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Canada China Business Council
Conseil d'affaires Canada-Chine
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Extending our Horizons:

Business and ESG Integration in China

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Preface

China is on what could be characterized as a globally unprecedented mission; to green its economy, to increase quality of life for its citizens, and to create a sophisticated, fair and modern market for business. At the macro level, these goals would inspire increased confidence from most executives in Canada and beyond seeking to trade and invest in this complex landscape – but what are the on-the-ground commercial implications for companies operating in these shifting tides?

This CCBC and PwC China report seeks to begin to unravel that question through the lens of Environmental, Social and Governance (ESG) guidance for Canadian organizations in China.

Policies in China in this space are changing rapidly, and will have significant primary and secondary business effects. In the pursuit of greater equality, concepts such as "common prosperity" may well yield transformative results. However, the operating environment changes that a company will face as the interpretation of these high-level ideas trickles down into more granular ramifications could cause growing pains for firms that find themselves unprepared. China's dual carbon targets are ambitious and admirable, and yet that more tightly controlled space will leave, for example, Canadian natural resource exporters with significant new regulations to contend with as we drive towards 2030 and 2060. And as financial markets become more contentious, board operations, disclosures and monitoring of ESG metrics will become critical for firms in the public sphere to ensure they are conducting themselves responsibly and transparently. The overarching goals are positive, but the associated market risk is considerable as well.

Against this backdrop, the bilateral trade and investment relationship continues to become more complicated and adversely affected by geopolitics. We at the Canada China Business Council, with support from CanExport Associations, were pleased to partner with industry leaders at PwC China on this important report that discusses commercial realities for companies that want to be ahead of the game, as ESG factors are already beginning to contribute to that already complex matrix.

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Preface

Around the world, the focus on sustainability is more intense than ever. As China steps up to address global challenges, such as climate change, social equality and poverty alleviation, Environmental, Social and Governance (ESG) issues are increasingly critical for all business sectors.

In line with these trends, we have seen a rapid increase of ESG awareness and reporting in recent years. China's ambition to reach peak carbon by 2030 and achieve carbon neutrality by 2060, along with other policy goals such as greater social equality, will drive greater demand for transparency around the sustainability of companies' operations, supply chains and products. Indeed, these ambitions are already resulting in a faster than expected proliferation of ESG-related policies, as well as changes to investment and business engagement that will have significant impact on companies across various business sectors.

As detailed throughout this report, these developments present opportunities for companies to build trust with local stakeholders, regulators and supply chain partners, to advance the quality of products through better supply chain management and to build stronger brands both in China and further afield by engaging positively with local communities. On the other hand, foreign companies operating in or sourcing from China will be increasingly exposed to ESG risks and will need to stay on top of the fast-paced changes in both regulatory requirements and market expectations.

PwC China attaches great importance to this opportunity to work with the Canada China Business Council to share ESG highlights, relevant policy developments and local practices. This document aims to help Canadian companies better understand the market realities and implications and be better prepared to comply with evolving ESG standards while achieving their business goals in China. We hope to continue engaging with Canada China Business Council and supporting its member companies on their ESG transformation journeys.

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Abbreviations and Acronyms

AMAC	Asset Management Association of China
CBAM	Carbon Border Adjustment Mechanism
CDP	Carbon Disclosure Project
COP15	Fifteenth meeting of the Conference of the Parties
CSCS	Corporate Social Credit System
CSRC	China Securities Regulatory Commission
ESG	Environmental, Social and Governance
ETS	Emissions Trading System
EU	European Union
GHG	Green House Gas
GPBB	Global Partnership for Business and Biodiversity
GRI	Global Reporting Initiative
HKEX	Hong Kong Exchanges and Clearing Limited
IUCN	International Union for Conservation of Nature
MEE	Ministry of Ecology and Environment
NDRC	National Development and Reform Commission
PBoC	People's Bank of China
RBC	Responsible Business Conduct
SAMR	State Administration for Market Regulation
SASAC	State-owned Assets Supervision and Administration Commission of the State Council
SBTi	Science Based Targets initiative
Scope 1 emissions	Direct emissions from company-owned and controlled resources
Scope 2 emissions	Indirect emissions from the purchased electricity, steam, heating & cooling for own use
Scope 3 emissions	Indirect emissions that arise from other value chain activities
SDG	Sustainable Development Goal
SSE	Shanghai Stock Exchange
SZSE	Shenzhen Stock Exchange
TNFD	Taskforce on Nature-related Financial Disclosures
UN	United Nations

Understanding key ESG issues in China

Drivers of sustainable development

China has incorporated the concept of "ecological civilization" and the implementation of sustainable development into its national strategy. The report of the 19th National Congress of the Communist Party of China stresses the implementation of the sustainable development strategy, requiring adherence to the "harmonious coexistence between humans and nature".

Industrial transformation is critical to achieve the country's high-quality development. After more than 40 years of rapid growth, China's economic focus has shifted to high-quality development. This transition requires building new development patterns and cultivating new economic growth pillars supported by information technology, network economies, artificial intelligence and much more.

Through its goal of "Common Prosperity", the government seeks to safeguard social stability by focussing on quality of life and balancing the development of urban and rural areas. While China met its goal of irradicating poverty by 2020, there is still uneven development among different regions.

Currently, the country is seeking to achieve comprehensive, coordinated and balanced sustainable development with the goal of "Common Prosperity". This includes planning for improvement in aspects of people's livelihood such as education, medical care, social security, and income distribution.

Moreover, China sees sustainable development not only as a domestic growth issue, but as an opportunity to enhance its global image as well as an avenue of cooperation with other countries. In an increasingly fractured world, reaching a global consensus is challenging. Sustainable development has become an area of focus for the international strategies of many countries, and a top choice of building common understanding through bilateral or multilateral mechanisms. For example, under the UN SDG framework, the world is connected in addressing 17 top challenges faced by the planet. [1] The pandemic, along with the climate crisis has exacerbated the challenges of progressing sustainable development and 2030 agenda, making it more urgent in building collective efforts.

[1] UN SDG

Key ESG issues in China

Sustainable development has rapidly become a key area of focus for countries, regions and enterprises globally. A series of reports tracking companies' SDG priorities in China found that over the past two years there has been a clear shift[2] . Enterprises in China are starting to put greater focus on SDGs connected with economics and environment, whereas previously, priorities had focused on social dimensions[3].

When ESG emerged in China in the 2000s, it was closely linked to the Global Reporting Initiative (GRI) disclosure framework. Later driven by interest from regulators and investors, ESG management gradually gained focus amongst Chinese corporates. Currently, ESG requirements in China are similar to the "Responsible Business Conduct" (RBC) standards, which outline how companies do business in a socially responsible and environmentally sustainable manner.

Seven ESG issues out of the full list in **Exhibit 1** will be discussed in this report. These specific elements of ESG are increasingly important in China and need to be addressed by foreign companies operating in, or sourcing from China. In the following sections, each issue will be presented in the context of policy updates and market implications for enterprises.

[2] The reports are co-published by PwC China, UNDP China and CCOIC, and aims to provide an overview of how companies in China are engaging with the UN SDGs.

- https://www.pwccn.com/en/services/consulting/publications/private-sector-awareness-of-the-sustainable-development-goals-jul2020.html;
- https://www.pwccn.com/en/services/issues-based/esg/pathway-to-net-zero-report-dec2021.html

[3] The increased prioritization of the economic dimension may be partially explained by the impact of COVID-19, and the increased prioritization of the environmental dimension is trigged by the dual carbon targets.

