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Throughout our 154-year history, we have strived to contribute to communities and to help our customers thrive. As a global organisation dedicated to serving the needs of clients around the globe, we believe that we are uniquely positioned to make a meaningful impact.

Our key priorities are to assist in the global transition to a low-carbon economy and to help people access education and training that will give them the skills they need in the world of the future. We continue to engage with policymakers globally in order to evolve the policy frameworks that can help deliver more sustainable outcomes.

Within HSBC Global Asset Management, we believe that environmental, social and governance (ESG) factors will affect the value of all investments, thus making ESG issues integral to sound investment decisions in order to preserve and deliver long-term growth of our clients’ capital while supporting the transition to a more sustainable world.

In this report, we will set out the progress we have made and the actions we continue to take towards more responsible investing across three dimensions – informing and supporting a sustainable financial system, actively managing investments on behalf of our clients and applying responsible investment principles through the entire investment process and across all capabilities.

I hope you find this report helpful.

Sridhar Chandrasekharan
Global Chief Executive, HSBC Global Asset Management.
As of end of December 2018, we managed USD455.2 billion globally for a range of clients, from some of the largest institutional investors in the world to commercial and corporate clients, financial intermediaries, retail and private banking clients.

We believe that considering ESG factors while investing with purpose and discipline across all portfolios is critical to delivering sustainable growth and reducing risks for each client we serve.

With a strong heritage of successfully connecting our clients to global investment opportunities, and proven expertise in connecting the developed and developing world, we have a unique perspective on ESG factors.

We combine these strengths with a long-term commitment to our clients and a structured and disciplined investment approach, to deliver solutions that support their financial ambitions while transitioning to a more sustainable future.

Presence in 26 countries and territories

Around 600 investment professionals

82 Americas
343 EMEA
165 Asia Pacific
HSBC Global Asset Management offices
Countries where our investment teams sit are in bold.

**Americas**
- Argentina
- Bermuda
- Canada
- Mexico
- USA

**EMEA**
- Austria
- France
- Germany
- Italy
- Jersey
- Luxembourg
- Malta
- Saudi Arabia
- Spain
- Sweden
- Switzerland
- Turkey
- UAE
- UK

**Asia Pacific**
- Australia
- China¹
- Hong Kong
- India
- Japan
- Singapore
- Taiwan

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1. Asia-Pacific includes employees and assets of Hang Seng Bank, in which HSBC has a majority holding
2. HSBC Jintrust Fund Management Company is a joint venture between HSBC Global Asset Management and Shanxi Trust Corporation Limited
3. Alternatives assets include USD4.1bn from committed capital ("dry powder")
4. Other is the assets of Hang Seng Bank, in which HSBC has a majority holding, and of HSBC Jintrust Fund Management, a joint venture between HSBC Global Asset Management and Shanxi Trust Corporation Limited.

Source: HSBC Global Asset Management as at 31 December 2018. Any differences are due to rounding.
Commitment to sustainability since 2001

Launched first Socially Responsible Investing (SRI) equity fund

Launched first SRI bond fund

Joined Institutional Investor Group on Climate Change

2001

2006

2007

2018 highlights and looking ahead to 2019

In 2018 we voted on more than 73,000 resolutions at over 7,000 company meetings across 74 markets;

We engaged on environmental, social and governance (ESG) issues with 1,219 companies, across our equity and fixed income holdings, in 58 countries;

We established an ESG investment oversight committee to further drive our integration efforts – the group guided the development of 24 ESG sector checklists to support analysts and portfolio managers in the integration of ESG to our investment process, and in their engagement with companies, and thematic research on supply chain labour standards;

We published a major report on Low-carbon transition scenarios: exploring scenario analysis for equity valuations.
In 2019 we will be focusing on applying responsible investment principles across all portfolios by expanding our work on scenario analysis and embedding it within our investment process.

We will continue to inform policy by actively engaging with regulators and policymakers on building a more sustainable financial system. This will include our membership in the Strategic Advisory Group to the British Standards Institute, providing support as they develop new standards on sustainable finance.

We will be leading and supporting investor engagement under the Climate Action 100+ initiative, co-filing shareholder resolutions at ExxonMobil and BP, and driving improvements in climate governance, risk management and disclosure.

We will be working with selected partners to explore innovative blended finance solutions.
Our approach to Responsible Investment
Building a sustainable future

At HSBC Global Asset Management, our mission is to unlock sustainable investment opportunities for investors and their advisors by offering expert insights and specialist investment strategies that draw on the depth of HSBC’s network and our global on-the-ground expertise. We aim to preserve and deliver long-term growth of our clients’ capital while transitioning to a more sustainable world.

Environmental, social and governance (ESG) factors will affect the value of all investments, thus making ESG integral to sound investment decision-making. We have formally integrated ESG factors into our investment decisions since signing the Principles for Responsible Investment (PRI) at their launch in 2006; we were one of the first asset managers to do so. Our first responsible investment fund was launched in 2001.

We recognise our responsibility to contribute to the United Nations’ Sustainable Development Goals (SDGs) and the global transition to a low-carbon economy. The 17 SDGs are a globally-agreed framework to help protect the planet, end poverty and ensure peace and prosperity. An important way in which we support this objective is by innovating and delivering a range of sustainable investment solutions for our clients.

We exclude investment in weapons banned by international Convention - Anti-personnel mines, Biological weapons, Blinding laser weapons, Chemical weapons, Cluster munitions and Non-detectable fragments – from all of our funds including active, passive and ETFs.

