HSBC Asset Management

UK Stewardship Code Report 2020

Foreword

We welcome the UK Stewardship Code 2020, which we have applied during the course of 2020. We were early signatories to the first Stewardship Code and recognised the ISC Statement of Principles which preceded it.

Our stewardship is an important expression of our fiduciary responsibility to our clients. We believe that deep consideration of environmental, social and governance (ESG) issues and commitment to active stewardship is integral to sound investment decisions that will deliver sustainable returns to our clients.

I hope that this statement will give clients and other stakeholders a good understanding of how we have applied the Code. The COVID-19 pandemic meant that 2020 was an extraordinary year. The impact of the pandemic was the focus for much engagement but did not divert investors and companies from significant progress in addressing other systemic risks such as climate change.

As we emerge from the Covid-19 crisis, we support the call to build back a better, more inclusive and sustainable world. There is much to be done to achieve these goals, and we are committed to playing our part. We will continue our active stewardship, incorporating ESG factors in our investment process and creating long term value for our clients, supporting the transition to a more sustainable economy and society.

Joanna Munro, Chief Investment Officer

PURPOSE & GOVERNANCE

Principle 1

Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Report

Our purpose is to help our stakeholders prosper – our clients, shareholders, the societies in which we operate, and most importantly, our planet.

The world is going through a number of major transitions that present both sources of investment returns and risks. In particular, we are uniquely positioned to benefit our stakeholders by focusing on the following two:

- The move to sustainability-driven investing;
- The shift in balance of wealth between developed nations and emerging Asia.

The move to sustainability-driven investing: Being part of HSBC Group gives us insights into sustainable finance as well as enhanced access to proactively influence ESG agendas. These insights feed our creation of ESG solutions and into our investment processes, enabling us to understand, assist and invest in this transition.

We have an established role as a pioneer in sustainable and impact investing, seen in our 2020 launches of:

- Real Economy Green Investment Opportunity fund;
- Sustainability-focused ETF funds;
- HSBC Pollination Climate Asset Management.

With 30 years of experience, operations in 25 countries and a large investment manufacturing capability in Europe and Asia (including China), we can credibly bridge East and West, promoting global sustainable standards and providing value to clients in both regions.

Our strategy

To implement our vision, we are transforming our business into a 'core solutions' and 'specialist emerging markets, Asia and alternatives' asset manager, with client service, investment excellence and sustainability as key enablers.

As a result, we have identified a number of long-term strategic initiatives centred around three core themes: providing responsible investment solutions; generating active returns where we are relevant and have a competitive advantage; and positioning our business for the rising wealth in emerging Asia.

Responsible investing and stewardship are key elements in our five-year business road map, which includes our ambition to become a leader in responsible investing. We will embed responsible investment thinking in the heart of everything we do – from our interaction with clients, the incorporation of ESG factors into our core products and solutions, to the creation of new products and solutions that deliver value for end-investors and positive impact for society at large. We will invest with purpose and discipline, supporting the preservation of clients' assets and unlocking investment opportunities, whilst continuing to engage with companies, policy makers, regulators and industry initiatives for the benefit of our stakeholders and to create a healthy financial system.

Our culture

At HSBC Asset Management, we aim to create a truly motivated diverse, equitable and inclusive asset management workforce, proactively shaped to deliver our vision and strategy and to reflect the clients we want to serve and the societies in which we want to live. Being inclusive is an expression of our values to be dependable, open and connected. We want to be a place where people are valued, respected and supported to fulfil their potential – and we foster an environment where people can speak up to remove barriers to success, and collaborate to put the best ideas into practice.

We recognise that organisational culture is constantly evolving. In 2020, we established a Diversity, Equity and Inclusion initiative to build on our existing policies and practice and evolve them to reflect new norms.

Investment beliefs

Markets are not fully efficient; they are prone to mispricing over the short-term. Anomalies can persist for a while, but ultimately prices tend to align with fundamental values. This creates opportunities for research-driven investors

- Our investment process is implemented with judgement and skill to deliver sustainable risk-adjusted performance, not to chase short-term returns.

We believe that a disciplined approach based on research, intellectual capital and 'built for purpose' systems has power and predictability:

- Whilst individual flair and creativity remain important, structure and discipline lie at the heart of our investment decisions;
- Research underpins our decisions in all asset classes and is central to our approach. Our research departments work closely with our investment teams and are responsible for generating insight, investment ideas and support;
- Our robust proprietary tools provide consistency of approach across our teams and locations.

We believe that good governance – clear investment beliefs and a well-executed process – is the key to delivering long-term value for our clients and to ensure that the portfolios we manage are in line with their investment constraints and objectives

Responsible investment

Responsible investment is integral to our investment philosophy and approach. We believe that ESG issues can have a material impact on company fundamentals and performance over the longer-term.

ESG issues are linked to opportunities and risks that financial markets may not be pricing appropriately.

- 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.

Building a sustainable future

As part of our fiduciary duty to clients we are focused on increasing the climate resilience of our clients' investments. Alongside climate issues, we formally integrate ESG factors into our investment decisions. Since we signed the Principles for Responsible Investment (PRI) in 2006 we have integrated material ESG factors into our investment analysis and decision-making, to reduce risk and enhance returns.

We recognise the contribution we can make to the United Nations' Sustainable Development Goals (SDGs) and the global transition to a low-carbon economy. The SDGs and Paris Climate Agreement set a long-term transformational framework with the objective of ending poverty, fighting inequalities and tackling climate change. We will continue to collaborate with institutional investors, development finance institutions and policy-makers to deliver tangible investment flows into the real economy.

We have 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 through:

- Creation of solutions based on client needs designed to mitigate risk and capture opportunities around ESG issues;
- Engagement with companies, improving market transparency and sustainability disclosure to better understand investment risks and opportunities;
- Work with policy makers and industry leaders to the benefit of our clients and the long-term health of the financial system and to support the transition to a low-carbon economy.

Our analysts and portfolio managers use ESG data, including carbon emissions metrics, to enable us to identify and manage ESG risks and opportunities and make well-informed investment decisions. We see it as consistent with our fiduciary duties to our clients to review the climate resilience of investments and contribute towards financing the transition to a low carbon economy.

Furthermore, we have a responsibility to exercise active stewardship on behalf of our clients. We meet with companies regularly to improve our understanding of their business and strategy, signal support or concerns we have with management actions, and promote best practice. We believe that good corporate governance ensures that companies are managed in line with the long-term interests of their investors. We also engage with carbon intensive companies to encourage climate–resilient business strategies.

Reflection

Whilst we are ambitious for our clients, we recognise the scale and complexity of the transitions we are focused upon. We have long identified the transition to sustainable investing but have not always carried every part of our business towards that transition or communicated to clients our work in this field as well as we could have done. Our new strategy is intended to ensure that we are working as one with our clients to achieve our common sustainability goals.

PURPOSE & GOVERNANCE

Principle 2

Signatories' governance, resources and incentives support stewardship.

Report

Governance

As a fiduciary with complex responsibilities, we believe it is fundamental to have a robust and transparent governance framework.

We have a legal entity-based structure that aligns with the countries in which we operate. Each business is ultimately a wholly owned subsidiary of HSBC Holdings, plc (HSBC Group), one of the largest financial services organisations in the world.

Each of our fund ranges has a supervisory body aligned to its respective legal structure, regulatory requirements, and business practices.

The Global Management Committee – comprising the senior leadership team globally – is responsible for overseeing the implementation of our strategy and ensuring an appropriate control framework and culture is operating effectively. While continually balancing the needs of various stakeholders, the Committee and its members give precedence to client and regulatory needs, including our stewardship obligations.

Our stewardship policies and approach are approved by the Responsible Investment and Stewardship Forum, which comprises Global Management Committee members – the Global Chief Executive Officer, Global Chief Investment Officer, Chief Risk Officer – as well as the Global Head Asset Management Compliance and Global Head of Responsible Investment. This Forum met three times in 2020, considering: engagement policy and voting guidelines reviews, conflicts of interest in voting, responsible investment annual review and PRI submission, responsible investment policy, as well as monitoring of stewardship activity and initiative approvals. They also give *ad hoc* approval to collaborative engagements and other potentially high profile stewardship initiatives.

Local management structures and fund supervisory bodies also adopt policies and receive regular stewardship reporting relevant to their responsibilities.

These polices and reports are maintained, reviewed and submitted by the stewardship team.

This structure ensures that there is business oversight of the key stewardship decisions. Whilst responsibility for stewardship activity as part of the meeting our stewardship obligations lies across senior management, the Responsible Investment and Stewardship Forum brings together those with most immediate responsibility to oversee the activity and approve initiatives. Regulatory accountability is also ensured with reporting to relevant local management and fund oversight bodies.

Responsible investment team

The Global Chief Investment Officer has overall management responsibility for stewardship activity. Stewardship is carried out across the investment function, with all portfolio managers and analysts contributing to the responsible allocation, management and oversight of capital.

Our responsible investment team is within the investment function and reports to the Global Investment team. It currently comprises 16 people – 5 women and 11 men– based in London, Paris and Hong Kong.

The leadership of this team has considerable experience of stewardship and responsible investment, with the Global Head of Responsible Investment, Global Head of Corporate Governance and Global Head of ESG

Research all having at least 20 years' experience of responsible investment, ESG integration and / or stewardship. The team includes members who have previously worked in third party ESG research, credit analysis, equity analysis, product analysis, corporate sustainability consulting, public policy and a wide range of other fields, with academic qualifications including business, economics, development and computer science amongst many others. This range of skills and experience enables us to deliver stewardship responsible investment activity that is in line with our strategy, relevant to our clients, investors and products, drawing upon investment experience, academic research and a number of external data sources.

The responsible investment leadership team receive continuous training relevant to their roles. The Global Head of Responsible Investment and Global Head of Corporate Governance, based in the UK, are subject to an annual training & competence review, which requires 25 certified hours of relevant training each year.

The stewardship team is part of the responsible investment team, comprising six people, with further yet to be filed new roles created as part of the firm's review of responsible investment activity. This team leads our voting and engagement activity, focusing in particular on thematic and collaborative engagement. Three members of the stewardship team are 'embedded' in local investment groups, supporting the engagement activity of portfolio managers and equity or credit analysts. Other elements of the responsible investment team include ESG research, integration and product specialists. Situating the stewardship team within responsible investment as part of the wider investment function reflects the team's dependence and influence upon related activities to maximise its impact and effectiveness. It also maintains focus in ensuring that stewardship activity helps to deliver the firm's responsible investment objectives and ambition.

As an international firm with offices in some 25 locations, we recognise the importance of drawing upon a diverse range of backgrounds and experience to inform our investment and stewardship. We also recognise that the finance industry, including ourselves, needs to do more to build a truly diverse workforce, reflecting the societies in which we operate. To this end, we have our own programmes and are participating in a number of initiatives to enhance ethnic, gender and social diversity in our recruitment and internal promotion. For example, we are working with the Investment Association's Investment 20/20 on a KickStart programme under which we will recruit a 16-24 year-old impacted by COVID-19 and currently on universal credit. Whilst these initiatives are across the firm, we expect them to impact our investment and stewardship teams alongside others.

Training

During 2020, different types of ESG training (in person, e-learning, and webinars) were provided at different levels of the business. These covered our approach to ESG integration, key ESG risks and how they are managed and considered in investments, and how we engage with portfolio companies and communicate results to clients.

For example, we provided climate risk training to senior management to understand and assess the financial risks from climate change that affect the firm, and to be able to address and oversee these risks within the firm's overall business strategy and risk appetite.

Additionally, working with the PRI we developed a comprehensive e-learning curriculum on approaches to sustainable investment strategy, key trends, and how to discuss these with clients. This e-learning was built in response to, and anticipation of growing client interest and demand for investment solutions that integrate responsible investment principles into portfolios, to mitigate risk, enhance portfolio value, and address societal challenges.

While most of the colleagues that undertook this training were client-facing, it was also completed by other teams including product and risk. The completion rate was over 90 per cent and feedback was positive. To follow up this training, webinars were conducted with smaller groups on these topics, providing a deeper dive on the approach taken by HSBC Asset Management and how we can communicate better with clients.

Systems, processes, research, analysis & service providers

Our investment capability is founded upon the talent and skill of our more than 600 investment professionals. Many of them are engaged in fundamental research which is a key element in our investment process across asset classes.

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.

Much of the ESG information gathered by analysts is derived from our own stewardship activity in their monitoring of companies and proprietary research. This stewardship activity is both complemented and informed by the use of external research providers as follows.

- MSCI ESG Research: Intangible Value ESG Assessment, comprehensive ESG assessment and Financial Crime Compliance screening. We use MSCI because their wide coverage of issuers and sector specific methodology.
- ISS ESG (formerly ISS Ethix and ISS Oekom): Identifying issuers involved in the production and/or marketing of controversial banned weapons like cluster munitions and landmines, and government bonds' environmental and societal assessment. The specificity of our banned weapons definition can be implemented by ISS-Ethix, whilst ISS Oekom is one of the only providers covering government bonds.
- Trucost Research: Quantitative environmental research to measure the carbon footprint of our funds. Trucost is the leader in carbon footprint assessment.
- Sustainalytics: UN Global Compact compliance. We appreciate the simple and transparent evaluation provided by Sustainalytics as well as their strong coverage in emerging markets.
- RepRisk: Tracking companies' reputational risk and involvement in ESG-related controversies. Provides an ongoing view of issuer’s ESG performance, risks, and controversies.

We use Institutional Shareholder Services (ISS) as our global proxy voting research and vote instruction provider. ISS provides custom policy recommendations based upon our voting guidelines. For around 2,000 active holdings, UK listed holdings, and our largest 500 holdings by value, these recommendations are reviewed by portfolio managers and / or members of the responsible investment team. Smaller passive holdings are voted automatically with the recommendation.

Performance management and reward

Responsible investment is included in the objectives, appraisal and reward of the most senior management of the firm, as well as investment analysts and responsible investment staff.

In evaluating the quality of the investment process under our Investment Excellence program, ESG integration is specifically included as an element that needs to be considered, alongside the broader process, performance and people aspects.

Specifically, in evaluating portfolio manager performance in the UK, the extent to which they integrate ESG is explicitly referenced in evaluating the qualitative aspects of performance, which support their performance rating and which is a key input to their variable remuneration, alongside their behaviours.

Reflection

Across the firm

We are currently undertaking a major six-month Responsible Investment Initiative across the firm, initiated by our Global Chief Executive. This is considering all aspects of the role of responsible investment in our business, under three main pillars: commercial, investment and culture. Workstreams include: product strategy, intermediaries, brand & client profile, reporting & data, investment policies & guidelines, ESG integration & stewardship, research & insights, and culture & education. This work builds upon our long record of ESG integration and stewardship and seeks to ensure that they are efficient, impactful, well- resourced and reflected in our internal and external culture, products and communication.

Governance structures and processes to support stewardship are kept under review. The Responsible Investment and Stewardship Forum assumed responsibility for oversight of responsible investment in March 2020, having been established two years' earlier as the Stewardship and Fiduciary Conflicts Forum. This reflected the integration of the stewardship team into responsible investments. The most important support elements in effective stewardship activity are open communication with portfolio managers and analysts exposed to any issuer and with senior management to ensure support for the positions taken by the firm in its stewardship and advocacy. Whilst portfolio managers and analysts retain an important responsibility for the stewardship of their assets, the decision to increase headcount in the stewardship team with planned new hires reflects the increased demands on and importance of stewardship activity.

