Responsible investment for sustainable returns

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HSBC
Global Asset Management

> The principles of responsible investment incorporate environmental, social and governance (ESG) factors that can be clearly linked to a firm's sustainability and financial performance.

Foreword

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Responsible investment seeks to generate sustainable economic value for the longer-term. It incorporates environmental, social and governance (ESG) issues that can be captured through a range of quantitative and qualitative measures. The financial relevance of ESG issues are coming into focus today as investors position their portfolios for the future.

We believe that ESG issues can have a material impact on company fundamentals and performance over the longer-term. ESG issues are linked to opportunities and risks that financial markets may not be pricing appropriately.

HSBC Global Asset Management's commitment to responsible investment is put into practice in three primary ways:

- ESG analysis is incorporated alongside financial analysis to quantify a company's potential risks and returns over the longer-term
- We strive to educate our clients and the markets about the relevance of ESG to long-term economic performance and the sustainability of the financial system
- We are actively engaged in furthering the adoption of responsible investment practices in investment; for example, we recently signed the Montreal Carbon Pledge, which commits us to reporting on the carbon footprints of our portfolios

Finally, the HSBC group has an all-encompassing commitment to sustainability. This allows us to make significant contributions to positive socio-economic development, environmental protection, strong governance and the rule of law.

HSBC's long term commitment to responsible investment

HSBC Global Asset Management highlights

2001
- Joined the UK Sustainable and Finance Association (UKSIF)
- First SRI equity fund

2002

2003
- Joined Association Française de Gestion Financière (AFG) – member of Corporate Governance Commission
- Joined Observatoire pour la Responsibilité Sociétale des Enterprises (ORSE)

2004
- First SRI bond fund
- Joined the International Corporate Governance Network (ICGN)
- Joined Association Française de Gestion Financière (AFG) – member of SRI Commission
- Joined the European Sustainable Investment Forum (Eurosif)

2005
- Joined Forum pour l'Investissement Responsable (FIR)
- Joined Italian Forum for Sustainable Finance (Italian SIF)

2006
- **Signatory to the Principles for Responsible Investment (PRI)**

2007
- Joined Institutional Investor Group on Climate Change (IIGCC)
- ESG global research platform launch

2008

2009

2010
- Signatory to the UK Stewardship Code

2011
- Joined the Asian Corporate Governance Association (ACGA)

2012

2013

2014

2015
- Signatory to the Montreal Carbon Pledge

2016
- Signatory to the Cambridge Institute of Sustainability Leaders - ILG

2017
- Ranked Tier one signatory to the FRC UK Stewardship Code
- Joined Council of Institutional Investors
- Joined Workplace Disclosure Initiative

HSBC Group highlights

2007

- The HSBC Climate Change Centre of Excellence publishes fundamental research on climate change risks and opportunities

2011

- HSBC Group pledge to reduce carbon emissions by employee from 3.5 tonnes to 2.5 tonnes in 2020

2012

- Signed up to the UN's Principles for Sustainable Insurance

2014

- Introduced Equator Principles 3

2015

- HSBC Group is a founding member of the Green Bond Principles

2016

- HSBC joins the SDIP (Sustainable Development Investment Partnership)
- Partner to The Climate Bonds Initiative
- Member of China's Green Finance Committee
- Green climate fund accreditation

2017

- HSBC creates the Sustainable Finance Unit to drive the development of green and sustainable business at HSBC

Source: HSBC Global Asset Management - September 2017 - Non contractual document

Responsible investment at HSBC Global Asset Management

HSBC Global Asset Management believes that environmental, social and governance (ESG) issues can have a material impact on long-term company fundamentals in terms of both opportunities and risks.

Responsible investment is integral to our investment philosophy and approach. We incorporate ESG analysis into our investment decisions to target sustainable long-term returns. We integrate material ESG issues into our investment process across all asset classes, recognising that ESG issues can impact long-term corporate performance and investment returns.

