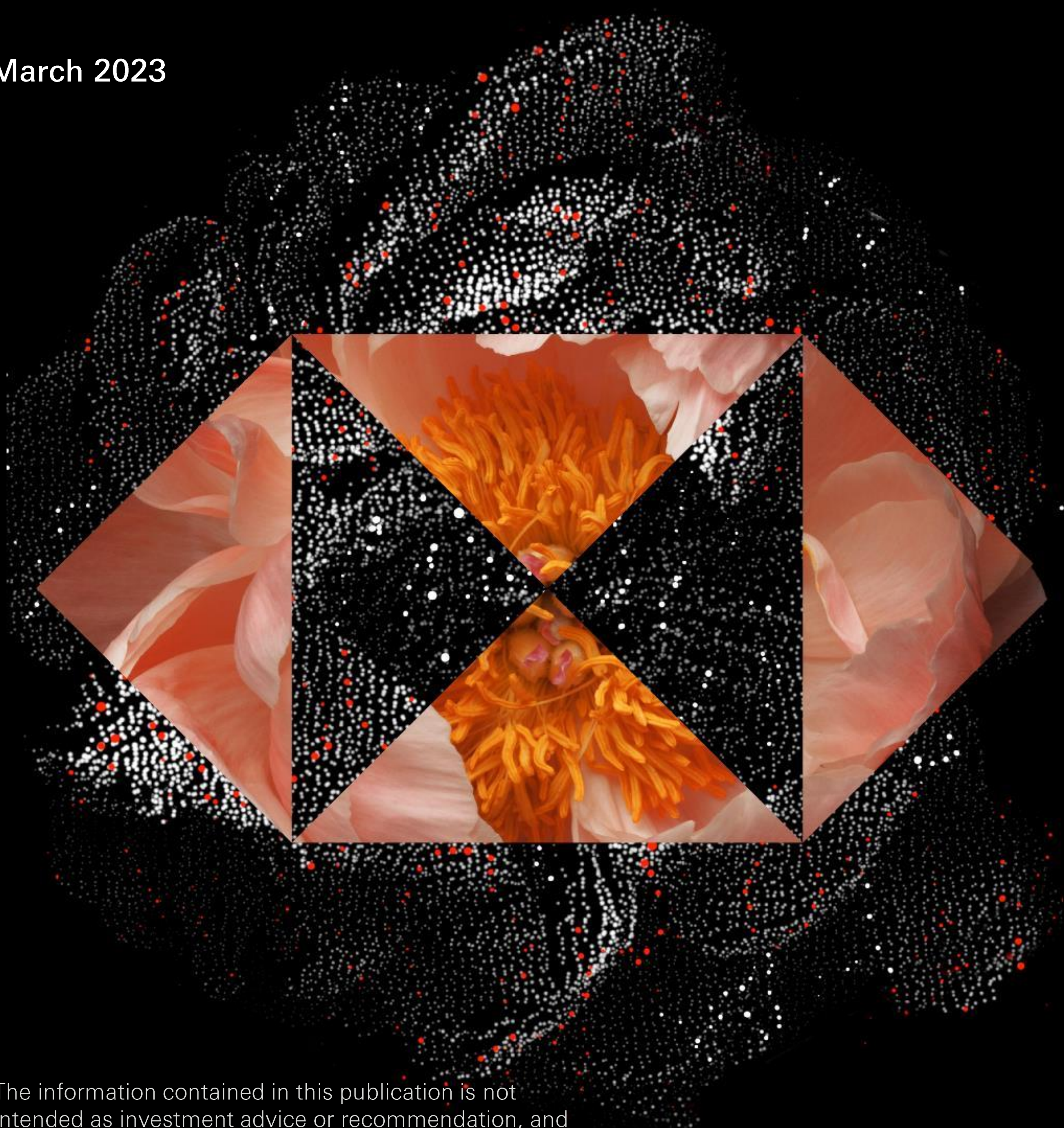
Asset Management

Responsible Investment Review

March 2023



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Content

Chief Executive Welcome

Nicolas Moreau
Chief Executive Officer
HSBC Asset Management

I'm pleased to present to you our latest Responsible Investment Review – HSBC Asset Management's annual reporting bringing together our sustainability-related achievements, viewpoints, and commitments.

2022 was indeed another year of great progress for sustainable finance in general, and for the asset management industry in particular. Continued investors' demand for sustainable investment solutions pushed our industry to go deeper in ESG integration, and has been a formidable catalyst for innovation around new asset classes. Coupled with a fast-evolving regulatory environment, this driving force has also led to more transparency around the sustainable outcomes of the solutions available to investors.

HSBC Asset Management has fully embraced this structural shift and in 2022 our sustainable assets grew to over US$55 billion. This is what our report aims to demonstrate, providing you with a download of the significant work taking place across our entire organisation. You will see that we reinforced our governance frameworks to ensure that we deliver on our commitments. You will also see that we pursued our objective to provide our clients with solutions that meet both their financial and sustainability targets.

Exciting investment opportunities are developing from the new technologies emerging in the sustainable economy, and alternative asset classes are at the forefront 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 the flow of capital. Our joint venture with Pollination, Climate Asset Management, raised $650 million of committed capital across two strategies that support nature restoration and renewal. Our climatech strategy has taken minority equity stakes in early-stage technology companies that accelerate de-carbonisation and de-pollution of industries. And we plan to add an Asia-focused energy transition infrastructure team in the near future, which is intended to make a significant impact in the Asia-Pacific region for energy transition infrastructure investments.

You will find many more illustrations of our commitment to sustainability as you explore our 2022 Responsible Investment Review. I trust you will find it interesting and illustrative of our strategic ambition.

Foreword

Erin Leonard
Head of Sustainability
HSBC Asset Management

Xavier Baraton
Global Chief Investment Officer
HSBC Asset Management

The purpose that we set out in 2021 remains unchanged along three pillars. We have a responsibility to help facilitate the flow of capital from investors to the businesses that are driving the transition to a sustainable global economy. We have a fiduciary obligation to ensure that our clients' assets are managed for positive long-term environmental and social outcomes. Today, we and many of our clients contribute to greenhouse gas emissions. This is why HSBC Asset Management, together with other asset managers, have an important role to play in supporting the transition to a net zero economy. Step by step, we are developing strategies to reduce our own emissions and to help our clients reduce theirs. And finally, we have a further responsibility to use our voice and influence with the companies that we invest in and in the industry at large.

To fulfil on our purpose, we must have strong principles to guide our decisions. This is why, in 2022, we made two important commitments: setting carbon emission reduction targets as part of the Net Zero Asset Managers Initiative and announcing an ambitious Thermal Coal Phase-Out Policy. Both pledges have required a delicate balance between our ambition for long term impact and the need to be fully transparent on what is feasible in the short term. Building on these pledges and implementing them across our business globally will be a priority in the years to come – we will approach this by using all the levers of our influence and buying power.

In our core investment area, we continue to advance our research and investment processes to elevate ESG considerations in our investment decision-making. We have notably developed new Sustainability Contribution Scores, metrics that reflect the contribution that companies are making to the UN Sustainable Development Goals. Our ESG Research team has also increased the integration of social and societal issues in ESG analysis and scoring. Engaging with our investee companies is another critical part of our approach and we are making improvements by reviewing best practice standards on the most pressing themes in climate, nature, and human rights, to name a few. Enhancements such as these are part of our ongoing efforts to ensure that our sustainable investment capabilities are managed with clear intent and evidencing on the sustainability outcomes.

We are active participants in a number of leading industry initiatives that are at the heart of the transition movement. The COP conferences continue to be a focal point of our annual calendar, and several of our colleagues attended the COP27 conference in Egypt and the Biodiversity COP15 conference in Montreal. With climate and biodiversity being at the top of our priority list, we will continue to support the UN-sponsored agenda in the years ahead. On the social side, we are partnering with the Impact Investment Institute to advance considerations of a just transition, so that we can seek to mitigate the potential negative social consequences and take advantage of the opportunities that the transition offers. Finance for Biodiversity, UNPRI, the One Planet Initiative and Climate Action 100+ are other priority activities for our business.

Overall, 2022 was about the detailed work of setting targets and defining the policies that are required to get there. As we now build on these achievements, our strategic direction is clear, and we look forward to supporting our clients in their sustainable investment goals.

Key Achievements in 2022

Our progress in responsible investing and steps that we took to drive positive change

Mobilising capital to support a more sustainable future

US$55 billion+
assets managed under
Sustainable Investment strategies

Launched investment strategies under the sustainable investment themes **circular economy, climate technology venture capital, sustainable infrastructure** and more

Using engagement as a tool for driving change

We voted at more than **7,000 meetings** with over **75,000 resolutions**

ESG and other issues were raised in engagements with **2,150** companies and other issuers

We joined **10 new industry commitments** including the PRI Advance Human Rights Initiative and the Breakthrough Energy Catalyst to support the scaling up of climate critical technologies for hard-to-abate sectors.

A zoom on advancements in alternatives

US$650 million raised by **Climate Asset Management**, our joint venture with Pollination, across two Natural Capital strategies

We created an Alternatives-specific Responsible Investment policy and established our Alternatives Sustainability Oversight Committee to guide further ESG integration in this asset class.

Net Zero Transition

As part of the Net Zero Asset Managers Initiative, we announced the ambition of reducing

Scope 1 and 2 carbon emissions intensity by 58% by 2030

for 38 % of our total assets under management[1] as of end of 2019.

We published our **thermal coal policy,** which sets out the target timeframe for the active funds we manage to exclude thermal coal companies by 2030 in the EU and OECD, and globally by 2040.

Climate Investment Strategy team, Climate Investment Committee and Climate Implementation Framework have been created to support the development of climate solutions and the integration of climate considerations into our investment processes.

