ESG DISCLOSURE IN CHINA: MARKET READINESS AND PRI INVESTOR SURVEY

INTRODUCTION

The United Nations-backed Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 3000 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $90 trillion in assets under management.

Responsible investment explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors in investment decision-making for the long-term health and stability of financial markets.

The COVID-19 crisis has demonstrated the importance of resilient societies and economies, supported by a sustainable financial system. In the short-term, policy makers have rightly focused on the health crisis, immediate economic relief and the prevention of future outbreaks. Policy makers will also need to address existing environmental and climate challenges to ensure the recovery is sustainable. Issuers' disclosure on ESG factors, and climate change in particular, remain a priority for financial institutions.

The PRI is working to help investors protect portfolios from risks and to expose them to opportunities in the shift to a low-carbon global economy. The PRI welcomes the opportunity to contribute comments and suggestions to the work on environmental disclosures for listed companies in China.

ABOUT THIS BRIEFING

This briefing provides investor feedback and market update as part of the PRI's work on ESG disclosure in China, with support from the UK China PACT Programme. It is based on the research and recommendations of the report *ESG Data in China: Recommendations on Primary ESG indicators*.[1] This research showed that while there was broad alignment between international and Chinese corporate ESG data disclosure practices, the disclosures provided by Chinese companies are not standardised and not readily comparable across markets, industries and portfolios. The report commented that this lack of comparability limits investors' ability to integrate ESG data into their investment decisions, and acts as a barrier to increased investment in green and sustainable assets.

The report therefore recommended that Chinese financial regulators introduce a mandatory ESG disclosure framework, requiring all major companies to report on a series of standard ESG indicators and to supplement these quantitative metrics with related information on governance, strategy and risk management of ESG issues.

In addition to this report, the PRI was asked by the China Securities Regulatory Commission (CSRC) to gather feedback from investors on the need for a standardised disclosure framework. This briefing is the PRI's response to that request. It provides an update on the market readiness for mandatory ESG disclosure and presents the results of an investor survey on ESG disclosure led in May 2020.

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[1] https://www.unpri.org/fiduciary-duty/esg-data-in-china-recommendations-for-primary-esg-indicators/4345.article

POLICY SIGNAL HAS BEEN GIVEN TO THE MARKET

- **In 2016, seven ministries and commissions launched the Guidelines for Establishing the Green Financial System**, which set a target of mandatory environmental information disclosure for all listed companies in China by 2020.
- **In November 2018, the Asset Management Association of China (AMAC) issued the first Green Investment Guidelines** to promote green investment in the capital market. The Guidelines encourage fund managers to adopt responsible investment practices and to leverage investors' rights to urge investee enterprises to improve their environmental performance and information disclosure. In 2019, 378 AMAC member institutions submitted effective self-assessment reports and showed varying degrees of adoption of the guidelines.[2]
- **In March 2020, the General Office of CCCPC and the General Office of the State Council** issued the Guiding Opinions on Building a Modernized Environmental Governance System encouraging the establishment and improvement of mandatory environmental information disclosure mechanism for listed companies and bond issuers.[3]
- **Both stock exchanges, in Shanghai (SSE) and in Shenzhen (SZSE), are expecting directions from the CSRC** on the framework for ESG disclosure so they can draft detailed rules for listed companies.[4]

INCREASING NUMBER OF RESPONSIBLE INVESTORS IN CHINA INDICATES GROWING NEED FOR CORPORATE ESG DATA

- **The number of PRI signatories in China has witnessed a sharp increase in recent years, increasing from 4 in 2016 to 49 as of August 2020**. PRI signatories are committed to incorporating ESG issues into investment analysis and decision-making process and seeking appropriate disclosure on ESG issues by the entities they invest in.
- **Nine financial institutions in China, representing RMB 50 trillion of assets participate the UK-China Climate and Environmental Information Disclosure pilot program, covering banking, asset management and insurance**. The pilot participants, in accordance with the guidance of the People's Bank of China (PBoC), developed the Guidelines for Financial Institution Environmental Information Disclosure on the basis of the pilot practices and results.[5]
- **China Asset Management and Ping An Insurance have joined Climate Action 100+** and committed to engage the world's largest corporate greenhouse gas emitters to strengthen their climate-related disclosure by implementing the TCFD recommendations.