We are active owners of the companies in which we invest and we seek to exercise stewardship on behalf of our clients. We engage directly with companies across the capital structure to understand how they manage ESG issues to future-proof their business strategies. We encourage companies to adopt ESG best practice to protect and enhance the value of the assets we are managing for our clients. We have a rigorous approach to proxy voting. Our global voting policy is framed around global guidelines that aim to promote good governance practice that meet HSBC Group values. We publicly disclose our voting and offer clients a summary vote rationale and explanations where we do not support management resolutions.

ESG issues that create risk and opportunity for companies include: climate change, water scarcity and availability, inequality, health and nutrition as well as traditional corporate governance issues around ownership structures, management conduct and competence and board oversight. The ability of companies to manage material ESG risks and opportunities can impact the long-term value of client investments and they are important factors to consider when making investment decisions.

We include ESG research and analysis as an additional metric in all of our investment strategies alongside traditional financial analysis. ESG research and analysis is based on HSBC proprietary systems and strengthens our understanding of a company's underlying risks and opportunities. We also use ESG analysis as a screening tool in our specialised SRI strategies to meet clients' mission-related or ethical concerns.

HSBC Global Asset Management's commitment to ESG is reflected more broadly at HSBC Group level. Sustainability means running our business for the long term. It means investing in customer relationships, ensuring that our governance is robust, and that our risk appetite is prudently managed. This approach allows us to contribute to socio-economic development and environmental protection, and to support robust governance and the rule of law.

Representative overview of the investment process, which may differ by product, client mandate or market conditions.

Seven styles of responsible investment[1]

Responsible investment covers a wide range of investment approaches to meet investor needs across the spectrum, from ethical exclusion or negative screening to ESG integration, thematic investing and impact investing. We can offer investors a full range of solutions covering passive, market-cap weighted and Alternative Weighting Schemes (AWS), smart beta and factor strategies as well as active fundamental equity strategies and credit.

1. **Negative/exclusionary screening:** the exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria

2. **Positive/best-in-class screening:** investment in sectors, companies or projects selected for positive ESG performance relative to industry peers

3. **Norms-based screening:** screening of investments against minimum standards of business practice based on international norms such as the UN Global Compact

4. **ESG integration:** the systematic and explicit inclusion by investment managers of environmental, social and governance factors into financial analysis

5. **Sustainability themed investing:** investment in a single or multi-thematic strategy specifically related to sustainability (for example climate change, clean energy, or demographics)

6. **Corporate engagement and shareholder action:** the use of shareholder power to influence corporate behaviour, including through direct company engagement of management and boards, filing or co-filing shareholder proposals and proxy voting guided by comprehensive ESG guidelines

7. **Impact investing:** direct investment into companies, organisations and funds with the intention to generate social and environmental impact alongside financial return