Awards and Recognitions

Awarded **"ESG Advanced"** by Morningstar[2] "Among the industry's strongest ESG proponents" **for a second year running**

#5 ranking out of 42 asset managers assessed in an ESG integration study conducted by Scope[3]

Our efforts in building a diversified and inclusive work environment have won us two recognitions at the **Citywire Gender Diversity Awards 2022**[4]

1. The AUM in scope for the interim target consists of listed equity and corporate fixed income, where data and methodologies in decarbonisation are the most mature. Investments in both developed and emerging markets are covered. 2. Out of 94 asset managers assessed by Morningstar only 17 asset managers earned a Morningstar ESG Commitment Level of Advanced. © Copyright 2023 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. 3. Scope's ESG integration study: notable differences between asset managers (July 2022), 'Exemplary multi-level ESG research on companies, sectors but also selected topics with the aim of both supporting investment teams in their ESG due diligence and providing ongoing training' 4. The two awards won by HSBC AM are 'Most Improved Retention Rates' (female portfolio managers retention in the last 10 years and 'Best AUM Split' (funds managed by male/female portfolio managers). More information can be found on Citywire's website.
Source: HSBC Asset Management and Morningstar, data as of 31 December 2022.

In 2022, we established our Climate Investment Strategy team within the Responsible Investment team. They are responsible for driving insights and implementing frameworks for a low-carbon transition, which are used to inform investment decision making, portfolio management and to support our clients. In addition, this team is in charge of defining our net zero strategy, which includes our journey to align our investments with net zero emissions by 2050 or sooner. This is part of our commitment to the Net Zero Asset Managers (NZAM) initiative. We became a signatory to the initiative in July 2021 and published our first set of interim targets in November 2022. These targets are underpinned by a clear roadmap and represent the first step in a long, multi-stage journey.

Our transition to net zero

As a signatory of the NZAM initiative, we have committed to our interim net zero targets for 2030, which:

- Covers 38 per cent of our total assets under management (based on 2019 figures)
- Consists of corporate fixed income and listed equity portfolios
- Will be achieved through reducing the intensity (tCO2e/$million invested) of our scope 1 and 2 carbon emissions by 58 per cent when compared with our 2019 baseline

Scope and methodology

For our emissions reduction target, we examined our holdings' carbon emissions from year end 2019 to calculate our emissions baseline. More recent years were not chosen because we do not believe they give an appropriate reflection of carbon emissions generated by most sectors due to the pandemic's impact on the global economy.

To define our assets under management (AuM) in scope, we began the process by looking at our total 2019 AuM, and conducted detailed analysis to narrow down our scope based on factors such as data availability and the existence of standard methodologies. The resulting AuM in scope consists of our corporate fixed income and listed equity portfolios, including both developed and emerging markets. Both benefit from market-approved net-zero methodologies – e.g. following the Partnership for Carbon Accounting Financials (PCAF) Standard. We will look to increase our scope of asset classes as new methodologies are released.

Framework and scenario pathway

Frameworks are used as guidelines on metrics, methodologies, and approaches to net zero to help drive consistency, comparability, and credibility across the industry. They also help hold firms to account for delivery of net zero commitments. Our chosen net zero framework is the Net Zero Investment Framework (NZIF), which has been created by the Institutional Investors Group on Climate Change (IIGCC). It has been designed to be used by asset owners and asset managers, considering their different mandates and starting points. It is the most commonly adopted methodology across the industry.

Our chosen scenario pathway is the International Energy Agency Net Zero Emissions by 2050 scenario (IEA NZE). This means that our decarbonisation target has been calculated using economic activity assumptions from the IEA NZE pathway, which is consistent with a global 1.5°C temperature increase as set out in the Paris Agreement. The IEA NZE provides open access to clear, transparent data points, enabling firms to develop methodologies to expand upon the core scenario to evaluate how their specific portfolio will evolve. It also provides global coverage across developed and emerging markets, including key sectors and regions.

Using the IEA NZE pathway, we mapped instruments to pathways based on their sector and region. From this, the instrument emission reductions were aggregated and used to set portfolio-wide emissions reduction targets.

Implementation plan

Our interim target will be revised at least once every five years until 100 per cent of our AuM is in scope for net zero by 2050, as per the NZAM initiative commitment. We will communicate the actions we are taking to implement net zero alignment throughout our investment platform and the organisation.

As we progress in our journey, we will continue to prioritise engagement over divestment in order to influence the issuers and companies that we invest in. We see divestment as a last resort option, used when we deem engagement to be unsuccessful in a timeframe we consider as reasonable for companies to implement desired changes. Our dedicated Stewardship team and the analysts in our asset class investment teams are employed to engage consistently on net zero transition plans of companies we invest in.

Our approach aims to be realistic and authentic about the actions that can be taken now, versus those that will take longer to put in place. We believe this gives strength and integrity to our initial interim targets.

- Fatima Hadj, Climate Strategist, HSBC AM

A stewardship and engagement perspective

> Accountability and progress are vital for climate issues, along with being cornerstones for voting. The necessity of facilitating positive change means that investors are empowered in their stewardship activities, encouraging companies to enhance their approaches in measurable and practical ways for tangible outcomes.
>
> **- Asad Butt, Senior ESG Engagement Analyst, HSBC AM**

2022 saw a record number of climate-related annual general meeting voting items, proposed by either management or investors.

These 2022 proposals called for the development of emission reduction targets, improvements in climate reporting, alignment of targets with a net zero outcome and a greater consideration of environmental risks. With regard to our holdings and when voting was possible, we supported the majority of proposals filed. They were assessed based on the company's climate strategy, our engagements with the company and alignment of proposals with climate science and good practice.

During 2022, we co-led the filing of a shareholder proposal, calling for an energy supplier to create credible emissions reduction targets along with the disclosure of said targets - this was the first climate-related proposal brought to a Japanese company. We also voted against management, including against Chairs or equivalent board members at re-elections, where we felt there had been insufficient consideration of climate risk or inadequate policies and measures at their companies.

Looking forward: supporting asset owners

Our commitment to net zero will further accelerate our focus on developing net zero solutions and expertise, which will benefit our clients and their investment objectives.

For wholesale and retail clients, we already offer multiple sustainable fund offerings that incorporate climate and net-zero (including climate change and lower carbon funds as well as Paris-aligned ETFs). For our institutional clients, we customise our capabilities based on their specific investment guidelines, restrictions, objectives, and their own decarbonisation goals.

As we further develop our climate capability with additional data sources, proprietary research and fundamental transition expertise, we will progressively provide clients with enhanced climate reporting and climate innovative solutions.

Natural capital

Natural capital will play an important role in the net zero transition due to its carbon removal properties and role in preserving biodiversity. It is therefore becoming an increasingly valuable asset class.

Through our joint venture with Pollination, 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.

Industry involvements

There are many market initiatives that have been launched to enable effective climate action. HSBC AM has been engaged with a number of these throughout 2022 and aims to be an active participant in 2023.

Examples of HSBC Asset Management's broader industry involvements

PRI (Principles for Responsible Investment)

Global Climate Action 100+

IIGCC (Institutional Investor Group on Climate Change)

Finance for Biodiversity Pledge

One Planet Asset Manager Initiative

Blue Carbon Pledge

Source: HSBC Asset Management, January 2023.

Our responsible investment policies set out how we apply sustainability beliefs in our investment activity. We have a range of policies explaining our approach to issues including climate change, biodiversity, human rights and banned weapons. These policies are reviewed regularly to reflect developments in our thinking and in client and regulatory expectations.

> Our policy portfolio is an expression of our ambition to be market leaders in sustainable investing. It sets the path for our investment teams as they work to deliver our client objectives and contribute to addressing societal challenges.

- Thomas O'Malley, Head of Policy, HSBC AM

United Nations Global Compact

Our commitment to the UN Global Compact is an important element in our responsible investment policies. As investors we support the ten principles covering human rights, labour issues, environmental action and anti-corruption. We conduct enhanced due diligence on issuers alleged to be in breach of these principles where their securities are held in actively managed portfolios.

Climate change

Our climate change policy is aimed at increasing the climate resilience of our clients' investments, as well as contributing to financing the transition to a low carbon economy. At the heart of the policy are our commitments under the Net Zero Asset Managers initiative – set out in the previous chapter. Our path to net zero requires action to address sectors with the largest emissions held in our portfolios, starting with thermal coal.

Phasing out thermal coal

During 2022, we published a new policy on thermal coal. As well as fulfilling an obligation under the Net Zero Asset Managers initiative, this policy supports the HSBC Group thermal coal phase-out objectives.

Phasing out thermal coal is a priority for early action in achieving net zero emissions. Burning coal for electricity generation is one of the most carbon emission intensive activities in the economy. Unlike some uses where a technological advance is needed to replace fossil fuels – such as finding an alternative to jet fuel for long distance flights – solar, wind, hydro and nuclear power are technologies that already exist for low or zero carbon electricity generation.

Many countries are well advanced in phasing out thermal coal power. But some emerging markets still rely on coal for most of their electricity and need more time for the transition. For that reason, our thermal coal policy allows more time for the emerging markets to phase-out thermal coal.

Our thermal coal policy is a ten-point plan:

1. By the end of 2030, we will not hold listed securities with more than de minimis[5] revenue exposure to thermal coal in EU / OECD markets in our actively managed fund portfolios.
2. By the end of 2040, we will not hold listed securities with more than de minimis revenue exposure to thermal coal in all markets in our actively managed fund portfolios.
3. We do not make direct investments in projects for coal-fired power or coal mining-related infrastructure.
4. Our sustainable funds already exclude thermal coal mining and power generation above 10 per cent revenue exposure.
5. Our actively managed portfolios do not participate in IPOs or new fixed income financing by issuers developing new thermal coal or, unless they have adequate transition plans, those with more than 10 per cent revenue exposure to thermal coal.
6. We conduct enhanced due diligence on active holdings with more than 10 per cent revenue exposure to thermal coal – starting with developed markets. We expect to divest over time where transition plans are inadequate.
7. We continue to engage with issuers, prioritising those where we have the highest exposure.
8. Following engagement & due diligence, we vote against the re-election of chairs of issuers with exposure to thermal coal which do not provide Taskforce for Climate-related Financial Disclosure - aligned or equivalent reporting, and where transition plans are weak.
9. We do not launch new ETFs and index funds including issuers with more than de minimis exposure to thermal coal, unless the strategy has specific Paris-aligned 1.5°C objectives and / or clear divestment pathways.
10. We actively engage with clients to inform and support their own net zero commitments.

