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HSBC Investor Brief 2021

Why investors should back the 2021 climate change resolution at HSBC

ShareAction»

About ShareAction

ShareAction is a campaigning organisation pushing the global investment system to take responsibility for its impacts on people and planet, and use its power to create a green, fair, and healthy society.

We want a future where all finance powers social progress. For 15 years, ShareAction has driven responsibility into the heart of mainstream investment through research, campaigning, policy advocacy and public mobilisation. Using our tools and expertise, we influence major investors and the companies they invest in to improve labour standards, tackle the climate crisis and address inequality and public health issues.

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This briefing makes the case for the climate change resolution filed by 15 institutional investors representing US$2.4 trillion in assets and over 100 individual investors, coordinated by ShareAction, at Europe's second largest fossil fuel financier, HSBC. We recommend investors vote for the resolution at HSBC's May 2021 AGM.

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Executive summary

Resolution

- **Key ask:** The resolution, filed by 15 institutional investors representing US$2.4 trillion in assets, asks HSBC to "set and publish a strategy and short-, medium- and long-term targets to reduce its exposure to fossil fuel assets on a timeline aligned with the goals of the Paris agreement, and starting with coal".
- **Scope:** Exposure here is defined in terms of provision of financial services, particularly project finance, corporate finance and underwriting.
- **Timeline:** HSBC should report on progress against its targets and strategy in its annual report on an annual basis, starting from 2022 onwards, including a summary of the framework, methodology, timescales, and core assumptions used.

Key points

- **A long history of engagement:** ShareAction has engaged with HSBC on climate change since 2016. In March 2019, ShareAction coordinated a letter signed by investors representing US$1 trillion in assets, which asked the bank to strengthen its coal policy.
- **A net-zero ambition that lacks details:** In October 2020, HSBC announced a net-zero ambition – an important announcement given the bank's strong presence in Asia. Yet, the announcement was criticised by ShareAction and investors alike for its silence on the bank's financing of fossil fuels, especially coal, and for lacking detail on how the ambition would be implemented in the short-term.
- **Europe's second largest provider of financing to the fossil fuel industry:** Over the period 2016 to 2019, HSBC channelled c. US$87 billion into fossil fuels, making it Europe's second largest fossil fuel financier since the Paris Agreement was signed[i]. The bank showed the 4th largest year-on-year increase (+US$6.7 billion) in fossil fuel financing worldwide in 2019.
- **An almost nonexistent coal policy:** HSBC's coal financing in 2019 was 3.5 times as high as it was in 2016, and the bank channelled almost US$8 billion to coal developers between 2016-2019, such as KEPCO. HSBC's coal policy remains one of the weakest in Europe. HSBC is one of the only mainstream European bank with no financing restrictions for companies exposed to thermal coal, and its policy remains silent on coal developers. It also hasn't asked its clients to publish coal phase out plans aligned with the Paris climate goals.
- **Coal is not an appropriate energy solution for development:** The environmental, financial, health and social risks and impacts associated with coal power in the short-, medium- and long-term prevent it from becoming a viable energy solution in low-income countries. Global heating, which has primarily been caused by coal burning, will cause over 100 million people to slide into extreme poverty by 2030.
- **Prominent financier of oil and gas expansion companies and weak unconventional oil and gas policies:** HSBC is in the core banking group of notorious oil and gas developers that lack credible energy transition plans. Despite recent improvements, the bank's policies remain ineffective in tackling the full spectrum of ESG challenges posed by oil sands and Arctic drilling and has not yet set clear decarbonisation expectations for its oil and gas clients.

- **Profitable retail bank faces reputational risks:** Reputational risk arising from HSBC's fossil fuel financing activities presents a significant threat to its retail operations, which account for a material portion of the group's profitability and funding. Recent surveys have demonstrated that HSBC's retail client base is largely unaware of these activities and that 14 per cent of customers would be 'very likely' to consider changing banks once presented with information on HSBC's fossil fuel financing track record.
- **An opportunity to show leadership:** With the UK hosting COP26 this year, there is a real opportunity for HSBC to demonstrate its strong climate leadership to a global audience. The bank has a unique chance to operationalise its net-zero ambition by backing the shareholder resolution.

Next steps for investors

- Tell HSBC to back the shareholder resolution. HSBC should publish its voting recommendation on the shareholder resolution in the week starting 22 March.
- Vote in favour of the shareholder resolution and consider pre-declaring your voting intention.
- Engage with the bank on the contents of its energy policy and financing of the fossil fuel industry, including coal.

Introduction

In a supervisory statement issued in April 2019, the Bank of England noted that a "too little, too late" scenario, where significant action is taken, but too late to achieve climate goals, could result in the most severe financial risks crystallising in the banking and insurance sectors[ii]. The report added that "the window for an orderly transition is finite and closing." In fact, it might close sooner than initially thought. Recent research suggests that countries will have to rein in their greenhouse gas (GHG) emissions even more than expected to limit rise of sea levels because climate change is causing oceans to rise quicker than scientists' most pessimistic forecasts[iii]. Too little action taken now increases the likelihood of abrupt policy intervention, acute socio-economic impact for affected communities and stranded assets in the future. The effects of energy insecurity, poverty and economic instability - that HSBC regularly puts forward as reasons not to reduce its exposure to fossil fuel assets[iv] – would be exacerbated by this "too little, too late" approach the bank is leaning towards.

Fossil fuel financing has increased year-on-year since the Paris Agreement was signed in 2015[v]. If global average temperature continues to rise at the current rate, the Intergovernmental Panel for Climate Change (IPCC) predicts with high confidence that 1.5°C of warming will be reached between 2030 and 2052, relative to a 2020 baseline[vi]. This poses severe risks to society and the economy.

To avoid this, a 45 per cent reduction in global greenhouse gas emissions is needed by 2030 relative to 2010. Scientists at Imperial College and the University of Leeds have found that meeting the 1.5°C goal could require immediate phase-out of current fossil fuel infrastructure[vii]. Achieving this will require an "unprecedented" level of action, from both private and public actors.

The COVID-19 crisis has exposed the vulnerabilities of our health and social systems and the fragility of our economies – and how important disaster preparation, good risk management, and taking a precautionary approach to looming systemic risk such as climate change is[viii].

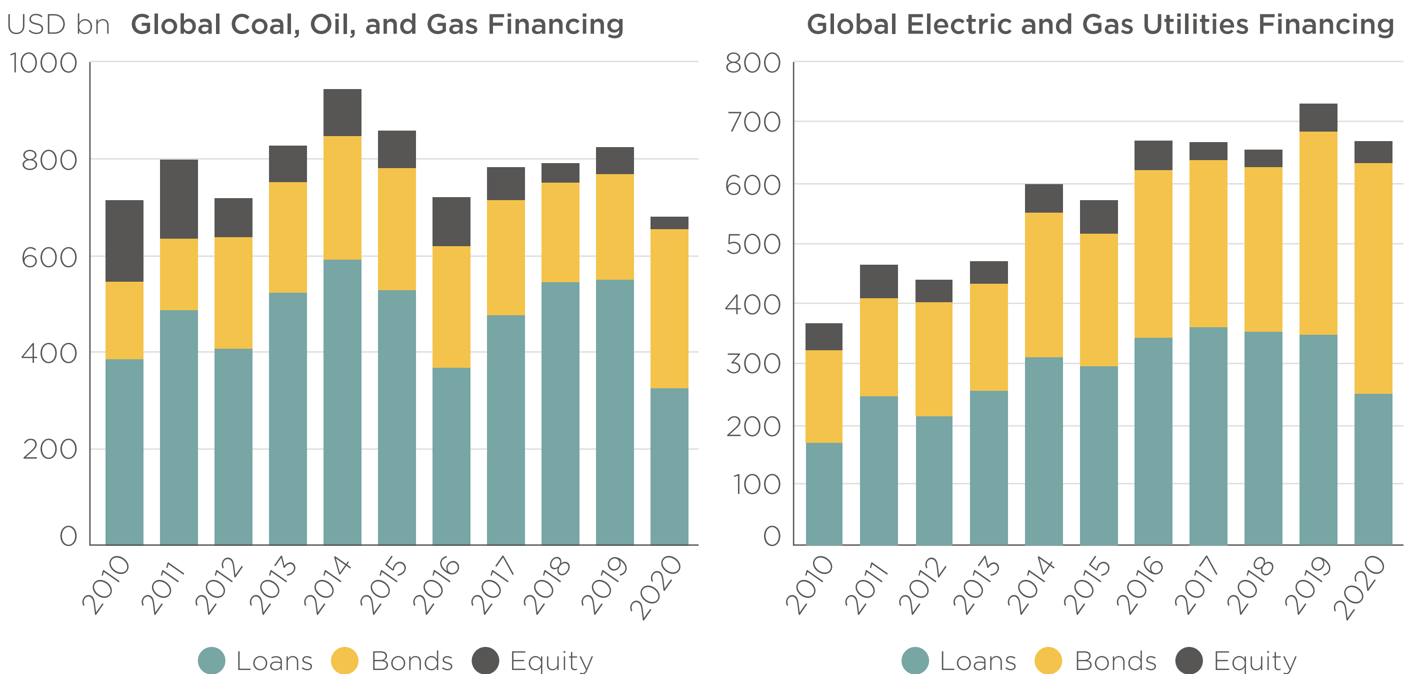
This briefing sets out the rationale behind the filing of a shareholder-led resolution at HSBC, which asks the bank to "set and publish a strategy and short-, medium- and long-term targets to reduce its exposure[1] to fossil fuel assets on a timeline aligned with the goals of the Paris agreement[2], and starting with coal".

