HSBC BANK (UK) PENSION SCHEME
DEFINED BENEFITS

Statement of
Investment Principles

September 2019
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Section 1: Introduction

Background

1.1 Under Section 35 of the Pensions Act 1995 (Pensions Act) and as amended by the Pensions Act 2004 and the Occupational Pension Schemes (Investment) Regulations 2005 ("the Investment Regulations"), trustees of a pension fund are required to prepare a statement of principles governing their investment decisions. This is that statement for the Defined Benefits of the HSBC Bank (UK) Pension Scheme ("the Scheme"). The Trustee of the Scheme is HSBC Bank Pension Trust (UK) Limited ("the Trustee").

1.2 The Scheme operates for the exclusive purpose of providing retirement benefits and death benefits to eligible participants and beneficiaries. The Scheme consists of three sections; the HSBC UK ("HBUK") Section, the HSBC Bank plc ("HSBC Bank plc") Section and the HSBC Global Services (UK) Ltd ("HGSU") Section. Whilst Defined Benefit and Defined Contribution benefits are provided by each section, the Statement of Investment Principles for the Defined Contribution Sections is separate to this document.

1.3 In preparing this statement, the Trustee has consulted the person performing the role of the bank (the "Principal Employer") in relation to all three sections and the Scheme Actuary and has sought written advice from the Scheme's investment consultant. At the date of this document, the Principal Employer in relation to the HBUK Section is HSBC UK Bank plc, the Principal Employer in relation to the HSBC Bank plc Section is HSBC Bank plc and the Principal Employer in relation to the HGSU Section is HSBC Global Services (UK) Limited. It is the intention of the Trustee to review this statement annually or sooner following any unscheduled actuarial valuation or any other material change in the asset or liability position of the Scheme. It will also be reviewed following any material change to the Scheme's investment strategy.

1.4 The Trustee will consult:

a the Principal Employer of the HBUK Section on changes to this statement that apply to the HBUK Section; and

b the Principal Employer of the HSBC Bank plc Section on changes to this statement that apply to the HSBC Bank plc Section; and

c the Principal Employer of the HGSU Section on changes to this statement that apply to the HGSU Section.

The ultimate power and responsibility for deciding investment policy, however, lies solely with the Trustee.

1.5 In accordance with the Financial Services and Markets Act 2000, the Trustee sets general investment policy, but delegates the responsibility for selection of specific investments to appointed investment managers. The investment managers shall provide the skill and expertise necessary to manage the investments of the Scheme competently.

1.6 In preparing this statement, the Trustee has had regard to the requirements of the Pensions Act 1995 (as amended) and the Occupational Pensions Schemes (Investment) Regulations 2005 concerning the exercise of its investment powers and, in particular, concerning
diversification and the specified criteria to be applied in choosing investments. The Trustee will consider those requirements on any review of this statement or any change in its investment strategy. These requirements were also taken into account in determining the benchmark, permitted asset classes and the investment restrictions applicable to the investment managers.

1.7 The Scheme is a Registered Pension Scheme for the purposes of Chapter 2 Part 4 of the Finance Act 2004.
Section 2: Governance

2.1 The Trustee has ultimate responsibility for decision-making on investment matters. The Trustee appoints an Asset and Liability Committee to which it has delegated responsibility for certain investment functions such as developing investment strategy, assessing the quality of performance and processes of the investment managers and identifying potential future asset classes and investment managers. These delegations are set out in a Terms of Reference for each Committee.

2.2 The Asset and Liability Committee handles the majority of investment matters in relation to the assets. The Committee then makes recommendations to the Trustee where decisions are required to be taken by the Trustee.

2.3 When making decisions about the Scheme’s investment arrangements, the Trustee takes advice as appropriate from its Investment Consultants, the Scheme Actuary and/or the Trustee’s other advisers. To improve the efficiency of this decision-making process, the Trustee has appointed a Chief Investment Officer to the Pension Scheme Executive. It is the responsibility of the Chief Investment Officer to liaise with the advisers of the Scheme to ensure that the procurement of legal and investment advice and their input to the Trustee’s decision-making process are optimised from the Trustee’s perspective. It is also the responsibility of the Pension Scheme Executive, and especially the Chief Investment Officer, to provide oversight to the Scheme’s consultants, advisers and investment managers, on behalf of the Trustee.