5. This threshold would be set at no more than 2.5 per cent of issuers' revenues.

Source: HSBC Asset Management, January 2023.

Developing policy on other fossil fuel energy uses

In December 2022, HSBC Group updated their energy policy to help deliver their financed emissions targets and phase down fossil fuel financing in line with their net zero ambitions. We expect to develop our own energy policy aligned with this during 2023. It will also develop our policy on the use of fossil fuels under our net zero commitments.

Biodiversity

Natural ecosystems are under threat as a result of deforestation, land degradation, pollution of water, air and soil, hunting and harvesting, and climate change. This presents broad challenges for society and a systemic risk for investors. We are signatories to the Finance for Biodiversity Pledge to work to protect and restore biodiversity through our investments. Under this Pledge, we are committed to: work with other investors; engage with companies; assess impacts of our investment on biodiversity; set targets on impacts; and report publicly before 2025. We attended the COP15 in Montréal in December 2022, where a Global Biodiversity Framework was agreed. We expect to develop our investment policies and approach to biodiversity during 2023.

Action to address deforestation

We recognise that ending deforestation has a crucial role in achieving net zero emissions. Deforestation releases carbon into the atmosphere from trees that are cut down and from loss of the ecosystems which they support; it also reduces the stock of trees and plants that absorb carbon from the atmosphere. Our approach to deforestation will be an important element in delivering our net zero targets. Reversing deforestation is also essential in addressing biodiversity loss. We have a long record of engagement to encourage companies to limit deforestation impacts. Between 2017 and 2021, we were lead or co-signatory to 320 letters to companies exposed for deforestation risk as part of the CDP annual campaign to encourage companies to respond to its questionnaire on deforestation. During 2023, we expect to develop further policies to encourage the reversal of deforestation.

Banned weapons

Under our banned weapons policy, the active, systematic and index portfolios which we manage do not hold listed or unlisted equities and bonds issued by companies assessed to have proven involvement in certain weapons banned by international convention, including anti-personnel mines, biological weapons, blinding laser weapons, chemical weapons, cluster munitions and non-detectable fragments.

Our sustainable funds also apply some additional restrictions to companies including, but not limited to, those with involvement in controversial weapons such as nuclear weapons and white phosphorous. These policies do not apply universally to strategies incorporating third party funds.

Human rights

We are committed to respecting human rights and support international principles and standards including the Universal Declaration of Human Rights, the International Labour Organisation's standards and the United Nations Guiding Principles for Business and Human Rights.

More information on our policies and engagement activity is available on our website.

One of our core beliefs is that genuinely embedding ESG at the core of our investment decision-making process contributes to the generation of superior long-term risk-adjusted returns. This year again, we have further improved our scoring and integration processes. We notably focused on two priorities: making our proprietary assessment more holistic and rolling out our virtual sector teams to develop analytical frameworks across sectors.

Enhancing sustainability measurement

Introduced by the European Commission in 2019, the bulk of the implementation of the Sustainable Finance Disclosure Regulation (SFDR) rolled out in 2022. SFDR aims to improve transparency in the market for sustainable investment products and prevent 'greenwashing'. Under this regulation, sustainable investment has been defined as investment that generates net-positive environmental and/or social outcomes. The resulting market-wide challenge has been around measuring individual holdings' environmental and social contribution, while ensuring that positive contributions do not come with negative side-effects – i.e. adverse impacts.

Our proprietary sustainable investment assessment enables these calculations. Over recent years, our methodology has grown from seeking historical revenue alignment to sustainable development goals, to a more holistic view that considers business models, operational activities, and ambitions. This scope enlargement better reflects the company's commitment and actions to address the sustainability challenges. In addition, the assessment also includes a 'Do No Significant Harm' (DNSH) test while considering good governance. This test includes the consideration of principal adverse impacts (PAI), as required by the SFDR regulation. PAI consists of a list of environmental and social factors to be taken into account and reported – these include, among others, greenhouse gas emissions and intensity, carbon footprint, emissions to water or gender pay gap. For example, thermal coal revenue is used as an DNSH exclusion screen to indirectly address the greenhouse gas emission related PAIs.

For all these items, data accuracy and data suitability are key to deliver a comprehensive picture of both positive and negative impacts associated with our investments. Our ESG Research team selects the appropriate data and work with operational teams to deliver the implementation. Importantly, the process is dependent on one third-party ESG data vendor, and whilst using such data, the team constantly challenges the results. In some cases, a different conclusion is reached as a result of the analysis conducted internally, emphasising a more forward-looking view.

SFDR is one of many regulatory regimes we have incorporated into product development. It has been an important feature of solutions design, both in terms of investment process and reporting. To ensure an up-to-date understanding of fast-changing regulation and a successful implementation of our constantly enhancing processes, we conduct regular internal training sessions and workshops across the entire investment platform.

Virtual Sector Teams: aligning sustainability and value creation

Building on our 20+ year experience in ESG integration, one of last year's focuses was to set up a 'materiality matrix' enabling us to capture the most financially relevant ESG criteria. In December 2021, we set up 12 Virtual Sector Teams (VSTs) aimed at leveraging ESG knowledge and establishing greater granularity in our Risk Scoring process across all asset classes and geographies. Acting as sector-focused centres of excellence, their role is to define and assess sector/industry-specific ESG materiality frameworks which form the first steps of our proprietary ESG scoring definition.

Overall, our VSTs are made up of 120+ investment professionals in various offices (including London, New York, Paris, Dusseldorf and Hong Kong). The geographical diversity of the VST initiative optimally combines 'on-the-field' expertise and quantitative rigour. This includes deeper analysis into the ESG risk drivers, a reweighting of E, S and G pillars as well as a specific sector overlay.

Beyond SFDR and other sustainability regulations to come, the whole purpose of ESG integration is to make better-informed investment decisions across all geographies, industries, and asset classes.

- Xavier Desmadryl, Global Head of ESG research, HSBC AM

Virtual sector teams: 12 teams regrouping 120+ investment professionals[7]

	Energy	Materials	Aerospace & Defense	Industrials	Consumer Goods & Services	Auto & Transport	Food & retailing	Healthcare	Financials	Tech Media Telecom	Utilities	Real Estate
Equity (no. of portfolio managers & analysts involved)	5	6	/	7	10	8	6	8	4	11	6	5
Credit (no. of portfolio managers & analysts involved)	7	15	4	11	8	10	7	7	18	10	11	11
Responsible Investment (no. Of specialists from ESG Reseach, Stewardship and RI Investment involved)	3	4	5	3	5	4	5	2	4	3	4	2

7. Each investment professional can be involved in more than one Virtual Sector Team. Source: HSBC Asset Management, March 2023.

Each VST is chaired by a member of the ESG research and integration team acting as the coordinator and the catalyst to ensure global consistency and cross-fertilisation of best practice. Each virtual team also benefits from the support of stewardship and engagement specialists tasked with defining a set of specific engagement questions which help gather valuable investment insights and refine our understanding of the investment case.

In terms of outputs, the VSTs focus on developing analytical frameworks for each of the sectors analysed, identifying the most critical and or financially/material ESG issues. The VSTs also act as the primary forum for reviewing, checking, and assessing the actual level of ESG accuracy of controversial companies. This encompasses assessment of UN Global Compact breaches, involvement in controversial and banned weapons, thermal coal involvement and negative impact on biodiversity.

In addition, we are now developing our ability to convert each issue into a score through identifying representative metrics and data points. We started 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. Progressively, all ESG issues will be approached in the same manner whether these belong to the E, S or G pillars. The methodology applied to build these scores will be consistent, but the nature of the data considered will be substantially tailored.

Source: HSBC Asset Management, January 2023.

Looking forward

After climate and net zero, our next focus will be on utilities. This industry is certainly among the most impacted by all kinds of ESG issues, and as such will be a useful testbed for the implementation of the ESG framework and scoring approach which will extend to cover all sectors and industries.

Simultaneously, we are developing scoring frameworks which will be updated automatically, on a monthly basis, before feeding our reporting systems. To achieve this, we will leverage our cloud platform combined with the data aggregation and back-testing facility, which we will use for data aggregation, score building and back-testing.

Finally, our ambition for the months to come is to further explore emerging themes like the just transition, diversity, equity & inclusion and biodiversity. These themes are fully aligned with those adopted by our Stewardship team through engagement. Our primary objective is not to develop academic or fundamental research, but rather to develop usable insights that will inform our investment decision-making processes.

External recognition

> Exemplary multi-level ESG research on companies, sectors but also selected topics with the aim of both supporting investment teams in their ESG due diligence and providing ongoing training.
>
> \- HSBC Asset Management ranks #5 in Scope's ESG Integration Study[6]

Our commitment in numbers

Our virtual sector teams bring together **120+ investment professionals** carrying out sector-specific ESG research across our investment platform

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 **19,000** financial instruments.

6. Scope's ESG integration study: notable differences between asset managers (July 2022)

Source: HSBC Asset Management, January 2023.

We believe that sustainability and financial dimensions go hand-in-hand in sustainable investing. In an environment where sustainable investment regulations are complex and rapidly evolving, it is important to establish internal investment standards to support the development of our funds and ensure consistency across our asset classes. This was especially the case in 2022, where we saw a range of new regulations and reporting requirements get introduced. Oftentimes, the interpretation of regulatory requirements could differ across the industry. To establish what sustainable investing means at HSBC Asset Management, we have been contributing to the continuous development of our Group Sustainable Investment Definitions Framework ('Definitions Framework') since 2020.