Exhibit 1 - Key ESG Issues in China [4]

Environmental pillar

Climate Change	1 **Net Zero Targets**	2 **Carbon footprint**	Financing environ-mental impact	Climate change vulnerability
Natural resources	Water stress	3 **Biodiversity & land use**	Raw material sourcing	
Pollution & waste	Toxic emissions & waste	Packaging material & waste	Electronic waste	
Environment opportunity	Opportunities in clean tech	Opportunities in green building	Opportunities in renewable energy	

Social pillar

Human capital	4 **Employee welfare**	Health & safety	Human capital development	5 **Supply chain labour standards**		
Product liability	Product safety & quality	Chemical safety	Financial product safety	Privacy & and data security	Responsible investment	Health & demo risk
Stakeholder opposition	Controversial sourcing					
Social opportunity	Access to communi-cation	Access to finance	Access to health care	Opportunities in nutrition & health		

Governance pillar

Corporate governance	6 **ESG governance**	Executive pay	Ownership	Accounting	
Corporate behaviour	Business ethics	7 **Anti-competitive practices**	Corruption & instability	Financial system instability	Tax trans-parency

[4] PwC analysis.

Implications for Canadian companies

The development of ESG in China is largely driven by newly minted laws, regulations and standards across many segments of government and markets. In line with China's ambitious goal of carbon neutrality and the improvement of social equality, ESG related policies are being developed much faster than had been expected, and will have significant impact on companies across various business sectors.

Canadian companies, those which have subsidiaries operating in China, or are simply doing business with Chinese companies directly (or indirectly through supply chains) may also be affected. When considering ESG issues in China, while there is a top-down approach in terms of policy development, companies also need to dive into local policies relevant to the specific concerns. When addressing each ESG issue, this report will start with a policy overview at the national level.

Under the guidance of the "Responsible Business Conduct" standards, Canadian companies are encouraged to do business responsibly abroad. There are examples of Canadian companies which have made net zero commitments, worked to empower women, youth and communities, or set ESG principles at the core of corporate governance. Best practices could be shared and implemented with Chinese subsidiaries and through the supply chain, building trust with local communities, authorities and directly with suppliers, and presenting a positive brand story that can be shared with consumers. Canadian companies could also learn from success stories of leading Chinese companies which may have a clearer understanding of local policies and cultures.

With the changing environment of ESG development, companies of any size, in any sector, and in any market will be faced with both opportunities and challenges. To seize the business opportunities as well as mitigate financial or reputational risks, it is important for all Canadian companies to understand ESG issues in China and to incorporate ESG into business strategies and daily operations. Market implications and takeaways relating to each of these issues are featured throughout this report.

Net zero strategies are being adopted to address climate change

Policy spotlight

A holistic policy framework for carbon neutral economic development is being established

At the UN General Assembly in September 2020, China announced its target of peaking carbon emissions before 2030 and reaching carbon neutrality before 2060, which is widely regarded as a major step forward in the global fight against global warming. In October 2021, China formulated the "1+N" policy framework, where "1" refers to the long-term approach to combat climate change[5] and "N" refers to implementation plans in key areas and sectors as well as a series of supporting measures to achieve the dual carbon goal **(Exhibit 2).**

[5] "1" is well documented in The Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy issued on October 24, 2021.

Exhibit 2- Related Climate Regulations/Policies

2016 2017 2018 2019 2020 2021 till now

Seven authorities, including the PBoC and the CSRC, jointly issued the Guidelines for Establishing the Green Financial System, requiring **the gradual establishment of the mandatory environmental information disclosure system for listed companies and bond issuers.**

The CSRC and the MEP signed the **Cooperation Agreement on Jointly Developing Environmental Information Disclosure of Listed Companies**.

The CSRC revised the Listed Company Governance Code, stipulating that **listed companies have the responsibility to disclose ESG information**. The Asset Management Association of China (AMAC) issued the first Green Investment Guide (Trial) and the Research Report on ESG Evaluation System for Chinese Listed Companies.

The PBoC issued a trial guideline to pilot financial institutions, which spelled out the framework and content for **financial institutions' environmental information disclosure.**

President Xi Jinping **announced** that China aimed to hit carbon emission peak by 2030 and achieve carbon neutrality by 2060, which is also known as **the dual carbon targets**.

The CSRC revised format standards for annual reports and semi-annual reports of listed companies, **separating relevant provisions on environmental and social responsibility of listed companies.**

China **released an action plan** for reaching carbon emission peak before 2030 and published the **Common Ground Taxonomy on Climate Change Mitigation** with EU.

The MEE **released the Measures for Enterprises to Disclose Environmental Information**, which requires five types of enterprises to disclose environmental information accordingly.

The State Council published the 14th Five-Year **Comprehensive Work Plan for Energy Conservation and Emission Reduction.**

The NDRC and other four authorities issued the **Implementation Guidelines for Energy Conservation and Carbon Reduction Renovation and Upgrading in Key Areas of Energy-intensive Industries** (2022 Edition).

Market implications

Raw material cost and operational expenditures might increase in the short term as a result of decarbonization solutions

In order to meet energy conservation and emission reduction requirements, Chinese enterprises often need to install energy-saving equipment or use renewable energy sources (such as rooftop solar panels), which may increase the price of their products and services. Companies operating in or sourcing from China need to be aware of such cost pressure and integrate it into their medium-and-long-term business strategies.

Enterprises should establish long-term decarbonization strategies

Corporate climate action plans are becoming a “must-have” rather than a “nice-to-have.” By setting up carbon reduction targets in line with the goals of the Paris Agreement and adopting business transition and decarbonization solutions, corporates may develop new business opportunities and establish new market advantages.

Case study

Setting clear goals to achieve carbon neutrality and designing corporate climate action plans

Box 2.1 Ant Financial 's Carbon Neutrality Strategy[6]

In March 2021, Ant Financial released its net zero commitment, proposing three major goals:

1) To facilitate carbon reduction by technology-driven solutions and developing a carbon neutrality action plan through joint-efforts with all stakeholders.

2) To achieve net zero in its operations (Scope 1 and Scope 2 emissions) by 2021.

3) To achieve net zero in both its operations and value chains (Scope 1, Scope 2, and Scope 3 emissions) no later than 2030.

Concrete action plans came after these ambitious targets, which include:

1) Promote employees' awareness of net zero and incorporate emission reduction targets into supplier management.

2) Carry out energy-saving and emission-reduction transformation in existing industrial parks, and adopt green building standards in new ones.

3) Strengthen GHG data management and offset the remaining emissions.

4) Actively and steadily explore green investment and jointly establish a fund for net zero technology innovation.

Takeaways

- When establishing and disclosing net zero or low-carbon strategies, companies are expected to set goals in the short, medium, and long term.
- There is no unified net-zero strategy that fits every company. Strategies should be developed based on the characteristics of the industry, the business operation model, and expectations of both internal and external stakeholders.
- Action plans should go beyond the company itself to partners in the supply chain, where factors like level of influence and data accounting are critical to success.
- Companies are increasingly expected to be able to track the environmental footprint of their subsidiaries and top-tier suppliers. Enforcing emissions reduction initiatives among key suppliers will become critical.

[6] https://www.antgroup.com/news-media/media-library?type=%25E7%25A4%25BE%25E4%25BC%259A%25E8%25B4%25A3%25E4%25BB%25BB%25E6%258A%25A5%25E5%2591%258A

Corporate and product level carbon footprint management is expected

Policy spotlight

Corporate and product carbon emissions disclosure has been brought into focus

Emissions from the consumption of products account for nearly two-thirds of total global emissions[7]. As early as 2015, the Chinese government issued the Implementation Plan for the Energy Efficiency "Frontrunner" System, which promoted low-energy-consuming products and serves as the local carbon footprint label system for green and low-carbon products. China has put forward the "dual control system", a mechanism used to control energy consumption and energy intensity. This will eventually transition into the same control system for carbon. China has also demonstrated its commitment to green supply chain management by issuing a series of policies since 2014 **(Exhibit 3)**. As to industrial standards, the "Green Manufacturing - Green Supply Chain Management Guidelines for Manufacturing Enterprises" was issued in 2017, providing basic guidance for enterprises to carry out green supply chain management. In addition, dozens of green supply chain standards have been launched by government authorities in China, including the Ministry of Industry and Information Technology, the Ministry of Ecology and Environment, and the Ministry of Commerce.