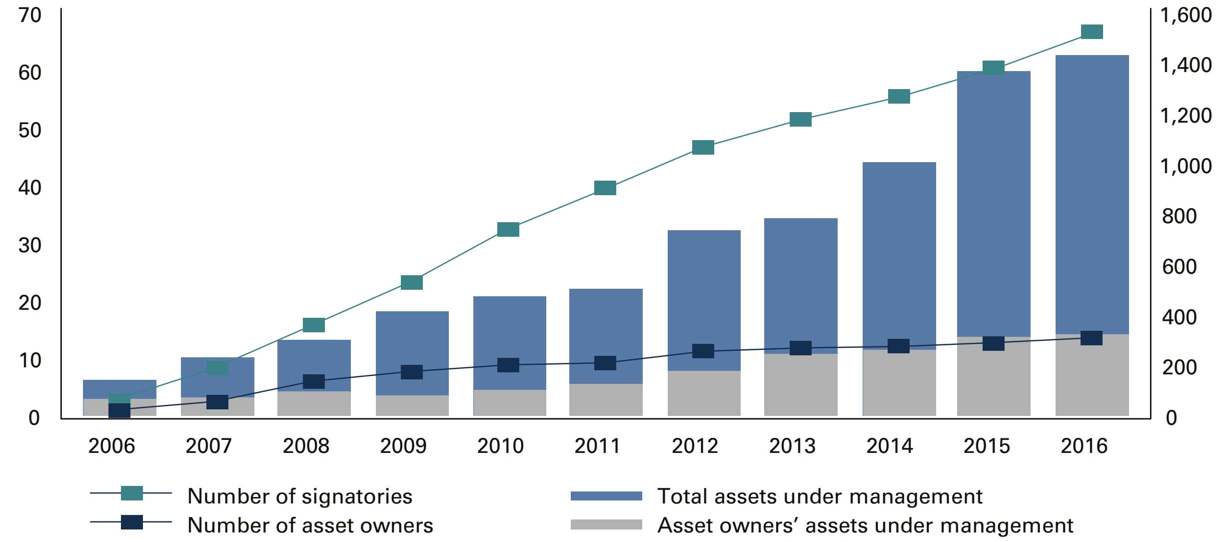
1 Source: Global Sustainable Investment Alliance (GSIA) 2016 report.

Responsible investment drivers

According to the 2016 Global Sustainable Investment Alliance (GSIA) Review, one-in-three dollars is now invested responsibly. PRI membership has soared to 1700 signatories and an AUM of USD73 trillion in just over a decade from a small base of a few hundred at the initiative's launch in 2006.

The PRI has grown consistently since it began in 2006

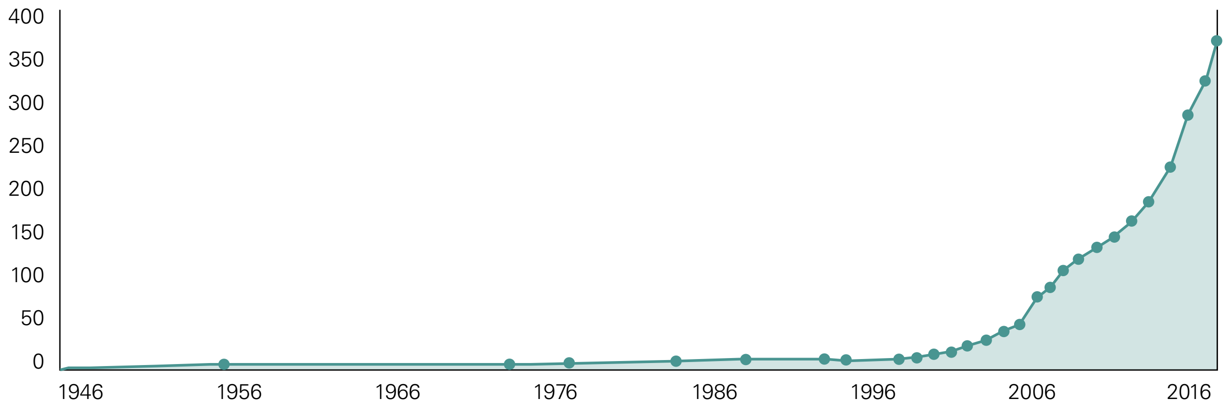
Fig 1. Growth in PRI signatories and AUM (2006-2016)



Regulatory change is also driving the adoption of responsible investment, responsible policies and practice. The fallout from the global financial crisis of 2007-08 has been a key factor as policy makers and regulators seek to put the global financial system on a more sustainable footing and to address the long-term challenges of climate change and global inequality.

Growth in ESG regulation

Fig 2. Cumulative number of policy interventions per year (counting individual revisions separately)



Source: PRI. The PRI has undertaken an extensive review to develop this database, but please be aware it should not substitute for your own due diligence. For corrections or additions, please email policy@unpri.org.