The Definitions Framework is used internally as an investment standards guide and has been key to ensuring consistent standards when designing strategies to meet a range of client sustainable investment objectives. It has also allowed us to articulate 'what good looks like' in an industry that is rapidly evolving.

To summarise, we consider a sustainable fund as one that promotes or delivers strong and/or improving sustainable outcomes alongside financial returns. ESG integration and exclusions on their own are not sufficient to qualify a fund as sustainable. Rather, a fund's intentionality towards sustainability is embedded throughout the investment process, product design and fund structure.

We consider sustainable investing along a spectrum, from broad based strategies that promote sustainability considerations to more concentrated strategies that target specific goals or outcomes. To support a range of investor objectives, they can span across asset classes, strategies and themes. If a fund meets our sustainable investment criteria, they typically align to the underlying classifications which form the basis of our Definitions Framework. We are continually re-assessing and evaluating our standards to reflect industry best practices.

Our Definitions Framework is complemented by HSBC Asset Management procedures and bespoke frameworks to support specific regulatory regimes in markets where we operate. In order for products to be classified as sustainable externally in each respective regulatory regime, they will need to comply with local regulatory requirements which may differ from market to market.

2022 was a key year for accelerated demand for sustainable products, clearer standards set by new regulation and the need to enhance governance, reporting and monitoring of sustainable products. This required an agile and focused approach to documenting standards and frameworks to ensure we adhere consistently to these requirements.

- Ruwan Madura, Acting Head of Responsible Investment, HSBC AM

Managing greenwashing risks

To help mitigate 'greenwashing' risks, the Responsible Investment team introduced the multi-tiered governance structure in 2021, which is detailed in the 'Governance' section of this report. Its purpose is to strengthen the oversight of our sustainable investments capabilities by establishing coordination forums and committees that include risk, compliance, and investment capability functions. This is important to the upholding of our sustainable investment standards and the prevention of 'greenwashing'. This governance structure includes the ESG Investment Committee that approves all products being aligned to the Definitions Frameworks and relevant regulatory regimes, and the Sustainable Portfolio Review Committee that monitors all sustainable portfolios against their objectives and targets.

We contributed to shaping our HSBC Group Sustainable Investment Definitions starting in 2020. Our Group collaboration helped foster deeper dialogue across manufacturing and distribution, establish HSBC best practices across businesses, encourage consistency of interpretation and application, and ensure good governance for our sustainable investment definitions. We believe this has been critical in supporting key product innovation, consistency and transparency.

- Andrea Griffin, Head of Responsible Investment Specialists, HSBC AM

Our stewardship approach incorporates exercising shareholder rights through voting and an outcomes-oriented approach to engagement for all asset classes. Research on systemic and material issues that impact long-term business value creation also forms part of our approach. These stewardship activities help the core of our business by directly supporting investment decisions.

As stewardship involves an ongoing and constructive dialogue with relevant stakeholders, it may ultimately be more effective than disinvestment to nudge changes in policies and behaviours.

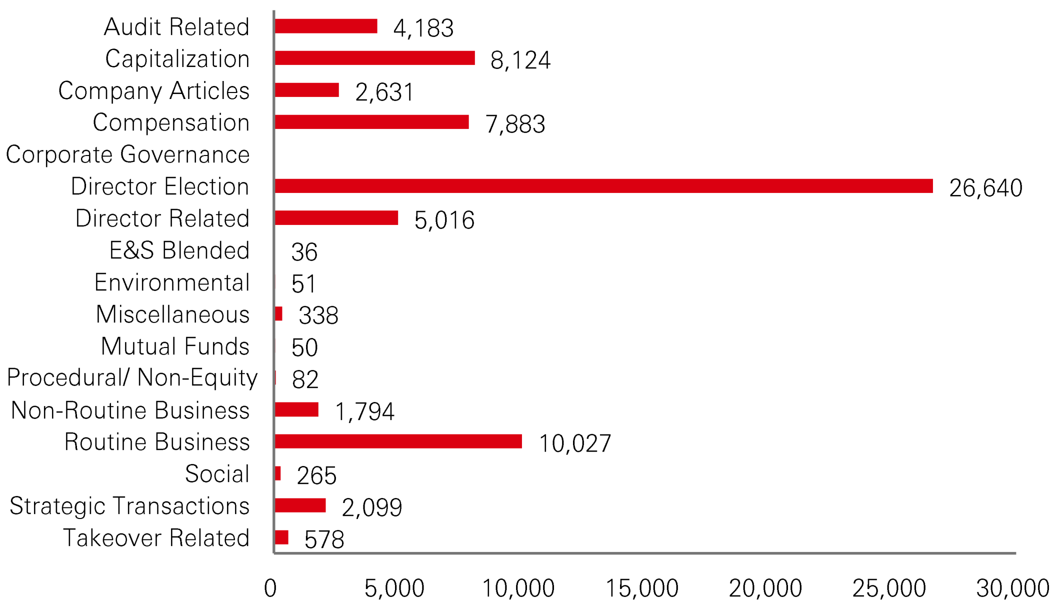
- Sachi Suzuki, Senior ESG Engagement Analyst, HSBC AM

Voting in numbers

In 2022, HSBC AM voted at more than 7,000 meetings, with over 75,000 resolutions.

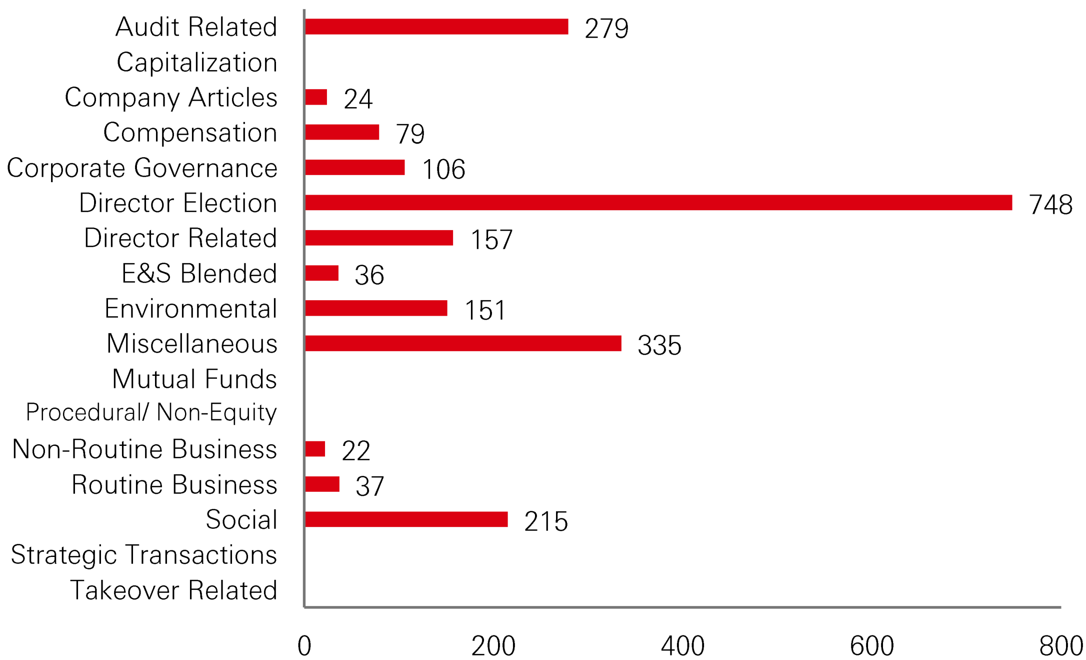
Last year, we voted 85 per cent of resolutions in line with management, compared to 89 per cent in 2021. By geography, the top five markets account for over 60 per cent of the total votes cast.

Management (votes cast by proposal category)



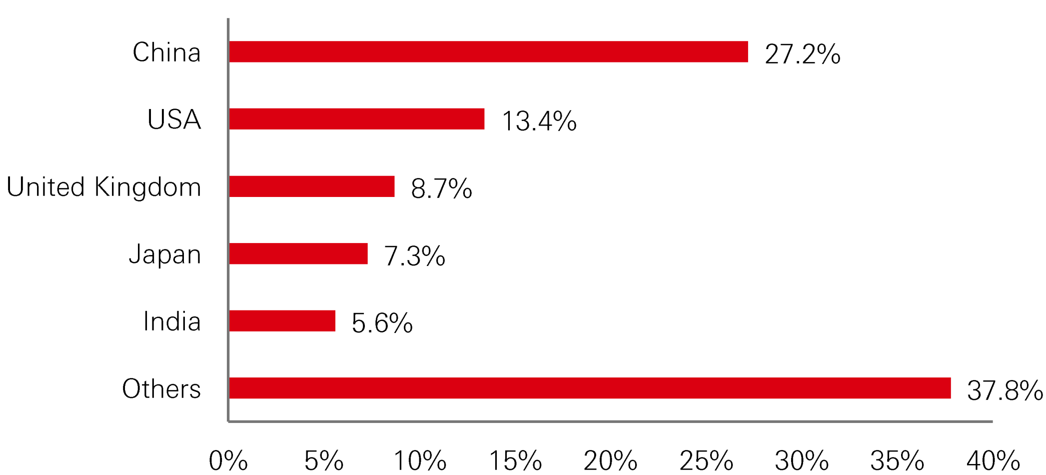
Source: HSBC Asset Management as of 31 December 2022.

Shareholder (votes cast by proposal category)



We introduced the Proxy Voting Dashboard to increase transparency, where voting information is publicly available online and in real time. There are five years of vote information statistics, dating back to January 2017. Voting can be searched by market, company name, security identification number or ticker number. The dashboard consists of votes cast by proposal category, which are separated by management or shareholder proposals.

Resolutions by Country



Source: HSBC Asset Management as of 31 December 2022.

