Responsible Investment Review

March 2022

HSBC
Asset Management

Contents

Chief Executive welcome

It's my privilege to present to you our latest Responsible Investment Review – HSBC Asset Management's annual compendium of sustainability-related information, achievements, viewpoints and policies.

It hardly needs to be said that 2021 was another year of extraordinary progress for sustainable finance, with the asset management industry playing its part. Clients now expect investment solutions that were considered fringe not so long ago. Our own sustainable assets grew strongly to $30bn.

I am committed to embedding sustainability in everything we do, the success of which couldn't be clearer in the pages that follow. But our fiduciary duty must never be compromised. Delivering sustainable outcomes while maximising risk-adjusted returns requires constant innovation, which is why we're pushing the boundaries in natural capital, climate tech, healthcare, and green bonds.

The flip-side of the explosive growth in sustainable assets is increased regulatory scrutiny. Investors are rightly concerned about so-called 'greenwashing'. Robust governance and oversight is essential, which ensures not only that we do what we say we do, but that our sustainability offerings are honest, easy to understand, and supportable with data.

Some final words on three corners of the sustainable universe that are close to my heart right now. The first is Asia, having recently moved my family to Hong Kong. Any serious approach to sustainability must focus on the region: 60 per cent of humanity lives there and it accounts for half of emitted carbon dioxide. Asia is also fast growing yet low-income in parts – hence a socially sensitive approach to sustainability is required. Equity and inclusion is another passion of all of ours at HSBC Asset Management.

We are well positioned to understand how to invest in Asia, with large on-the-ground teams supported by countless HSBC relationships. Our sustainability know-how in the region is unrivalled, and nowhere does this matter more than supporting our belief in alternative assets. Literally trillions of dollars of investment spending are required for Asia to become sustainable. Much of that has to be financed directly via loans, private equity, or venture capital. This explains our new alternatives hub in Singapore, with sustainability central to its success.

Whatever your relationship with us, I trust you will find this report an interesting and useful resource.

Nicolas Moreau
Chief Executive Officer
HSBC Asset Management

Head of Sustainability foreword

2021 was a year of tremendous progress in Sustainable Investing, and at HSBC Asset Management we are proud to have played our part. Colleagues world-wide have embraced our purpose-driven ethos, transforming the way that we think about investing for the long term. I am pleased to present this annual report on the important work taking place across our global business.

We have aligned our purpose to three key pillars to anchor our approach to Sustainability. First, we have a responsibility to help to facilitate the flow of capital from the world's leading investors to the businesses and projects around the world that are driving the transition to a sustainable global economy. Second, we have a fiduciary obligation to ensure our clients' monies are managed for positive long-term environmental and social outcomes. Finally, we have a responsibility to use our voice and influence with the companies in which we invest and the industry at large.

Of course a key highlight of the year was the COP26 conference and its critical call to action on climate. The commitments made at COP26 marked a major milestone in the journey to net zero, with important implications for both financial markets and investors around the world. We are deeply committed to this cause, and our participation in the Net Zero Asset Manager Initiative is a key element of our strategic development. In 2021 we announced the formation of a new Climate Centre of Excellence. This will form the heart of our climate investing capabilities, allowing us to guide our clients through the transition pathways ahead.

An important and still under-appreciated part of the net-zero solution set is Nature. With the Task Force for Nature-Related Financial Disclosures just getting started, we expect rapid and meaningful progress over the next few years. Natural capital invests in the resilience of nature, and this emerging asset class will combat climate change and build biodiversity whilst generating superior long-term returns. We are committed to the development of natural capital as an asset class. As a result, we are incorporating biodiversity into our investment solutions and launching a range of innovative investment solutions to open up a world of sustainable investment opportunities for our clients.

There is no doubt that exciting investment opportunities are developing from emerging technologies in the sustainable economy, and alternative asset classes are at the leading edge of this. We are building innovative investment solutions to provide funding for projects and businesses supporting the transition to lower emissions. Sustainable infrastructure, clean technology and nature-based solutions need funding, and we are working to build the investment capabilities and funds needed to facilitate this flow of capital. In 2021, we co-developed the FAST-Infra Sustainable Infrastructure label that will help investors identify quality infrastructure assets.

We hope that the FAST-Infra SI label will encourage host governments and developers to consider environmental and resiliency issues at the pre-construction phase. We also hope it will draw more institutional investors at the post-construction phase. This important work is yet another demonstration of our commitment to developing new sustainable asset classes that will drive the transition economy.

In our core investment area, we have made significant advancements in three key areas. Our investment teams have added new data sources and research capabilities to add depth to decision making on our most critical issues. We have defined clear investment and product standards to ensure that our sustainable funds are managed with clear intent and evidence key sustainability outcomes. We have elevated our stewardship activities with new experienced hires and an increased focus on impacting key issues with the companies in which we invest. This progress will ultimately support our clients with improved transparency and clarity on sustainable investing issues.

2021 was about committing to the journey ahead. 2022 will be about the detailed and challenging work of setting targets and defining the policies required to get there. We will need to make difficult decisions and balanced assessments of complex interdependencies. We are looking closely at the policy commitments we will need to make as investors, to ensure that our actions are truly driving the change that is needed. Two areas of particular focus for 2022 will be Just Transition considerations and fossil fuel commitments. We are united in our purpose and vision at HSBC Asset Management, and we look forward to supporting our clients in the journey ahead.

Erin Leonard
Global Head of Sustainability
HSBC Asset Management

2021 Key Achievements

In 2021 we celebrated many milestones and achievements in Responsible Investing. Some of these include:

$30bn

Sustainable assets under management (AUM) reached $30bn[1] by the end of December. The majority of our other assets were responsibly invested.

We launched 18 new sustainable funds. We also defined clear Sustainable Finance Disclosure Regulation (SFDR) product principles and uplifted 17 funds from SFDR Article 6 to Article 8.

Our investment teams reinforced ESG integration with process enhancements and developed new sustainability-focused investment strategies

A full organisational review was completed that created our Sustainability Office and Responsible Investment team, increasing our dedicated staffing toward sustainability.

We recruited a number of new team members, bringing additional depth and extensive industry experience to our investment capabilities and shareholder voting activities.

We participated in the COP26 conference, supporting Biodiversity themes and the Fast Infrastructure Initiative.

We announced our plans to develop a

Climate Centre of Excellence

and hired a Climate Investment Strategist to drive these efforts forward.

We launched the

'Drive positive change'

campaign to promote our vision in responsible investment.

1. Rounded up from $29,7bn as of 31 December 2021. Source: HSBC Asset Management

We were delighted to earn the Morningstar ESG Advanced Rating, a recognition of our investing ethos and capabilities.

We were accepted as a signatory to UK Stewardship Code.

To solidify our commitment to climate change remediation, we signed the Net Zero Asset Manager initiative in July 2021.

As a mark of our commitment to diversity in the asset management industry, we invested in RadiantESG, a female-owned, independent asset management firm focused on next-generation ESG investment opportunities for institutional and wealth management clients worldwide.

We supported the development of the Natural Capital asset class, through our ongoing support of the Climate Asset Management joint venture and anchor investment in the inaugural Natural Capital solution.

Our responsible investment framework

HSBC
Asset Management

Our responsible investment framework

Our beliefs

With the anticipation that environmental, social and governance issues will be increasingly inter-twined with economic stability and growth, we have been embedding ESG considerations into the way we manage assets and consider risk-adjusted returns over the long-run since 2010.

As an investor with fiduciary duty to our clients, we have the responsibility to embed sustainability risks in managing their portfolios. As an asset manager, we recognise the need to look beyond the financial statements of a company and allocate capital towards investments that promote and deliver sustainable outcomes.

Extreme weather conditions have shown us that the climate crisis is far from a remote concern. Alignment with the Paris Agreement to fight against climate change means all sectors of the economy will need to cut their carbon emissions by half by 2030 and achieve net zero by mid-century. While this decade is crucial in setting the world on course to reach these targets, it will also be marked by rapid growth in sustainable infrastructure, especially in Asia. Hence new and valuable technologies are necessary to support this growth, creating exciting opportunities for investors.

Sustainability is not limited to climate change and net zero. We see opportunities across many emerging E, S and G themes – notably natural capital, affordable health care, circular economy, agriculture and food, and transitioning industries. The UN Sustainable Development Goals provide a useful framework to assess sustainability themes.

In 2021, we established our sustainable investment beliefs as shared below.

There are two kinds of responsible investment	There are two kinds of responsible investment. The first is investing sustainably in order to achieve positive real world outcomes. The second incorporates sustainability into decision making in order to generate superior risk-adjusted returns. We believe investors desire both.
Asset managers have a key role to play in both	Our industry is fiduciary bound, which means it's our duty to understand how sustainability affects valuations, risks and returns. As asset allocators and influencers of policy, we can help mobilise capital towards positive real world impacts.
ESG integration can improve risk adjusted returns	Our proprietary quant-based historic analysis demonstrates that ESG integration can improve excess returns. This is true for each E, S and G pillar, as well as across regions. It's also true for ESG improvers.
Positive sustainable change is an opportunity more than a risk	The low-carbon transition is aligned to attractive risk-adjusted returns over the long term. It may unlock trillion-dollar opportunities, give rise to new business models and valuable asset classes. Examples include nature-based solutions, sustainable infrastructure and critical green technologies.
Engagement is central to performance and outcomes	Engagement is a key feature of responsible investing. It plays an important role in enhancing investment returns as well as delivering sustainable objectives. This is especially the case for businesses funded by long-term or permanent capital.

Why we're different

Sustainable investing is not new to us. Our track record in ESG dates back to the launch of our first Socially Responsible solution in 2001, making us an early mover. We were among the first asset managers to sign up to the UN Principles for Responsible Investment (PRI) in 2006, where we have received an A+ rating. Since 2010, ESG considerations have been systematically integrated into our equity, fixed income and multi-asset capabilities and are being increasingly applied in liquidity and alternatives, with our proprietary ESG database now covering more than 17,000 financial instruments.

We put investors first. We believe ESG considerations not only protect their wealth, but also grow it by capitalising on the transition to a more sustainable world. To better serve the different needs of our investors, we offer sustainable solutions along an investment continuum. From basic ESG integration, to thematic funds that focus on emerging areas of growth and innovative asset classes seeking to drive positive changes in specific areas like natural capital and sustainable infrastructure.

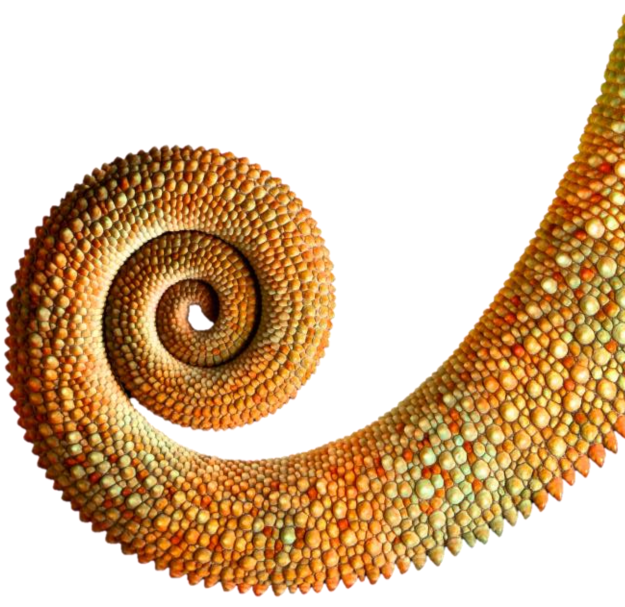
Our ESG process is truly 'quantamental'. We have access to both a large quant team and a global network of on-the-ground equity and credit analysts. With our quantitative analytics tools, we can assess the materiality of E, S and G factors on historical performance and subsequently form our inhouse view on their impacts going forward. This is also supported by the qualitative overlay provided by our analyst teams based on years of experience and access to corporates. Our investment approach has been acknowledged by the Morningstar award of 'ESG Advanced', recognising us as one of the 'firms who are among the industry's strongest ESG proponents'.

