Asset Management

Climate change policy

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HSBC Opening up a world of opportunity

The climate change challenge

A rapidly changing climate represents an urgent threat to habitats, societies and economies around the world. This was recognised in 2015, when 195 countries signed the Paris Climate Agreement, committing countries to transition to a lower carbon economy and limit the global average temperature rise to well below 2 degrees Celsius (°C) above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 °C.

The 2018 Intergovernmental Panel on Climate Change (IPCC) Special Report on Global Warming of 1.5 °C highlights that the lower maximum increase of 1.5°C warming would already be reached by 2040 on current emissions levels unless global carbon dioxide (CO2) emissions decline by 45% by 2030 and remain on course for ‘net zero’ by 2050. The report outlined the benefits of aiming for the lower threshold but recognised that this would require rapid and far-reaching.

In May 2021, the International Energy Agency published Net Zero by 2050 – *A Roadmap for the Global Energy Sector*, which detailed the measures required to limit temperature rise to 1.5°C.

Given the scale and speed of the transition that is required, even an orderly transition will impact how companies operate now and in the future. This transition risk – alongside physical risks and liability risk – is one of the three channels through which climate risk may affect financial stability. The changes are already creating investment risks and opportunities, and they are likely only to gather pace going forward.

Our strategic response

Our climate change policy is aimed at increasing the climate resilience of our clients' investments, as well as contributing towards financing the transition to a low-carbon economy.

We are signatories to the Net Zero Asset Managers initiative, committed to work in partnership with our clients on decarbonisation goals, consistent with an ambition to reach net zero emissions by 2050 or sooner across all assets under management. We have set a 2030 interim target for a 58 per cent reduction in the emissions intensity of 38 per cent of our assets compared with 2019. These assets will be managed in line with the attainment of net zero emissions by 2050 or sooner.

We have chosen the Net Zero Investment Framework, created through the Paris Aligned Investment Initiative. It provides guidelines on metrics, methodologies and approaches to net zero. It has been designed to be used by asset owners and asset managers and is the most commonly adopted methodology across the investment industry.

Our chosen pathway is the International Energy Agency Net Zero Emissions by 2050 scenario. Our decarbonisation target has been calculated using economic activity assumptions from this pathway, which is consistent with limiting the global temperature increase to 1.5° C.

We aim to:

1

Deliver lower-carbon investment solutions and opportunities that meet our clients' investment criteria while meeting their risk and return objectives

2

Identify and integrate the climate-related risks and opportunities presented by climate change and climate policy in our investment portfolios, using relevant data and analysis to inform our investment decisions

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3

Engage with investee companies to better understand and support their disclosure and management of the risks and opportunities presented by climate change and climate policy. We engage directly and collaboratively, using our voting decisions to escalate issues where appropriate

4

Disclose publicly and to our clients the actions we have taken and the progress we have made in addressing climate-related risk and investing in climate-related solutions

5

Advocate a supportive policy framework, working with policymakers to support their efforts to implement measures that encourage capital deployment at scale to finance the transition to a low-carbon economy and encourage investment in climate- change adapt

We are strong supporters of the disclosure recommendations of the Financial Stability Board's Task Force on TCFD. We first disclosed our equity portfolios' carbon footprint as signatories to the Montreal Carbon Pledge in 2015, we published our first Climate Change Policy in 2016, and have publicly disclosed our responses to the PRI TCFD-aligned questions in our Transparency Reports. Our UK business is making TCFD disclosures in 2023.

Governance

The integration of climate-related risks and opportunities into our investment decisions for public markets, alongside integration of all material ESG considerations, lies with our Global and local Chief Investment Officers (CIO). Our asset-class CIOs and investment teams are responsible for integrating ESG issues into their respective investment decisions, supported by our ESG specialists.

Strategy

As a global investor, we are aware of the risks climate change presents to our investments and, as such, we are committed to playing our full part in addressing the challenge of climate change. Without global action, investors' holdings, portfolios and asset values will be impacted in the short, medium and long term. From an investment perspective, the transition to a low-carbon economy presents both risks and opportunities.

