

# Principal MPF – Smart Plan

## Governance Report for the year ended 31 December 2022

(If there is any inconsistency between the English and Chinese version,  
the English version shall prevail.)

Exclusive Distributor



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## Section 1: Trustee's Governance Framework

### About the Trustee

Principal Trust Company (Asia) Limited ("Principal"), the Trustee, was incorporated in Hong Kong in 1997 and has been acting as trustee of retirement assets in Hong Kong since 2000. Principal provides one-stop shop services on retirement scheme management, including corporate trustee, fund and scheme administration services. The Trustee collects contributions in accordance with the scheme rules of the Principal MPF - Smart Plan (the "Scheme" or "SMART") and invests the contributions in the Constituent Funds ("CFs").

### Trustee's Governance Framework

Good governance refers to the way in which an institution exercises authority and manage resources properly. It is essential for ensuring accountability, transparency, and effective decision-making. A good governance framework is a set of principles, policies, and procedures that guide how the institution operates and delivers services.

A good governance framework should include several key components. First and foremost, it ensures the Trustee operates in compliant to the regulatory requirements. Secondly, it should promote accountability and transparency, such that the decision-making processes are clear and accountable. Thirdly, it should also encourage participation, with information flow efficiently via proper reporting mechanism. Lastly, it should also promote effectiveness and efficiency, with periodic evaluation to ensure the resources are deployed in an effective and efficient manner.

Principal adopts a top-down approach in the governance structure, where the Board of Directors is responsible for defining the organization's mission and vision, and setting overall objectives and strategic direction. The Management team, in turn, formulates the strategies and plans necessary to achieve those objectives and oversees their implementation. The Board also establishes committees to manage specific areas of the business, which are responsible for executing policies and procedures related to their respective areas of responsibility. All staff members, from all business functions, are expected to participate in the implementation of these plans and contribute to the overall success of the organization. In this way, the top-down approach provides a clear and structured framework for decision-making, accountability, and effective communication, ensuring that the organization's objectives are achieved in a consistent and sustainable manner.

### Trustee Board Structure

The Board is ultimately responsible for the sustainable performance of the Trustee, including the consistent achievement of business plans and compliance with statutory as well as corporate obligations. The Board is also ultimately responsible for the development and implementation of the Trustee's corporate governance practices.

#### i. Directorship Composition

The Board comprises five (5) Directors (which consist of one (1) Executive Director and

four (4) Non-Executive Directors (“NEDs”)) and two (2) Independent Non-Executive Directors (the “INEDs”):

Name	Title
Mr. CHEONG Wee Yee (Thomas) (c)	Executive Vice President, Principal Asia
Mr. LAU Martin Kin Yeung	Chief Executive Officer
Mr. LIU Man Kwong (Jonathan)	Chief Compliance Officer, Asia
Mr. Uday JAYARAM*	Executive Managing Director & Head of SE Asia
Mr. John Michael EGAN*	Vice President & Chief Financial Officer, Principal International
Mr. LAM Heung Yeung Herman	INED
Mrs. Hong Mei KNIGHT (May)	INED

(c) denotes Chairperson of the Board

\* denotes overseas residence

The ED represents the senior management staff of the Trustee, with extensive experience and knowledge in the MPF operations. The NEDs are representatives from the regional group office, with extensive experience and knowledge in the MPF industry. The INEDs are experienced industry veterans who provide an independent view on our business operation and best practices for corporate governance. To further strengthen corporate governance and achieve an appropriate degree of checks and balances of the Board, it is our practice to appoint NEDs as the Chairman of the Board.

## ii. Independent Non-Executive Director(s) (the “INEDs”)

The role of an INED is to bring an “independent” view to the Board’s deliberations, and to broaden the level of experience and balance of expertise on the Board.

At present, there are two INEDs on the Board, and the term of an INED is three (3) years. The fixed tenure ensures the discipline to review the effectiveness of the INEDs for re-appointment.

