ESG Essentials

A world of sustainable investment opportunity

HSBC
Asset Management

Opening up a world of opportunity

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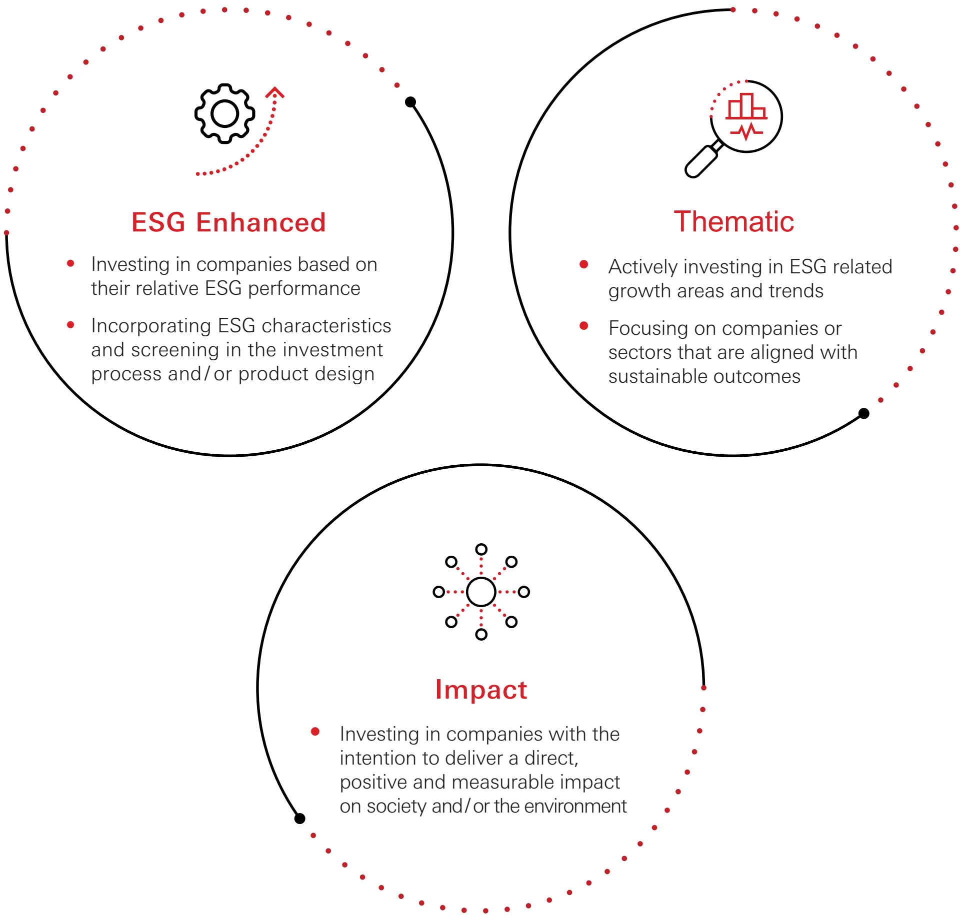
A world of sustainable investment opportunity

Global carbon emission reduction targets re-emerged as a hot topic as the United Nations Climate Change Conference (COP26), the most important climate-related summit on the planet, concluded in Glasgow. Sustainable investing has become a crucial investment trend, presenting decades-long opportunities of wealth creation with sustainable outcomes. With a variety of sustainable strategies, we can identify investment opportunities across different markets and asset classes to achieve both financial and sustainability goals.

1 Sustainable Investment Definitions Framework

At HSBC Asset Management, as part of our responsible investing policy, we have developed a framework to define what we consider to be 'sustainable investing'. With this framework, investment funds that are HSBC 'sustainable' do more than just embed good ESG integration and active ownership into their investment process. They typically include sustainability considerations in their product design to achieve sustainability outcomes.



Source: HSBC Asset Management, December 2021

2 ESG opportunities across diversified asset classes

ESG and sustainability factors influence a wide range of industries from agricultural, industrial, consumption, technology to medical sectors as these factors are closely connected to social policies, economic development and individual lives. Meanwhile, various ESG-related investment opportunities are available across the global equity and bond markets.

The climate-related investment opportunities in equity and bond markets can be divided into two main categories – the enablers whose products or services are helping to create a low carbon future and the adaptors who have committed to decarbonise and factor in renewable energy in business strategies.