The primary areas are identified below:

Transition risk

The structural changes required for a global movement from a high-carbon to a low-carbon economy could result in a reassessment of the value of a range of assets. This could be driven by higher explicit or implicit carbon prices as a result of tighter environmental regulations, the adoption of energy-efficient and disruptive technologies, or market changes. Large carbon emitters may also be found liable for damages associated with the direct impact of their activities on the environment, or with inadequate disclosure related to their climate risks

Physical risk

More frequent and severe climate events, as well as longer-term shifts in climate patterns, could result in the devaluation of assets due to physical damage to property and facilities, disrupted global supply chains and reduced access to natural resources

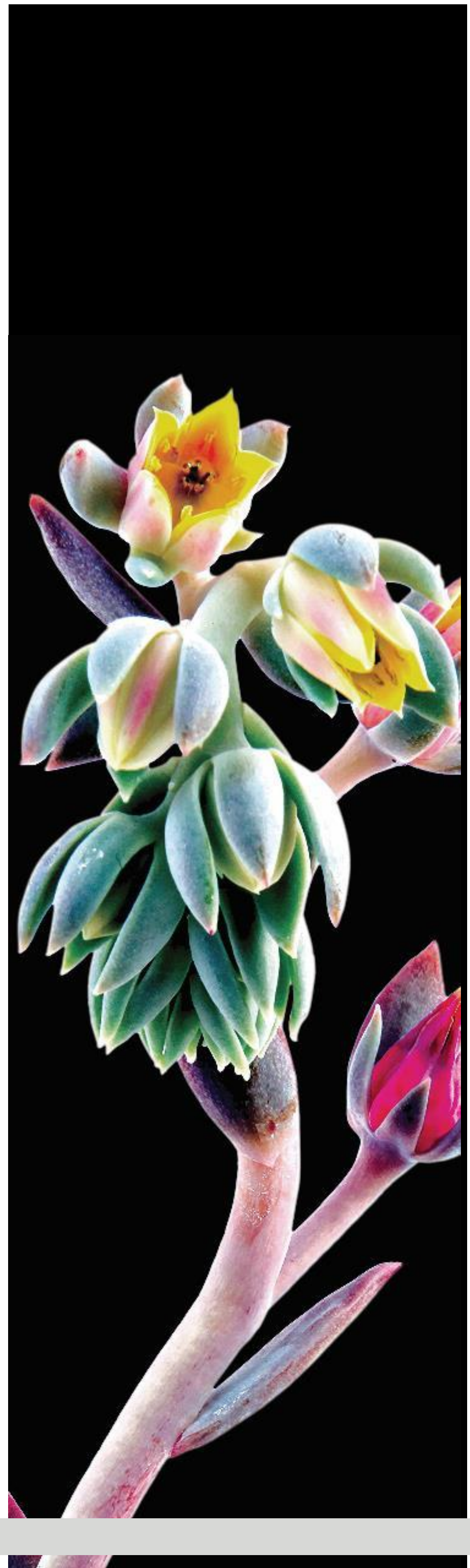
Climate opportunities

At an operational level, companies can benefit from efficiency and cost savings associated with reducing greenhouse-gas emissions. There is also a growing market for existing and new disruptive technologies focused on reducing the climate impact. Our strategy is to identify and integrate the climate-related risks and opportunities presented by climate change and climate policy in our investment portfolios, using relevant data and analysis to deliver more resilient portfolios and lower-carbon investment solutions and opportunities for our clients.

We have previously worked with an external provider to explore the impact of six illustrative low-carbon climate-transition scenarios on equity valuations, including a review of the implications of a 1.5 degree approach. We also explored the implications of the various scenarios on corporate credit valuations.

The report of our high-level findings was featured as a case study in the 2019 IIGCC report ‘Navigating climate scenario analysis’.