## iii. Board Meeting Format

The Board meets four (4) times a year on a quarterly basis. Board meetings are usually held in person, except for Directors who reside overseas to join virtually.

Furthermore, to ensure the INEDs can keep abreast of the latest development in the MPF market and bring an independent view for deliberations, the Board only appoints INEDs who reside locally in Hong Kong with a close connection to the MPF community. The INEDs are committed to attend the Board meetings in person where feasible, unless there is unavoidable conflict of other engagements, in which event they will join virtually.

#### iv. Coverage of Business Functions

At each quarterly Board meeting, a wide range of topics are discussed, to ensure good coverage of all the critical business functions with latest updates.

- Management Updates
- Business Strategy and Product Development
- Investment Performance Review
- Finance
- Audit
- Legal & Compliance
- Risk
- Information Technology
- Business Development
- Operations
- Human Resources

#### v. Experience and Skills of Directors

As the market evolves over time, it is essential to ensure the Board composition possesses immense experience and skills to cope with the changing environment. The Board therefore review the experience and skills of the directors on an annual basis.

On an annual basis, all directors would formally complete an evaluation questionnaire to identify any areas of improvement for the Board, which would be properly addressed at the Annual Board Retreat, besides the quarterly Board meetings.

#### vi. Review of Board Effectiveness

Besides possessing immense experience and skills, maintaining a high level of effectiveness is equally important. This is to ensure that the Board meetings are held efficiently, and the decisions are made effectively.

The Directors would formally complete an evaluation questionnaire, and the assessment would be reviewed at the Annual Board Retreat.

#### Establishment of Committee(s) & Delegation of Authority

While the Board retains ultimate responsibility for the strategic direction and control, it has established various committees to facilitate the delivery of strategic direction and operation.

At the Board level, a dedicated Risk Management Committee is established to oversee risk management:

##### i. Board-level Risk Management Committee

The Board is ultimately responsible for establishing and overseeing risk management, which includes setting our risk appetite and strategy which should be in line with the long term interests of Principal and are embedded in the corporate culture of Principal

as well as our parent group (i.e. Principal Financial Group); providing appropriate risk management systems and ensuring their effective operation; and approving and reviewing the adequacy and effectiveness of risk management policies for material risks on a regular basis; ensuring sufficient resources are in place for risk management.

This Board-level Risk Management Committee is comprised of the full Board to assume such responsibilities.

As part of the Board meeting matrix, the Board-level Risk Management Committee therefore convenes four (4) times a year.

The Board has also established a number of committees at the Management level, with the delegation of authority to such committees. The Board is kept appropriately and fully informed on all material issues, through detailed reports and/or meeting minutes, in a timely manner.

i. Executive Committee

The Executive Committee is responsible for overall leadership and execution of the strategy, initiatives, and standards. It oversees the operating and financial performance, and it ensures resource management practices are properly executed.

Under the leadership of the Chief Executive Officer, the Executive Committee comprises other senior executives of the Trustee and affiliates, and it is delegated by the Board to deliver the strategic direction and goals determined by the Board.

The Executive Committee meets on a monthly basis.

ii. Executive Risk Management Committee

The Executive Risk Management Committee (“ERMC”) is responsible for overseeing risk management. Chaired by the Chief Risk Officer, the ERMC comprises the Executive Committee members, and Internal Audit will be invited to join as an observer.

The Executive Risk Management Committee meets four (4) times a year.

iii. Fiduciary Committee

The Fiduciary Committee is responsible for reviewing all fiduciary activities undertaken by the Trustee on behalf of scheme members and investors, and it serves as a forum for discussion and decision making on behalf of the Trustee.

In particular, the Fiduciary Committee reviews and monitors investment related matters, including investment compliance, fund performance, and environmental, social and governance (“ESG”) integration.

Chaired by the Chief Executive Officer, the Fiduciary Committee comprises other senior executives of the Trustee. The Chief Executive Officer has ultimate accountability for decisions made in the Fiduciary Committee.

