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HKSE New Climate Disclosure Requirements – Changes to the HK Listing Rules

Last Friday, the Hong Kong Stock Exchange (***HKSE***) published consultation conclusions:

- to bring in new climate-related disclosure requirements (***New Climate Requirements***) to enhance climate-related disclosures under its environmental, social and governance (***ESG***) framework;
- to align more closely with the **IFRS S2**; and
- to take into account Hong Kong Government's **vision** and approach towards developing a comprehensive ecosystem for sustainability disclosure in Hong Kong.

HKSE has received broad based market support to enhance listed issuers' climate-related disclosure and the New Climate Requirements will become effective from the 2025 reporting year in phases. HKSE will be among the world's first exchanges to enhance climate related disclosures requirements based on IFRS S2.

ISSB Standards

Published by the International Sustainability Standards Board and currently comprise:

IFRS S1 – General Requirements for Disclosure of Sustainability-related Financial Information (*June 2023*); and

IFRS S2 – Climate-related Disclosures (*June 2023*).

"Fully acknowledging the importance of sustainability disclosure, we **aim to be among the first jurisdictions to align the local sustainability disclosure requirements with the ISSB Standards**" – **Vision Statement** by the Hong Kong Financial Services and the Treasury Bureau on 25 March 2024

1. What are the New Climate Requirements?

A new Part D will be introduced to Appendix C2 to the Hong Kong Listing Rules setting out the environmental, social and governance reporting guide which will be changed to environmental, social and governance reporting code (***ESG Code***).

This Part D of the ESG Code sets out disclosure requirements for climate-related risks and opportunities to which issuers are exposed under four core pillars, namely governance, strategy, risk management and metrics and targets.

All Hong Kong listed issuers will be divided into:

(i) **LargeCap issuers**, defined as Hang Seng Composite LargeCap Index (***HSCLI***) constituents throughout the year immediately prior to the relevant reporting year. This means if your company is in the HSCLI throughout 2025, you will be a LargeCap issuer for the purpose of the New Climate Requirements and your first reporting under the new Part D will appear from 2026 onwards. The new rules are clear that once a LargeCap issuer, you must continue to disclose information according to the New Climate Requirements even if you subsequently ceases to be an HSCLI constituent;

(ii) **Main Board issuers other than LargeCap issuers**; and

(iii) **GEM issuers**.

Different categories of listed issuers will be subject to start reporting on the New Climate Requirements at different times, with a phased-in approach and different degree of compliance requirements i.e. mandatory, "comply or explain" or voluntary.

2. Let's start with scopes 1, 2 and 3 GHG emissions

Scope 1 and scope 2 GHG emissions disclosure will be **mandatory for ALL listed issuers** in Hong Kong (i.e. both Main Board and GEM listed issuers) in respect of financial years commencing on or after **1 January 2025**. Issuers are required to:

(i) use the Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (2004), unless required by a jurisdictional authority or an exchange on which the entity is listed to use a different method, to mirror the wording of IFRS S2;

(ii) disclose the measurement approach, inputs and assumptions used to measure GHG emissions; and

(iii) in disclosing scope 2 GHG emissions, use the location-based method and provide information about any contractual instruments that is necessary to enable an understanding of their scope 2 GHG emissions.

Scope 3 GHG emissions disclosure will be **mandatory for LargeCap issuers** in respect of financial years commencing on or after **1 January 2026**, subject to the following:

(i) reasonable information relief will be available – this means that an issuer is required to use all reasonable and supportable information without undue costs and effort when the issuer selects the measurement approach, inputs and assumptions it uses in measuring in scope 3 GHG emissions;

(ii) issuers may use information from a reporting period that is different from that of the issuer if that information is obtained from entities in its value chain with reporting periods that are different from the issuer's reporting period, subject to certain specified criteria;

(iii) issuers should disclose the categories included in the issuer's scope 3 GHG emissions in accordance with the Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard (2011); and

(iv) financed emissions disclosure is encouraged: where an issuer's activities include asset management, commercial banking or insurance, the issuer is encouraged to disclose additional information about the issuer's Category 15 greenhouse gas emissions or those associated with its investments.

Scope 3 GHG emissions will be required to be disclosed on a **"comply or explain"** basis in respect of financial years commencing on or after **1 January 2025** for **all Main Board issuers**.

In any event, issuers are urged to start identifying the carbon intensive activities along their value chain and engage with these value chain entities as soon as possible to raise their awareness of, and secure their support for, the New Climate Requirements.

3. What is the phased-in approach for the non-GHG emissions New Climate Requirements?

	In respect of financial years commencing on or after:
LargeCap issuers	1 Jan 2025 – "Comply or explain" 1 Jan 2026 – Mandatory disclosure
Non-LargeCap Main Board issuers	1 Jan 2025 – "Comply or explain"
GEM issuers	1 Jan 2025 – Voluntary disclosure

Non-climate-related disclosure requirements as set out in Parts A to C of the ESG Code will continue to apply.