Applying responsible investment principles

We believe that ESG factors can have a material effect on the financial performance of the securities and assets in which we invest. We therefore integrate material ESG factors in our investment analysis and decision-making, with the aim of reducing risk and enhancing returns.

Integration of ESG factors
We apply responsible investment principles through the entire investment process, incorporating the analysis of ESG factors, across all asset classes, alongside financial analysis, to inform our investment decisions and target sustainable long-term returns.

Driving positive behaviour and promoting high standards

Active ownership
Active ownership is a key pillar of our approach to responsible investment, and of the way we deliver value to our clients. Our activities are focused on protecting and enhancing our clients’ investments with us, through both engagement and voting. This activity allows us to better understand and evaluate the ESG risks and opportunities at a company level, drive positive behaviour and promote high standards.

Informing and supporting a sustainable financial system

Policy and advocacy
Every day, we engage in the creation of a healthy global financial system. We aim to play a constructive role in shaping the debate around sustainable finance and investment by engaging directly, and where appropriate collectively, with policymakers and regulators. Our current focus areas are the low-carbon transition and resilience; Improving market transparency and sustainability disclosure and mobilising sustainable capital.
Integrating ESG Considerations
Our investment process

We believe that ESG factors can have a material effect on the financial performance of the securities and assets in which we invest over the short, medium and long term. Our investment process integrates the identification and analysis of ESG factors with the aim of reducing risk and enhancing returns for our clients. This means putting in place the right team, tools and training to support our analysts in taking material ESG issues into account in their research recommendations.

Accountability for the integration of 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 processes, supported by our ESG specialists, who reinforce the process by providing ESG data, sector knowledge and thematic insights.

In 2018, we established the ESG investment oversight committee to promote better cross-asset class insights. Led by our Global Heads of Equity Research and Credit Research, this group brings together equity and fixed income analysts, our Global Head of ESG Research and our Global Head of Corporate Governance to drive our integration efforts.
Tools and data

Data and analysis
We take data and analysis into consideration on a range of ESG issues, based on our own in-house analysis, multiple specialist third-party ESG research providers, direct engagement with companies and a host of relevant public and industry sources.

Proprietary sector-specific weightings
We use proprietary sector-specific weightings for ESG factors, to reflect the materiality of each set of issues to the sector. These data points and scores are built into our ESG research platform and specific equity and fixed income portfolio analytic tools. We have ratings covering over 10,000 issuers from developed, emerging and frontier markets, and have developed ESG sector checklists for 24 industries to support sector-specific analysis.

Using the tools
Our equity and fixed income analysts use these multiple data sources and tools to make their investment recommendations. Our fundamental research framework for all companies incorporates ESG analysis as specific inputs. In the case of our equity research, our company research notes include consideration of the impact ESG issues may have on valuation; in the case of corporate fixed income the company research notes, we assess the company’s management of ESG issues and any specific liabilities (legal, social or environmental) which feeds into our proprietary credit rating. We consider both absolute criteria (i.e. the violation of one or more of the 10 UN Global Compact principles may lead to exclusion of an investment), and relative ESG performance. The bottom 5% of securities are ranked as high risk, and subject to enhanced due diligence, which may include engagement with the company to improve their record. The lack of progress or satisfactory answers can lead to exclusion of the security from our portfolios.

Training
We facilitate the ongoing training and exchange of ideas on ESG integration through the ESG investment oversight committee. In addition, we arrange periodic training calls with analysts to update them on our evolving data provision. We also hold cross-asset class, sector-specific calls, using the ESG sector checklists to dive deeper into relevant regulatory and industry trends, and established or emerging best practice within sectors.

This year, we included a dedicated ESG session within our core fixed income training programme, which was delivered across five key investment centres. Topics included quantitative analysis on the use of ESG scores, green bonds and the role of engagement within fixed income.
ESG analysis and credit decisions

Helping make informed investment choices
In 2017, analysis of a European unlisted company (with an external credit rating of AA and a low governance rating attributed by an ESG service provider), failed to confirm the existence of anti-corruption policies. Due to the issuer’s high level of government-regulated income and involvement with government procurement, this information was potentially financially material. Therefore, without it, the liabilities (legal, social and environmental) component of our credit analysis could not be completed. When contacted, the company treasurer agreed to disclose the policy documentation making it possible for us to approve the credit and invest in the company’s upcoming bond issue.

Uncovering unseen risk
A corporate in the European unlisted market had a complex financial structure and limited public disclosure which prevented us from forming a comprehensive view on the credit. This lack of clarity led to uncertainty on the potential for stable future cash flows and credit metrics. Several unsuccessful attempts to engage with company management further amplified our concerns. We felt that these factors meant that risks were not fully priced into the company’s bonds. We internally downgraded the credit, and informed the company that we would not be able to participate in any new issues unless it increased its willingness to engage with debt investors.

Evolving supply-chain labour standards in high-risk sectors

Thematic research
In June 2018, we analysed labour standards in two high-risk sectors – technology and retail ‘fast fashion’. The analysis focused on the extent to which fundamental labour rights – primarily freedom of association and the effective recognition of the right to collective bargaining, as well as the protection of the workforce from forced or compulsory labour or the use of child labour – are upheld and appropriately managed within companies and their supply chains.

