強制性公積金計劃管理局
MANDATORY PROVIDENT FUND SCHEMES AUTHORITY

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By Email

26 November 2021

Circular Letter: PR/CTR/2021/002

To All MPF Approved Trustees

Dear Sir/Madam,

Principles for Adopting Sustainable Investing in the Investment and Risk Management Processes of MPF Funds

The investment horizon of MPF funds stretches over several decades, making them vulnerable to long-term investment risks. Environmental, social and governance (**ESG**) risks are among those evolving long-term investment risks that should be taken into account in the investment and risk management processes. Sustainable investing is the consideration of ESG factors in the investment and risk management processes.

One of the principles in the "Governance Principles for MPF Trustees" issued by the MPFA in November 2018 is that "an MPF trustee should establish and maintain an effective risk management framework for its MPF business and operations". It is both a stewardship obligation and a fiduciary duty on the part of MPF trustees and investment managers in the MPF System to be mindful of how material financial risks, including the ESG risks, would impact on the interests of MPF scheme members and what would be an appropriate and responsible response to address those risks.

In view of the above, the MPFA formed a working group with MPF trustees (**Industry Working Group**) in March 2021 to deliberate and formulate how MPF trustees should integrate ESG factors in the investment and risk management processes of MPF funds and make disclosure to MPF scheme members.

Principles

After gathering views of the MPF industry through the Industry Working Group and making reference to relevant local and global requirements on ESG integration and disclosure approach, the MPFA developed a set of guiding principles - "Principles for Adopting Sustainable Investing in the Investment and Risk Management Processes of MPF Funds" (**the Principles**). The Principles, with explanatory notes, are attached at Annex.

The Principles lay down a high level framework that serves to assist MPF trustees in integrating ESG factors into the investment and risk management processes of MPF funds from a financial risk management perspective and to make relevant disclosure to MPF scheme members. The Principles cover four key elements: governance, strategy, risk management and disclosure.

(a) **Governance:** MPF trustees should have a governance framework to monitor management of ESG risks by investment managers;

(b) **Strategy:** MPF trustees should formulate an ESG integration strategy at the MPF scheme level;

(c) **Risk management:** MPF trustees should ensure the consideration of ESG factors in the investment and risk management processes of MPF funds; and

(d) **Disclosure:** MPF trustees should disclose ESG integration strategies and report implementation progress regularly including the metrics and targets adopted.

Implementation timeline

The launch of the Principles aims to provide recommendations and practical examples to MPF trustees in enhancing their governance standards. To demonstrate good governance as set out in the Principles, MPF trustees should report to MPF scheme members at least annually on how they put their ESG integration strategy into practice via various channels, such as publishing the information on trustees' websites and in the MPF schemes' annual consolidated reports. MPF trustees should disclose their progress of ESG integration according to the recommendations set out in the Principles in MPF schemes' annual consolidated reports for all financial years ending on or after 30 November 2022.

Action required

MPF trustees are required to review and assess whether their existing investment and risk management framework and arrangements are in adherence to the Principles. In areas where gaps are identified, MPF trustees are expected to draw up an action plan and submit it to the MPFA by **25 February 2022**.

If you have any questions on the above, please contact Mr Franco Au on 2292 1363 or Ms Susanna Lai on 2292 1354.

Yours faithfully,

Joseph Lee
Director
Product Regulation Division

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Annex

Principles for Adopting Sustainable Investing in the Investment and Risk Management Processes of MPF Funds

Introduction

1. The Principles for Adopting Sustainable Investing in the Investment and Risk Management Processes of MPF Funds (**the Principles**) lay down a high level framework that serves to assist MPF trustees to integrate environmental, social and governance (**ESG**) factors[1] into the investment and risk management processes of MPF funds from a financial risk management perspective and to make relevant disclosure to MPF scheme members. The Principles cover four key elements: governance, strategy, risk management and disclosure.

2. In October 2019, the International Organization of Pension Supervisors (**IOPS**) published the Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds (**IOPS Guidelines**). The MPFA makes reference to the IOPS Guidelines in developing the Principles. The IOPS Guidelines set out how pension funds integrate ESG factors in their investment and risk management processes that may have financial consequences and propose an enhanced disclosure of ESG factors by pension funds.