4. Exactly what are the non-GHG emissions New Climate Requirements?

In summary, disclosure of the following information will form the New Climate Requirements:

(i) governance process, controls and procedures to monitor and manage climate-related risks and opportunities;

(ii) climate-related risks and opportunities and their impact on the issuer's business operations, business model and strategy;

(iii) transition plans, progress of transition plans and climate-related targets;

(iv) assessment of climate resilience to the issuer's strategy (including business model) and operations;

(v) financial effects of climate-related risks and opportunities and anticipated financial effect;

(vi) risk management process to identify, assess and manage climate-related risks and opportunities;

(vii) non-GHG cross-industry metrics;

(viii) internal carbon price or a negative statement if an issuer does not apply a carbon price in decision-making;

(ix) how climate-related considerations are factored into remuneration policy or a negative statement; and

(x) consider industry-based disclosure requirements prescribed under international ESG reporting frameworks and make disclosures as the issuer sees fit.

There will be implementation reliefs (see below) available to assist listed issuers onto their journey of sustainability reporting in Hong Kong.

5. Where do these climate-related disclosure requirements come from?

The New Climate Requirements are developed based on IFRS S2. IFRS S1 and IRFR S2 are a pair of two sustainability disclosure standards published by ISSB, a new standard setting board established on 3 November 2021 under the **IFRS Foundation**. IFRS S1 and IFRS S2 aim to serve as a global baseline of sustainability reporting standards for entities worldwide to prepare consistent, comparable and reliable sustainability disclosures.

The ISSB Standards have been endorsed by the International Organisation of Securities Commissions (***IOSCO***) in June 2023 and IOSCO has called on its members comprising more than 95% of the world's exchanges to consider ways in which they might adopt, apply or otherwise be informed by the ISSB Standards within the context of their jurisdictional arrangements.

The New Climate Requirements are part of Hong Kong's roadmap to prepare listed companies towards eventual sustainability reporting in accordance with Hong Kong sustainability standards. The **Hong Kong Institute of Certified Public Accountants (HKICPA)** will assume the role of sustainability reporting standards setter in Hong Kong to develop local sustainability reporting standards aligned with the ISSB Standards.

6. Can listed issuers use other international ESG reporting guidance like the ISSB Standards?

An issuer can choose to use international ESG reporting guidance, including the ISSB Standards, so long as it includes comparable disclosures to those required under the ESG Code in their ESG reports.

To avoid duplicate reporting, the ESG Code makes it clear that **ESG reports prepared in compliance with the ISSB Standards (i.e. both IFRS S1 <u>and</u> IFRS S2) are considered to have complied with the New Climate Requirements**.

The existing requirements in Part A (Introduction), Part B (one page on Mandatory Disclosure Requirements) relating to governance structure, reporting principles and reporting boundary) and Part C (a few pages of "Comply or explain" Provisions) like hazardous and non-hazardous waste, water consumption, health and safety and labour standards will continue to apply but these are not obstacles to using the ISSB Standards.

7. What is the definition of "materiality" for the New Climate Requirements?

The ESG Code was developed in 2012 with reference to the Global Reporting Initiative (GRI) standards. The materiality reporting principles under the ESG Code is not being changed at this juncture, and the Hong Kong Listing Rules do not prevent boards from applying a financial materiality threshold (as required under the ISSB Standards) in determining disclosure of a climate-related risk or opportunity.

In fact, Part A of the ESG Code has included an amendment that for the purpose of Part D i.e. the New Climate Requirements, an issuer **must disclose** information about climate-related risks and opportunities that could reasonably be expected to affect its cash flows, its access to finance or cost of capital over the short, medium or long term.

8. What are the Hong Kong implementation reliefs?

In addition to the reasonable information relief, the following reliefs are available:

Capabilities relief – An issuer's skills, capabilities, and available resources when assessing and disclosing climate-related information are acknowledged.

Commercial sensitivity relief – An issuer is allowed to withhold disclosure of commercially sensitive information regarding climate-related opportunities, given specific conditions are met.

Financial effects waiver – An issuer can provide qualitative information instead of quantitative information when disclosing climate-related impacts, provided that certain conditions are satisfied.

New Climate Requirement	Reasonable information relief	Capabilities relief	Commercial sensitivity relief	Financial effects waiver
All paragraphs with respect to climate-related opportunities			✓	
Identification of climate-related risks and opportunities	✓			
Determination of the scope of the value chain	✓			
Qualifications of current and anticipated financial effects		✓ (Anticipated financial effects only)		✓
Preparation of disclosures on anticipated financial effects	✓	✓		
Use of climate-related scenario analysis	✓	✓		
Measurement approach, inputs, and assumptions of Scope 3 GHG emissions	✓			
Calculation of metrics in particular cross-industry metric categories	✓			

9. What help can we expect from HKSE?

HKSE has published a 140-page Implementation Guidance to accompany the New Climate Requirements.

