

**Asset Management**

# **Sustainable investment methodology**

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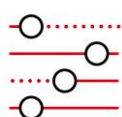


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## Sustainable investment under the definition of SFDR

SFDR defines Sustainable Investment as an investment in economic activities that contribute to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in economic activities that contribute to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.



### > Our definition of SFDR Article 8 and 9 products

HSBC Asset Management established investment frameworks for SFDR Article 8 and Article 9 fund classifications. Article 9 funds have sustainable investment as their primary objective and/or invest wholly in sustainable investments to fulfil their primary investment objective. We have defined 'wholly' as a minimum of 90% of AUM invested in sustainable investments. When an issuer is deemed to be sustainable, it can be considered eligible for an Article 9 fund as long as its economic activities are aligned to the sustainable investment objective of the fund. The objective can either be focused on advancements in the environmental aspect (with carbon reduction included), in the social aspect or a combination of the two. The SFDR regulation does not require Article 8 funds to be wholly invested in SI nor is there a minimum % of AUM invested in SI. Therefore, Article 8 funds can have less than 90% of their AUM invested in SI.



## > Assessing whether an instrument or issuer is sustainable

Our proprietary investment framework ('methodology') determines whether an instrument/issuer is a sustainable investment under SFDR. The sustainable investment methodology laid out below was initially modelled based on our Article 9 framework, which considers types of qualifying criteria considered to be 'sustainable' along with thresholds to provide transparency to our stakeholders. Our proprietary methodology has been developed and approved in 2022 by our ESG oversight committee, which is chaired by the Global CIO, and attended by Asset Class CIOs, Head of Risk, Head of Stewardship, Head of Responsible Investment and Head of Sustainability.

In our methodology, there are multiple ways that an instrument or issuer can be deemed 'sustainable', which underpins the assessment of a company's sustainability characteristics. We take into consideration the companies' contribution to sustainability objectives based on their source of revenue and areas such as their business models, operational activities and ambitions. In-depth analyses are conducted based on several third-party data sources and internal extra-financial analysis.



To be more precise, our evaluation on whether the investment can contribute to sustainability objectives considers 6 potential areas as listed below.

1

#### **Current and projected sustainable product and services**

e.g. revenues, capex and opex, leading market share

2

#### **Sustainable thematic**

e.g. metrics specific to a theme such as Circular Economy

3

#### **Sustainable Business models**

e.g. proprietary assessment to quantitatively assess the alignment of issuer

4

#### **Sustainable ambition/practice**

Relevant KPIs linked to Paris Aligned transition plan with demonstrated progress towards achieving significant contribution towards regional sustainability challenges or ambition to address inequality in accessibility of services for underprivileged communities

5

#### **Sustainable Transitioning Industries**

e.g. investments in transition sectors that meet our sector specific guidelines as per our Article 9 Framework

6

#### **Sustainable Bonds**

Green or social use of proceeds. For bond instruments, we also consider the green, social and sustainability bonds as sustainable investments based on the fact that there is a clear and direct contribution to environmental and social objectives.

Internal sustainability thresholds have been established and companies that meet the criteria in one of the 6 listed areas can be considered as sustainable.

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In addition, our investible universe is screened based on a systematic scoring on net sustainable product revenue. The net contribution score is calculated using internal and third-party data based on the company's reports under sustainable revenue frameworks. Data sources include Sustainalytics, Trucost, FTSE Green Revenue, S&P Trucost EU Taxonomy, and our proprietary GreenShare and EU Taxonomy data. Data is refreshed automatically on a regular basis in internal systems that are available to all investment teams.

Finally, Do No Significant Harm (DNSH) is considered by netting out activities according to our sustainable and standard exclusions. Article 9 funds may have additional exclusions beyond the DNSH criteria set out in our SFDR sustainable investment methodology, such as degrees of controversies. DNSH is considered alongside good governance, which is a basic requirement in our fundamental analysis and investment process.

Where proprietary data and analysis are concerned when determining sustainability investment, the ESG Oversight Committee approves the research framework and the asset class ESG oversight committees evaluates the quality of the analysis and approves the use of such input.