We introduced five custom market voting policies for China, Hong Kong, the United States, Japan and India, to complement the existing market specific policies for the United Kingdom and the regional policy for Continental Europe. This is to ensure that our voting policies reflect the markets we are most active in as a shareholder, and to ensure that the policies are customised to market-specific expectations.

By industry, the top sectors that cover over three per cent of the total number of resolutions include:

Sectors	% of meetings out of total voted
Industrials	15.4
Financials	14.1
Information technology	12.3
Materials	11.8
Consumer discretionary	10.5
Real estate	8.4
Health care	8.3
Consumer staples	6.7
Communication services	4.7
Utilities	4.0
Energy	3.8
Total	**100.0**

Source: HSBC Asset Management as of 31 December 2022.

Engagement in numbers

In 2022, we introduced our annual Stewardship Plan, with a summarised version publicly available online. The plan includes a new, outcomes-based, and milestones-led approach to engagement, aligned with the UK Stewardship Code. There were 299 engagements that follow this new approach in 2022, 8.7 per cent of a total of 3,456 engagements.

ESG and other issues were raised in engagements with 2,150 companies and other issuers during 2022. A breakdown of the list of ESG issues engaged on are as follows[7].

Issues	Number of engagements on related topic
Environment	
Climate Change	1102
Water/Natural Resources	841
Pollution Waste	332
Social	
Labour, Sourcing & Safety	955
Inequality	743
Product, Liability & Safety	259
Human Capital Management	258
Governance	
Corporate Governance	1324
Strategy & Capital Use	1018
Corporate Behaviour	744
Leadership Chair/CEO	714
Remuneration	703
Financial Performance	660
Firm Strategy Purpose	500
Corporate Reporting	375
Risk Management	310
Shareholder Rights	72

- 20.5 per cent of engagements are with Chief Executive Officers (CEOs) and 14.3 per cent with Chief Financial Officers (CFOs)
- 1.8 per cent engagements are with board chair or committee chairs on boards, 0.9 per cent with other board directors. Engagements also took place with Chief Sustainability Officers (CSOs), corporate secretaries and legal counsels

7. Multiple issues can be raised with the company during one meeting
Source: HSBC Asset Management as of 31 December 2022.

Thematic engagement

We actively participate in external initiatives that align to our stewardship beliefs, including:

Workforce Disclosure Initiative (WDI)[8]

We are an active member of WDI initiative. The initiative aims to improve corporate transparency and accountability on workforce issues, provide companies and investors with comprehensive and comparable data and help increase the provision of good jobs worldwide. Notably, the collaborative engagement allowed us to compare the ESG performance of major UK based supermarkets over a number of years, which contributed to decisions on whether to co-file shareholder proposals.

HK Board Diversity Initiative[9]

This is a group of asset owners and asset managers, with the aim to improve board diversity among Hong Kong listed companies. We are an active member of the initiative, writing to 26 companies with no women on their board to express our concerns.

CDP Non-disclosure campaign[10]

A collaboration with capital markets signatories to engage with companies that have failed to respond to requests to disclose through CDP climate change, forests and/or water security questionnaires. We have supported active outreach of 16 international companies on climate, water, and forest questionnaires.

Business Commission to Tackle Inequality (BCTI)[11]

Its mission is to tackle inequality, with priorities of inclusive growth and shared prosperity. We contributed to several of their working groups during 2022, including the Future of Work, Human Rights, and Distributing Value and Risk Equitably, which have helped to inform our engagement.

Climate Action 100+

An investor-led initiative to engage with the world's largest corporate greenhouse gas emitters to take action on climate change.

8. https://shareaction.org/investor-initiatives/workforce-disclosure-initiative
9. https://www.boarddiversityhk.org/
10. https://www.cdp.net/en/investor/engage-with-companies/non-disclosure-campaign
11. https://tacklinginequality.org/

Engagement in practice

Multinational natural resource trading and mining company – Climate Action 100+ collaborative engagement with objectives completed.

Source: HSBC Asset Management, January 2023. This section refers to HSBC Engagement activities in 2022. 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.

Objective

- Strengthen short term targets such as ending a new greenfield project
- Improve disclosure around capex plans that are Paris-aligned
- Establish and disclose a just transition strategy for impacted assets and communities
- Set specific targets linked to remuneration that shall lead to absolute emission reduction

Activity

The company's emissions targets are misaligned with a 1.5-degree Celsius trajectory. We engaged with the CEO to voice our concerns over assumptions used in Paris aligned scenario analysis. We co-filed a shareholder proposal asking for improved disclosure on 1.5-degree Celsius alignment in December 2022.

Developments

In November 2022, the company committed to withdraw applications for approval for a new greenfield coal mine and pledged to a just transition plan. The company also enhanced its medium-term greenhouse gas emission reduction target from 40 per cent to 50 per cent by 2035, to come primarily from reduction in coal assets. It also stated its intention to leave the World Coal Association.

Our stewardship plan

In 2023, we will continue to build on the 2022 Stewardship Plan to deepen existing thematic priorities. Our core themes for this year include:

1. **Climate change**: support a just transition, disclosures of emissions reporting, public net zero commitments and risk management within climate strategies.

2. **Biodiversity and nature-based solutions**: engage with companies to have a comprehensive biodiversity policy, time-bound targets to realise their ambitions, and biodiversity-related KPIs.

3. **Human rights**: engage on how companies ensure to respect human rights through their operations, products/services and value chains, and encourage them to communicate their impacts.

4. **DE&I**: set appropriate objectives for issuers in our engagement coverage using our engagement framework and engage with stakeholders to enable systemic change.

5. **Inclusive growth and shared prosperity**: engage on company practices on economic inequality, tax responsibility, workforce enhancement and cost of living, capital allocation and the mission economy.

6. **Public health**: engage with companies on broader healthcare related topics, and where appropriate, assess companies' contributions to making healthcare more affordable and accessible.

7. **Trusted technology and data**: we will examine whether effective data protection, data security and data breach prevention strategies have been integrated into information security policies. We aim to encourage greater alignment of company policies and practices with standards and obligations under the UN Guiding Principles.

We believe that our deep understanding of environmental, social and governance issues enriches our investment decision-making and contributes to sustainable long-term investment performance. As such, HSBC Alternatives seeks to identify and assess material ESG issues as part of our investment process, and aims to ensure that these issues are properly managed over the lifetime of our investments. We are, however, cognisant of the specific challenges involved with implementing responsible investment best practices in alternative asset classes due to the idiosyncratic nature of the asset classes, the lack of data and standard market frameworks.

Consequently, we mobilised our resources to build our own framework, with a clear articulation of what is endeavoured and how this process will be managed and governed. Our alternatives-specific responsible investment policy, published in 2022, provides the overarching charter for our responsible investment approach across all alternative capabilities. 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 that apply across the Alternatives platform, such as materiality risk assessment, engagement, reporting, and oversight.

Successful implementation of responsible investment best practices within alternatives requires strategic coherence, ongoing governance, and continual evolution and improvement of integration processes. With this ethos in place as a foundational driver for our alternative capabilities, 2022 saw each team continue to enhance their respective process and in so doing we created more client solutions to meet increasing demand.

– Michelle Hilliman, Head of Responsible Investment and Business Management, HSBC Alternatives

Real assets

In 2022, we prioritised real assets for early action. Real assets account for over 60 per cent of greenhouse gas emissions in the OECD[12]. Given this, cross-investment team working groups in Infrastructure and Real Estate were established, with investment specialists from the direct and indirect teams across geographic locations. These knowledge forums help us embed market best practices into our investment decision-making and support the enhancement of existing strategies along with the development of new ones.

12. Financing Climate Futures: Rethinking Infrastructure – OECD

Infrastructure

During the year, we expanded our infrastructure capabilities, unleashing greater potential to support a net zero transition. In March, we added a listed infrastructure equity team, increasing our sustainable infrastructure solutions to investors and giving them access to a highly diversified portfolio of infrastructure companies that support a just transition with daily liquidity. After joining, the team undertook a review of their ESG scoring process with the support of our responsible investment resources. They have built an ESG database of 400+ variables to inform enhanced due diligence undertaken by the analysts. The team also undertook several ESG driven engagements, in conjunction with the Stewardship team, aimed at understanding ESG challenges faced by investees and encouraging management teams to improve practices and outcomes.

We also plan to extend our Asia coverage with the acquisition a Hong Kong energy transition infrastructure team specialising in direct equity investments. The Asian infrastructure sector is a strategic priority due to the region's large share of global greenhouse gas emissions and the scale of the impact we can potentially generate. Asia Pacific accounts for more than half of global energy consumption, with 85 per cent of that regional consumption sourced from fossil fuels [13]. In 2023, HSBC Alternatives aims to launch two energy infrastructure transition solutions in Asia.

On the credit side, the infrastructure debt investment team continues to invest in energy decarbonisation across the globe. Through the year, the team enhanced and refined their proprietary asset class-specific ESG scorecards which now cover power and utilities, telecommunications, oil and gas, transportation, and social infrastructure. Each sector has its own materiality factors and specific weightings for those factors. In 2022, around 95 per cent of total investments made by the team were in assets rated 'good' or 'strong' under the enhanced ESG rating system, which means these investments generate neutral to positive impacts on the environment and society.

Real Estate

The real estate sector alone currently consumes a third of global energy and contributes nearly 40 per cent to global greenhouse gas emissions[14]. The key priority to achieve sector decarbonisation targets is renovation of existing building stock to a zero-carbon-ready level – 20 per cent of the existing building stock needs to be converted by 2030 to be on the path to Net Zero by 2050. This is equivalent to an annual deep renovation rate of over two per cent from now to 2030 and beyond[15]. Our Real Estate teams focus on identifying attractive investment opportunities that can be economically refurbished to improve their sustainability features throughout the life of the asset to realise value creation.

In 2022, our team in France obtained the Socially Responsible Investment label for their flagship real estate fund. This label, created by the French Ministry of the Economy and Finance, aims to identify investment funds with a proven socially responsible investment methodology with measurable and concrete results.