The Fiduciary Committee meets on a monthly basis.

#### iv. AML Committee

The AML Committee was established to ensure adequate and appropriate AML/CTF<sup>1</sup> programs in place and to advise on matters in relation to AML/CTF, including ongoing monitoring of the implementation of the AML/CTF programs, overseeing suspicious transactions reporting, and conducting appropriate training for employees.

Chaired by the Chief Compliance Officer, the AML Committee comprises other senior executives of the Trustee and affiliate companies, as well as the AML Compliance Officer and Money Laundering Reporting Officer.

The AML Committee meets four (4) times a year.

## Section 2: Scheme Assessment Areas

### I. Value for Money Assessment

MPFA always strives to ensure MPF value for money, and one crucial indicator is the Fund Expense Ratio (“FER”). At Principal, it is also our priority to ensure good value for money for our members. As the MPF System has driven down the average FER over the years, it is also important for us to evaluate the FER of our MPF scheme and to ensure the expense ratio is justifiable.

While FER is a handy approach to measure and compare the cost borne by the members, low price does not always mean good value. We believe it is equally important to ensure the investment fund choices are delivering reasonable performance, therefore ongoing fund performance monitoring is also a crucial element to the value for money assessment.

Besides the quantitative evaluation of FER and fund performance review, there are also qualitative perspective to the value for money assessment. Most of our members stay in our MPF scheme throughout their career, and their investment needs and risk profiles evolve as they reach different stage of life, therefore it is also our duty as Trustee to ensure our MPF scheme offers sufficient and appropriate investment fund choices to members, and to provide efficient and user-friendly services, such that the members would have a satisfactory journey over the long investment horizon.

#### 1. Review of Fee

The Trustee calculates the FER per Code of Disclosure for MPF Investment Funds. We would also compare the FER of the current financial year with that of previous year and observe the changes over the year.

The average FER of the Principal MPF - Smart Plan CFs was 1.59% as of 31 December 2022; latest Market Average FER (i.e. Overall FER of all MPF CF) published by MPFA was 1.33%<sup>2</sup>.

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<sup>1</sup> AML/CTF denotes anti-money laundering and counter-terrorist financing

<sup>2</sup> Sources: Mandatory Provident Fund Schemes Statistical Digest Quarterly Report 12/2022. The Overall FER was drawn from Table III.5.3, which was compiled on the basis of the FERs of MPF constituent funds with their financial year end dates falling within the period from 1 April 2021 to 31 March 2022 which was published in the MPFA website on 31 December 2022.

Principal also reviews the headline management fee at the CF level on an annual basis. The headline management fee review at the CF level is conducted for each fund category by comparing with the peer medians. This is to ensure each CF is priced in line with market average, and any excess is justified.

The following table shows the FER of each CF and the average of the respective category:

<u>Constituent Fund</u>	<u>Latest FER</u>	<u>Fund Type</u>	<u>Average</u>
Principal Cash Fund	0.99	Money Market Fund - Other than MPF Conservative Fund	0.96
Principal - MPF Conservative Fund	1.31	Money Market Fund - MPF Conservative Fund	0.31
Principal Core Accumulation Fund	0.82	Default Investment Strategy - Core Accumulation Fund	0.78
Principal Age 65 Plus Fund	0.83	Default Investment Strategy - Age 65 Plus Fund	0.78
Principal Growth Fund	1.72	Mixed Assets Fund - 81% to 100% Equity	1.63
Principal Balanced Fund	1.71	Mixed Assets Fund - 61% to 80% Equity	1.52
Principal Stable Fund	1.68	Mixed Assets Fund - 21% to 40% Equity	1.52
Principal Guaranteed Fund	1.82	Guaranteed Fund	1.84
Principal - Hang Seng Index Tracking Fund	1.03	Equity Fund - Hong Kong Equity Fund (Index Tracking)	0.85
Principal Dynamic Hong Kong Equity Fund	1.64	Equity Fund - Hong Kong Equity Fund	1.55
Principal Dynamic Greater China Equity Fund	1.43	Equity Fund - Greater China Equity Fund	1.81
Principal Dynamic Global Equity Fund	1.79	Equity Fund - Global Equity Fund	1.47
Principal Dynamic Asia Pacific Equity Fund	1.81	Equity Fund - Asia Equity Fund	1.60
Principal Dynamic Global Bond Fund	1.53	Bond Fund - Global Bond Fund	1.19
Principal Dynamic Asian Bond Fund	1.41	Bond Fund - Asia Bond Fund	1.05