Innovative products and solutions. We are constantly on the hunt for new sustainability-based opportunities for our clients. In 2021, we launched a Climate Venture Tech strategy that focuses on companies providing software solutions to support the transition of hard-to-abate sectors. We already lead the way in real economy emerging market green bonds, as well as Paris aligned ETFs and sustainable liquidity solutions.

We prioritise engagement. Avoiding exposure to carbon intensive industries may be intuitive in this transitioning period on the surface. Yet, as one of the biggest greenhouse gas emitters and an important part of the global supply chain, these industries hold the key to a successful transition to net zero. Through engaging with sectors such as transportation, steel, chemicals, cement and energy, we offer them our expertise in sector transformation and climate critical technologies.

We are part of HSBC Group. We are supported by the resources and long-term commitment of one of the world's leading international banks. We benefit from a shared global infrastructure and relationship management. HSBC Group is also a recognised leader in sustainability, having been named by Euromoney as World's Best Bank for Sustainable Finance both globally (2019, 2020) and regionally – in the Middle East (2019, 2020, 2021), Western Europe (2020) and Asia (2019, 2020, 2021).[1]

Our Asian heritage. Nowhere will the transition and sustainability be more important than in Asia. The region is responsible for the majority of the current climate emissions and is therefore a key player in the move to a lower-carbon economy[2]. As one of Asia's largest and oldest international financial institutions, we have an important role to play in driving the sustainable investment market. Our local expertise and insights benefit our clients in Asia as well as those seeking exposure to sustainability assets in the region.

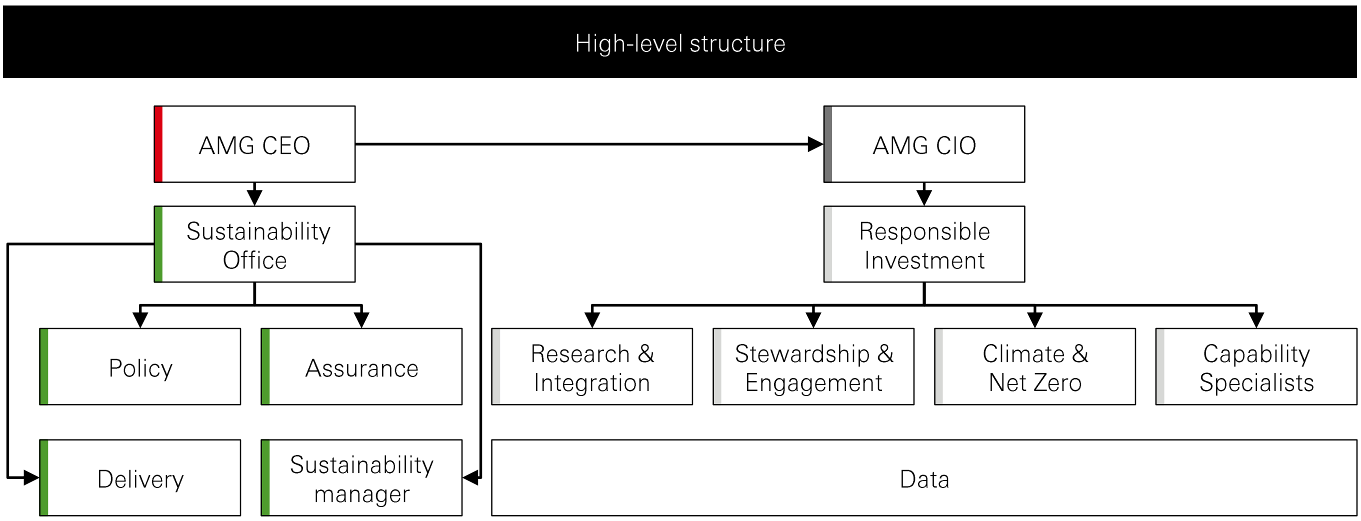


1. Source: Euromoney.
2. Source IMF, September 2021

Past performance is no guide to future performance

Sustainability governance and oversight

HSBC Asset Management has a multi-layered governance structure to support and oversee our sustainable investment business. It is based on two key pillars – the Sustainability Office and Responsible Investment team. While the Sustainability Office is in charge of establishing the overarching policies and corporate initiatives, the Responsible Investment team focuses on investment processes, capabilities and product development across asset classes.



Target operating model – oversight, standards, and preventing greenwashing

In 2021, the Sustainability Office and the Responsible Investment team introduced the target operating model. Its purpose is to strengthen the oversight of our sustainable investments business by establishing coordination forums and committees that involve risk, compliance and investment capability functions. This is important to the uphold of our sustainable investment standards and the prevention of greenwashing.

To oversee and ensure alignment of standards across our functions, we established a multi-tiered governance structure.

To begin with, virtual sector teams (VSTs) have been set up to capture ESG sector specific knowledge across asset classes and geographies. Run by our Head of ESG Integration and Research, these teams bring together RI specialists, and credit and equity analysts stationed in different regions. They are responsible for conducting sector research, overseeing ESG checklists, deriving ESG scores and aligning our engagement activities with risk issues, which makes them a key component of our enhanced ESG integration framework described further down.

Outputs from VSTs then go to our Asset Class ESG Committees, which hold the responsibility of overseeing ESG implementation across investment processes, and the monitoring of risk and engagement progress. Each committee leverages our sector insights, proprietary ESG scoring and data analytics generated by the VSTs. This information is synthesised to support our investment teams with decision making and new product development.

The next layer is the Portfolio Review Committee that oversees the alignment of sustainable portfolios against our Sustainable Investments (SI) group definitions and regulatory requirements. It also ensures compliance to our SRI restrictions, tail risk policies and other relevant SRI risk considerations.

The last layer, ESG Oversight Committee, is the highest ranking investment decision making body. Chaired by our Global Chief Investment Officer, it oversees ESG implementation, ensuring best practices and alignment with our RI policies. The ESG Oversight Committee reviews products, frequently makes final decisions related to our sustainability standards and oversees the application of standards to investment processes and capabilities.

RI teams, committees, and forums	
Virtual sector teams	Conduct sector research, ESG scoring and overrides, oversee checklists, inform asset class teams of material risk issues, engagement questions
Research and Engagement Forum	Oversee alignment to sustainability policies, help to identity engagement priorities/ themes, advise investment teams, address controversial issues
Asset Class ESG Committee(s)	Implement and review ESG integration, monitor risks and engagement progress, oversight and approvals, engagement coordination
Portfolio Review Committee	Oversee the alignment of portfolios against Group Definitions and regulatory requirements, validate compliance to SRI restrictions and tail risk policy
ESG Oversight Committee	Highest RI approval committee, responsible for alignment with RI policy, ESG integration, escalations, engagement oversight, product sign-off

Beyond our formal oversight and governance framework, we have established working groups dedicated to sustainability standards and definitions, net zero alignment and solutions, and ESG research and engagement.

High level business policies

Our responsible investment policies set out the approach we take on issues important for the sustainability of companies in which we invest. They help us communicate with investors and set our expectations for companies. We recognise that investors' requirements have risen as society focuses more on the role of asset managers and owners in helping companies to respond to sustainability challenges faced by our world.

Our policies are framed by our commitment to the Principles for Responsible Investment, which describe how we meet the requirements of the EU Sustainable Finance Disclosure Regulation. We prioritise climate related themes and select social issues. At the start of 2021, we completed a major review on our responsible investment policies, and published new and revised policies.

Our Responsible Investment Policy defines the role of ESG integration, active stewardship and advocacy. It sets out the importance we attach to UN Global Compact principles as a framework against which to assess corporate conduct. It also summarises our policies on climate change, biodiversity and banned weapons. It is accompanied by Responsible Investment Implementation Procedures which detail how ESG factors and sustainability risks are integrated into portfolio construction and investment decision making processes.

We published an updated Climate Change Policy. To play our part in reducing global carbon emissions, we are committed to: support the goal of net zero greenhouse gas emissions by 2050; integrating climate related physical and transition risks in the management of client portfolios; encouraging the phase out of unabated thermal coal; and catalysing investment flows to support a low carbon economy.

In July 2021, we announced our commitment to the Net Zero Asset Managers initiative. By the end of June 2022, we will set an interim target for the proportion of assets to be managed in line with achieving net zero emissions by 2050 or sooner. For those assets, we will set interim emission reduction targets for 2030.

We published a new Biodiversity Policy. Natural ecosystems are under threat as a result of deforestation, land degradation, pollution of the water, air and soil, hunting and harvesting, mining and climate change. This presents broad challenges for society and a systemic risk for investors. We therefore encourage investee companies to: manage natural resources in a sustainable manner; avoid or minimise the release of pollutants; commit to 'No Deforestation, No Peat and No Exploitation'; avoid or minimise impacts on biodiversity; improve efficiency in the consumption of natural resources; and use independent certification in supply chains to reduce biodiversity risk.

We also have a Banned Weapons Policy. Our active, systematic and index portfolios do not have direct exposure to listed or unlisted equities and bonds issued by corporations with proven involvement in weapons banned by international conventions, including: anti-personnel mines, biological weapons, blinding laser weapons, chemical weapons, cluster munitions and non-detectable fragments.

During 2022, we expect to review our existing policies and in particular examine our commitments on coal, deforestation, human rights and tobacco.

Public policy and advocacy

We are committed to playing an active and constructive role in supporting the development of a well-functioning and more sustainable financial system. This involves engaging with regulators and policymakers directly and through our participation in industry bodies. We have identified three focus areas for our activities:

1

Addressing the key risk of climate change through encouraging policy and action to support the transition to a low carbon economy. We join public investor statements and participate in industry working groups that advocate policy measures and frameworks to advance the low carbon transition.

2

Directing capital to deliver on the Paris Climate Agreement and UN Sustainable Development Goals. Collaboration is central to making progress with these challenges; we leverage our global relationships with development finance institutions, investors, regulators and relevant organisations to work towards finding effective solutions.

3

Improving market standards and transparency on sustainability. This can help markets operate more efficiently and enable investors to identify material ESG risks and opportunities. The quality and availability of ESG data are critical to investors. We support voluntary and regulatory frameworks to enhance company disclosure on material sustainability issues.

We are active members of a variety of industry bodies, initiatives and networks that advocate progressive public policy development and action on sustainable investment. Here are a few examples:

- Member of European Fund and Asset Management Association (EFAMA)'s ESG & Stewardship Standing Committee;
- Member of British Standards Institution (BSI)'s Strategic Advisory Group;
- Member of The Investment Association (IA)'s Stewardship Reporting Working Group;
- Member of Sustainable Stock Exchanges consultative group;
- Member of Impact Investing Institute Advisory Council

We work closely with these bodies and our HSBC Group Public Affairs colleagues to respond to consultations and discussion papers that contribute to shaping a more sustainable financial system.

Over the past year we have participated in various consultations and working groups, including:

- Financial Conduct Authority (FCA) consultation on sustainability disclosure requirements;
- FCA consultation on Special Purpose Acquisition Companies (SPACs);
- FCA roundtable on ESG principles;
- Hong Kong Exchange consultation on corporate governance code;
- Hong Kong Securities and Futures Commission (SFC) consultation on ESG labelled funds;
- Hong Kong SFC consultation on fund managers' climate-related risks;
- Hong Kong Mandatory Provident Fund (MPFA) working group on ESG integration;
- IOSCO consultation on ESG data and rating product providers;
- IOSCO consultation on sustainability-related practices, policies, procedures & disclosure in asset management; and
- UK Government review of listing rules

For climate-related public policy, COP26 in November was the landmark event of the year. Ahead of the summit, we participated in a number of initiatives to communicate investor expectations, among which was the Global Investor Statement to Governments on the Climate Crisis. This was a strong call from investors for governments to raise their climate ambition and implement meaningful policies. It advocated for climate-related financial reporting to be mandatory and for resilient economic recovery plans from Covid-19 to support the just transition to net zero emissions. We also participated in working groups of the Prince of Wales's Sustainable Markets Initiative ahead of the summit.