For further details, please refer to the table in the appendix.



## Detailing sustainable investment criteria

An issuer or instrument can be deemed 'sustainable' if it meets the criteria in one of the following 6 areas:

### 1. Sustainable Product & Services - Quantifiable financial metrics

- ◆ Net sustainable product & service revenue or net projected in 3-5 years  $\geq 30\%$  OR
  - Lower threshold (net-positive) may be applied to companies in EM in order to enable the transition towards sustainable activities
- ◆ (Net) EBIT/EBITDA in sustainable product & services or (net) projected EBIT/EBITDA in 3-5 years  $\geq 30\%$  OR
- ◆ Growth CAPEX related to sustainable development  $\geq 30\%$  for transitioning companies OR
  - Growth CAPEX related to sustainable development  $\geq 10\%$  for hard to abate sectors (steel, cement, and those where green solutions are not yet readily available as of today)
- ◆ CAPEX % in sustainable product & services exceeding revenue % in product & services OR
- ◆ Sustainable R&D as % of OPEX  $\geq 5\%$
- ◆ Leading market share (top 5) in sustainable product & services globally or in local markets

### 2. Sustainable Thematic - Expanding thematic expertise

Circular Economy (Note that 'sustainable thematic' will not be limited to a single theme/SDG. Metrics are based on specific themes and aligned to proprietary assessment processes. This example is only for illustration purposes.)

- ◆ Enabler:  $\geq 20\%$  thematic revenue (this is a new and developing trend hence lower threshold to capture most players) OR  $\geq 5\%$  + leading market share (Top 5) ; this is adapted for emerging industries enabling sustainable economy practices in a growing and/or fragmented industry OR
- ◆ Trailblazers: score  $\geq 30$  in sustainable theme questionnaire

### 3. Sustainable Business Model - Balanced sustainability assessment

Sustainable Business Model Scorecard

- ◆  $\geq 50\%$  of the scorecard achieving highest rating

### 4. Sustainable Ambitions & Practice - Verified ambition and practice

Where positive SDG contribution is identified but the financial metrics mentioned in the above categories are not satisfied, an issuer review can be triggered. The verified ambition could be considered as 'sustainable' if the issuer has demonstrated progress and practice towards its ambitions through relevant material KPIs, using standards established by relevant industry bodies. Ambitions considered:

- ◆ Has approved SBTi targets or has verified carbon reduction targets OR
- ◆ Has significant contribution to regional sustainability challenges OR
- ◆ Has ambition to address inequality in access of services for underprivileged communities

### 5. Sustainable Transitioning Asset - Sector specific considerations

Criteria are set out for the sectors traditional energy (oil & gas) and power generation to be considered as 'sustainable' based on Towards Sustainability Label (previously know as Febelfin Label).

### 6. Sustainable Bonds - Specific use of proceeds

Sustainable bonds (includes Green bonds, Social bonds and Sustainability bonds)

### Do No Significant Harm Exclusions

For Corporate issuers:

- ◆ Banned & controversial weapon score<sup>1</sup> = 10 or 8
- ◆ Tobacco production revenue  $> 0\%$
- ◆ Thermal coal extraction revenue  $> 10\%$
- ◆ Thermal coal power generation revenue  $> 10\%$  (2.5% for SFDR Article 9 product)
- ◆ UNGC = non-compliant
- ◆ Highest Controversies Flag<sup>2</sup> = Category 5 (Category 3 for SFDR Article 9 product)

For Sustainable Sovereign Issuers:

- ◆ Social Violation Flags<sup>2</sup> = 5
- ◆ Any of the countries on the HSBC sanction list

### Good governance

is a basic requirement in our fundamental analysis and investment process. Our consideration goes beyond governance or ESG ratings. The minimum threshold is no high governance controversies for active funds. Tail risk policies are also in place to monitor governance risks.

1. Data sources include ISS-Ethix

2. Data sources include Sustainalytics

Source: HSBC Asset Management. Representative overview of the investment process, which may differ by product, client mandate or market conditions.



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