Greater transparency on labour practices is mandated through regulations such as the Modern Slavery Act in UK, the Duty of Care of Parent Companies and Ordering Companies in France, the Child Labour Due Diligence Law in Netherlands, the Trade Facilitation and Trade Enforcement Act in the US (which bans the import of goods produced by forced labour) and the Transparency in Supply Chains Act in California.

While the growing list of legislation predominantly stems from Europe and the US, its impact is already starting to be felt worldwide. These regulations, in conjunction with investor and consumer pressure, are making supply chain labour standards a key risk (or opportunity) for companies. Our analysis reviewed companies’ business models and supply chain management to identify companies that face potential financial risks as a result of their practices.
Factor investing: optimising a portfolio’s carbon footprint

To incorporate climate considerations in a portfolio, two approaches currently dominate: either excluding “fossil-fuel related” stocks or restricting choice to a number of “climate themed” names.

In a recent research paper, we contend that, instead, integrating a lower-carbon tilt to passive or multi-factor portfolios can allow investors to support the transition to a low-carbon economy, and to mitigate climate-change risks in their portfolios, while continuing to meet their other investment objectives.

Drawbacks of Exclusion
The first drawback is that investors cannot engage with companies they don’t hold, whereas inclusion allows investors to play an active stewardship role.

Secondly, from a portfolio and risk management perspective, restrictions can introduce biases to a portfolio. Low-carbon portfolio optimisation offers another option which, without exclusion, nevertheless allows investors to increase their exposure to companies benefitting from climate action strategies.

Two approaches can then be used, which offer different risk / return profiles:

- Passive carbon-tilting, to track the index but with a lower-carbon measure. According to our research, this approach avoids the systematic biases of simple exclusion, and derives nearly all its tracking error from the carbon tilting, while delivering significant carbon improvement.

- Carbon factor optimisation, aiming to deliver multi-factor outperformance in conjunction with a carbon improvement. Many investors seek outperformance. Multi-factor strategies provide transparent and cost-efficient solutions like index funds, while retaining the aim of active funds to beat the index and minimise unintended factor exposures.

Analysis of corporate and sovereign bond ESG scores

Quantitative insights
We wanted to better understand the relationship between our proprietary ESG scores and returns on corporate and sovereign bonds.

ESG and Corporate Bonds
For corporate bonds, we studied the components of the ICE BofAML Global Corporate Index, looking at their MSCI industry-adjusted ESG scores and risk/return profiles between 2012 and 2017. We tested both the overall ESG scores and each of the 3 ESG pillars independently from each other. We ran the back-test on two long/short strategies:

- Strategy 1: buying the first quartile and selling the last quartile
- Strategy 2: buying the above-median group and selling the below-median group

ESG and Government Bonds
To analyse the effect of ESG on government bonds, we used countries’ MSCI ESG scores, and the risk-return profile of their 5-year credit default swaps, running the tests over the period between January 2012 (when MSCI began publishing ESG country scores) and December 2017. We tested the same two long/short strategies.

What we learned

- On average, our initial analysis indicates that taking ESG scores into account adds value in most circumstances. In other words, buying the group of bonds in the best quartile or above-median in terms of ESG scores, and selling the group of bonds in the bottom quartile or below-median in terms of ESG scores delivers value (calculated as a proxy of the Sharpe ratio) in most of our simulations, and does not erode value.

- The lower the credit rating, the more relevant ESG scores become, as the disparity of ESG practices increases between lower-quality companies. In the case of sovereign bonds, this makes ESG score more relevant for emerging and frontier markets.

- Governance is the factor with the strongest predictive power on risk-adjusted returns, followed by environmental factors. Social factors currently have the least predictive power.
Active ownership
What active ownership means to us

Active ownership is using our power as investors to encourage corporate behaviour that protects and enhances value. We fulfil this responsibility through proxy voting, company engagement and filing or co-filing shareholder proposals.

Active ownership is a key pillar of our approach to responsible investment. It allows us to better understand and evaluate the ESG risks and opportunities at a company level, drive positive behaviour and promote high standards.

We are signatories to investor stewardship codes globally including the UK Stewardship Code, the Hong Kong Principles of Responsible Ownership and the Taiwan Stewardship Principles.

Voting

We aim to vote all equities for which clients have given us voting authority, except where this is not practical for reasons such as share blocking or overly burdensome power of attorney requirements.

Our voting aims to support and encourage companies to follow local governance codes and international principles of good governance, social practices and environmental sustainability.

As global investors, we recognise that corporate governance codes, standards and practices vary across different markets and we are sensitive to this in the application of our guidelines. We look to directors of companies in which we invest to provide effective stewardship and ensure that the companies act in the long-term interests of all shareholders. Our voting policy helps us hold them accountable to this. We expect companies to apply governance good practice for their market of listing and, for larger companies, to meet globally-recognised good practice standards.
Voting in practice

In 2018, we voted more than 73,000 resolutions at over 7,000 company meetings across 74 markets, representing 96% of the ballots at which we were entitled to vote. This compares with more than 70,000 resolutions at over 6,500 company in 2017.

We supported management on 88% of resolutions, abstaining or voting against on 12%. The issue we most frequently opposed was compensation (38% of votes against management), followed by director re-election (26%), predominantly for reasons of lack of independence, followed by capitalisation issues.

Source: HSBC Global Asset Management as at 31 December 2018.

* Totals may not add up to 100% due to rounding.

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Key*
- Asia Pacific – Developed Market (11%)
- EMEA – Developed Market (28%)
- North America – Developed Market (27%)
- Asia Pacific – Emerging Market (18%)
- EMEA – Emerging Market (6%)
- Americas – Emerging Market (1%)
- Frontier and Others (8%)

Source: HSBC Global Asset Management as at 31 December 2018.