Regulatory requirements on supply chain emissions management will be strengthened

Currently, China's policies and regulations only require large enterprises in key industries to disclose environmental information. It is expected that relevant authorities and leading companies will develop more stringent green requirements on the upstream and downstream supply chain, covering annual energy and water savings, carbon reduction, use of sustainable packaging materials, and so forth. Relevant information will not only be reported to government authorities but also be open to the public based on the information disclosure framework.

Exhibit 3 - Related Carbon Footprint Regulation/Policies

2016

Issued the "**Industrial Green Development Plan (2016-2020)**", requiring the establishment of a green supply chain supported by green supply chain standards and an extended producer responsibility system.

Issued the "**Notice on the Construction of Green Manufacturing System**", which includes green factories, green products, green parks, and green supply chains.

The Ministry of Finance and the Ministry of Industry and Information Technology **issued the Notice on Integration And Optimization (Green Manufacturing)**.

2020

Issued **Opinions on Speeding up Establishing Legal and Policy System for Green Production and Consumption**, which aims to improve current laws and regulations, and facilitate green production and consumption nationally.

2021

Beijing released **Guidelines for Electronic Information Products Carbon Footprint Accounting**.

Issued the "**Guiding Opinions of the State Council on Accelerating the Establishment and Improvement of a Green, Low-Carbon and Circular Development Economic System**", which proposed a clear timeframe, and set targets by 2025 and 2035.

2022

Approved the standard called General Principles of Enterprise **Carbon Label Evaluation**.

[7] UNEP, the Emissions Gap Report 2020

Market implications

Enterprises operating in China may also be confronted with challenges from local NGOs regarding carbon footprint

Non-government organizations are actively monitoring and evaluating corporates' carbon footprint management and achievements. The Corporate Information Transparency Index (CITI) [8], a well-known index evaluating brands in China, was developed by the Institute of Public & Environmental Affairs (IPE) in 2014 to measure and rank companies' supply chain environmental management performance. In 2021, a new index named the "Corporate Climate Action Transparency Index" (CATI) was released by the same organization, focussing on climate actions taken. Enterprises are expected to improve supply chain transparency throughout the industry by empowering their suppliers. Currently, few companies disclose their supply chain emissions (Scope 3 emissions), as the data is too difficult to verify. For enterprises sourcing from or operating in China, it is essential to improve their environmental management capabilities. Based on the latest disclosed information gathered on the Carbon Disclosure Project (CDP)[9] platform, the number of Chinese suppliers with low-carbon products or services increased from 67 in 2018 to 243 in 2020, accounting for 19% of the overall Chinese suppliers recorded on the platform[10].

Product carbon labelling will play an important role in international trade

Carbon labelling will play an important role in the process of international trade, especially affecting those in developing countries and potentially giving rise to new "green barriers". The world's leading economies continue to innovate policies and actions around emission reductions. In July 2021, the EU issued a proposal to establish a carbon border adjustment mechanism (CBAM), which is expected to be launched on a three-year trial basis, beginning in 2023, before it is officially implemented in 2026[11] . In China, the pilot carbon footprint label program started in 2018[12], and more industrial carbon footprint standards are expected to be established in the future. Product-level emissions disclosures can serve as a clear mechanism to interact with consumers. Confronted with potential "green barriers" in international trade, enterprises need to continuously improve their internal governance and assessment on green supply chain management and to carry out in-depth cooperation with upstream and downstream partners.

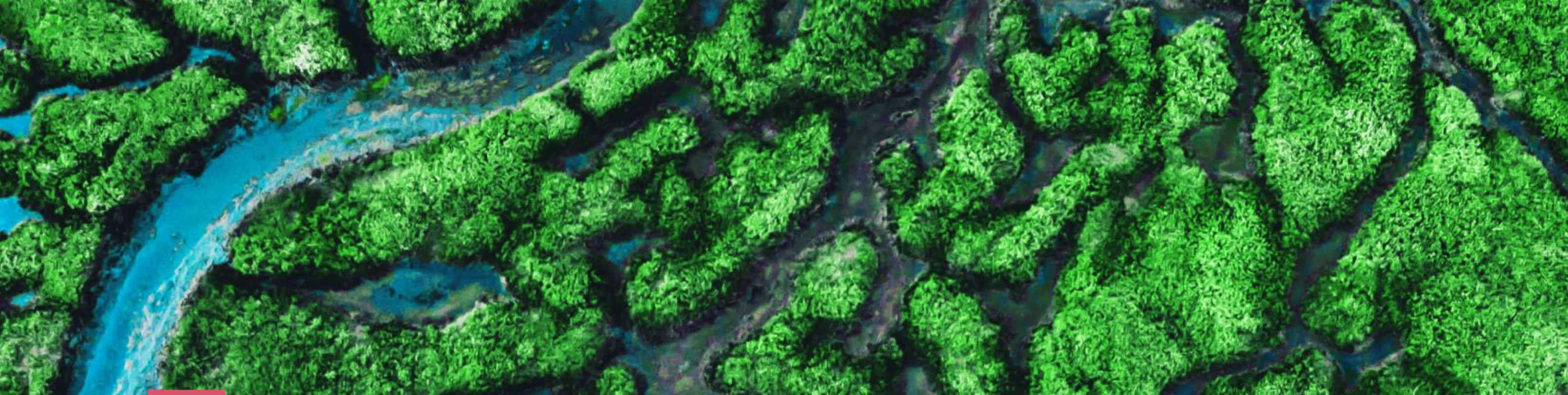
[8] http://www.ipe.org.cn/GreenSupplyChain/Main.html.

[9] https://www.cdp.net/en.

[10] CDP, "Seizing Green Recovery Opportunities and Accelerating Supply Chain Transparency", 2020 China Supply Chain Report.

[11] The proposal is still being amended and cannot rule out the possibility of adjustments to the relevant arrangements, such as the timing of the official implementation of the carbon tariff.

[12] In November 2018, the China Electronic Energy Conservation Technology Association piloted the China Carbon Footprint Label program, resulting in subsequent standards being developed by organizations including the National Low Carbon Certification Technical Committee, China Electronic Energy Saving Technology Association (CEESTA), and the China Quality Certification Center (CQC).



Case study

Extending carbon footprint management from compliance to collaboration and enhancing consumer engagement through digital solutions

Box 2.2 Textile companies are enhancing their communication with consumers by disclosing environmental footprint information

Kering developed an Environmental Profit & Loss (EP&L) toolkit[13] for measuring and quantifying environmental impact.

The EP&L measures carbon emissions, water consumption, air and water pollution, land use, and waste production along the entire supply chain, thereby making the various environmental impacts of Kering's activities visible, quantifiable, and comparable. These impacts are then converted into monetary values to quantify the use of natural resources.

A Chinese textile company displays the carbon footprint of its cotton T-shirts

Peacebird, a Chinese textile enterprise, reported the carbon footprint of its cotton T-shirts in 2021. The T-shirts have QR code tags linking to a report on the carbon footprint of the product.

Takeaways

- Enterprises need to understand and be able to disclose environmental information across their supply chain. Failing to disclose might result in financing difficulties, loss of trust from consumers, or other negative impacts on the business.
- Requirements on product-level emissions reduction will start from carbon intensive industries and gradually cover a broader range of sectors. Companies which reduce product carbon intensity in advance will have a competitive advantage.
- Chinese consumers have gradually raised their expectations for traceable information of goods they purchase, especially regarding raw materials and product inputs. Leading companies with transparent disclosure policies can further build their brand and gain recognition from their consumers.

