Principles for Responsible Investment

CONSULTATION RESPONSE

PRI RESPONSE TO THE CHINA BANKING AND INSURANCE REGULATORY COMISSION'S CONSULTATION ON REGULATIONS OF INSURANCE ASSET MANAGEMENT COMPANIES (CONSULTATION DRAFT)

8 January 2022

INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment initiated and supported by the United Nations. The PRI has now over 4,500 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $120 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

ABOUT THIS CONSULTATION

This proposed regulation amends and replaces the Interim Regulations on Insurance Asset Management Companies issued in 2004. It steps up the reform and opening up of the financial sector while taking into account the challenges and development strategies of insurance asset management companies (IAMCs). By setting out rules on corporate governance, risk management, and particularly certain risky investment practices, this regulation intends to lead IAMCs onto a track of healthy development and provide patient capital to support the high-quality development of the real economy. Key amendments include:

- adding an independent Chapter setting out clear corporate governance requirements,
- comprehensively upgrading risk management requirements,
- further opening the financial sector to foreign investors by removing ownership restrictions on foreign insurance companies in IAMCs, and
- clarifying basic operational principles for the management of entrusted assets.

The PRI welcomes the opportunity to respond to the CBIRC call for feedback on Regulations on Insurance Asset Management Companies.

This consultation response represents the view of the PRI and not necessarily the views of its signatories. More information: www.unpri.org

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KEY RECOMMENDATIONS

The PRI welcomes the clear definition of IAMCs in the proposed regulation, which clarifies that IAMCs manage assets on behalf of qualified investors and pursue increased long-term value of entrusted assets. The PRI also welcomes that the proposed regulation attaches great significance to improving corporate governance and risk management of IAMCs and prohibits them from engaging in excessively risky investment practices that are against their investor obligations towards clients.

For IAMCs to pursue increased long-term value of entrusted assets for the benefits of their clients, they have to manage environmental, social and governance (ESG) related risks and opportunities. Empirical and academic evidence demonstrates that incorporating ESG issues can be a significant source of investment risk and performance.[1] ESG analysis assists investors to identify value-relevant issues and mitigate downside risks. For IAMC's, ESG related factors can contribute to a variety of existing categories of risks identified in the proposed regulation, including insurance risks, credit risks, market risks, liquidity risks, operational risks, reputational risks, and strategic risks.[2]

Given the widespread acceptance of the materiality of ESG factors for investment performance, the PRI concluded that failing to take into account ESG risks and opportunities in investment governance and risk management processes should be viewed as a failure of fiduciary duty.[3] This has reflected in global market practice by the mainstreaming of responsible investment practices[4] and has been increasingly clarified by policy makers and financial regulators around the world.[5]

There are many ways to invest responsibly. Approaches are typically a combination of two overarching areas: ESG incorporation and stewardship.

CONSIDERING ESG ISSUES WHEN BUILDING A PORTFOLIO (known as: ESG incorporation)			IMPROVING INVESTEES' ESG PERFORMANCE (known as: active ownership or stewardship)	
ESG issues can be incorporated into existing investment practices using a combination of three approaches: integration, screening and thematic.			Investors can encourage the companies they are already invested in to improve their ESG risk management or develop more sustainable business practices.	
Integration	**Screening**	**Thematic**	**Engagement**	**Proxy voting**
Explicitly and systematically including ESG issues in investment analysis and decisions, to better manage risks and improve returns.	Applying filters to lists of potential investments to rule companies in or out of contention for investment, based on an investor's preferences, values or ethics.	Seeking to combine attractive risk-return profiles with an intention to contribute to a specific environmental or social outcome. Includes impact investing.	Discussing ESG issues with companies to improve their handling, including disclosure, of such issues. Can be done individually, or in collaboration with other investors.	Formally expressing approval or disapproval through voting on resolutions and proposing shareholder resolutions on specific ESG issues.

[1] ESG study 2018 (where an analysis of over 2000 academic studies on how ESG factors affect corporate financial performance found "an overwhelming share of positive results", with just one in 10 showing a negative relationship); also see PRI commissioned report, How ESG engagement creates value for investors and companies (which indicates that engaging with companies on ESG issues can create value for both investors and companies, by encouraging better ESG risk management and more sustainable business practices).