Within the investment function

From our signing of the UN Principles of Responsible Investment when it was launched in 2006, we have held firm to our belief that ESG integration and the exercise of stewardship lies first with the investment decision makers across our firm. We have provided investment teams with ESG data, tools and training. Our dedicated stewardship resources complement their work, with governance and voting expertise, thematic engagements, engagement with issuers only held in passive and active quant mandates, and in collaborative engagement.

The Responsible Investment Initiative is assessing the resources available to investment and stewardship teams, as well as how far investment and stewardship activities inform one another. We believe that there is scope for an enhanced level of dialogue on ESG integration and stewardship both internally and externally.

Service providers

ESG research providers can only consolidate information that is already available from companies. In many fields and markets, ESG data is either inconsistent or absent. We have also found that in some markets, such as China, data available in local language sources is sometimes not captured by research providers. These limitations hinder systematic integration into investment and stewardship.

Over time, more data has become available; we are active supporters of initiatives such as the CDP and Workforce Disclosure Initiative which encourage better and more consistent disclosure. In the coming year, we expect to make more use of the ESG data functionality available in Bloomberg which, although subject to the same sourcing constraints, is more easily integrated into financial analysis.

The challenge of research providers' access to ESG data is a particular issue for small cap mandates, such as those we manage covering European and Asian equities. This can also represent an engagement opportunity – we have engaged with a number of Asian issuers to explain the research providers' requirements, investors' reliance upon them and to assist their disclosures. This has sometimes resulted in improved coverage and better ratings for the companies concerned.

The use of ISS for custom recommendations based upon our global voting guidelines enables us to focus attention and thinking on more serious governance breaches. Our guidelines have been developed over a number of years and are reviewed annually to reflect changes in governance codes, good practice and our own engagement priorities. ISS's own depth of resources and experience means that its research provides a comprehensive introduction to the voting issues at each meeting. Its reporting functionality allows us to provide client specific reports as well as analyse voting across markets and issues. The application of our own voting guidelines resulted in 8 per cent of votes globally that were different from the ISS standard policy recommendation.

PURPOSE & GOVERNANCE

Principle 3

Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

Report

As an asset manager and a fiduciary, we recognise our responsibility to all our clients. Conflicts may arise as we exercise those responsibilities. A summary of our conflicts of interest policy is available at:

https://www.global.assetmanagement.hsbc.com/conflicts-of-interest

This summary identifies the main potential conflicts of interest: one client versus another; the firm versus a client; an employee versus a client; an employee versus the firm; one part of HSBC Group versus the firm. These could arise with establishing new products, cross-referral, revenue sharing, joint ventures, business / operations transfers, the prospect of financial gain or loss at the expense of a client, interest in the outcome of a service or transaction. It sets out how we deal with such conflicts, maintaining registers of these potential conflicts, preventing or managing them, disclosing as appropriate and maintaining evidence of occurrences that cannot be managed. Steps taken include employees not being permitted to advise on matters where they have a personal interest and could include declining to act for one or more clients. Ultimately, if we believe we cannot appropriately manage a conflict then that relationship or business will be exited.

We also publish a statement addressing the conflicts of interest that can arise in stewardship. This statement is largely reflected below. It is also available at:

https://www.assetmanagement.hsbc.co.uk/-/media/files/attachments/common/resource-documents/stewardship-and-conflicts-of-interest-en.pdf

We recognise that conflicts of interest may arise as part of our stewardship activities. However, in all of these activities we are committed to delivering fair outcomes for our clients; and applying a consistent and transparent approach to conflicts.

Examples of situations where potential conflicts of interest could arise in our stewardship include:

- Exercising voting rights over holdings of shares in our ultimate parent company, HSBC Holdings plc;
- Exercising voting rights over holdings of shares in an HSBC sponsored fund;
- Exercising voting rights through holdings in both sides of a proposed merger and/or acquisition transaction;
- Exercising voting rights over holdings of shares where an HSBC employee is a director;
- Exercising voting rights and/or undertaking engagement activities over holdings or shares in a company that has a commercial relationship, interest, and/or connection with HSBC Global Asset Management and/or with other HSBC Group companies; and
- Undertaking engagement activities – inadvertently or directly – results in being privy to material non-public information.

We have established policies, procedures and protocols that are designed to identify and manage all of these potential conflicts. These include organisational and administrative arrangements to safeguard the interests of our clients, which include:

While we are part of the HSBC Group, we maintain an arm's length commercial relationships with other HSBC Group companies and as such carry out our stewardship activities independently of any other relationships within the HSBC Group;

Our Voting Guidelines are intended to identify the best interest of all clients as investors in a particular company. These are applied to the holdings of all clients for whom we vote. A small number of clients have retained voting authority for themselves, usually for reasons of consistency across holdings with different managers. As such conflicts do not generally arise between our voting guidelines and the voting policies of clients;

Our Engagement Policy defines our requirements to ensure when we undertake engagement we maintain a high standard of research, communication and documentation. We engage from the perspective of a long-term owner of the company. When we engage, we represent the interest of all holdings in an issuer, whether equity, fixed income or another asset class;

We have procedures in place to escalate, manage and monitor conflicts, which are documented on a register alongside their corresponding mitigating controls;

Significant conflicts are escalated to our Group local Conflicts Management Office (CMO). The CMO will provide guidance on appropriate management of the conflict; and

As required, information barriers will be put into place, restricted lists amended, and trading activity – personal and/or on behalf our clients – restricted; however, in practice we prefer not to be made insiders as part of our engagement activities.

Oversight of conflicts of interest is embedded within our governance framework that includes:

- Risk Management Meeting – comprising our global senior leadership team – responsible for setting our risk management strategy and appetite, policies and control standards and to monitor their implementation. In this regard, the Risk Management Meeting reviews the material risks affecting our business – including conflicts of interest – via regular reporting from the business and control functions;
- Responsible Investment and Stewardship Forum – comprising a sub-set of our global senior leadership team – responsible for managing and monitoring our fiduciary responsibilities regarding stewardship as well as serves as a forum to discuss subjects that could result in a conflict for us in fulfilling our fiduciary obligations; and
- Chief Executive Officer – who is ultimately responsible for compliance with all aspects of the HSBC Group's Conflict of Interest Policy and associated regulatory requirements – provides regular updates on conflicts of interest to the Board of Directors.

Reflection

How we address conflicts around voting

Custom policy voting recommendations from our proxy research provider ISS are based on our global voting guidelines for all company meetings, irrespective of whether a potential conflict of interest may exist. Under our voting procedures, we usually follow these recommendations, although fund managers or governance specialists may decide to depart from them. Where they wish to do so in a situation where we are aware of a conflict of interest, a special review process is required. No such case has arisen this year. We have followed custom policy recommendations where we have voted on HSBC Asset Management funds. None of our staff hold directorships in the listed companies where we are voting.

For voting shares in our ultimate parent company HSBC Holdings plc, we have during the year strengthened our conflict of interest process. Holdings will be voted in line with standard recommendations under ISS's own voting policy, rather than with custom policy recommendations.

Other conflicts

Beyond voting, other potential conflicts listed above have not arisen in the course of the year. Engagement are conducted irrespective of any business relationship. Where we believe we may have received material non-public information, this is reviewed by compliance; we may contact the company concerned to confirm the nature of information received and, if necessary, asking them to make an early market statement.

PURPOSE & GOVERNANCE

Principle 4

Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

Report

In line with our Purpose, we are committed to playing an active and constructive role in supporting the development of a well-functioning and more sustainable financial system. This involves engaging with regulators and policymakers directly, for example by responding to consultations or attending in person bilateral meetings or roundtables, and indirectly through industry bodies.

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

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

We have identified three focus areas for our activities:

- Supporting the transition to a low-carbon economy – we recognise climate change as a top and emerging risk and therefore support policy and action to support the transition from high carbon to low carbon;
- Improving market standards and transparency on sustainability – transparency enables markets to operate more efficiently with better information. We focus on corporate sustainability disclosure to strengthen the identification of investment-relevant ESG risks and opportunities and greater transparency to clients to help build the market. The development of appropriate standards is playing an increasingly important role;
- Mobilising private capital to deliver on the Sustainable Development Goals and Paris Climate Agreement – the investment gap to deliver on the SDGs and Paris Climate Agreement is considerable and requires capacity building across markets and innovation in new investment models and instruments.

During 2020, we signed the Finance for Biodiversity pledge, which commitments to collaboration, engagement and transparency, and is aimed at restoring biodiversity through our financing activities and investments.

Policy work on climate

As global investors, we are aware of the risks and opportunities climate change presents to the investments we make on behalf of our clients and as such we are committed to playing our full part in addressing this challenge. Policy is one of the key drivers of the scale and speed of the transition to a low-carbon economy. We therefore join public investor statements and participate in industry body working groups where we believe this will signal backing for policy measures and frameworks that support the low-carbon transition and develop relevant insights. During the course of the year we have responded to a number of consultations / participated in joint action, including:

Business Groups CEO resilient recovery letter post COVID-19 (May 2020)

Following the global COVID-19 pandemic and resulting market-wide risks we worked with HSBC Group Public Affairs to join other CEOs in writing to the British Prime Minister on the importance of working towards a green recovery. We asked for clear vision for recovery efforts to ensure they were focused on sustainable growth and aligned with national climate goals. We also re-confirmed our commitment to support the government in responding to climate change by ensuring the UK is on track to achieve net zero greenhouse gas emissions by 2050 at the latest.

Outcome – the ambition for a green recovery was reflected in the UK's commitment announced in December 2020 to reduce greenhouse gas emissions by at least 68 per cent by 2030, compared to 1990 levels.

Open letter to EU leaders from investors in a sustainable recovery from COVID-19 (June 2020)

We signed this letter alongside 182 other investors, representing over EUR12 trillion in assets under management, co-ordinated by Institutional Investors Group on Climate Change (IIGCC), Principles for Responsible Investment (PRI) and CDP. The letter outlined recommendations to the EU on how best to initiate an investable and sustainable economic recovery from the COVID-19 pandemic, including prioritising climate resiliency and net zero emissions economic solutions and embedding investor participation in recovery planning. Again, we offered our support to work with government leaders in implementing the actions.

Outcome – EU leaders agreed a green recovery deal in July 2020, including nearly €550 billion over seven years for green projects.

EC Consultation on a Renewed Sustainable Finance Strategy (July 2020)

We provided a submission to the European Commission's consultation on a 'A renewed Sustainable Finance Strategy for Europe' and strongly supported the objectives of the strategy setting out actions to 1) increase private investment in sustainable projects and activities to support the different actions set out in the EU work programme and particularly the European Green Deal, 2) help more individuals and firms (financial and non-financial) to make an impact by increasing opportunities for sustainability, 'financing green' and 3) manage and integrate climate and environmental risks into financial firms and the financial system 'greening finance'. We provided responses to over 100 questions highlighting where the EU could go further on climate risks, biodiversity and the sustainability transition in order to promote the continued improvement of actions taken by the EU to tackle climate change and deliver net zero.

Outcome – the European Commission published a summary report of the outcome of the consultation in February 2021. This will inform the Commission when the adopt an updated strategy in the first half of 2021.

Revision of the EU non-financial reporting directive (NFRD) (July 2020)

We support improved non-financial disclosure, in particular climate-related performance. As a signatory to TCFD, we understand that improved disclosure by our clients and investee companies will be a critical part of understanding our own climate-related risk and opportunity. We believe that a regime for effective disclosure should be designed with the interests both of investors and issuers in mind. Good disclosure should be seen by issuers as beneficial to their business and to relations with lenders, investors and other stakeholders. Our response highlighted the importance of ensuring any NFRD requirements for financial institutions are aligned to other financial sector regulations e.g. EU taxonomy and Sustainable Finance Disclosure Regulation and are implemented in a sound and pragmatic manner. We also supported the expanded scope of the application to include large non-listed companies.

Outcome – the European Commission published a summary report of the outcome of consultation in July 2020. Our view of the need for alignment in requirements was shared by 67 per cent of respondents. The Commission has not yet announced the timing of further steps.

MAS Proposed Guidelines on Environmental Risk Management (August 2020)

HSBC Global Asset Management (Singapore) responded to the consultation of the Monetary Authority of Singapore's (MAS) proposed Guidelines on Environmental Risk Management and we were supportive of the intention to enhance financial institutions' resilience to and management of environmental risk. We provided responses on subjects such as how best to oversee environmental risk management, examples of tools and metrics that may be used by asset managers to access the impact of environmental risk and the form of disclosure requirements which should be applied to asset managers. Through the leadership of MAS, we hope our responses will help shape the guidelines and improve international alignment on this agenda which will drive more effective implementation.

Outcome – the MAS published its response to the consultation in December 2020, as well as the new Guidelines. These set out the expectations for asset managers to integrate environmental risk in their investment activities; it allows for the international alignment which we had sought.

IFRS consultation on Sustainability Reporting (November 2020)

We contributed to an HSBC Group response to this consultation on whether the IFRS should establish a Sustainability Standards Board to develop global sustainability reporting standards. We supported the establishment of such a Board, encouraging it to build on the sector and financial materiality based work of the independent Sustainability Accounting Standards Board. We welcomed the proposed focus on climate issues but encourage the early inclusion of other sustainability indicators.

Outcome – the IFRS announced in February 2021 that its consultation had indicated strong demand to improve the consistency of sustainability reporting as well as for the IFRS to play a role in this. They will undertake further analysis of the requirements for success before considering whether to establish a new board.

Mobilising private capital

One Planet Asset Manager initiative

The One Planet Sovereign Asset Manager (OPAM) initiative aims to advance the understanding of the implications of climate-related risks and opportunities within long-term investment portfolios through the sharing of investment practices. We are one of eight founding members of this initiative which provides a significant message to markets that investors expect companies to manage climate risks. Through our work we support the One Planet Sovereign Wealth Framework and have committed to further the objectives set out within it. The OPAM shares investment best practices, publishes relevant research and engages with Sovereign Wealth Funds and other key actors, including standard setters, regulators and the broader industry to support the implementation of the Framework.

Finance to Accelerate the Sustainable Transition (FAST) Infrastructure –

HSBC Asset Management is a founding member of this industry-wide initiative, playing a key part in its four working groups. The aim is to develop sustainable infrastructure into a deep and liquid asset class and scale-up private investment in emerging and developing countries. The four working groups aim to: 1) Produce environmental, social and resiliency standards applicable to infrastructure investments, 2) Define the mechanics of a labelling system; including reporting and governance, 3) Scale financial support for infrastructure investments and 4) Develop platforms for targeted financial interventions. In order to be most effective we are working alongside numerous other stakeholders including governments, NGOs, institutional investors, banks and other funding bodies.

