



ESG REPORTING & INVESTING

SUMMARY

Environmental, Social and Governance (ESG) has become a practice for businesses amid investors' growing interest in ESG information. ESG criteria is increasingly being used for portfolio development in many overseas markets. Fund managers and financial analysts who are looking for opportunities for long-term value creation for investors and society may potentially develop a competitive advantage. Governance issues seem to be driving ESG momentum. A report from EY suggested that investors are enthusiastic about the benefits of integrated reporting. Study of Deutsche Asset & Wealth Management and the University of Hamburg investigate found that companies with high degree of ESG have a lower cost of capital in terms of debt and equity. The study also indicated that only 10% of the companies show a negative ESG – financial performance relationship.

What is ESG?

ESG is used to describe a group of risks – environmental, social and governance – that are explicitly acknowledged and integrated into the research, decision-making process and reporting. Socially conscious investors use ESG to screen investments. Environmental criteria examines how a firm operates with environmental issues or its compliance with the government’s regulations. Social criteria looks at how a firm manages relationships with different stakeholders, including staff, clients, suppliers and the communities. Governance checks with the accuracy and transparency of its performance. What constitutes an acceptable set of ESG criteria is subjective, so it varies from different investors.

ESG Reporting in Hong Kong

The Stock Exchanges of Hong Kong (HKEx) strengthens their Environmental, Social and Governance Reporting requirements from voluntary to a “comply or explain” approach. The amendment was proposed by HKEx in July 2015.

According to Listing Rules Appendix 14 “CORPORATE GOVERNANCE CODE AND CORPORATE GOVERNANCE REPORT”,

1. The listing rule amendments and upgrade of the ‘general disclosures’ in the Guide from recommended to comply or explain, as well as the revised recommended disclosures, have already come into effect for financial years commencing on or after 1 January 2016.
2. The upgrade of the ‘key performance indicators’ in the ‘environmental’ subject area of the Guide from recommended to comply or explain will come into effect for financial years commencing on or after 1 January 2017.

Starting from 1 January 2016, the amended ESG Reporting Guide applied to listed companies on both mainboard and Growth Enterprise Market of the HKEx. As for the disclosure of environmental key performance indicator of the ESG Reporting, companies will need to make mandatory public disclosures on environmental data no later than 2017 financial year.

Listed companies are required to disclose:

TIMELINE			
ASPECTS	Comply or Explain from financial year 2016	Comply or Explain from financial year 2017	Recommended Disclosures (i.e. Voluntary)
SUBJECT AREA A: ENVIRONMENT			
A1- Emissions	Policies and compliance relating to emissions, discharges, and wastes	KPIs: A1.1 Types + respective volume of emissions A1.2 Total GHG Emission + Intensity A1.3 Total hazardous waste + Intensity A1.4 Total non-hazardous waste + Intensity A1.5 Mitigating measures and results for emissions A1.6 Handling & reduction measures + results for hazardous & non-hazardous wastes	Recommended disclosures for all environmental KPIs <u>before financial year of 2017</u>
A2- Use of resources	Policies on the efficient use of resources	KPIs: A2.1 Direct & Indirect energy use A2.2 Water Consumption & Intensity A2.3 Efficient use of energy initiatives & results A2.4 Water sourcing, saving initiatives & results A2.5 Total packaging material	
A3- The environment and natural resources	Policies on minimising environmental impacts	KPI: A3.1 Environmental impacts and management	

SUBJECT AREA B: SOCIAL			
B1- Employment	Policies and compliance relating to employment		KPIs: B1.1 Total workforce by gender, age, location & type B1.2 Turnover rate by gender, age, group & location
B2- Health and safety	Policies and compliance relating to occupational health & safety		KPIs: B2.1 Number & rate of fatalities B2.2 Lost days due to work injury B2.3 Occupational health & safety measures & management
B3- Development and training	Policies on development & training		KPIs: B3.1 Percentage of employees trained by gender & category B3.2 Average training hour per employee by gender & category
B4- Labour standards	Policies and compliance relating to child & forced labour		KPIs: B4.1 Measures taken to prevent child & forced labour B4.2 Steps to eliminate child & forced labour if these practices exist
B5- Supply chain management	Policies environmental and social risks of the supply chain		KPIs: B5.1 Number of suppliers by location B5.2 Description of engagement with suppliers
B6- Product responsibility	Policies and compliance to product responsibility matters		KPIs: B6.1 Percentage of products subject to recalls for safety and health reasons B6.2 Products related complaints received and handling B6.3 Intellectual property rights protection practices B6.4 Quality assurance process and recall procedures B6.5 Consumer privacy protection