13. International Renewable Energy Agency (IRENA) Asia and Pacific (irena.org)
14. World Green Building Council.
15. International Energy Agency (IEA).
Renovation of near 20% of existing building stock to zero-carbon-ready by 2030 is ambitious but necessary – Analysis - IEA

Direct lending: a case study

Partnering with HSBC UK, our team developed a UK Direct Lending strategy allowing our client to access loan origination opportunities. We have the right, but not the obligation, to invest alongside the Bank in each deal. Our process also allows pre-investment engagement with companies. As an illustration, there was an opportunity to refinance an existing company loan via a sustainability-linked loan (SLL). These loans achieve their sustainability impact by linking pricing to the attainment of measurable goals, usually though interest rate 'step-ups' or 'step-downs'. These SLLs enable borrowers to credibly signal their ESG commitments to external stakeholders, while lenders supply financing with the downside protection that good ESG practices can provide.

Our engagement, coupled the expertise of HSBC Commercial Banking's Sustainability team, helped the company to define ambitious performance targets around three pillars: climate action, waste reduction and making charitable donations. These annual targets will be published in the company's annual report and verified by an independent third party, and the company will receive a margin discount, or penalty.

Venture capital

As we get closer to the 2030 interim checkpoint, the role of innovation becomes more crucial than ever. Investment in technology focused on climate change reached historic highs in 2022. Venture funding for climate tech start-ups totaled $52 billion during the first three quarters of 2022, representing more than a quarter of total venture funds[16].

Over the year, our Venture Capital team made great strides in building our responsible investment propositions, with the first closing of a fintech fund and the deployment of long-term capital in a climate-tech fund. To support decision-making and negate the dearth of data for early-stage companies, we utilise specialised ESG data providers to prepare independent ESG due diligence reports and assess the alignment of investments to the UN Sustainable Development Goals. Given the nature of venture capital investing, engagements with prospective investee companies are also critical. As such, the investment team actively engages with portfolio companies about the ESG risks identified and emerging, often as a member or an observer on the company's board.

Hedge funds and private market solutions

Our Indirect Alternative investment teams invest in third-party manager strategies to provide clients with private equity and hedge fund asset class solutions, amongst others. Strict due diligence is undertaken to monitor ESG risks and engage with third-party managers as appropriate. We developed a proprietary ESG questionnaire which is completed by all third-party managers with whom we invest. In addition, dedicated ESG interviews with each manager by the investment and operations due diligence teams are required to determine our final ESG ratings. During 2022, the ESG framework was refined further by including Principal Adverse Impacts requirements and more policy-related documents as well as a continued refinement of the weighting scheme used.

16. PWC Climate Tech 2022 Report.

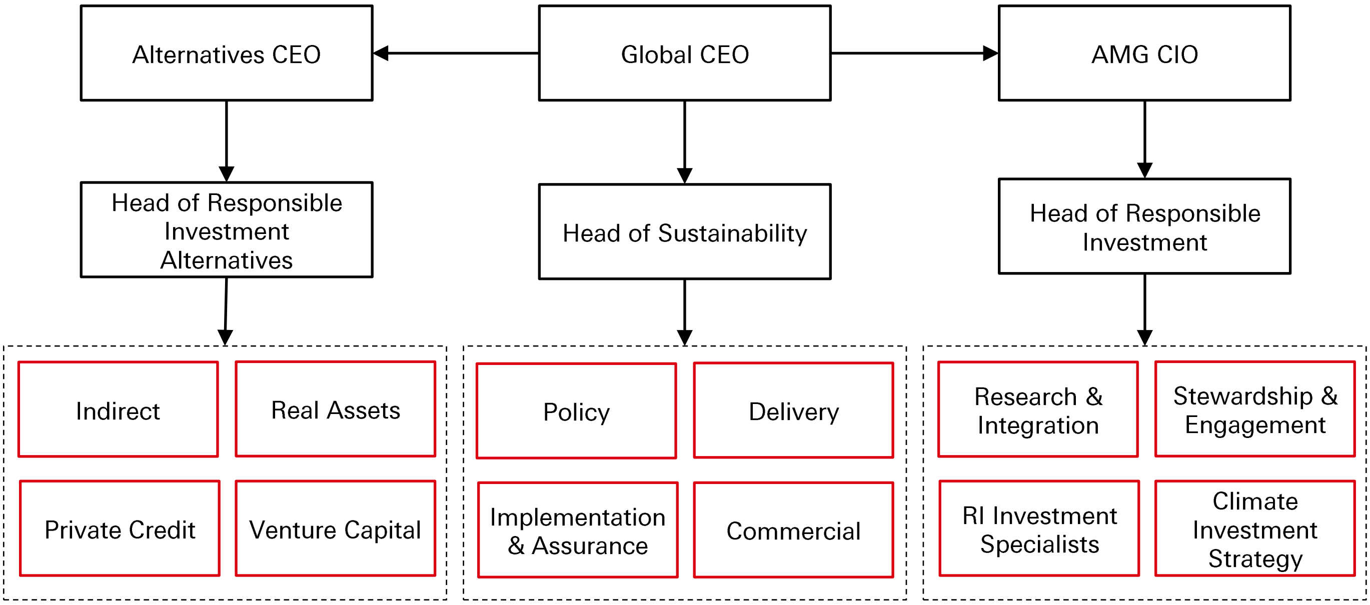
To meet our sustainable ambitions and embed sustainability across our business, strong governance is crucial. Investors assess asset managers on their ability and capacity to deliver on sustainability commitments. Similarly, regulators in most regions require asset managers to demonstrate that they are adequately monitoring and mitigating sustainability risks. Internally, clear and strong governance is also a powerful way to showcase to our own teams the importance we put in sustainability. It generates awareness, strengthens our culture and builds our collective pride in contributing to something positive.

For all these reasons, ensuring we have clear and strong sustainability governance is a key and constant priority to HSBC AM. We have continued to reinforce our governance structure, having notably formalised the oversight of HSBC Alternatives, added a commercial pillar to our Sustainability Office, and created a Climate Investment Strategy team within the Responsible Investment (RI) team.

Our current governance

At the end of 2021, we established a global sustainability governance structure. This global approach enables us to strengthen synergies and ensure we are consistent across the organisation.

Our sustainability governance structure



This chart is representative of inputs and responsibilities, and does not represent official reporting lines. For informational purposes only. Source: HSBC Asset Management, January 2023.

The Sustainability Office and the RI team work in partnership to deliver on our objective of becoming a leader in sustainable investing. We believe our clients benefit from this dual structure as it allows us to increase our focus and resource alignment, helping to develop innovative products and solutions consistent with our sustainability commitments. Alongside the traditional asset classes RI team, we have a dedicated team focusing on alternatives in order to address the specificities of this market.

The Sustainability Office is responsible for setting our strategic approach to sustainable investing and for driving the delivery of the transformational agenda. The RI team is responsible for ESG integration (standards, best practices, and implementation) throughout our investment activity for traditional asset classes, developing new ESG, climate and thematic products and solutions, and for stewardship activities as well as research and innovation.

Although spanning across different areas of expertise, the RI team operates as a single collaborative team. As part of Investments, the RI team works hand in hand with asset class teams in integrating ESG in all stages of the investment processes and in product development. Another key role of this team is to establish sustainability frameworks, such as the Definitions Framework and regulatory regimes. This includes SFDR, impact analysis of sustainability policies on investment strategies, creation of proprietary sustainability and ESG scoring, product design standards, sustainable product approval and monitoring of these against sustainable objectives and targets.

The Alternatives team is responsible for ESG integration across non-traditional asset classes, including oversight of best practices, governance and product strategy in conjunction with the head of each Alternatives Capability. The function works closely with the Sustainability Office and the traditional assets RI team to ensure alignment and cross-fertilisation of best practices.

Structure as an enabler

Our sustainability governance structure

HSBC AM has set up several global committees to support the work and governance of RI-related activities, with the formalised oversight of strategies and policies of traditional asset classes, as well as enhanced Alternatives governance, feeding into the structure. This includes, (but is not limited to):

Sustainability Forum

The Sustainability Forum includes our Global CEO and various members of our senior leadership team. Chaired by our Head of Sustainability, this Forum provides strategic vision, objectives and oversight to the development and execution of sustainable implementation plans.

More specifically, this committee formally approves policies, product guidelines, external commitments, and fiduciary responsibilities. The Sustainability Forum reports to the HSBC Asset Management Risk Management Meeting.

The ESG Investment Committee

The ESG Investment Committee oversees ESG integration processes (and any relevant policies) across traditional asset classes and thematic issue areas. The committee has an important role to play in ensuring that policies and processes are maintained, consistently applied and that the right resources are allocated to support. The Committee includes senior members of the investment function with operational oversight on ESG integration; this includes the Global CIO, Asset Class CIOs, Head of Risk, Head of Stewardship, Head of Responsible Investment and Head of Sustainability.

The ESG Investment Committee has several sub-committees each focusing on specific topics such as stewardship or portfolio review.

This chart is representative of inputs and responsibilities, and does not represent official reporting lines. For informational purposes only. Source: HSBC Asset Management, January 2023.

Asset Class ESG Committees

We also hold monthly Asset Class ESG Committees for traditional asset classes, which ensure our investment teams are consistently implementing ESG integration, monitoring enhanced due diligence risks and engagement progress (for example, reviewing and monitoring engagement activity, setting engagement milestones). The purpose of the Asset Class ESG Committees is to promote best practices of ESG integration throughout our asset classes. These committees are attended by our Global and Regional CIOs, Investment teams and our Responsible Investment Specialists.

Alternatives Sustainability Oversight Committee

We have established an Alternatives Sustainability Oversight Committee within HSBC Alternatives to oversee the integration of ESG across the alternatives platform, and to ensure alignment with responsible investment and sustainability policies and principles across AM. As considerations for illiquid and alternative asset classes differ from traditional listed assets, there are Alternatives Asset Class Investment Committees to review and approve investments recommendations presented, as well as Asset Class Oversight Committees to monitor ESG developments.