* Totals may not add up to 100% due to rounding.

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Key*
- Compensation (38%)
- Director elections, etc (26%)
- Capitalisation (17%)
- Routine (5%)
- Transactions (4%)
- Anti-takeover (1%)
- Shareholder resolutions – G (7%)
- Shareholder resolutions – E&S (2%)

Source: HSBC Global Asset Management as at 31 December 2018.

* Totals may not add up to 100% due to rounding.
We vote on a large number of resolutions, paying close attention to the details of these to ensure our shareholder rights are upheld or enhanced. For example we do not support resolutions to maintain or extend shareholder inequalities or support large-scale potential share dilution without the right to subscribe when a company issues new equity.

Our stance on shareholder rights has long been reflected in our voting. We focus on two issues:

**Voting thresholds**
In most circumstances, we believe a simple majority (50%) of voting shares should be sufficient to effect change in a company’s practices. Requiring more than a simple majority may permit management to entrench its position by blocking actions that are in shareholders’ best interests.

To this end, we believe the reduction in voting requirements from a supermajority of outstanding shares to a simple majority of shares is a positive step and represents an enhancement in the company’s corporate governance structure.

In 2018, we received 64 proposals to reduce super-majority (67/75/80%) vote requirements, and we cast all our votes in favour of the change. By contrast, we voted against proposals put forward by some companies to adopt supermajority voting.

**Share issuance**
In 2018, we received 113 proposals to amend company articles to reflect changes in their capital structure.

We supported the vast majority of these, but voted against 12 which we thought would reduce the rights of existing shareholders, or which lacked sufficient disclosure for us to make an informed decision.

For example, we voted against Xior Student Housing’s proposal to authorise an increase in share capital with 50% of the issuance offering no pre-emptive rights to existing shareholders.

We received 1,816 proposals in relation to the issuance of equity or equity-linked securities. Of these, 27% we opposed as they were looking to issue shares in excess of 15% without pre-emption rights or 35% with pre-emption rights. Issuances at these levels are a concern given their potential dilutive effect on existing positions. For example, Akka Technology requested the authority to issue equity up to 100% of existing capital. This is not the type of resolution we feel able to support.
Shareholder resolutions

We support climate-related resolutions, as well as shareholder resolutions on other ESG issues, where these are in line with the principles of good governance outlined in our voting guidelines or where we consider the issue to be material and the proposal to be in the best long-term interest of clients.

This means we support greater disclosure and the introduction of appropriate policies (provided the proposal is not overly prescriptive).

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.

In 2018, we supported 1,074 shareholder resolutions, 60.9% of the 1,764 resolutions. This compares to 956 shareholder resolutions supported in 2017, 50% of the 1,908 resolutions on which we could vote.

Among these, we supported more than 158 resolutions on environmental and social issues. For some of the higher-profile resolutions that called for greater transparency on what companies do to limit the impact of climate change, we publicly declared our support in advance.

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Key*

- Compensation (4%)
- Corporate Governance (14%)
- Directors Related (50%)
- Environmental (8%)
- Other – Environmental / Social (7%)
- Routine / Business (17%)
- Social / Human Rights (2%)

Source: HSBC Global Asset Management as at 31 December 2018.

* Totals may not add up to 100% due to rounding.
We use our influence as a global asset manager with a long-term investment approach to engage directly with the companies we invest in on behalf of our clients to protect and enhance the long-term value of our investments.

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

- Improving our understanding of a company’s business and strategy
- Monitoring performance
- Signalling support or raising concerns about company management, performance or direction
- Promoting good practice

We have developed a clear process for each formal equity engagement based on setting defined objectives, tracking progress made and measuring company action. We are formalising our engagement planning for fixed income. We believe that good corporate governance ensures that companies are managed in line with the long-term interests of their investors.

We engage across both our equity and fixed income holdings, leveraging our strong research capabilities across both asset classes. In 2018, we developed 24 ESG Sector Checklists.

These checklists support both ESG integration into our investment process and engagement with companies, identifying material sector-specific ESG issues and key engagement questions. Our engagement activity includes letters, calls or in-person meetings, site visits and AGM attendance.

While we have a dedicated stewardship team with engagement specialists, engagement is integral to the fundamental research process. Our 63 equity and 46 credit analysts – as well as our portfolio managers – engage with issuers as part of the investment process, both before and during the period of investment and they also cover all relevant ESG issues in their research and discussions. Last year, ESG issues featured in 28% of routine equity team meetings (up from 18% in 2017) and 29% of corporate fixed income meetings (up from 20% in 2017).

In 2018, we held engagements which included ESG issues with 1,219 companies in 58 countries (compared with 823 companies in 43 countries in 2017). The equity team discussed ESG issues with 973 companies while the fixed income team raised ESG topics with 306 companies, governments and other issuers (these figures include some engagement with the same companies).

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**Regional breakdown**

We have dedicated engagement specialists in London, Paris and Hong Kong. This enables us to engage globally, across developed and emerging markets.

Over 45% of our engagement is with companies headquartered in EMEA developed markets. In the UK, we engaged with approximately 140 companies in advance of voting at their shareholder meetings. We engage around voting in other markets on an ad hoc basis, as the issues concerned arise in our company meetings.