[13] Data source: https://keringcorporate.dam.kering.com/m/123011b213f0bbf4/original/Rapport-Kering-Environmental-Profit-and-Loss-report-2020-EN-only.pdf

Biodiversity and better land use are increasingly front of mind in China

Policy spotlight

Environmental authorities have published a variety of biodiversity-related policies and regulations

The United Nations General Assembly set 2010-2020 as the "United Nations Decade for Biodiversity Conservation". As the host country of the fifteenth meeting of the Conference of the Parties (COP15) to the United Nations Convention on Biological Diversity, China has a key role in promoting consensus among countries on the post-2020 Global Biodiversity Framework. Chinese local authorities have formulated and revised more than 50 laws, regulations, and other multi-level legislation related to biodiversity conservation. Since changes in land-use patterns will directly lead to climate and biodiversity risks, China has proposed ecological red lines, which initially cover 25% of its land area, for safeguarding natural resources. In addition, China views nature-based solutions as a critical component of policies related to climate change in the "1+N" policy framework **(Exhibit 4).**

Regulations on biodiversity risk management in the financial sector will increase, which will in turn affect all other business sectors

Research on biodiversity loss and financial stability is increasingly being included in the agendas of many of the world's central banks[14] and financial regulators. Considering biodiversity is becoming relevant to corporates' financing and investment activities, new policies have been issued to encourage and support this process[15]. Leading industry alliances and initiatives have been set up. The Natural Capital Alliance, together with the World Business Council for Sustainable Development and a local consultancy GoldenBee, launched the "Business for Nature" initiative[16]. At COP15, a coalition of leading financial institutions, composed of 36 Chinese banks, 24 foreign banks, and other international financial organizations, jointly committed their support for biodiversity conservation and formalized the "Joint Declaration of the Banking Sector to Support Biodiversity Conservation"[17].

Exhibit 4 - Related Biodiversity Regulation/Policies

1992: Became **one of the first countries to sign the Convention on Biological Diversity**, ratified and acceded to the Cartage Protocol on Biosafety and the Nagoya Protocol on Access to Genetic Resources.

2010: Formulated and implemented the **China Biodiversity Conservation Strategy and Action Plan (2011-2030).**

2011: Established **the National Committee for Biodiversity Conservation** to coordinate conservation actions.

2015: Joined the **"Global Partnership for Business and Biodiversity" (GPBB)** initiated by the Secretariat of the Convention on Biological Diversity.

2016: The Thirteenth Five-Year Plan (2016-2020) **established a national landscape management system**, which delineated redlines of ecological protection, and developed a natural reserve system for national-wide ecological protection.

2017: **Ecological protection redlines** were first proposed by China in 2011, officially adopted in 2017 to protect territorial area, and are being extended to the marine protection.

2019: Five authorities, jointly announced national plan of the new round of the **Returning Farmland to Forests and Grassland**.

2020 till now:

- Released the **Overall Plan for National Major Ecosystem Protection and Restoration Major Projects (2021-2035).**
- **Held the COP15** and demonstrated responsibility to unswervingly promote the construction of "ecological civilization" and to **"Build a Shared Future for All Life on Earth".**
- Released the white paper **Biodiversity Conservation in China** to systematically introduce China's biodiversity conservation status.
- Issued the **Opinions on Further Strengthening Biodiversity Conservation** , which required to speed up the improvement of biodiversity conservation policies and regulations.

[14] A joint study group of the Central Bank Green Finance Network (NGFS) and INSPIRE, composed of more than 90 central banks, financial regulators, and international organizations.

[15] For example, the recently issued national policy named Opinions on Encouraging and Supporting Social Capital to Participate in Ecological Protection and Restoration.

[16] The initiative focuses on the "natural capital" and aims to help companies to understand the importance of natural capital and the necessities to incorporate it into investment decisions.

[17] https://new.qq.com/omn/20211015/20211015A0C3LU00.html

Market implications

Consideration of biodiversity needs to be included in business decisions

In order to protect its status as one of the most biodiverse countries in the world, China has put forward the concept of “ecological civilization”. Understanding how business activities affect biodiversity, how dependent they are on natural systems, and the extent to which companies take steps to mitigate these impacts along their value chains, will help companies effectively identify and manage the risks and opportunities. The Taskforce on Nature-related Financial Disclosure (TNFD) has been launched to promote relevant disclosure by enterprises and financial institutions and channel capital flows into areas consistent with the protection of natural resources[18].

Enterprises need to identify and manage nature-related risks

While companies are increasingly able to identify climate-related risks, the ability to identify nature-related risks is lagging. CDP and International Union for the Conservation of Nature (IUCN) analyzed the 4367 companies that responded to CDP climate, forests, and water questionnaires globally[19]. Of the respondents, 68% identified climate-related risks, and less than 1% identified nature-related risks (i.e., ecosystem vulnerability). Among the climate and nature-related opportunities disclosed by companies, “enhancing resilience to climate change impacts" was reported most frequently (66%), followed by "reducing water consumption" (17%) and "sourcing sustainable materials" (14%). Similarly, in China, while companies have only recently started to disclose water and forestry-themed data, climate change information topped the list[20].

[18] The Taskforce on Nature-related Financial Disclosures (TNFD) was announced in July 2020, with the preparatory phase of the initiative running from September 2020 until June 2021.During the preparatory phase, an Informal Working Group – comprising 75 members, including 49 financial institutions and corporates, 8 governments and 18 consortiums worked on the scope and workplan of the TNFD.

[19] https://portals.iucn.org/library/sites/library/files/documents/2021-038-En.pdf

[20] CDP, Dealing with the Environmental information Disclosure And accelerating the Low-Carbon Transformation, the 2020 China Listed Companies Report.

Case study

Factoring natural capital[21] into business

Box 2.3 China General Nuclear Power Group (CGNPC) quantified the relationship between business and nature in their nature capital assessment report[22]

CGNPC, a large state-owned clean energy enterprise in China, published the first domestic biodiversity conservation report in 2021 based on the natural capital framework which aimed to put a dollar value on the services provided by nature.

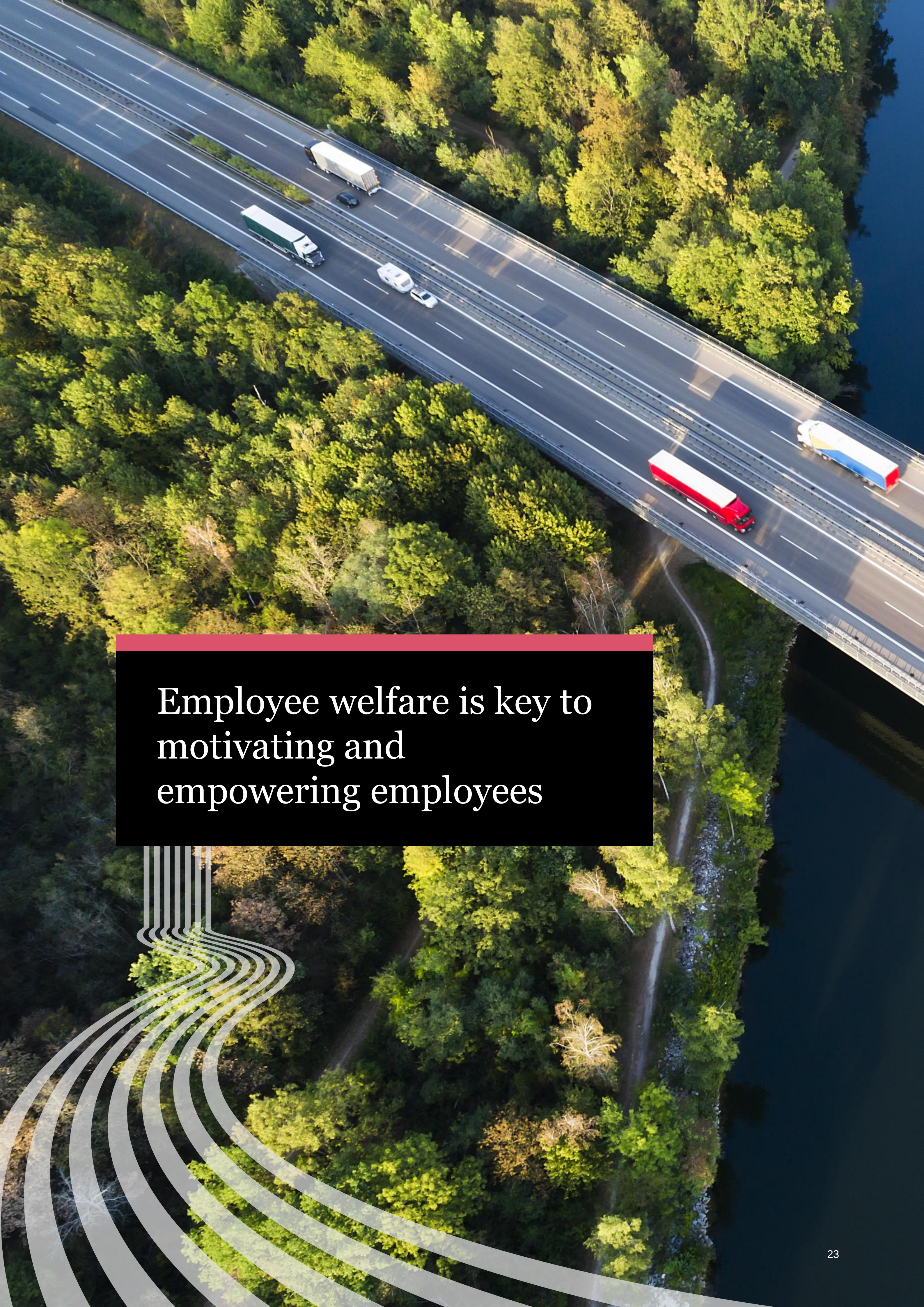
The report valued the natural capital of the Shenzhen Daya Bay Nuclear Power Base during the operation period from 1994 to 2019 (CNY 424 billion), and that of the Yunnan Modoushan Wind Farm from 2012 to 2019 (CNY 774 million). The report also laid out CGNPC's biodiversity conservation hierarchy of "avoid-reduce-mitigate-compensate" and adopted international quantitative and qualitative approaches to natural capital accounting.