Source: <http://csr-asia.com/csr-asia-weekly-news-detail.php?id=12545>

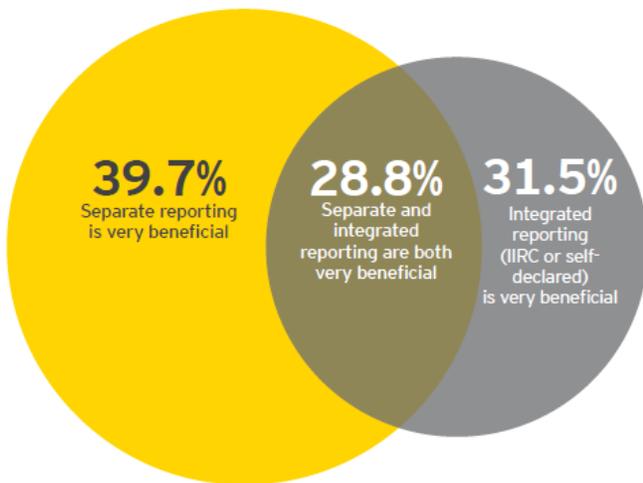
B7- Anti-corruption	Policies and compliance to anti-corruption		KPIs: B7.1 Number of concluded legal cases regarding corrupt practices B7.2 Preventive measures against corruption
B8- Community investment	Policies on community engagement and consideration of community issues		KPIs: B8.1 Focus areas of contribution B8.2 Resources contributed to focus areas

CORPORATE GOVERNANCE

Corporate Governance is covered in Appendix 14 of the Main Board Rules (Appendix 15 for GEM)
 Note that Appendix 14 (See reference) was updated in 2014 and would also be in effect from 1 Jan 2016. Companies may want to double check if they are meeting the updated requirements.

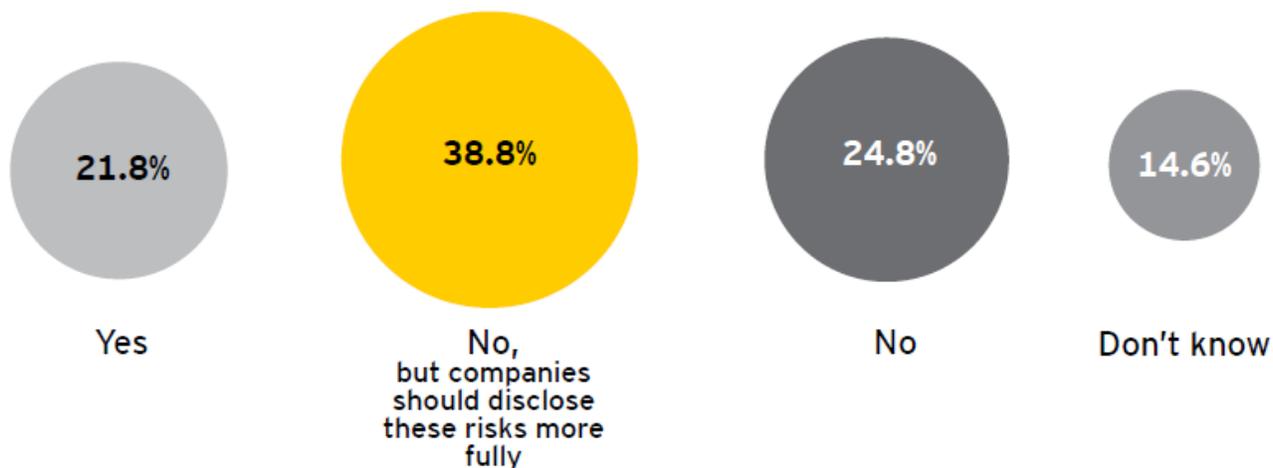
Source: <http://csr-asia.com/csr-asia-weekly-news-detail.php?id=12545>

A 2015 report from - Tomorrow’s Investment Rules 2.0 conducted by Ernst & Young, shows the necessity of integrated reporting, which includes ESG factors.