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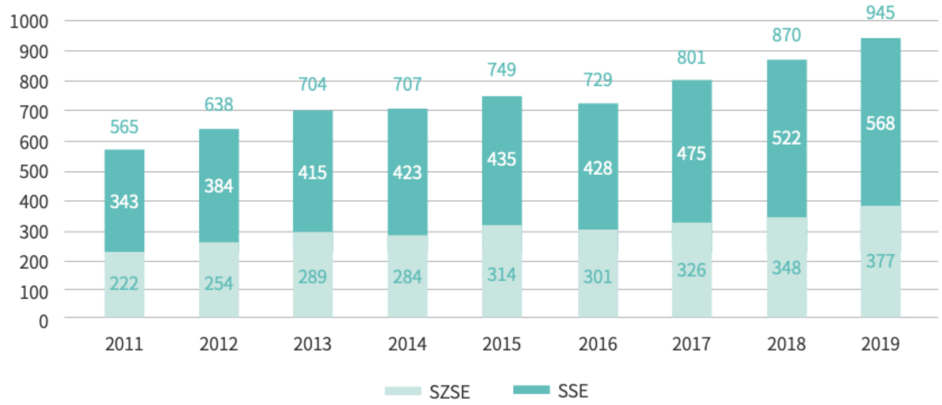
[2] http://www.amac.org.cn/researchstatistics/report/zgsmjjhyjxshzrbg/202003/P020200330706926313723.pdf
[3] http://www.gov.cn/zhengce/2020-03/03/content_5486380.htm
[4] https://www.bloomberg.com/news/articles/2019-12-10/china-risks-missing-own-deadline-for-environmental-disclosures
[5] https://www.unpri.org/climate-change/uk-china-pilot-on-climate-and-environmental-risk-disclosure-2nd-year-progress-report/5744.article

MARKET IS READY FOR STRICTER ESG DISCLOSURE

- **Chinese companies have been disclosing environmental information for years and their ability to disclose is increasing:**
  - High-polluting companies are required to disclose key pollutant emissions, as stipulated by the 2016 standards for the contents and formats of listed companies' annual and semi-annual reports issued by the CSRC;
  - No. of A-share companies disclosing voluntary ESG information rises year by year:



Source: SynTao, 2019. Statistical Analysis of CSR Reports of Listed Companies in 2019.

- **The Hong Kong Stock Exchange (HKEX) introduced new mandatory ESG disclosure requirements in 2020**:
  - mandatory disclosure requirements to include the board's role in ESG management; materiality, quantitative and consistency reporting principles; and reporting boundaries;
  - disclosure of significant climate-related issues which have impacted and may impact the issuer;
  - amending the Environmental KPIs to require disclosure of relevant targets;
  - upgrading the disclosure obligation of all Social KPIs to "comply or explain";
  - shortening the deadline for publication of ESG reports to within five months after the financial year-end.[6]
- **The updated ESG disclosure regulation applicable to Hong Kong-listed companies has the potential to boost disclosure of ESG information in mainland China.** As of the end of September 2019, 245 or 89% of the 276 H-share companies have issued ESG reports. This number is expected to increase with the ESG disclosure regulation of 2020. 116 H-share companies are also listed on SSE or SZSE.
- **International and domestic ESG ratings and indices are forcing listed companies to pay attention to ESG issues and improve ESG disclosure**. International index companies, such as MSCI and FTSE Russell, have partially included Chinese A shares. Chinese ESG rating agencies, such as Sino-Securities Index Information Service and SynTao Green Finance, are also developing ESG ratings for Chinese companies. Increasing these ratings can only be achieved through enhancing ESG performance as well as disclosure, as the assessments are mainly based on companies' disclosure and publicly available information.
- **Domestic investors increasingly consider ESG issues as factors that would bring significant impact on investee companies.**[7]

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[6] https://www.hkex.com.hk/news/regulatory-announcements/2019/191218news?sc_lang=en
[7] http://www.amac.org.cn/researchstatistics/report/gmjjhybg/202003/P020200330706430008626.pdf

RESULTS OF THE PRI'S INVESTOR SURVEY ON ESG DISCLOSURE IN CHINA

Lack of reliable and comparable ESG data remains the biggest barrier for sustainable investment in China. This has been confirmed recently by the AMAC survey, reporting that lack of reliable and comparable ESG data is regarded as the biggest challenge faced by institutional investors in 2018 and remain as a key challenge for investors in 2019. This was also confirmed by the UK-China Climate and Environmental Information Disclosure Pilot 2019 Progress Report, finding that lack of corporate disclosure is regarded by investors as a key challenge for them to measure climate and environmental risks and opportunities.[8] The SIF report published in 2019 also found that lack of sources of ESG information (51%) is one of the biggest challenges for individual investors to consider sustainable investment.[9]

The PRI, together with SynTao Green Finance and input from AMAC and CIFCM/CSRC, conducted an investor survey on ESG disclosure in China in May 2020. The aim of this survey was to consult investors on the importance of a mandatory, standardised ESG disclosure framework in China. The survey was answered by 49 organisations (2 Asset Owners, 39 Investment Managers, 8 Service Providers, 25 based in mainland China, 10 based in HK, 14 based in other countries/regions).