3. The MPFA is a member of the Green and Sustainable Finance Cross-Agency Steering Group[2] (**Steering Group**) set up in Hong Kong. The Steering Group announced its green and sustainable finance strategy[3] in December 2020 with an aim to strengthen Hong Kong's financial ecosystem to support a greener and more sustainable future. Among the ESG factors, the Steering Group adopts a climate first approach and agrees to align climate-related disclosure of financial institutions with the Task Force on

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[1] ESG factors are regarded as indicators used to analyse a (investee) company's prospects based on measures of its performance on ESG criteria.

[2] Members of the Steering Group also include the Financial Services and the Treasury Bureau, the Environment Bureau, the Hong Kong Exchanges and Clearing Limited, the Hong Kong Monetary Authority, the Insurance Authority and the Securities and Futures Commission.

[3] Press release issued by the Green and Sustainable Finance Cross-Agency Steering Group on 17 December 2020 (https://www.mpfa.org.hk/en/info-centre/press-releases/9810_record).

Climate-related Financial Disclosures[4] (**TCFD**) recommendations by 2025. As such, the MPFA makes reference to TCFD recommendations in developing the Principles and all references to ESG factors in the Principles also include climate-related risks.

[4] TCFD was established by the Financial Stability Board to develop recommendations for more effective climate-related disclosure that could promote more informed investment and enable stakeholders to understand the financial system's exposure to climate-related risks.

The Principles

<u>Governance</u>

Principle 1-

To be in line with their fiduciary duty, MPF trustees should be mindful of all material financial risks impacting the interest of MPF scheme members. ESG factors could be a source of financial risk with long-term financial impact on the value of MPF investment portfolios.

4. ESG factors may have a direct and, potentially substantial, financial impact on the accrued benefits of MPF scheme members, particularly in the longer term. MPF trustees should therefore ensure that relevant and material ESG factors are considered in the investment and risk management processes of MPF constituent funds in MPF schemes under their trusteeship.

5. Where the integration of ESG factors is incorporated into the investment and risk management processes of investment managers, MPF trustees may rely on the investment managers to determine the relevance and materiality of different ESG factors.

6. In appointing investment managers or selecting the underlying funds of MPF constituent funds, MPF trustees should consider whether the investment managers to be appointed or the investment managers of the underlying funds have incorporated ESG factors into their investment and risk management processes. MPF trustees should also evaluate the ESG risks monitoring frameworks developed and applied by the investment managers. The same evaluation should also be performed when MPF trustees conduct on-going monitoring of the performance of the investment managers.

Principle 2-

The board of directors of MPF trustees should have oversight of the integration of ESG factors into the investment and risk management processes and assign management with a clear role in reporting progress against goals set.

7. The board of directors (**the Board**) should ensure that a robust governance framework on ESG risks management is put in place. The Board should require senior executives of the MPF trustee to regularly report to the Board on the progress and level of integration and disclosure at the scheme level.

8. The process of integration of ESG factors should recognize an MPF scheme's specific circumstances and portfolio asset allocations as well as the availability of investment options in the market. The granularity level of incorporation of ESG factors in the investment and risk management processes may be subject to proportionality[5].

9. Given that each investment manager has its own proprietary model, policies and approaches to sustainable investing, the extent of ESG integration vary across investment managers. MPF trustees should determine their assessment process and criteria in view of the differences.

<u>Strategy</u>

Principle 3 -

MPF trustees should consider incorporating ESG factors along with all other substantial financial factors that may contribute to achieving the long-term retirement objectives of MPF scheme members and document how ESG factors are treated.

10. MPF trustees are required to document the ways they are treating ESG factors by setting out their ESG integration strategy at the MPF scheme level and describing how this strategy can be implemented in view of the investment structure of the MPF schemes under their trusteeship.

11. The investment management function is carried out by investment managers. MPF trustees should therefore set out their expectation on the level of integration by the investment managers in the trustees' ESG integration strategy.

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[5] That means taking into account the size, internal organization and complexity of the governing structure of an MPF scheme, as well as the size, nature, scale and complexity of the activities of MPF funds.

