ESG Service
by Hang Seng Indexes Company Limited
What is ESG?
ESG stands for “Environmental, Social and Governance”

Definition of ESG

ESG stands for “Environmental, Social and Governance”. Investors and companies are increasingly recognising that ESG performance directly impact their reputation, value and investments.

What does ESG entail?

There is no exhaustive list of ESG issues. The tables below are some sample ESG issues that investors and companies need to consider when understanding ESG related risk and growth opportunities.

The Hong Kong Exchanges and Clearing Limited (“HKEX”) has required all Hong Kong listed companies to issue ESG reports in accordance with its Environmental, Social and Governance Reporting Guide (“ESG Guide”) since 2016. If listed companies do not complied with the “comply or explain” provisions set out in the ESG Guide, they must give considered reasons. Further, certain ESG disclosures have been upgraded to mandatory requirements since 2020.

<table>
<thead>
<tr>
<th>ENVIRONMENT</th>
<th>SOCIAL</th>
<th>GOVERNANCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Climate change</td>
<td>Human rights</td>
<td>Bribery and corruption</td>
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<tr>
<td>Emissions, effluents and waste management</td>
<td>Employee management</td>
<td>Board governance and quality</td>
</tr>
<tr>
<td>Energy and resource use</td>
<td>Health and safety</td>
<td>Business ethics</td>
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<tr>
<td>Biodiversity protection</td>
<td>Product responsibility</td>
<td>Stakeholder engagement</td>
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</table>
In 2021, the Securities and Futures Commission ("SFC") also issued amendments to the Fund Manager Code of Conduct, requiring fund managers managing collective investment schemes to take climate-related risks into consideration in their investment and risk management process, and to make appropriate disclosures to meet investors’ growing demand for climate risk information.

ESG institutions around the globe, such as Task Force on Climate-related Financial Disclosures ("TCFD"), The Principles for Responsible Investment ("PRI"), Sustainability Accounting Standards Board ("SASB"), International Sustainability Standards Board ("ISSB"), and Global Reporting Initiative ("GRI") are working to formulate standards and define materiality to facilitate the incorporation of these factors into the investment process.
ESG and CSR (Corporate Social Responsibilities) are not identically the same but both consider company’s impact on society and environment. CSR describes a company’s socially responsible commitment, efforts and practices and is often used by the corporate side. On the other hand, ESG is the term used by asset managers and investors to evaluate corporate behaviour and to determine risks and growth opportunities based on non-financial metrics.

**INCENTIVE is the key to encouraging participation at all levels**

Responsible investment\(^1\) is an approach to investing which explicitly acknowledges the relevance of ESG factors in investment decision-making as well as the long-term health and stability of the financial market as a whole. Furthermore, it recognises stable, well-functioning and well-governed social, environmental and economic systems.

Reference: 1. The Principles for Responsible Investment
Why ESG?
A common debate is if ESG adds value to companies' performance. According to a study by the University of Oxford\(^1\), a “high sustainability portfolio” outperforms a “low sustainability portfolio” by 4.8% on an annual basis (when using a value weighted portfolio, the results indicate an annual outperformance of 2.3%). Overall, the findings point to the possibility of earning an alpha by investing in firms with a superior sustainability profile.

The table below shows the Indexes with ESG considerations perform better than HSI over the long run

![Index Performance Graph](image)

<table>
<thead>
<tr>
<th>Index Points (Rebased)</th>
<th>Annualised Return</th>
<th>Annualised Volatility</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1-Yr</td>
<td>3-Yr</td>
</tr>
<tr>
<td>HSI ESG Enhanced Index</td>
<td>-23.44%</td>
<td>-4.87%</td>
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<tr>
<td>HSI Low Carbon Index</td>
<td>-21.52%</td>
<td>-5.14%</td>
</tr>
<tr>
<td>Hang Seng Climate Change 1.5°C Target Index</td>
<td>-24.56%</td>
<td>-3.02%</td>
</tr>
<tr>
<td>Hang Seng Corporate Sustainability Index</td>
<td>-7.68%</td>
<td>-2.13%</td>
</tr>
<tr>
<td>Hang Seng ESG 50</td>
<td>-16.48%</td>
<td>-3.14%</td>
</tr>
<tr>
<td>HSI</td>
<td>-21.87%</td>
<td>-5.67%</td>
</tr>
</tbody>
</table>

Source: Hang Seng Indexes Company, as of 30 Jun 2022

Reference: 1. 2015 University of Oxford & Arabesque Partners Meta-study, How sustainability can drive financial performance
The ESG Rating Model
How is ESG Measured?

Globally, many research institutes, rating agencies, index providers and investment management companies provide ESG ratings to reflect the management quality and the performance of a company with respect to ESG topics. Since 2010, Hang Seng Indexes Company has appointed an assessment body to provide ESG rating for the construction of Hang Seng Corporate Sustainability Index Series. Over the years, Hang Seng Indexes Company also on boarded international ESG ratings agencies such as Sustainalytics, ISS, and ESG Book, and launched various ESG Indexes.

In Hong Kong, the Hong Kong Quality Assurance Agency (“HKQAA”)’s rating model is designed to rate a company’s management system maturity and risks with regards to sustainability performance. The assessment captures both general and industry-specific criteria covering seven core subjects.