[2] UNEPFI, 'Managing environmental, social and governance risks in non-life insurance business' (2020)

[3] PRI, Fiduciary Duties in the 21st Century, Final Report, at 8.

[4] The PRI has now over 4,500 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $120 trillion in assets under management.

[5] PRI has identified that 96% of responsible investment policies have been developed since the year 2000. As of September, over 159 new or revised responsible investment policy instruments were established in the year 2021, more than all of 2020. https://www.unpri.org/pri-blog/88-new-policies-added-to-pris-regulation-database/8532.article

Table 1: two overarching areas of responsible investment: ESG integration and stewardship[6]

Fiduciary duty per se is not a well-established concept in Chinese law. However, many of the principles that underpin fiduciary duties – for example, duties of loyalty and prudence, requirements to act with care, skill and diligence, and requirements to act in good faith in the interest of beneficiaries and clients – are familiar to Chinese investors,[7] which are also enshrined in this proposed regulation in Article 3. Together, they create a set of investor duties and obligations that mirror the duties and obligations expected of investors in other jurisdictions.

CBIRC has encouraged ESG investing in the Interim Measures for Regulatory Rating of Insurance Asset Management Companies by allocating additional credits to institutions who engage in green or ESG investing.[8] Apart from that, in order to ensure that IAMCs are appropriately taking into account material ESG factors in their decision making and keeping pace with market best practice, the proposed regulation should make clear that IAMCs must consider ESG factors in their corporate governance, risk management, investment activities, [9] stewardship[10] and disclosure practices.

PRI's key recommendation include:

- **specifying that IAMCs' duties include incorporating financially material ESG factors in their corporate governance, risk management, and investment analysis and decision-making process, consistent with their investment time horizons;**
- **setting out IAMC's stewardship responsibilities to require IAMC's to monitor corporate ESG performance, to engage with companies and vote proxies with the aim of improving ESG performance and mitigating systemic risks;**
- **understand and incorporate clients' sustainability-related preferences; and**
- **report on how they have implemented these commitments.**

DETAILED RESPONSE

Chapter 3 Article 36-47 (corporate governance)

This regulation adds a separate chapter on corporate governance which sets out rules on duties of shareholders, shareholder meetings, board of directors, special committees, independent directors, supervisory committee, senior management, chief risk officer, and mechanism of incentives and restrictions.

The PRI recommends CBIRC add requirements as follows,

IAMCs should ensure that its senior management is responsible for overseeing ESG incorporation in investment decision making and stewardship activities. They shall retain necessary resources and expertise for the effective integration of ESG risks and opportunities into and investment and stewardship practices.

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[6] PRI, An Introduction to Responsible Investment: Stewardship

[7] PRI, Investor Duties and ESG Integration in China, at 5.

[8] http://www.cbirc.gov.cn/cn/view/pages/govermentDetail.html?docId=958449&itemId=879&generaltype=1

[9] PRI and World Bank, A Toolkit for Sustainable Investment Policy and Regulation (Part 1)

[10] PRI, An Introduction to Responsible Investment: Stewardship

ESG incorporation and stewardship enable investors to align investment activities and decision making at investee companies with long-term interests of their clients. To fulfil this purpose, it is important to set up proper internal governance that guarantees oversight and accountability for effective ESG incorporation and stewardship. It is equally important to devote sufficient resources and provide training to enhance the capacity of staff responsible for ESG incorporation and stewardship.[11]

Article 50 (management of entrusted fund)

This article requires an IAMC entrusted with the management of insurance funds to comply with the relevant regulatory provisions on the use of insurance funds and the entrusted investment management of insurance funds.

The IAMC is required to manage and operate the investment of other funds entrusted to it and the assets of insurance asset management products in accordance with the regulatory provisions and contractual agreements.

