

# Appendix 4

## Environmental, Social, and Governance Policy for the Long-Term Investment Pool

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## 1 Introduction

This document sets out the guiding principles of The Hong Kong University of Science and Technology's (HKUST's) environmental, social, and governance (ESG) policy, as applied to its Long-Term Investment Pool (CCP).

HKUST is a globally respected university and contributes both locally and internationally to talent development, new knowledge, and societal interests. Being international is an intrinsic element of the HKUST spirit. The University was founded on the principle that education, original scholarship, and the development of society are integrally linked and best pursued together. We believe that humanity's advancement is generated through the fostering of an international community and the nurturing of individuals through holistic education, original research, and knowledge transfer into the wider society. [1] We recognize our role as a responsible steward of our capital, which has two distinct aspects:

1. Firstly, responsible stewardship of our own portfolio requires us to take into account all material determinants of risk and opportunity for the investments we make. These include ESG factors which are in many cases material to the longer-term success and resilience of businesses in which we invest.
2. Secondly, we seek alignment with our values as an educational institution and certainly to avoid misalignment. Our goal is to be a sustainability leader across the region and beyond, and a trusted resource for businesses and government alike. With grand generational challenges to solve in climate change, water scarcity, building a circular economy, transforming food production systems, and building a fair, just, and equitable society, HKUST has a special responsibility to advance technical research, policy solutions, and educational expertise to spotlight a sustainable pathway forward. [2] We therefore are interested in understanding how managers integrate these considerations into their investment decisions.

HKUST's portfolio is invested via third party investment managers, and we will be investing into pooled investment funds with their own fixed policies. Thus, HKUST's ESG policy will be implemented in large part through our choice of investment managers and their own ESG policies.

## 2 Core Beliefs

We believe it is important to consider what material ESG-related risks and opportunities apply to the assets in which we invest and the managers through whom we invest. This may provide insight into future performance as well as facilitate good decision-making and encourage a long-term mindset. Example topics include, but are not limited to, climate change, supply chain and human rights, fair pay, diversity, and global health. These areas, as well as others, may present both risks and opportunities from an investment point of view. Accordingly, we do not see ESG integration in itself as a drag on returns, rather a potential enhancement.

Further, we are keenly aware that investment strategies that do not align with our core beliefs present serious risks to our reputation and our standing within the community. A misalignment can cause skepticism of our true intentions to fulfil our vision for a sustainable campus of the future, and can inhibit our ability to recruit top tier students and globally recognized faculty and researchers. We believe that our core beliefs must be consistent throughout.

To implement an ESG policy through third party managers while delivering attractive returns requires a degree of pragmatism and flexibility. The more that hard limits and targets are imposed, the fewer manager options available and the greater the danger of achieving compliance over quality. HKUST accordingly prefers to invest with managers whose own investment philosophies are already closely aligned with our own ESG policies.

## 3 ESG Investing Approach

### 3.1 ESG Integration

HKUST intends to work with investment managers for whom ESG considerations are integral to their investment philosophy and manifested throughout their investment process. We accept that different approaches may be necessary in different asset classes or strategies, according to current market practice, but we will use our voice as an investor to encourage better standards, especially regarding transparency. A well-explained, well-documented, evidenced-based process for how ESG is integrated into the investment decision-making is a priority. We expect to understand the link between a manager's ESG considerations and their investment decisions. To be credible, managers need to evidence clearly and regularly how this is achieved in practice and report adequately.

### 3.2 Responsible Ownership of Assets

HKUST believes that good stewardship can enhance long-term portfolio performance and we expect our investment managers to recognize their role as responsible stewards of capital. Managers' voting policies and records shall form part of manager selection due diligence and shall be monitored for consistency with HKUST's ESG policy. Effective proxy voting is only the minimum threshold for responsible ownership. However, and we prefer to see managers directly engaging with portfolio companies to encourage improvement in line with ESG considerations and the interests of long-term shareholders. Reporting on the outcomes, both good and bad, from engagement efforts demonstrates the credibility of an engagement program.

## 4 Net-Zero Policy

### 4.1 Introduction

HKUST considers climate change, driven by human-induced greenhouse gas (GHG) emissions, to be one of the most critical global issues for at least the next several decades. As a long-term investor, HKUST has decided to incorporate climate change into its investment decision-making process. It supports the goals of the 2015 Paris Agreement to limit global warming by eliminating net emissions of carbon and other GHGs by mid-century as well as Hong Kong's commitment to achieving carbon neutrality by 2050. The goal of this policy is to ensure our investment approach is informed by the scientific consensus on climate change and consistent with the goals of the Paris Agreement, as operationalized by the Science Based Targets initiative (SBTi) initiative [3], or equivalent for the benefit of long-term returns and for all stakeholders.

### 4.2 Goals

The policy has three broad goals:

- To ensure the risks and opportunities arising from a low carbon transition are reflected in the way investments are chosen for the portfolio.
- To seek out investments whose activities can accelerate or otherwise support the low carbon transition while contributing to our return goals.
- To support and encourage all businesses to adopt business plans and strategies consistent with the goals of the Paris agreement.