Takeaways

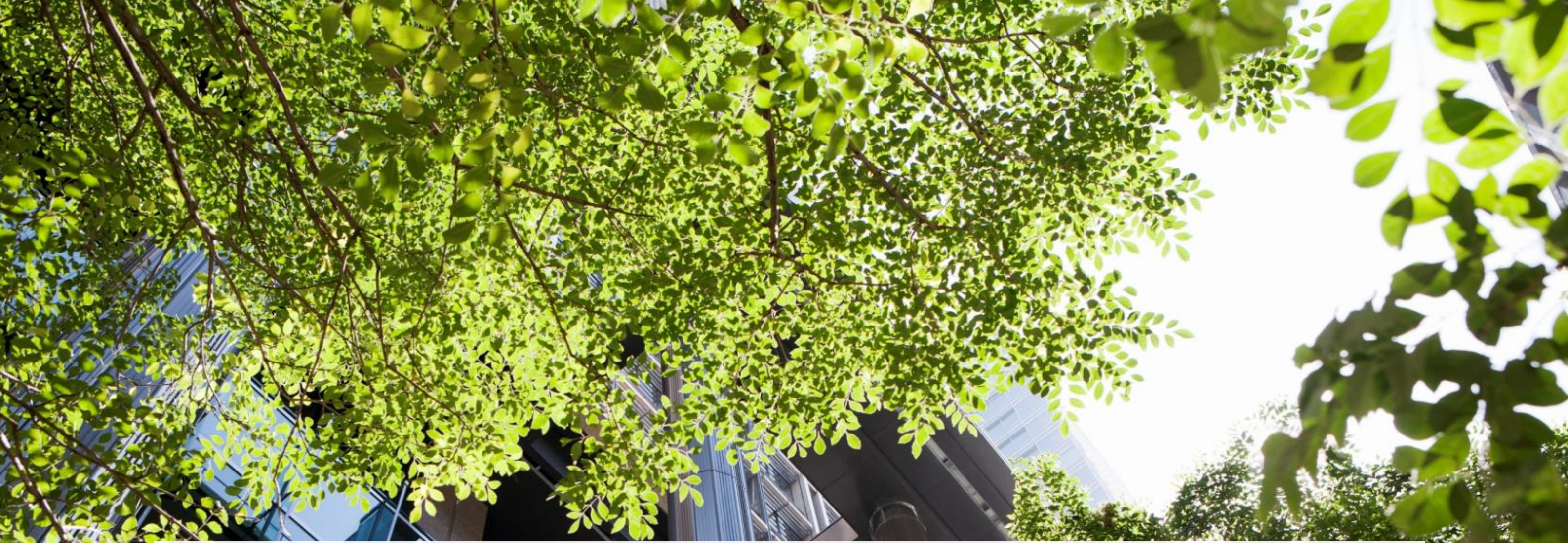
- Biodiversity issues may induce significant risks. Enterprises should make efforts to identify, evaluate and quantify the potential impact of natural capital loss as part of their due diligence.
- To avoid unintended negative outcomes, enterprises should fully understand local regulations, policies and standards covering climate change, environmental pollution, and biodiversity.

[21] https://capitalscoalition.org/.

[22] The China General Nuclear Power Group Biodiversity Conservation Report http://www.cgnpc.com.cn/cgn/c101087/zlk.shtml



Employee welfare is key to motivating and empowering employees



Policy spotlight

Employee welfare is increasingly important during the pursuit of "Common Prosperity"

In China's journey to build a society based on "Common Prosperity", government authorities are increasingly focussing on employee welfare. In the post COVID-19 period, people are more concerned with quality of life. Topics like labour benefits, workplace safety and work-life balance are widely discussed in both traditional and social media. Companies in China are required to comply with a series of employee welfare policies and standards, ranging from equal pay, transparent promotion policies, public holidays, maternity, and paternity leave to professional training (Exhibit 5). It is reported that for China's Generation Z (those aged 18-25), personal well-being and mental health rank as their second most important factor to consider when selecting a job[23].

Exhibit 5 - Related Employee Welfare Regulation/Policies

The Ministry of Commerce revised the Measures for the Administration of Overseas Investment which stipulates that enterprises shall **abide by local laws and regulations in oversea markets**... **perform social responsibilities in environmental and labour protection**.

Requirement of **equal employment and anti-discrimination** was stipulated into China's Employment Promotion Law.

Five authorities formulated the Code of Conduct for Overseas Investment and Operation of Private Enterprises, which put forward requirements on strengthening localized operation, **respecting cultural traditions, strengthening communication and improving information disclosure**.

2013 | 2014 | 2015 | 2016 | 2017 | 2018

Formulated the Guidelines for Environmental Protection in Outbound Investment and Cooperation, requiring enterprises to **respect the local religious beliefs, cultural traditions and ethnic customs** when investing in the host country.

Formulated the national standard "Social Responsibility Guidelines" based on the "ISO 26000 Social Responsibility Guidelines", which reaffirmed the applicability and importance of **human rights protection amongst various types of organizations**, including enterprises.

The "Measures for the Administration of Overseas Investment of Enterprises", which required Chinese investors to **protect the legitimate rights and interests of employees**, perform social responsibilities, and pay attention to ecological environment protection.

[23] https://www.accaglobal.com/gb/en/professional-insights/pro-accountants-the-future/gen-z.html

Market implications

The importance of flexible working has grown in the post-pandemic period

Attracting and retaining key talent is always one of the top factors for a successful business, especially for sectors like professional services and education. Nowadays, employees in the China are paying more attention to welfare issues like workplace safety, flexible work location, flexible working hours and having the technology required to support virtual meetings.

Strong employee engagement is critical for retaining key talent

In the post COVID-19 world, employee engagement is more critical than ever before. To attract and keep talent, some corporates have started projects for employees' children, such as spring and autumn outings, Children’s Day parties, and extracurricular interest groups. Corporates from different sectors may have different priorities concerning employee welfare. A report in 2021 shows that foreign companies tend to focus most on the mental health of employees, Chinese private companies have the largest investment in financial health, and state-owned enterprises are most concerned about the occupational development and social health of employees[24].