Our Chief Executive and Head of Sustainability attended COP26, participating in a number of events. In addition to improved pledges of carbon dioxide emission reductions, there was an important focus on natural capital at the summit. Our commitment to the Net Zero Asset Managers Initiative is one way in which we are taking action to deliver on COP26 ambitions.

As a founding member of the One Planet Asset Manager Initiative, we continued to support its work during the year. The One Planet Summit in January focused on biodiversity with the launch of the High Ambition Coalition for Nature and People, now supported by 70 countries pledged to protect at least 30 per cent of land and ocean by 2030. In October, we joined an OPAM statement in support of climate disclosures and targets under the TCFD framework.

Biodiversity was another major focus area for our policy work during the year. HSBC Group Is represented on the new Task Force for Nature-related Financial Disclosure, which will develop a framework for financial institutions and companies to report and act on evolving nature-related risk. We signed the Finance for Biodiversity pledge and have participated in policy and stewardship working groups to encourage public policy support of financial flows that protect nature and biodiversity, and to develop engagement best practice. We are also part of Club B4B + (Business for Positive Biodiversity), which aims to develop a Global Biodiversity Score based on company level data.

Our sustainable investment definitions

Today the word sustainability is ubiquitous. Responsible investment has entered the mainstream. We have long believed that ESG integration is a hygiene factor, as is engagement. Therefore, we do not consider these activities sufficient to qualify as sustainable investments.

In 2019, HSBC Asset Management together with other parts of the Group including our Wealth and Private Bank, established the Sustainable Investment Definitions Framework. The purpose of the framework is to establish a set of criteria for what we believe to be a sustainable strategy.

We define sustainable investments to be those that go beyond ESG integration and set out to promote and/or deliver on positive sustainability outcomes, while enhancing risk-adjusted returns. Intentionality is key – sustainable objectives must be clear from the outset and integral to the investment process. These will differ by strategy and we group them by the definitions below.

HSBC sustainable investment definitions

	ESG Enhanced	Thematic	Impact
Description	Strategies that promote sustainable outcomes by incorporating strong sustainability characteristics into the underlying investment process or product design. This includes ESG improvers, ESG tilts and ESG positive screens.	Strategies that provide exposure to ESG related growth areas and trends by seeking out companies or sectors that align with specific sustainable outcomes. This includes e.g. circular economy, low carbon transition readiness, gender equality and affordable healthcare.	Investing to deliver a direct, positive and measurable impact on society and/or the environment.

Sustainable Finance Disclosure Regulation (SFDR) product classification

Article 8 (typically)	Article 8 or 9	Article 9 (typically)

Incorporate strong sustainability considerations → **Deliver sustainability outcomes**

The foundation of these categories can be found in the Global Sustainable Investing Alliance's (GSIA) seven sustainable investing styles. Four of the GSIA approaches (negative exclusion, positive screening, thematic, impact) are aligned to these newly defined categories.

Article 8 SFDR =The product promotes environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices even if this is not its central point, or the central point of the investment process.
Article 9 SFDR : the product has a sustainability objective
For informational purposes only and should not be construed as a recommendation for any investment product or strategy. Any forecast, projection or target where provided is indicative only and is not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecast, projection or target. Not an exhaustive list of capabilities. Source: HSBC Asset Management

ESG and performance

Evaluating how companies manage their impact on the environment, their relationships with stakeholders, and their operations enables us to identify potential risks and opportunities which financial markets may not price appropriately.

Publicly available ESG risk scores tend to be based on historical data and aspirational commitments. As a result, ESG scores today are not necessarily indicative of a company's intrinsic valuation, especially in the long-term. At HSBC Asset Management, we combine ESG scores with data driven and qualitative analysis to understand the materiality of E, S, and G factors on security performance in a forward-looking way. Our integrated ESG methodology ascertains which and to what extent E, S, and G factors are 'material' to the intrinsic value of a company or the risk of a country.

We also assess the attribution of E, S and G factors on historical valuation and performance to assess potential impacts in the future. Thus, we are able to determine a company's intrinsic value relative to their current price which informs our investment/portfolio construction process.

Our belief in this approach is backed by numbers. Our own quantitative analysis of historical data shows that companies with higher sustainability scores have outperformed peers across different markets. This is not only true for the overall ESG scores, but also the individual E, S and G scores. This is based on only ten years of analysis, but as datasets improve, we are confident that the case for ESG integration in security analysis will only become stronger.

Research criteria:

- Companies with the top 30 per cent of sustainability scores
- Compared to the original MSCI equity benchmarks
- Equal-weighted
- Long-only portfolio
- Monthly rebalancing
- Data presented in two periods as the availability and quality of sustainability data has significantly improved since 2015

Annualised excess returns (%) in different markets

	Europe		North America		Asia Pacific ex-Japan	
	2009-2014	**2015-2020**	2009-2014	**2015-2020**	2009-2014	**2015-2020**
E	1.7	**0.5**	0.4	**2.0**	0.7	**2.2**
S	0.5	**1.5**	-0.6	**1.2**	0.0	**-0.1**
G	1.8	**3.1**	0.9	**0.5**	0.7	**2.9**
ESG	2.6	**1.5**	0.5	**0.6**	-0.7	**0.5**
Carbon intensity	1.5	**2.0**	-0.1	**3.1**	-2.3	**2.6**

Our quantitative research shows that companies with higher sustainability scores consistently outperformed peers across different markets.

The performance figures relate to the past performance which should not be seen as an indication of future returns. The capital invested in the fund can increase or decrease and is not guaranteed. Future returns will depend, inter alia, on market conditions, fund manager's skill, fund risk level and fees. Source: HSBC Asset Management. For illustrative purposes only. The commentary and analysis presented in this document reflect the opinion of HSBC Asset Management on the markets, according to the information available to date. They do not constitute any kind of commitment from HSBC Asset Management. Consequently, HSBC Asset Management will not be held responsible for any investment or disinvestment decision taken on the basis of the commentary and/or analysis in this document.

Our proprietary RI scoring and integration framework for listed assets

MASSIVE

Materiality, **A**ctive **S**hare, **S**ectoral **I**nsight, **V**aluation, **E**ngagement

One of our core beliefs is that incorporating ESG into the investment decision making process contributes to the generation of superior long-term risk-adjusted returns. We have further improved our scoring and integration process this year through sharpening our focus on what matters, deepening collaboration between research teams and taking a more activist approach to engagement. By utilising the latest quant techniques, we ensure that risk/return analysis is material while referencing valuation. This is the proprietary framework which we call MASSIVE.

The key to the framework's success is that it takes a portfolio manager's point of view – focusing on how to boost alpha through ESG integration. If our quantitative backtesting shows that a certain ESG factor does not have much predictive power when it comes to share price returns, then we move onto something else. Likewise, we focus on a portfolio's biggest over and underweights as these drive the majority of performance.

We recognise that for funds that are trying to maximise investment returns, potential ESG related risks and returns must be assessed with reference to price. A security may have the best sustainability scores in the industry, but if sky-high valuations already reflect this fact, there may be little scope for excess return.

Our MASSIVE framework also utilises the fact that HSBC AM has a large and experienced active investment platform – with hundreds of sector and regional experts all around the world. We first rely on quantitative research teams to conduct backtesting on third party ESG data, then conduct our own sector-based assessments of E, S and G factors in order to maximise their accuracy.

We do this not only to improve securities' ESG risk scores, but also to conduct a sensibility check on our assessment of a company's 'sustainability-ness'. That is, analysing the breadth and depth of their sustainability outcomes: what is their contribution – positive and negative – to sustainable development? Does it have a genuine impact on our environment or society?

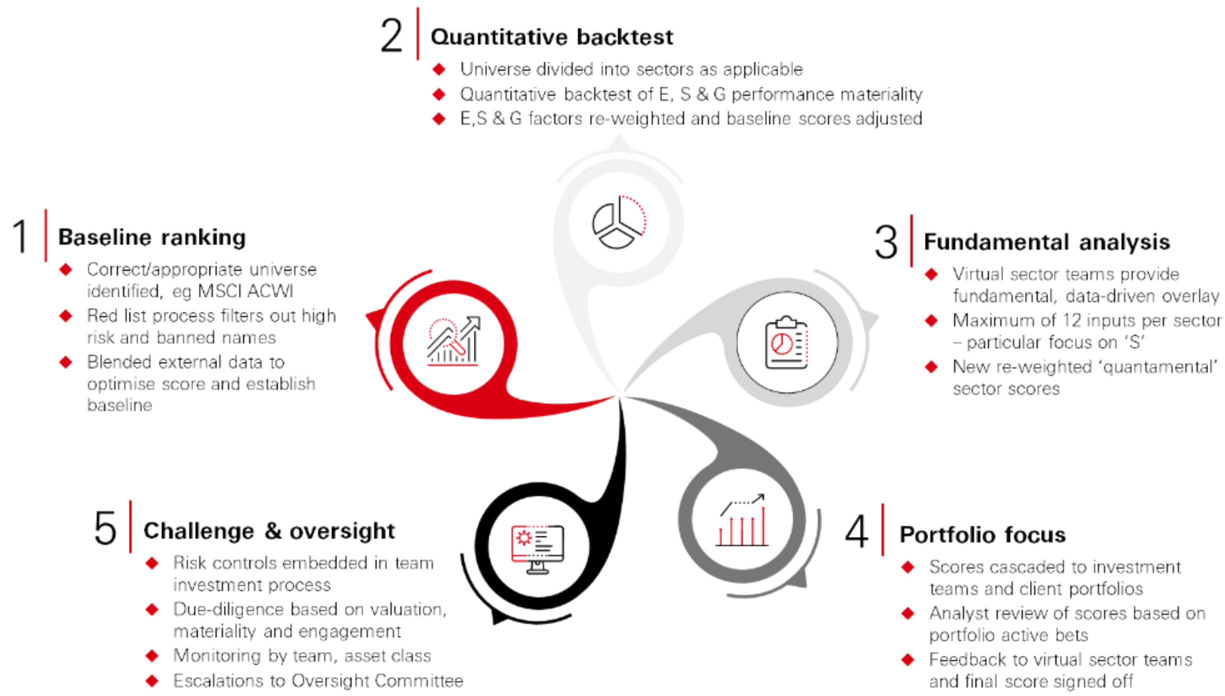
To achieve this, we divided the investment universe into twelve sectors. Each is owned by a virtual sector team, which are global research groups comprising representatives from equities, fixed income, RI research and engagement, as well as domain experts from our offices around the world. VSTs crystallise our in-depth understanding of sector specifics, ESG issues, and trends.

Based on this, they have to derive proprietary sector-specific scoring frameworks leading to monthly ESG ratings that feed into our investment processes. Our RI team helps to coordinate these VST meetings to offer guidance as well as to ensure global consistency and best practice. Output scores are regularly reviewed, eventually overridden and escalated if deemed necessary.

The last key element of our framework is engagement. We are more targeted on certain issues and particular companies, believing this leads to superior outcomes both in terms of financial performance and sustainable outcomes. This is particularly true in secondary market securities where capital is more permanent and hence financial influence is muted.

ESG integration is different at HSBC Asset Management thanks to:

- A large quant team as well as a global network of experienced on-the-ground analysts
- A 'quantamental' ESG scoring methodology with factors subjected to materiality-based backtesting
- A focus on active share and understanding that risk and return must be seen in relation to price
- Activist engagement, targeting specific themes and companies



Source: HSBC Asset Management, December 2021. For illustrative purposes only. Representative overview of the investment process, which may differ by product, client mandate or market condition.