Chapter 1 of the Implementation Guidance makes it very clear that issuers are strongly encouraged to prepare climate-related disclosures under Part D of the ESG Code following the conceptual foundations and general requirements set out under IFRS S1 and to refer to IFRS S1 for details.

The Implementation Guidance also includes illustrative examples, step-by-step workflows and external frameworks and tools which would be helpful in the preparation of disclosures.

The Implementation Guidance does not constitute part of the Hong Kong Listing Rules.

10. Differences between IFRS S2 and the ESG Code

HKSE has very helpfully prepared a very detailed comparison between the requirements of IFRS S2 and mapped it against the relevant paragraphs in the ESG Code (not just against the New Climate Requirements in Part D).

This comparison shows that the New Climate Requirements are very closely aligned with IFRS S2. There are only a handful of departures from IFRS S2 as follows:

(i) No requirement to disaggregate, for scope 1 and scope 2 GHG emissions disclosure purposes, the information between the consolidated accounting group e.g. if using IFRS Accounting Standards, the parent and its consolidated subsidiaries, and the unconsolidated investees e.g. associates, joint ventures and unconsolidated subsidiaries.

(ii) Disclosure of additional information about an issuer's category 15 GHG emissions or those associated with its investments (financed emissions) is encouraged but not mandatory.

(iii) Disclosure of percentage of remuneration linked to climate-related considerations is not required.

(iv) Positive requirement of a negative statement to clarify that an issuer is only required to make relevant disclosure if it has factored climate-related considerations into its remuneration policy.

(v) Disclosure of industry-based metrics is on a voluntary basis only.

11. What about IPO Applicants?

IPO applicants should embrace the New Climate Requirements and start the necessary work to ensure that they have the relevant systems, policies and processes in place to ensure compliance after listing as the New Climate Requirements will become effective on 1 January 2025.

IPO applicants should also consult Chapter 4.3 of HKSE's Guide for New Listing Applicants, which provides principles and guidance on prospectus disclosures concerning ESG matters.

12. Top tips for your listed issuer to take things forward

(i) **DO** a gap analysis of your listed issuer's sustainability disclosure to know what gaps you need to plug to satisfy the New Climate Requirements.

(ii) **ASSESS** your internal governance and risk management process, controls and procedures to make sure they are sufficient to allow your listed issuer and its board and committees to assess, report, monitor and manage climate-related risks and opportunities.

(iii) **USE** the New Climate Requirements as a fresh opportunity for your listed issuer to review its existing ESG disclosure. This process is to ensure that not only are the disclosures up-to-date, but greenwashing free and represent your company's best narrative in terms of business strategy, progress and challenges to help with your own climate-related targets, opportunities and risks and sustainability goals.

(iv) **START** planning for scope 3 GHG emissions disclosure even if you are not a LargeCap issuer, as the direction of travel is very clear. Even if your listed company is on a "comply or explain" regime or will enjoy implementation reliefs, you are encouraged to provide information on the work plan, progress and timetable for making the required disclosure.

(v) **USE** the New Climate Requirements as an excellent opportunity to edit, amend, rewrite and write your sustainability-related disclosure and to make them more stakeholders-focused and in particular investors-focused and user-friendly.

(vi) **REMEMBER** to reduce duplicative disclosures. The establishment of ISSB is in part to reduce the alphabet soup of sustainability reporting and to remove duplicative disclosures. HKSE has clarified that where an issuer manages its ESG-related (including climate-related) risks and opportunities on an integrated basis, which should normally be the case, it should provide one set of integrated governance disclosures that complies with the disclosure requirements under both paragraphs 13 and 19 of the ESG Code.

(vii) **DON'T FORGET** to start thinking of integrating sustainability reporting with financial reporting. The consultation conclusions make it clear that issuers are encouraged to follow the ISSB Standards and align the scope of entities or operations that are included in the ESG report (including the climate-related disclosures) with that of its financial statements. This may facilitate issuers' future reporting under the HK Standards, which are expected to align with the ISSB Standards.

(viii) **CONSIDER** using the ISSB Standards on a voluntary basis as HKSE has made it very clear that the New Climate Requirements are, in the words of Ms. Julia Leung, CEO of the Hong Kong Securities and Futures Commission, "*a head-start in speaking the common international language of the ISSB to the investing public and capital markets*".

Contact Us

We will be very happy to assist you on your journey with sustainability reporting and discuss any aspects of this client briefing with you. Please feel free to contact any of us below or your contact at Freshfields if you have any questions.

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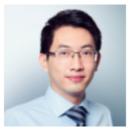

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