The PRI recommends CBIRC add requirements as follows,

- **IAMCs should be required to incorporate ESG issues into investment analysis and decision-making processes, consistent with their investment time horizons.**
- **IAMCs should also be required to exercise stewardship, including monitoring corporate ESG performance, engaging with companies and voting proxies with the aim of improving ESG performance and mitigating systemic risks.**

Financially material ESG issues are important drivers of long-term investment value[12]. An analysis of over 2000 academic studies on how ESG factors affect corporate financial performance reveals "an overwhelming share of positive results".[13] Climate change, for example, presents significant risks to investors, as well as opportunities for those exposed to companies that are likely to prosper in a lower carbon world. A 2019 Mercer report found that pension funds, insurers, wealth managers and endowments and foundations with diversified portfolios and multidecade time horizons will be exposed to costs associated with climate change and that investment returns are likely to be impacted.[14] The expected financial materiality of these risks is also supported in reports by the G20 Financial Stability Board,[15] and the Bank of England.[16]

To discharge obligations owed to clients, IAMCs should manage ESG related risks and opportunities through incorporating ESG factors in investment decision processes. In addition, they should also actively engage with investee companies and monitor their corporate governance to ensure the decisions of corporate managers are in line with the long-term interests of clients.[17]

Article 59 (report and explanation)

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[11] Examples of such requirements: TCFD recommendations report, 19; SFC of HK SAR, Circular to licensed corporations Management and disclosure of climate-related risks by fund managers (it amends the Fund Management Code of Conduct paras. 1.2 (a) to (d), 1.6 and 1.8 on governance); EU, UCITS Article 5(5), Article 9 (g) and AIFMD, article 22, article 60 (i).

[12] PRI, ESG and Alpha in China.

[13] https://download.dws.com/download?elib-assetguid=714aed4c2e83471787d1ca0f1b559006&wt_eid=2156623951900953270&wt_t=1566240624353

[14] Mercer, Investing in A Time of Climate Change.

[15] Financial Stability Board, Report on Promoting Climate-Related Disclosures.

[16] Bank of England, The Bank of England's Response to Climate Change

[17] Examples of such requirements: SFC of HK SAR, Circular to licensed corporations Management and disclosure of climate-related risks by fund managers (it amends the Fund Management Code of Conduct para. 3.1A on Investment management, EU UCITS Article 4, 5(a), AIFMD Article 57, and MiFID 2, Article 21.

This article required the IAMC to report to the clients on a regular basis or in accordance with the contractual agreement on the management and use of the assets entrusted to it.

The IAMC is required to fulfil its information disclosure obligations in a timely manner in accordance with the laws and regulations, relevant regulations of the CBIRC and the insurance asset management product contract, etc.

The PRI recommends CBIRC add requirements as follows:

To discharge reporting obligations provided in this article, IAMCs should also report how they have carried out ESG incorporation and stewardship as a part of their investor obligations, specified in the laws, regulations or contracts.

This will help enhance transparency and accountability in terms of how IAMCs have managed entrusted funds, particularly in relation to the management of ESG related risks and opportunities. In light of the need to achieve carbon neutrality by 2060 and hit carbon peak by 2030, many financial solutions have been developed in response to this demand. Setting out clear reporting requirements will help minimize the risks of green washing and incentivize IAMCs to pioneering innovative ways of ESG incorporation and stewardship to drive low-carbon transition at investee companies. On the global level, the IFRS Foundation Trustees announced the creation of the International Sustainability Standards Board (ISSB) to deliver a comprehensive global baseline of sustainability-related disclosure standards which will cover the financial sector.[18] Policymakers in, for example, EU,[19] HK SAR[20] and UK[21] have already established or are establishing rules for ESG related disclosure of financial institutions. The PBoC also developed Guidelines on Environmental Information Disclosure for Financial Institutions as a voluntary guidance for financial institutions, including insurance companies and asset managers, to disclose environmental information.[22]

Article 60 (marketing management)

This article requires that IAMCs should establish and improve client service standards, strengthen sales management, regulate the promotion and marketing of insurance asset management products and business, and not engage in improper sales or unfair competition.

The PRI recommends CBIRC to expand this article to include requirements of assessing investor suitability before providing financial services or products to clients:

IAMCs should understand clients' ESG preferences and the length of time for which the client wishes to hold the investment. IAMCs should make sure the financial services or products they provide suit the client's ESG preferences and investment time horizon.