Sectors set to benefit from the net-zero goals

	Potential opportunities	Examples
Enablers	Strong revenue growth expected from continuous business expansion	Wind turbines and solar panels producers Producers of electricity converters Producers of insulation materials used on buildings Developers of precision agriculture technology that reduces carbon emission
Adaptors	Strategic adaptations to climate change will benefit long-term business development	Builders that adopt recycled materials Software companies operating data centres with renewable energy Sustainable forestry Electric car manufacturers

Sustainable bonds

Development in the sustainable bond market is noteworthy. Sustainable bonds differ from other bonds as most of them adhere to the "use of proceeds" principle in which bonds are judged by how the proceeds raised are actually spent instead of the levels of "greenness" of the issuers. While investors are more familiar with green bonds, many other types of sustainable bonds are available in the market.

A diverse universe of sustainable bonds

Green projects

Social projects

Green bonds

- Issuers must ensure that the proceeds raised are 100% spent on green projects
- The first green bond was issued in 2007 by European Investment Bank with proceeds dedicated to renewable energy and energy efficiency projects
- Non-green issuers with higher credit ratings are also eligible to issue green bonds which not only offer investment opportunities in quality environmental projects, but also help reduce financing costs for green projects

Sustainability bonds

- Proceeds raised can be used to fund both environmental and social projects

Social bonds

- Generate financial returns alongside positive social outcomes
- Provide financing for underserved communities in projects such as education and healthcare improvement

Transition bonds

- A new type of bonds
- Proceeds raised can be used on non-green projects as long as they can drive significant reduction of carbon emissions
- Project examples include enhancement of energy efficiency or energy transition in which "brown companies" are encouraged to lower carbon emissions

Social impact bonds

- It is not a bond but a contract with organisation typically in the public sector to provide financing for social programs
- Returns depend on whether the specified goals are achieved
- Investors may not receive any return or repayment of principal if the goal fails

Sustainability-linked bonds

- Proceeds raised in sustainability-linked bonds are not restricted to be used on green projects but issuers are required to achieve tailor-made ESG targets within a certain period
- Examples of targets include a higher adoption of renewable energy
- Coupons will increase if the issuers fail to achieve the targets

Source: HSBC Asset Management

3 ESG factor analysis and screening strategies

Integrating ESG issues in investment decisions can help manage risks and unlock new investment opportunities. There are many investment strategies available and often used in combination. Investors can exclude specific companies or industries or include companies with higher ESG performance. Some common strategies are:

ESG integration

Incorporate ESG factors and data into the traditional investment analysis process to enhance investment decision-making

Positive screening

Select companies with stronger ESG performance with reference to in-house scores or third-party ratings

Negative screening

Screen out companies or sectors that deliver negative ESG impacts

Norms-based screening

Screen out companies that do not adhere to international norms

How do we conduct ESG analysis?

Asset management companies typically conduct investment case studies with a combination of data from third-party providers (e.g. MSCI or Morningstar) and their own proprietary analysis tools. For example, HSBC Asset Management uses absolute and relative analysis approaches as well as data from independent third-party to examine companies and issuers. Scores are then compiled to generate an ESG risk rating which enables us to focus on companies with lower risk ratings.

Absolute approach

We measure levels of risks based on the company's compliance with UN Global Compact principles which is a set of 10 global norms covering human rights, labour standards, environment and anti-corruption etc. Levels of risks are measured in accordance with the following criteria:

Low Risk: No breach
Medium Risk: Alleged breach
High Risk: Proven breach

Relative approach

We apply different weight combinations of ESG factors to each industry based upon their materiality. Levels of risks are measured based on how a company ranks relative to our 30 proprietary ESG sector ratings derived from MSCI Global Industry Classification Standard (GICS):

Low Risk: 20th to 100th percentile
Medium Risk: 5th to 20th percentile
High Risk: 0 to 5th percentile

4 Active ownership

Active ownership is an important part of sustainable investing. At HSBC Asset Management, we use our influence as investors to encourage corporate behaviour that protects and enhances value, through voting, company engagement, and as signatories of a number of statements and investor stewardship codes that publicly call for or commit to ESG related action.

More information about our active ownership approach can be found in our ESG Essentials series – “An active approach to ESG investing” booklet.

Conclusion

Sustainable investing takes into account the profound effect ESG factors are having on businesses. It does not only consider a company’s current profitability. It serves as a guide to safeguard investments and our collective interests in the long run by shining a light on companies that are leading the way in a changing world. The growing space of ESG assets is offering broad investment opportunities with diversification advantages to mitigate risks, enabling investors to achieve both financial and sustainability goals.

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