1 Exposure here is defined in terms of provision of financial services, particularly project finance, corporate finance and underwriting.

2 As set out by Article 2.1(a) and Article 4.1 of the Paris Agreement.

Banks provide a significant proportion of financing to the fossil fuel sector

Figure 1: Banks provide a significant proportion of financing to coal, oil and gas companies.



Source: Eikon, 2021

Banks provide a significant proportion of financing for coal, oil and gas, and utilities, with syndicated loans on par with combined equity and bond issuances worldwide (Figure 1). From 2016 to 2019, 35 global banks provided US$975 billion via lending and underwriting to 100 companies expanding fossil fuels according to the Rainforest Action Network (RAN)[ix]. Over the same period, HSBC channelled c. US$87 billion into fossil fuels, making it Europe's second largest fossil fuel financier since the Paris Agreement was signed. The bank was also Europe's second most active player in oil sands and the world's 15th largest coal power financier (respectively US$2.6 billion and US$3.0 billion). Failure by HSBC to limit the increase in its fossil fuel portfolio is of great concern to meeting global climate commitments. The bank showed the 4th largest year-on-year increase (+US$6.7 billion) in fossil fuel financing worldwide in 2019 and its financial support to coal power companies was 3.5 times higher in 2019 than it was in 2016. Furthermore, analysis by ShareAction showed that in the four months leading up to HSBC announcing a net-zero ambition, the bank pumped an additional US$1.8 billion into fossil fuel companies, including some involved in the construction of new infrastructure for coal and oil sands[x]. Yet, the bank has not yet outlined how it intends to reduce its exposure to fossil fuel assets on a timeline aligned with the Paris climate goals, despite this being a key topic of engagement between the bank and its investors.

What does the resolution ask for?

The resolution asks HSBC to "set and publish a strategy and short-, medium- and long-term targets to reduce its exposure[3] to fossil fuel assets on a timeline aligned with the goals of the Paris agreement[4], and starting with coal". The resolution is compliant with the recommendations of the Taskforce on Climate-related Financial Disclosures ('TCFD-compliant'):

- **Metrics and targets:** The resolution asks for clear short-, medium- and long-term targets, on a timeline that is Paris-compliant. It also asks the bank to disclose against progress on an annual basis, and include a summary of the framework, methodology, timescales, and core assumptions used.
- **Risk management:** Meeting the resolution ask should entail, amongst other things, setting a robust energy policy, clear decarbonisation objectives, and a 1.5C aligned engagement policy that reduces transitional climate risk, and systemic risk linked to runaway climate change, and minimises reputational risks linked to the bank's image as Europe's second largest fossil fuel financier.
- **Strategy:** The resolution asks the bank to set and publish a strategy to reduce its exposure to fossil fuel assets -starting with coal- on a timeline aligned with the Paris climate goals.
- **Governance:** The resolution provides a clear framework that can be used to evaluate both the board and management.

The resolution also encourages HSBC to consider the social dimension of the transition to a low-carbon economy ('a Just Transition') when developing its strategy. Investors representing more than US $10.2 trillion have expressed support for the Just Transition[xi].

It also encourages the bank to use climate scenarios that do not rely excessively on Negative Emissions Technologies when developing its targets. The IPCC special report on 1.5°C states that large-scale CO_2 removal is "unproven" and that "reliance on such technology is a major risk in the ability to limit warming to 1.5°C"[xii].

The full resolution wording and supporting statement are available on ShareAction's website[5].

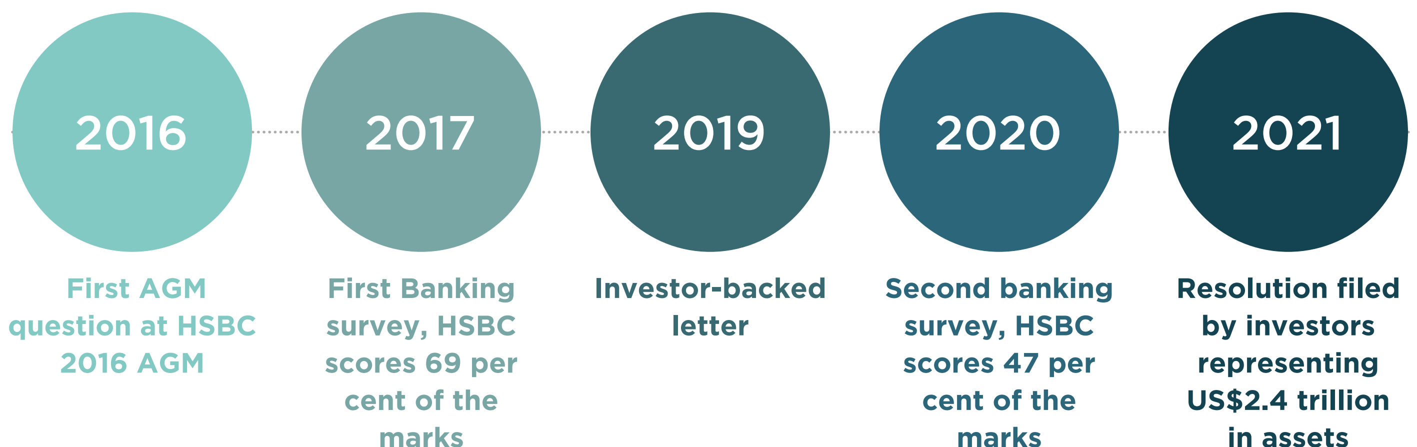
3 Exposure here is defined in terms of provision of financial services, particularly project finance, corporate finance and underwriting.

4 As set out by Article 2.1(a) and Article 4.1 of the Paris Agreement.

5 For a copy of the full wording, see here: https://shareaction.org/wp-content/uploads/2021/01/HSBC-resolution-wording.pdf

ShareAction's engagement with HSBC

Figure 2: A summary of ShareAction's engagement history with HSBC



Throughout: AGM questions and private engagement with the bank's senior management team and sustainability team

ShareAction started engaging with HSBC in 2016, after asking a question at the 2016 HSBC AGM. The question related to the bank's endorsement of the Paris Pledge for Action, and the implications of the Paris climate agreement for the bank's strategy, credit requirements, and energy policy. Since then, ShareAction has had numerous meetings with the bank's senior management team, including its former CEO Stuart Gulliver and its Group Chief Risk Officer Marc Moses, as well as with members of its sustainability team.

In 2017, ShareAction's published its first 'Banking on a Low-Carbon Future' survey[xiii]. The survey, which gives a comprehensive assessment of the climate strategies of Europe's largest publicly listed banks, has enabled in-depth conversations with HSBC on its climate strategy and energy policy, amongst other things.

In March 2019, ShareAction coordinated a letter backed by a group of investors representing more than US$1 trillion in assets, which raised serious concerns over the bank's coal policy. The group included Schroders, Hermes EOS, and Edentree Investment Management[xiv]. The letter urged the bank to a) close a loophole enabling HSBC to continue financing coal power projects in Bangladesh, Indonesia and Vietnam, b) further strengthen its coal policy by excluding any corporate funding and advisory services to clients highly dependent on coal mining or coal power, in line with the Global Coal Exit List methodology, and c) define a clear, timebound plan to phase out existing exposure to coal-related assets. The letter led to several meetings with the bank. So far, the bank has only met one of the asks of the letter, by closing its coal power loophole allowing for project financing in the emerging countries mentioned above (except if CCS or equivalent technology becomes commercially viable and utilised on a new plant)[xv].

In April 2020, ShareAction published the second iteration of its "Banking on a Low-Carbon Future". HSBC received a score of 47 per cent – i.e., the bank scored less than half of the points available[xvi]. The survey takes a holistic perspective by looking at banks' climate-related governance process, low-carbon products and services, risk assessment and management processes and public policy advocacy. HSBC performed best in the 'governance' section (with around ~65 per cent of the marks available) and the policy engagement and collaboration sections (with around ~59 per cent of the marks available). However, it did not perform well in the questions related to banks' energy policies and engagement policies, amongst other things.

Following several meetings with the bank's sustainability team throughout 2020, in January 2021, ShareAction announced that it had filed a resolution at HSBC, together with 15 institutional investors representing US$2.4 trillion in assets and 117 individual investors[xvii].