2.4 Only persons or organisations with the necessary skills, information and resources are actively involved in taking investment decisions affecting the Scheme. The Trustee of the Scheme draws on the skills and expertise of external advisers including the investment managers, custodians, legal advisers, accountants, investment consultants and Scheme Actuary, as well as that of the Pension Scheme Executive, especially the Chief Investment Officer.

2.5 The Trustee has appointed investment managers who are authorised under the Financial Services and Markets Act 2000 to undertake investment business. After gaining (and reconfirming, at least as frequently as annually) appropriate investment advice, the Trustee has specified asset allocation guidelines for each manager. Investment choice has been delegated to the managers subject to defined tolerances relative to their respective benchmarks. In this context, investment advice is defined by Section 36 of the Pensions Act 1995 (as amended).

2.6 Monitoring is carried out by having regular meetings with the investment managers to ensure that they continue to carry out their work competently and have the appropriate knowledge and experience to manage the investments of the Scheme. The appointment of the investment managers will be reviewed from time to time, based on the results of monitoring of performance and process and after gaining (and reconfirming, at least as frequently as annually) appropriate investment advice. This includes, where applicable, the investment managers’ compliance with the requirements of the Pensions Act 1995 (as amended) and the Occupational Pension Schemes (Investment) Regulations 2005.
Section 3: Objectives of the Scheme

3.1 There are three Defined Benefit entitlement investment strategies, one for the HBUK Section, one for the HSBC Bank plc Section and one for the HGSU Section.

Objectives for HBUK Section assets

3.2 The objectives for the Defined Benefit HBUK Section are:

a. Maintain a portfolio which, together with an agreed schedule of contributions from the Principal Employer, will enable the Trustee to meet the cost of current and future benefits that the Defined Benefit HBUK Section of the Scheme provides;

b. Limit the VaR95* measures of the portfolio to the levels specified in Appendix F;

c. Within the constraints of (b) above, and with the prudent investment of any contributions from the Principal Employer, attain a funding level not less than the Scheme’s Technical Provisions in accordance with the Scheme’s Statement of Funding Principles.

3.3 The Scheme Actuary is responsible for carrying out a full investigation into the financial position of the Defined Benefit HBUK Section and certifying the Technical Provisions on a triennial basis. As an actuarial investigation could give rise to changes in investment policy, it is intended that this statement will be comprehensively reviewed within a reasonable timeframe of the date as at which any such triennial investigation is made. It would also be reviewed following an unscheduled actuarial investigation, or where the Trustee considers a review is needed for other reasons. The Trustee will consult the Scheme Actuary and the Principal Employer when deciding upon the appropriate response to any shortfall identified by any actuarial investigation.

3.4 In order to achieve its objectives, the Trustee has agreed a General Framework (“GF”) with the Principal Employer. This includes the concept of a Target Matching Portfolio (“TMP”), a low risk portfolio consisting of UK Government bonds, high quality corporate bonds, and other secure income assets. As of the date of this document, the Trustee believes it has sufficient assets which, when invested in the TMP, result in the Defined Benefit HBUK Section being fully funded on a technical provisions basis. The Trustee is now transitioning the portfolio towards the TMP and aims to achieve this by 2025 at the very latest.

3.5 The Trustee considers that the investment policy and direction set out in this statement is consistent with it meeting its overall long-term investment objectives.

Policy for HBUK Section assets

3.6 The Trustee’s policy is to seek to achieve the objectives through transitioning the assets towards the TMP in a reasonable timeframe. The current benchmark, and TMP are outlined in Appendix A.

* VAR95: The minimum expected deterioration in the Scheme’s deficit one year in twenty (compared with the expected position)
3.7 The TMP is a Cash flow Driven Investment (CDI) portfolio comprised of three sub-portfolios:

a An LDI Portfolio consisting of gilts, swaps, other bond derivatives, and cash, and will act as a ‘completion’ portfolio to help the asset cash flows equate more closely to the liability cash flows.

b A Credit Portfolio consisting of high quality corporate and government agency bonds across a range of durations. This provides a credit premium over and above the return on UK gilts.

c An Illiquid Matching Portfolio investing in a range of assets which benefit from secure and/or inflation-linked cash flows, but whose value is not readily realisable. This provides an illiquidity premium over and above the return on UK gilts.

