

Sustainable investment methodology

July 2023



This document is produced in accordance with the SFDR Regulation (Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019)". This is a regulatory document and not a marketing document. This document is not by any means intended as an investment advice.



HSBC

Opening up a world of opportunity

The SFDR Regulation (Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019) on sustainability-related disclosures in the financial services sector came into force in 2021 with the obligation for financial institutions to make principles-based disclosures on ESG-related activity.

Under this regulation, as defined in Article 2, point (17) SFDR, sustainable investment has been defined as investment that generates net-positive environmental and/or social outcomes. The resulting market-wide challenge has been around measuring individual holdings' environmental and social contribution, while ensuring that positive contributions do not come with negative side-effects – i.e. adverse impacts.



Sustainable Investment is an investment in an economic activity that contributes to an **environmental objective** or an investment in an economic activity that contributes to a **social objective** 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.



> How do we measure corporate sustainability?

- Our proprietary investment framework ('methodology') enables us to determine whether an instrument/issuer can be defined as a 'Sustainable Investment' as defined by the Article 2(17) SFDR and accounted for when disclosing the proportion of investment in 'Sustainable Investment' and monitoring the compliance with fund level commitments.
- Over recent years, our methodology has grown from seeking historical revenue alignment to the Sustainable Development Goals (SDGs) defined by the United Nations, towards a more holistic view that considers also the compatibility of business models, operational activities, and ambitions. This scope enlargement better reflects the company's commitment and actions to address the sustainability challenges.
- The assessment also includes a 'Do No Significant Harm' (DNSH) test while considering good governance. This test includes the consideration of principal adverse impacts (PAI), as required by the SFDR regulation. PAI consists of a list of environmental and social factors to be taken into account and reported – these include, among others, greenhouse gas emissions and intensity, carbon footprint, emissions to water or gender pay gap.

Assessing whether an investment is sustainable

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.

Our assessment is based on whether the investment can contribute to UN Sustainable Development Goals (SDGs) and considers three dimensions¹:

- Companies' net contribution to one or more UN SDGs based on their source of revenue
- Convergence of the entire business models of companies towards UN SDGs framework
- UN SDGs-compatible projects and/or use of proceeds

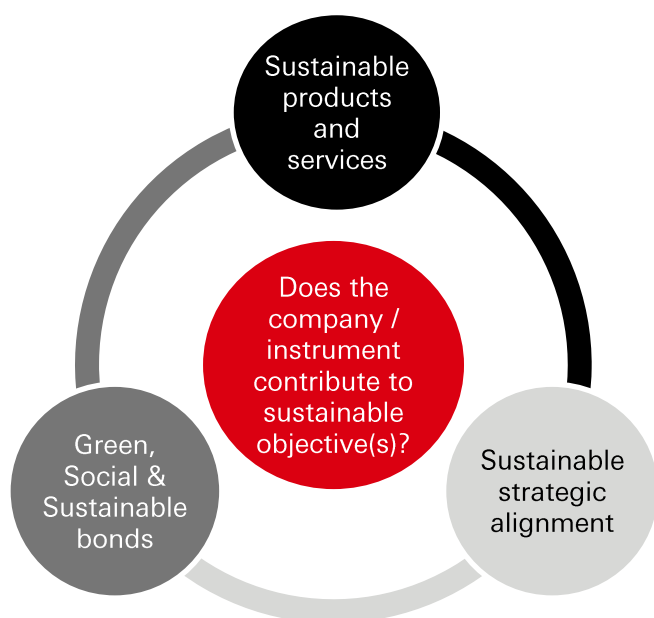


The 2030 Agenda for Sustainable Development, adopted by all United Nations Member States in 2015, provides a shared blueprint for peace and prosperity for people and the planet, now and into the future.

At its heart are the 17 Sustainable Development Goals (SDGs), which are an urgent call for action by all countries - developed and developing - in a global partnership.

They recognize that ending poverty and other deprivations must go hand-in-hand with strategies that improve health and education, reduce inequality, and spur economic growth – all while tackling climate change and working to preserve our oceans and forests.

Please visit <https://sdgs.un.org/goals> for more information.



In-depth analysis is conducted based on multiple third-party data sources and internal analysis and research. Data sources include Sustainalytics, S&P Trucost, FTSE Green Revenue, and our proprietary GreenShare and EU Taxonomy² data.

Sustainability thresholds have been established in each area, and issuers/instruments that clear at least one of these three aforementioned dimensions will be deemed sustainable.

⁽¹⁾ These three dimensions and respective thresholds or indicators may change over time without prior notice depending, for example, on regulations change or clarifications, data availability, technological progress, etc. The parameters are at the date indicated.

⁽²⁾ The EU taxonomy is a cornerstone of the EU's sustainable finance framework and an important market transparency tool that helps direct investments to the economic activities most needed for the transition, in line with the European Green Deal objectives. It is a classification system that defines criteria for economic activities that are aligned with a net zero trajectory by 2050 and the broader environmental goals other than climate. https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en

To which extent an investment contribute to one or more of the 17 UN SDGs?



