futurefocus

The HSBC Bank (UK) Pension Scheme

2018 Taskforce on Climate-related Financial Disclosures (TCFD) Statement

HSBC

For members of the HSBC Bank (UK) Pension Scheme

Introduction

The Trustee of the HSBC Bank (UK) Pension Scheme believe that Climate Change is a systemic risk and seek to manage that risk on behalf of its members. This is especially the case for Defined Contribution (DC) members as the value of their pension pots are directly related to the underlying investments. In that regard, primary emphasis has been on the exposure to the developed equity markets as our DC members have long-term exposure to those markets.

Assurance Process

Prior to being approved by the Trustee Board, the TCFD Statement was reviewed by the Trustee's Asset & Liability Committee and the Audit & Risk Committee.

However, the Trustee's focus on Climate Change risk mitigation is not just on developed market equities, as it plays an important role in how investments are managed across all assets classes and in both the DC and Defined Benefit (DB) parts of the Scheme. At a policy level the Trustee is supportive of initiatives that contribute towards mitigating Climate Change risk on its members' investments.

As such the Trustee is a signatory to the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). The Trustee's TCFD statement will be referenced in the Stewardship Report with a link provided to the full statement.

The Taskforce, chaired by Michael R. Bloomberg, was established by the Financial Stability Board in December 2015 to develop a set of voluntary and consistent disclosure recommendations for use by companies in providing information to investors, lenders and insurance underwriters about their climate-related financial risks.

The 32 industry members of the Task Force, who were drawn from a wide range of industries and countries from around the globe, finalised the recommendations in June 2017 after extensive public engagement and consultation.

The TCFD developed four recommendations on climate-related financial disclosures that are applicable to organisations across sectors and jurisdictions. The recommendations are structured around four thematic areas:

- **Governance**:
  The organisation's governance around climate-related risks and opportunities.
- **Strategy**:
  The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.
- **Risk Management**:
  The processes used by the organisation to identify, assess and manage climate-related risks.
- **Metrics and Targets**:
  The metrics and targets used to assess and manage relevant climate-related risks and opportunities.

The Trustee of the HSBC Bank (UK) Pension Scheme is supportive of initiatives it believes will be in the long-term financial interest of the Scheme members. TCFD is one such initiative as the Trustee believes greater disclosure will lead to better investment decisions. Indeed, where appropriate, the Trustee will also engage with its appointed fund managers to support such initiatives.

In the tables on the following pages are both the four headline recommendations of the TCFD and commentary about the current and evolving position of the Trustee with regard to the TCFD recommendations.