HSBC's net-zero ambition fails to address the bank's financing of the fossil fuel sector

On 9 October 2020, HSBC pledged to "reduce financed emissions from [its] portfolio of customers to net-zero by 2050 or sooner, in line with the goals of the Paris Agreement"[xviii]. ShareAction published a detailed analysis of this net-zero announcement in response[6].

Despite some encouraging commitments on sustainable finance, HSBC failed to back its net-zero ambition with credible short- and medium-term decarbonisation targets for its sectoral portfolios, including its energy and power portfolios. As evidenced in the above engagement history, HSBC has historically been evasive and resistant to addressing its financing of the fossil fuel sector. In the context of the bank choosing to take a non-targeted approach to portfolio decarbonisation, this is cause for concern. At the time of the announcement, HSBC shareholders such as Aviva Investors, BMO Global Asset Management, and Edentree Investment Management, expressed concern that the bank's ambition lacked detail and that it remained silent on coal[xix].

In a move that sharply contrasts with HSBC's approach to decarbonising its portfolio, Barclays recently published its methodology for meeting its recent net-zero commitment. Despite some of the shortcomings of the methodology, the bank sets out a targeted approach to decarbonising its portfolio that is backed by a clear rationale. It makes it clear that "the first sectors to be covered by BlueTrack™ are Energy and Power; these two sectors are responsible for up to three quarters of all emissions globally"[xx].

6 For a copy of ShareAction's fully analysis of HSBC's net zero ambition, see here: https://shareaction.org/resources/a-detailed-analysis-of-hsbcs-net-zero-ambition/

HSBC's financing of the coal sector remains high, and the bank has no plan to stop

Coal expansion is not compatible with the goals of the Paris Agreement

The burning of coal for energy is the single largest contributor to anthropogenic global temperature rise, accounting for one third of the 1°C of temperature rise thus far[xxi]. Studies suggest that per unit of energy produced, coal releases 30 per cent more carbon dioxide emissions than oil and 70 per cent more than gas[xxii]. In 2019, the burning of coal accounted for 30 per cent of all energy-related carbon dioxide emissions globally[xxiii].

In 2015, Christiana Figueres, then head of the UN Framework Convention on Climate Change (UNFCCC), warned: "There is no room for new coal"[xxiv], and the OECD Secretary-General Angel Gurría called new coal-fired power plants "the most urgent threat to our climate"[xxv].

Indeed, Climate Analytics has shown that coal needs to be phased out by 2030 in OECD countries and by 2040 in non-OECD countries to keep global temperature rise under 1.5°C. To keep within 2°C of warming, a warming scenario that carries significant risk of disastrous impacts[xxvi], climate scientists have estimated that 88 per cent of all known coal reserves need to stay in the ground[xxvii].

This need to "phase out thermal coal power worldwide by set deadlines" was recognized in the 2019 Global Investor Statement on Climate Change, which was endorsed by a group of 631 investors managing over US$37 trillion in assets[xxviii]. More recently, a group of 30 asset owners asserted that no further thermal coal power plants should be financed, insured, built, developed, or planned, and that there should be a phase-out of all unabated existing coal-fired electricity generation in accordance with 1.5°C pathways[xxix]. Fatih Birol, executive director of the International Energy Agency (IEA), has recently warned that coal power cannot expand and must be prematurely phased out to meet global green recovery goals[xxx].

HSBC's financing of the coal industry

HSBC is the world's 15th and Europe's fourth largest coal power financier over the years since the Paris agreement was signed, according to RAN[xxxi]. Its financial support to coal power companies was 3.5 times higher in 2019 than it was in 2016.

Figure 3: HSBC is among the largest coal power financiers

	2016 – 2019
Coal power financing	US$3.011bn
Europe Rank	4th
Global Rank	15th

Source: Rainforest Action Network, Banking on Climate Change 2020

Case study: HSBC's financing of KEPCO

Four months before announcing its net-zero ambition, HSBC took part in a US$498 million bond issuance to KEPCO, one of Asia's most aggressive expanders of the coal industry. According to Eikon, the bank underwrote $732 million of bonds to KEPCO in total in 2019-2020. In recent years, KEPCO has tapped into US$3.5 billion of project financing to build the Jawa 9 and 10 coal-fired power plants near Jakarta, Indonesia. At the end of 2020, KEPCO decided to spend US$189 million on a 40 per cent stake in the proposed 1,200 MW Vung Ang 2 coal power project in the Ha Tinh province of Vietnam. In May 2020, Japanese NGOs submitted a petition, signed by 127 organisations from 40 different countries, calling for the cancellation of Vung Ang II[xxxii]. This followed an assessment by the Environmental Law Alliance Worldwide, which found that the Environmental Impact Assessment for Vung Ang 2 did not align with international standards[xxxiii].

Global investors including Blackrock[xxxiv], Legal & General Investment Management (LGIM), APG and the Church Commissioners[xxxv] have also urged the company to drop overseas coal power projects, citing financial and environmental concerns. For example, LGIM stated that "building new coal plants is fundamentally at odds with the path that scientists tell us we need to be on to avoid dangerous climate change, and it is increasingly at odds with market trends"[xxxvi]. In October 2020, investors with assets totalling US$3.6 trillion wrote to financial institutions and companies involved in Vung Ang 2, urging them to withdraw from the project"[xxxvii]. On 1 February, APG sold its stake in KEPCO after the company gave the green light to the construction of new coal-fired power plants in Indonesia and Vietnam[xxxviii].

In addition to directly financing KEPCO, HSBC acted as a joint bookrunner on a bond issued by the Japan Bank for International Cooperation (JBIC) in February 2021[xxxix]. While not directly financing a specific project, the bond was issued weeks within JBIC entering a loan agreement to fund Vung Ang 2[xl].

These case studies illustrate the limitations of project finance exclusions and the need for banks to set robust corporate finance restrictions and analyse the coal expansion or investment plans of the companies that they provide financing to.

HSBC's coal policy compared to peers

The financial and climatic risks associated with the coal industry are not going unnoticed. The Institute for Energy Economics and Financial Analysis (IEEFA) reports that over 100 institutions had restricted finance or insurance to coal by 2019. At the time of publishing its analysis, IEEFA found that, on average, a new commitment was made every two weeks[xli]. This trend is likely to accelerate. 2020 has seen China, Japan and South Korea, all large producers and financiers of coal, commit to carbon neutrality targets. China, which burns half of the world's coal, announced that it is aiming to become carbon neutral before 2060[xlii]. Whilst no substantial plans have been disclosed yet, central government inspectors recently slammed China's energy authority for failing to apply environmental standards on rampant coal power expansion across the country – a potential sign of things to come as China operationalises its net-zero commitment[xliii].

The exit from coal by global financial institutions and government-backed agencies has become apparent to the coal sector. Participants at Asia's biggest gathering of the coal industry reported that financing for coal projects is drying up at ever-increasing rates[xliv]. Coal miners have reported facing a funding squeeze and losing billions in financing. This has raised the cost of capital and could jeopardise the viability of more carbon-intensive projects, as financial institutions move away from coal and other high-carbon assets[xlv].

Figure 4: Comparison of European banks' coal power policies

Bank	Project Finance	Corporate Finance				Phase-out
		Developers	Absolute threshold	Relative Threshold		
				Below 30% (included)	Above 30% (excluded)	
Credit Mutuel	x	x	x	x		x
Societe Generale	x	x	x	x		x
BNP Paribas	x	x		x		x
Natixis	x	x		x		x
UniCredit	x	x		x		x
Credit Agricole	x (*)	x		x		x
ING	x (*)			x		x
BBVA	x (*)	x		x		
Danske Bank	x			x		
Credit Suisse	x (*)			x		
Lloyds Bank	x (*)			x		
NatWest (RBS)	x (*)			x		
UBS	x (*)	x		x		
Commerzbank	x (*)			x (Germany)	x	
Intesa Sanpaolo	x (*)	x		x (OECD)	x	
ABN Amro	x (*)	x			x	
Barclays	x (*)				x	
CaixaBank	x (*)				x	
Deutsche Bank	x (*)	x			x	
Nordea Bank	x				x (new clients)	
Banco Santander	x (*)		x (new clients)			
Rabobank	x					
DZ Bank	x (*)					
HSBC	x (*)					
Standard Chartered	x (*)					

(*) indicates that exemptions to threshold are included

The above table gives a clear picture of how HSBC's coal policy performs amongst the 25 largest European banks by assets, according to S&P[xlvi]. For the purposes of building this table, we have classified a 'phase-out' policy as one that sets a clear timeline for the complete phase-out of finance to the coal industry, both project and corporate, and also includes a timebound expectation that clients will develop transition plans in line with the bank's own timelines.

