end of 2022, the new requirements would start to apply in part for reports published in 2024, covering the financial year 2023. Full disclosures would be required from January 2026.

Read more from the source:
https://www.icaew.com/insights/viewpoints-on-the-news/2021/april-2021/proposed-new-eu-rules-on-sustainability-reporting-and-assurance-whats-covered

How can BDO help?

At BDO, our Risk Advisory Services (RAS) team, a group of dedicated professionals trained in ESG reporting requirements, GRI Standard and ISO-14064, have knowledge about carbon audit and experienced in providing all the assistance required to meet your needs in ESG practice. Please do not hesitate to contact us and talk to our consultants. We are pleased to provide further insight or assistance, if needed.

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