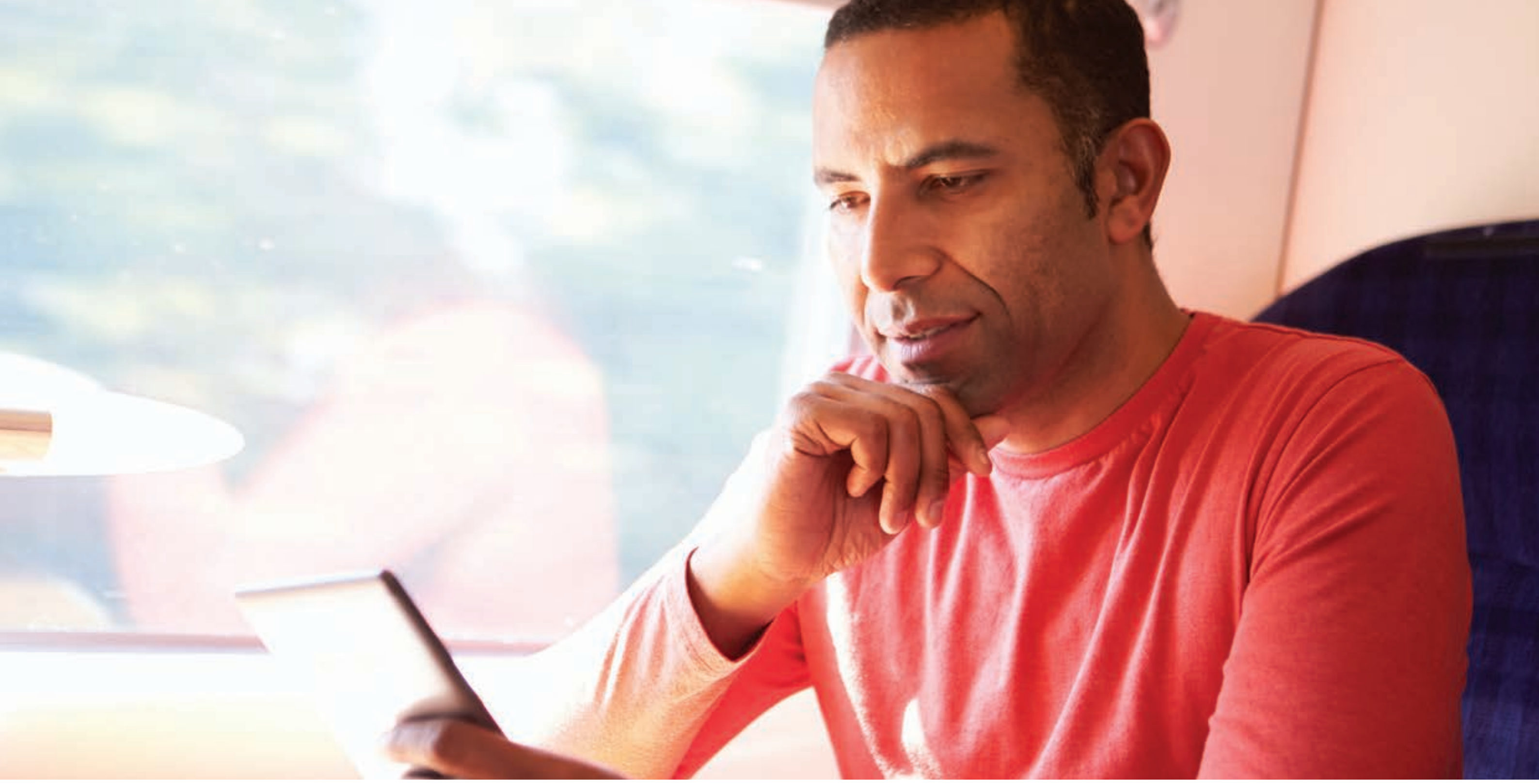
Governance

Recommended disclosure A: Describe the board's oversight of climate-related risks and opportunities	The Trustee Board's investment strategy is built upon a set of its investment beliefs. One of the beliefs is: 'Environmental (including Climate Change risks), Social and Governance issues are a material factor in investment decision making.' In this context in June 2015 the Trustee Board adopted a Trustee Climate Change Risk Policy that is recorded in its Statement of Investment Principles. See Appendix A. The Trustee Board is ultimately responsible for the oversight of climate-related risks and opportunities. However, there are two sub-committees of the Board that oversee the implementation of the Trustee's Climate Change Risk policy: • The Asset & Liability Committee, that is responsible for ensuring that the Climate Change Risk Policy is implemented into the Trustee's investment policy. • The Audit & Risk Committee, that is responsible for the Trustee's Risk Framework, which incorporates Climate Change risk, primarily due to its impact on investment strategy and the Sponsor Covenant.
Recommended disclosure B: Describe management's role in assessing and managing climate-related risks and opportunities	The Trustee Board is non-executive and is supported by a full time management team – The Pension Scheme Executive (PSE). Three of the individuals in the PSE structure are specifically responsible for assessing and managing climate-related risks. They are: • Chief Executive Officer for policy and covenant monitoring. • Chief Investment Officer for investment strategy. • Head of Finance and Risk Reporting for the risk framework and register.