In Q1 2020, HSBC announced that it would not finance new thermal coal mines and new thermal coal plants (with a potential exception if carbon capture and storage technology becomes available and is utilised on a new coal-fired power plant[xlvii,xlviii]). Yet as Figure 4 shows, all 25 largest banks in Europe now have project finance exclusions for coal, although most of these policies have some exemptions that allow them to finance existing projects with CCS and/or brownfield sites. While welcome, the effect of such policies is limited. Banktrack estimated that only around 5 per cent of total financing to coal power developers between January 2014 and September 2017 was project finance, the rest being corporate lending and underwriting[xlix].

HSBC also introduced some corporate financing restrictions for coal mining in 2020. Yet, these only apply to new clients that generate more than 50 per cent of their revenues from coal mining, thus limiting their effectiveness to screen out companies that are highly dependent on coal. HSBC remains one of the only banks in Europe to have no corporate finance restrictions for companies highly dependent on thermal coal or companies building new coal capacity. It also has not asked its clients to publish credible coal phase out plans aligned with the Paris climate goals. This is concerning as, according to the Global Coal Exit List, HSBC provided almost US$8 billion of financing in the form of loans (US$1.77 billion) and underwriting (US$6.15 billion) to 29 coal developers including AES Corporation, China Petrochemical Group, KEPCO, and Yangquan Coal Industry, from 2016 to 2019 [l].

Banks use different metrics to reduce their exposure to coal, with most using revenue threshold as a proxy for coal exposure. Revenue thresholds can mask a company's actual exposure to the coal sector and give no indication of the company's expansion plans. According to the 2020 Global Coal Exit List, 144 companies with a coal share of revenues of <50 per cent have a coal share of power production of >50 per cent. Of those 144 companies, 42 have coal expansion plans[li]. Recognition that revenue-based thresholds fail to screen out some of the most polluting companies has led a growing number of banks to introduce financing restrictions linked to companies' coal power production, absolute exposure to the coal sector and/or coal expansion plans.

Furthermore, a small number of banks, such as Credit Agricole and BNP Paribas, have asked their clients to publish transition plans that show how they will phase out from coal by 2030 in OECD countries and by 2040 in non-OECD countries by a specific date – or risk not receiving financing from the bank going forward. Indeed, engagement with teeth also helps banks reduce their exposure to fossil fuel assets. Robust project and corporate finance restriction criteria should be accompanied by a 1.5°C-aligned engagement policy for clients in high-carbon sectors. HSBC should set explicit conditions when providing financing tied to net-zero commitments, with clear timelines and milestones for reducing emissions. This will allow the bank to reduce financing of, and its exposure to, Paris-misaligned activities while scaling up green financing.

Leading practice examples: Credit Agricole's coal policy includes a total ban on new thermal coal mines, plants and coal infrastructure projects, as well as restricting finance to companies that get more than 25 per cent of their revenues from thermal coal and an exclusion of financing for coal mine/plant/infrastructure developers. The bank has also committed to a full coal phase out strategy by 2030 in the OECD and 2040 in the rest of the world and is requiring its clients to publish a coal phase out plan in line with these timelines by the end of 2021[lii].

Credit Mutuel goes one step further by setting absolute thresholds and restricting finance to companies with over 10Mt of annual coal production or 5GW of coal power capacity[liii].

Case study: State Bank of India

HSBC's exposure to coal is not limited to direct financing of the coal mining and coal power sectors. Recently, it was reported that the State Bank of India (SBI) was looking to arrange a US$650 million loan for the controversial Carmichael coal mine (or 'Adani mine') in Australia. According to the Anthropocene Fixed Income Institute, HSBC has been a dominant transaction provider for SBI, and has supported a green bond and arranged a EUR loan in green format[liv]. HSBC's green credentials in bond transactions could be at risk if the SBI's Carmichael loan goes through, since the bank might appear to be enabling Carmichael financing solutions. Several financial institutions, including Axa, Amundi, Blackrock, KfW Development Bank, and Storebrand Asset Management have raised concerns about the SBI's potential support for the Carmichael coal mine[lv] [lvi]. AXA went as far as selling off its green bond holding in the SBI and most recently, Amundi followed suit[lvii].

Busting the 'coal is necessary for development' myth

In response to the shareholder resolution, the Chair of HSBC Mark Tucker argued that "divestment [of coal companies] was not the best option for the environment or for the people and the communities that rely on these traditional industries." This presumption rests on the belief that coal is necessary for development. It was used by HSBC back in 2017 to justify its coal project finance loophole, which gave it the option to finance coal projects in Bangladesh, Indonesia and Vietnam. HSBC told the Financial Times at the time that "For now, coal is such a fundamental part of power generation in many developing countries where we operate that we do not think it is the right thing, from a social or economic perspective, to withdraw. What we want to do is work with clients to make sure that, when they build new plants, they are the cleanest possible and to work with investors in those markets to develop renewable resources"[lviii].

This presumption is wrong for the following reasons:

- **The expansion to coal infrastructure anywhere in the world is incompatible with the Paris goals (see p12) and a failure to meet the Paris goals will disproportionately affect low-income countries[lix].**

The unabated expansion of the coal industry will have grave consequences for low-income countries. Germanwatch's Climate Risk Index shows that 70 per cent of the ten countries most affected by extreme weather events between 1999 and 2018 are among the least developed countries. The IPCC found that this trend was likely going to worsen as global temperature continues to rise[lx].

Furthermore, more than 100 million people could be thrown into extreme poverty by 2030 because of climate change's systemic impacts on the global economy and food system[lxi]. The UNDP reports that 200 million people could be displaced and forced to migrate due to more frequent and severe climatic disasters by 2030[lxii].

- **Coal power is not a prerequisite for economic development and has received too much credit historically for poverty reduction.**

In China, the eradication of extreme poverty occurred mostly between 1981 and 1987 – before the large-scale deployment of coal power infrastructure. In India, 95,000 MW of new coal power capacity was installed between 2001 and 2011, yet the proportion of electricity-poor households in the country remained largely unchanged throughout that timeframe[lxiii].

As early as 2015, the World Bank already argued that clean energy, not coal, was a solution to poverty[lxiv]. This is partly explained by the fact that globally, 84 per cent of those without electricity live in rural areas without access to an energy grid[lxv]. Topography in those areas makes expansion of the grid system unfeasible. Instead, small-scale renewable energy and deployment of micro-grids presents a better solution for energy access[lxvi].

Finally, coal power and mining are highly water consumptive processes. Yet, in China and India, half of all coal power stations in operation are in water stressed areas. Risks of water shortages are predicted to compound as incidences of drought increase with a heating climate[lxvii].

- **Coal power and mining has significant impacts on the environment and public health.**

A systematic review of 113 peer-reviewed publications concluded that living near coal power plants was associated with numerous adverse public health impacts, including all-cause and premature mortality, respiratory disease and lung cancer, cardiovascular disease, poorer child health, and higher infant mortality[lxviii]. A recent meta-study found that "all phases of the coal use continuum (mining, processing, combustion, and waste disposal) create adverse public health and environmental impacts. Public health impacts include cancer, cardiovascular disease, respiratory disease, kidney disease, mental health problems, adverse birth outcomes, impaired child development, and others"[lxix].

The Centre for Research on Energy and Clean Air has found that reductions in harmful particulates resulting from reduced activity in the coal and oil industries meant 11,000 avoided air pollution-related deaths in Europe in 2020[lxx]. In South-East Asia, research conducted by Harvard University in 2017 estimated that the proposed pipeline of coal projects at the time of analysis would have caused nearly 70,000 premature deaths in the region[lxxi]. In India alone, emissions from coal are estimated to cause the premature deaths of up to 115,000 people annually, including 10,000 children under the age of five[lxxii].

- **Renewable technologies can better serve the energy needs of low-income regions and are becoming more competitive than coal in many regions of the world.**

In 2019 BHP reported to its investors that it intends to phase out exposure to coal mining, because it thinks that the fuel will be phased out "potentially sooner than expected". The company went on to say that it has "no appetite for growth in energy coal regardless of asset attractiveness"[lxxiii]. This echoes a trend in an industry that operates at over capacity, runs inefficiently, and is exposed to high transition risks. In 2018, 42 per cent of the global thermal coal fleet was unprofitable. This is set to rise to 50 per cent by 2030 and 72 per cent by 2040[lxxiv,lxxv].

BNEF recently found that wind and solar power are the cheapest form of new electricity in most of the world today[lxxvi]. New analysis has found that in Bangladesh, Indonesia, the Philippines and Vietnam, as much as 62GW of coal power may have been cancelled from project pipelines in 2020, an 80 per cent decline from just five years ago[lxxvii]. Underutilisation of coal fleets because of lower-

than-expected demand and overcapacity in the sector can be blamed for some of these financial problems. For example, in India coal fleet utilisation dropped from 77.5 per cent in 2010 to 60.6 per cent in 2019, due to excessive capacity build out and low and slow growth in demand[lxxviii].