Key 2021 RI integration initiatives:

- **Virtual sector teams:** Broadening of global coverage to 12 teams incorporating analysts, portfolio managers and regional experts from our equity, credit, and international investment teams. Purpose of the VSTs is to capture ESG sector specific knowledge across asset classes and geographies, build investment-relevant scores, and share and disseminate this knowledge with broader investment platform and beyond
- **Virtual quant teams:** Established to support the VSTs and investment teams in the analysis of ESG information, review of external data, the materiality of ESG factors, and optimal incorporation of ESG scoring into investment portfolios
- **Research and Engagement Forum:** Weekly meeting where the RI research and stewardship teams discuss a range of research and engagement-related issues with portfolio managers and analysts. Meeting ensures alignment to sustainability objectives, helps prioritise engagement themes, and ensures ideas and best practices are disseminated across the platform
- **Diversity, equity and inclusion working group:** Established to scale-up the integration and monitoring of DE&I issues in ESG analysis and scoring, as well as in portfolio management
- **Proprietary climate score:** Development of a climate scoring methodology which combines qualitative and quantitative environmental factors such as current carbon metrics but also more innovative ones like 'avoided carbon' to have a more holistic view on companies' impact on climate change. At present, the climate scores have been attributed to European issuers, with the aim to expand to other market segments
- **Internal credit rating:** ESG factors have long been part of our internal credit rating methodology. In 2021, we defined industry-specific key ESG risks factors; each of them being assigned a weight that contributes to the overall internal credit rating. Hence, we are able to better assess the materiality of ESG factors and their impact on credit quality of issuers. This internal credit rating methodology has been designed by our global credit research teams worldwide in collaboration with our fixed income quantitative team
- **Asset-backed securities:** Expansion of our ESG integration to asset-backed securities, where the coverage from external data providers, including rating agencies, is limited. As such, for each sector we have defined dedicated ESG issues and their respective weight that contributes to the overall internal scoring
- **Google cloud platform:** Implementation of a new ESG data infrastructure on Google Cloud as a golden source to feed all user services of ESG data, from investments teams to Risk, Reporting, Restrictions and Controls teams

Case study

What was the ESG issue?

In April 2021, Techtronics, a Hong Kong power tools and electronic equipment maker, announced its first female independent director to the board. Not only did our investment team note the improvement in gender diversity, the new board member also had ESG expertise. It was a time of volatility for the company, as demand for home tools was slowing down in the US, one of the major markets. But our analysts were more interested in whether this positive step at the most senior level was a sign of more enlightened decision making to come.

At HSBC, the gender diversity of boards is a key ESG engagement issue. We had already written to Techtronics the year before, highlighting that it was lagging its Hong-Kong large cap peers, which had an average of 12 per cent female board members in the first half of 2020. We further communicated our position on the matter through a vote related engagement with the company in January 2021. In these conversations, management demonstrated a genuine intention to improve. The fact that Techtronics acted so quickly was a good sign in our view. Clearly we also wanted to understand if there was a shift towards a more ESG mindset and whether that would improve business performance.

Why did it matter?

We believe that all companies should aspire to have a diverse and inclusive board. In addition, industry studies have suggested that more gender diverse boards make better decisions, have better attendance, and are associated with superior financial results. Improving gender balance on the board can also be a catalyst for improving gender diversity at all levels of the company, which could lead to positive impacts on financial returns. Finally, for family/founder firms such as Techtronics, it is crucial that board diversity is effective rather than simply structural.

What did we do?

We engaged with the company soon after the new independent director announcement. Through our conversations we understood that the company recognised the issue of board entrenchment, and the need to increase female representation and ESG expertise on board. Indeed, soon after, three new directors were appointed, including a female independent director that improved the composition of the board. The company also shared its thoughts on nomination and appointment criteria, process, and its strategy for board succession planning. Bringing ESG thinking to the board is also part of its strategic thinking.

We reviewed our ESG credentials of the company. Our analyst assumed that it would continue to strengthen its environmental initiatives and considered that the supply chain disruption risk is manageable. While we were comfortable with ESG performance and governance, we have also identified operational transparency as something to watch.

How did it influence our investment decisions?

More than a ticking the box exercise, the current governance improvement at Techtronics gave us the confidence to increase our holdings in this company. Meanwhile, we recognise that the improvement in ESG performance and disclosure is embryonic and have suggested the continued monitoring of ESG metrics.

RI and alternatives

Alternative investments play a key role in the transition to a more sustainable economy – from venture capital investments in climate tech, to sustainable infrastructure and natural capital. But alternatives also pose challenges for responsible investors. Illiquidity, data opacity and management control can make it difficult to assess and manage ESG risks. These characteristics also differ substantially within alternative asset classes. For instance, an investor will have a greater ability to influence change when direct investments are made and/or an investor has board representation – compared with third party/indirect investments. Given the unique nature and characteristics of each alternative asset class (and the sub-strategies within), responsible investing will manifest differently.

HSBC Alternatives, as part of HSBC Asset Management, believes that a deep consideration of ESG factors, specific to the nuances of each alternative asset class, is integral to sound investment decisions that preserve and deliver long-term value to our clients. As such, we believe that identifying and assessing material ESG issues as part of our investment processes, and ensuring these are properly managed over the lifetime of our investments, can help create more successful, impactful and sustainable businesses over the long term while generating the risk-adjusted returns our clients demand.

Our Responsible Investing Policy provides the overarching charter for our investment approach across all alternative asset classes. The ESG integration framework is customised to each alternative asset class, and ESG issues are considered throughout the whole investment process – from sourcing through to exit. Although the implementation in each asset class differs, there are common pillars such as materiality risk assessment, engagement, reporting, and oversight.

For each potential investment, the respective investment team uses a proprietary scorecard/checklist, developed in conjunction with the HSBC AM Responsible Investment team, to guide the process. This integration of ESG factors into the investment decision enables a clear focus on future monitoring of ESG risks as well as areas of engagement with partners/investee company management.

Engagement is central to alternative investing. Where we have influence in the ownership or capital structure, we will engage with an investment to ensure it delivers high levels of corporate responsibility, including appropriate disclosures. In other strategies, we seek to monitor ESG risks and engage with third party hedge fund and private market fund managers as appropriate. Engagement extends to cooperation and collaboration with peers and industry body initiatives, such as the Net Zero Asset Managers Initiative.

Our implementation framework ensures that senior management is responsible for the governance of ESG, allowing appropriate oversight (independent of the investment team) and focus (embedding ESG into existing investment governance and oversight forums).

It is worth noting that data quality and availability remain challenging in alternative markets, and as such, there are limited third party tools to support ESG investing compared with public markets. With increasing regulations such as SFDR and investments in new technologies, we expect the situation to improve.

Case study

Akora – a Paris office investment

What was the issue?

Given the high premium placed on physical space in densely populated urban areas, our real estate team understands that the world's major cities exhibit relatively few green spaces – as roads, parking lots and high rise buildings take precedence. Given this price premium, it is almost impossible to have dedicated green spaces.

Why is it material?

Cities are major contributors to climate change. According to UN Habitat, cities consume over three-quarters of the world's energy and produce more than half of all greenhouse gas emissions. This climatological impact is exacerbated by the lack of green spaces. Local biodiversity suffers too, as indigenous plants and animals struggle to adapt to the modified environment of cities. Furthermore, access to natural spaces – so called green-and-blue spaces (parks, lakes and riversides) – is known to have positive effects on human mental health and physical well-being.

As such, cities are increasingly looking for integrated development solutions that increase green-and-blue spaces alongside concrete, asphalt and buildings. Real estate premises must therefore evolve to meet the requirements of a modern city, businesses and their employees, as well as other sustainability challenges.

What did we do?

HSBC Alternatives designed and renovated an office building in the La Défense district of Paris in order to improve its ESG credentials. The changes included the conversion of a 1,500 square meter roof-top into an accessible dedicated green space. The latter will accommodate birdhouses and 'insect hotels'. With an ambitious plan in favour of biodiversity, our building will be labelled BiodiverCity. We also believe the installation of a roof-top green space will lead to improved insulation, energy efficiency, and human well-being.

Stewardship and engagement highlights

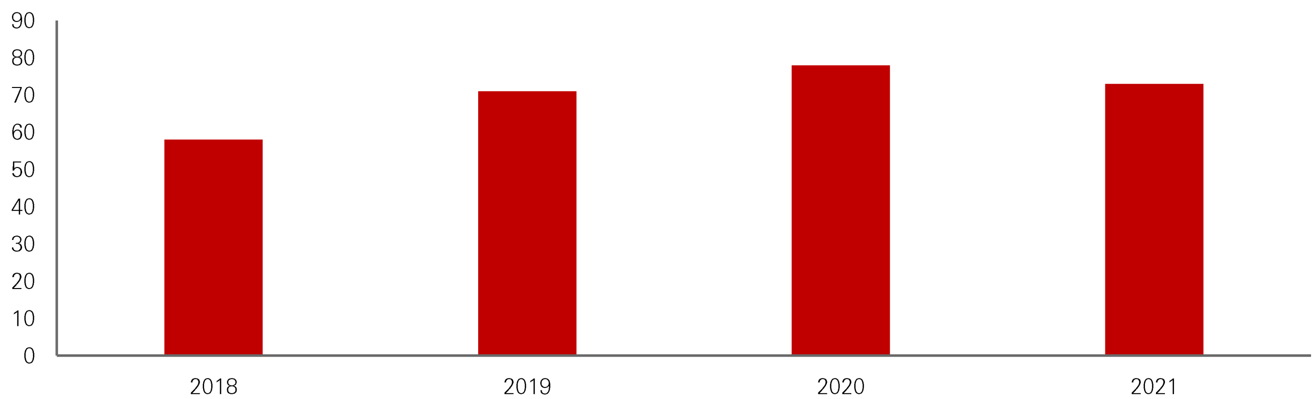
HSBC
Asset Management

Stewardship and engagement highlights

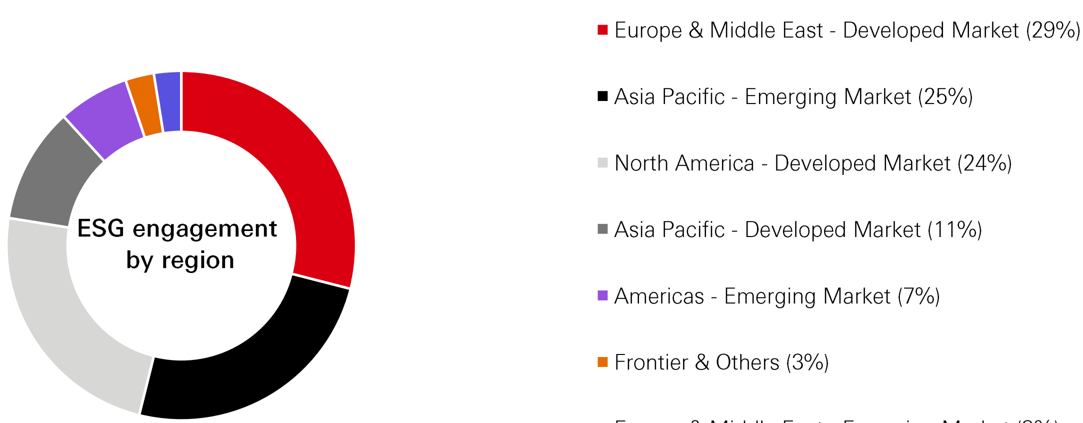
Engagement in numbers

ESG issues were raised in engagements with over 1,800 companies and other issuers in 73 markets during 2021. ESG issues arose in equity team meetings with 627 companies – that is, in roughly 50 per cent of all equity meetings with companies. For our fixed income teams, ESG issues arose with 955 issuers – almost 80 per cent of all their engagements. In addition to this, our stewardship team engaged with 478 companies and other issuers seeking improvements in ESG practices and reporting[1].