Climate change – investment alignment

Climate change is one of the most complex issues facing us today. The World Economic Forum has identified climate action failure and extreme weather as the top two long-term investment risks currently faced. Extreme weather and natural disasters can accelerate biodiversity loss and create economic instability. Leading climate scientists have warned that urgent action is needed to curb emissions to avoid catastrophic environmental breakdown resulting in material financial impact on investments. In 2020, we published our second report on climate scenarios; *The roads to low carbon transition: what it means for investors*. This expanded on the 2018 framework we developed alongside Vivid Economics to better understand company-level climate-related transition risks to help investors make better-informed decisions. In our report, we identified 10 scenarios that represent a broad range of low-carbon futures, influenced by two primary factors: climate policy and regulation; and the cost and performance of technology options available to reduce emissions. We built these updated scenarios by looking at increased policy stringency, varying policy timing and updated technology scenarios as well as implications for credit ratings. As part of our commitment to developing solutions to support the transition to a lower carbon future, we:

- launched the HSBC REGIO Fund which invests in emerging market green bonds and other similar bonds;
- created HSBC Pollination Climate Asset Management with the aim to create the world's largest capital manager (see under Principle 7 below); and
- expanded our suite of low carbon funds with the launch of seven Sustainable ETFs.

We aim to increase the climate resilience of our clients' investments, as well as contributing towards financing the transition to a low-carbon economy. We can help to achieve this through:

- lower-carbon investment solutions and opportunities that meet our clients' investment criteria while meeting their risk and return objectives;
- identifying and integrating 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 – during the year, we continued to develop our use of third–party climate data to provide our portfolio managers and analysts with the means to assess the climate exposure of client portfolios;
- our 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;
- disclosing 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.

During the year, we reported the carbon footprint of our clients' investment portfolios, in line with our commitment as signatories to the Montreal Pledge. We use the TCFD recommended metric – weighted-average carbon intensity.

Biodiversity

We have for many years offered clients the opportunity to invest to help combat climate change. But the world is facing dual threats, not just climate change but also significant bio-diversity loss. Natural capital is being destroyed at an unprecedented rate, with significant negative consequences such as bio-diversity collapse, climate change, localised temperature rise, soil loss, and the spread of diseases: indeed, the COVID-19 pandemic may even have been resulted from our encroachment on the natural world.

As a global investor, we believe we have a key role to play in tackling biodiversity loss. In August 2020, as part of our commitment to developing solutions to support the transition to a lower carbon economy, we created HSBC Pollination Climate Asset Management. This partnership with Pollination, a climate advisory firm, aims to create the world's largest natural capital manager and is the first large-scale venture to develop natural capital as a mainstream asset class.

We were also one of the founding signatories of the 'Finance for Biodiversity Pledge' in December 2020. This includes commitments by 2024 at the latest, to:

- Collaborate and share knowledge on assessment methodologies, bio-diversity related metrics, targets and financing approaches for positive impact;
- Incorporate biodiversity into our ESG criteria and engage with companies to reduce their negative and increase their positive impacts on biodiversity;
- Assess our investments for biodiversity impact and identify drivers for its loss;
- Set and disclose targets based on the best available science;
- Report on an annual basis and be transparent about the significant positive and negative contribution to global biodiversity goals linked to our financial activities and investments.

Whilst the case for action on biodiversity is clear, we are at an early stage as investors and as society in addressing the challenges of biodiversity loss. The steps we have taken in the past year are merely the first of many.

COVID-19 pandemic

The COVID-19 crisis is an extraordinary event with few parallels in modern economic and financial history. It has also threatened the integrity of the global financial system in a unique manner. We have always emphasised client centricity and the value of communication, not just to clients but also wider stakeholders who have an interest in our activities. This meant we were well placed to respond to the crisis, keeping clients and stakeholders informed of events – which often moved at high speed – and their market implications.

Throughout the crisis, we have published a range of research papers on the impact of COVID-19 on the economy and financial markets. These include rapid-response 'Investment Event' publications as well as more reflective 'Macro Insight' papers. Topics covered include the initial shock of the pandemic to the markets, the policy response including its impact on liquidity and the implications of the discovery of a suite of effective coronavirus vaccines. We have also published research that analyses the longer-term structural impact of COVID-19, particularly on investments that have a tilt towards ESG factors ('ESG resilience in an uncertain world'). These outputs were sent to clients and their agents on both the wholesale and institutional side of the business, as well as being accessible to eligible investors on our various corporate websites. All of our investment teams have full access to this research. There are also monthly internal 'Strategizer' macro-economic conference calls which are widely attended, where the strategists explain the risk which they are tracking and give their view on the likely and potential market impact of these.

Our analysis of the impact of COVID-19 focuses on investment strategy, strongly supported by macroeconomic and policy research. A key set of metrics which guide our research comes from our cross-asset valuation models. These models – which rely on fundamental drivers of investment performance – informed our views on asset allocation at the height of the crisis in March and helped make the case for remaining selectively invested in risk assets over a longer time horizon. A clear focus on the policy picture has also been essential. An understanding that the aggressive and timely fiscal and monetary stimulus measures – of the nature we outlined in our March 2020 paper 'COVID-19: Whatever it takes' – would limit the economic damage was also essential to our view that investors should stay cautiously invested.

Our research promoted a well-functioning financial system by providing clear information at a time of great uncertainty. In the first instance it supported our internal portfolio managers who invest on behalf of our clients. Secondly, it is likely to have assisted the asset allocation decisions of external clients who received the research and to have informed the decisions of other stakeholders among the eligible public.

In line with this, we continue to provide a range of products throughout the crisis to suit investors' needs or preferences. These include a suite of liquidity options to meet clients' short-term cash requirements, but also various options to stay selectively invested across a range of asset classes including those that reflect the likely long-term structural changes that may result from the COVID-19 pandemic.

We also participated in an Investor Forum project on capital raising which analysed the various capital raising structures utilised by companies in response to impacts from the COVID-19 pandemic.

Other risks

The impact of COVID-19 overwhelmed many of the other risks perceived at the start of the year. Threats to global trade were partly dissipated by a US-China trade deal but global trade flows were then impacted far more by the reduced demand caused by lockdowns across developed economies. Concerns about monetary and fiscal constraints where either reversed or put on hold as the need for liquidity and fiscal support drove central bank and government policies. Other risks which we identified in the course of the year included threats: to supply chains in globalisation, and to access to technology, especially in education, and through cyber-attacks.

COVID-19 has highlighted the extent of economic inequality within and between nations. This had already been identified as a growing systemic risk before the pandemic but the differential impact of the illness itself and of the consequences of lockdowns has brought these issues to the fore. Investors need to consider carefully the potential impact of this inequality and measures to address it. These range from the sustainability of those corporate business models seen as perpetuating inequality through to policy impacts and political stability of nation states. The impact of COVID-19 was a major consideration in our engagement in 2020 as set out under Principle 9 below but we are only at an early stage in understanding the wider consequences of the inequality it has highlighted; calls for a green recovery have been joined by those for a just recovery. We expect this issue to develop in our stewardship activities in the coming years.

We also participated in the Investor Forum project on improving voting transparency, a long-standing systemic issue facing investors in their stewardship activity. We welcome the Law Commission review on issues arising in the intermediated securities system, which was published in November 2020.

Reflection

The challenges of climate change and the transition to a low carbon economy are a good example of where the fiduciary role of investment stewardship can go beyond decisions of when or whether to buy or sell particular securities. The need for all parts of the financial system to work together and the perspective available to investors represent a strong case for those investors to participate in the development of frameworks to support the transition and to encourage investee companies to do so as well. Investors do not have unique insights into the science of climate change but their skill and experience in the allocation of capital and in evaluating the capital allocation decisions of companies and other issuers means that they have an important contribution to make. We aim to participate in policy development as investors, both directly and through our membership of representative bodies. We also encourage companies to manage their exposure to climate change and transition in an open and transparent manner using frameworks such as the TCFD. We do not work alone in this, and it is in our collaborative engagements with companies that we have seen the most direct impact. It is an effective means for investors to demonstrate their commitment to promoting sustainability, thereby helping to address the clear systemic risk which climate change represents to our clients' investments. In our contribution to regulatory and policy reviews on the need for public markets to respond to climate transition, we have found an increased open-ness to the disclosure and transparency that is a key step in holdings companies to account.

The transition to a low carbon economy must also be just. We are conscious that the current focus on companies' net zero ambitions and milestones towards these means that the need for a just transition has not been at the top of investors' priorities in the past year, including our own. We believe that this will emerge as an important theme for stewardship, not least in light of the inequality issues highlighted above.

If climate represent a particular long term challenge to the financial system, COVID-19 has represented the ultimate short and medium term shock. As fiduciaries, we were able to continue to manage our client assets with almost no access to offices or physical meetings with colleagues or companies. We would not claim to have anticipated the physical lockdown of large parts of the economy but our risk management plans did enable us to keep functioning. An economic shock tests all companies and provides opportunities for some. The ability of financial markets to see through to the other side of the crisis has provided some respite for investors but the impact of the crisis will continue to emerge over the coming months and years; we shall continue to consider these carefully on behalf of all our clients.

PURPOSE & GOVERNANCE

Principle 5

Signatories review their policies, assure their processes and assess the effectiveness of their activities.

Report

Our responsible investment policies provide the framework and reference point for our stewardship and wider responsible investment activities. Policies are subject to annual review for accuracy, relevance and comprehensiveness, as well as *ad hoc* review as we reflect new developments and requirements.

Responsible Investment policy

We reviewed our responsible investment policy during 2020, publishing a revised policy at the start of 2021. We undertook this review because the existing policy did not set out all the actions we would be prepared to take in our investment portfolios, particularly to address climate change risks. Our review included an assessment of current policy frameworks relevant to the issues covered in the policy. We analysed the impact on portfolios of different approaches. We also considered the alignment of these approaches with the outlook and interest of different client groups.

The policy is based upon the recognition that sustainability risks can lead to outcomes that have negative impacts on our clients' investments. We therefore aim to incorporate all material sustainability issues within our investment process. We support the UN Global Compact principles and have stand-alone policies on banned weapons, biodiversity and climate change.

Climate Change policy

Responding to the challenges of climate change is a key element in our stewardship and responsible investment. 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.

We expect to review this policy in the coming year to reflect the positions taken in our responsible investment policy. The points above reflect the key elements of the policy; the full text of the policy is available at:

https://www.assetmanagement.hsbc.co.uk/-/media/files/attachments/common/resource-documents/hsbc-climate-change-policy-en.pdf

Biodiversity policy

The wealth of plants and animals and their interactions are known as biological diversity or biodiversity. Natural ecosystems are under threat as a result of deforestation, land degradation, pollution of the water, air and soil, hunting and harvesting, and climate change. This presents broad challenges for society and a systemic risk for investors.

Our consideration of biodiversity is part of our overarching approach to responsible investment. We are committed to:

- Collaborate and share knowledge on assessment methodologies, biodiversity-related metrics, targets and financing approaches for positive impact;
- Engage with companies to reduce the negative and increase positive impacts on biodiversity;
- Integrate biodiversity risk into our investment process – we assess our investments for significant positive and negative impacts on biodiversity. We may exclude companies where engagement is not delivering sufficient progress on reducing biodiversity loss, prioritising companies using mountaintop removal techniques, companies endangering the status of UNESCO World Heritage Sites, and UN Global Compact breaches related to the Rio Declaration on Environment and Development;
- Develop investment products that deliver positive biodiversity outcomes – we are aiming to build one of the world's largest natural capital managers;
- Reporting and target setting – we will report annually on our progress and be transparent about our biodiversity impact.

Banned weapons policy

Our active, systematic and index portfolios do not have direct exposure to listed or unlisted equities or bonds issued by corporations considered to have proven involvement with weapons banned by international conventions, including: anti-personnel mines, biological weapons, blinding laser weapons, chemical weapons, cluster munitions and non-detectable fragments. This policy does not apply to strategies incorporating third party funds such as fund of hedge funds.

Engagement policy

This policy is a straightforward statement of our approach to engagement. We had previously relied upon our Stewardship Code and similar statements in the UK and other markets to describe our approach. We adopted the policy in 2019 in response to the Shareholder Rights Directive II. We shall review the policy as our practices evolve.

The policy sets out the role of our engagement as part of our ESG integration and in our stewardship oversight. It explains how we monitor investee companies and other issuers. The policy explains the different engagement approaches which we might deploy and how we prioritise engagements based upon the scale of client holdings, salience and exposure to the ESG issues at stake. It explains the role of collective engagement and escalation, as set out under Principles 10 and 11 below. It also sets out our approach to conflicts of interest in engagement as explained under Principle 3 above.

The full text of the policy is available at: https://www.assetmanagement.hsbc.co.uk/-/media/files/attachments/common/resource-documents/engagement-policy-en.pdf

Voting guidelines

Our voting guidelines have evolved over a number of years. They have developed from a high level statement of the issues we prioritise in our voting to a more detailed statement of our approach on different issues. Our annual review starts with an analysis of votes during the year where we have chosen not to apply the guidelines to understand whether this was due to company specific factors or should be reflected in an amendment to the guidelines. We review changes in local governance codes in key markets. We also consider changes in policy adopted by bodies such as the Investment Association, and in the standard policies of ISS. We analyse areas where our vote has differed from ISS to understand whether they are capturing an issue which our guidelines have not included. We are increasingly considering our engagement and how far good and bad engagement experience should be reflected in our voting. This is one means of escalation following unsatisfactory engagement.

One trend in our voting guidelines has been the application of standards we expected of developed market companies to emerging markets as well. Although governance standards might once have been lower on paper in some emerging markets, we have in the past been cautious about seeming to impose a developed market 'Western' approach in our voting that was insensitive to local practices. In many cases, our engagement has found examples of good practice. For example, during this year we have engaged with companies in emerging markets on gender diversity – our findings encouraged us to extend our developed market voting standard on this to emerging markets. In early 2021, we updated our voting guidelines to reflect issues that had arisen during the year and improvements in good practice. Changes included: extending minimum gender diversity requirements to emerging market boards; ensuring executive pay was not out of line with employee and shareholder experience – particularly during the COVID-19 pandemic; support for a 'say on climate'; increased use of voting to hold directors accountable on ESG issues; and improved disclosure on shareholder resolutions that we support.

The key elements of the policy are set out under Principle 12 below.

Assurance

During the course of the year, we conducted an internal risk review of ESG integration in our investment processes. This found a good policy framework but called for more systematic evidencing of ESG analysis; including commentary on the direction and rate of change in an issuer's practices, not just absolute measures. Following this review, the risk function is more closely involved in investment & stewardship oversight.

Our responsible investment and stewardship activity were included in our UK firm-wide Assessment of Value Report. This noted the role of ESG integration of delivery of value to clients.

All published and client reports are reviewed by our compliance function. Senior management also reviews documents such as our Responsible Investment Annual Review and PRI annual assessment response. Certain limited data on stewardship that is included in HSBC Group reporting is subject to internal assurance.

We are reviewing the use of external assurance for our PRI annual assessment response. We need to review our experience of the new reporting framework to determine whether to proceed. We have discussed the potential scope with our auditor and feel we have a good understanding of the potential benefits and limitations of this assurance. Our 2020 PRI assessment resulted in an A+ rating across all areas in which we had investment activity.

In addition to the required review, approval and signature, this Stewardship Code Report has been subject to management review and sign-off before final submission.