39.7% OF ALL RESPONDENTS SEE ONLY SEPARATE REPORTING AS VERY BENEFICIAL, WHILE 31.5% VIEW INTEGRATED REPORTING AS VERY BENEFICIAL. 28.8% OF THE RESPONDENTS SEE BOTH SEPARATE AND INTEGRATED REPORTING AS VERY BENEFICIAL.

Source: Tomorrow’s Investment Rules 2.0, Ernst & Young



Source: Tomorrow's Investment Rules 2.0, Ernst & Young

The report also suggests companies to make adequately disclose their ESG risks, following the survey asking the respondents whether companies adequately disclose their ESG risks that could affect their current business models. 38.8% of respondents viewed insufficient disclosure about the ESG risks in the reporting.

• Performance of ESG Reporting

There is mounting evidence proved a positive linkage between ESG reporting and corporate financial performance. Since the traditional approach to analysis and decision making may have been mainly based on companies' track record, ESG reporting offers an alternative to investors with insight into the long run sustainability of the companies' business in an attempt to achieve higher returns. The importance of ESG reporting is growing in emerging markets. It is believed that requirements of ESG discourse or reporting could draw high quality companies and investors to the markets and more capital is expected from investors with ESG investment practices.

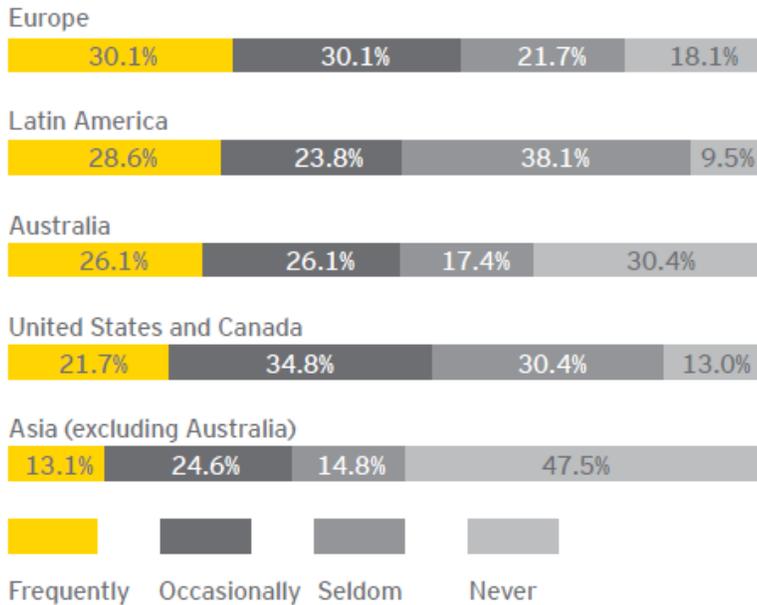
ESG Investing

• Integration of ESG Investing

-Global

The Schroders Global Investor Study 2016 surveyed 20,000 end investors in 28 countries found Millennials (ages 18 to 35) ranked ESG factors as equally important as investment outcomes when considering investments decisions. Most portions of investors are considering good corporate governance, rating it an average of 7.4% out of 10. The study also showed 82% global investors would stay invested in ESG investments longer than usual. One-third of institutional investors said they would increase portfolio allocations to ESG investing in the coming three years as they see more opportunities for outperformance in ESG investments.

A study - ESG and Corporate Financial Performance: Mapping the Global Landscape, 2015, conducted by Deutsche Asset & Wealth Management and the University of Hamburg revealed an overall positive performance embedding ESG factors into the investment process and improved corporate financial performance.

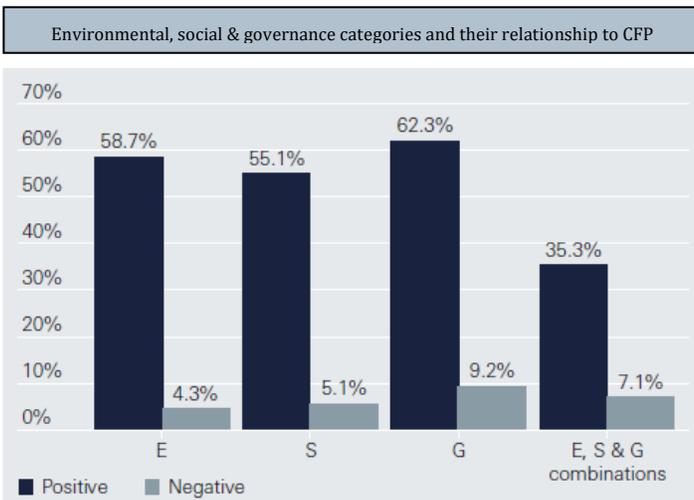


Source: Tomorrow's Investment Rules 2.0, Ernst & Young



IN THE LAST 12 MONTHS, HOW FREQUENTLY HAS A COMPANY'S NONFINANCIAL PERFORMANCE PLAYED AN IMPORTANT ROLE IN INVESTMENT DECISION MAKING IN DIFFERENT COUNTRIES?