The decline in the coal industry is being hastened by the falling cost of installing new wind and solar power. In India, wind and solar are the cheapest form of new power generation. In many instances, it is cheaper to build new wind and solar farms rather than run existing coal-fired power stations[lxxix]. In the USA, Morgan Stanley reports that coal is on track to disappear from the USA's power grid by 2033, with renewables supplying 39 per cent of USA's energy needs by 2030 and 55 per cent by 2035[lxxx]. In China, the falling cost of renewable energy has seen the construction of new wind and solar farms more than double in 2020. Wind power, in particular, saw huge growth, nearly tripling on 2019 levels[lxxxi].

This pattern is emerging in Europe. BloombergNEF published a report in July 2020 outlining an optimized, lowest-cost scenario energy mix for the Balkan region. This energy mix is primarily comprised of renewable energy, which is encouraging in a region that is historically reliant on coal power and that is responsible for a quarter of Europe's energy-related emissions. The report finds that a transition to renewables could attract 45 billion euros in clean energy investment and create up to 45,000 jobs in the region[lxxxii].

In summary, the claim that coal power is the only route to development in some low-income nations is a fallacy that should be challenged by investors.

HSBC is a core relationship bank of the largest oil and gas expansion companies

There is little room left for new oil and gas development to limit global warming to 1.5°C[lxxxiii]. In fact, when looking at climate scenarios not overly reliant on carbon capture or removal, burning existing developed reserves already takes emissions past the level consistent with a temperature rise of 1.5°C [lxxxiv]. Since HSBC is committed to be a net-zero emissions bank by 2050, a 1.5°C temperature threshold should sit at the core of its financing strategy. Yet, historical financing data shows that, far from reducing exposure to existing oil and gas assets, HSBC is one of the most prominent supporters of oil and gas exploration activities.

Most notably, HSBC is in the core relationship bank group of ExxonMobil and Saudi Aramco. With annual capex plans in the US$20-30 billion range mainly devoted to exploration and production, both companies have shown no willingness to transition towards lower carbon energy portfolios.

Figure 5: ExxonMobil's banking relationships

Rank	Bank	Amount (USD bn)	Number of Deals
1	JP Morgan	10.7	9
2	Citi	10.5	8
3	Bank of America	10.4	7
4	Barclays	9.3	7
5	**HSBC**	**6.4**	**9**

Source: Eikon, 2021. Equity, bonds and loans since 2018 (accessed on 26 January 2021)

While other super-majors display various degrees of adaptation to the energy transition, ExxonMobil's strategy has mainly consisted of increasing oil and gas production to take advantage of a hypothetical recovery of fuel prices. The company's 2018 investment strategy would have led to a surge in GHG emissions equivalent to the entire output of Greece if the COVID-19 pandemic hadn't derailed its plan[lxxxv]. More recently, Exxon Mobil has responded to increased pressure from activist investors with a timid increase of investment plans focusing on carbon capture and a reduction in emissions, which fell short of expectations[lxxxvi].

Figure 6: Saudi Aramco's banking relationships

Rank	Bank	Amount (USD bn)	Number of Deals
1	Citi	4.7	7
2	JP Morgan	4.5	6
3	**HSBC**	**3.9**	**4**
4	Morgan Stanley	3.7	3
5	National Commercial Bank SJSC	3.7	3

Source: Eikon, 2021. Equity, bonds and loans since 2018 (accessed on 26 January 2021)

Saudi Aramco was added to the Climate Action 100+ target list in 2020, at a time when HSBC (member of CA100+ through its asset management arm) was helping the company issue bonds with tranches of up to 50 years[lxxxvii]. This raises serious concerns considering the company's lack of energy transition plans. Following its IPO in 2018 (where HSBC acted as leading bank), Saudi Aramco is currently one of the few major listed oil companies that does not report scope 3 emissions. The company often justifies its expansion of oil and gas production based on claims of low-carbon upstream operations. However, Saudi Aramco's GHG accounting practices include only wholly owned facilities in Saudi Arabia and estimates show that its direct emissions could be hugely underestimated[lxxxviii].

HSBC underplays its involvement in oil sands

Figure 7: HSBC's historical exposure to Canadian oil sands

	2016 – 2019
Oil sands financing	US$2.6bn
Europe Rank	2nd
Global Rank	9th

Source: Rainforest Action Network, Banking on climate change 2020

As highlighted in ShareAction's report "High risk, Low Reward"[lxxxix], extracting Canadian oil sands presents serious ESG challenges and carries significant financial risk. Oil sands operations are more carbon-intensive than other types of oil and trigger a number of environmental issues in ecosystems that provide large potential for carbon sequestration and act as vital sources of livelihoods for Indigenous Peoples. Making oil sands' output commercially viable is also more capital intensive than other types of oil and new developments are uneconomic in a Paris-aligned world.

Despite compelling reasons to rein in financial support to oil sands operations, banks have channelled around US$102 billion of funding to the sector since the Paris Agreement was signed[xc]. Data shows that since 2016, HSBC was one of the only European banks taking leading roles on debt financing deals with Canadian upstream players overexposed to oil sands. While the bank has recently strengthened its energy policy and reduced exposure, it continues to support pipeline operators working to expand oil sands infrastructure.

Case study: HSBC passively supports expansion of oil sands infrastructure.

Historically, growth of oil sands operations has been limited by pipeline capacity constraints further weighing on oil sands' poor economics. This situation has led to major pipeline expansion projects being proposed: the Trans Mountain expansion (owned by the Canadian government), Keystone XL (developed by TC Energy) and the Line 3 Replacement project (developed by Enbridge). In addition to putting the environment at risk, these projects are linked to human rights controversies as they do not have the Free, Prior and Informed Consent of some Indigenous Peoples living in affected areas. Over 150 First Nations and Tribes across Canada and the U.S. have signed the Treaty Alliance Against Tar Sands Expansion, opposing the use of the signatories' Indigenous territories and coasts for new or expanded pipeline infrastructure projects that would facilitate the expansion of oil sands.

In 2020, HSBC participated in two bonds worth US$1.9 billion and two Revolving Credit Facilities worth US$4 billion raised by Enbridge. The bank also participated in a Revolving Credit Facility worth US$4.5 billion to TC Energy. While the Keystone XL permit has been revoked by the Biden Administration, the Line 3 Replacement project is still underway. The most pressing implication for HSBC is an increased reputational risk. Research has shown that financial institutions associated with the equally controversial Dakota Access oil pipeline lost US$4.4 billion in account closures and divestments in 2017[xci].

Figure 8: Comparison of European banks' oil sands policies

Policy	Banks
Full phase-out	–
Project finance exclusion/Corporate finance restrictions	BNP Paribas, BBVA, CaixaBank, Danske Bank, ING, Natixis, Nordea, Rabobank, Societe Generale, UBS, UniCredit
Project finance exclusion	ABN AMRO, Crédit Agricole, Lloyds Banking Group, Crédit Mutuel, Deutsche Bank, Commerzbank, **HSBC**, NatWest, Santander, Standard Chartered
Enhanced Due Diligence (EDD)	Barclays, Credit Suisse
No policy	DZ Bank*, Intesa Sanpaolo

Source: company websites
* DZ Bank has stated that sectoral rules exist for extractive industries[xcii]

Excluding solely project-level finance is a welcome yet rather weak commitment when it comes to reducing exposure to the oil sands sector. In fact, policies excluding or restricting solely asset-specific transactions fail to capture most funding delivered to the oil sands sector by European banks, whose clients are mostly integrated, investment-grade players able to rely on general

corporate purpose funding and their own balance sheet. Even if general corporate purpose finance is not utilised (e.g. undrawn Revolving Credit Facility), these companies can benefit from off-balance sheet commitments to issue other debt or equity instruments. Therefore, the lack of corporate finance restriction leaves the door open to general corporate purpose finance "leakage" towards oil sands assets, a significant pitfall of HSBC's policy considering it is one of ExxonMobil's main banks. ExxonMobil derives around seven percent of revenues and 16 per cent of its proven and probable (2P) reserves from oil sands[xciii]. This stresses the importance for HSBC to publish a clear engagement policy outlining the bank's expectations for its clients and a timeline for escalating engagement with companies that have failed to develop transition plans in line with its climate ambitions.

As highlighted in ShareAction's oil sands report, an in-depth analysis of banks' oil sands policies reveals a number of caveats that serve to weaken these policies. For example, HSBC's project finance 'exclusion' is in fact merely a restriction, as it does not apply to brownfield projects. Although multi-billion dollar greenfield projects are unlikely to be sanctioned in the current market environment, smaller projects and expansions on the lower side of the cost curve are more likely. Projects currently in the pipeline involve Canadian oil and gas companies as well as Chevron, Shell, ExxonMobil and ConocoPhillips[xciv].