1 Source for graphs: PRI, 'Global guide to responsible investment regulation', 2016.

Academic research underpins market growth

Significant academic evidence exists to support the view that ESG can enhance investment performance across the capital structure. For example, a 2014 study by the University of Oxford and Arabesque ('From the stockholder to the stakeholder: how sustainability can drive financial outperformance') analysed almost 200 academic studies and sustainability sources to assess how corporate sustainability affected financial returns.

The study concluded that 88% of the research showed that "solid ESG practices result in better operational performance of firms and 80% of the studies show that stock price performance is positively influenced by good sustainability practices". A 2016 Breckenridge MIT Sloan study showed correlation between ESG scores and tighter credit spreads that persisted both in times of market turbulence as well as in equilibrium.

Academic and investment research publications in ESG:

- Eccles, Ioannou and Serafeim; The impact of a corporate culture of sustainability on corporate behaviour and performance Harvard Business School Working paper:
  http://trippel.sdg.no/wp-content/uploads/2014/09/Eccles-HBR_The-Impact-of-a-Corporate-Culture-of-Sustainability1.pdf
- Dimson, Karakas and Li Active; Ownership the review of financial studies, 2015:
  http://rfs.oxfordjournals.org
- Friede, Busch & Bassen ESG and financial performance: aggregated evidence from more than 2000 empirical studies Journal of Sustainable Finance & Investment,2015.
  http://dx.doi.org/10.1080/20430795.2015.1118917
- Clark, Feiner and Viehs; From the stockholder to the stakeholder, how sustainability can drive financial outperformance, 2015:
  https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf
- Elfner and Fernandez; ESG integration in corporate fixed income, 2015:
  https://www.breckinridge.com/insights/details/esg-integration-in-corporate-fixed-income
- Alex Edmans; Does the stock market fully value intangibles?
  Employee satisfaction and equity prices. Journal of Financial Economics:
  http://faculty.london.edu/aedmans/Rowe.pdf
- Morgan Stanley Research Global: Embedding sustainability into valuation 2.0. Our updated global framework for analysing environmental, social and governance risks and opportunities
- HSBC Global Research; 10 reasons ESG matters:
  https://www.research.hsbc.com/R/20/gs9TPLF7RPQp

Source: HSBC Global Asset Management - Septembrer 2017

HSBC Global Asset Management's responsible investment framework

Portfolio construction and implementation

ESG at the heart of the investment engine

ESG research and analysis

Committed to integrating ESG considerations into our investment process across all asset classes and regions.

Active ownership

Engagement dialogue and active proxy voting

Transparency and disclosure

Stewardship reporting for clients
Portfolio carbon footprinting

Policy and advocacy

Individual and collective policy-level engagement to address systemic challenges

Climate focus

Carbon conscious and climate aware

Representative overview of the investment process, which may differ by product, client mandate or market conditions.