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<th>Region</th>
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<tr>
<td>North America – Developed Market</td>
<td>20%</td>
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<td>Asia Pacific – Emerging Market</td>
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<tr>
<td>Americas – Emerging Market</td>
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* Totals may not add up to 100% due to rounding.
Thematic engagement

We engage on a range of environmental, social and governance issues, identified from a bottom-up perspective. We often raise issues spanning several themes – such as climate change and supply chain labour standards. The breakdown of the high-level ESG issues we raise when engaging with companies or institutions is illustrated below.

Addressing cobalt mining and human rights

During 2018, we engaged with automotive and consumer electronics companies to understand how they minimise child labour and other human rights risks in their cobalt supply chains. Cobalt is an important component in many of the compact batteries used in electronic devices and electric vehicles. But, more than half of global production is sourced in the Democratic Republic of Congo, where artisanal mining often has poor safety standards and can involve child labour.

We identified 29 companies in our portfolios whose reporting lacked relevant information on responsible sourcing of cobalt. We contacted these companies to explain the rationale of our engagement and our expectations. We had follow-up calls or meetings with around half the companies. These engagements enabled us to identify best practices introduced by those with substantive exposure to the cobalt supply chain to prevent violation of human and labour rights. We also encouraged increased disclosure on this issue.

Key*

- Environmental and Social issues including climate risk management, resilience and disclosure, water management, deforestation, labour standards, health and safety and breaches of UN Global Compact (42%)
- Governance issues including board composition, auditor independence, remuneration, political donations (35%)
- Combined issues (23%)

Source: HSBC Global Asset Management as at 31 December 2018.

* Totals may not add up to 100% due to rounding.
Engaging on labour standards in the food supply chain

Labour practices, both direct and in supply chains, have become an increased risk for all companies. These risks include: regulatory risk resulting from legislation such as the UK’s Modern Slavery Act; reputational risk arising from media coverage of poor practices; and operational risk with likely increased employee turnover, declining product quality and supply chain disruption.

Over the past two years, we have participated as a lead investor in an engagement with companies dependent upon agricultural products organised by the PRI. Agriculture is a sector facing particular labour standards risks, including child labour, high workplace accident and fatality rates – due to agricultural machinery, pesticide exposure and harsh weather conditions – as well as poor access to workers’ rights.

The companies we engaged with included Carrefour, Costco, Hershey’s, Ingredion, Tyson and Walmart. We have found a good awareness of the issues and a range of monitoring and reporting standards, though companies often find it difficult to get beyond their immediate or next-level suppliers to have full visibility of the supply chain.

In June 2018, we joined institutional investors collectively representing USD2.1 trillion assets under management in setting out our expectations of companies in addressing forced labour in global supply chains.


Tackling deforestation

We have also been lead investors over the past two years in a collaborative engagement campaign on deforestation initiated by the PRI and Ceres. This has encouraged companies to demonstrate commitment to eliminating deforestation within their supply chain. We have investigated and encourage good practice in: awareness and governance; risk management and traceability; strategy and risk mitigation; and metrics and monitoring. The engagement covers several commodities including palm oil and cattle.

In 2018, our engagement has focused on Nike and Adidas, involved in the cattle supply chain through use of leather in their products. We had meetings with both companies in which we asked about their monitoring programmes to prevent deforestation linked to cattle in their supply chain, their involvement in the Leather Working Group and the status of their policies on deforestation.

Both companies demonstrated a good understanding of the issue and are gradually phasing out leather. In the meantime, they are collaborating with other members of the Leather Working Group to advance audit and monitoring standards. In one example of best practice, Nike uses GPS to monitor the potential violation of boundaries in areas from which it is sourcing leather.
Collaborating for better stewardship

Collaborative engagement is an effective tool to foster dialogue and promote change. We actively participate in investor-led collaborative engagement initiatives that align with our thematic priorities and holdings. Where we engage collectively, we lead the majority of engagements in which we participate.

Following are examples of collaborative engagement:

**Principles for Responsible Investment**
The PRI Clearinghouse provides a platform for collaborative investor engagement initiatives.

As a signatory of the PRI, we work with other investors in leading engagement on a range of issues, including a focus on the prevention of deforestation in the supply chains of cattle and palm oil. We are active members of the Engagements Advisory Committee (ESG).

**ClimateAction 100+**
We are on the steering group of this landmark five-year collaborative investment initiative on climate change which was launched on the 2nd anniversary of the Paris Agreement.

This global initiative is initially focusing on 100 of the world’s largest corporate greenhouse gas (GHG) emitters. It aims to secure commitments from their boards and senior management to establish strong governance frameworks, GHG emissions reduction targets across their value chains, and enhanced disclosure in line with TCFD recommendations.

In 2018, in collaboration with other lead investors, we supported Equinor ASA (formerly Statoil) in preparing and publishing a gap analysis on the implementation of the TCFD guidelines. We spoke at the AGM of BHP about its reporting on and management of climate risk exposure. In parallel, we challenged BMW on its position regarding Climate Change and its involvement in trade associations that lobby against the Paris Agreement.

**CDP**
As longstanding supporters of CDP, we have engaged with companies that have failed to reply to the CDP questionnaire on their water and carbon footprint for last three years. We contacted almost 300 companies in 2018 on CO2 disclosure, water and forestry issues.

We also notified a number of energy-intensive companies held in our portfolios that failing to disclose on CO2 emissions, following the TCFD or CDP standards, will result in our voting against the re-election of the Chairman at the next AGM when this item is up for shareholders, vote.
**Workforce Disclosure Initiative (WDI)**
We joined this initiative at its launch in 2017. Its aim is to call for increased transparency from companies on how they manage their workforce – including information on workforce composition, stability and development, and worker engagement, for both direct employees and workers across the supply chain.