Number of markets where ESG engagements took place

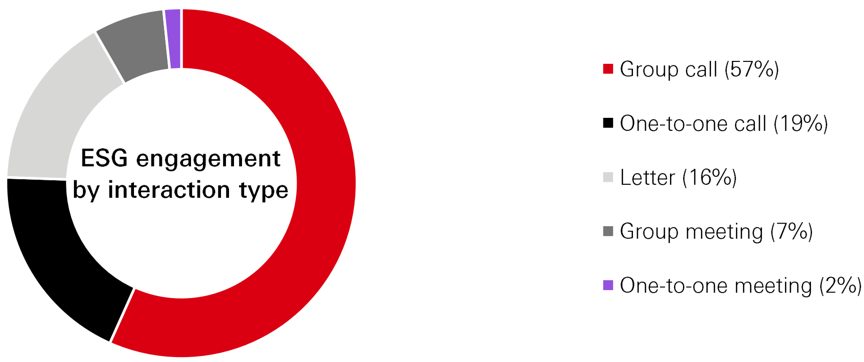


Source: HSBC Asset Management as at 31 December 2021.



Source: HSBC Asset Management as at 31 December 2021. Totals may not add up to 100% due to rounding.

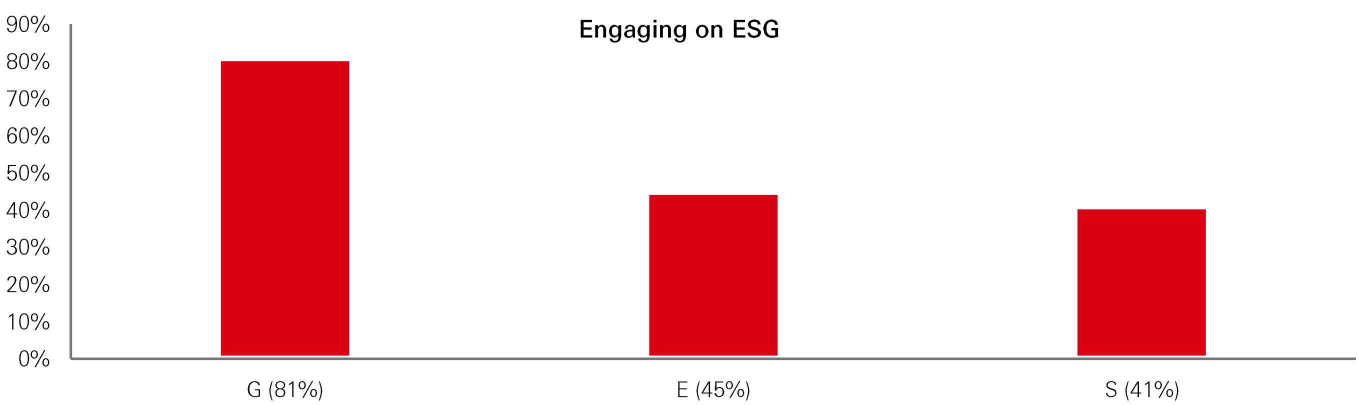
1. These figures include some engagements where members of multiple teams were in attendance.



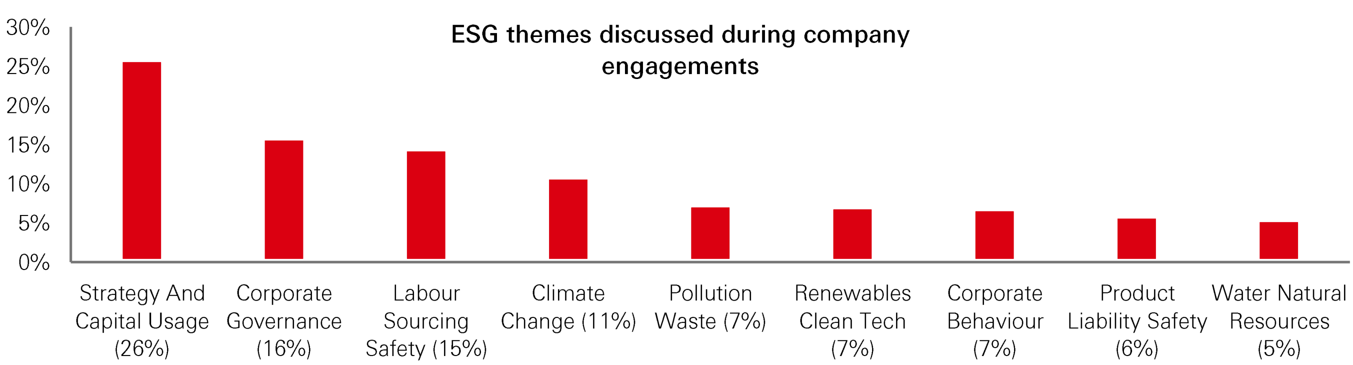
Source: HSBC Asset Management as at 31 December 2021. Totals may not add up to 100% due to rounding.

Engagement by theme

In 2021, we continued to engage on a range of environmental, social and governance issues. We often raised more than one concern – for example climate change and supply chain labour standards – during an engagement. The breakdown of ESG issues which arose when engaging with companies and other institutions is illustrated below.



Source: HSBC Asset Management as at 31 December 2021. Totals may not add up to 100% due to multiple issues raised.



Source: HSBC Asset Management as at 31 December 2021. Totals may not add up to 100% due to multiple issues raised.

Thematic engagement case studies

Biodiversity and the food sector

What was the issue?

As a signatory of the Finance for Biodiversity Pledge[1], we recognise the need for shareholders to ensure that future returns do not come at the cost of the world's range of species. With up to half the world's output moderately or highly dependent on nature, a healthy environmental ecosystem is critical to future resilient economic growth, and thus investment returns.

In our research into biodiversity, we have become increasingly aware of the impact that the food production system has on the abundance and variety of life on earth. In fact, according to the World Economic Forum, food production may be responsible for up to 70 per cent of biodiversity loss.

What did we do?

We first researched how we can contribute to positive change and via which client holdings. This led us to focus on companies in the food sector most exposed to land use change, intensive farming practices, and industrial animal production systems. Combined, these activities can cause significant biodiversity loss. We identified 26 of our holdings, either because they operate directly in these activities or had supply chains that did so. We then segmented these companies into: packaged foods, agricultural products, and food retail.

We then arranged first round discussions with each company. It was clear that they found it difficult to measure and monitor their biodiversity impact, due to a lack of agreed standards. We investigated ways to help, such as reviewing organisations working on this problem, and circulated the information we found with our holdings.

In our second contact with the holdings, we also shared what we regard as leading innovations being developed to improve biodiversity outcomes and food production resiliency. We encouraged those holdings that were lagging to investigate the use of these technologies and schemes, and to report back.

A socially equitable transition to greater environmental sustainability is important too. We therefore support companies to think about biodiversity improvement within a sustainable development strategy which also involves higher incomes for end farmers.

What was the outcome?

Following our engagements, the materiality of biodiversity issues has been elevated to the top of the agenda for a number of companies in the most relevant sectors, such as food and retail. HSBC Asset Management provided best practices examples and discussed key performance indicators to support companies in achieving targeted changes. Another notable outcome from these engagements has been the adoption of a biodiversity and climate integrated business growth strategy at one of the target companies.

We expect to be able to report on more improvements in the medium term as companies further respond to our suggestions and advice. Our third engagement round with the targeted 26 holdings continues this year.

1. Finance for Biodiversity Pledge

Electronic waste

What was the issue?

We embrace circularity by design and encourage companies to improve waste management, particularly electronic waste as it is an increasing concern for our investment teams. In response, the stewardship team launched a research and engagement project on the topic to inform our thinking and help portfolio companies improve.

In our research, we learned that despite the vast majority of the global population being covered by e-waste recycling schemes, only around a fifth of global e-waste is being recycled. There is wide variation in this number, from less than five per cent in China to 40 per cent in the European Union.

What did we do?

We defined a target group of device makers and retail electronics sellers based on holdings data and their exposure to e-waste risk. We then researched each holding's actions based on a number of core criteria, from circular economy strategy and recycling functionality to e-waste risk management. Particularly important to this research was engaging with a number of e-waste and circular economy NGOs, who were able to give us useful insights into how the companies were behaving in practice, behind the well prepared ESG reporting. We ranked the companies, and prepared customised letters to each, outlining where we felt their gaps were, and what they could do to improve.

The vast majority of these companies were willing to discuss our concerns. We explained our views, and how the issues we found could affect the company in the long run. In general, target companies were open to the suggestions we made around commitments to making longer use life products, enhancing long term software and parts availability for older devices, and teaching customers more about repair options for products. That said, we feel the industry has a long way to go to becoming more circular as a great deal of revenue is still linked to annual device sales.

Our final action so far has been to share our first round of engagement findings with the holdings, and outlining what we see as good practice. We hope to see more brands announce circular electronics strategies in the next few years, with extending the life of devices at the core of this proposition.

What was the outcome?

We were encouraged by firms that are taking a lead on recovering devices in order to resell them, or are shifting business models to services led revenues. It is also positive that some companies are disclosing where raw materials are used and how much is recycled. Others made commitments to reducing the use of virgin raw materials.

There is now a marked improvement in circular economy reporting at a number of companies after our engagement, reflecting broader corporate changes. Similarly, one of the world's largest consumer electronics makers has recently committed to widening access to device spare parts and repair information, allowing consumers more means to repair devices, and thus lengthen the product life. Finally, one of our core UK engagement targets recently joined the Circular Electronics Partnership, an industry group focused on sustainability for consumer electronics.

We see all these outcomes as great initial steps to achieving positive improvements in the issue of electronic waste.

Workforce Disclosure Initiative (WDI)

What was the issue?

Social reporting varies greatly from company to company. It can be ambiguous and lacks agreed standards, making it hard to compare. We think this is particularly true in the field of workforce management, a key social investment factor.

For this reason, HSBC Asset Management is a supporter of the Workforce Disclosure Initiative, which was set up to improve corporate transparency and accountability on workforce issues. The WDI's 'theory of change', is that by improving workforce reporting and disclosure, companies will learn about gaps in their workforce management plans, fill them, and thus improve outcomes for workers. The WDI is a UK-based team, run within ShareAction, a charity focused on improving corporate behaviours.

What did we do?

As a member of the WDI, we join other asset managers in committing to engage with holdings shortlisted by the WDI, with input from managers. These companies answer an annual survey and the WDI estimates that after three years, a WDI participant discloses three times more workforce information than non-participants.

We took responsibility for engaging with 60 companies, asking them to participate for the first time, or to continue disclosing. Companies were selected based on the size of our holding in the company, the quality of their existing social reporting, the needs of our portfolio managers and analysts, and the materiality of workforce issues to business performance.

Our engagement approach was to write to each company, building on the request letter sent by the WDI team to the company's chief executive. We outlined the benefits of making the suggested disclosures and how this could be achieved. We offered a call to further the discussion, which was taken up by a high proportion of the target group.

What was the outcome?

As one of just a handful of global asset managers to commit to the WDI, we were pleased to have introduced the initiative to a number of Indian, African, and South Korean holdings that had not previously been aware of the WDI, and would be the first listed company in their country to participate.

Meeting different individuals at companies to discuss the WDI gives us insights into the company culture and a dive beyond the more polished investor relations and management presentations. Moreover, willingness to consider participating in the WDI gives us another insight on the company's level of commitment when it comes to sustainability. We were disappointed in some cases that companies, well owned by ESG-focused investors, did not show more willingness to join the WDI, and will follow up more with these companies on this topic in the future.

Finally, as a member of WDI, HSBC Asset Management gains access to the full workforce dataset created from all the companies' submissions, which is taken into consideration in our company research and engagement initiatives. Going forward, we hope to incorporate it into the database of our ESG analysis.

Company specific engagement

Case study 1: Encouraging focus on renewables opportunity – China Longyuan

What was the issue?

China Longyuan, one of our holdings, operates a fast-growing wind energy business but it also owned small legacy coal assets – two active plants. These assets had a major negative impact on the company's carbon footprint, so China Longyuan couldn't be included in the investment universe of most 'green' funds. In addition, operating coal assets may have diverted management's attention from the major renewables opportunity. The company's valuation reflected these two issues.