Strategy

Recommended disclosure A: Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term.	The Trustee's approach to investment is rooted in its understanding of its fiduciary duty, which is consistent with the 2014 Law Commission Report. The Trustee considers Climate Change risk as a 'Financially Material' factor. As such the Trustee believes that Climate Change risk could have an impact on the value of the investments that it makes on behalf of its members over the short, medium and long term, and therefore needs to be understood and managed. For example, climate change risk could affect: • The creditworthiness of the issuers of the fixed income assets in which the Trustee invests. • The rental values of the real estate assets the Trustee owns. • The dividend paying capability, and therefore the share prices, of companies in which the Trust is either directly or indirectly a beneficial owner. Mitigating climate change risk can also offer attractive investment opportunities, and the Trustee believes that investing in such opportunities is also consistent with its fiduciary responsibility.

Recommended disclosure B: Describe the impact of climate–related risks and opportunities on the organisation's business, strategy and financial planning.	The impact of climate-related risks on the Trustee's business and financial planning is that mitigating them, and indeed wider Environmental, Social and Governance (ESG) risks, is integrated into its investment strategy in a number of overlapping ways. For example: • In establishing investment mandates with its appointed fund managers, the Trustee assesses how the manager incorporates the management of climate-related risks within its approach consistent with the asset class in question and the Trustee's fiduciary responsibility. • Consistent with its long-term horizon and strategic approach, the Trustee stopped having its appointed fund managers attending investment committee meetings seven years ago. In its place the Trustee established a process whereby the Trustee's Chief Investment Officer (CIO), often accompanied by individual Trustees, visit the appointed fund manager at least annually in their premises for a more thorough monitoring meeting than can be achieved at an investment committee meeting. A core part of such meetings is reviewing how the manager is incorporating ESG risk mitigation, and within that, climate-related risk, within its core process. In 2015 following the adoption of its Climate Change risk policy, the Trustee engaged with all of its appointed fund managers to understand how climate-related risks were being mitigated. These engagements continue, as both the Trustee and its appointed fund managers seek to continually improve. • The Trustee delegates voting to its appointed fund managers and expects the managers to vote consistent with the Trustee's fiduciary responsibility. The Trustee receives a quarterly report from its appointed quoted equity fund managers on their voting and engagement activities. The reports are collated, reviewed by the Trustee and dialogue had with the fund manager if the Trustee disagrees with fund manager policy or how it is implemented. As an Asset Owner, the Trustee believes it is important that it engages with its agents (the fund managers) to continually push to evolve best practice, as it believes this is in its members' best interest.
Recommended disclosure C: Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios including a 2 degree or lower scenario.	Historically the Trustee has undertaken analysis to estimate the financial impact on the Scheme's Defined Benefit assets of different future climate scenarios, as well as considering mitigating investment actions that could be undertaken. While the Trustee found the analysis useful in developing its thinking with regard to climate-related risks, the effectiveness of the scenario analysis was limited in part due to the inadequate disclosure from portfolio companies. The Trustee is therefore supportive of greater disclosure of climate-related risk data from issuers of equity and debt, and will continue to monitor and assess improvements in climate-related scenario analysis. However, the earlier scenario analysis did allow the Trustee to consider the impact on the Scheme's assets of more extreme climate scenarios. In a climate breakdown scenario there was little in the way of mitigating investment actions the Trustee could take to preserve member's investment values. This analysis gave the Trustee the fiduciary justification to be advocates of public policy that seeks to limit the risk of rising global temperatures because climate breakdown would have a significant negative effect on the valuation of Scheme assets. In this context, the Trustee has become a member of Institutional Investors Group on Climate Change (IIGCC),the strategic objectives of which are: • Changing market signals by encouraging the adoption of strong and credible public policy solutions that ensure an orderly and efficient move to a low carbon economy as well as measures for adaptation. • Informing investment practices to preserve and enhance long-term investment values. In addition the Trustee is also a member of the University of Cambridge's Institute for Sustainable Leadership – Investment Leaders Group. The Trustee will continue to monitor the effectiveness of scenario analysis in the context of Climate Change in the light of market developments.