IAMC clients are major suppliers of capital that allow the financial system to function and the field of responsible investment to exist. It is paramount that investors understand their true interests and place them at the centre of investment decision-making. While clients' interests have often been

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[18] https://www.ifrs.org/groups/international-sustainability-standards-board/#about, for details please see the disclosure requirements prototypes proposed by the Technical Readiness Working Group: Prototype General Requirements for Disclosure of Sustainability-related Financial Information (General Requirements Prototype), Prototype Climate-related Disclosures Requirements (Climate Prototype), Supplement: Technical Protocols for Disclosure Requirements (Climate Prototype).

[19] Regulation on Sustainability-Related Disclosure in the Financial Service Sector ; Shareholder Rights Directive

[20] Circular to management companies of SFC-authorized unit trusts and mutual funds-ESG funds; Principles of responsible ownership; Circular to licensed corporations
Management and disclosure of climate-related risks by fund managers (it amends the Fund Management Code of Conduct para 6.2A on disclosure)

[21] Consultation: CP21/17: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers, UK Stewardship Code

[22] https://www.cfstc.org/bzgk/gk/view/yulan.jsp?i_id=1925&s_file_id=1867

interpreted as solely being about seeking a certain financial return, it has become clear that many clients have preferences related to the sustainability performance of their investments. Policymakers are taking actions in response to this demand. For example, within the EU, revisions made to MiFID 2 and Insurance Distribution Directive require financial institutions to obtain the sustainability preferences of clients and potential clients and to offer products compatible with those preferences. PRI found that apart from being a major element of investor obligations, understanding clients' sustainability preferences would bring a wide range of benefits, including client satisfaction, enhancing competitiveness, minimising reputational risk and positive investment contributions.[23]

Article 61 (prudent operation)

This article requires an IAMC to operate prudently, maintain a sound financial position and meet the needs of the company's operations, business development and risk management.

The PRI recommends CBIRC add requirements as follows,

When complying with requirements provided in the first paragraph, IAMCs should take consideration of material ESG risks and opportunities.

Reasons for this recommendation are similar to those for Article 50.

Chapter 5 Article 63-71 (risk management)

This Chapter sets out requirements to enhancing risk management at IAMCs, including taking a systemic governance approach to risk management (Article 63), retain sufficient resources for risk management (Article 64), establishing internal control and auditing system (article 65), risk management of subsidiary companies (article 66), management of related party transactions (article 67), conduct requirements for staff to prevent unlawful behaviours (article 68), risk serves (article 69), data support (article 70) and emergency management (article 71).

The PRI welcomes a comprehensive and systemic approach to risk management and recommend that CBIRC require IAMCs to fully consider and manage ESG related risks throughout the process of risk management.

As was explained above ESG issues could be material to investors. Moreover, the financial system could also be exposed to systemic risks caused by ESG issues. In October 2021, the Financial Stability Board unequivocally warned about financial risks caused by the pandemic and climate change:

"Exposure to the physical and transition risks posed by climate change is a pressing emerging vulnerability. Climate-related events could lead to sharp changes in asset prices, and be concentrated in certain sectors or geographies. A disorderly transition to a low-carbon economy could have a destabilising effect on the financial system." [24]

"The economic impact of the pandemic and of policy responses to address it have led to a rise in indebtedness across sovereigns, non-financial corporates and households. There is a risk of higher insolvencies and credit losses as policy support is unwound."[25]

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[23] PRI, Understanding and Aligning with Beneficiaries' Sustainability Preferences.

[24] FSB, 2021 FSB Annual Report, Promoting Global Financial Stability, 1.

[25] Ibid.

In light of mounting ESG related risks, particularly systemic risks, a systemic and comprehensive approach to risk management at IAMCs should enable IAMCs to fully consider and manage ESG related risks, especially systemic risks such as climate change.[26]

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of CBIRC to improve the regulatory framework for responsible investment in China. Any question or comments can be sent to policy@unpri.org.

[26] Examples of such requirements: SFC of HK SAR, Circular to licensed corporations
Management and disclosure of climate-related risks by fund managers (it amends para. paragraph 1.7.1, paragraph 3.11.1(b), and paragraph F under Appendix 2 of the Fund Management Code of Conduct on Risk Management), EU UCITS Article 38 (1), 5(a), AIFMD Article 40, and MiFID 2, Article 23(1)(a).