We advocate a strong and supportive policy framework to deliver on the systemic change and capital deployment at the scale required to transition to a low-carbon economy. As an example, we are also active members of the IIGCC Global Policy Reference Group and signed the 2022 Global Investor Statement.



Risk Management

Climate Change is a core ESG consideration for us and, as such, we integrate climate-risk management in our overall approach. We address climate risk at three levels:

Company/Issuer-specific assessment of climate-related issues: this includes identifying material risks and opportunities using third-party and in-house analysis and assessment, and integrating these risks and opportunities in our investment cases as part of our fundamental research process. Analysts and portfolio managers are provided with training, tools and resources to enable them to perform these assessments

Portfolio-level assessment of climate-related issues: our active fundamental portfolio managers' decision support tools embed ESG and carbon data. This allows the managers to make high-level assessments of their climate-related risk exposure, on an absolute and relative basis, as part of their ongoing portfolio management activities

Sector-based assessment of climate materiality: our Virtual Sector Teams include climate risk in their analysis of ESG risk drivers. They have started their development of risk scores with an approach to climate and net zero issues, which will combine greenhouse gas emissions data, physical risk and transition risk indicators and net zero commitments.

Engagement with investee companies, to better understand and support their disclosure and management of the risks and opportunities presented by climate change and climate policy, is an important part of our process. We engage directly and collaboratively with our peers, using our voting decisions to escalate issues where appropriate.

We were founding signatories of the Climate Action 100+ initiative and have been part of its Steering Committee. We are the lead / co-lead investor in engagement projects with companies across three continents, working in collaboration with other signatories to help those firms deliver improved governance, targets and disclosure of their climate-related risks. We have been focusing on improved disclosure for many years, supporting CDP[1] disclosure campaigns and encouraging companies to disclose their carbon emissions and climate-related risks, in line with the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD), through our Global Voting Guidelines.

We strongly believe in the impact and effectiveness of engagement in improving corporate responses to climate change. We engage with companies on four key areas:

- Net Zero commitments;
- Climate strategy and risk management;
- Emissions reporting
- A Just Transition.

Where the strategy or actions of a company in a carbon intensive sector fall short of that required for low carbon transition, we may vote against the re-election of the chair or relevant board director.

We are a signatory to the Statement of Investor Commitment to support a Just Transition on Climate Change.

In line with our commitment to the Paris Climate Agreement and net zero ambition, we have prioritised Thermal Coal for early action:

- **By the end of 2030**, we will not hold listed securities of issuers with more than de minimis revenue exposure to thermal coal in EU / OECD markets in our actively managed portfolios.

- **By the end of 2040,** we will not hold listed securities of issuers with more than de minimis revenue exposure to thermal coal in all markets in our actively managed portfolios.

- **We do not make direct investments in new or existing thermal coal projects.** This includes but is not limited to: creation of new thermal coal assets; thermal coal expansion; extensions to the unabated operating lifetime of existing thermal coal assets; new captive coal-fired power plants or new captive thermal coal mines; new thermal coal infrastructure; coal to gas / liquids plants and thermal coal mines using Mountaintop Removal.

- **With immediate effect,** actively managed portfolios will not participate in IPOs or primary fixed income financing by issuers engaged in thermal coal expansion. For other issuers with more than 10 per cent revenue exposure to thermal coal, participation by actively managed portfolios in IPOs or primary fixed income financing will be subject to enhanced due diligence of transition plans to ensure alignment with our Net Zero Objective. We will divest over time from issuers whose transition plans are considered incompatible with our Net Zero Objective.

See our Thermal Coal Policy for further details and for commitments on research and engagement.

Note:
1. Previously known as 'Carbon Disclosure Project', CDP runs a global disclosure system for companies and others to manage their environmental impacts.

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Today, we and many of our customers contribute to greenhouse gas emissions. We have a strategy to reduce our own emissions and to help our customers reduce theirs. For more information visit https://www.assetmanagement.hsbc.com/about-us/net-zero

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