Leading practice example: BNP Paribas and Natixis

BNP Paribas and Natixis' policies capture upstream/infrastructure and specifically mention brownfield and greenfield developments, which leaves no room for interpretation. BNP Paribas takes a step further by extending corporate level restrictions to integrated and trading players. Both banks have implemented corporate restrictions using thresholds relative to the companies' exposure to oil sands, with Natixis' threshold applying at both borrowing entity and parent level. Both BNP Paribas and Natixis' policies cover all banks' products and services (funding, advisory, ancillary) and include their asset management arm. However, while these policies are viewed as leading practice, none of them consider phasing out oil sands and both allow for international integrated or diversified players to retain investments indefinitely, and even materially increase exposure in the event they regain interest in oil sands.

Arctic oil and gas – the onshore corporate loophole

Figure 9: HSBC's historical exposure to Arctic oil and gas

	2016 – 2019
Arctic oil financing	US$903m
Europe Rank	6th
Global Rank	10th

Source: Rainforest Action Network, Banking on climate change 2020

Weather conditions, technology requirements and lack of infrastructure make Arctic drilling the least cost effective and most dangerous way to produce oil and gas[xcv]. The region is particularly vulnerable to oil spills and some of its fossil fuel reserves are found in fragile ecosystems Indigenous Peoples rely on[xcvi]. Alongside several other banks, HSBC announced Arctic oil and gas financing restrictions over the past two years. However, a detailed analysis of the bank's energy policy casts doubts as to whether it is effective in mitigating the risks posed by Arctic drilling.

Figure 10: Comparison of European banks' Arctic oil and gas policies

Policy	Banks
Full phase-out	–
Project finance exclusion/ Corporate finance restrictions	Barclays, BNP Paribas, ING, Societe Generale, UBS, UniCredit
Project finance exclusion	ABN Amro, BBVA, CaixaBank, Commerzbank, Credit Agricole, Credit Mutuel, Credit Suisse, Deutsche Bank, **HSBC**, Lloyds, Natixis, NatWest, Rabobank, Santander, Standard Chartered
No policy	Danske Bank, DZ Bank*, Intesa Sanpaolo, Nordea

Source: company websites
* DZ Bank has stated that sectoral rules exist for extractive industries[xcvii]

HSBC's policy focuses on offshore oil and gas projects and adopts a narrow definition of "Arctic" (limited to the area within the Arctic Circle subject to sea ice). However, land is thought to hold about 16 per cent of the Arctic's remaining undiscovered oil and gas resources[xcviii]. In effect, HSBC would be able to finance onshore projects in other parts of the Artic Circle including the Arctic National Wildlife Refuge (ANWR), where oil and gas leases were tendered by the US administration in January 2021 (without much success – see discussion below). Broader definitions would include "the region inside the Artic Circle" (UniCredit), "all land north of the 10°C July isotherm" (Natixis), or specifically mention the ANWR (Barclays). In addition, HSBC's policy fails to capture Arctic oil and gas related infrastructure.

Another major weakness of HSBC's policy is that it does not restrict financing at the corporate level, nor does it set expectations for clients that are active in the Arctic. HSBC should set explicit conditions when providing financing tied to net-zero commitments, with clear timelines and milestones for reducing emissions. In the absence of a specific engagement strategy, this could leave HSBC exposed to a "leakage" of general corporate purpose financing to companies drilling for Arctic oil and gas. For example, Rosneft announced a US$134 billion project in the Arctic Circle[xcix]. According to data collected by RAN, HSBC is the fourth largest fossil fuel financier of BP (US$2.1 billion between 2016 and 2019). The oil major holds a 19.75 per cent share of Rosneft.

Discussion: Is divestment effective? The failed ANWR lease auction

Speaking at the Asian Financial Forum in January 2021, HSBC Chairman Mark Tucker said: "Just because we, as a bank, and others of the big banks divest, means that it will just force heavy fossil fuel users to go elsewhere, thereby just moving the problem."[c] Recent market activity has demonstrated this statement is incorrect.

In a similar trajectory to coal, for which finance and insurance is drying up at an increasing rate[ci], the market witnessed how all six big US banks consecutively announced project finance exclusions for Arctic oil and gas in 2020. In parallel, the sale of certain leases in the ANWR area, contemplated by the Tax Cuts and Jobs Act of 2017, was accelerated and a bid auction took place in January 2021. A 2018 congressional report predicted this round of lease sales, plus another due to be held by the end of 2024, would raise US$2.2 billion in revenues over a 10-year period[cii]. The auction attracted almost no interest from potential bidders and raised only US$14.4 million, leaving the state of Alaska, acting through the Alaska Industrial Development and Export Authority, in the awkward position of leasing the lands itself. The lack of support from lenders and project rationale on both economic and environmental grounds deterred bidders from participating in the auction. This is a situation other fossil fuel assets could face should an increasing number of financial institutions take steps to reduce their exposure to fossil fuel assets on a timeline aligned with the Paris climate goals.

Nevertheless, engagement and divestment are not competing strategies. In fact, they are complementary. By spelling out a meaningful fossil fuel phase out strategy, HSBC can provide more details on the escalation mechanism underpinning its engagement activities.

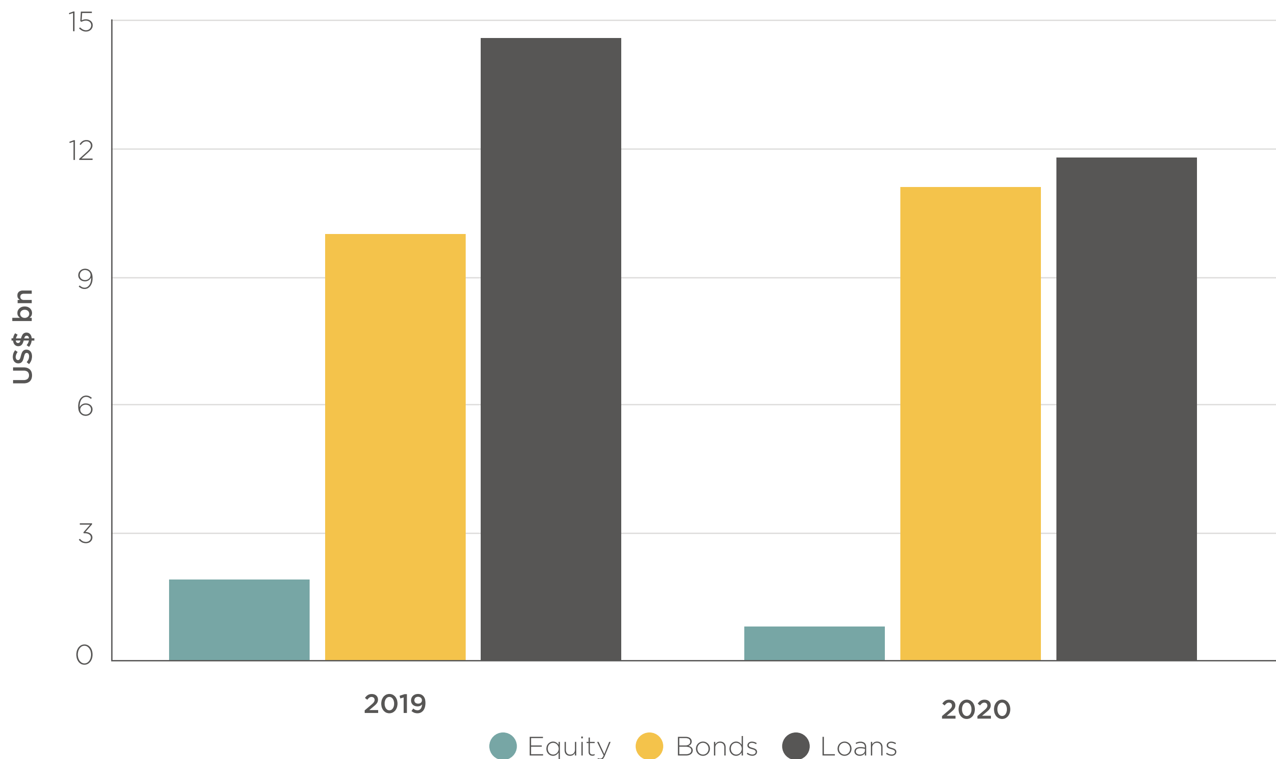
Climate-related risks and opportunities

In its October 2020 announcement, HSBC indicated that it will "use the Paris Agreement Capital Transition Assessment Tool (PACTA) to develop clear, measurable pathways to net-zero". PACTA, developed by the 2 Degrees Investment Initiative ("2DII"), can provide interesting insights in terms of capital allocation and as a decision-making tool to assess financing opportunities. However, relying solely on this methodology to achieve a net-zero ambition is not credible. Firstly, at its core PACTA is not designed to develop an emissions pathway for a bank's financed emissions to reach a certain level, in part because in 2DII's opinion this approach is ineffective, and at best unreliable, to drive decarbonisation of the real economy[ciii]. Instead, when considering the fossil fuel and power sectors, the "default" version of PACTA aims to assess alignment of production and installed capacity in a bank's lending portfolio with a climate scenario (and underlying carbon budget). Alignment focuses on upstream activities and is measured through technology mix and production trajectory metrics (spot and forward-looking)[civ]. This is an interesting feature for relationship managers and risk decision makers, but is hardly applicable to develop a full-fledged and meaningful net-zero emissions pathway for a financial institution. In addition, PACTA's sector-based approach would in theory allow a financial institution to "green" its power portfolio by increasing low-carbon assets at a faster pace than high-carbon assets. While this might be possible only in the short-term, delaying action is not compatible with HSBC's ambition as limiting global warming to 1.5°C involves a rapid reduction of emissions over the next decade according to the IPCC.