The WDI now has more than 120 investor signatories with over USD13 trillion assets under management. 90 global companies disclosed to the 2018 WDI survey. We support this initiative, not only to drive better information to feed into our investment decisions, but ultimately to drive better jobs in line with Sustainable Development Goal #8 to achieve ‘Decent Work and Economic Growth’.

Large multinational companies can play a key role in delivering on ‘decent work for all’.

**Investor Stewardship Group**
We fully endorse the Investor Stewardship Group (ISG), a collective of large US and global asset managers formed to establish a framework of investor stewardship and corporate governance standards in the US.

In 2018, we identified share pledging as a material issue for our US-based holdings, because it can undermine the bond between management and shareholders, and potentially influence share-price volatility. We engaged with 59 companies, asking them to set up an “anti-pledging” policy and to regularly monitor and gradually reduce the volumes of shares pledged by executives and directors. While a large number of companies stated that their Boards were reviewing the issue, some confirmed they were in the process of implementing the required policy and monitoring process.

**The Investor Forum**
We are members of this initiative for collective engagement with UK companies with governance concerns.

In 2018, the work of the Forum informed our position on a number of corporate issues, including the proposed corporate re-structure of Unilever. We also participated in a collective engagement with UK companies that have sponsored American Depositary Receipts (ADR) programmes around concerns that votes in the programmes could be used by the companies themselves and, more generally, that there was poor vote solicitation for ADR investors. This resulted in undertakings from a number of companies to review the depositary agreements.

**Asian Corporate Governance Association (ACGA)**
We are members of this group, which works to improve governance standards in Asian markets.
Public policy and advocacy
Informing public policy

We aim to play a constructive role in shaping the debate around sustainable finance and investment by engaging directly, and where appropriate collectively, with policymakers and regulators.

We are active members of a variety of organisations, initiatives and networks that serve to progress public policy dialogue on responsible investment, including the PRI Global Policy Reference Group, IIIGCC Policy Group, and relevant committees of the European Fund and Asset Management Association (EFAMA) and the UK Investment Association.

We work closely with our HSBC Group Public Affairs colleagues to respond directly to consultations and discussion papers that have wide-ranging impacts on establishing a more sustainable financial system.

‘Greening’ the system

2018 saw a step-change in the pace and scale of ambition demonstrated by policymakers in setting out proposals to manage sustainability issues impacting the financial system, in particular climate risks, and to mobilise the flow of public and private capital towards sustainable investments.

Driving better disclosure by financial system actors continues to be a strong theme – encouraging financial institutions to be more transparent in terms of their carbon footprint, ESG policies and sustainable investments in particular.

The Action Plan on Sustainable Finance proposed by the European Commission in 2018 presented the most comprehensive set of policy initiatives, but we have seen meaningful and growing engagement with the official sector in other markets around the world.
In March 2018, the European Commission outlined 10 Actions as part of its Action Plan for Financing Sustainable Growth. These included:

- Providing an EU-wide classification system of initially climate-related sustainable activities ("sustainability taxonomy")
- Creating standards and labels for green financial products, including green bonds
- Clarifying institutional investors, and asset managers’ duties to ensure that environmental, social and governance (ESG) issues are considered as part of the investment process
- Strengthening sustainability disclosure for issuers and improving transparency by asset owners and asset managers towards their clients and beneficiaries

In support of the legislative proposals, HSBC Group responded to the series of consultations related to the Action Plan throughout 2018.

In addition to contributing to the Group’s answer, we met in person with Vice-President Dombrovskis and senior officials in the European Commission’s Directorate General for Financial Services to share our views, and we actively engaged in key policy-focused groups.

The proposals are very likely to remain a high priority for the new European Commission, appointed later in 2019, and we look forward to continuing engagement on how the proposals can be shaped and successfully implemented, both to grow the market for green finance, and to “green” the broader market for finance.

Our policy advocacy continues to focus on three key areas:

- Facilitating the transition to a low-carbon economy
- Improving market transparency and sustainability disclosure to identify risks and opportunities
- Mobilising private capital to deliver on the Sustainable Development Goals and Paris Climate Agreement

Key highlights for 2018 are outlined on the following pages.
1. Low-carbon transition and resilience

Global Investor Statement
In 2018, we joined over 400 investors representing more than USD32 trillion in assets in issuing a Global Investor Statement to Governments on Climate Change. This statement reiterates our full support for the Paris Agreement and strongly urges all Governments to implement the actions necessary to achieve its goals. We highlighted three areas:

- Taking action to achieve the Paris Agreement goals – by communicating long-term emission reduction strategies including strengthening nationally-determined contributions (NDCs)
- Accelerating private-sector investment into the low-carbon transition – by putting a meaningful price on carbon, and phasing out fossil-fuel subsidies and thermal coal power worldwide by set deadlines
- Improving climate-related financial reporting – including a commitment to support and implement the recommendations of the Financial Stability Board’s Task Force on Climate-related Financial Disclosures (TCFD) no later than 2020

COP24
The 24th Conference of the Parties (or COP24) in Katowice, Poland was an important milestone in the ongoing climate negotiations where all Parties came together to agree the rulebook which sets out how the Paris Agreement will be implemented from 2020.