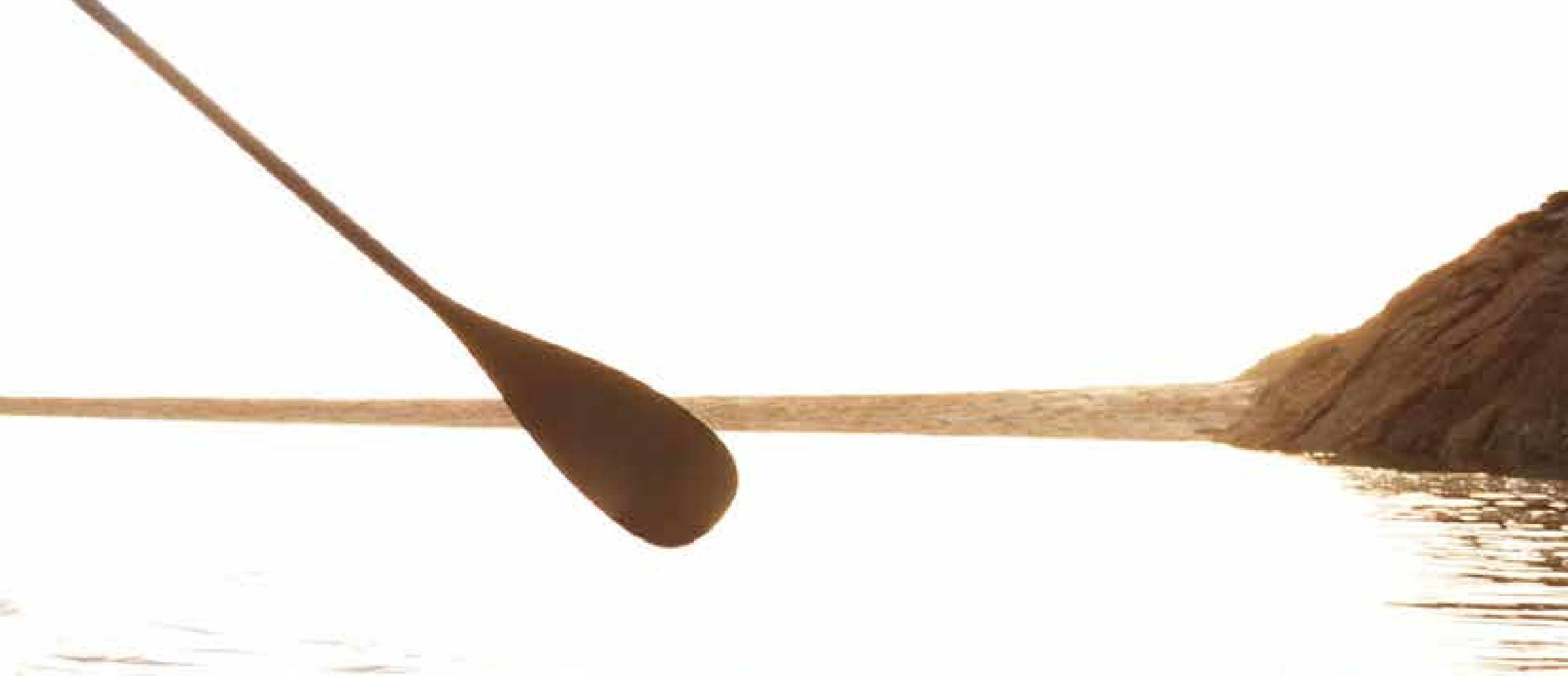
Portfolio construction and implementation

Equities and corporate credit

Our analysts and portfolio managers identify and manage ESG risks and opportunities. We consider ESG factors within our research and investment process where appropriate. Material ESG considerations are incorporated into the overall company analysis alongside fundamental financial considerations such as the company's competitive positioning, scale and financial metrics. We carry out an ESG analysis of all potential investments alongside the financial analysis using proprietary ESG databases and third-party analysis, to help identify possible high-risk names when screening and rating stocks. Each company is rated high, medium or low, and the lowest-quality stocks undergo an enhanced due diligence assessment and additional senior investment professional or CIO sign-off before a fund manager can invest. This robust ESG analysis enhances our qualitative financial analysis and supports the generation of investment ideas.

We produce an executive summary for each company and integrate the most up-to-date ESG data into our portfolio assessment and construction tools. This enables the portfolio managers to create a snapshot of a portfolio's ESG profile and assess ESG criteria alongside profitability and valuation measures. We integrate ESG research and analysis into our credit analysis in order to assess the downside credit risk and default risk potential of an investment.

Historically, sovereign debt has been excluded from the scope of responsible investment concerns due to the perceived creditworthiness of government debt. However, the global financial crisis demonstrated that investors were exposed to greater risk with regards to certain sovereign issuers and ESG analysis of sovereign risk is becoming part of the responsible investment toolkit. Corruption is an issue that concerns many investors and we use Transparency International and World Bank governance indicators in our sovereign risk analysis to assess a sovereign's corruption risk. Inequality, which can prompt social unrest, and has an indirect impact on consumption and investment is a social area of focus that we also include in our analysis. Tax receipts, which can impact a government's budget and by implication monetary policy, are another material concern for sovereign debt analysis. Given the increased focus on global tax reform and the BEPS (base erosion and profit shifting) initiative, tax receipts and the use of tax revenues are likely to remain in focus as a material ESG issue.