Risk Management

Recommended disclosure A:

Describe the organisation's processes for identifying and assessing climate-related risks.

Asset owners should describe, where appropriate, engagement activity with investee companies to encourage better disclosure and practices related to climate–related risks to improve data availability and asset owner's ability to assess climate-related risks.

The Trustee has a preference for engagement, rather than exclusion, as a method in encouraging greater disclosures and practices with regard to climate-related risks. Two examples of such engagements are:

Example 1

Legal & General Investment Management's (LGIM) Future World Fund was co-developed with the HSBC Trustee. The fund is the accumulation fund for the HSBC DC section's default investment strategies and the method by which the DB section achieves its exposure to Developed Market Equities.

With regards to engagement on climate-related issues, the Future World Fund has two aspects. Firstly, it benefits from the LGIM Climate Impact Pledge. The six global industries with the greatest potential impact on climate change were identified and LGIM wrote to the Chair of the 84 largest companies in those sectors requesting to engage with them on the plans that the company was developing for a sustainable future. If after a year of engagement, the company was not implementing a viable plan to transition to a sustainable future, LGIM pledged to vote against the re-election of that company's Chair at the next annual general meeting with all of the assets LGIM has under management. Secondly, the Future World Fund would go one step further and divest from such a company even though it remains part of the benchmark index. The eight companies that were divested from June 2018 are shown in appendix C.

This is an ongoing process as companies divested from the fund could be repurchased if they improve, and other companies divested if they do not deliver on their sustainability plans.

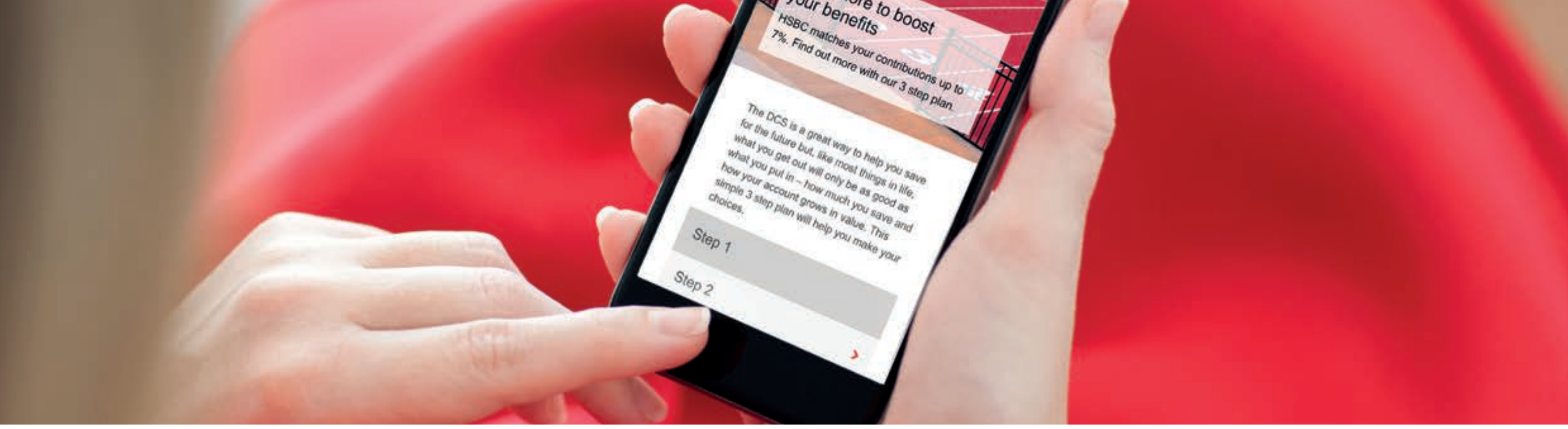
Example 2

The Trustee wrote to the Chief Executive Officer or equivalent of all of its appointed fund managers following the publication of the TCFD Recommendations in June 2017. The Trustee asked how their organisation was incorporating the recommendations of the TCFD in their engagement with the entities that issue or reside within, the investments they invest in on behalf of the Trustee.