12. Some MPF trustees do not appoint any investment managers for MPF constituent funds investing in a single approved pooled investment fund (**APIF**). These MPF trustees should incorporate in their APIF selection and on-going monitoring process a review as to whether their ESG integration strategies align with the integration policies adopted by the investment managers of the APIFs. If the investment managers of the APIFs have yet to implement any ESG integration policies, MPF trustees should understand when the investment managers plan to adopt ESG integration in their investment and risk management processes and consider whether the situation affects the continuous appointment of the investment managers.

13. In the case that MPF trustees do not appoint any investment managers for MPF constituent funds investing in a single index-tracking collective investment scheme (**ITCIS**) which does not adopt ESG integration, they should convey their expectation to the investment managers of the ITCISs that the latter should exercise the ownership rights and influence investee companies to promote positive change through strong corporate engagement in order to safeguard sustainable returns in the long run.

14. MPF trustees should understand the ESG integration policies of the investment managers and how these policies affect the funds' investment strategies. If the investment managers adopt their group level ESG integration policies, MPF trustees should also understand the applicability of those policies to the management of MPF constituent funds or the underlying funds.

Risk Management

Principle 4 -

MPF trustees should consider ESG factors with no prejudice for the objective of obtaining an appropriate risk-return profile on purely financial grounds.

15. ESG factors are regarded as indicators used to analyse an investee company's prospects based on measures of its performance on ESG criteria. There is no exhaustive list of ESG factors. Globally recognized principles and standards could serve as common reference point for investment managers considering ESG factors.

16. For the purpose of the Principles, ESG factors are considered as financial factors which may materially impact the long-term risk and return of investments and thus ESG integration does not mean sacrifice of risk-adjusted returns.

17. Investment managers can consider ESG issues in their investment decisions only if relevant and timely information is available. For example, in less sophisticated markets or those that have not yet developed sufficient depth to provide reliable and actionable ESG information, data on ESG factors may be limited.

18. MPF trustees should understand the investment managers' processes for identifying, assessing and managing ESG factors and how these processes are integrated into the investment managers' overall risk management. For example, MPF trustees may refer to the investment managers' documented policies on ESG integration or specific subject matters such as climate change, stewardship and engagement, or responsible investment.

19. MPF trustees may encourage investment managers to develop appropriate scenario testing of their investment strategy of individual MPF constituent funds, if the investment managers consider that the analysis will be relevant and useful for them in evaluating the resilience of investment strategies to ESG risks. Such tests should consider all substantial financial factors, including ESG factors that can cause extraordinary losses or make the control of risk in the investment strategy difficult. The scope and complexity of stress tests should be subject to the principle of proportionality[5].

Disclosure

Principle 5 -

MPF trustees should disclose the MPF schemes' integration strategies and investment managers' integration policies and report implementation progress regularly.

20. MPF trustees should report to MPF scheme members and the MPFA at least annually on how they have put their ESG integration strategy into practice. They may decide on the depth and breadth of details in their disclosure with regard to information made available by the investment managers and evolvement of the relevant assessment and

disclosure standards. Disclosure can be made via various channels such as websites and MPF schemes' annual reports.

Principle 6 -

MPF trustees should describe how ESG factors are factored into the relevant investment strategies by the investment managers and how the investment managers identify, assess, and manage relevant and material ESG factors.

21. MPF trustees should require the investment managers to report on their awareness of ESG-related risks and policies and the methods they use to incorporate ESG factors in the investment and risk management processes of MPF funds. Investment managers may present the ways they manage ESG risks related to changes to market sentiment, new financial or environmental regulations or the emergence of new technologies.

22. MPF trustees may signpost disclosure, including the disclosure made to fulfil relevant requirements set by the Securities and Futures Commission, made by investment managers where applicable. The information disclosed by the investment managers may include investment managers' engagement with the investee companies, including voting and engagement rights. Information on other actions such as application of exclusionary policies, positive screening and participation in initiatives with sustainability objectives may also be disclosed.

Principle 7 -

MPF trustees should disclose metrics and targets adopted by investment managers where available.

23. In disclosing metrics and targets, MPF trustees should consider existing international and industry standards. For metrics and targets for climate-related risks, recommendations are made by the Task Force on Climate-related Financial Disclosure. Disclosures on ESG matters (e.g. carbon footprints) should help MPF scheme members appropriately assess and price ESG risks and opportunities, therefore creating the right

incentive for MPF scheme members to understand the risks of investment and make informed investment decisions.