Reflection

Policy statements have an important role if defining objectives and priorities and in communicating these to clients and others. They also set out the approach against which our performance can be judged by stakeholders. Given the scale of ambition in our statement of purpose and of the challenge on issues such as climate change, we need to be vigilant that our actions across the firm reflect commitments that will have been defined by those working most closely with these issues. Our incremental review process, along with assurance and oversight help ensure that our policies remain ambitious, relevant and reflected in our actions.

Specifically, in our voting guidelines, we have found a tension between having an accessible statement of how we approach voting and a more detailed references as to how we would respond to different issues. We have had conflicting feedback from clients as to which is preferred. We have tried to maintain a clear and accessible format. Clients seeking a more detailed understanding of our approach include our voting in annual and other review meetings.

Whilst we have amended our voting guidelines and practice to allow escalation in response to inadequate company response to engagement, this could yet be extended further.

INVESTMENT APPROACH

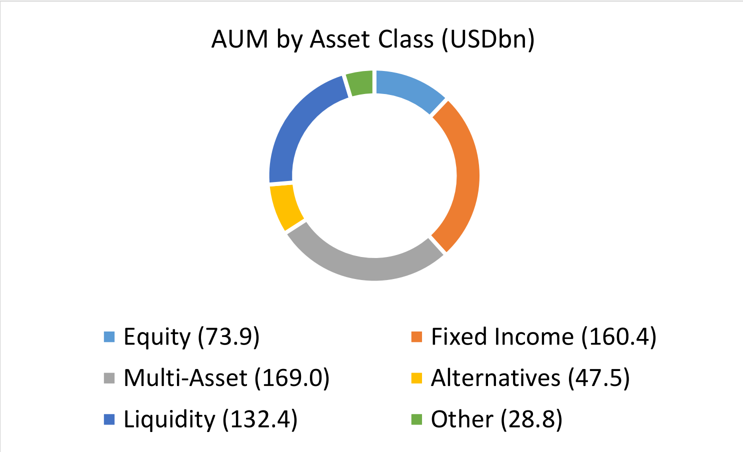
Principle 6

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

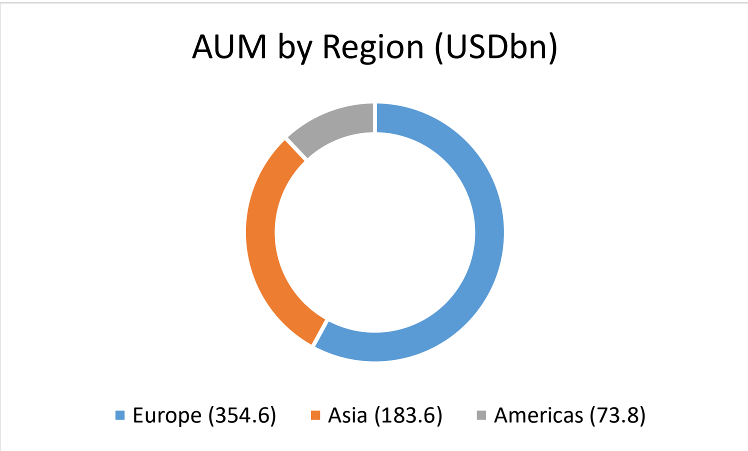
Report

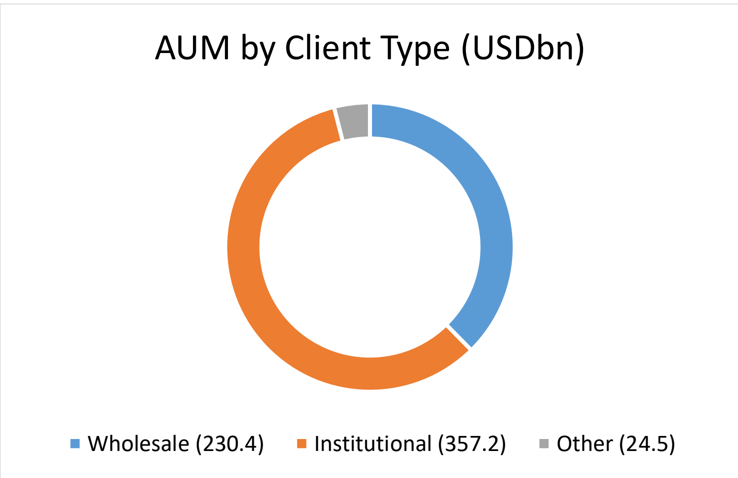
Helping our clients to prosper is a key element of our purpose. Understanding client needs, providing solutions to meet those needs and communicating how we have done so is the essence of our business.

Client base – assets under management



Total assets under management – US$612.0 billion





We have a very geographically diverse client base, with clients served from across our 25 office locations.

As can be seen from the distribution by asset class, fixed income and equities represent less than half of the value of the asset classes in which clients have invested, although multi assets portfolios will also have considerable exposure to fixed income and equities. In terms of client type, a significant proportion of institutional clients have liquidity strategies.

Investment time horizons vary from a few months with the need for instant access for some liquidity clients, through to decades for some pension funds and long term institutional asset owners.

As we retain investment exposure to issuers through passive funds and long duration instruments, our approach to our stewardship activity is as a long term owner of the issuer.

Understanding client needs

We have dedicated client segment teams, which are committed to gaining an in-depth understanding of each client, ultimately enabling us to tailor our proposition meet their specific needs. We have chosen this approach reflecting the similarity if client requirements within each segment.

These global teams supplement the local perspective with knowledge from other regions and examine global trends to interpret how they might impact local markets in each client segment.

We collaborate with our clients to understand their goals and continuous dialogue helps us design and adapt our strategies to address ongoing changes in markets and regulations as they evolve.

Our wholesale client base is mainly served by other parts of the HSBC Group. We have a continuous dialogue with them about client needs, including in responsible investment and stewardship. These issues were a particular focus in the final quarter of 2020, when we have had a number of in-depth meetings and workshops initiated by our client channels to review every aspect of our responsible investment. The discussions were focused on product strategy and design as well as thought leadership and client education and reporting on sustainable investment outcomes. There is a very high level of interest and enthusiasm for responsible investment and stewardship, although the level of understanding of the field by the end clients remains lower than for institutional clients.

Our institutional clients demonstrate a wide range of levels of interest in responsible investment. Some are recognised as amongst the leading asset owners in terms of their engagement with these issues, whilst others, are only at an early stage of expressing interest. We value the dialogue we have with all these clients. In particular, the challenge from the former group ensures that we are aware of leading edge client demands in terms of integration, stewardship and reporting. We seek feedback on our approach and gauge alignment with clients' priorities through our regular meetings and conversations with clients.

The whole RFP and client take-on process is also crucial in understanding client needs. Over recent years, we have seen a huge increase in the number and depth of questions about our responsible investment and stewardship. These questions are increasingly relevant and aligned to the mandate on offer, where initially they were sometimes generic or related to other asset classes. Where we reach the final stages of a selection process / are awarded mandates we develop a deep understanding of the clients' needs, which informs our work with them and / or future opportunities.

We undertake structured independent feedback with key clients (institutional and wholesale distributors) via our client insights programme. This includes feedback on the quality of our products / propositions and client service across three areas – people, processes and product. We also use external consultant surveys to better understand client segment preferences and investment product trends.

Responsible Investment products

Whilst most clients recognise the benefits of ESG integration in investment processes across asset classes, we have developed a number of responsible investment products to meet client objectives to reduce exposure to ESG – particularly climate risk.

We have a long-standing climate change global equity fund, as well as SRI Euroland and global equity funds specifically designed to meet the needs of some continental European clients, based on a 'best in class' process.

In 2017, we launched two lower carbon funds to deliver performance aligned with their respective assets classes combined with lower carbon intensity, one investing in global equities, the other in global corporate bonds.

In December 2018, we launched an energy transition strategy investing in in European equities directly contributing to the energy transition: smart grid, green buildings, ecologic transportation, and renewables.

In 2020 we launched a suite of sustainable ETFs enabling clients to easily implement ESG in their various strategies. We also launched the HSBC REGIO Fund which invests in emerging market green bonds and other similar bonds.

Clients considering products such as these take a detailed interest in the decisions we have taken in their construction. Some clients are looking for solutions as close as possible to their existing exposures but with the benefit of ESG risk mitigation. Others have high level requirements for particular sustainability solutions. For some, third party endorsement of our approach is important; others value thought leadership and reporting capability.

Over the past year, we were able to construct strategies to meet clients' ESG needs. In one case an existing multi-factor global equity strategy with 30 per cent lower carbon emissions and weighted better ESG ratings was adapted to apply ESG exclusions for activities in contravention of the client's own ESG policy.

Reporting

Clients can receive a full range of reports on our stewardship activity, in addition to investment performance reporting. Voting reports are available in summary, covering every vote, or votes against management. Some clients receive portfolio specific engagement reporting, whilst others receive reporting on our engagement activity across portfolios. We also publish details of all our voting as well as an overview of engagement.

We can provide ESG reports on carbon intensity and carbon footprint, carbon emissions from reserves, carbon disclosure, ESG scores, ESG ratings and rankings as required. HSBC Asset Management also reports our carbon data as part of the Montreal Carbon pledge.

For clients in France, reporting under Article 173 of the Energy Transition Law covers management of climate change-related risks and contribution to the financing of the green economy.

Reflection

In fulfilling our purpose to support the transition to sustainable investing, we believe that our expertise in ESG enables us to support clients as their needs evolve. Our continuous dialogue with clients gives us a good understanding of those needs and we have developed products and reporting to meet them.

Our current Responsible Investment Initiative review is a recognition that client needs are changing fast and we must continue to focus our efforts. Areas such as recording our engagements in a format that lends itself to client reporting are amongst those where there is scope for improvement.

Clients must determine whether we have met their needs. In some cases, we have not won mandates which we felt we were well suited to provide, or lost mandates for a range of reasons. Our emphasis on responsible investment has helped us to secure a number of new client mandates during 2020.

We are not aware of instances where we have not managed assets in alignment with our clients' stewardship and investment policies. In some cases, clients' policies have evolved and we have presented solutions to meet their new requirements. For clients invested in pooled vehicles, the policies or investment objective of the vehicle may not suit their changes; in these cases, a segregated mandate can be the answer where the mandate is sufficiently large to justify additional costs. For clients invested in index funds, a move by them to exclude stocks on ESG grounds may require a new fund or mandate.

INVESTMENT APPROACH

Principle 7

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

Report

We integrate ESG, including stewardship, into our active investment processes. Our portfolio managers and analysts are the first stewards of client assets: ESG integration is an important element in their stewardship.

Active equities

Portfolio managers and analysts consider ESG issues alongside over factors that can impact companies' performance and the sustainability of their earnings.

The starting point for ESG analysis is often the score derived from third party research providers, which we re-weight on a sectoral basis to create an in-house ESG rating. Companies' main ESG characteristics are captured in automated Executive Summaries, providing investment professionals with a concise ESG 'SWOT' analysis. For companies with the weakest ESG rating, PMs and analysts have to complete Enhanced Due Diligence (EDD). This ESG inclusive investment case also makes use of sell-side research, Bloomberg data, company CSR (Corporate Social Responsibility) reports and the outcomes of past engagements.

We also use screening to exclude stocks with exposure to banned weapons like land mines, cluster munitions, biological and chemical weapons and non-detectable fragments (these exclusions apply to all strategies: active, passive, active quant).

When presenting an investment case, portfolio managers and analysts have to include an assessment of the ESG risks and opportunities associated with the company. In some cases, this may be a key driver for the investment view, in others it may be a secondary consideration.

To further support integration, they can draw upon our ESG key topic sheets, which summarise the most relevant ESG issues, on a financial materiality basis, for each sector. These also suggest topics for engagement, issues to raise when meeting company management.

Once a company is held in active strategies, portfolio managers and analysts exercise close oversight, including regular meetings with company management, as well as monitoring the company's performance, business strategy, risk management, and culture. Portfolio managers are also responsible for voting shares in these companies as well as escalating engagement issues alongside the stewardship team.

Active equity teams are required to evidence their integration of ESG factors wherever they are based. Although European companies might historically have been more used to responding to investor questions and providing date on their management of ESG risks than their Asian peers, geography is increasingly less of a determinant in how far companies are open to ESG dialogue. This is also reflected in the high levels of interest in ESG factors amongst our portfolio managers and analysts, irrespective of location. We have a small number of active funds with climate change or sustainability objectives and constraints but out approach is otherwise consistent across our active funds.

As set out above, external research providers play an important role in our ESG integration. Our use of ratings and data gathered by these providers reflects the quality and availability of data. The data quality and coverage provided by external research providers can fall short of our requirements; the market for ESG data is still evolving and we engage with data providers as issues arise. Our voting activity is another aspect of this integration, set out in greater detail under Principle 12 below, with our oversight of proxy voting research provider ISS set out under Principle 8. ESG factors relevant to voting are set out in our global voting guidelines, which are provided to ISS. These are underpinned by a voting policy matrix defining the considerations for custom policy recommendations on each of almost 600 resolution issue identifier codes.

Active fixed income

All active fixed income strategies include ESG integration in their investment processes.

The same ESG data resources and requirement for Enhanced Due Diligence on low rated issuers as for active equity apply to the active fixed income process.

For government bonds, we use data from ISS-ESG (formerly ISS Oekom), which contributes governance & social data to a proprietary sovereign issuers ESG rating for emerging markets debt. We have found that ESG criteria are financially material in some sovereign bond markets, especially in emerging markets and in sectors where there is the largest credit dispersion. In addition to the exclusions of certain sovereigns due to government sanctions we are considering excluding issuers with a very low ESG score as part of our portfolio risk mitigation.

We are in the process of introducing our own internal corporate credit rating integrating ESG factors. Sustainability risks, especially corporate governance, have long been incorporated in our traditional credit rating methodology. As such, including ESG factors in our internal credit rating will not represent a change of philosophy. Nonetheless, it will enhance transparency around ESG factors that impact our internal rating as well as capturing ESG considerations with material credit impact. This internal credit rating methodology applies to all asset classes from non-financial to financial corporates. We have defined industry-specific key ESG risks factors by reviewing 22 sectors and identifying 225 ESG factors; each of them weighted within the overall internal rating. For financials, particular emphasis is put on governance - including risk monitoring, audits and controls, corruption and bribery, contribution to financial instability - which we view as the most material factor in the overall ESG assessment. For non-financials the priority issues will vary; for companies in extractive industries, emphasis will be more on direct environmental impacts - greenhouse gas emissions for instance - and for healthcare and pharmaceutical, the focus will be more on social dimensions such as access to medicines, prevention and control of medicines' potential misuse.

Fixed income has global processes for its different strategies. Thus the integration described applies wherever corporate fixed income is managed, supported by a global credit research team. As the key elements of the integration are based upon our own and external research, our integration is less dependent on the relative responsiveness of issuers in different markets.

Thematic fixed income

Lower Carbon bonds. This applies the same internal ratings as traditional portfolios while reducing the average carbon intensity by 40 per cent or more versus the reference benchmark. The analysis is supported by our global research platform, examining issuer carbon impact and green bonds to understand the overall footprint, and by our engagement with issuers to encourage carbon reduction when necessary.