Source: (i) Principal, (ii) MPFA, "MPF Fund Platform", [https://mfpa.org.hk/eng/mpp\\_list.jsp](https://mfpa.org.hk/eng/mpp_list.jsp)

We aim at driving FER down together with the market. However, while FER is a handy approach to measure and compare the cost borne by the members, low price does not always mean good value. Particularly, active investment management need more extensive research to seek for higher long-term alpha than a passive solution could deliver. We want to ensure the expense ratio is justifiable, therefore we would focus on fund performance, unique product features etc.. For any CF that bears higher FER than market average, but performance is substandard, we monitor closely and ensure remedial actions are taken to bring improvement.

## 2. Investment Manager Monitoring

The role of an investment manager is to manage and invest funds for the Scheme with the aim of achieving the highest possible returns while minimizing risk. However, given the complexity and volatility of the financial markets, it is essential to have a reliable monitoring system to ensure that the investment manager is discharging its duties and adhering to ethical standards.

Principal is responsible for overseeing the performance of the investment manager and ensuring that they are meeting their obligations as outlined in the investment management agreement. This includes conducting regular reviews of the investment manager's services and evaluating the fund performance.

In the event that the fund performance deteriorates, Principal will seek remedial actions from the investment manager. This could include changes to investment strategies or the removal of specific investments that pose a risk to the portfolio. In addition, Principal may also consider taking any other appropriate actions to

increase efficiency of schemes or investment return for members, including but not limited to replacement of underperforming underlying funds and replacement of underperforming investment manager.

In addition to monitoring funds' investment performance, Principal is also responsible for ensuring that the conflict of interest are monitored and mitigated. Principal Asset Management Company (Asia) Limited, acting as the investment manager of the Scheme, is an affiliated company of Principal, but it is an independent entity that operates with its own board of governance and reporting structure.

A comprehensive annual compliance due diligence is also conducted on the investment manager as a key element of monitoring. This process involves reviewing the investment manager's compliance policies, procedures, and controls to ensure that they are in line with industry standards and regulatory requirements. This includes assessing the investment manager's internal controls, code of ethics, and risk management practices.

Overall, Principal monitors the performance and behavior of investment managers by conducting regular reviews and due diligence, in order to ensure that the investment manager is discharging its duties and adhering to ethical standards. This helps to minimize risk and protect the interests of the members.

### 3. Fund Performance Monitoring

Principal Asset Management Company (Asia) Limited ("PAM"), being the investment manager of the Scheme, employs a thorough, well-structured, proprietary process to identify, select, and monitor the delegate managers of the underlying funds. The review process consists of both quantitative and qualitative assessments.

Quantitative assessment focuses on the elements of the funds (at both CF and Approved Pooled Investment Funds ("APIF") level) that can be measured objectively and compared to predefined targets such as benchmarks and peer median. A weighted formula is applied to ensure both near-term and longer-term performances are taken into consideration during the performance review.

The objective of the qualitative assessment is to ensure the delegate managers retain the organizational traits and the investment process characteristics that served as the basis for the original hiring decision. Ongoing conference calls and meetings with delegate managers will be conducted throughout the year to review each investment team and strategy and discuss business issues identified. Any material changes at the delegate manager, which might impact the selected fund, would trigger immediate attention.