Developing a robust net-zero alignment methodology is not an easy task, and while PACTA's implementation might prove easier than other frameworks, one of its weaknesses as an open-source framework is that it can largely be adapted by banks (e.g. Katowice Banks[cv]). This can result in different levels of ambition and a lack of transparency in the absence of prescriptive criteria and disclosure requirements, adding to the significant gap in how banks account for the risk of climate change. In particular, the lack of criteria (e.g. temperature target or specific carbon budgets) to select a climate scenario, the most important parameter in any Paris-alignment methodology, could lead to different standards to assess decarbonisation efforts required from banks.

An important distinction should be made, however, between climate risk management and portfolio alignment with climate scenarios. While both approaches can be complementary, risk mitigation doesn't necessarily mean portfolio alignment, let alone climate impact, and an aligned portfolio is not necessarily climate-risk free. A good illustration of this is how HSBC currently assesses transition risk, where it fails to include financing provided through underwriting services. The bank estimates that approximately 20 per cent of this wholesale loan book is exposed to "six higher transition risk sectors" (Oil & Gas; Building & Construction; Chemicals; Automotive, Power & Utilities; Metals & Mining). Up to half of this risk (10 per cent) is attributed to fossil fuels. While excluding off-balance sheet activities could make sense from a credit risk perspective, it greatly underestimates the bank's exposure to the fossil fuel sector and efforts required to make financial flows consistent with the goals of the Paris Agreement. In 2019 and 2020, HSBC provided almost as much financing to the Energy and Utilities sector in the form of underwriting than as it did in the form of loans.

Figure 11: HSBC's financing of Energy and Utilities sector in 2019-2020



Source: Eikon, 2021. Deals where HSBC is reported as Book Runner or Mandated Arranger. Facility amount divided by number of bookrunners or mandated arrangers.

Yet, HSBC Global Research's own research concluded that "it will be difficult for net-zero committed institutions to justify holding Oil and Gas issuers in net-zero portfolios"[cvi]. HSBC's independent research team has warned that, as a result of net-zero commitments, oil and gas bonds could face a "similar trajectory in the next five years to tobacco bonds over the last five years", in reference to tobacco bonds' underperformance resulting from many tobacco free pledges among financial institutions.

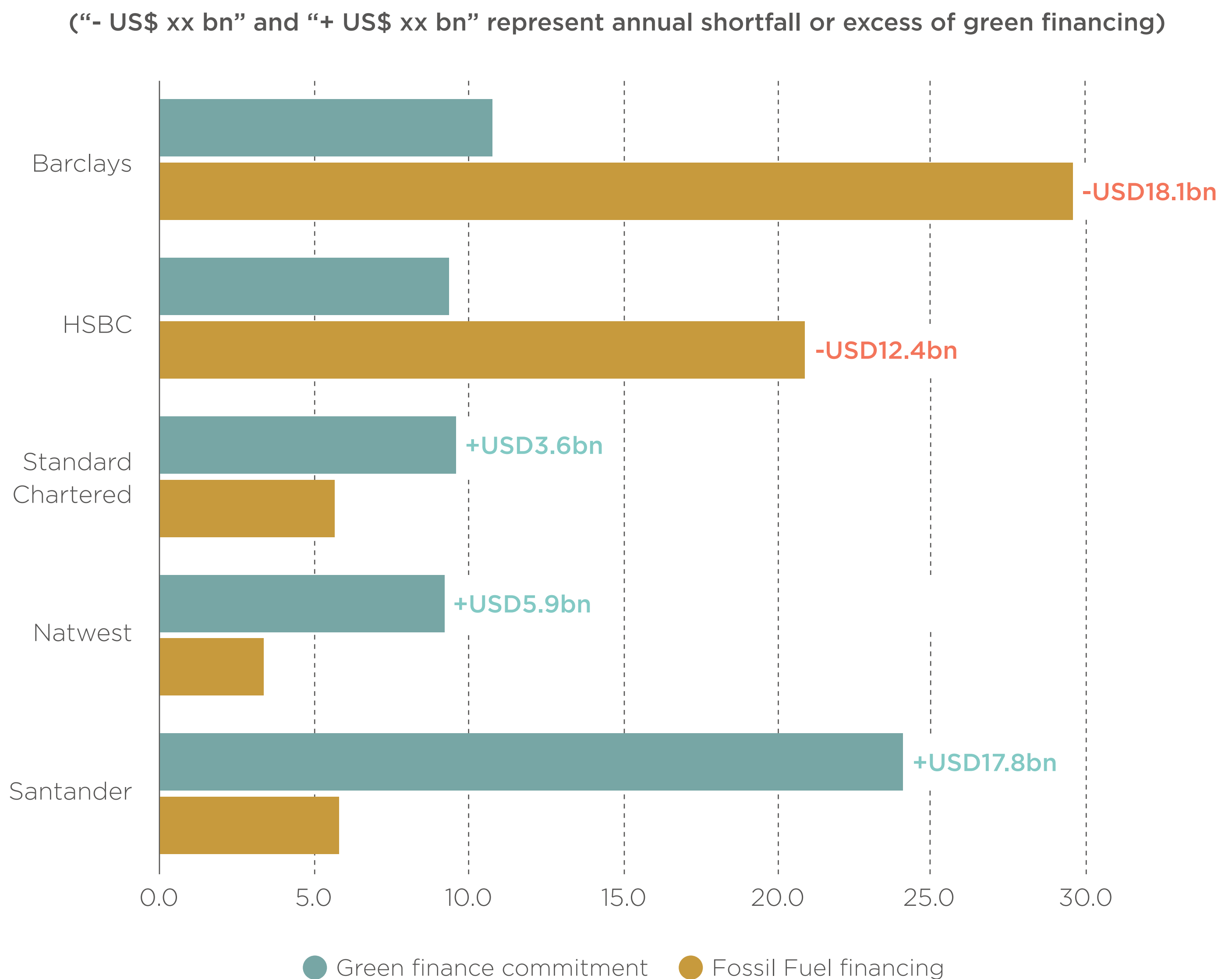
HSBC's ESG record, however, does not only carry risk for its wholesale activities. In fact, the reputational risk arising from its wholesale activities could have a bigger impact on its retail operations. In 2019, 42 per cent of HSBC's revenue came from its retail franchise and 25 per cent of its funding base was made of Wealth and Personal Banking accounts. Universal banks like HSBC operate in a disruptive environment where technology and changing expectations from customers have lowered barriers for new entrants. At the same time, customers and the public at large are increasingly inclined to take ESG lenses to assess their banking providers.

According to recent research from Deloitte, 60 per cent of UK banking customers wish that their bank would do more to create a positive social and environmental impact[cvii]. Thinking about what would cause them to leave their bank, almost half of customers responded that they would if they found out the bank was financing fossil fuels. Another survey conducted by Market Forces focusing on HSBC and Barclays echoes these results[cviii]. Market Forces found that HSBC benefits from a low level of awareness of their climate impacts, with 80 per cent of customers unaware that their bank is investing in fossil fuels. According to the survey, 14 per cent of HSBC customers stated that they would be very likely to consider changing banks once presented with the facts about the bank's leading role in financing the fossil fuel industry.

While HSBC has announced sizeable green finance commitments and was named "Best Bank for Sustainable Finance 2020", it can't obscure the fact that it is the second largest fossil fuel financier among UK high street banks. In fact, when comparing green finance commitments with fossil fuel financing on an annual basis, HSBC and Barclays are the only UK banks displaying a negative balance.

Figure 12: Average annual green commitment vs average annual fossil fuel financing (US$ bn)

("- US$ xx bn" and "+ US$ xx bn" represent annual shortfall or excess of green financing)



Source: Rainforest Action Network, Banking on climate change 2020; Company websites; FX rates as of 28/01/2021: GBP/USD = 1.37 and EUR/USD = 1.21; Methodology: Average annual fossil fuel financing based on 2016-2019 figures. Green finance 'ambitions' are excluded. 'Sustainable' commitments are divided by 3 (to account for spread across green, social and sustainability) except where details have been provided by the bank. Example: in 2017, HSBC committed to provide US$100 billion of sustainable finance by 2025. 83 per cent of this amount (US$83 billion) is considered green based on progress across green, social and sustainability as reported in HSBC's ESG report 2019, divided by 9 years (2017 to 2025 including start and end year).