Green bonds. These play an important role in transitioning to a lower carbon economy and increase the robustness of the overall portfolio. Our approach is to invest in labelled green bonds that satisfy both our bottom up analysis to ensure that the bond finances projects that provide clear environmental benefits eligible under the Climate Bonds Initiative taxonomy and a more granular top-down green assessment at the issuer level to ensure that green bond issue is the result of a broader environmental strategy. We exclude companies exposed to substantial environmental risks that do not have a clear strategy to reduce this exposure or manage the associated climate risk.

Real Economy Green Investment Opportunity (REGIO) fund. We have launched a dedicated strategy combining our ESG and green bond approach for emerging markets with the aim to allow investors to achieve ESG and climate change objectives by investing in green and sustainable bonds focused on the real economy. This strategy has been created alongside leading Development Finance Institutions. It invests in emerging market green bond issuers, to deliver real economy impacts in primarily lower Gross National Income countries and enable investors to achieve long term, sustainable returns, whilst delivering on broader climate and environmental objectives in line with the SDGs and Paris Climate Agreement. By supporting and building the market for green and sustainable bonds, we can also promote and develop sustainable finance and investment in emerging markets.

Passive and active quant strategies

We have a number of purely passive equity index funds and ETFs, active quant factor equity funds and passive fixed income funds. Some of these include ESG criteria, either through the index they track or as an integral part of the fund's investment process. Stewardship for holdings in these fund is undertaken by the stewardship team and by active portfolio managers and analysts when they engage on behalf of all our holdings in an issuer.

Securitised credit

Compared to other fixed income and equity, there is little coverage by ESG ratings providers of securitised debt. Credit ratings agencies offer only limited ESG analysis. Yet the potential for ESG issues to impact investment sustainability is the same for other asset classes. For this reason, we have developed our own proprietary ESG integration process.

ESG factors are assessed with respect to their relevance to credit risk (as opposed to considering ESG opportunities). Each transaction under review is scored with a 'Low', 'Medium' or 'High' impact on credit. Each ESG factor is evaluated by a credit analyst based on the information provided by the originator/sponsor of the transaction or the sell side. In absence of any third party ESG research for securitised credit, proprietary weights are used to assess the relevance of each factor.

Similar to Corporate (financial) fixed income, governance is typically allocated a substantial weighting in all securitised credit transactions, however, each asset class within securitised credit may have a different skew towards environmental or social factor due to the importance of these aspects to the respective asset class.

Securities backed by auto loans will have a skew towards environmental factors due to environmental risks of certain engine types, their impact on residual values as well as impact of fines and remediation costs following the emissions testing failings. Consumer loan backed transactions will have a higher weighting allocated to the social factor to reflect the risks of discriminatory or aggressive lending and servicing practices. In residential mortgage backed securities as well as single family rental transactions, social factors will be assessed - accessibility to affordable housing. For commercial mortgage backed securities, a focus on environmental factors will capture any 'green' credentials of the buildings as well as consider issues related to the tenants.

For collateralised loan obligations, the CLO manager's ESG policy resulting in portfolio selection and industry allocation will be central to the transaction's ESG risk assessment.

Any transaction with 'High' impact on credit will require mitigating factors to be thoroughly documented, however, if no such mitigating factors can be identified and transaction will be deemed ineligible, it will not be submitted to the Investment Forum for review.

Private and infrastructure debt

For private debt, ESG analysis is integrated through the initial transaction screening process, subsequent due diligence and ongoing stewardship and monitoring. The nature of the transactions means that there is significant access to management teams and external due diligence available on environmental and legal issues to enable understanding of historic liabilities as well as future risks. All investments need to be approved by the relevant investment committee. The current focus is on ESG risks rather than ESG opportunities.

Infrastructure projects are typically assets with a long economic life, which as such lock in the associated carbon footprint for the long-term. All potential investments are reviewed with consideration of the impacts from a transition to a low carbon economy such as future changes to energy mix, carbon price, fossil fuel price, transportation preferences as well as associated regulatory changes linked to climate change. We encourage project owners to measure and disclose associated greenhouse gas emissions. Some investments may be declined where ESG impact and subsequent reputational risk are deemed to be too high.

Liquidity

Liquidity represents a large portion of our assets under management yet it is an asset class where ESG integration and stewardship have been little developed. For the client, the combination of the expected return and the ability to access the assets as needed is the priority. We believe that there is scope for incorporation of ESG factors in the construction of liquidity portfolios.

We plan to create money market funds based upon an ESG Liquidity investment process that incorporates ESG factors and engagement with issuers. We will apply this approach to an asset class that is held by a broad range of investors, providing them with an entry point into sustainable investments and creating a robust, sustainably invested product for those clients who choose to invest their cash in a sustainable way.

We believe that ESG integration is a necessary part of the credit process and we currently integrate ESG factors into all of our existing liquidity funds but the process needs to go further to qualify as a sustainable investment.

Our ESG money market funds will integrate AMG's proprietary ESG research to score all issuers in the investible universe and apply screens based on relative ESG score that meaningfully impact the universe resulting in a money market fund portfolio that invests in only those issuers who have demonstrated an ability to better manage ESG risks. We will continue to systematically engage with our approved assets managers in order to make sure their social and governance policies are aligned with our practices and policies.

Hedge funds

We have a fund of hedge funds business. ESG factors are an integral part of the due diligence process when assessing an underlying hedge fund. They are part of the overall qualitative assessment of a potential fund constituent and weigh upon the outcome of the process, which is binary; potential investment with insufficient consideration of ESG is rejected. This process is not yet mature; we envisage fine tuning of the ESG criteria, as well as the opportunity for engagement with managers to understand their approach to ESG and encourage good practice.

HSBC Pollination Climate Asset Management

In 2020, we entered into a joint venture agreement with Pollination Group Holdings Ltd to establish HSBC Pollination Climate Asset Management – subject to regulatory approval. The partnership will aim to create the world's largest natural capital manager and is the first large-scale venture to mainstream natural capital as an asset class.

Through the creation of private funds, HSBC Pollination Climate Asset Management aims to offer investors a wide exposure to global natural capital themes in both emerging and developed markets. The partnership will also provide stewardship and evaluation of the investments, enabling investors to quantitatively measure impact.

The proposed group of funds will aim to attract capital from institutional investors, including sovereign wealth funds, pension funds and insurers into natural capital investments. The funds will invest in a diverse range of projects that will preserve, protect and enhance nature over the long-term.

Sustainable investment in natural capital provides exposure to projects focused on nature including sustainable forestry, regenerative and sustainable agriculture, water supply, blue carbon (carbon captured by oceans and coastal ecosystems), nature based bio-fuels, or nature based projects that generate returns from reducing greenhouse emissions.

Reflection

For the active management of equities and fixed income, our ESG integration processes have evolved over time. They continue to evolve as record keeping and oversight become more formalised. Portfolio managers and analysts understand well their role as stewards of the assets they manage and their engagement with companies is part of their investment process, the one informing the other.

Our current Responsible Investment Initiative review has recognised that there can be better feedback loops between investment teams, across asset classes and with the stewardship team. These will ensure that all investment decisions benefit from stewardship insights and that stewardship activity is informed by any active positions and views

For other asset classes where we are managing clients' money, ESG integration is often not so long established. We are applying integration to other asset classes because it aligns with our purpose and investment beliefs. Applying ESG integration is an act of stewardship in itself, whilst other aspects of stewardship in the integration and ownership of these assets will take longer to develop.

Client time horizons and investment priorities are initially reflected in their choice of asset class and strategy. Our stewardship activity is typically undertaken as long-term holders in the issuers concerned. Issuers' response to long-term issues can however impact the value of their securities in the short-term. For example, BP and Shell re-stated the value of their assets during 2020 following a reassessment of future oil demand due to low carbon transition. Clients are also interested in the alignment of ESG time horizons with investment; many share our view that ESG risk management is prudent for the short as well as medium and long-terms. We maintain a dialogue with clients to ensure that we maintain a good understanding of their time horizons and that these continue to be reflected in our investment management and stewardship activity.

INVESTMENT APPROACH

Principle 8

Signatories monitor and hold to account service providers.

Report

Service providers play an important role in helping us to deliver our responsible investment and stewardship activity. ESG ratings and the data which underlie them are often the starting point for identifying ESG risks for research and stewardship intervention. They are also often the basis for exclusion or factor weighting in systematic ESG products. For voting guideline research and vote instruction we rely upon ISS to provide gather information on the matters for consideration at company meetings and ensuring that our vote is accurately captured and communicated down the voting chain.

ESG data providers

The review process for these providers includes understanding their coverage universe, so as to ensure that all clients regardless of the strategy they invest in, can benefit from the use of comparable ESG data. Furthermore, we consider how the service provider has helped us implement our policies - e.g. ISS-ESG for excluded issuers that breach our Banned Weapons Policy – or our investment processes - e.g. Sustainalytics for issuer compliance with the UN Global Contract.

As MSCI is one of our ESG data providers, it receives the brunt of our feedback and comment on the data available. We raise specific errors we uncover as well as where there are unwarranted gaps in data. This feedback is conveyed as part of our regular dialogue with MSCI and in meetings to raise concerns.

Our contracts with third party ESG data providers are limited to 3 years. The renewal of these contracts is subject to a formal RFP overseen by our Global Data Management Department, which is independent from the Investment function.

ISS

We provide ISS with instant feedback when we identify apparent errors in their research or their interpretation of our policy. In some cases, we ask for the custom recommendations to be reissued so as to ensure there is an accurate record of recommendation, intended vote (pre-engagement) and instruction. We also push them when research is not yet available for meetings with imminent instruction deadlines. Each of our local offices using ISS has a local customer support and provides feedback on service levels. We have an annual meeting to review the service globally and identify where improvements are required. For example, last year we identified an inconsistency in how meeting volumes were recorded for our Canadian office, which resulted in work involving the custodian and ISS to ensure that processes were aligned.

We have previously undertaken exercises to track our votes, although have not done so this year. We do monitor the confirmation of acceptance by the next element in the voting chain on an *ad hoc* basis. We have also participated in industry initiatives to improve the vote instruction chain. HSBC Group was an early investor in the Proximity business which aims to use real time data connections to transform the efficiency and transparency of the vote instruction process. We joined an Investor Forum collective engagement with Proximity during the year to understand their current progress; we continue to monitor this opportunity closely.

Reflection

We have discussed elsewhere the limitations on ESG data providers – they can only provide data that is already available, coverage can therefore be reduced in certain markets and for smaller cap companies, language can (but should not) be a barrier to their capture of some data. Our review process is intended that we ensure we secure maximum benefit from the data which they can access. Our engagement emphasis on encouraging transparency and disclosure – directly and through our support for initiatives such as CDP – are intended to help address the systemic weaknesses in data availability, consistency and quality.

The use of ISS for voting research and instruction by the majority of the world's large and many smaller asset managers and owners represents a collaborative solution to the challenge of covering many thousands of company meetings with relevant information from different sources and formats. We recognise the scale of this challenge and welcome the investment which ISS has undertaken in recent years to improve their service standards. Large-scale monitoring and assurance that each vote has been received and counted correctly is not proportionate. We remain hopeful that systemic improvements in vote confirmation can be secured.

ENGAGEMENT

Principle 9

Signatories engage with issuers to maintain or enhance the value of assets.

Report

We engage with issuers to protect and enhance the long-term value of our clients' investments. We raise a range of issues including delivery of corporate strategy, financial and non-financial performance and risk, allocation of capital and management of ESG issues. Our engagement objectives 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 engage across both our equity and fixed income holdings, leveraging our strong research capabilities across both asset classes. Engagement is integral to the fundamental research process. Our active equity and 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, covering relevant ESG issues in their research and discussions.

Where we have identified company specific or systemic risks we will raise these concerns through meetings, site visits, conference calls or correspondence.

The overarching goal of this engagement is assurance that risks are being managed and changes in practice encouraged where we believe they are not. Companies may decide to address investor concerns after one interaction, others require a multitude of engagements. Not all engagements result in a positive outcome, but this in turn may impact our view of a company. We regard stewardship as integral to our long-term approach to investment. We prioritise engagements based on our holding, issue and exposure, not necessarily whether we expect change and will be able to demonstrate outcomes.

Engagement methods

Our engagement is based upon our knowledge of the issuers and issues concerned. We monitor how well issuers are managing the risks associated with different ESG issues. Our monitoring covers: strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance. For thematic engagement we build an understanding of how different issuers are managing a risk, what good (and bad) practice looks like and the steps issuers can take to perform well.

We use a full range of engagement approaches, selecting the most fitting and resource appropriate. These include writing letters to raise concerns and / or explain our view, meeting investor relations and specialists, meeting company management and board members, and attending AGMs. We will often seek commitments from companies to address concerns. Subsequently we monitor issues and company progress.

Our engagement is focused on investee companies and other issuers but may also include stakeholders, regulators, industry partners and academics to inform relevant standards and practices.

Our participation in collective engagement and escalation where satisfactory outcomes have not been achieved are set out under Principles 10 and 11 below.

Much of our engagement is undertaken by portfolio managers and analysts as part of their regular contact with issuers. This approach means that the consideration of issuers' ESG risk management is fully integrated into our investment process. It also means that issuers understand that ESG concerns are part of our investment view, considered by investment decision-makers in their buy/sell decisions.

The stewardship team supports portfolio managers and analysts in their engagement, particularly where an ESG issue has been identified which may significantly impact the investment thesis for an issuer. This means that the experience of the team in conducting engagement, examining issuer disclosures and evaluating good practice complements the knowledge of issuers held by the other investment teams. There is an increasing role for this support in asset classes other than equity or fixed income, where there may not be such a long-established culture or knowledge of engagement. As set out under Principle 6, these asset classes represent an important element in our assets under management.

The stewardship team typically takes the lead on issue-based thematic and collaborative engagements. They investigate how a range of companies are addressing a particular issue, what are the current and potential regulatory requirements and what are feasible and optimal responses from issuers. Collaborative engagements are also resource intensive, involving extended contact with the issuers and co-ordination with other investors. This means that stewardship team members can deepen their knowledge of particular ESG issues, which informs future engagements as well as representing an in-house centre of expertise on those topics.

It is also appropriate to devote resources to thematic engagements as these include issuers held only in passive and active quantitative mandates.

Annual engagement plan

A large proportion of our engagement is undertaken by active investment teams in the course of their investment work.

For the engagement of the stewardship team, we undertake an annual planning exercise to identify risk exposures and priorities for engagement. We use ESG ratings scores and holdings information to evaluate our weighted exposure to different ESG issues. We also poll investment teams and client-facing colleagues from each office to ask them about investment and client engagement priorities, which may be added to our plan. This global and local approach also enables us to determine whether an issue encompass our holding globally or it is more relevant for specific markets.

Issues prioritised for our 2020 engagement plan included: Environmental – CDP disclosure campaign, use of plastics in packaging, water usage by beverage companies; Social – low rated emerging market issuers, cobalt supply chain labour standards; Governance – independence ratio on Japanese boards, US remuneration practices, Communist Party Committees in Chinese companies.