The evolution of our governance in 2023

HSBC AM has designed this global sustainable governance to generate synergies and to ensure consistency across the organisation on our approach to sustainability. HSBC AM is building on its existing framework to facilitate the flow of information and the decision-making in the relevant global and local committees.

Biodiversity underpins all we need to survive. It provides us with water and food as basic essentials, plays a key role in helping to address climate change, and delivers economic benefits that support human development.

According to the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES), there has been a 68 per cent decrease on average in the population sizes of mammals, birds, amphibians, reptiles, and fish between 1970 and 2016 – a decline occurring at a greater rate than at any other time in human history. The IPBES identified the main drivers of biodiversity loss as habitat loss, overexploitation, pollution, climate change, and invasive species. These drivers are continuing to increase at an unsustainable pace, and nearly one million species are currently at risk of extinction, many within decades.

Addressing biodiversity loss requires a collective effort from all of society, from government regulations like Sustainable Finance Disclosure Regulation and the EU green taxonomy, to action from companies and their supply chains. As companies rely on biodiversity too, investors and consumers alike are increasingly seeking companies with business models that help to restore rather than degrade biodiversity. Large-scale investment in nature-based solutions such as restoring peatlands, mangroves or ocean ecosystems are some of the opportunities.

HSBC AM has been focusing on biodiversity as a key area, which we are implementing namely through engagement (including voting), policies, and ESG integration frameworks.

Engagement

In addition to engaging with companies on avoiding and minimising negative impacts on biodiversity and ecosystem services, we believe the topic is best approached by focusing on specific aspects that impact biodiversity. These include aspects like deforestation, regenerative agriculture, animal welfare and water management – all aligned with our Biodiversity Policy which was published in 2022.

Biodiversity was part of the conversation in 841 of our engagements with companies in 2022, out of a total of 3,456 engagements. Using internal and external sources including the Farm Animal Investment Risk and Return (FAIRR) Protein Producer Initiative assessment and MSCI Natural Resource Management Scores, we developed a short-to-medium term list of companies to focus our engagement efforts on, given their high impacts and dependencies on biodiversity. In addition, we engaged with companies based on where we have significant ownership, where we believe there to be a good chance of engagement success, and where the company is held in a fund with higher sustainability expectations.

Our engagements with companies focused on understanding their impacts and dependencies on biodiversity, how they are mitigating biodiversity risks - including policies – and encouragement around disclosure on biodiversity through existing and emerging reporting frameworks. We also participated in collaborative engagements at a national and international level through groups like CDP and FAIRR to facilitate and strengthen engagements with companies.

Voting

In 2022, we introduced a new policy to vote against the chair or relevant board directors of companies that are on our 'Say on Nature' watchlist. The list consisted of around 60 companies, based on third party assessments as well as internal analysis of how companies are managing biodiversity and nature-related risks.

During the 2022 voting season, we voted against 16 directors based on our concerns about their companies' management of nature-related risks (typically only a portion of company chairs, alongside other directors, face re-election every year).

Very few shareholder proposals directly address biodiversity and nature, however, we have supported 25 shareholder proposals related to the main drivers of biodiversity loss identified in the landmark IPBES study.

ESG integration

The finance industry has previously struggled with understanding how to account for the importance of biodiversity impacts due to the lack of data and standardised frameworks. Since 2018, we have been working closely with investment teams to build an ESG framework and create ESG checklists by industry to tackle ESG risks and opportunities, as well as offer some guidance on engagement questions.

Biodiversity indicators are included into our ESG scoring at two levels. The first level of integration uses granular indicators, from which our third-party provider assesses biodiversity on several angles. These include indicators like the impact of lost species, exposure to company operations in regions with fragile ecosystems, management of efforts to increase biodiversity/reduce biodiversity loss.

The second level of integration is through screening for controversies. Any severe controversy linked to biodiversity will be screened out from our analysis for our existing holdings and discussed within the investment team on a case-by-case process. To help us with the screening, we use several third-party providers that utilise artificial intelligence, such as RepRisk.

As an example, the following table indicates the number of flagged companies when using RepRisk for controversies around topics like endangered species, forest burning, plastics and indigenous people.

RepRisk numbers of companies flagged[17]	2020	2021	2022
Very severe controversies	100	332	381
Severe controversies	1650	1929	1927

An innovative investment solution

In 2022, we launched an open-ended biodiversity screened passive strategy. The objective is to provide investors with a tool to build biodiversity considerations to their portfolios by investing in companies that have stronger biodiversity credentials. The strategy aims to track the Euronext ESG Biodiversity Index series which we jointly developed with Euronext and Iceberg Data Labs. The strategy has European Article 8 SFDR classification.

17. RepRisk categorises how severe a controversy is deemed to be based on consequences, extent and intentionality of an incident. There are 3 levels of severe controversies, with 'very severe' being the highest category.

Our voice in the industry

We have contributed to numerous biodiversity initiatives over the year, including the following:

- We contributed to a new guide under the Finance for Biodiversity pledge, titled 'Act Now! The Why and How of Biodiversity Integration by Financial Institutions', which launched during a side event at the UN CBD COP15 conference.
- We participated in numerous COP15 activities including panels, the Finance for Biodiversity Negotiating position, the launch of the Business Handbook for Biodiversity Conservation, and the Business for Biodiversity Conservation Cases
- We took part in testing the beta framework to contribute to the development of the Taskforce on Nature-related Financial Disclosures (TNFD).
- We participated in the consultation process of the World Benchmark Alliance Biodiversity Benchmark and the InfluenceMap Biodiversity report.
- We published an ESG Insights – Biodiversity Paper introducing the concept of biodiversity, the current crisis we face and how nature loss is a major risk for companies while nature-based investments offers opportunities

2023: enhancing our approach to biodiversity

As part of our engagements, and as detailed more comprehensively in our 2023 Stewardship Plan, we will expect companies to recognise the importance of biodiversity loss. This includes companies presenting a plan that aligns them with a biodiversity positive future, and reporting their progress on biodiversity-related key performance indicators through reporting frameworks. We will also expect companies to positively influence system-level change through participation in industry associations and biodiversity-related public policy.

On voting, we will use more data sources to enrich our watchlists, and will raise our expectations of the monitored companies. On our 'Say on Nature' watchlist for example, we will incorporate information from Iceberg Data Labs, the World Benchmark Alliance's Nature Benchmark and the Seafood Stewardship Index.

Preservation of biodiversity is one of the environmental indicators assessed within the ESG Virtual Sector Teams mentioned in the ESG Research and Integration section. We will continue to refine this approach in 2023 to assess and understand corporate biodiversity footprints.

We believe climate change is among the most significant threats to economic and social development worldwide – particularly in emerging markets. Tackling the climate crisis requires an extensive economic transformation, especially in areas such as energy, power, manufacturing, transport and food systems. However, this process must deliver benefits to the largest possible number of people for it to be sustainable. That's why the concept of a just transition – greening the economy in a way that is as fair and inclusive as possible – is so important.

Too often, the focus on climate change means we lose sight of the overall goal of building a greener, more inclusive and more equitable world. We cannot look at climate goals in isolation; we have to combine them with actions that help all members of society. If we don't strive for that just transition, our ambitions for the environment will be at risk.

– Fatima Hadj, Climate Investment Strategist, HSBC AM

The importance of the 'S' in ESG

Ensuring a just transition is crucial in supporting social cohesion and economic stability over the long term, underpinning the operating environment of the companies that we invest in. We are convinced that incorporating the notion of just transition into our investment philosophy and processes will inform our decision-making when investing. Concretely, it means that we have to monitor and assess the potential externalities that can have a negative impact if not managed well, e.g. poorly managed redundancies leading to low morale, operational disruptions from union strikes, and community protests. This is crucial since they could eventually become systemic detractors to the development of a company.

When transitioning to a greener business model, a company can, for example, neglect the potential impact it will have on local communities and its employment practices, potentially leading to negative outcomes for these groups. This could eventually reduce the company's ability to maintain or develop margins, shrink its customer base, detract its brand, and more.

That is why, when we evaluate companies, we look beyond the financial performance and environmental impact, and pay specific attention to the 'S' of ESG. Since the scope of potential societal issues is especially large, assessing them in an exhaustive way remains a challenge. Nevertheless, there are indicators that can help us to measure a company's societal footprint. Among others, labour policies, gender diversity and supply chain management are valuable inputs.

Supporting a just transition through engagement and stewardship

Effective engagement helps provide greater transparency and insights on the climate strategies of companies, as well as material societal and governance factors. This may help us identify companies with better sustainability profiles or, conversely, discover issues that pose a risk to a company's sustainability and investment potential. Indeed, there are many examples of businesses that have high environmental scores but lag in terms of the 'S' and 'G' criteria. A just transition lens brings together these considerations in a more holistic perspective.

Consequently, we have further developed our Stewardship Plan and created a specific thematic module on just transition under the climate change theme. During the year, we initiated just transition discussions with a number of portfolio companies, both to have a better perspective on their strategies on the topic and to share our expectations. As part of these engagements, we encouraged companies to consider including factors such as employee reskilling, engagement, mediation, and community investment in their climate strategy, as well as plans to repurpose and decommission assets in a responsible manner. We encouraged the disclosure of social risks and considerations associated with the energy transition in reporting, and shared best practices around supply chain engagement.

Stewardship, as realised through voting and engagement activities, is one of the most powerful tools asset managers and investors have available to influence corporate behaviour. As we continue to assess and engage with investee companies on their net zero strategies, we expect to see improved disclosures of their just transition considerations, and how these could impact their key stakeholders including workers and local communities.

– William Ng, Senior ESG Engagement Analyst, HSBC AM

Indeed, engagement activity is sensitive to regional and sectoral differences while still respecting global standards for companies and assets. As Asia continues full steam with its energy transition and decarbonisation journey, we expect our investee companies to further develop their climate commitments, with more details of their strategies and targets. We expect these strategies to include a social impact component, to consider the equity and inclusivity of the company's transition plans, and their engagement with relevant stakeholders.