Representative overview of the investment process, which may differ by product, client mandate or market conditions.

ESG research and analysis

As early signatories to the Principles for Responsible Investment, we are committed to integrating environmental, social and governance (ESG) considerations into our investment process. We identify and source relevant ESG data and analysis from multiple providers to build up a more complete picture of ESG performance.

We review the quality of our sources regularly and ensure both established and emerging issues are covered. Examples of key ESG factors we consider are outlined below.

Scope of ESG issues[1]

ENVIRONMENTAL

- Carbon emissions
- Energy efficiency
- Climate change risk
- Water stress
- Biodiversity and land use
- Raw material sourcing
- Environmental impact
- Toxic emissions and waste
- Packaging material and waste
- Electronic waste
- Clean tech
- Green buildings
- Renewable and alternative energies

SOCIAL

- Human capital management
- Health and safety
- Supply chain labour standards
- Product safety and quality
- Chemical safety
- Product suitability
- Privacy and data security
- Demographics
- Digital divide
- Financial exclusion
- Access to healthcare
- Nutrition and health

GOVERNANCE

- Bribery and corruption
- Business ethics
- Anti-competitive practices
- Financial system instability
- Corporate governance
- Minority shareholder rights
- Culture and values
- Responsible tax practices

1 Source: HSBC (illustrative and not exhaustive).

Active ownership

Active ownership is an essential part of our approach to responsible investment. We use our influence as a global asset manager with a long-term investment approach to engage directly with the companies we own on behalf of our clients, to protect and enhance the long-term value of our investments.

Engagement

We meet with companies on a range of ESG issues and we have a clear set of engagement objectives:

- Improve our understanding of companies' business and strategy
- Monitor company performance
- Signal support or raise concerns about company management, performance or direction
- Promote good practice

We have a clear process for each engagement based on setting defined objectives, tracking progress made and measuring company action:

Engagement issues range from traditional corporate governance concerns such as the protection of minority shareholder rights, director elections and board structure to environmental issues, including climate change adaptation and mitigation and the low-carbon energy transition, to social issues including human capital management, inequality and data privacy.

In addition to one-on-one company engagement, we undertake collective engagement via leading industry groups such as the Institutional Investors Group on Climate Change (IIGCC), the Principles for Responsible Investment (PRI) and the Investor Forum.

We have also joined several collective engagement initiatives coordinated by the PRI. In 2016, this covered over 200 companies. These engagements include climate change, sustainable palm oil production, labour practices in agricultural supply chains and environmental practices in seafood supply chains.

Voting policy

As a shareholder we have an ownership voice that we can use through the exercise of our proxy voting rights. We aim to vote all of our global equity holding, whether actively or passively managed (except in the case of practical restrictions), in line with our customised global proxy voting policy or by following specific client instructions where relevant.

We also consider broad corporate governance principles such as the ICGN guidelines. Our voting process is based upon consistent vote recommendations across our portfolios and we focus on delivering the best outcome for our clients. We publish a comprehensive quarterly voting record of our proxy voting activities.

In our passive portfolios, we focus on companies flagged as potentially high-risk due to poor ESG practices on a thematic basis and, where appropriate, we will engage directly with both the companies and industry stakeholders, and encourage companies over time and using our vote to address any ESG concerns.

Our Global Voting Guidelines and public disclosure of our votes are available at: http://www.global.assetmanagement.hsbc.com/about-us/responsible-investment

Transparency and disclosure

We believe transparency is part of good governance. We expect it from the companies in which we invest, because it allows us to make better-informed investment decisions. We believe it is equally important for us to be transparent and to disclose our responsible investment beliefs and activities to fulfil our fiduciary responsibilities towards our clients.