NONFINANCIAL INFORMATION AFFECTED INVESTMENT DECISION MAKING PROCESS MOST OFTEN IN EUROPE IN 2015, FOLLOWING BY LATIN AMERICA AND AUSTRALIA.

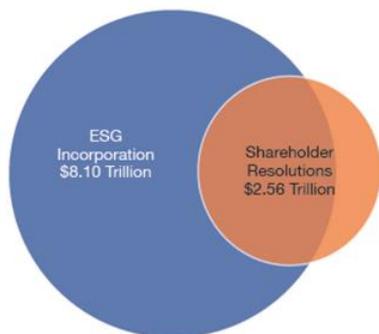


Source: Friede, Busch, Bassen (December 2015)

There is a highest positive relationship between ESG and corporate financial performance. In governance, 62.3% of surveyed corporates delivered a positive correlation, while environmental issues also showed 58.7% positive results. The outcome suggested that managers should take corporate governance risks as an essential part of their investment analysis, alongside financial analysis.

- U.S.

**Sustainable and Responsible Investing
in the United States in 2016: \$8.72 trillion**



SOURCE: US SIF Foundation.
NOTE: ESG incorporation assets in this figure include those in community investing institutions.

THE US SIF FOUNDATION'S
REPORT ON SUSTAINABLE AND
RESPONSIBLE INVESTING
TRENDS IN THE UNITED STATES
REPORTED \$8.72 TRILLION IN
TOTAL ASSETS UNDER
MANAGEMENT AT THE END OF
2015 USING ONE OR MORE ESG
INVESTING STRATEGIES.

The assets to which fund managers apply ESG criteria have surged significantly to \$8.1 trillion in 2016 from \$4.8 trillion in 2014, suggesting growing demand from individual and institutional clients and the incorporation of ESG criteria by large fund managers across wider portions of their holdings.

Another separate report - Tomorrow's Investment Rules 2.0 conducted by Ernst & Young also indicated investors' growing interest in ESG information. The number of investors concerned ESG reports 'essential' or 'important' when making investment decisions added to 59% in 2015 from 35% in 2014. Significant number of investors embedded ESG disclosures in their investment decision making and needed information that goes beyond financial statements to make both short term and long term investment.

• **Performance of ESG Investing**

By applying ESG criteria to existing standard investment decision making process, investors can measure their portfolios against the same standard benchmarks market used to measure performance. ESG risks can also be incorporated in the process to lower risks.

- U.S.

According to S&P Dow Jones Indices the 1,200 constituents of its S&P Global 1200 ESG Index achieved annualized returns of 6.44% during the last five years on the basis that all dividends are reinvested into the index constituents, outperforming 6.27% of the entire S&P Global 1200 Index. The S&P Global 1200 Index consists of 1,200 blue chip

stocks in 31 nations, covering 70% of the global stock market capitalization, weighed by their freely-traded market capitalization.

- Hong Kong

According to HKEX and findings from index compilers, share prices of companies that score high on ESG issues often outperforms the wider stock market. However, Asia is still lagging in ESG disclosures compared to other countries.

In Hong Kong, Hang Seng Indexes has launched five corporate sustainability indices since 2010. The Hang Seng Corporate Sustainability Index, The Hang Seng Corporate Sustainability Index, tracking 30 Hong Kong-listed stocks selected based on their market capitalization, turnover, listing history and sustainability performance, reported an average 1.2% annualized return in the five years to last year, outperforming the -1.99% return of the Hang Seng Index that has 50 constituents.

- Emerging Countries

There are tremendous growth opportunities in clean and efficient energy sectors in China, attracting investors to incorporate ESG criteria into their investment decision making process. Meanwhile, there is a strong growth in Brazil and South Africa that investors are pay more attentions to social equity themes and the transparency of financial and healthcare sectors.

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