Key findings from the survey indicate that:

- **Both domestic and international institutional investors have concerns about ESG information disclosure of China A-shares, especially the information related to ESG risks management.**
- The top three hurdles investors face when considering sustainable investment in China are:
    - lack of reliable ESG data (76%);
    - lack of comparable ESG data between Chinese companies (59%); and
    - lack of comparable ESG data with international peers (53%) .

  For overseas investors, lack of reliable data was a top challenge for 92% of respondents.
- Although an increasing number of companies publish sustainability reports, these do not systematically include quantified, standardised ESG information and do not provide meaningful data for investors.
- Investors face obstacles in engaging with A-share listed companies on ESG issues. Top three hurdles investors and service providers face are:
    - difficulty to receive meaningful response on ESG issues when engaging with Chinese companies;
    - corporate investor relations departments having limited knowledge of their company's ESG information and performance; and
    - difficulty finding the right department/person to communicate on ESG matters.
- **98% of respondents believe it is important to align with international frameworks and metrics.**
- In terms of metrics, over 90% of overseas investors believe GHG emissions, health and safety and workforce composition should be added to the ESG disclosure framework in China; 100% of Hong Kong-based investors also picked those metrics, in addition to pollutants disclosure, energy consumption, waste generation and water withdrawal.

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[8] https://www.unpri.org/climate-change/uk-china-pilot-on-climate-and-environmental-risk-disclosure-2nd-year-progress-report/5744.article

[9] http://syntaogf.com/Uploads/files/China%20Sustainable%20Investment%20Review%202019.pdf

- International investors expressed in the survey that if the A-shares improve ESG information disclosure, they will have more interest in investing in China, which indicates that better ESG information disclosure can promote the ‘two-way opening’ of the China’s capital market.

  If Chinese companies improve ESG disclosure,

  - 63% of investors are very likely to have more interest investing in mainland China; and
  - 80% of investors are very likely to have more interest investing *sustainably* in mainland China.

Additional feedback from investor respondents[10]:

We take the view that disclosures intended for investors need to focus on financially material and business relevant metrics and include supporting narratives. To that end, we recommend the Task Force on Climate related Financial Disclosures (TCFD) and the standards put forward by the Sustainability Accounting Standards Board (SASB) as the benchmark frameworks for a company to disclose its approach on sustainability management. These frameworks enable companies to disclose material and decision-useful information that is comparable within each industry across regions and markets. As such, we appreciate if the regulator can consider the merits of both reporting frameworks when formulating China’s ESG mandatory disclosure framework.
Listed companies should disclose more detailed ESG related information and provide more quantified ESG information, following global standards.
There is definitely a push to improve ESG standards in China, but the drive comes from foreign investors. International frameworks and standards are critical for meaningful implementation.
We would like to see more adoption and application of international reporting standards/frameworks, such as TCFD, CDP and SASB, in order to improve quality of disclosures and comparability with global companies.
We look forward to hearing details about the environmental disclosures of the A-shares.
China's responsible investment is just in its infancy. However, we believe that China's responsible investment disclosure will become more professional and gradually align with the international framework in the near future.
A standardized ESG disclosure format is crucial since it provides the condition for point-by-point comparison of ESG performance by different companies.
Some sustainability reports which state use of "in accordance" with the GRI standards don't actually report accurately on the same indicators. Most sustainability reports refer to projects they've done without setting a target. This gives the impression that they report on what is convenient for them, instead of what they should do to improve their ESG performance. Most reports are without meaningful statistics such as number of health and safety incidents - most of the time they report on number of safety training classes conducted. Better management disclosures are needed to have a better assessment.

[10] Feedback has been anonymised, edited for clarity and provided for illustration purposes only

ESG disclosure in China should be standardized and aligned with international metrics.
The framework should adopt existing international sustainability reporting standards such as GRI, SASB, and CDP. This would ensure there is not another standalone framework to assess companies' performance.
Our view is that ESG disclosure adoption will not happen voluntarily and will require a push from regulators. Once this has happened, the leading companies should have more confidence to disclose their practices and policies as they become rewarded for doing so.
The focus on ESG in China has been largely on E. While it is important, we need to see G and S to improve. Improvement on G has been slow.

This briefing was prepared by the PRI and SynTao Green Finance. The survey was conducted with support from UK PACT China.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of the Chinese regulators on promoting financial regulations aligned with a sustainable recovery and green economies.

Any question or comments can be sent to policy@unpri.org.