Enhanced engagement

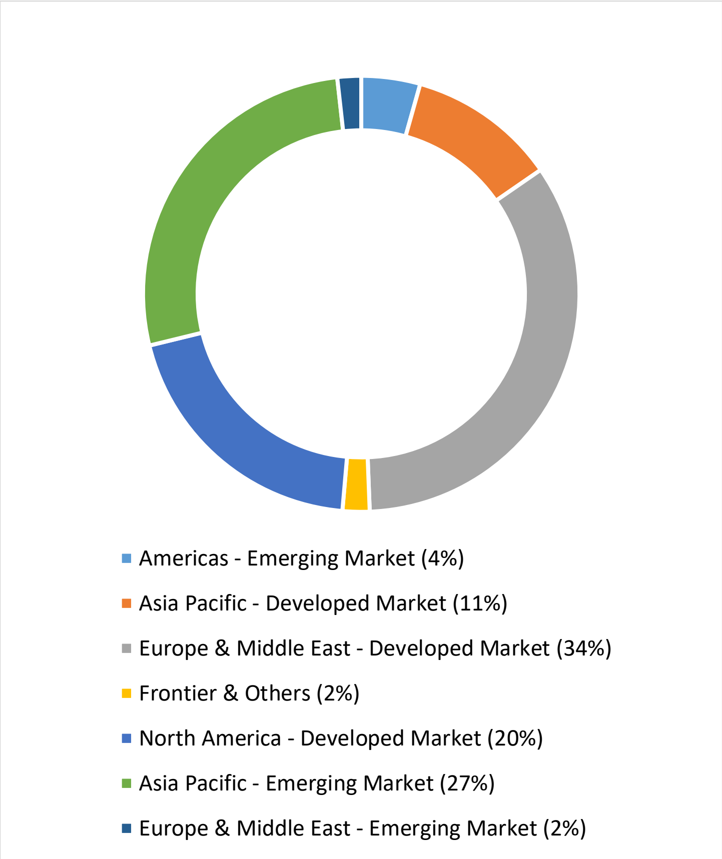
One recent development is the enhanced engagement undertaken by two of our active equity teams. Whilst the stewardship team often undertakes thematic engagement seeking change, the engagement of our active fixed income and equity teams is often either linked to the annual reporting cycle or in response to specific events or concerns. Enhanced engagement has been developed as an opportunity to step back and consider underlying concerns or issues where change could bring benefit to company and shareholders. The engagements are led by portfolio managers and analyst themselves, supported by the stewardship team. We are considering rolling out this approach to other investment teams and asset classes.

Engagements

Overall ESG issues were raised in engagements with over 2,300 corporate and non-corporate issuers in 78 markets in 2020.

Breaking these down by asset class, ESG issues arose in equity team meetings with 977 companies, 59 per cent of meetings. For our fixed income teams, ESG issues arose with in meetings with 998 companies, governments and other issuers, 87 per cent of meetings. In addition to this, our stewardship team engaged with 769 companies seeking improvements in ESG practice and / or reporting.

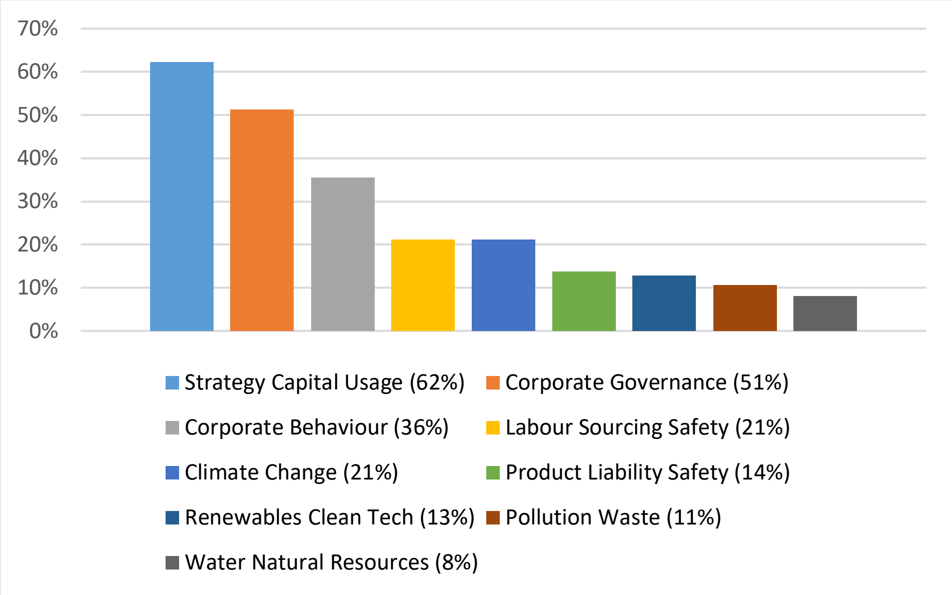
Regional breakdown of ESG engagements



Engagement by theme

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 ESG issues which arose when engaging with companies or institutions is illustrated below.

ESG issues arising in engagements



COVID-19 impact

Our engagements with companies went up in the second quarter of 2020 – by 11 per cent, from 1,504 in q2 2019 to 1,682 in q2 2020 – which reflects the more intense communications which companies were having with their shareholders through the crisis period of lockdowns (it stabilised in q3). COVID-related issues were recorded as a specific element in 306 engagements in q2, considerably more than any other quarter (136 in q1, 224 in q3 and 106 in q4) – though clearly wider business conditions would have been a factor throughout.

ESG continued to be a crucial element in our engagements – featuring in around 75 per cent of them. The spread of issues raised was broadly similar, with the most marked difference being increased focus on social issues. In particular, supply chain & production issues – labour / suppliers / supply chain safety – arose in 304 engagements (22 per cent of the q2 total), compared with 131 (9 per cent) in the same period in 2019. This reflected the challenges in maintaining supply sources during lockdown, as well as scrutiny of staff / labour / safety.

Capital raising by companies in the most challenged sectors clearly required close assessment of capital strength and requirements. We were generally sympathetic to companies seeking shareholder authority to raise capital and participated in some share issues. We were generally unsympathetic towards companies proposing executive remuneration increases or amendments out of line with staff and shareholder experience of the crisis, voting against some remuneration reports.

Engagement examples

These examples represent a selection of engagements undertaken within the fixed income and equity asset classes. They are drawn from a range of geographies and include holdings in a number of funds. Whilst portfolio managers and analysts engaging with issuers are likely to be mindful of holdings in their own strategies, we represent all of our holdings when we engage – holdings in active funds may be replicated across a number of clients and will usually also be held in passive and active quantitative strategies. We engage across all geographies, whether via local investment teams, local stewardship team members or from the UK. Whilst developed market issuers may often have larger teams for investor relations and communication on ESG issues, emerging and frontier market issuers are increasingly receptive to investor ESG engagement, often looking for a good understanding of expectations and good practice.

Fixed income examples

Company – Bayer AG, which produces and markets healthcare and agricultural products.

Issue – we were initially concerned about the potential negative effects of Monsanto acquisition, in particular potential liabilities related to Glyphosate litigation.

Action taken – we modelled potential settlements in our valuation, conducted voluntary Enhanced Due Diligence and engaged frequently with the company emphasising its reputational risk.

Outcome – the company has improved its communication compared with Monsanto.

Company – Verizon Communications Inc., an integrated telecommunications company.

Issue – the company announced that it had used the majority of green bond proceeds for operational, rather than capital expenditure, in breach of our green bond guideline 50 per cent limit for operational spending.

Action taken – we raised our concerns with the company and internally with our investment committee.

Outcome – the company has not updated its practice on the use of green bond proceeds; we have excluded the company from our list of approved green bond issuers until it does so.

Company – Shriram Transport Finance Company Limited is an Indian asset financing company.

Issue – we were concerned about the impact of the COVID-19 pandemic on the company's operations and access to funding; there were also concerns about systemic liquidity and non-bank-financial institutions.

Action taken – we increased the frequency of engagements with the company, making use of results briefings, third-party conferences as well as direct contact.

Outcome – the company addressed investor concerns, providing more detail around access to funding, monthly liquidity and system liquidity; in August it specifically briefed fixed income investors on capital raising plans.

Company – AB Volvo is a commercial vehicle manufacturer.

Issue – the company had not provided specific dates or deadlines regarding individual targets for emissions reduction like peers such as Daimler had with its 'Ambition 2039' strategy.

Action taken – we met company representatives to discuss our concerns and expectations.

Outcome – the company explained that even without published commitments it was bound by 2035 EU fuel consumption reductions by 2030. In November, it committed to the Science Based Targets initiative & in March 2021 to net zero emissions by 2050.

Equity examples

Company – Samsung Electronics Co., a South Korean electronic equipment manufacturer.

Issue – Samsung has been historically associated with poor labour relations, safety issues and controversies both in its own operations and its supply chain. We were concerned these issues could be increasingly damaging to the company's reputation with customers, impacting growth opportunities.

Action taken – In our regular twice- yearly meeting with the company's ESG & communications team, we informed them of our concerns and expectations for change. We also arranged a call with the newly appointed Head of Human Rights, repeating our concerns and pressing for change.

Outcome – Samsung's child labour policy coverage has been extended to all markets as we requested. The right to form a union has been introduced and all management staff trained to identify and prevent union busting activities. We also were assured that the victims of a long-standing chemical incident will be adequately compensated.

Company – JSW Energy, an Indian power company with mining assets.

Issue – We were concerned about the adequacy of JSW Energy's carbon reduction and energy transition strategy as it was rated below its sector median by MSCI and at 'C' by the CDP. Considering India's ambitious targets to reduce emissions and increase renewables by 2030, we felt JSW might miss growth opportunities if energy transition was not fully integrated into its strategy.

Action taken – We met company representatives and shared our expectations concerning increased transparency about the Board's involvement in reviewing climate-related risks and opportunities with stress testing of assets under different climate scenarios. We also called for improved disclosure of future investments and climate related targets.

Outcome – Whilst we acknowledged JSW's plan to increase its hydro, solar and wind capacity in the medium term through acquisitions and that it conducted scenario analysis test – although currently not disclosed – we remained concerned that planned capital expenditure only includes maintenance of its thermal plants. We will continue our engagement, encouraging disclosure about stress testing results – including carbon pricing.

Company – China Longyuan Power Group Corporation is a Chinese wind farm developer and operator.

Issue – China Longyuan is primarily a wind energy developer, however, it still operates two coal power plants. We estimate that only 4 per cent of the company's market capitalisation is attributed to its coal business. We were concerned that the management spend excessive time in managing the coal assets, whilst it would be better focusing on the wind energy opportunity.

Action taken – We met the company and encouraged it to decommission its coal assets rather than selling them. This may represent a short term cost to the company but would represent a social and environmental benefit.

Outcome – The company has not yet taken the steps that we seek; we remain confident that we have added our voice in the strong momentum that seeks more climate action in China and globally. We will continue to monitor the company's actions relating to its coal business and meet with senior executives.

Companies – a selection of 23 Chinese companies across multiple sectors.

Issue – Changes in regulation in China suggest increased influence of Communist Party Committees (CPCs) within companies. We were concerned about potential misalignment between the CPC and shareholder views that could impact valuations.

Action taken – We contacted a number of privately owned companies that are either listed as A-shares or as ADRs, and have significant operations in China. We encouraged companies to improve disclosure on the roles and responsibilities of the CPC. We also shared our expectations for independent and objective board decision-making and the need to protect minority shareholder interests (e.g. related party transactions, dividend policy).

Outcome – Our understanding from the dialogues we had is that CPCs are a means of 'soft control' over private enterprises in China. Whilst they may not have an explicit role other than in the educational/cultural sense, their presence provides an informal mechanism for the Chinese Communist Party (CCP) to monitor operations, governance and decision making at private companies, especially where senior personnel are CCP members. From our discussions it appeared to us that when senior members of the company are themselves Party members, the integration of Party objectives and considerations occurs naturally. We will continue to request information and encourage disclosures on CPCs when we interact with Chinese companies.

Company – UOL Group Limited is a Singapore-based global investment and real estate company.

Issue – To meet the Paris agreement targets the buildings sector's GHG emissions need to be reduced by 77 per cent by 2050 compared to current levels. We were concerned about how UOL was reacting to this challenge both directly and via its upstream supply chain (composed of heavy GHG emitters).

Action taken – We wrote to the company expressing our views on climate change-related risks and opportunities and its relevance to the company's operations. We asked about details of UOL's climate scenario analysis (if undertaken) and estimated financial impacts. We also asked the company to start setting targets aligned with the Paris agreement goals. Finally, we urged the company to engage with upstream suppliers to reduce emissions, to disclose findings and its scope 3 emissions.

Outcome – UOL's confirmed that the board has oversight of ESG issues such as climate change, supported by the Sustainability Committee that is led by the CEO and senior management – whose remuneration KPIs include sustainability metrics. We were also reassured that new sustainability targets for 2030 would soon be announced. The company also confirmed its environmental policy includes contractors, with certification and regular reporting requirements in place. We will review UOL's upcoming ESG report, and identify in more detail any additional gaps or concerns we may need to raise in the future.

Company – Sea Limited is a Singaporean online IT service provider.

Issue – There is limited coverage of this stock by third-party data providers; engagement was therefore key to improving our understanding of the ESG issues the company faces and the need for better disclosures. Alongside our concern regarding the negative physical and psychological impacts of gaming addiction, we were aware of Sea's exposure to regulatory limits on gambling across markets in which it operates (e.g. curfews, censorship, and spending limits) and potential negative reputational risks from gaming addiction and violence associated with its products.

Action taken – We contacted Sea seeking a meeting on these issues. After two months of multiple follow-ups their investor relations team agreed to talk. We met with company representatives to raise concerns on gaming addiction, gaming violence and their talent management.

Outcome – Despite being able only to address a couple of the points we wanted to discuss, Sea's team appeared unwilling to provide follow-up responses to our remaining questions. Overall, there was little evidence that the company would be addressing the identified issues adequately, as its representatives played down the risks throughout the call. Indeed, we questioned how far ESG issues such as video game addiction and violence were being monitored and managed within Sea. We encouraged Sea to publish more ESG data through a sustainability report, however, no commitment was given on this. We shall continue to seek updates to their ESG management and disclosures as well as monitoring closely the ESG risks associated with this company.

Company – China Resources Beer Company Limited (CR Beer) is a Chinese alcoholic beverage retailer.

Issue – In addition to dependency on water in the upstream supply chain, Food & Beverage companies also rely on clean and abundant water resources for their own operations (e.g. brewing, bottling). With many parts of northern China exposed to high or extremely high water stress, we were concerned this would impact the sustainability of our investments in the company in the medium to long term.

Action taken – We engaged with CR Beer on the issues highlighted, sharing our concerns about water stress, climate change and supply chain risks in the medium term.

Outcome – The meeting was positive and the company confirmed it was open to future engagement on ESG issues. Currently it appears to be more driven by regulatory compliance than a more holistic view. However, the company recognises it is on a journey with regards to ESG policies and was receptive to our feedback. We shall follow up with the company. This will include clear expectations on disclosure, with reference to CDP, CEO Water Mandate & industry best practice.

Company – Comcast Corporation is an American media and television broadcasting service provider.