[24] https://www.prnasia.com/story/340978-1.shtml

Case study

Designing employee welfare programs based on industry characteristics

Box 3.1 JD.com initiated employee welfare projects covering housing loans and medical insurance

In 2012, JD.com launched the “Housing Plan” welfare project to support employees with the down payment of their first home. After 5-years of execution, JD.com announced that it has expanded its employee housing plan fund pool to CNY 1 billion, helping nearly 1,500 employees. Eligible employees can receive as much as CNY 1 million of interest-free loans. In addition, JD.com stipulates that all existing employees who have worked for more than five years in the company will be provided with unlimited health insurance for major illness[25].

In 2021, JD.com supported one well-known Chinese media platform to jointly release the "2021 Employee Welfare Insight Report" to further understand the perception and demand changes of employees regarding corporate employee welfare.

Takeaways

- Employee welfare in China is no longer an "image project" that embodies the care and respect for employees, but a reflection of corporate culture and values, and will also become an important factor in attracting and retaining employees.
- Companies operating in China need to design their employee welfare programs based on the local situation, common practice in the industry, and most of all, the actual needs of their employees.

[25] Relevant information is published on the JD official WeChat account named JDBlackboard.

Supply chain management builds trust between enterprises and stakeholders

Policy spotlight

Corporates are expected to contribute to the goals of "Common Prosperity" through supply chain engagement

China has demonstrated its commitment to green supply chain management by successively issuing a series of policies since 2014. As a global manufacturing powerhouse, the Chinese market is easily influenced by changes in global supply chain. For example, England, France and Germany have successively passed the Supply Chain Act to strengthen due diligence on suppliers' environmental performance, which may urge the Chinese government to raise the bar of similar regulations for enterprises operating in China. Moreover, expectations and requirements on supply chain social welfare management are rising in China. Corporates are expected to make sure their behaviours on sourcing and operating are compliant, and their suppliers strictly follow local requirements and guarantee no failures in terms of labour abuse or forced labour **(Exhibit 6).**

Companies are encouraged to monitor and positively influence the labour welfare performance of their suppliers

The stock exchanges in China, which already required listed companies to disclose their performance on labour benefits, are encouraging companies to extend their responsibilities from their own operations to partners in the supply chain. To achieve this, detailed standards need to be established to help corporates keep track of their suppliers' performance on social issues, and to minimize the associated supply chain risks. Furthermore, it is not only the compliance risks that matter. How these social issues may be perceived by stakeholders internationally and at home should also be carefully considered.

Exhibit 6 - Related Supply Chain Management Requirements/Policies

2014

Issued the **Guidelines for Enterprise Green Procurement (Trial)**, which asked to establish a green supply chain.

2017

Issued the guideline **Green manufacturing—Green supply chain management in manufacturing enterprises**.

2018

Issued the "**Notice on Carrying out the Pilot Program of Supply Chain Innovation and Application (2018)**", which required companies to:

- Formulate the guidelines to construct green supply chains for key industries in pilot cities
- Ask the pilot enterprises to start upstream and downstream management for the construction of the whole green supply chain.

2019

The HKEX revised its Environmental, Social and Governance Reporting Guidelines. The new version of the Guidelines **made the disclosure obligation for the social key performance indicators (KPIs) a "comply or explain" provision**. Moreover, HKEX **added two new key indicators** in Social aspect, including the **"supply chain management"** requiring enterprises to conduct necessary environmental and **social risk assessments**, and urging enterprises to formulate green procurement in their supply chain.

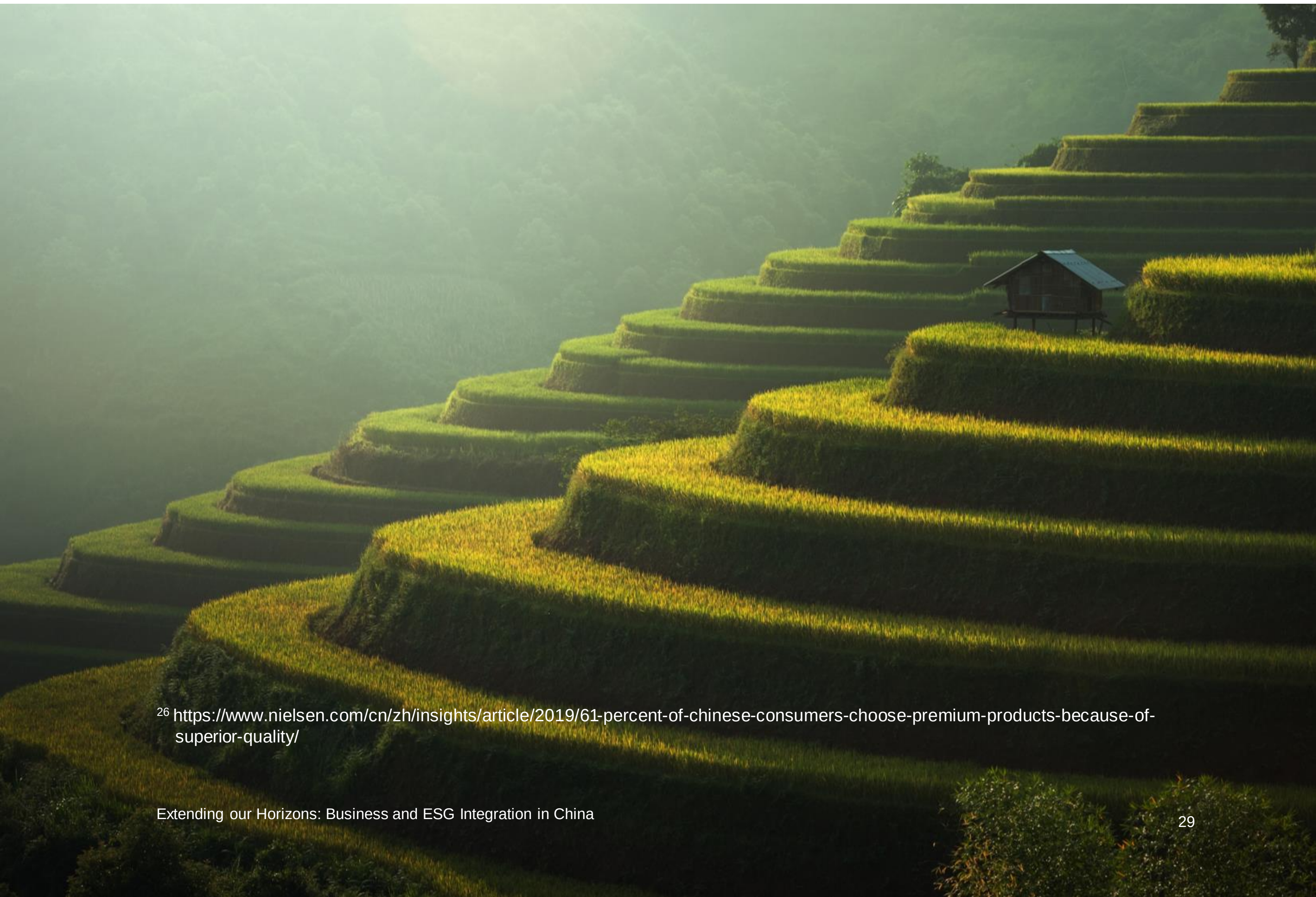
Market implications

Regular supplier audits based on implementation procedures will be required to support effective management

Simply establishing supply chain standards is not enough to fulfil effective supply chain management. Implementation procedures and audits are necessary to ensure a desirable outcome. To make sure that suppliers in different markets, including those in less developed areas, are all following the supply chain labour standards, companies need to make detailed implementation guidelines and conduct regular audits. Factors to be reviewed could include working hours, overtime accrued, contractual rates of pay, payroll, and health and safety standards and records. These audits should be conducted at least annually.

Chinese consumers are becoming more conscious of the importance of socially responsible products

Companies operating in China or sourcing from China need to ensure that they have good visibility of the labour standards of their supply chain partners. Product price is no longer the primary consideration for Chinese consumers when buying high-quality goods. According to a consumer survey[26], 37% of Chinese consumers are willing to pay more for socially responsible products.