Our transparent approach to responsible investment is embedded in our internal management and fiduciary governance structure. Our Global CIO works closely with our Global Head of Responsible Investment Products on our approach to responsible investment. Accountability for all investment management activities, including the integration of ESG considerations, lies with our Global CIO. Our internal fiduciary governance team led by the global head of fiduciary governance provides an additional layer of management oversight and assurance.

- We publicly disclose our Global Voting Policy and votes
- We publish an annual responsible investment policy and a climate change policy
- We actively participate in collective engagement initiatives through the PRI, ICGN and other investor initiatives, we also support a wide range of investor led RI initiatives
- We publish an annual carbon footprint of our investment portfolios in line with our Montreal Pledge commitment
- We participate in the development of industry standards

Stewardship Codes

Stewardship codes set out expectations for investors around active ownership and are being introduced in many markets, including Japan, Hong Kong, Taiwan and South Africa. The UK Stewardship Code, produced by the Financial Reporting Council (FRC) in 2010, was the first of its kind and sets out seven principles for investors, including a requirement to disclose publicly how they will discharge their stewardship responsibilities following the 'comply or explain' model set out in the UK Corporate Governance Code. HSBC Global Asset Management was ranked Tier One signatory to the FRC UK Stewardship Code in 2016 for its compliance with the Code.

Policy and advocacy

As part of the HSBC Group, we actively engage with regulators and policy makers on strategic sustainability and sustainable finance issues.

With its extensive global footprint and systemic importance, HSBC has an important role to play in helping to develop and protect a properly functioning financial system that is critical to secure the current and future prosperity of communities around the world.

We have taken a clear and progressive position on climate change, with active board-level support for initiatives such as the Energy Transitions Commission, New Climate Economy and WEF CEO Climate Leaders.

We also advocate for specific policy measures such as carbon pricing through the Carbon Pricing Leadership Coalition and climate-related disclosure through the FSB Taskforce on Climate-related Financial Disclosures.

We recognise that often we can achieve greater success if we engage collectively with other like-minded investors on challenges that are both long-term and systemic. We therefore play an active part in the collective policy and regulatory engagement through membership organisations including Institutional Investor Group on Climate Change (IIGCC), Principles for Responsible Investment (PRI), and the International Corporate Governance Network (ICGN).

In 2017, we joined over 280 Global investors to urge G7 leaders to stand by the Paris Agreement and drive its swift implementation. This follows a joint letter to the G20 Leaders in 2016 encouraging completion of their ratification of the Paris Agreement, supporting the doubling of investment on clean energy by 2020, prioritising the implementation of Nationally Determined Contributions and steps by national financial regulators to require disclosure of material climate risks.

We are a member of the PRI's Sustainable Stock Exchange Investor Working Group that engages with stock exchanges and regulators to enhance listing rules and regulatory initiatives to require the disclosure of sustainability strategies among listed companies. In addition, we wrote to a number of stock exchanges directly in 2017 to encourage further disclosure of environmental, social and governance performance.

Signatory of:

The Carbon Pricing Leadership Coalition (CPLC) was officially launched on the opening day of COP21 in Paris in December 2015. The coalition aims to share experiences of carbon pricing design and implementation at the global, regional and national levels. HSBC are members of the Carbon Pricing Corridors Panel, leading the effort to determine a credible estimate of future carbon-related price signals that will be valuable for business and investors seeking to make strategic decisions consistent with a low carbon economy.

Climate focus

As a global investor, we are committed to playing our full part in addressing the issue of climate change. We focus on increasing the climate resilience of our clients' portfolios as well as contributing towards financing the transition to a lower-carbon economy. We see this as consistent with our fiduciary duty to our clients.