Issue – We were concerned that the pledging of company shares held by executives and directors could undermine their alignment with shareholders' interests. Whilst we were satisfied with a policy prohibiting hedging and commended Comcast for that, we asked to apply the same strict criteria also for pledging.

Action taken – We wrote to the company asking for an explanation of their approach. We subsequently met them.

Outcome – We were subsequently contacted by the company to inform us that they had decided, through the Compensation Committee, to revise their policies and to prohibit any pledging of company stock -or holding such stock in a margin account.

Company – F&F Co. Ltd. is a South Korean manufacture and reseller of men's and women's apparel in Asia.

Issue – The company had started its operations in Korea but was rapidly expanding its geographic reach in China and various ASEAN countries. The growth strategy presented was compelling but we were unable to establish a clear relationship between F&F and the brand owners (i.e. legal structure, economic structure, conditions of the various agreements, geographic coverage, etc.).

Action taken – After undertaking internal research and analysis on these issues we shared and discussed our findings with the company's senior management.

Outcome – After our dialogue with F&F's representatives, we were still unable to gain the evidence we had sought surrounding the company's licensing arrangements. We decided to divest.

ENGAGEMENT

Principle 10

Signatories, where necessary, participate in collaborative engagement to influence issuers.

Report

Collaborative engagement has become an increasingly important element in achieving our purpose, in particular in our engagement on climate issues through the Climate Action 100+ initiative. We have also participated in a small number of collaborative engagements through the UK Investor Forum, and continued engagements undertaken though the Principles for Responsible Investment.

Climate Action 100+ (CA100+)

Limiting global warming to 1.5°C requires rapid, far-reaching and unprecedented changes in all aspects of society. The scale and speed of the transition that is required, means that even an orderly transition will impact how companies operate now and in the future. Given the systemic nature of the challenge, our participation in Climate Action 100+ (CA100+), has formed a central role in our engagement on this critical issue as this global initiative with 575 investor signatories provides us with greater ability to influence companies.

We have played an active role in this initiative, as chair of its global steering committee and as lead or support investor for eleven companies as well as joining further engagements. These include two emerging market producers Vedanta & China Shenhua, enabling us to bring our experience in addressing climate issues with European companies to our role as a major emerging market investor.

The initiative has had a significant role during the past year in encouraging companies with carbon exposure to make net zero commitments for 2050 and announce action plans and milestones for progress before them. Amongst companies where we have been involved with engagement, the following CA100+ targets have made this commitment: ArcelorMittal, BHP, BP, Equinor, Rio Tinto, Royal Dutch Shell and Total.

UK Investor Forum

The UK Investor Forum was established following the Kay review to provide for collaborative engagement by investors with UK companies. As members of the Forum, we have participated during the year in a small number of engagements.

These include an engagement with Barclays regarding its climate strategy which resulted in the company putting its strategy to the vote at its AGM and receiving significant support. We also participated in an engagement with Aviva which informed changes in the company’s CEO and Chairman.

Details of an engagement with SSP are set out below.

Principles for Responsible Investment (PRI)

As one element in its framework for the commitment to responsible investment of more than 3,000 asset managers and owners, the PRI provides a platform for collaborative engagement on a range of issues.

We are lead investor for a small number of companies across two collaborative engagements.

In the past year, we have continued our engagement with Nike on policies and disclosure in sourcing leather, and Costco on its policies on meat sourcing. Both of these engagements are focused on limiting deforestation.

Collaborative engagement examples

Company – BHP Group, a global resource mining company.

Issue – BHP is one of the world's largest producers of iron ore, mining a range of other minerals, including metallurgical and thermal coal, as well as maintaining oil & gas production. The company had been a leader in its sector in addressing the challenges of carbon transition, but needed to make new commitments to meet rising investor expectations.

Action taken – We are the European lead investor with the company under Climate Action 100+ and met the company more than a dozen times over the course of the year, providing feedback on various aspects of its climate strategy, as well as co-ordinating support investors and engaging with other listed members of the controversial Minerals Council of Australia lobby group.

Outcome – During the year, the company added to its existing net zero operational emissions commitment with a 2030 target to reduce operational emissions by 30 per cent, announced work to explore reductions in scope 3 emissions in its use of shipping and in steel production, strengthened the link between executive remuneration and the climate plan and improved its analysis of the impact of a no more than 1.5 degree scenario on its portfolio. It also committed to sell its thermal coal business.

Company – Equinor, Norway's main producer of oil & gas.

Issue – As a major upstream producer of oil & gas, the company needed to build on its existing commitments and strategy for the low-carbon transition.

Action taken – We are joint lead investor with the company under Climate Action 100+ and met the company several times during the year, encouraging the development of its climate strategy, as well as co-ordinating support investors.

Outcome – The company made a commitment to become net zero by 2050, including scope 1, 2 & 3 emissions (based on indirect emissions of customers' use of Equinor's equity production). It also committed to carbon neutral global operations by 2030, with net zero and no offsets by 2050. It enhanced its ambition as a renewable energy provider, planning to quadruple capacity by 2035.

Company – ExxonMobil, a leading US oil & gas producer.

Issue – ExxonMobil has not matched the low carbon transition plans announced by European competitors; questions remain about the sustainability of its operations.

Action taken – as a support investor under the CA100+ initiative, we have participated in investor discussions about company developments and how to respond to them. At the end of 2020, we co-filed a shareholder resolution calling for the company to publish its scope 3 emissions.

Outcome – The company published scope 3 emissions for the first time as part of its environmental reporting in 2021; further steps are required to detail its low carbon transition plans.

Company – Vedanta, an Indian-listed global mining company.

Issue – The company updated it energy and carbon policy in January but still had to make further commitments to meet the expectations of international investors. Engagement was interrupted when the company announced its intention to de-list but resumed after that did not go through.

Action taken – As co-lead investor under the CA100+ initiative, we met the company in the spring and followed this up with a letter setting out expectations. The engagement resumed in November, explaining the CA100+ net zero letter to the company.

Outcome – Despite the attempt by the company to de-list, it has maintained its public commitment to a transition strategy; and in November promised TCFD reporting in Q1 2021, followed by short, mid and long term emissions reduction targets in Q2 2021. Investors will then look for the plans to deliver these targets.

ENGAGEMENT

Principle 11

Signatories, where necessary, escalate stewardship activities to influence issuers.

Report

Escalation is an essential part of any engagement strategy. Whilst we would like companies to respond positively to every engagement, they often have competing or entrenched interests or simply take time to be persuaded of the need for change. Appropriate escalation is the means to continue to press our case.

How we escalate an engagement will vary according to issue, fund, assets and geographies; shareholders have different rights in different markets, whilst cultural norms impact the likely effectiveness of an approach. We consider the time a company has had to address a concern, the scope of our engagement to date, a company's responsiveness, as well as the likelihood of a particular approach actually being successful.

Initial escalations may include raising the concerns with the company Chair, independent board directors, or using our votes to express our concern over inaction. Where these fail to yield results we may engage collectively with other investors and consider more public interventions such as statements, letters to the press, AGM attendance, filing shareholder resolutions or requisitioning general meetings.

The appropriateness and relevance of an issue for escalation is an important consideration, as is the clarity of the message we would be sending. Where the issue is already a voting matter, the scope for escalation through voting is clear – as in the example of voting on non-independent board members at Japanese companies below, where we explain or approach in advance and communicate clearly on the rationale for our vote.

If there is not a clear shareholder vote on an issue, we may still use voting as an escalation – whilst we engage with a range of companies through the CDP campaign for companies not responding to its TCFD-aligned climate survey, our policy of voting against company chairs who do not respond – also set out below – is reserved for more energy-intensive sectors where the importance of clear disclosure is beyond dispute.

We are increasingly voting against directors with particular responsibilities as members of committees that have failed to exercise oversight of an ESG issue or respond to investor concern when there has been inadequate response over time, since an adverse vote expressed shareholder concern.

Other failures to respond to engagement may not merit escalation beyond follow-up contact – for example we engaged with companies on the use of plastic in packaging as part of our 2020 engagement plan, companies that did not respond have in the first instance received follow-up communications repeating our expectations and sharing some of our findings; we would not expect a punitive escalation on this issue until at least another round of research and engagement.

Just as we engage across funds and asset classes, so too do we escalate our engagement across funds and asset classes. The opportunities for a fixed income investor to vote on an ESG concern are limited so a voting sanction is less likely but inadequate engagement responses may lead to non-participation in the next bond issuance by the company concerned. Responsiveness to escalation can be influenced by the proportion of one's holding; a small cap fund holding which represents 1 per cent of a company's issued stock can be more likely to prompt a positive response to escalation than a 0.1 per cent holding in a much larger company, even though the value of the latter investment may be much greater.

Escalation examples

Company – around 40 large Japanese companies

Issue – Many Japanese companies have very few independent directors. The market requirement is for two outside directors who may not be independent. We believe that larger companies with international investors should be held to a higher standard and seek at least one third board independence.

Action taken – We write every year to companies in the TOPIX100 index with independent directors making up fewer than one-third of their board, asking them to indicate if they will improve their balance – 43 companies in 2020. We escalated this issue last year for companies which still did not meet the one third standard by voting against all non-independent directors, other than the CEO and founder/President.

Outcome – There has been a steady increase in the number of companies meeting the one third independence standard. Out of 71 companies we have written to since 2017, 27 now have at least one third independent directors on the board.

Company – companies in our portfolios in energy intensive sectors that do not have adequate disclosure of carbon emissions or transition strategy

Issue – We have participated for a number of years in the CDP disclosure campaign encouraging companies likely to have relatively high emissions to disclose their emissions and transition strategy in a standard framework now aligned with the TCFD. Many companies have started to report but a few have not / have stopped doing so.

Action taken – We have escalated the engagement by writing to companies in energy intensive sectors in our portfolios that have not responded positively to our CDP engagement to explain the importance which investors attach to understanding companies' exposure to climate risk and to warn them of our intention to vote against the re-election of their company chair if they do not make such disclosures. We voted against nine company chairs for this reason in 2020.

Outcome –there has been little improvement in disclosure rates for companies where we have voted against.

Company – SSP, UK-listed operator of food outlets at airports, railways and other transport hubs.

Issue – The company had a legal obligation to pay a final dividend even though the payment was due in the midst of the COVID-19 lockdown when it had issued new shares, applied for government support and furloughed staff. It had suggested investors defer receipt of the dividend but many were not able to do so.

Action taken – We raised the issue with the Investor Forum as an appropriate subject for collaborative engagement. The Forum sought expert advice and suggested to the company an alternative mechanism under which it could meet its obligations whilst avoiding the reputational risk of paying a dividend during lockdown.

Outcome – The company adopted the solution suggested by the Investor Forum, enabling recipients of the dividend payment to use it to subscribe for shares in a limited issue; we participated in the subscription.

EXERCISING RIGHTS & RESPONSIBILITIES

Principle 12

Signatories actively exercise their rights and responsibilities.

Report

We regard exercising votes at company meetings as an important part of our stewardship responsibilities. We aim to vote on all equities for which clients have given us voting authority.

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

Global voting guidelines

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

These full text of these guidelines is available at:

https://www.assetmanagement.hsbc.co.uk/-/media/files/attachments/common/resource-documents/global-voting-guidelines-en.pdf

The key elements are as follows:

- Independent and diverse representation on the board & in board committees
- Remuneration linked to challenging performance criteria with full disclosure
- Limit dilution of existing shareholders; shareholder vote on transactions
- Oppose poison pills & reductions in equal voting
- Defend auditor independence
- Support greater transparency through shareholder proposals

They reflect our approach in most developed markets. We have more specific criteria on remuneration arrangements and board balance in Europe (including the UK) where disclosure and good practice standards are more advanced. We apply a more flexible approach in emerging and frontier markets, although we are gradually phasing out this greater flexibility as governance standards and investor expectations rise for these markets. Amendments in 2021 are set out under Principle 5 above.

Voting service provider

We use Institutional Shareholder Services (ISS) as our global proxy voting research and vote instruction platform provider. ISS provides custom policy recommendations based upon our voting guidelines. For around 2,000 active holdings, more than 350 UK listed holdings, and our largest 500 holdings by value, these recommendations are reviewed by portfolio managers and / or members of the responsible investment team. Smaller passive holdings are voted automatically with the recommendation.

These guidelines are used for voting all funds and accounts managed in locations set up on the ISS platform, including Canada, US, Mexico, UK, France, India and Hong Kong. Fund supervisory bodies have adopted our guidelines in line with local practice.

Client voting policies

All client accounts which we vote have our guidelines applied to them. A small number of clients have retained voting rights for themselves, usually to ensure consistency across managers. Whilst we prefer to apply our guidelines due to better alignment with our investment and engagement approach, we have responded positively to questions about whether we could apply clients' own policies to segregated mandates, subject to agreement on practical arrangements, although none have chosen to take this up. For clients holding investments in pooled funds, there would be practical challenges – each vote would have to be split (which is not permitted in all markets) – to apply a different policy to a portion of a fund and could raise issues of equal treatment but we have agreed to examine these challenges and issues should a client reach with appropriate scale within a fund ask us to do so.

Stock lending and voting

We were not lending stock in 2020. We have introduced stock lending on some funds in 2021. We have taken this step as we believe that the additional returns that can be achieved would be serve clients best interest. We ensure that securities lending is conducted according to industry best practice to protect our clients' assets, for example with strict rules about the monitoring and quality of collateral. Our securities lending activity is undertaken in line with the Principles for Sustainable Securities Lending, published by the ISLA Council for Sustainable Finance.

All securities on loan are available for recall for the purpose of voting. In practice, we operate a systematic recall of securities on loan in order to vote at certain meetings on resolutions relevant to our governance and engagement priorities. We consider the scale of our overall holding in the company concerned and the salience of the voting issue. We shall also recall securities on an ad hoc basis in order to vote on particular resolutions where there is a material client interest in doing so.

Securing voting rights

Voting set-up is part of our normal new fund set-up process. As ISS is also proxy voting provider to HSBC in its role as custodian and the majority of our funds are in the custody of HSBC, funds are typically available to be voted from set-up. ISS also procures ballots for meetings of which it has become aware even if these have not initially been received for holdings in every fund. Our middle office voting teams also monitor meetings up to the instruction deadline even if holdings have already been voted to ensure that any new holdings can be voted. We regularly review all funds set up for voting to ensure we have the maximum intended coverage.