3.8 To the extent that the Scheme retains exposure to return-seeking assets during the transition towards the TMP, these are likely to be more volatile relative to the liabilities of the Scheme than the TMP assets, albeit with a higher expected return.

Objectives for the HSBC Bank plc Section assets

3.9 The objective for the Defined Benefit HSBC Bank plc Section is to maintain a portfolio which, together with an agreed schedule of contributions from the Principal Employer, will enable the Trustee to meet the cost of current and future benefits that the HSBC Bank plc Section of the Scheme provides;

3.10 The Scheme Actuary is responsible for carrying out a full investigation into the financial position of the Defined Benefit HSBC Bank plc Section and certifying the Technical Provisions on a triennial basis. As an actuarial investigation could give rise to changes in investment policy, it is intended that this statement will be comprehensively reviewed within a reasonable timeframe of the date as at which any such triennial investigation is made. It would also be reviewed following an unscheduled actuarial investigation, or where the Trustee considers a review is needed for other reasons. The Trustee will consult the Scheme Actuary and the Principal Employer when deciding upon the appropriate response to any shortfall identified by any actuarial investigation.

3.11 The Trustee considers that the investment policy set out in this statement is consistent with it meeting its overall long-term investment objectives.

Policy for the HSBC Bank plc Section assets

3.12 Given the small size of the HSBC Bank plc Section relative to the HBUK Section, the Trustee’s policy is to invest the assets in a strategy that:

a Is easy to implement

b Minimises costs

c Utilises the scale from the HBUK Section

d Is liquid.
3.13 The Trustee has decided that an investment strategy utilising an off-the-shelf passively managed diversified growth fund and an off-the-shelf passively managed index-linked gilt fund is appropriate for this Section.

Objectives for HGSU Section assets

3.14 The objective for the Defined Benefit HGSU Section is to maintain a portfolio which, together with an agreed schedule of contributions from the Principal Employer, will enable the Trustee to meet the cost of current and future benefits that this Section of the Scheme provides;

3.15 The Scheme Actuary is responsible for carrying out a full investigation into the financial position of the Defined Benefit HGSU Section and certifying the Technical Provisions on a triennial basis. As an actuarial investigation could give rise to changes in investment policy, it is intended that this statement will be comprehensively reviewed within a reasonable timeframe of the date as at which any such triennial investigation is made. It would also be reviewed following an unscheduled actuarial investigation, or where the Trustee considers a review is needed for other reasons. The Trustee will consult the Scheme Actuary and the Principal Employer when deciding upon the appropriate response to any shortfall identified by any actuarial investigation.

3.16 The Trustee considers that the investment policy set out in this statement is consistent with it meeting its overall long-term investment objectives.

Policy for HGSU Section assets

3.17 Given the small size of the Section relative to the HBUK Section, the Trustee’s policy is to invest the assets in a strategy that:

a  Is easy to implement

b  Minimises costs

c  Utilises the scale from the HBUK Section

d  Is liquid.

3.18 The Trustee has decided that an investment strategy utilising an off-the-shelf passively managed diversified growth fund and an off-the-shelf passively managed index-linked gilt fund is appropriate for this Section.

Suitability

3.19 The Trustee has taken advice that the strategic asset allocations for the HBUK, HSBC Bank plc and HGSU Sections are suitable, given their liability profile and the level of risk the Trustee is prepared to take. The Trustee will continue to monitor, and take advice on, the strategy and funds used/made available on an ongoing basis.
Realisation of Investments

3.20 The Trustee’s policy is that there should be sufficient investments in liquid or readily realisable assets to meet cashflow requirements in the majority of foreseeable circumstances so that realisation of assets will not disrupt the Scheme’s overall investment policies where possible.

3.21 The Trustee has delegated responsibility for the selection, retention and realisation of investments to the investment managers, within certain guidelines and restrictions.

3.22 The Trustee and investment managers that have delegated discretion, are required to exercise their powers in a manner calculated to ensure the security, quality, liquidity and profitability of the Scheme. The Trustee invests the assets in a manner it believes to be appropriate to the nature and duration of the expected future retirement benefits payable under the Scheme. The Trustee aims to invest the majority of the assets in regulated markets and any allocation to unregulated markets is maintained at a prudent level.

