JK Capital Management Ltd.

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ESG Disclosure Regulations in Asia are Catching up on the Western World

Following two years of exponential growth in so-called ESG assets globally, market regulators have stepped in to clamp down on "greenwashing risks" by refining ESG-related rules. The European Union, which is traditionally the leader in the space, has rolled out notable and pioneering efforts including new rules on ESG labelling, disclosure, and the creation of a green taxonomy that aims to define sustainable activities. With the backing of the Biden administration, the U.S. Securities and Exchange Commission (SEC) has also tightened its grip to prioritise the prevention of greenwashing and fund mislabelling.

Regulation is also a strong growth driver for ESG investing in Asia. But compared to their western counterparts, corporate ESG disclosure regulations across Asian markets are still at a relatively nascent stage. The market itself can be characterised as being fragmented. In this week's ESG newsletter, we would like to highlight some key developments in Asia's corporate ESG regulations as well as the progress we have observed on the ground.

Regulation for corporate ESG disclosure is generally the starting point of ESG investing in any market, and Asia is no exception. A few years back, as Hong Kong stood as the only major market in Asia that had mandated corporate ESG disclosure, a report by the Asia Investor Group on Climate Change concluded that disclosure levels in Asia were "generally lower than seen in other markets."

This year, by contrast, CDP (a global environmental disclosure platform in which JK Capital actively participates as a signatory) highlighted substantial progress of ESG disclosure across Asian markets as the number of corporate disclosures in China (2,500) and Japan (1,700) climbed up the ranking to the 2nd and 3rd place globally, surpassed only by U.S. firms. Indeed, major Asian economies, including China, Japan and Taiwan, have all released new rules and proposals that mandate public company disclosure of ESG information starting in 2023.

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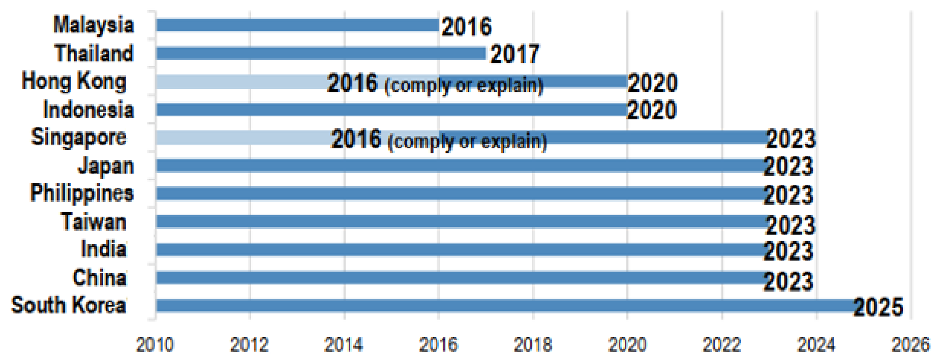
Corporate ESG Disclosure (proposed) Timeline by Country



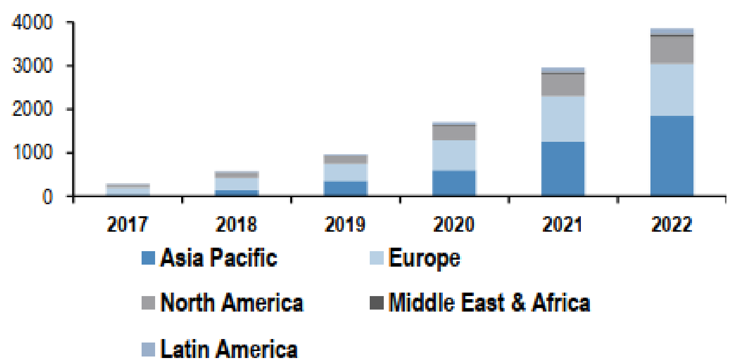
Source: JP Morgan

In May 2022, the Chinese regulator issued the Quality Improvement Action Plan for State-owned Enterprises (SOEs), mandating SOEs to improve their ESG performance/disclosure and play an exemplary role in the capital market. In July 2022, the Japanese regulator announced that companies will be required to disclose non-financial information about human capital/diversity and climate change measures in securities reports beginning in FY2023. These developments from Asia's two largest capital markets are critical for boosting the overall disclosure quality of Asian companies through network effects.

In some markets, mandatory ESG disclosures have been implemented in phases, with a prioritised focus on either the sectors that pose greater climate risks or on companies above a certain market capitalisation level. For instance, the Singapore Stock Exchange (SGX) has mandated climate disclosures for issuers in the financial, agriculture, food, forest products, and energy industries from 2023, and for issuers in the materials, buildings and transportation industries from 2024. In Taiwan, steel and cement companies with paid-in capital higher than NT$10bn ($330m) will be required to report greenhouse gas (GHG) emissions starting from 2023 with the deadline for all other listed companies set in 2026. Similarly, starting in 2025, ESG reporting requirements have been imposed on the largest 1,000 companies of India, and on Korean companies with 2 trillion won ($1.4bn) in total assets.

The rigorousness of these broad-based corporate ESG disclosure requirements varies widely from one market to another but encouragingly we have seen more and more market regulators making specific reference to internationally recognised disclosure frameworks/standards such as the Task Force on Climate-Related Financial Disclosures (TCFD). The front-runner of ESG in Asia, Hong Kong, has mandated Authorised Institutions such as banks to disclose their exposure to climate risks in line with the TCFD recommendations by 2023. Similarly, the Singaporean regulator also announced a roadmap for issuers to provide climate-related disclosure based on TCFD recommendations commencing 2022 on a ‘comply or explain’ basis. Thanks to such efforts, TCFD is now supported by over 3,800 organisations (including JK Capital itself) across the globe with the Asia Pacific region accounting for over 47% of all supporters, followed by Europe at 31%.

TCFD Supporters by Region



Source: JP Morgan

However, it is worth mentioning that most of the corporate ESG disclosure requirements we discussed are focused on climate-related topics, which is the “Environmental” aspect of the ESG acronym. The reason is simply that environmental disclosures are relatively easier to quantify compared to social and governance indicators, and that climate change is one of the most pressing issues facing humanity.

At the 2021 COP26 summit in Glasgow, the International Financial Reporting Standards (IFRS) Foundation announced the establishment of the International Sustainability Standards Board (ISSB), with the intention to deliver a comprehensive global baseline for sustainability-related disclosure standards. Such an upcoming standard is expected to make substantial references to existing frameworks such as the TCFD recommendations and industry-specific SASB Standards.

As an encouraging note, within Asia, the Chinese Ministry of Finance and the Japanese Financial Services Authority have both agreed to join an international working group that focuses on the compatibility of the upcoming ISSB Standard with specific initiatives taken by each country on sustainability disclosure. The potential adoption of ISSB across Asia would play a crucial role in further accelerating a regulatory shift from voluntary to mandatory ESG disclosure and driving compatibility between corporate ESG disclosures.

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