[26] https://www.nielsen.com/cn/zh/insights/article/2019/61-percent-of-chinese-consumers-choose-premium-products-because-of-superior-quality/

Case study

Publish guidelines with clear targets to review ESG performance throughout the supply chain to avoid potential risks

Box 3.2 Li Ning, a Chinese sportswear company, assisted its suppliers in improving ESG performance

In 2019, Li Ning disclosed supplier social responsibility management guidelines on its official website, which formulated relevant implementation standards on suppliers' ESG performance. The guideline is implemented during the new suppliers' selection process and the regular evaluation of existing ones.

"Zero Tolerance Rules" were introduced in this public guidance, which covers six dimensions including eliminating false records and documents, prohibiting commercial bribery, prohibiting forced labour and inhuman treatment, and not polluting the environment[27]. Only when suppliers pass the audit based on the Zero Tolerance Rules, can they move to the next step of supplier selection for further audit.

[27] http://ir.lining.com/tc/csr/csr_reports/scsrmm_190826.pdf

Takeaways

- In order to build trust with stakeholders including upstream and downstream partners as well as consumers, corporates should reconsider the expectations of their relationship with suppliers by setting up clear requirements and guidance, especially on labour standards.
- Corporates operating in or sourcing from China should learn and understand the labour laws enforced at national, regional, provincial, and industrial levels. In doing so they could empower their suppliers from different sites to comply with the authorities' requirements.

Corporates are expected to formulate an effective governance structure to manage ESG performance

Policy spotlight

Enhancement of corporate governance to promote ESG development is required by supervisors

Recognition of the importance of corporate governance principles goes back several decades in China. In the 1990s, China took its first steps toward modern corporate governance by establishing the Shanghai and Shenzhen Stock Exchanges and by creating the China Securities Regulatory Commission (CSRC) to regulate its new stock market. Recent years saw the emergence of incorporating ESG management into corporate governance structure, as the concept of ESG or sustainable investment has been introduced in China and regulators and investors are currently focused on corporate ESG performance **(Exhibit 7)**. For example, the board's responsibilities include setting the company's ESG strategy, providing effective leadership, supervising the management of ESG issues and reporting to shareholders on their stewardship.

Exhibit 7 - Related Corporate Governance Regulations/Policies

2008 — 2012 — 2015 — 2018 — 2020

- The SASAC **issued "Guideline for Corporate Social Responsibility"** for state-owned companies.
- The SSE issued the Notice on **Strengthening the Social Responsibility** of Listed Companies.
- The HKEX released the first edition of the Environmental, Social and Governance Reporting Guidelines, **which recommended listed companies publish ESG reports**.
- The HKEX revised the "Environmental, Social and Governance Reporting Guidelines", requiring listed companies to **disclose ESG reports, and follow "comply or explain"** principles for some ESG indicators.
- The CSRS issued the **revised Code of Corporate Governance for Listed Companies**, which established the basic framework for ESG information disclosure.
- The AMAC released the ESG Research Report on Listed Companies in China and the Green Investment Guidelines (Trial), and **established a core indicator system to measure the ESG performance of listed companies**.
- The HKEX further revised the IPO Guidance, **emphasizing that the board of directors of IPO applicants must ensure the establishment of corporate governance** and ESG management mechanisms during the listing process, and disclose ESG information.
- The Shenzhen Stock Exchange Listed Companies Information Disclosure Assessment Measures (2020 Revision) required listed companies to **disclose ESG performance**, emphasizing the importance of **substantial and complete disclosure**.

Market implications

ESG governance structure needs to be established along with dedicated personnel and regular communication with the parent company

Foreign companies need to establish proper governance structures with clearly documented roles and responsibilities to ensure the senior management's involvement and coordination across various functional units. The board, senior management as well as designated individuals should have sufficient knowledge and understanding of the regional and local developments related to ESG. Regular communication mechanisms between the headquarters of parent company and subsidiaries in China could help to ensure the implementation of localized ESG principles based on the support and overall ESG strategy at the headquarters.

Regular internal reporting and auditing will help identify critical issues and mitigate potential risks

Corporates should start to build up internal systems for identifying, evaluating, and rewarding appropriate ESG governance practices. The C-suite may appoint a professional third-party team to help to establish a clear corporate governance structure, revise responsibility for each board member and refine the internal management procedures on ESG-related issues. It is also critical to explore ESG risks and opportunities in external markets during the corporates' decision-making process. This could help to avoid potential scandals or significant financial damages at the outset. Identifying the material ESG issues by different stakeholders, including the board of directors, managers, shareholders, investors, and consumers, can help enterprises to stay closely connected with their partners.

Case study

Leading corporates are starting to embed ESG factors into daily corporate governance

Box 4.1 ChinaAMC set up a clear governance structure for ESG-related business and products[28]

ChinaAMC has established a four-layer governance structure with clear responsibilities and duties for each layer. In this governance structure, the managing director is the lead person to coordinate the internal collaboration on ESG. An ESG business committee was set up to support the managing director to deploy and oversee the ESG integration processes across each asset class, line of business, or function.

At the working level, the investment directors will regularly report on the progress and results of the ESG efforts from relevant business lines, such as fund managers, industry researchers and ESG researchers, which will support the ESG committee to adjust and specify responsible investment principles and strategies, and regularly review and update the company's ESG investment standards. This multi-layered approach ensures account ability on ESG commitments from managers up and down each business unit.

Takeaways

- For those who are yet to start their ESG journey, they need to assess their existing governance structure to decide an appropriate set-up for ESG governance, including the allocation of roles and responsibilities across existing functions and any newly established roles and committees.

- Corporates should start to build up internal systems for identifying, evaluating, and motivating appropriate governance practices. The C-suite positions may appoint a professional third-party team to help establish a clear corporate governance structure, clarify the roles and responsibilities of board members and senior management, and refine internal management procedures.

[28] https://www.chinaamc.com/guanyu/zeren/index.shtml

Anti-competitive practice will be more readily tracked and regulated

Policy spotlight

The anti-competitive regulations are being revised and enforced at the provincial and sectoral level in China

With the rapid development of the internet and the variety of business models appearing online, regulatory administrations have revised anti-competitive laws **(Exhibit 8).** In 2021, the anti-monopoly regulation was among the core issues discussed at the 21st meeting of China's Central Committee for Comprehensively Deepening Reform[29]. Soon after, the State Administration for Market Regulation (SAMR) sped up its enforcement activities, and its provincial branches accelerated AML enforcement on the local level. For example, the Shanghai AMR concluded two high-profile cases in the digital economy sector by prosecuting online platforms offering food delivery services in the city. The SAMR also concentrated AML enforcement in the sectors particularly relevant to people's livelihoods: pharmaceuticals, public utilities, automobiles and building materials.

Anti-competitive practices will be more readily tracked due to the enhancement of the corporate social credit system

As China is pushing towards data-driven governance, any anti-compliance business practices will be easily tracked and recorded by enhanced digital platforms, such as the newly built Corporate Social Credit System (CSCS). The CSCS, a unified and standardized reputation-based program for local and foreign firms doing business in China, was established to ensure regulatory compliance and improve corporate behaviour. Small and medium-sized enterprises that lack a robust corporate compliance infrastructure may be highly impacted. Furthermore, it seems to be challenging for companies to comply with the CSCS's regulatory requirements, as the CSCS makes firms accountable to the behaviour of business partners along the supply chain, which will increase enterprises' risk exposure to partners' non-compliance in return.

Exhibit 8 - Related Anti-competitive Practice Requirements/Policies

1993

The Anti-Unfair Competition Law was issued to **encourage and protect fair competition while curbing acts of unfair competition and defending the lawful rights and interests of consumers.**

2007

The **Anti-Monopoly Law** was promulgated, which stipulates monopoly agreements, abuse of dominant market position, concentration of operators, abuse of administrative power, restrict competition, investigation of suspected monopolistic actions.