Our objective was to encourage the company to divest or decommission their coal assets in order to solely focus on renewable energy generation.

What did we do?

We researched on the company's coal assets in order to assess their materiality in terms of financial metrics such as operating costs, capital expenditure requirements, and future revenue generation. Our sustainability experts also assessed the possible impact of decommissioning the coal assets. We communicated our findings to the company, but the engagement with the investor relations team didn't meet our expectations. So we decided to escalate our findings to the chairman. Simultaneously, our analysts used group meetings to further encourage the company to focus on its renewables opportunity.

What was the outcome?

Within a few months, China Longyuan issued a statement acknowledging the carbon impact of its coal assets. Just a year after the enhanced engagement had been initiated, the company announced it would be disposing of its coal assets via a transfer to another company. In return for these coal assets, China Longyuan gained wind assets. Since the engagement commencement, the stock price has almost tripled.

This section refers to HSBC Engagement activities in 2021. For illustrative purposes only. Any views and opinions expressed are subject to change without notice. This document does not constitute an offering document and should not be construed as a recommendation, an offer to sell or the solicitation of an offer to purchase or subscribe to any investment.

Case study 2: Indonesian thermal coal miners – various companies

What was the issue?

Thermal coal demand is expected to decline in the medium to long term as the world transitions to a lower carbon economy. Indonesian coal is generally of sub-bituminous quality and either used domestically or exported to other emerging markets in Asia. While a reduced demand for thermal coal is (or will be) a material issue for coal mining companies, most Indonesian coal miners do not yet have a climate transition plan. In line with our thermal coal policy, we have engaged with Indonesian coal miners to discuss our expectations in terms of climate transition planning, target setting and transparency.

What did we do?

We engaged with a number of companies such as Adaro Energy, BUMA, Bayan Resources, Indika Energy and United Tractors. Our objective was to understand their climate transition and coal diversification plans in order to assess our own potential transition risk exposure. We also pushed the companies to provide more transparency in their transition plans, and include targets and commitments where relevant. Given a relatively low ESG disclosure level in general, we requested these companies to disclose against CDP and TCFD.

What was the outcome?

A significant number of the companies we engaged with are now running various projects to diversify from thermal coal and reduce their operational emissions in the medium term. These initiatives notably include diversification into renewable energy, metals mining aligned with the climate transition (e.g. nickel and copper), engineering and construction, logistics and fuel storage.

We will continue to monitor the climate transition of these companies and their diversification plans. We will also follow up with clear expectations reflecting HSBC Asset Management's climate change policy and will support them in their efforts to meet their disclosure commitments.

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Case Study 3: IndiaMart and banned weapons

What was the issue?

In January 2021, IndiaMart was red-listed by HSBC Asset Management's Compliance and Investment Restrictions under our Banned Weapons Policy. Our ESG data and research provider for involvement in banned weapons flagged IndiaMart as 'amber' under the antipersonnel mine category. As such, the stock had to be divested / screened out. The crux of the assessment was that IndiaMart publishes government tenders on its website without screening them. In India, antipersonnel mines and other weapons and components are not illegal for those who haven't signed related international conventions or treaties. Since IndiaMart did not screen out antipersonnel mines from the tenders, it was deemed to be in proactive assistance in the production or acquisition of antipersonnel mines. Our data provider does not apply a materiality threshold in their assessment and company involvement is all-or-nothing.

What did we do?

Through our engagement we discovered that IndiaMart does not derive revenue from republishing government tenders – this is part of a wider subscription package for its customers. If they wish to respond to or liaise on a tender, this is done outside of IndiaMart's platform. For the score/risk to be changed, our data provider would need confirmation that IndiaMart has put in place measures to ensure that they will stop publishing tenders relating to banned weapons going forward. After engaging with them, IndiaMart agreed to provide written confirmation that it would actively screen out tenders that fall awry of the weapons conventions in our policy. This allowed us to discuss next steps with our data provider. Since IndiaMart had no expertise in this area, we also provided them with a list of banned items for screening.

What was the outcome?

Our initial engagement efforts with the company led to the implementation of a manual screening of controversial weapons – on a best-efforts basis. Initially, this added step was not sufficient for a re-rating by our data provider and the company remained on our restrictions list. But since, the company has included additional steps in their screening process and has been eventually upgraded to 'green' in January 2022.

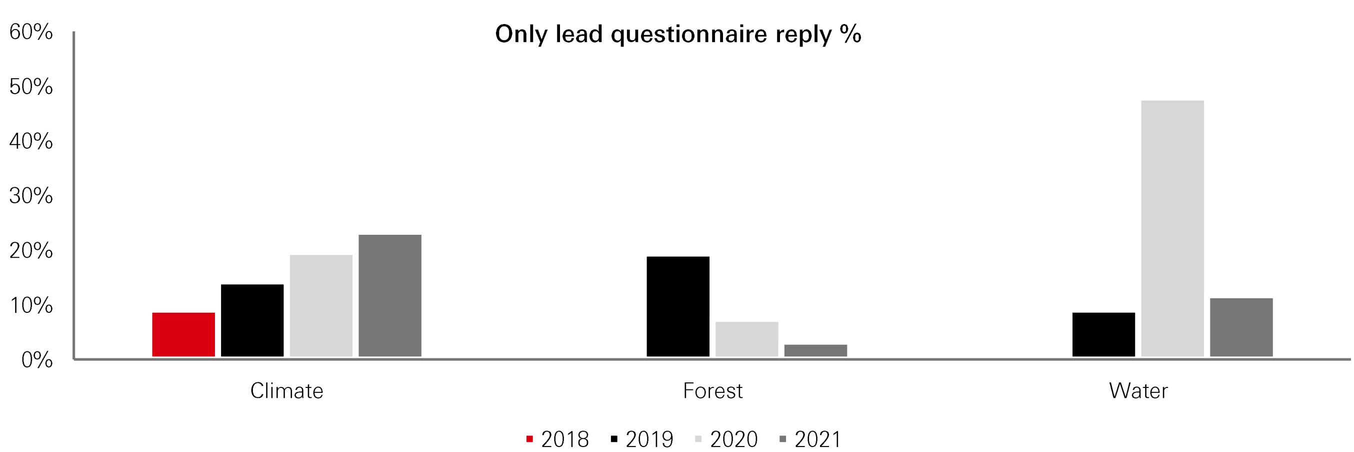
Collaborative engagement

Carbon Disclosure Project

We believe that greater disclosure on environmental issues is needed from companies – especially those in the highest emitting sectors – in order for investors to assess and manage climate risk within their portfolios and to encourage companies to reduce emissions. Since 2014, we have participated in the Carbon Disclosure Project's non-disclosure campaign which involves drafting and sending letters to companies to encourage meaningful disclosure on the most important environmental risk metrics.

A high reporting rate in the past campaigns resulted in a small decrease in the number of companies we have written to in 2021 – still an impressive 326 over the year. In terms of company responsiveness, we continue to see a rising response rate for the climate change questionnaire. Yet, this was not the case for the forestry questionnaire, where the response rate is low and decreasing. With increasing attention on the protection of biodiversity from a number of stakeholders, we believe a better response rate can be expected. With regard to the water questionnaire, last year's response rate was higher than usual but we expect an above 15 per cent response rate in future as water resources increasingly attract investor attention.

Source: HSBC Asset Management as at 31 December 2021.

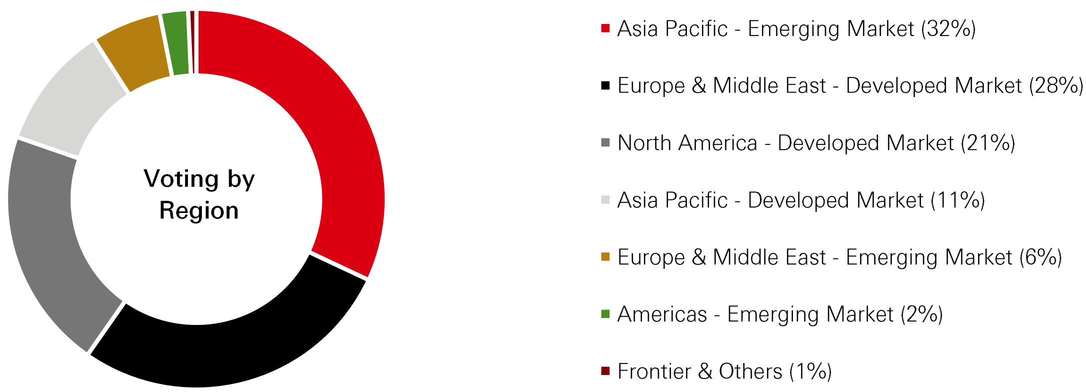


Source: HSBC Asset Management as at 31 December 2021.

Voting in practice

In 2021, we voted on more than **84,000** resolutions at over **8,400** company meetings across **72** markets, representing 94 per cent of the ballots on which we were entitled to vote.

We supported management on just under 90 per cent of resolutions, abstaining or voting against on the rest. The issues we most frequently opposed to were director re-elections (a third of votes against management), predominantly due to a lack of independence, followed by remuneration (almost a quarter of votes against management), then by capitalisation issues (17 per cent). Overall, in almost half of the meetings we voted against management on at least one resolution.



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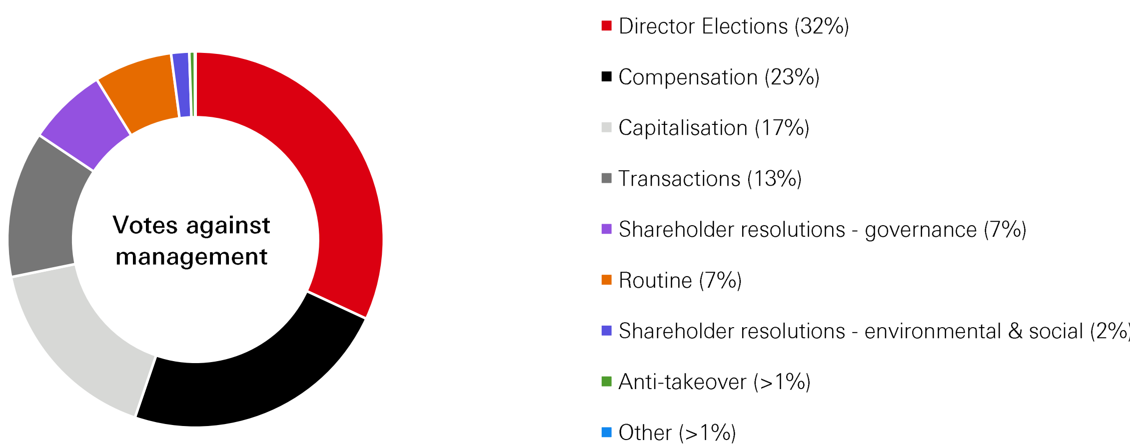
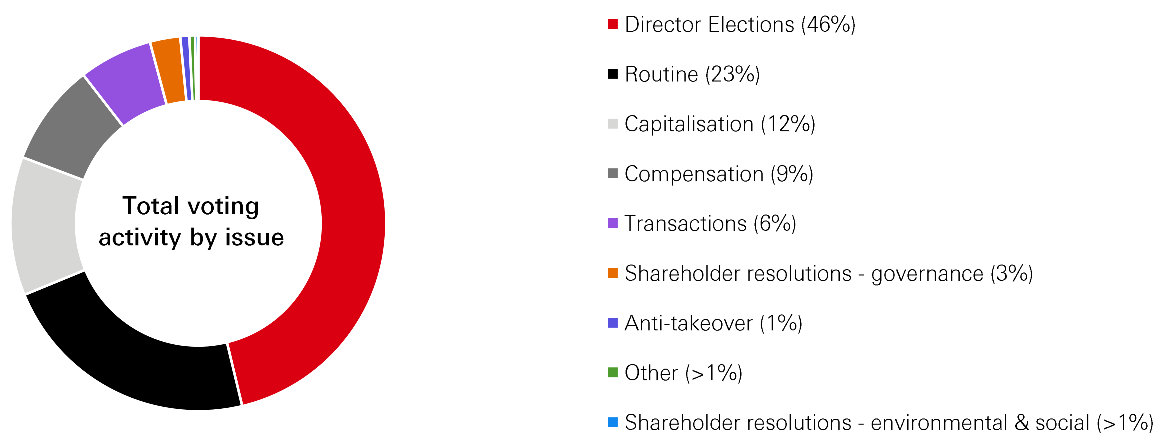


Source: HSBC Asset Management as at 31 December 2021. Totals may not add up to 100% due to rounding.