As early signatories to the Principles for Responsible Investment, we are committed to integrating environmental, social and governance (ESG) considerations into our investment process. Climate change is key amongst these considerations – we source climate-related data, including carbon footprint data, from multiple providers and integrate this into our in-house ESG investment tool across equities and bonds. This enables us to consider a security's carbon intensity as part of our investment decision-making. We also leverage research from the HSBC Climate Change Centre of Excellence, established 10 years ago with research specialists in London and Hong Kong and voted by Extel as Number one provider of Climate Change research for the fourth year in a row[1].

We take our stewardship responsibilities seriously – we engage with carbon-intensive companies on climate strategy and disclosure both directly and collaboratively through the Institutional Investor Group on Climate Change (IIGCC). In 2017, we wrote to over 400 companies, encouraging climate-related disclosure as part of the climate change programme of CDP (formerly the Carbon Disclosure Project).

We support and, where appropriate, co-file meaningful shareholder resolutions in line with our focus on climate strategy and disclosure. In 2016 we supported climate-related shareholder resolutions at over 40 companies in 8 countries. These resolutions included reporting on climate-related risks, 2-degree portfolio alignment and setting greenhouse gas (GHG) emissions reduction targets.

We believe that transparency and disclosure on sustainability issues are key to making markets more efficient. Climate-related disclosure is a particular area of focus. In June 2017, the Financial Stability Board's Task Force on Climate-related Financial Disclosure (TCFD) published its recommendations for voluntary, consistent climate-related disclosures for use by companies. HSBC Global Asset Management, jointly with HSBC Group, actively contributed to the development of these recommendations. Thanks to former Chief Accounting Officer Russell Picot, and through the industry leadership of Stuart Gulliver (via the World Economic Forum CEO Alliance of Climate Leaders), HSBC has been at the forefront of advocating for better disclosure on climate-related financial risk and opportunity. In September 2015 we signed the Montreal Carbon Pledge. The Pledge commits us to provide an annual carbon footprint of our global equity portfolios (see p12).

We have taken a clear and progressive position on climate change. HSBC has been one of the few universal banks to maintain a presence at numerous United Nations Framework Convention on Climate Change (UN FCCC) Conferences of Parties (COPs) with Stuart Gulliver providing a keynote speech urging faster progress at COP21.

"The signature of the Montreal Carbon Pledge is a good example of our continuous engagement in terms of transparency, good governance and incorporation of ESG factors in our investment decisions."

Chris Cheetham
Global CIO
HSBC Global Asset Management,
September 2015

Signatory of:
PRI Montréal PLEDGE
Principles for Responsible Investment

We are aware of the risks that climate change presents to our investments. We are committed to playing our part in addressing the issue and limiting its impact on the global economy. Our approach is to increase the resilience of our clients' investments by reducing climate-related financial risk.[2]

1 Source: Extel Survey 2017 winners
2 HSBC Global Asset Management Climate Change Policy, 2017

Sustainable Development Goals

In late 2015 the United Nations released a series of goals to replace the Millennium Development Goals. The Sustainable Development Goals (SDGs), officially known as "Transforming our World: the 2030 Agenda for Sustainable Development" are a set of 17 global goals that UN member states will be expected to use to frame their agendas and political policies over the next 15 years. The goals range from ensuring clean water and sanitation for all to achieving gender equality and reducing inequality within and between countries. The SDGs call on both public and private sectors to work together to tackle the most serious issues facing the planet.

In response to the SDG agenda HSBC Global Asset Management has joined the Investment Leaders Group (ILG), which is convened by the Cambridge Institute for Sustainability Leadership. The ILG is a group of major investors and asset managers committed to advancing the practice of responsible investment. The ILG's mission is to help shift the investment chain towards responsible long term value creation. To deliver this ambition, the ILG provides an overarching framework, inspired by the SDGs, to help investors understand, quantify and report the social and environmental impact of their investments.

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Contact your HSBC Global Asset Management Relationship Manager
for further information about responsible investment

Important information

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