

Sustainable & Responsible Investment

Engaging on Sustainability Issues: HSBC's Approach

HSBC Group Investment Businesses' engagement approach stems from the belief that environmental, social and governance (ESG) issues can enhance or threaten a company's value and its ability to generate sustained returns in the medium to long run. As a result, we encourage investment managers to engage with companies' senior managements on relevant sustainability issues and understand how they impact companies' business activities.

HSBC's SRI team has been conducting extensive engagement activities since 2003. Building on this experience, we have produced sector-specific engagement guidelines to support fund managers and analysts. By way of introduction, this document describes the broad principles underpinning our engagement approach.

Focusing on Materiality

In the context of changing competitive landscape and evolving expectations, we believe it is in investors' self-interest to work alongside companies' senior management to identify sustainability issues that are critical to their sectors and have a material impact on their business activities.

For instance, carbon management strategies have become an integral part of European utilities' business strategy since the enforcement of the "cap and trade" system under the Kyoto Protocol and the European Emissions Trading Scheme. Similarly, efforts to mitigate climate change have led to product innovation in automotive industry. Social issues such as concerns over obesity have resulted in a growing demand for healthier products, with some companies being better positioned to capitalise on this trend.

HSBC Investment's Engagement Approach

Unlocking hidden value

Focusing on:

- **Sector-specific issues**
- **Material impact**
- **Relevance to mainstream investors**

Identifying Sector-Specific Risk & Opportunities

Our focus on materiality means we favour a sector-specific approach which firmly puts the emphasis on a few sustainability issues which are important for each industry. We concentrate our engagement efforts on environmental and social issues that present new business opportunities or can lead to significant improvements in risk management.

Whilst recognising the importance of compliance, we believe that a focus on risk and opportunities sheds more light on a company's long-term competitive advantage and its ability to protect its reputation, its brand value and its license to operate, innovate and grow.

Corporate Governance: the exception that proves the rule

Corporate governance concerns include the composition of the board, the degree of independence of executive and non-executive directors, executive compensation and stakeholder consultations, amongst others. These issues relate to companies' governance structure and are therefore equally relevant across all sectors. Consequently, we have developed separate sets of guidelines on corporate governance based on relevant national legislation. Besides engaging with companies' senior management on corporate governance matters, we exercise our voting rights to signal our views to companies' management and promote improved corporate governance practices¹.

¹ For more information, see our UK and France voting policies:
http://www.hsbcinvestments.co.uk/site/about_us/corpogovernance_institution
https://www.hsbcinvestments.fr/Commun/doc_vote.asp

Engagement in practice

Investors can stress the importance of these issues to protect long-term shareholder value through direct engagement with senior management. We believe that engagement is most effective when conducted in a private and confidential manner. Our preferred approach is therefore one-on-one meeting with companies' senior management which offers the best route for a constructive dialogue on environmental, social and governance issues.

SRI team's Engagement Scope and Priorities

To date, HSBC Group Investment Businesses' SRI engagement activities have been driven by the SRI team. The primary focus of the SRI team has been large Pan-European companies. Since 2003, European-based SRI analysts have engaged with over 350 companies across all sectors.

Using the HSBC Investments' proprietary SRI rating system (ESG/CRO methodology), the SRI team identifies sector leaders which are raising the bar by demonstrating industry's best practices. The SRI analysts engage with sustainability leaders to define a sector benchmark. The benchmark then provides a basis for our engagement with sector peers. We also liaise with portfolio managers to determine engagement priorities based on the stocks held in portfolio, the size of the holding and the sensitivity of the stock to environmental, social and governance issues.

The launch of the global SRI platform in July 2007 offered the SRI team the opportunity to progressively enlarge our engagement focus to include emerging markets, reflecting the importance of these regions for the Group. In Europe, our engagement efforts are increasingly directed at Central and Eastern European companies. Our SRI capabilities have also been growing to include Brazil and India, where locally-based SRI analysts engage on environmental, social and governance issues that are becoming increasingly relevant for local companies.

Finally, we increasingly engage with "solution providers", i.e. small and mid caps companies whose innovative business models address sustainability challenges and which are attractive from a financial perspective.

Mainstreaming sustainability issues – leaping out of the "SRI niche"

We believe that an understanding of environmental, social and governance issues can enrich financial analysis. Consequently, we strongly encourage companies to communicate the strategic importance of material environmental, social and governance issues to mainstream investors and to disclose information in a timely and consistent fashion. In practice, this means incorporating relevant environmental, social and governance matters in annual reports, rather than confining them to Corporate Social Responsibility (CSR) reports.

Success metrics

As a global investor we recognise that legislation and best practice standards vary regionally and we must remain sensitive to this. However, as a minimum we expect the companies in which we invest to comply with the national legislation which applies to them. We also encourage companies to work towards best practice standards of corporate governance, environmental and social management where this will contribute to long-term business success.

Depending on the local context, our engagement objectives can vary significantly. Typically, they range from obtaining management's acknowledgment of sustainability issues as a business concern, to the identification of appropriate responses and viable alternatives, to evidence of improvement in companies' practices.

We measure our success by monitoring corporate communications on key environmental, social and governance issues and maintaining a dialogue with management. Increasingly we

also assess the extent to which the relevance of these issues is being communicated effectively to mainstream investors.

Reporting

The SRI team produces engagement reports on a quarterly basis highlighting the main discussion points with companies. These reports are sent to our clients and are available to all investment professionals within HSBC Group Investment Businesses on the SRI Intranet platform.