Diversification

3.23 The need for adequate diversification is taken into account in the choice of asset allocation and manager structure in the HBUK, HSBC Bank plc and HGSU Sections.

Derivatives

3.24 The Trustee may use, or permit the investment managers to use derivative instruments if they contribute to a reduction of risks or facilitate efficient portfolio management (including the reduction of cost or the generation of additional capital or income with an acceptable level of risk).

Borrowing

3.25 The Trustee does not borrow money and does not allow investment managers of its segregated portfolios to borrow money except for purposes of temporary liquidity.

Additional Voluntary Contributions

3.26 The Scheme provides a facility for the receipt of additional voluntary contributions by members to enhance member benefits at retirement. The Scheme has undertaken a large project to significantly reduce the number of legacy funds available to Defined Benefit members who pay voluntary contributions or bonus sacrifices and provide them with access to the fund range offered to members with Defined Contribution benefits. The majority of members’ assets held through the range of legacy funds have been transitioned to the Defined Contribution fund range. With certain exceptions, all future voluntary contributions and bonus sacrifice payments will be directed to the Defined Contribution fund range. The Asset and Liability Committee will continue to monitor the remaining legacy funds.
Section 4: Strategic asset allocation and manager structure

**HBUK Section**

4.1 The Scheme’s HBUK Section investments are currently transitioning towards the TMP. The current strategic asset allocation represents a ‘staging post’ towards this longer term goal.

4.2 The Scheme’s HBUK Section strategic asset allocation has been set following an analysis of both assets and liabilities that has considered the full range of investment opportunities available to the Scheme. Asset allocation is regularly reviewed. The strategic asset allocation and TMP are detailed in Appendix A.

4.3 The HBUK Section asset allocation is driven by the financial characteristics of the Scheme, in particular the Scheme liabilities and the risk tolerance of the Trustee and the Principal Employer of the HBUK Section. The allocation takes account of the need to adequately diversify the HBUK Section’s investments and to avoid undue concentration of risk.

**HSBC Bank plc Section**

4.4 Given the nature of the liabilities within the HSBC Bank plc Section (largely covering the effects of salary increases), the Trustee believes that a diversified portfolio of growth assets plus a portfolio of index-linked gilts is appropriate. In the interest of simplicity and cost minimisation, the Scheme has invested these assets in a low-risk diversified growth pooled fund and a passive index-linked gilt pooled fund. The HSBC Bank plc Section’s asset allocation and manager structure are outlined in Appendix C.

**General**

4.5 The Trustee has considered the use of both passive and active investment management when reviewing the Scheme’s strategy, in each of the sections of the Scheme. The resultant use of active and passive management is formed following consideration of the efficiency, liquidity and level of transaction costs likely to prevail within each market as well as the impact of the investment manager fees on future expected returns.

**Rates of return**

4.6 In setting the strategic asset allocations, the Trustee has regard to the historical rates of return earned on the various classes of asset available for investment. The Trustee’s expectations for the future long-term returns on the asset classes in which the Scheme’s assets are principally invested are set out in Appendix E.
HGSU Section

4.7 Given the nature of the liabilities within the HGSU Section (largely covering the effects of salary increases), the Scheme believes that a diversified portfolio of growth assets plus a portfolio of index-linked gilts is appropriate. In the interest of simplicity and cost minimisation, the Scheme has invested these assets in a low-risk diversified growth pooled fund and a passive index-linked gilt pooled fund. The HGSU Section's asset allocation and manager structure are outlined in Appendix D.

General

4.8 The Trustee has considered the use of both passive and active investment management when reviewing the Scheme's strategy, in each of the sections of the Scheme. The resultant use of active and passive management is formed following consideration of the efficiency, liquidity and level of transaction costs likely to prevail within each market as well as the impact of the investment manager fees on future expected returns.

Rates of return

4.9 In setting the strategic asset allocations, the Trustee has regard to the historical rates of return earned on the various classes of asset available for investment. The Trustee’s expectations for the future long-term returns on the asset classes in which the Scheme's assets are principally invested are set out in Appendix E.
Section 5: Investment beliefs

5.1 The Trustee holds the following beliefs in relation to Defined Benefit investments

- Mandates that either access non-mainstream markets and/or systematically replicate active managers more cheaply (known as ‘Smartbeta’), are preferable solutions for some asset classes.