Sustainable product and service - Quantitative score

Net sustainable revenue or net projected in 3-5 years $\geq 30\%$

Measuring the % of net-positive sustainable revenues aligned with one or more of the 17 UN Sustainable Development Goals: measuring current or expected SDG-aligned revenues (CAPEX², OPEX³ or EBITDA⁴) netted out by the unsustainable products & services (Tobacco, Thermal Coal, Banned weapons, very severe Environmental, Social and Governance (ESG) controversies..).



Sustainable strategic alignment - Proven & verified (SMART⁵)

Business models

Sustainable Business Model scorecard $\geq 50\%$ of the scorecard achieving highest rating

Sustainability assessment of the company's business model including own operations and supply chain, in the transition to a more sustainable economy encompassing either Social & Environmental aspects and management of impacts the business's activities and/or generation of positive outcomes assessed through their contribution to the UN SDGs⁷.

Sustainable Thematic

Company's thematic revenue $\geq 20\%$ or, Sustainable Thematic scorecard $\geq 30\%$

These thresholds are adapted for emerging industries enabling sustainable economy practices in a growing and/or fragmented industry (such as circular economy)

Ambitions & practices

Verified progress towards the company forward-looking sustainable ambitions through relevant standards established by relevant industry bodies such as approved Science-based Targets (SBTi⁶) for credible carbon reduction targets.

Energy Transition pathway

Assessment of activities that contribute to the energy transition and those that go against in order to determine the green share of company business (percentage of turnover) funding the energy transition or the shift towards renewables.

A company is considered as a "sustainable transitioning asset" based on its green share intensity and on criteria aligned with the Towards Sustainability Label⁷ for the traditional energy (oil and gas) and power generation sectors.



Green, Social & Sustainable bonds - Specific sustainable use of proceeds

For fixed income instruments, we 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. Green, social and sustainability bond instruments, as defined by the International Capital Market Association ("ICMA")⁸, and structured in accordance with its principles or guidelines contribute by design to an environmental and/or social objectives mapped to the UN SDGs.

¹ These three dimensions and respective thresholds or indicators may change over time depending, for example, on regulations change or clarifications, data availability, technological progress, etc.

² Capital expenditures (CapEx) is money invested by a company to acquire or upgrade fixed, physical or non-consumable assets. Capex is primarily a one-time investment in non-consumable assets used to maintain existing levels of operation within a company and to foster its future growth. Capex is used to buy or invest in tangible capital assets, such as real estate; raw materials; and plant, property and equipment. These assets benefit a company beyond one fiscal year. Intangible, nonphysical assets, such as patents and licenses, also qualify as Capex.

³ Opex (operational expenditure) includes selling, general and administrative expense, which are costs incurred through the main business activities, or overhead.

⁴ EBITDA, or earnings before interest, taxes, depreciation, and amortization, is an alternate measure of profitability to net income. By stripping out the non-cash depreciation and amortization expense as well as taxes and debt costs dependent on the capital structure, EBITDA attempts to represent cash profit generated by the company's operations.

⁵ specific, measurable, achievable, relevant, and time-bound

⁶ Science-based targets provide a clearly-defined pathway for companies to reduce greenhouse gas emissions, helping prevent the worst impacts of climate change and future-proof business growth. Targets are considered 'science-based' if they are in line with what the latest climate science says is necessary to meet the goals of the Paris Agreement – limiting global warming to 1.5° C above pre-industrial levels.

⁷ <https://towardsustainability.be>

⁸ www.icmagroup.org/assets/documents/Sustainable-finance/2022-updates/Mapping-SDGs-to-GSS-Bonds_June-2022-280622.pdf

Our methodology assessment (see the three dimensions in the previous page) also includes a “Do Not Significantly harm” (DNSH) test while considering good governance processes.

Sustainable Investments meet the requirements of the DNSH principle as provided by SFDR (under its article 2, point (17)) , by netting out activities according to our sustainable and standard exclusions.

Do No Significantly Harm Exclusions

For Corporate issuers:

- ◆ Banned & controversial weapon score²
- ◆ Tobacco production revenue > 0%³
- ◆ Thermal coal extraction revenue > 10%³
- ◆ Thermal coal power generation revenue > 10%³
- ◆ United Nations Global Compact = non-compliant^{3, 4}
- ◆ Highest Controversies Flag³

For Sovereign Issuers:

- ◆ Social Violation Flags³
- ◆ Any of the countries on the HSBC sanction list

Finally, DNSH is considered alongside good governance of investee companies which is a basic requirement of our fundamental analysis and investment process.

Good governance assessment

Our consideration goes beyond governance or ESG (environmental, social and governance) scores. The quality of governance is assessed on the basis of criteria specified in the investment process that include, but are not limited to, business ethics, corporate culture and values, governance framework, and corruption.

We determine the materiality of governance by focusing on the governance framework, controversies and compliance with the principles of the UN Global Compact and the OECD Guidelines at the intent of multinational companies. The minimum threshold is to exclude very severe ESG controversies for active funds.

(1) end of December 2022

(2) Data sources include ISS-Ethix

(2) Data sources include Sustainalytics. Examples of controversies: activities related to child labour, major environmental damages, corruption & bribery, pollution...

(3) The United Nations Global Compact is a voluntary initiative based on CEO commitments to implement universal sustainability principles and to undertake partnerships in support of UN goal - <https://unglobalcompact.org/>

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