Our votes differed from the ISS (Institutional Shareholder Services) standard policy recommendation on more than 6,300 votes (seven per cent). More than half of these votes were against management, predominantly where we voted more often than ISS on capitalisation and director elections in China as well as compensation in the US.



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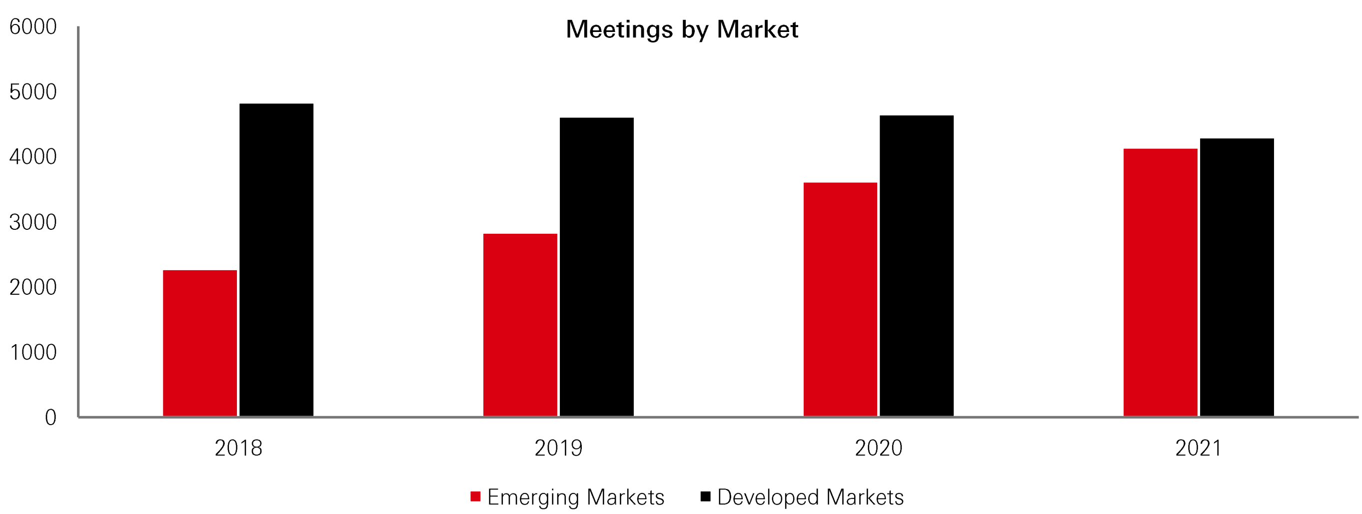


Source: HSBC Asset Management as at 31 December 2021.

Emissions disclosure at energy-intensive companies

As mentioned previously in this report, we have participated for a number of years in the CDP disclosure campaign, which encourages companies that are likely to have relatively high emissions to disclose their emissions and transition strategy in a standard framework now aligned with the TCFD. Many of these companies have started to report, but a few have not, or have since stopped doing so.

We followed up by writing to companies in energy intensive sectors in our portfolios that have not responded positively to our CDP engagement. We explained the importance that investors attach to understanding company exposure to climate risk and warned of our intention to vote against the re-election of the company chair if disclosures are not forthcoming. We voted against six company chairs for this reason in 2021.

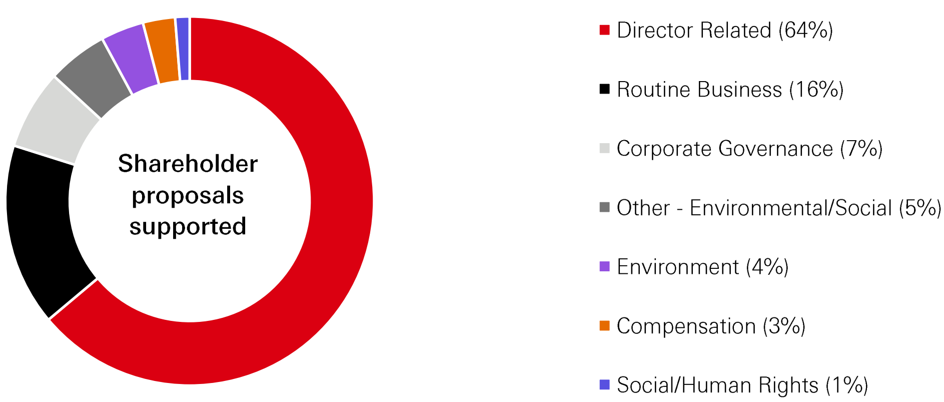
Shareholder resolutions

Shareholder resolutions are used as an engagement tool to encourage changes in corporate behaviour, promoting greater disclosure and the introduction of appropriate policies. We support shareholder resolutions on ESG issues where these are in line with the principles of good corporate governance outlined in our voting guidelines, or where we consider the issue to be material to financial performance or sustainability, and thus where we believe the proposal is in the best long term interest of our clients.

In 2021, we supported 1,664 shareholder resolutions – 70 per cent of the resolutions on which we could vote. We supported all of the shareholder resolutions in the US which received more than 50 per cent support (36 in total).

We supported 172 resolutions on environmental and social issues. On climate change, we typically support resolutions asking for the adoption of climate change policies, two-degree transition plans and/or quantitative greenhouse gas emission reduction targets, and resolutions asking for annual assessments of portfolio resilience.

Shareholder resolutions have been used under the Climate Action 100+ initiative as a means of promoting better management of climate risks. In the coming year, we shall be supporting the move by Climate Action 100+ and others to encourage companies to put their climate transition plans to a vote.



Source: HSBC Asset Management as at 31 December 2021. Totals may not add up to 100% due to rounding.

Responsible investment themes in focus

HSBC Asset Management

Responsible investment themes in focus

Climate change

Transitioning to net zero by mid-century will be critical in order to limit the world to 1.5 degrees Celsius above pre-industrial temperatures. Action is required now if mankind is to stay in touch with this target[1].

Climate change exposes us all to physical and transition risk. Physical risks such as extreme weather events and wild fires, as well as biodiversity loss are already happening. Transition risks entails a sudden loss in the value of high carbon assets, as climate regulation, large scale consumer boycotts and industrial disruption can lead to rapid change.

HSBC Asset Management is attuned both to the risks and opportunities that these changes foreshadow. We have fully integrated ESG analysis to ensure that the looming environmental, social and governance risks that companies face are taken into consideration in investment decision making. We have created and will continue to develop funds that invest in firms providing environmental and social solutions. This includes Impact funds that offer investors the opportunity to fund important environmental and social goals, and potentially benefit from financial returns.

Our transition to net zero

In July 2021, HSBC Asset Management signed up to the Net Zero Asset Managers Initiative. In doing so, we commit to work towards the target of net zero emissions across all AUM by 2050 or sooner. In addition to the reinforcement of sustainability considerations in existing products, we are also developing an important set of sustainable and net zero aligned funds and ETFs that respond to the challenges ahead.

We have set up a team called Climate and Net Zero under the lead of the Responsible Investment team. They are responsible for driving insights, frameworks and future scenarios for low-carbon transition, which will be used to inform investment decision making, portfolio management and to support our clients.

1. Energy Transitions Commission Consultation Papers (2021)

Natural capital

Natural capital will play an important role in enabling net zero due to its carbon removal properties and role in preserving biodiversity. According to the Energy Transitions Commission, there will be around 3-5 gigatonnes of residual carbon emissions per annum after 2050[1]. Natural capital is one way to support carbon removal and is therefore becoming an increasingly valuable asset class.

Through our joint venture Climate Asset Management, we hope to offer clients the opportunity to access the asset class that safeguards our most valuable resource - nature. Climate Asset Management aims to support projects both in restorative agriculture and sustainable forestry in a range of OECD countries.

Several factors are leading natural capital to emerge as an investment opportunity. For a start, governments and firms increasingly recognise that protecting natural capital brings two gains: protecting biodiversity and slowing climate change. Metrics, such as mean species abundance are being developed to measure biodiversity. This allows us to measure and score firms for their impact on biodiversity, and to take this into account when we undertake investments. The many states and firms that make net zero emission targets are ready buyers for natural capital solutions, such as natural capital assets and carbon permits. Meanwhile, land owners may benefit from multiple sources of cash flow from a single piece of land through the sale of restorative agricultural products, CO2 permits, responsible tourism etc.

HSBC Asset Management is keen to develop and utilise metrics to adjudge the relative impact of different firms on biodiversity. This would allow us to score the firms we analyse in terms of their biodiversity impact.

As a signatory to the Finance for Biodiversity Pledge, we intend by 2024 at the latest to contribute to:

- Collaboration and knowledge sharing – we will collaborate and share knowledge on assessment methodologies, biodiversity-related metrics, targets and financing approaches for positive impact
- Engaging with companies – we will incorporate criteria for biodiversity in our ESG policies, while engaging with companies to reduce their negative and increase positive impacts on biodiversity
- Assessing impact – we will assess our financing activities and investments for significant positive and negative impacts on biodiversity and identify drivers of its loss
- Setting targets – we will set and disclose targets based on the best available science to increase significant positive and reduce significant negative impacts on biodiversity
- Reporting publicly – we will report annually and be transparent about the positive and negative contribution to global biodiversity goals linked to our financing activities and portfolio investment

1. Energy Transitions Commission (2021): ETC's consultation on carbon dioxide removals

Investment solutions

Sustainability objectives are unique to each investor. Some investors seek to allocate their capital to deliver sustainable outcomes while others seek to incorporate sustainability into their investments to generate superior risk adjusted returns – many investors desire both!

We believe investors can use ESG not only to mitigate the risks associated to climate change, but also to take advantage of the opportunities emerging from the transition into a more sustainable world'. Therefore, we strive to develop a robust product offering that enables investors to meet a range of sustainability objectives while also promoting activities that contribute to a more sustainable world.

We view ESG integration as an initial step – to manage both ESG risks and opportunities. The vast majority of our assets integrate ESG considerations into the investment decision making process. As illustrated by our Sustainable Investment Definitions, we consider ESG integration as a hygiene factor and on its own, does not make an investment 'sustainable'.

Sustainable Investment labelled solutions are those that go beyond ESG integration and engagement to either support or deliver sustainable outcomes.

We have built our sustainability offering to meet various sustainability objectives. From ESG-integrated funds to manage ESG risks and opportunities, to sustainable themed funds that invest in emerging growth areas, and innovative asset classes seeking to drive specific sustainable change in areas such as natural capital.

Sustainable Fixed Income

HSBC Real Economy Green Investment Opportunity (REGIO) – GEM strategy

- Enables investors to align capital with real economy and delivers against the Paris Climate Agreement and SDGs

Natural capital

Climate Asset Management

- Invests in activities that preserve, protect and enhance nature based assets and carbon sinks

Climate technology

Climate venture tech strategy

- Provides clients opportunities to invest in technology start ups that address global climate change challenges

Net-zero

Paris alignment solutions

- Paris Aligned and Sustainable ETFs to support investors seeking to minimize their exposure to climate risks

Sustainable themes

Global equity sustainable healthcare strategy

- Invests in sustainable healthcare themes and products, which to help improve value for money of healthcare spending

Low-carbon / sustainable

Launched 11+ lower carbon strategies

- Launching a number of sustainable and low-carbon solutions across asset classes focused on Asia and emerging markets

In 2021, we expanded our product offering across the Sustainable Investment range.

