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The Future of Climate Reporting: A Deeper Look at ISSB, HKEX Proposals

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CFA Institute and CFA Society Hong Kong call for auditor oversight and proportionate approach to climate disclosure with differentiated requirements for GEM issuers.

Built on investor-focused standards and complemented by the Global Reporting Initiative, ISSB **issued** IFRS S1 and S2 on 26 June, to meet investors' information needs and demand for a harmonized reporting framework. IFRS S1 and S2 serve as the inaugural global baseline on climate-related disclosure.

Developments in Asia-Pacific

Following the issuance of the exposure draft of IFRS S1 and S2, the Stock Exchange of Hong Kong Limited (a HKEX subsidiary) has proposed to upgrade "**Appendix 27 Environmental, Social and Governance Reporting Guide**" in its recent **consultation**. It will become effective on 1 January 2024, and interim provisions will last for two reporting years following the effective date.

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

Other Asia-Pacific jurisdictions including **Australia**, **Japan**, **South Korea**, **Taiwan** and **Malaysia** have also already indicated they plan to implement the ISSB standards locally.

HKEX: Adoption of a balanced approach

HKEX has adopted a market-focused approach, coupled with standard-setter thinking and technical methodology, considering the maturity and ESG literacy of issuers, and HKEX's 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.

Issuers are subject to a higher level of reporting obligation based on TCFD, enhanced from "comply or explain" to a mandatory regime. With that, the HKEX has localised ISSB in certain areas to incorporate Hong Kong-relevant nuances. For issuers, adherence to the Code strengthens their resilience and adaptation capabilities, which are essential for businesses to remain competitive in the face of climate change.

On the investor side, the proposed Environmental, Social and Governance Reporting Code (the Code) will help to improve their understanding of how to integrate climate-related risks and opportunities into their investment decisions. CFA Institute and CFA Society Hong Kong **co-responded to HKEX's consultation**, expressing our appreciation for this comprehensive proposal, including the efforts to engage with end users of financial statements and understand market needs.

With the move by HKEX, Hong Kong will have the opportunity to be an early adopter and adapter of ISSB-aligned disclosures. Coupled with a comment period following the issuance of IFRS S1 and S2, this enhancement proposal has captured the attention of market participants and provided them with the opportunity to deliberate.

Proposed requirements

Below is a summary of the proposed climate-related disclosure requirements, across the four pillars of 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 Code. As an investor organization, 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 to overall risk management framework

We are happy to see a more comprehensive list of disclosure requirements, in particular the basis for risk prioritization, 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 prioritize climate-related risks over other types of risks.

Metrics and Targets:

Current: environmental KPIs, such as GHG emissions Scope 1 and 2, based on 'comply or explain' basis

Proposed: GHG emissions Scope 1, 2, and 3 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. 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.

Oversight and Proportionate Approach

When it comes to Appendix 27 of the Listing Rules, the proposed enhancement 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 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 HKEX leverage the existing financial reporting mechanism and regulatory framework to require the 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 help secure buy-in from a range of stakeholders. In particular, a proportionate approach to climate disclosure with differentiated requirements is needed for the GEM issuers, who are facing proportionality challenges.

A long journey ahead

CFA Institute and CFA Society Hong Kong support disclosures based upon the global baselines ISSB and TCFD. 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 learnings, investor engagement is equally important, given that they are the audience of the reports and users of the proposed Code with respect to stewardship.

Lastly, we encourage the HKEX to continue offering capacity-building support, transitional reliefs, 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.

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