Having received responses from all of its fund managers, the Trustee wrote back again to all of the fund managers sharing what it was observing as developing best practice in this area.

The Trustee believes that this form of stewardship is an important role for an Asset Owner.

Recommendation B: Describe the organisation's process for managing climate-related risks. Asset owners should describe how they consider the positioning of their portfolio with respect to the transition to a lower carbon energy supply production and use. This could include explaining how asset owners actively manage their portfolio's positioning relative to this transition.	While the Trustee consider the impact of climate-related risks on all of the assets within which it invests, the primary focus has been on its equity exposure. The section above explained how the Trustee had co-developed the LGIM Future World Fund, its climate-related engagement activities and how the fund is used in both Scheme DB and DC assets. As part of that same development process, the Trustee and LGIM worked with FTSE Russell to develop a new FTSE Russell index that became the benchmark for the Future World Fund. The new index was built in three stages: • Firstly, Controversial Weapons Manufacturers were excluded from the universe of stocks that make up the FTSE All World Index universe, as the Trustee has a financial preference for avoiding such stocks where possible. • Secondly, a four factor index was created (Value, Quality, Low Volatility and Low Size) that rebalances regularly through time to create a 'Balanced Factor' index with more attractive risk-return characteristics than the standard market capitalisation index. • Finally, three climate-related tilts were applied to the 'Balanced Factor' index to create a 'Climate Balanced Factor' index. The FTSE All World (ex controversial weapons) Climate Balanced Factor Index tilts away from Carbon Reserves and Carbon Emissions, whilst positively tilting towards Green Revenues. The tilts are set such that the inclusion of the climate-related tilts, introduces a relatively modest tracking error compared to the Balanced Factor index without climate tilts. This allowed the Trustee to conclude that the new index was consistent with its fiduciary duty and provided an element of climate change protection. Comparing the fund index with the market capitalisation index led to marked reductions to Carbon Reserves (86%) and Carbon Emissions (44%) and a far greater exposure to Green Revenues (75%) as at 31st December 2017. Source: FTSE Russell As mentioned above, while the primary focus of the Trustee has been on Developed Market Equities with regard to mitigating climate-related risks, a considerable amount of activity has occurred in other asset classes in which the Scheme invests. Examples of this would include: • Engaging with our Real Estate managers to ascertain how the mitigation of the physical risks of climate change as well as regulatory changes are incorporated into the property portfolios. • Working with the Trustee's corporate credit managers to understand how climate change risk is factored into the assessment of the quality of an issuer's credit. • Incorporating within the Trustee's Infrastructure Equity and Debt portfolios exposure to Renewables, such as solar parks and wind farms.
Recommendation C: Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management.	Climate Change risk is explicitly identified as a Scheme risk on the Trustee's Risk Register, as overseen by the Audit & Risk Committee, and reported to the Board on a quarterly basis. At a more granular level: • Where feasible within its fiduciary responsibility mitigation of climate-related risks are factored into the mandates the Trustee has with its appointed fund managers e.g Future World Fund. • For all appointed fund managers ESG risk management, which includes climate-related risks, are an explicit part of both the take-on process and continued due diligence or monitoring that the Trustee undertakes. • Through memberships of organisation such as the IIGCC, the Trustee aims to contribute towards wider public policy solutions that ensure an orderly transition to a low carbon economy.



Metrics and Targets

Recommended disclosure A: Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process. Asset Owners should describe metrics used to assess climate-related risks and opportunities in each fund or investment strategy. Where relevant, asset owners should also describe how these metrics have changed over time. Where appropriate asset owners should provide metrics considered in investment decision making and monitoring.	As explained above the Trustee has implemented climate-related tilts within its primary Developed Market Equity exposure across its DB and DC assets.
Recommended disclosure B: Disclose Scope 1, Scope 2 and if appropriate Scope 3 greenhouse gas (GHG) emissions and the related risks. Asset owners should provide the weighted average carbon intensity, where data are available or can be reasonably estimated for each fund or investment strategy. In addition, assets owners should provide other metrics they believe are useful for decision making along with a description of the methodology used.	See Appendix B for analysis of the Scheme's Equity holdings as conducted by FTSE Russell.
Recommended disclosure C: Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	The Fund is not currently using quantitative targets as part of its climate change risk mitigation strategy, but will regularly review this situation should it become apparent how this would be additive to its desire to transition the portfolio to a sustainable future within a fiduciary framework.