In terms of indexing strategies, we introduced a range of Sustainability ETFs in 2021. This includes the MSCI Paris Aligned Benchmark ETFs, which are classified as SFDR Article 9. A number of them were awarded the Fabelfin 'Towards Sustainability' label in January 2022. We have also launched the FTSE Russell Sustainable ETFs, which are classified as SFDR Article 8.

In the spectrum of active strategies, we have also broadened the offering of sustainable themed investment products. For instance, our Global Equity Sustainable Healthcare strategy addresses healthcare's rising costs by investing in companies with innovative solutions aimed at making healthcare more affordable whilst improving patient care. Another innovative example is our Climate Venture Tech strategy, which focuses on companies that provide innovative software solutions to address current emissions from high-carbon sectors and activities. These include energy, transportation, agriculture and global supply chains. Some examples include sustainable power grid transformation, electrification of transport, sustainability of supply chains (especially for heavy industry) and climate risk software that can assess and reduce physical and financial costs of climate change for various industries.

We uplifted 17 of our existing funds from SFDR Article 6 to Article 8 within our sustainable investment range. The objective of these funds is to promote sustainable outcomes by integrating strong and improving ESG characteristics into their fund design and investment process. Uplifted funds include global strategies as well as those with regional focuses. They span across equities, fixed income and securitised credit.

Sustainable ETFs

We launched our new range of sustainable equity ETFs in 2020, and have continued to grow them throughout 2021. These products offer a cost-efficient sustainable exposure to developed and emerging equity markets at global, regional and country levels. They track the customised FTSE ESG Lower Carbon Select indices, targeting three areas of improvement: 20 per cent ESG score uplift, 50 per cent carbon emissions reduction and 50 per cent fossil fuels reserve reduction; while applying pre-tilt and post-tilt exclusions based on a custom list and UN Global Compact principles.

As an investor member of the Institutional Investors Group on Climate Change, HSBC Asset Management advocates an investment led approach to meeting the challenges of climate change and real-world decarbonisation. Building on this, in 2021 we have launched a series of ETFs which provides a means for investors to encourage companies to align their environmental strategies with the Paris Agreement. These products track the MSCI Climate Paris Aligned Indices, factoring in transition risk, green opportunities, physical risk and 1.5 degrees Celsius alignment. They adhere to TCFD recommendations and exceed the minimum standards of the EU Paris Aligned Benchmark, giving investors confidence they are going the extra mile.

This year we have collaborated with Bloomberg to create a new range of ESG-screened fixed income ETFs, underlining our drive to embed ESG thinking into all of our products. Our holistic approach to screening is thorough, consistent and designed to incentivise change. We believe that the right combination of embedded tilts and exclusions ensures that our products will remain relevant into the future even as the sustainable fixed income landscape continues to evolve. In particular, we have embedded a number of ESG screens into our products, including SRI filters designed to remove or limit exposure to companies involved in controversial practices; tilts to redistribute weight from issuers with weaker to those with stronger ESG credentials; exclusions to remove companies with the poor ESG credentials; a carbon intensity filter to exclude issuers with relatively high carbon intensity profiles.

Liquidity

The importance of considering sustainability in cash investing has continued to grow. For corporate treasurers, the use of a money market fund that credibly applies ESG to its investment process can contribute to the company's overall sustainability objectives. For individual or institutional investors with a specific focus on sustainable investing, cash no longer needs to be an afterthought in a sustainably invested portfolio.

Throughout 2021 we have continued to see increased investor demand for ESG solutions within the liquidity space. To meet this evolving client interest, in October 2021 we successfully launched the HSBC ESG Sterling Liquidity solution. The strategy is a Low Volatility Net Asset Value (LVNAV) money market solution that invests in issuers that are better at addressing ESG factors. The innovative approach to sustainable investment within money market funds follows a best-in-class strategy to ESG investing. With our 20-plus years of responsible investment experience, we have created a more sustainable list of high quality issuers from which we construct our portfolios. The result is a meaningful improvement in ESG score compared to the money market investable universe.

In 2022 we envisage further client interest in this area and believe there will be a deepening shift in prioritisation among a broad range of corporate and NBFI investors in this asset class. We expect to see chief financial officers and boards of companies taking a more direct and forward thinking approach to sustainability, as there will be further pressure for treasury to actively support the broader sustainability strategies of businesses with sustainable treasury solutions for both funding and investment.

Sustainable healthcare

Market outlook

In recent years, the healthcare industry has been subjected to unprecedented challenges. A growing population, increasing life expectancy and more than 400 million confirmed cases of covid-19 around the world have highlighted the need for accessible healthcare. The coronavirus pandemic also exposed the inequalities that exist between different socio-economic groups and their respective access to treatment. Such inequity is undoubtedly exasperated through reducing healthcare budgets and increasing industry costs[1]. Overall, these factors compound to create a clear humanitarian need for investment in healthcare to provide accessible and financially viable solutions. Healthcare companies must move towards sustainable, 'value-driven' operating models.

Investment opportunity

According to the United Nations, the global pandemic has stalled or reversed a decade of progress in reproductive health, maternal health and child health[2]. Investing in healthcare enables investors to directly contribute towards advancing UN Sustainable Development Goal 3, "ensuring healthy lives and promoting well-being for all at all ages". Failure to achieve this goal is a blocker in eradicating extreme poverty, making investment in healthcare even more essential.

The healthcare sector accounts for 13 per cent of MSCI World Index and has a strong record of outperformance[3]. Sustainable business models will enable companies to benefit financially whilst also increasing patient access to treatment. Based on the issues outlined above, medical and pharmaceutical companies must find innovative ways to bring healthcare products to market in a cost-effective manner. This can provide an exciting opportunity for investors to capitalise on recent advances in medical science, for example, three-quarters of the newest therapies have been developed by mid-cap companies in the sector[3]. Investing in innovative solutions can enable companies to harness the power of digital solutions and scale opportunities to treatment for patients.

Our sustainable healthcare proposition

At HSBC Asset Management, sustainable healthcare goes beyond ESG. The Global Equity Sustainable Healthcare solution assesses providers through engagement with firm management and utilises specialised data banks to measure and compare companies. The strategy aims to address the healthcare industry's most pressing challenges by investing in companies that are cost-effective or those that level out access to healthcare.

1. Fixing broken healthcare investment model, HSBC AM (Fixing the broken healthcare investment model (hsbc.co.uk))
2. United Nations, Department of Economic and Social Affairs, Sustainable Development, January 2022 (Goal 3 | Department of Economic and Social Affairs (un.org))
3. A value and profit driven healthcare investment model: BT Podcast, January 2022 (BT Podcast: A value and profit-driven healthcare investment model | The Straits Times)

Real Economy Green Investment Opportunities

We launched REGIO in 2019. It is an innovative solution that looks to buy high quality emerging market corporate green bonds – bonds where all of the proceeds are spent on green projects in the developing world. REGIO seeks to blend public and private capital to enable investors to align their financial objectives with real economy impact, to advance the objectives of the Paris Agreement and the UN Sustainable Development Goals.

The strategy targets positive environmental impacts by investing in eligible green bonds using a robust investment process, including HSBC Asset Management's Green Impact Investment Guidelines: a framework for identifying eligible activities for the use of proceeds. The strategy also aims to stimulate further issuance of eligible green bonds and further develop the sustainable bond market.

The Green Impact Investment Guidelines require (amongst other things) a use of proceeds aligned with at least one of the following UN SDGs: 6 (clean water and sanitation), 7 (affordable and clean energy), 11 (sustainable cities and communities), 12 (responsible consumption and production), 13 (climate action), 14 (life below water) and 15 (life on land). The guidelines also contain requirements to ensure alignment with the ICMA Green Bond Principles and assessing that investee companies meet internationally recognised environmental, social and governance standards.

REGIO aims to be fully invested by the end of the investment period (seven years from the initial funding date). The strategy's assets under management at December 2021 was $548 million, comprising 22 green bonds, representing a 37% of the total.

The largest allocation within the strategy is to affordable and clean energy (SDG 7), representing over half of its green bond exposure, mainly in renewable energy investments and projects in India, Indonesia, Peru, Chile and Guatemala. The second largest exposure within the green bond allocation is to life on land (SDG 15), mainly in investments and projects related to sustainable forestry and environmentally sustainable management of living natural resources and land use in Brazil and Chile. The third largest impact is on SDG 11, sustainable cities and communities, with 12 per cent.

Though regular communication and engagement with market participants and prospective issuers we seek to improve the green transition via issuance of strong guidelines and standards in the developing green bond market in the different emerging markets regions.

To address the sustainable infrastructure funding gap in emerging markets, HSBC Asset Management leads the development of 'Finance to Accelerate the Sustainable Transition-Infrastructure' (FAST - Infra) – a first of a kind label qualifying sustainable infrastructure as a new asset class in emerging markets. The new label aims to close the trillion-dollar sustainable infrastructure investment gap by transforming sustainable infrastructure into a mainstream liquid asset class. As such, it will play a critical mobilising investor capital towards sustainable projects in emerging markets, especially in Asia.

Looking forward

Transition sectors and climate critical technologies

Heavy industries are the largest contributors to global greenhouse gas emissions and count as one of the biggest obstacles to achieving net zero. Sectors such as energy and utilities, steel, cement, chemicals, and heavy transport contribute over half of global greenhouse gases and their production methods can be difficult to decarbonise. As such, we believe supporting innovative start-ups is critical to the scale up of climate critical technologies.

It is with this belief in mind that we launched the **ClimateTech Venture Capital Strategy.** We aim to provide investors the opportunity to invest in technology start-ups that address global climate change challenges. The strategy will focus on companies that provide innovative software solutions to address current emissions from high-carbon sectors and activities.

To amplify our activities, HSBC joined the **Breakthrough Energy Catalyst** as an anchor investor and Leadership Council member. In doing so, we have committed to invest $100m of equity into projects that deploy climate critical technologies such as green hydrogen, sustainable aviation fuels, and direct air capture for heavy industries. Alongside industrial anchors investors, HSBC will be leveraging its participation to support deep decarbonisation insights and new product opportunities.

Asia

Nowhere will sustainable investing be more critical to achieving climate and sustainability goals than in Asia, where nearly half of current carbon emissions come from[1]. The region is also where 40 per cent of total sustainable infrastructure investment will be required in order to reach net zero by mid-century, according to the Energy Transitions Commission[2].

The good news is that a number of countries have recently made net zero and carbon neutrality commitments around COP26, driving growth in sustainable investments in the region. This includes the region's major emitters such as China (carbon neutrality by 2060) and India (net zero by 2070).

Investor attitudes towards sustainable investing are also shifting. According to the HSBC 2021 Investor Survey, 85 per cent of investors in Hong Kong, China and Singapore believe ESG issues are central to managing their investments. Moreover, 70 per cent of asset owners in Asia have an ESG, responsible or sustainable investment policy and around 60 per cent expect to incorporate ESG issues into their investment decision making process[3]. These factors together with the rise in Asia's middle class will be key drivers behind the region's growth and innovation in sustainable investments.

Our ambition is to be the leading provider of sustainable investment solutions in Asia. As part of the region's largest international bank, our on-the-ground expertise enables us to create unique investment solutions that meet local and international client needs.

For example, in 2021 we introduced a number of new strategies within our sustainable investment solution range for Asia based clients. These include the Global Equity Climate Change (in India), Paris Aligned exchanged traded solutions, Global Equity Sustainable Healthcare and the ESG Sustainable Multi-Asset solutions (in Taiwan). Additional ESG solutions will be introduced in 2022, with the sustainable multi-asset income and the Asia ESG bond strategies already launched.

1. International Energy Association (2021)
2. Energy Transitions Commission (2021)
3. HSBC investor Survey (2021)

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