A rigorous Watchlist Mechanism ("Watchlist") is in place, based on the above quantitative and qualitative assessments. If a CF or APIF triggers the Watchlist, PAM will monitor such delegate manager closely requesting regular updates and reviews, and the same would be reported to the Fiduciary Committee. Should the subpar situation remain, PAM will request a performance enhancement plan from such delegate manager including, but not limited to, a change in investment strategy. For externally managed APIF, a supplement or replacement fund would be an option.



For the year of 2022, some CFs triggered the Watchlist. The Fiduciary Committee reviewed the situation with PAM, who provided in-depth analysis. PAM took remedial actions to address the fund performance issues, despite the volatile market condition throughout the year, and the CFs on Watchlist have shown notable improvement towards the end of the year. The Trustee's commentary provides the assessment results and actions taken in the investment report of the annual consolidated report of the Scheme.

In addition to fund performance monitoring, Fiduciary Committee has also initiated a new regular reporting item, *Sustainability Risk Monitoring Report ("SRM Report")*, at the Fiduciary Committee meeting. The SRM Report provides an ongoing review of the ESG Scores of the underlying funds. Combining the Watchlist Mechanism and the SRM Report, the Fiduciary Committee is equipped to enhance the fund performance monitoring with an ESG perspective. Should there be any ESG / Sustainability concerns arise, Fiduciary Committee can take immediate action with the Investment Manager accordingly.

#### 4. Review of Investment Fund Choices (Range of Constituent Funds)

The Product Approval Committee, which was established under Principal International Hong Kong to support various affiliates including the Trustee, provides governance and oversight of all investment products, throughout the product lifecycle, from design and approval through termination.

On an ongoing basis, the Product Approval Committee will review the existing products, ensuring continued viability and appropriateness. Further escalation may be sought by committee members with the Fiduciary Committee.

New addition of CF should demonstrate that it is sufficiently diverse to address the needs of scheme members with different investment outcome expectations and risk appetites in both the accumulation and decumulation phases. In other words, funds with uniqueness (i.e. inflation hedged, low volatilities, ESG-themed), different asset class / geographical exposure, and less correlation would typically be preferred. Among those, lower fee solutions are studied in the best interest of scheme members.

The Board opines that the range of investment fund choices on the Scheme is viable and appropriate to meet with the different risk profiles and the demographic structure of our scheme members.

In the year of 2022, no new CF was added to the Scheme.

#### 5. Member Experience

MPF investment is a long-term engagement, as it covers both the accumulation phase of a member's working life and the decumulation phase as he/she retires. To the Trustee, this means long-term partnership with our members, and we strive for excellence in servicing our members.

Our Service Pledge to members can be found at our website: <https://www.principal.com.hk/resources/our-service-pledge>

In addition to the items listed in the Service Pledge, we also held a series of seminars in the year of 2022. Additional communication work was arranged to facilitate the Employment Support Scheme (“ESS”) for the relevant employers.

A new upgraded Principal Retirement Service Centre (online portal at Principal Hong Kong website) for members of the Scheme was planned to be launched in Q1 2023.

## II. Sustainable Investing Strategy and Implementation Progress

Principal Financial Group is committed to meeting our global clients’ values and sustainability preferences by making savings and insurance products, services, and resources more accessible to individuals and businesses, while delivering investment solutions aligned with their unique sustainable investment goals. As the Trustee of the Scheme, it is Principal’s commitment to ensure the impact of ESG factors are contributing to the Scheme.

The Board is responsible for overseeing 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.

As explained in the previous section, the Fiduciary Committee reviews and monitors investment related matters, including the integration of ESG factors into the investment and risk management processes.

PAM, being the investment manager of the Scheme, is therefore under close scrutiny by the Fiduciary Committee to ensure PAM not only uphold its commitment to Sustainable Investing, but also properly apply its ESG research into the portfolio construction of the APIFs (which are then invested in by the CFs of the Scheme).

