Climate change policy

Fulfilling our fiduciary duties on climate

August 2019

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 issue of climate change. This 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 see this as consistent with our fiduciary duties to our clients.

HSBC Global Asset Management

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 target of 1.5°C warming will be reached by 2040 on current emissions levels unless global carbon dioxide (CO2) emissions decline by 45% by 2030 and reach 'net zero' by 2050. The report outlined the benefits of aiming for the lower threshold but recognised that this would require rapid, far-reaching and unprecedented changes in all aspects of society.

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 Bank of England Governor Mark Carney sees climate risk affecting financial stability. The changes are already creating investment risks and opportunities, and they will only 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 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 – including scenario analysis – to inform our investment decisions
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** for 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 adaptation

Task Force on Climate-related Financial Disclosures (TCFD)

We are strong supporters of – and an early signatory to – the disclosure recommendations of the Financial Stability Board's Task Force on TCFD. We started disclosing our equity portfolios' carbon footprint as signatories to the Montreal Carbon Pledge in 2015, we published our first Climate Change Policy in 2016, and publicly disclosed our responses to the PRI TCFD-aligned questions in our 2017/18 Transparency Report.

Our responses to the four recommended areas of disclosure – governance, strategy, risk management, and metrics and targets – are outlined below. These will continue to evolve.

Governance
The integration of climate-related risks and opportunities into our investment decisions, alongside integration of all material ESG considerations, lies with our Global Chief Investment Officer (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. There are also early indications that large carbon emitters may 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.

- Over the course of 2018, we worked with Vivid Economics to explore the impact of six illustrative low-carbon climate-transition scenarios on equity valuations. This was a major project engaging our Global CIO, Deputy CIO, Global Head of Equity Research and Global Head of Strategy. We also held a workshop with key equity analysts reviewing the approach, findings and implications. This work is continuing into 2019, with additional scenario analysis on a broader set of policy outcomes and a review of the implications of a 1.5 degree approach. We are also exploring the implications of the various scenarios on corporate credit valuations.

- We issued a public report of our high-level findings in October 2018 (Low-carbon transition scenarios: Exploring scenario analysis for equity valuations) which was featured as a case study in the IIGCC report ‘Navigating climate scenario analysis’. We continue to be an active member of the IIGCC ‘Investor Scenario Analysis’ Working Group.

- We **advocate** for 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 active members of the IIGCC Policy Working Group and signed the 2018 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 a wealth of training, tools and resources to enable them to perform these assessments

- **Portfolio-level assessment of climate-related issues:** all our portfolio managers’ decisions 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, at any time, as part of their ongoing portfolio management activities

- **Macro/sector research on climate-related issues:** the analysis of climate-related issues, in particular transition risks, and their impact on financial markets, is an evolving area of research. We continue to lead the way, through proprietary research such as our report on Low-Carbon Transition Scenarios, collaboration with outside experts and industry initiatives. We share the insights from this work across our investment teams, to better inform our investment decisions

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, using our voting decisions to escalate issues where appropriate.

We are founding signatories of the Climate Action 100+ initiative, and part of its Steering Committee. We are the lead / co-lead investor in engagement projects with companies across four continents, working in collaboration 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. In 2018, our Global Voting Policy explicitly articulated that, in our engagement, we encourage 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). Where companies in energy-intensive sectors persistently fail to disclose their carbon emissions and climate-risk governance, we normally vote against the re-election of the company chairperson.

In line with the Paris Agreement, we recognise the imperatives of a just transition of the workforce and have committed to the Statement of Investor Commitment to Support a Just Transition on Climate Change.

Metrics and Targets

As signatories to the Montreal Pledge since 2015, we have committed to measuring and publicly disclosing the carbon footprint of our clients' investment portfolios on an annual basis. We use the TCFD recommended metric – weighted-average carbon intensity.

We publish our Montreal Pledge report on an annual basis on our website.

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