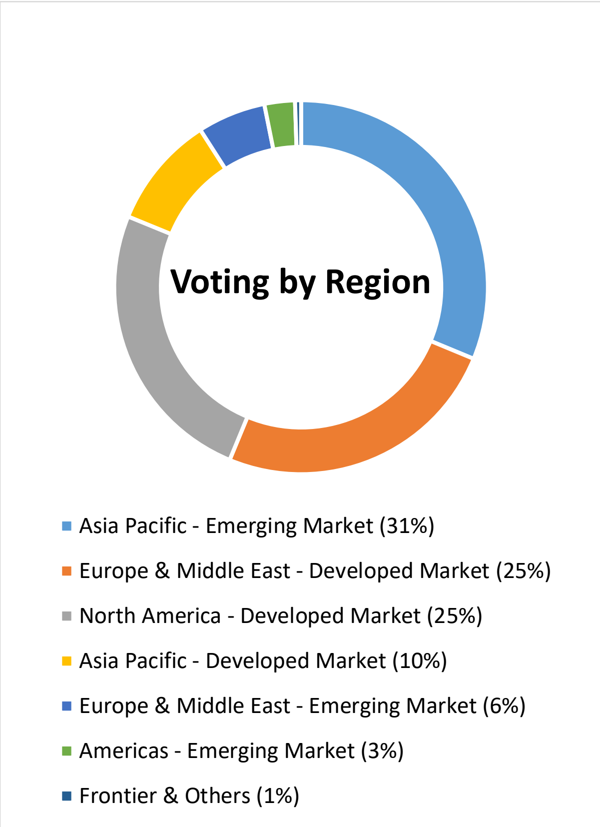
Voting in practice

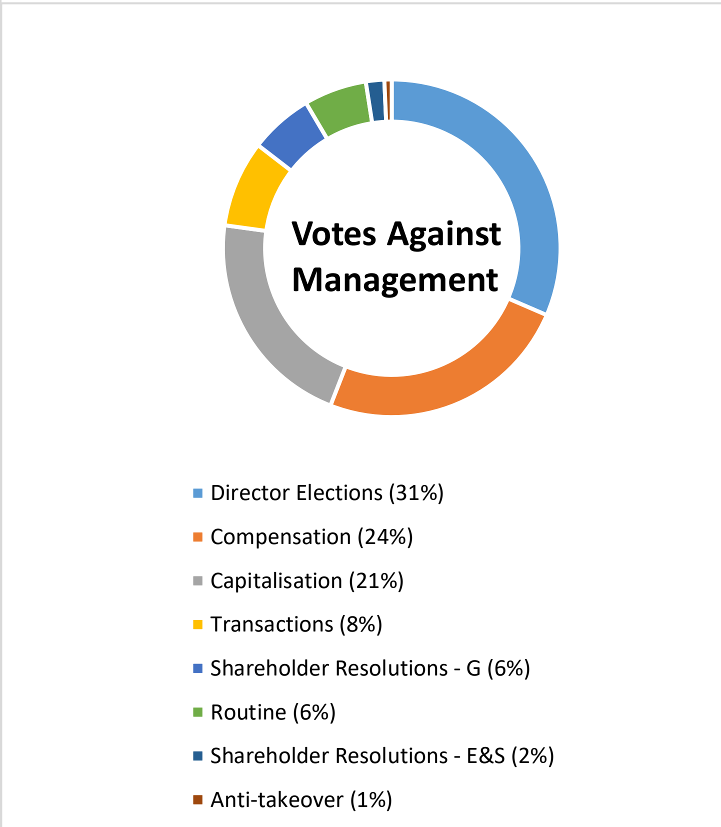
In 2020, we voted on more than 86,000 resolutions at around 8,200 company meetings across 70 markets, representing 96 per cent of the ballots which we were entitled to vote.

We supported management on 90 per cent of resolutions, abstaining or voting against on 10 per cent. The issues we most frequently opposed were director re-elections (31 per cent of votes against management) predominantly for reasons of lack of independence, followed by remuneration (24 per cent of votes against management), followed by capitalisation issues (21%). This included voting against at least one resolution at 43 per cent of meetings.

On 238 resolutions (>0.5%), our vote was different from the initial view based upon our voting guidelines, from the ISS custom recommendation. On these occasions, we determined that guidelines had not be correctly applied, circumstances particular to the company meant that we should not apply the guidelines, or the company had undertaken to address the issue concerned. Around 50 per cent related to director elections, 30 per cent related to compensation. 72 per cent of these votes were against management.

Our votes differed from the ISS standard policy recommendation on more than 7,000 votes (8%). More than half of these votes were against management, with capitalisation and director elections in China, and compensation in the US, predominantly where we had voted against management more often than ISS.





All of our votes are disclosed at:

https://www.assetmanagement.hsbc.co.uk/en/institutional-investor/about-us/responsible-investing/stewardship

The section on that page marked Shareholder Rights Directive 2 has all votes cast by HSBC Global Asset Management (UK) Ltd, and includes a rationale for all votes against management. We are working to include further rationales, such as against shareholder resolutions and out of line with our voting guidelines, as well as covering all offices.

Where we did not vote shares, this was invariably in markets with burdensome power of attorney requirements and / or for markets or meetings where there is shareblocking. Many of our holdings are in retail funds which receive unpredictable daily in and out flows. The blocking of shares between the date of instruction and of the meeting could impede the ability of these funds to trade certain holdings; we have determined that this client interest outweighs the benefit of participating in the small proportion of shareholder meeting impacted. A small number of meetings may not be voted because the ballot was not received until after the deadline for instruction – which may arise with a recently acquired holding.

Shareholder resolutions

Shareholder resolutions are used as an engagement tool to encourage changes in corporate behaviour. We support shareholder resolutions on 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.

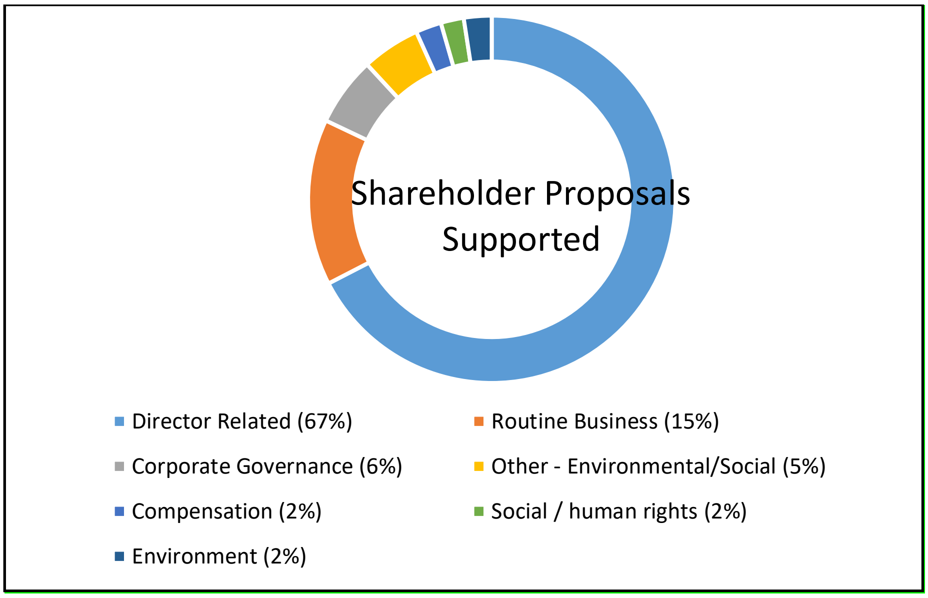
This means we support greater disclosure and the introduction of appropriate policies (provided the proposal is not overly prescriptive).

In 2020, we supported 1,633 shareholder resolutions, 67 per cent of the 2,434 resolutions on which we could vote.

We supported 95 per cent of the shareholder resolutions in the US which received more than 50 per cent support.

We supported 157 resolutions on environmental and social issues.

On climate change, we typically support resolutions asking for the adoption of climate change policies, Paris-aligned transition plans and/or quantitative greenhouse gas emission reduction targets, and resolutions asking for annual assessments of portfolio resilience.



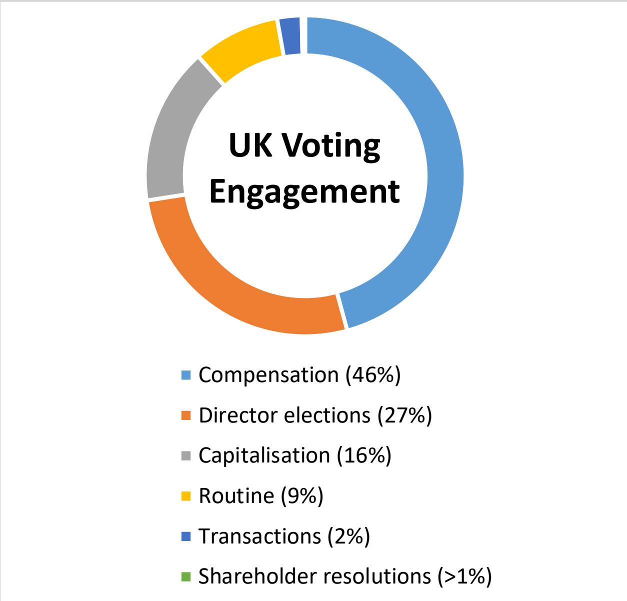
Shareholder resolutions have been used under the Climate Action 100+ initiative as a means of promoting better management of climate risks. In the coming year, we shall be supporting the initiative by Climate Action 100+ and others to encourage companies to put their climate transition plan to the vote.

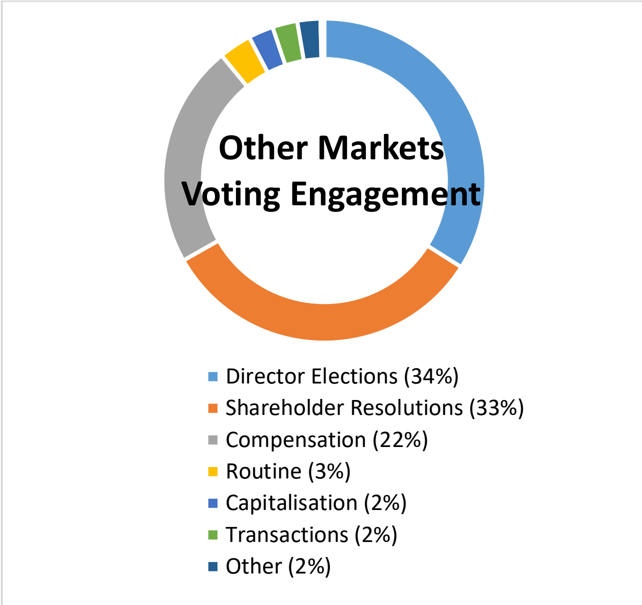
Voting-related engagement

In 2020, we engaged with 310 companies to discuss our voting decisions on resolutions where we felt unable to support management. These companies were prioritised based on our largest holdings and markets and represented just over 30 per cent of our global equity AUM.

A large proportion of these companies were in the UK, where we engaged with 127 companies in advance of voting at their shareholder meetings. Issues discussed included compensation (46%), director elections (27%), capitalisation (16%), routine (9%) and transactions (2%).

Outside the UK, we communicated our votes to 183 companies after their shareholder meetings to express our concerns and views inviting companies to further discuss them. Issues covered included director elections (34%), shareholder resolutions (33%), compensation (22%), routine (3%), capitalisation (2%), transactions (2%) and anti-takeover (>1%).





Fixed income rights & responsibilities

We participate in bond holder meetings for the restructuring of bond as they arise. We do not have voting guidelines for these meetings as each item is regarded as an investment decision in its own right, where the client's interest as investor is the sole consideration. We vote in the interest of holders of the bond in question rather than for any other interest.

We have not been involved in any bond holder restructuring committee in recent years. We would need to address insider information concerns before participating.

Whilst we do not usually find that there is scope to renegotiate the terms of a bond offered for sale on issue, we have found circumstances where we have needed to question information about the use of green bond proceeds. Our assessment of green bonds relies on a bottom-up approach to make sure that the bond finances projects that provide clear environmental benefits. This includes making sure that the green bond framework follows the Green Bond Principles but also that the projects to be financed are eligible under the Climate Bonds Initiative (CBI) taxonomy. In addition, to screen and control that green bonds are environmentally sound and support the transition to a post-carbon economy, the stated aims of the green funding projects should be transparent, well disclosed and reported. When this is not the case, we write to the issuer seeking a third party opinion as to the sustainability purposes of the bond, and commitments to sustainability reporting. Disclosed information that is easily accessible enables informed decisions and enhances investors' trust.

Other asset classes

Multimanager – we exercise our votes in the holding entities as investors in third party funds, typically applying the same governance standard that would apply to listed companies in the market of domicile.

Debt – for private debt and infrastructure debt, there are restructurings which can be initiated by the issuers and occasionally by investors. These are rarely on environmental or social issues but can relate to changes in the governance of the debt. We determine our stance on the basis of investment interest of our clients.

Voting examples

Company	Alphabet Inc.	Apple Inc.	Chevron Corporation	Exxon Mobil Corporation	Tokyo Electron Ltd.	3M Company	Abbott Laboratories	Eli Lilly and Company	Microsoft Corporation	PepsiCo, Inc.
Proponent	Shareholder	Shareholder	Shareholder	Shareholder	Management	Management	Shareholder	Shareholder	Shareholder	Shareholder
Date	03-Jun-2020	26-Feb-2020	27-May-2020	27-May-2020	23-Jun-2020	12-May-2020	24-Apr-2020	04-May-2020	04-Dec-2019	06-May-2020
Resolution	5	5	6	4	3	3	7	10	5	4
Title	Approve Recapitalization Plan for all Stock to Have One-vote per Share	Link Executive Pay to Social Criteria	Report on Climate Change	Require Independent Board Chairman	Elect Director	Advisory Vote to Ratify Named Executive Officer's Compensation	Reduce Supermajority Vote Requirement	Link Executive Pay to Social Criteria	Gender Pay Gap	Amend Articles/Bylaws /Charter - Call Special Meetings
Summary	Approve Recapitalization Plan for all Stock to Have One-vote per Share	Assess Feasibility of Including Sustainability as a Performance Measure for Senior Executive Compensation	Report on Climate Lobbying Aligned with Paris Agreement Goals	Require Independent Board Chairman	Elect 7 directors (7 separate resolutions)	Advisory Vote to Ratify Named Executive Officers' Compensation	Adopt Simple Majority Vote	Report on Integrating Drug Pricing Risks into Senior Executive Compensation Arrangements	Report on Gender Pay Gap	Reduce Ownership Threshold for Shareholders to Call Special Meeting
Outcome	Supported Management	Supported Management	Against Management	Supported Management	Supported Management	Supported Management	Against Management	Supported Management	Supported Management	Supported Management
Vote	Against Management	Against Management	Against Management	Against Management	Against Management	Against Management	Against Management	Against Management	Against Management	Against Management
Vote against management	31.7%	12.1%	53.5%	32.7%	5.2-8.7%	7.0%	84.5%	24.5%	29.6%	44.8%
Rationale	We support the principle of one share-one vote as we believe that this is the best means of ensuring accountability to all shareholders, in the long term interest of the company.	We favour proposals calling for the integration of extra-financial metrics in determining executives' variable remuneration.	We favour resolutions that request increased reporting & accountability on climate change issues.	We favour the separation of CEO and Chairman. We also have concerns about the extent to which the company met investor expectations on climate issues.	We do not support non-independent directors - including executives - for large Japanese companies where the board does not have one third independence	We are concerned where overall dilution from all share schemes exceeds 10 per cent and could not support the resolution for this reason.	We favour one share, one vote and support measures to reduce / remove supermajority requirements	We favour proposals calling for the integration of extra-financial metrics in determining executives' variable remuneration.	We favour transparency around gender pay as we believe this can encourage appropriate management of the issue.	We favour increased ability by shareholders to call special meetings.