Among the implementation details now specified in the rulebook are guidelines for how countries report on their actions to reduce greenhouse gas emissions and progress against their climate targets (nationally-determined contributions or NDCs).

While COP24 received less coverage than the Paris Agreement, its outcome is critical for the implementation of the goal, agreed by 195 Nations in 2015, of keeping a global temperature rise this century well below 2 degrees Celsius and of driving efforts to limit the temperature increase even further to 1.5 degrees Celsius above pre-industrial levels. In October, the Intergovernmental Panel on Climate Change (IPCC) report made clear the urgency of this action and the benefits of limiting the rise in global temperatures to 1.5°C rather than 2°C.

Investing in a Just Transition
Launched at COP24, the Statement of Investor Commitment to Support a Just Transition on Climate Change recognised that achieving a just transition, one that is sustainable and fair to those who stand to lose out, such as workers in high carbon industries, in line with the 2015 Paris Agreement on Climate Change, will help accelerate climate action in ways that deliver the Sustainable Development Goals.

We endorsed the statement, now signed by over 130 investors representing USD8 trillion in assets, committing to take action to support the just transition by integrating the workforce and social dimensions in our climate practices.
2. Improving market transparency and sustainability disclosure

Enhancing corporate disclosure
Good-quality information on material environmental, social and governance issues is a prerequisite for good-quality integration. We use multiple sources of ESG data and related information. An important input for a number of these sources, as well as the fundamental research we undertake, is company reported data. We therefore actively encourage better corporate disclosure.

We strongly support the Financial Stability Board-backed (FSB) Taskforce on Climate-related Financial Disclosures (TCFD) recommendations, CDP disclosure programmes on climate change, water and forests and the Workforce Disclosure Initiative on human capital information.

We engage directly with companies to encourage disclosure in line with these frameworks. Engagement is particularly important for private companies issuing debt, as they are currently not subject to the same reporting requirements as listed companies.

In 2018, we participated in the UK Financial Reporting Council ‘Lab’ on Performance Metrics. This culminated in a report issued in November providing guidance to companies to ensure meaningful disclosure on performance metrics which investors can use to make decisions.

Regulatory or quasi-regulatory requirements
We also focus on systemic changes to regulatory or quasi-regulatory requirements to enhance corporate level disclosure. For example, as members of the PRI’s Sustainable Stock Exchange Investor Working Group, we engage with stock exchanges and regulators to enhance listing rules and to support regulatory initiatives that require listed companies to disclose sustainability factors. Disclosure is an important pillar of the EC Sustainable Finance Action Plan. As HSBC Group, we responded to the Technical Expert Group proposals on climate-related reporting in early 2019, and to the UK FCA Climate Change and Green Finance Discussion Paper, strongly supporting their proposal to implement TCFD on a ‘comply or explain’ basis.

Reporting on impact
We recognise the important role asset managers can play in providing greater disclosure to clients and end beneficiaries. We have started reporting weighted-average carbon-intensity metrics and weighted aggregate ESG scores in fact sheets for key funds.

As part of the Cambridge Institute for Sustainability Leadership Investor Leaders Group, we continue to work on establishing an impact metrics framework. Its aim is to allow fund managers to communicate the social and environmental performance of funds in a simple and meaningful way. The latest report was released in January 2019.
3. Mobilising sustainable capital

Stewardship 2.0
The introduction of the first UK Stewardship Code by the Financial Reporting Council (FRC) in 2010 marked an important development in financial markets; setting out principles for good engagement between institutional investors and companies to help improve long-term returns. The revised code, issued in 2012, made clear the respective responsibilities of asset managers and asset owners for stewardship, and we have seen similar codes emerge across the world.

In January 2018, we hosted the launch of the Tomorrow’s Company ‘Better Stewardship’ report. This report, written with the input and guidance of Tomorrow’s Company Stewardship Alliance, of which we are a member, recommends actions across the stewardship chain – asset owners (investors), investment consultants, asset managers, sell-side analysts and companies – to improve stewardship. We believe a more systemic view of how stewardship can be delivered is central to building more sustainable financial markets.

Following publication of the Better Stewardship report, Tomorrow’s Company held four roundtables, involving a total of 75 participants across asset managers, asset owners, investment consultants, pension funds, companies and advisory groups. We shared our insights and recommendations from these roundtables with the FRC directly and provided input on the proposed revisions to the UK Stewardship Code issued in January 2019.

As part of the Stewardship Alliance, we also contributed to Tomorrow’s Company’s response to the consultation on the Wates’ Corporate Governance Principles for Large Private Companies. These are particularly important to us as bondholders.

Standards for sustainable investment
In October 2018, the UK Department for Business, Energy & Industrial Strategy (BEIS) announced that the British Standards Institution (BSI) would be developing two new standards on sustainable finance. Standards can play an important role in building recognition and trust in a complex market. We were invited to join the new Strategic Advisory Group, established to provide strategic oversight and guidance on the delivery of BSI’s activities. The Group falls under the Green and Sustainable Finance Standardisation Programme, which includes the new International Organisation for Standardisation (ISO) Technical Committee, tasked with developing international standards on Sustainable Finance, as informed by the UK-led work.

Blended finance
We recognise the role we can play in contributing to the United Nations’ Sustainable Development Goals (SDGs) and the global transition to a low-carbon economy. The SDGs and Paris Agreement set a long-term transformational framework with the objective of ending poverty, fighting inequalities and tackling climate change. Mobilising private capital to deliver on these goals is critical. We are committed to finding innovative and impactful investment solutions to enable our clients to participate in this transition.