2017

The **Anti-Unfair Competition Law was revised for the first time**, modifications are mainly in the following aspects: the definition of "operator" has been improved; the provisions on the use of technical means to implement unfair competition in the Internet field have been added; the more reasonable definition of commercial bribery; the improvement of legal liability provisions, and the increased penalties for unfair competition.

2019

The **Anti-Unfair Competition Law was revised for the second time**, with many new contents added, such as the recognition and regulation of network unfair competition actions, the coordination with related rules in the Anti-monopoly Law, the clarification of certain concepts, etc.

2022

The NDRC and other nine authorities issued the Several Opinions on Promoting the Healthy and Sustainable Development of the Platform Economy, proposing to **amend the Anti-Monopoly Law and improve the supporting rules of the "Data Security Law" and the "Personal Information Protection Law".**

29 https://news.cgtn.com/news/2021-09-01/China-steps-up-anti-monopoly-regulation-13ctOQ7ijhS/index.html

Market implications

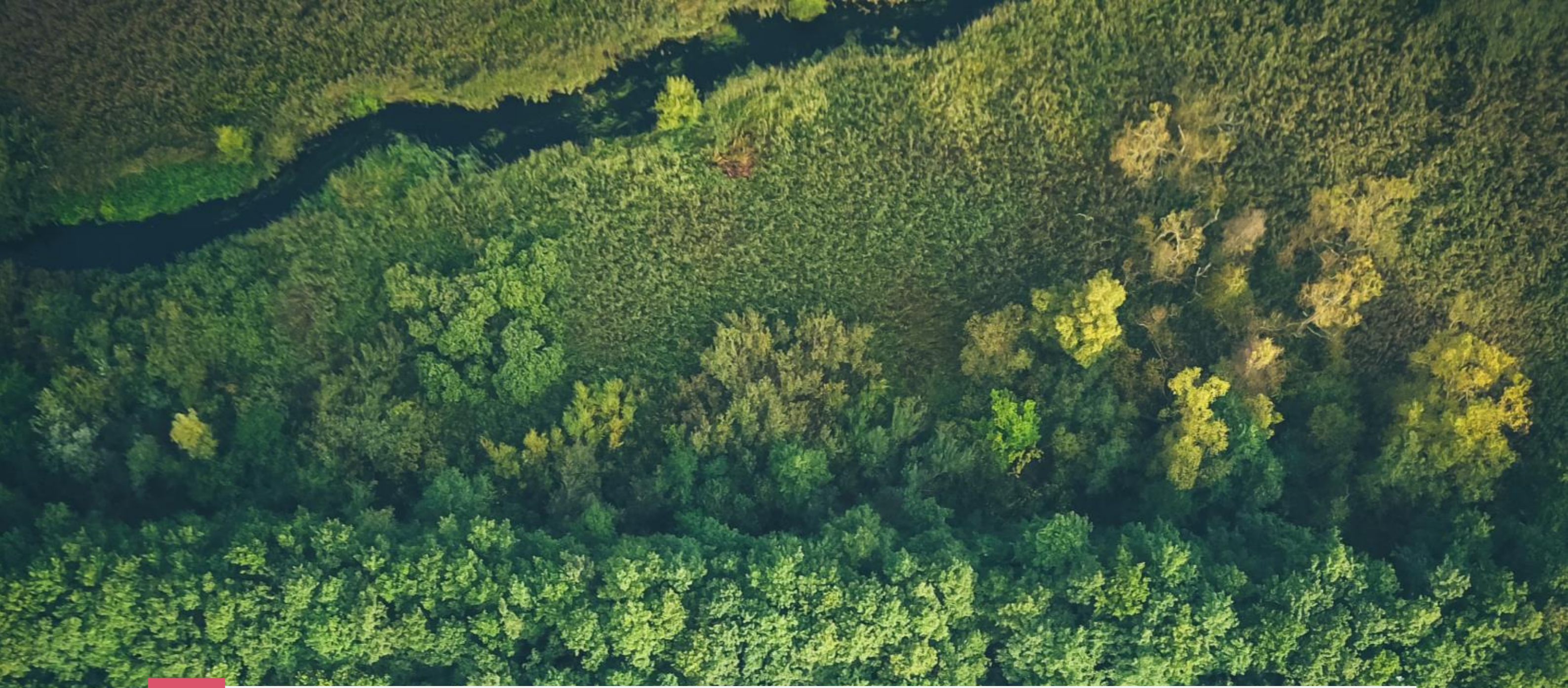
Corporates may be faced with stricter anti-monopoly requirements

In 2021, the SMAR strengthened their supervision on suspicious transactions where corporates are acquiring shares or ownership positions. This enhanced scrutiny is also reflected in the severity of penalties, with those found to be in violation being ordered to pay at the top end of the fine range.

Further to 2021 being considered as a banner year for China's anti-monopoly legislation in the internet industry, supervision will also gradually strengthen within the aforementioned sectors that are closely related to quality of life of ordinary citizens, including automotive and pharma.

Corporates should pay much closer attention to how they collect and manage user data

Data privacy changes are sweeping across the China market, and enterprises should ensure that they are doing their utmost in ensuring adherence to these regulations. Consumer protections are broadening, and this means companies should also take significant care in terms of marketing and communications, and avoid any wording that could be considered being misleading on digital platforms or software. Collection and management of user and customer data is an increasingly tightly monitored space in China and organizations must be cognizant of this rapidly developing policy space.



Case study

Ignorance of anti-competitive practices may bring huge penalties

Box 4.2 A Chinese internet giant is struck with enormous fines for forcing exclusivity agreements

Earlier in 2021, a massive Chinese internet company was fined CNY 18 billion for implementing an exclusivity practice on vendors and customers, essentially forcing these companies to only deal with one player in the marketplace. In the same year, 22 local internet companies were fined CNY 500,000 each for actions including acquiring stakes in other companies that might improperly increase their market power.

Takeaways

- The risks associated with being party to an anti-competitive agreement or abusing a dominant position are serious. In addition to the consequences highlighted in the foregoing, one other major risk to a company is the disruption and damage to its reputation which may arise from lengthy investigations or subsequent litigation from customers, competitors, and consumers.
- To mitigate such risks, corporates need to strengthen their internal control and audit when coming into activities like merging, share acquisition and bilateral cooperation with peers.

Looking forward

Given the fast evolution of the ESG regulatory and market environment in China, it is essential for Canadian companies operating in China or sourcing from China to keep monitoring this development and associated trends. Specific management teams or personnel need to be designated and vested with sufficient authority within the organizational structure, including direct and regular communication with senior management in the parent company.

Best practices are important. Worked out through trial and error, they are the best way for companies to advance ESG management and practices. Companies could always learn from peers in China through various channels, including via exchange platforms at business councils.

For companies navigating the ESG transformation journey, it is better to establish an ESG management system, which mainly consists of governance, strategies, risk management and information disclosure.

Robust ESG governance:

- Define the role of the board and senior management in overseeing and identifying ESG risks and opportunities, including those of the subsidiaries in China.
- Design ESG-related KPIs and include them in performance evaluation, especially for the management team in China.

- **Clear ESG strategies:**
  - Analyze the impact of environmental and social risks and opportunities on the companies' businesses, strategy, and financial planning.
  - Incorporate ESG considerations into corporate strategy and balance profitability and sustainability when operating in China or sourcing from China.
  - Design roadmaps to implement the ESG strategy over the medium and long term, and make action plans over the short term.
- **Sound ESG risk management:**
  - Carry out environmental and social risk assessment to identify and measure potential risk factors.
  - Establish detailed risk monitoring and mitigation plans to manage ESG risks, which should be incorporated into the company's overall risk management.
- **Proactive ESG disclosure:**
  - Proactively communicate with both internal and external stakeholders.
  - Disclose ESG targets, risks and opportunities, as well as performance against the targets on a regular basis and through various channels.

List of Exhibits

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