Appendix A: Climate Change Risk Policy

Within the context of its fiduciary responsibility, the Trustee is supportive of the United Nations Framework Convention on Climate Change (UNFCCC) agreement to limit temperature rises to 2 degrees centigrade above pre-industrial levels. In this context, the Trustee:

- Expects its appointed investment managers to be cognisant of climate change risks and opportunities within their investment processes as applied to the assets of the Trustee. Investment managers are further expected to annually report on how these risks and opportunities have been incorporated into the investment process.
- Has a preference for 'Engagement' rather than 'Exclusion' as a method of incorporating climate change risks into an effective fiduciary framework. However, the Trustees expect investment managers to independently consider whether exclusion or engagement is more appropriate within their investment process.
- Encourages the further development of asset classes that are supportive of obtaining the 2 degree target provided they are all based within the primary fiduciary framework.
- Supports the further development of effective climate change risk metrics to enhance the ability of all stakeholders in the investment chain to assess and minimise such risks.
- Recognises that 'Climate Change' will be subject to much further analysis and subsequent policy changes in the coming years. The Trustee is supportive of adopting an evolving policy in order to ensure all relevant developments are captured.
- Is supportive of policy initiatives that, in its opinion, contribute towards achieving the 2 degree target.

Appendix B

The tables below give the carbon emissions intensity (Weighted Average Carbon Intensity – scope 1 and 2 as recommended by the TFCD) as calculated by FTSE Russell for the main equity exposures of both the DB and DC assets of the Scheme as at 31st December 2017.

DB	FUM £m 31/12/17	Carbon emissions intensity (Weighted Average Carbon Intensity – Scope 1 & 2) - tonnes CO2e/mUSD revenue		
		Fund	Benchmark	Difference
Global Equities	2,245	185	544	-66%
Emerging Market Equities	1,203	229	437	-48%

DC	FUM £m 31/12/17	Carbon emissions intensity (Weighted Average Carbon Intensity – Scope 1 & 2) - tonnes CO2e/mUSD revenue		
		Fund	Benchmark	Difference
Global Equities – passive*	2,400	185	544	-66%
UK Equities – passive	18	152	152	0%
Shariah Law Equities – passive	20	84	84	0%
Global Equities – active	433	301	489	-38%
UK Equities – active	83	194	152	+28%
Sustainable & Responsible – active	27	233	544	-57%
Emerging Market Equities – active	77	207	437	-53%

The FTSE Russell carbon footprinting analysis uses modelled data for those companies that do not report on their carbon emissions. All funds show exposures equal or lower than their benchmark, with the exception of the DC UK Equities – active Fund. This is a result of one of the underlying fund's current recovery strategy, a special situations fund.

*The Global Equity exposure in the DB element of the Scheme and the DC Global Equities – passive Fund, are passively managed against the FTSE All World (ex-Controversial Weapons) Climate Balanced Factor Index. This index has climate tilts built within it, and as a result the table shows the exposure of this index against a benchmark of the FTSE All World Index.

Appendix C – Exclusions

The following eight companies were excluded from the Global Equity exposure in June 2018.

- China Construction Bank
- Dominion Energy
- Japan Post Holdings
- Loblaw Companies
- Occidental Petroleum
- Rosneft
- Subaru
- Sysco Corp

This is an ongoing process. These companies could be repurchased if their sustainability credentials improve, while other companies could be divested if their sustainability plans fail to deliver.

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HSBC Bank Pension Trust (UK) Limited, 8 Canada Square, London, E14 5HQ Registration number: 489775