With an ambition to provide between US$750 billion and US$1 trillion of finance and investment by 2030 to help customers transition, HSBC has the opportunity to build on its sustainable credentials and become a leader in sustainable finance. However, its efforts to capture climate-related opportunities might be hindered by a failure to set clear decarbonisation expectations for its clients, including an engagement policy with objectives and timelines aligned with its ambition to become net-zero emissions by 2050.

Conclusion and recommendations for investors

This briefing set out to illustrate why this special resolution is essential for HSBC to meet its net-zero ambition. We believe it provides a compelling case for investors considering voting in support of the resolution.

The salient facts are: HSBC is the second largest financier of fossil fuels in Europe; HSBC has some of the weakest policies in Europe for restricting finance to the most extreme fossil fuels and has so far not set expectations for clients exposed to the fossil fuel sector; HSBC has a history of being evasive when engaged on the above issues; and, HSBC has failed to outline a strategy and short- and medium-term targets for reducing its exposure to fossil fuel assets in its net-zero ambition. These facts comprise a rationale for filing this resolution alongside 15 institutional investors - holding assets worth over US$2.4 trillion - and 100 individual investors.

In the year that the UK hosts COP26, there is a real opportunity for HSBC to demonstrate strong climate leadership globally. The bank has a unique chance to show that actions, not ambitions, are essential to the world meeting the challenges of net-zero and seizing the opportunities presented by a just transition away from fossil fuels by backing the shareholder resolution.

Recommendations for investors

We recommend that investors who are supportive of the resolution take the following actions:

1. Tell HSBC to back the shareholder resolution. HSBC should publish its voting recommendation on the shareholder resolution in the week starting 22 March.
2. Vote in favour of the shareholder resolution and consider pre-declaring your voting intention.
3. Engage with the bank on the contents of its energy policy and financing of the fossil fuel industry, including coal.

FAQ

Question 1: HSBC, is it an Asian bank?

In 2019, more than 80 per cent of HSBC's profit before tax came from Asia. While current distribution of risk-weighted assets (RWA) paints a slightly different picture – Asia accounts for 'only' 40 per cent of the group's RWA – the bank is committed to reallocating more capital towards Asia as part of its 2022 strategic plan. The group's total market value is roughly equivalent and even dropped below the Asian holding company's tangible book value in 2020. In effect, the market is saying that HSBC's value lies in Asia. In that context, two questions emerge: is HSBC an Asian bank or a British bank, and can it be compared to European peers from an ESG perspective?

The shortest answer to the first question is that HSBC is on the path to remain both a British bank and an Asian bank in the foreseeable future. While it has leading retail banking market shares in Hong-Kong, the bank is deeply rooted in the UK, where it has been conducting business for almost two centuries and now serves more than 15 million customers across several retail brands (HSBC UK, First Direct, M&S Bank, and John Lewis Financial Services)[cix]. The bank has reported a 14 per cent market share in personal current accounts and 7 per cent in retail mortgages. It was ranked 4th by retail market share in 2018[cx] and has ambitions to become a top 3 UK financial institution as part of its 2022 strategic plan. The UK ring-fenced bank was among HSBC's strong performing franchises in 2019 with 15 per cent of revenues generated and the only 'European' franchise hitting the 10 per cent return on tangible equity hurdle set by the bank.

HSBC's foothold in Europe is not limited to its UK retail banking franchise. Bridging financial flows for businesses between East and West is at the heart of HSBC's business model. HSBC has strong trade finance and cash management franchises as demonstrated by recurrent Euromoney top positions in these areas, and 30 per cent of the bank's revenues come from Commercial Banking. It is also among the top 3 Debt Capital Markets and Loans players for EMEA according to Global Capital. Furthermore, 40 per cent of HSBC's funding sources come from UK customer accounts and a quarter of the bank's accounts are denominated in GBP. While HSBC's largest shareholder is Chinese asset manager Ping An Asset Management (8 per cent ownership as of 9th February 2021), only 10 per cent of the bank's institutional investor base is registered in Asia.

In 2016, HSBC said it would keep its headquarters in London following a review of whether it should move elsewhere, a decision that was intended to settle the question for the medium-to-long term amid rumours of a move of domicile to Asia. In 2020, a spokesperson for HSBC said: "There are no discussions to review HSBC's global headquarters and no plans to reopen the issue."[cxi] As Autonomous' Global Head of Research Manus Costello puts it, "HSBC wants to be seen as an international bank with business in Hong Kong, not a Hong Kong bank with business internationally."[cxii]

The second question needs to be answered in the context of the public relations script HSBC representatives have been sticking to. The bank has repeatedly emphasised how its focus on Asia is a hurdle to scaling back financing of fossil fuels compared to other European banks, considering regional reliance on coal in particular. However, all banks need to align with the goals of the Paris Agreement regardless of location. HSBC's geographical footprint and capital allocation strategy should not serve the purpose of levelling down its global decarbonisation efforts, but rather the opposite. Because HSBC is more exposed to Asia than the average European peer, decarbonisation of its portfolio in a timeline aligned with the goals of the Paris Agreement could involve steeper emission reductions in parts of its portfolio.

Question 2: Just Transition - Will this resolution negatively impact communities and workers?

A transition to a 1.5°C world is only 'just' if it considers the effects of both the transformation through climate action on local communities and workers, and the impacts of climate inaction on all vulnerable communities and sectors.

Although renewables have a much higher level of job creation per US$1 million of investment, with 7.49 full-time jobs created vs. only 2.65 in the fossil fuel industry, careful attention should be given to the way in which a transition away from the coal industry is managed[cxiii]. Specifically, policy frameworks must be developed that support the retraining of coal industry workers. The technical capability, physical competence and attention to safety that roles within the coal industry require are well suited to roles on the installation side in the solar industry[cxiv].

Yet, the 'Just Transition' is only 'just' if it is fully aligned with 1.5°C and also considers the impact that climate inaction could have on vulnerable communities and sectors. Therefore, it cannot be used as an excuse for inaction – but should rather be part of any climate discussions to ensure a good future for communities affected by the impacts of climate policy and climate change. The Just Transition cannot be used as an excuse the financing of coal developers – it should involve banks looking at what alternatives exist in the regions these coal developers operate in, whether financing is needed to create alternatives, grow low-carbon businesses, reskill workers etc.

The supporting statement of the resolution therefore calls on HSBC to consider the Just Transition when developing its strategy to reduce its exposure to fossil fuel assets. HSBC should engage with clients to ensure that workers and local communities are at the centre of their transition plans, but also consider the impact that its financing of e.g. coal developers might have on vulnerable communities.

Question 3: In an article dating from 10 January 2021, the FT mentioned that HSBC was debating whether to propose its own motion on the subject and is considering whether to give shareholders an annual vote on climate change policy, according to a person familiar with internal discussions[cxv].

What should investors make of that?

By filing this shareholder resolution, a group of HSBC's institutional and individual shareholders representing US$2.4 trillion in assets have called on the bank to take one step further and publish a strategy to reduce its exposure to fossil fuel assets on a timeline aligned with the Paris climate goals. As explained in detail in this brief, the resolution focuses on fossil fuels as this is one of the sectors that contribute the most to climate change and one that the bank is heavily exposed to yet has been reluctant to act on in the past. The ask is reasonable, would help operationalise the bank's net-zero ambition, and, if backed by the bank, could propel it to a leadership position.

Proposing a 'Say on Climate' vote is not a good alternative to supporting the resolution. Indeed, the idea behind the 'Say on Climate' vote is to give investors more of a direct say on a company's transition plan. Yet, by filing this resolution, shareholders have *already* made their expectations for HSBC clear. If the bank is indeed planning to propose an advisory 'Say on Climate' vote -as proposed by the likes of Unilever- it should also back the shareholder resolution. It can then use the 'Say on

Climate' vote to report on its progress towards meeting the ask of the resolution and operationalising its net-zero ambition. If the bank failed to back the resolution, a Say on Climate vote would not necessarily lead to the bank committing to take stronger action on fossil fuels, and could run the risk of delaying much needed-conversations about and action on the bank's coal policy to the following year.

If the bank is planning to file its own motion, as suggested by the FT above, investors should ask themselves why. This briefing has demonstrated that the bank is an important financier of the fossil fuel industry, lacks a strategy to reduce its exposure to fossil fuel assets, and is lagging behind its peers.

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About ShareAction

ShareAction is a campaigning organisation pushing the global investment system to take responsibility for its impacts on people and planet, and use its power to create a green, fair, and healthy society.

We want a future where all finance powers social progress. For 15 years, ShareAction has driven responsibility into the heart of mainstream investment through research, campaigning, policy advocacy and public mobilisation. Using our tools and expertise, we influence major investors and the companies they invest in to improve labour standards, tackle the climate crisis and address inequality and public health issues.

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