Seven Core Subjects

- **Corporate Governance**: Business ethics, controversial investments, and others
- **Labour Practices**: Labour-management relations, employee health and safety, supply chain – child labour / forced labour, and others
- **Fair Operating Practices**: Anti-competitive practices, bribery and corruption, and others
- **Community Involvement and Development**: Adverse impact on local communities, and others
- **Human Rights**: Freedom of expression and censorship, human rights abuses, and others
- **Environment**: Land use and biodiversity, spills and sewage, operation toxic or non-toxic waste impact of products and services, and others
- **Consumer Issues**: Marketing and advertising, production quality and safety, customer relations, and others
HKQAA Sustainability Rating Scale

Plan-Do-Check-Act Scoring Approach

**Starting**
No action taken

**Forming (Plan)**
Actions are under development / established without full implementation / implemented on an ad-hoc basis

**Implementing (Do)**
Actions have been fully implemented with advance planning to realise the recommended practice

**Confirming (Check)**
Data collection and analysis of the actions are conducted to gather relevant information to evaluate the effectiveness of the implemented practice

**Improving (Act)**
There is a review of the implemented actions to identify improvement areas
<table>
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<tr>
<th>Stage</th>
<th>Time Frame</th>
<th>Responsible Party</th>
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</thead>
<tbody>
<tr>
<td>Provision of a list of eligible companies</td>
<td>MAR - JUN</td>
<td>Hang Seng Indexes Company</td>
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<tr>
<td>Questionnaire pre-filling</td>
<td>MAR - JUN</td>
<td>HKQAA</td>
</tr>
<tr>
<td>Pre-filled questionnaire distribution</td>
<td>APR - JUN</td>
<td>HKQAA / Eligible companies</td>
</tr>
<tr>
<td>Feedback to HKQAA</td>
<td>MAY - JUN</td>
<td>Eligible companies</td>
</tr>
<tr>
<td>Scores and ratings finalised</td>
<td>JUL</td>
<td>HKQAA</td>
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<tr>
<td>Reports compilation</td>
<td>AUG - SEP</td>
<td>HKQAA</td>
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Our ESG Solutions
Milestones of our ESG Indexes

2010
Launch of Hang Seng Corporate Sustainability Index Series, composed of 3 indexes:
- Hang Seng Corporate Sustainability Index
- Hang Seng (China A) Corporate Sustainability Index
- Hang Seng (Mainland and HK) Corporate Sustainability Index

2011
Hang Seng Corporate Sustainability Index Series added 2 new benchmark indexes:
- Hang Seng Corporate Sustainability Benchmark Index
- Hang Seng (China A) Corporate Sustainability Benchmark Index

2013

2015
Launch of Hang Seng ESG Index Series:
- HSI ESG Index
- HSCEI ESG Index
Expanded the coverage from 300 A-shares to over 1,200 A-shares in 2019 yearly review

2019

2020
Launch of:
- Hang Seng ESG 50 Index

2021
Launch of:
- HSI ESG Enhanced Index
- HSI Low Carbon Index
- Hang Seng Shanghai-Shenzhen-Hong Kong Autonomous and Electric Vehicles Index
- Hang Seng Shanghai-Shenzhen-Hong Kong Clean Energy Index

2022
Launch of:
- Hang Seng Climate Change 1.5°C Target Index
- HSCEI ESG Enhanced Index
From ESG Data to Formulating Our Indexes

(1) **Best-in-Class:**
Selection of companies with the best ESG rating;

(2) **Integration of ESG factors:**
Incorporating the ESG factors into a base index;
- The constituent weights of the underlying index are adjusted according to the companies’ ESG factors
- The weightings of constituents with good ESG factors are tilted up while the weightings of those with bad ESG factors are tilted down
- Reduce tracking error from benchmark while integrating ESG considerations into the existing investment portfolio
(3) **Negative screening:**
Exclusion of companies with the worst ESG rating or deriving a certain threshold of their revenue from business activities seen as negative for society, e.g. thermal coal, controversial weapon or tobacco;

(4) **Norm Based screening:**
Exclusion of companies that violate global recognized norms, e.g. the United Nations Global Compact (UNGC) principles;

(5) **Sustainability Themed investing:**
Selection of companies with revenues generated or business related to sustainability theme, e.g. clean energy, electric vehicle;

(6) **Customized Indexes:**
With datasets from various international and local ESG rating providers, we can provide customised ESG index solutions which fit our clients’ needs.
## Sustainability Indexes

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<th>Sustainable investment Strategies / Focus</th>
<th>Best-in-Class</th>
<th>Negative Screening</th>
<th>Norm Based Screening</th>
<th>ESG Integration</th>
<th>Sustainability Themed</th>
<th>Decarbonisation-focused</th>
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<td><strong>Hong Kong-listed</strong></td>
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<td>Hang Seng Corporate Sustainability Benchmark Index</td>
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<td>Hang Seng Corporate Sustainability Index</td>
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<td>Hang Seng ESG 50 Index</td>
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<td><strong>Mainland-listed</strong></td>
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<td>Hang Seng (China A) Corporate Sustainability Benchmark Index</td>
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<td><strong>Cross-market</strong></td>
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b. ESG Ratings

Company ESG Ratings

Our webpage “ESG Service” was launched in August 2020 to serve as a comprehensive platform of our ESG solutions.

ESG Performance of our ESG index constituents can be viewed on the webpage: or you may go there to download ESG reports of individual companies.

Step 1:
Input the Company Name or Stock Code into the search bar

Step 2:
Click on the company name to view its ESG reports

Step 3:
You can download the report by clicking “Download Report”
Logo for Constituent Companies

The Hang Seng Corporate Sustainability Index Series includes companies that perform well with regard to corporate sustainability. Being a constituent member of this index series reflects high environmental, social and corporate governance standards in a company.

Constituent companies can use the logo under permission, which is renewed on an annual basis. The display of the logo on corporate or promotional materials is a reflection of a company’s achievements in the area of corporate sustainability.
For more information, please contact

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