A just and inclusive climate transition: An investment stewardship perspective

> We have laid out our stewardship vision to help shape a sustainable world that is fair and inclusive in one of our Responsible Investment Insights.

Collective action for a just transition

At a global level, we expect more climate and just transition commitments from governments in 2023, having already seen social impact included in one of the key pillars of the G20 Transition Finance Framework[18], announced during the G20 Summit in November 2022.

In the private sector, more groundwork in corporate disclosures will be necessary to improve market transparency and just transition related data and metrics. We expect 2023 will bring more concerted efforts to join the dots between social impacts and environmental objectives, whether through investment policies, stewardship activities, or product innovation.

We believe that financing a just transition requires collaboration and partnerships between industry, financial institutions, policymakers, civil society, and multilateral organisations.

During 2022, we are proud to have joined the Impact Investing Institute Just Transition Finance Challenge[19], actively participating in roundtables and sharing our feedback on draft criteria that will underpin the just transition label for investment products. We continue to collaborate with the Impact Investing Institute to develop the label and drive industry standards to enable a just and orderly climate transition.

We also joined Advance[20], an investor-led stewardship initiative coordinated by UNPRI to address human rights and labour risks, focusing on the renewable energy and metals and mining sectors. As we collaborate with other investors, we expect this will be a good opportunity to engage with target companies on human rights topics broadly, and on including just transition considerations in their climate strategies.

Mobilising the funding needed for a just transition

> As an asset manager operating in both developed and emerging markets, we know that directing financial flows only to the most advanced countries will not address the overarching problems that we are seeking to resolve collectively. So, we are proactively developing investment solutions that aim to speed up the transition globally, rather than only in those countries that are already well placed to transition their economies and societies.

Overall, we think that many investment opportunities will arise from the net zero transition, and that our focus on a just transition is an opportunity for us to allocate capital in driving positive change.

– Andrea Griffin, Head of Responsible Investment Specialists, HSBC AM

18. https://g20sfwg.org/wp-content/uploads/2022/10/2022-G20-Sustainable-Finance-Report-2.pdf
19. https://www.impactinvest.org.uk/project/just-transition-finance-challenge/
20. https://www.unpri.org/investment-tools/stewardship/advance

Diversity is in our roots. As a business operating in many markets and investing all around the world, we believe diversity brings benefits for our clients, our business and our people. Internally, our key objective is to embed an authentic culture that values a strong commitment to Diversity, Equity & Inclusion as part of delivering on objectives and meeting the expectations of our clients. We promote all forms of diversity by theme and by function – gender, ethnicity, ability, LGBTQi+, mental health, social mobility, faith, working parents, commercial, veterans and investments.

Our diversity and inclusion priorities extend to how we manage money, being integrated into our commercial activities through the types of solutions we provide our clients, our ESG integration, as well as our stewardship activities.

– Xavier Baraton, Global CIO, HSBC AM

DE&I in investments: integration and engagement

DE&I is an important part of the 'S' in our ESG evaluation and engagement with companies. Social factors encompass a variety of different issues including human capital management, health and safety, and supply chain labour standards. We consider product safety and quality, as well as data usage and technology depending on the company or sector. We also look at demographics and the digital divide, as well as financial exclusion, access to healthcare, and nutrition and health. Additionally, we evaluate a company's gender pay gap, the percentage of women in leadership positions and the policies around diversity and inclusion. We also have artificial intelligence tools to screen ESG controversies where DE&I can be captured at the company level.

In 2022, we set up a DE&I working group in Investments to scale-up the integration and monitoring of DE&I issues in ESG analysis and scoring, as well as in portfolio management. We seek to learn from our own experience to inform issuers on how to address challenges related to DE&I, from pipeline development, ways to address fairness and unconscious bias, to best practices in fair hiring and talent management.

We are members of industry initiatives that drive diversity, such as the 30% Club UK's Investor Group[21], Diversity Project and the Hong Kong Board Diversity initiative. There is increasing evidence that diverse companies can outperform peers thanks to the benefits brought about by having a more representative board. Boards need diversity of outlook and experience to exercise good judgment. Globally, a high number of issuers have under 30 per cent of women on their boards. This varies somewhat by region, with an average of less than 20 per cent representation in most emerging market countries, to an average of 30 to 40 per cent in North America and Europe.

21. https://30percentclub.org/

We set targets for board diversity in key markets so that we influence progress globally. For companies not meeting our expectations, we may vote against the Chair of the Nomination Committee or other relevant Directors, unless the company communicates a timely and credible plan to address our concerns.

In addition to addressing gender and ethnic diversity at the board level, we have engaged with companies about diversity lower down the organisation – from the executive team, to hiring conducted at an entry level. Working with stakeholders like the Workforce Disclosure Initiative, a collective initiative focusing on improving corporate workforce transparency, provides us with reliable data sources to guide engagement conversations with companies. We have kicked off 2023 by enhancing our DE&I data to support an evidence-based approach to driving change, and will be embedding this data in our investment processes.

Turning the mirror to ourselves

Being inclusive is an expression of our values. We were founded on the strength of different experiences, attributes and voices; they are integral to who we are and how we work. We strongly believe that diverse voices, together with genuine challenge, lead to more robust decision making. Consequently, we are fully committed to building a corporate culture that supports effective teamwork, gives wider viewpoints, better investment decisions, better results for our clients and ultimately a more sustainable business.

HSBC Asset Management has a very proactive global DE&I programme with a vision to create a truly motivated, diverse, equitable & inclusive asset management workforce, proactively shaped to deliver our vision & strategy and to reflect the clients we want to serve and the societies in which we live in.

– Ozge Usta, Head of Sustainability Delivery, HSBC AM

To achieve our DE&I ambition, recognising that equity and inclusion is global, and diversity is more nuanced locally, we have identified four overarching objectives for HSBC Asset Management:

1. To embed Inclusion and Allyship by improving inclusive leadership behaviours;

2. To increase the representation of women in senior roles[22], as well as creating a larger pool of talent at lower levels;

3. To increase the representation of key identified Minority Groups (Ethnicity, Disability, LGBTQi+) in senior roles, with an emphasis on black heritage colleagues, as well as creating a larger pool of talent at lower levels; and

4. To enhance DE&I in our investment & engagement processes as a competitive advantage

22. Senior roles are roles classified as band 3 and above in our global career band structure.

This programme is sponsored by our global CEO and supported by his leadership team. In 2022, we introduced the multi-pillar structure for DE&I Investment workstreams, and we now have around 250 volunteer members across the globe who meet monthly to progress initiatives.

Our People Forum, established in 2020, is a sub-forum of our Management Committee to sponsor, review and take decisions on people related topics. The People Forum's key objective is to keep a pulse on our people, improve their employee experience and maintain our strong, collegiate and supportive corporate culture. In order to bring our employees' diverse voices directly into executive decision-making, we have now appointed four employees (elected by number of votes received from all employees) onto our forum.

A few figures

As part of an industry in which women have long been underrepresented, we are making progress towards improved gender balance, particularly at senior levels. Women accounted for just under 50 per cent of promotions to our most senior levels in 2022 (18 of 40 such promotions).

Furthermore, HSBC Asset Management currently ranks in the top quartile of Citywire's Alpha Female Report for percentage of female portfolio managers.

Our DE&I journey has come a long way with the drive and determination of our DE&I leadership team and volunteers. There is more to do and more to change, in our company, the industry and in our societies - we are committed to progressing DE&I in 2023.

Source: HSBC Asset Management as of September 2022.

External recognition

HSBC Asset Management and our employees have been recognised for our DE&I work, winning the following awards:

1. Citywire Gender Diversity Awards 2022 (Global)
   - Most improved retention rates (female portfolio manager retention last 10 years)
   - Best AUM split (funds managed by male/female portfolio managers)
2. Diversity Award at Insurance Asset Management Awards 2022
3. Head of Sustainability, Erin Leonard named as one of the top 100 Women in Finance by Financial News
4. Kate Hassey, Head of Distribution Oversight, Fund Operations, HSBC AM, has been included in 'LGBT Great Top 100 Game changers 2022'.
5. One among four shortlisted for 'Championing Social Mobility' in the FT Adviser Diversity in Finance Awards 2022.

Source: HSBC Asset Management, January 2023. More information can be found on the respective websites: 1. Citywire; 2. Insurance Asset Management; 3. Financial News; 4. LGBT Great; 5. FT Adviser

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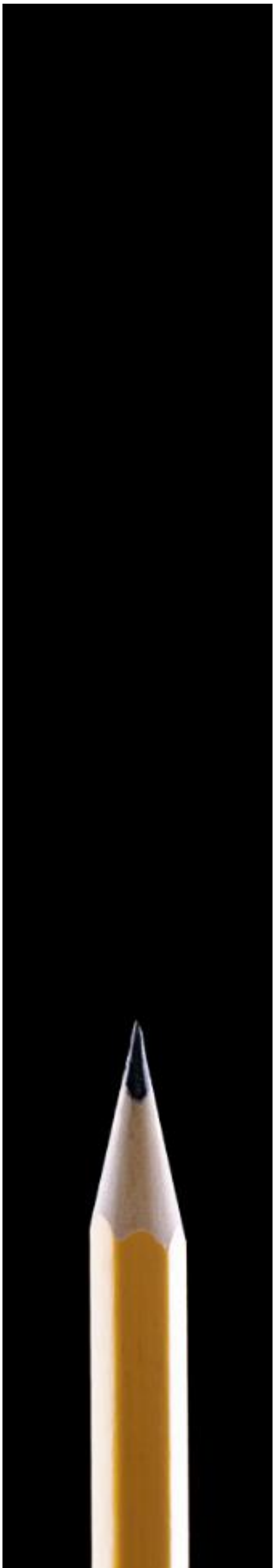

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