Goals 1 and 2 align the portfolio with net-zero, i.e., benefit from a low carbon transition while at the same time protecting against the risks from uncontrolled climate change. Goals 2 and 3 also contribute to net-zero as an economy wide, and global goal not merely transferring GHGs from HKUST's balance sheet to someone else's. This is important given uncontrolled climate change implies vast net costs to the global economy, in extremis posing existential risks to complex societies. Targeting net-zero for the economy as a whole seeks to preserve the economic returns that drive the portfolio and therefore HKUST's ability to meet its target return into the long-term future.

## 5 Net-Zero Implementation & Targets

HKUST acknowledges that there is no one right approach and that methodologies are evolving. Accordingly, it aims to be pragmatic and move forward promptly where the path is clearest. Because the portfolio is invested through third party investment managers, it is through the choice of managers and what HKUST asks of them, that the policy can be implemented.

### 5.1 Policy Applicability

The availability of emissions data, methodologies for target setting, and the means of control vary widely across asset classes. It is therefore not practical to set a uniform approach for each asset class. For the time being, this policy applies fully to public equities and public fixed income, referred to as ‘in-scope’ assets. [4] For other asset classes, HKUST will evaluate all investment opportunities according to whether they contribute to or hinder climate goals. Managers whose strategy clearly hinders climate goals—even through indifference only—will be ineligible for the portfolio.

It is accepted that the world has more than sufficient existing reserves of exploitable fossil fuels to meet its energy needs through a Paris Agreement consistent transition. Moreover, investing in such businesses is to some degree conflicted with our goal of low carbon transformation—essentially taking away the market for their principal products. Such business assets may become ‘stranded’—unusable and worthless—in the event of successful decarbonization. For these reasons, HKUST pledges to divest from fossil fuels within the Long-Term Investment Pool.

### 5.2. Strategy

To achieve the long-term goal of net-zero emissions by 2045, HKUST needs a clear and robust strategy to guide its actions and against which success can be measured. Data and methodological gaps limit how specific targets can be today, but the approach will be tightened and refreshed over time. Initially, HKUST is adopting the following strategy:

1. Reduce and target to eliminate investments in fossil fuels.
2. Improve portfolio transparency:
  - Aim for full transparency in public equities and public fixed income, which allows for detailed carbon analysis.
  - Extend to Hedge Funds and Private Investments over time.
3. Engage to drive real world change:
  - Invest in managers with aligned policies.
  - Use its influence as an asset owner to request and require managers across all assets and strategies to adopt net-zero aligned processes.

#### 4. Reduce carbon-emissions:

- Halve emissions for in-scope assets by 2030 from a 2021 baseline calculated on a consistent basis.
- Ensure in-scope asset class emissions are below relevant benchmark index on an ongoing basis from end 2023.
- By 2025, 70% of emissions from in-scope assets should be from companies which are aligned with net-zero or with whom HKUST is engaging (directly or indirectly) toward that objective. Increase this target to 100% in 2030.

#### 5. Investment in ‘climate solutions’ [5] to increase as a percentage of the portfolio by 5% by end 2025.

### 5.3 Measurement

An annual review will be undertaken covering all investments, with details to vary by asset class depending on information available. This is to include a detailed ‘look-through’ to the underlying holdings of each manager. Managers should support this by identifying exposure to material ESG issues, be they positive or negative, and explaining how negatives are being managed both by the underlying company and by the manager themselves (e.g. through engagement or position sizing). This annual review will also identify managers who either don’t provide holdings transparency or are not explaining the negatives to our satisfaction, and what action is being taken to either engage with them or remove them from our portfolio.

- Portfolio GHG emissions are measured in CO<sub>2</sub> equivalent (CO<sub>2</sub>e), with the baseline at portfolio emissions in 2022, and tracked on an annual basis.
- The degree to which portfolio holdings are Paris-aligned with commitments confirmed by SBTi, TPI [6] or equivalent is also tracked on an annual basis via manager reporting.

### 5.4. Private Investments

Methodologies and data for net-zero are less developed around private investments so it is more challenging to include them in the targets and monitoring framework. Nevertheless, HKUST will lay out its aspirations as well as guideposts to prevent committing now to long-term investments that will impede net-zero goals in future. HKUST’s aspiration and expectation from private investment managers follow from the approach to public investments:

- Disclose robust data on emissions from portfolio companies.
- Require and support portfolio companies to adopt Paris-aligned targets.

#### References:

1. From HKUST’s Strategic Plan 2021 - 2028
2. From HKUST’s Sustainability and Net-Zero carbon commitment
3. From <https://sciencebasedtargets.org>.
4. This covers 64% of the CCP’s Strategic Asset Allocation.
5. Climate Solutions include Cleantech and renewable infrastructure as well as industrial businesses whose products support a low carbon transition.
6. <https://www.transitionpathwayinitiative.org/>