At the Global Climate Action Summit in San Francisco in September 2018, we joined the inaugural meeting of the Blended Finance Taskforce Sustainable Infrastructure Investor Club. The Taskforce seeks to develop the financial instruments which can support investment and mobilise capital for sustainable infrastructure, particularly in emerging markets.
Focus on climate change
The climate change challenge

A recent Intergovernmental Panel on Climate Change (IPCC) report 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. Limiting global warming to 1.5°C 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:

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

- **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

- **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

- **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.

- **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
Green bonds

Green bonds can play an important role in channelling investments into activities that generate tangible and positive environmental outcomes. We recognise that this can be particularly valuable in emerging markets.

We support the International Capital market Association (ICMA) Green Bond Principles, and we actively engage with issuers – both corporate and sovereign – to encourage green bond issuance, and improved and timely reporting on the use of proceeds.

In early 2019, we participated in roundtables, organised by HSBC, in Costa Rica and Panama for issuers and policymakers on sustainable finance. We presented the opportunity that green bond issuance presents, and set out our expectations from an investor perspective. We believe this activity is important to build the market and, ultimately, direct capital flows towards carbon reduction activities that will help us deliver on the Paris Agreement.

Our green bond holdings as at the end of 2018 exceeded USD1.3 billion, over 20% of which are emerging-market issuers.

Low-carbon transition scenarios

Exploring scenario analysis for equity valuations

In 2018 we developed six illustrative climate-transition scenarios* to explore how policy timing and future technology costs can influence both sector and company-level equity valuations.

We compared scenarios that characterise early policy action (from 2020) and later policy action (from 2030) designed to provide at least a 50% change of limiting warming to 2°C, with a baseline reflecting existing climate policies and predicted technology cost trends, with no further policy changes.

We also looked at three future technology-cost pathway scenarios:

- Reduced costs for solar and wind energy (Renewable revolution)
- Increases in energy productivity (Efficiency boost)
- Reduced costs for Carbon Capture and Storage (CCS Storm)

This quantitative, company-level analysis provides a rich set of investment insights on the nature and relative magnitude of impacts within and between sectors, which we hope will contribute to the industry debate on managing the low-carbon transition.

* http://www.global.assetmanagement.hsbc.com/climate-change
Scenario analysis

In response to a call from G20 Leaders and to support better disclosure of, and ultimately business and investment decisions on, climate-related risks and opportunities, the Task Force on Climate-related Financial Disclosures (TCFD) (established by the Financial Stability Board (FSB)) delivered recommendations for voluntary disclosures of material, decision-useful climate-related financial risks in 2017.

A key TCFD recommendation is for organisations to conduct scenario analysis to better understand and then disclose the resilience of the organisation’s strategy to different climate-related scenarios.

Understanding transition risks and the impact on clients’ investments is a huge undertaking, as the transition to a low-carbon economy will disrupt company valuations across a diverse set of sectors and geographies, at least temporarily: it will not only affect production and distribution costs, but also change demand for products and services, impacting earnings and cash-flows in multiple ways.

In such a complex environment, scenario analysis can be a useful tool. Throughout 2018, we have been working with Vivid Economics to develop scenario analysis. We believe investors should share their thinking as they explore low-carbon transition scenarios. Not only will this help establish effective models to translate transition risks into measurable factors in security valuations, but it will also uncover the areas where key data needs to be disclosed. We shared our own initial insights in a report published in October, and we have been active participants in the IIGCC Investor Practices Programme Investor Scenario Analysis Working Group since 2017.

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 relating 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.

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.

In 2018, we reported on all equity portfolios, and on corporate fixed-income portfolios managed in five major locations—the USA, the UK, France, Hong Kong and Germany. This represents approximately 80% of both our equity and corporate fixed-income holdings, or around 33% of our total assets under management (AUM).

### Equity Portfolio

Weighted Average Carbon Intensity (tons CO2e / USDm revenue)

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<td>Value</td>
<td>211</td>
<td>280</td>
<td>367</td>
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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’ 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, 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.
Key documents and contacts

The following documents are available on our website – www.global.assetmanagement.hsbc.com/responsible-investing

Responsible Investment Policy
Banned Weapons Policy
Climate Policy
Global Voting Guidelines
Montreal Carbon Pledge Report

Participation in industry initiatives
As a global asset manager we support a number of industry initiatives, globally and locally, that aim to share and develop best practice in the responsible investment industry. A selection of these are listed below:

- Principles for Responsible Investment (Global)
- ClimateAction 100+ (Global)
- International Corporate Governance Network (ICGN) (Global)
- CDP – investor member (Global)
- Blended Finance Taskforce (Global)
- Cambridge Institute for Sustainability Leadership – Investor Leaders Group (Global)
- Workforce Disclosure Initiative (Global)
- Asian Corporate Governance Association (ACGA) (Asia)
- European Fund and Asset Management Association (EFAMA) (Europe)
- Institutional Investor Group on Climate Change (IIGCC) (Europe)
- Council of Institutional Investors (CII) (North America)
- Investor Stewardship Group (North America)
- City of London Green Finance Initiative (GFI) (UK)
- The Investment Association (UK)
- The Investor Forum (UK)
- Tomorrow’s Company – The Stewardship Alliance (UK)
- UK Sustainable Investment and Finance Association (UKSIF) (UK)

Contacts
For further information about responsible investing at HSBC Global Asset Management, contact your relationship manager.
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