PAM reports to the Fiduciary Committee on a quarterly basis on investment matters, including progress updates on ESG implementation (if any). PAM also monitor the overall ESG Scores of all the underlying funds versus their respective benchmarks on an ongoing basis. Referencing to MSCI ESG model, which evaluates each CF with a breakdown into MSCI ESG Leaders/Average/Laggards sub-categories and are analogous to the MSCI ESG Ratings, Fiduciary Committee can therefore monitor not only the Overall ESG Rating of each underlying funds, but also the breakdown of sub-categories and ensure each CF achieves at least 50% in MSCI ESG Average or above. Any anomaly would be reported at the Fiduciary Committee for immediate attention, and PAM would take necessary action to rectify such anomaly.

PAM delegates the investment management functions to affiliated company Principal Global Investors LLC. (“PGI”) in managing the underlying funds invested by the CF of the Scheme, and PAM leverages the group resources in investment management and risks management, including ESG related risk. Disclosure of ESG related risk is available here, which also includes PAM’s Engagement Policy: [https://www.principal.com.hk/sites/default/files/general-files/Disclosure\\_of\\_ESG\\_Related\\_Risks.pdf](https://www.principal.com.hk/sites/default/files/general-files/Disclosure_of_ESG_Related_Risks.pdf)

PGI has been a signatory to the United Nations Principles for Responsible Investment (“UNPRI” or “Principles”) in December 2010. The Principal Global Investors Responsible Investment Policy Statement provides an overview of PGI’s global

approach to responsible investing, their dedication to ESG issues, and how their specialized investment team model has adopted implementation paths that fit best with their investment processes and the needs of the clients.

Consistent with a specialized investment team model, ESG integration approaches are determined by the specific investment process of the underlying asset class. PGI's ESG Oversight Committee has worked with each investment team to help categorize alignment with the framework into traditional and ESG Integrated Strategies.

For listed securities, the consideration of ESG factors currently takes place within the investment process as part of the fundamental research driving security selection. The analysts are best placed to determine the importance of such factors in relation to a specific security or sector. The analysts provide the essential insights into industry trends and company-specific considerations integrating ESG factors into their final investment thesis. These insights and considerations have always been crucial to the evaluation of sustainable competitive advantages and risks at a company specific and industry level.

In fixed income, ESG integration within the investment process is utilized for the purposes of risk management and alpha generation. The research teams are organized by areas of industry sector specialization, the analysts are responsible for providing essential insights into industry trends, and company-specific considerations, which may include certain ESG issues deemed material and relevant to the evaluation of sustainable earnings trends, sentiment, and valuation. Every corporate issuer in the coverage universe is assigned a specific ESG score, with all assessments captured via the ESG scoring grid. That score is an essential deliverable of investment thesis. Both industries and issuers are scored using the model.

For Principal - Hang Seng Index Tracking Fund, being a passively managed CF that invests into the Tracker Fund of Hong Kong (2800.HK), an Index Tracking Collective Investment Scheme ("ITCIS") managed by Hang Seng Investment Management Limited ("HSVM"), Principal would expect PAM to convey Principal's expectation to HSVM that the HSVM should exercise the ownership rights and influence investee companies to promote positive change through active engagement in order to safeguard sustainable returns in the long run.

In signing the UNPRI, PGI publicly commits, where consistent with the fiduciary responsibilities, to the following:

1. to incorporate ESG issues into the investment analysis and decision-making processes;
2. to be active owners and incorporate ESG issues into the ownership policies and practices;
3. to seek appropriate disclosure on ESG issues from the entities PGI invest in;
4. to promote acceptance and implementation of the Principles within the investment industry;
5. to work with other signatories to enhance effectiveness in implementing the Principles; and
6. to report on the activities and progress towards implementing the Principles.

The Board opines that the investment manager has high level of ESG integration into their investment and risk management processes in managing the CF via the underlying APIF. The Board will continue to monitor the ESG risks and review the ESG integration strategy of the investment manager regularly.

### **Board Endorsement**

The Board of Principal Trust Company (Asia) Limited hereby confirm and endorse the above Governance Report for PRINCIPAL MPF – SMART PLAN.