- Active management can only be profitably harnessed by skilful managers in selected asset classes, and where appropriate skilful managers can be identified by the Trustee its Pension Scheme Executive and its advisers.

- Environmental (including Climate Change risks), Social and Governance risks are all important factors in investment decision making.

- Liability risks (interest rate, inflation and longevity) should be hedged where practicable and in a cost efficient manner.

- Both qualitative and quantitative factors should be taken into account in evaluating investment risk, so that risk can be properly assessed and, where practical, managed.

- Any conflict of interest between the Trustee, as asset owners, and their agents (advisors, fund managers, Pension Scheme Executive) should be monitored and managed.

- There are exploitable risk premiums over the long term from: Equities, Credit, Illiquid Assets (such as Real Estate and Infrastructure).

- There can be a first mover advantage for investors who are able to react swiftly to new investment opportunities.

- The Trustee’s governance budget (money and time) should be focused on investment decisions that will have the greatest positive effect on member investment outcomes.

- Having taken due consideration of the funding level, the amount of risk taken in the Defined Benefits investment strategy will be directly related to the strength of the Sponsor’s covenant for each Section.

- The Trustee believes that investment delivering an appropriate risk adjusted return can also have a social impact.
Section 6: Corporate governance and Socially Responsible Investing

Environmental, social and governance (“ESG”) and other financially material considerations

The Trustee’s investment beliefs state that Environmental (including Climate Change risks), Social and Governance risks are all important factors in investment decision making.

6.1 In setting the investment strategy for the HBUK Section, the HSBC Bank plc Section and the HGSU Section the Trustee’s primary objective is to maintain a portfolio appropriate to each Section which, together with an agreed schedule of contributions from the Principal Employer, will enable the Trustee to meet the cost of current and future benefits that the Scheme provides.

6.2 ESG factors, including climate change can have a material financial impact on the value of the Scheme’s investments over the time horizon applicable to each Section. The Trustee therefore believes that by taking such factors into account in its investment process, the Scheme is better positioned to deliver on its objectives.

6.3 The Trustee takes account of ESG factors when setting the asset allocation for each Section, and when selecting (and monitoring the performance of) its appointed investment managers.

6.4 The Trustee adopts the following approach in relation to the selection (and monitoring) of investment managers:

- In relation to funds where the investment manager is permitted to make active decisions about the selection, retention and realisation of investments the Trustee expects the investment managers to take steps to ensure financially material considerations (including climate change and other ESG considerations), are implicitly incorporated into the investment decision-making process where permissible within applicable guidelines and restrictions. The Trustee undertakes regular reviews to ensure the policy is being carried out effectively and in line with evolving good practice.

- In index-tracking (passive) mandates, the Trustee recognises that the choice of index dictates the assets held by the investment manager and that the manager has minimal freedom to take account of factors that may be deemed to be financially material. The Trustee accepts that the role of the passive manager is to deliver returns in line with the index and this approach is in line with the basis on which their current strategy has been set. The Trustee periodically reviews the indices employed for this purpose and keeps up to date with other passive ESG fund options available in the market via updates from its Investment Advisors.

6.5 The Trustee applies these principles to all asset classes, although a greater emphasis is given to listed and unlisted equities, property and infrastructure assets.
6.6 The Trustee recognises climate change as a systematic, long-term material financial risk to the value of the Scheme’s investments. Therefore the Trustee has a fiduciary duty to consider climate change risk when making investment decisions. Within the context of its fiduciary responsibility, the Trustee is supportive of the Paris Agreement to avoid dangerous climate change by limiting global warming to well below 2°C above pre-industrial levels and pursuing efforts to limit it to 1.5°C. 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 within applicable guidelines and restrictions;

- Has a preference for 'Engagement' rather than 'Exclusion' as a method of incorporating climate change risks into an effective fiduciary framework. However, the Trustee expects 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 well below 2°C target provided they are all based within the primary fiduciary framework;

- Supports the Task Force on Climate-related Financial Disclosures (TCFD) and aims to incorporate its recommendations into the Scheme's reporting, subject to availability of data;

- 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; and

- Is supportive of policy initiatives that, in its opinion, contribute towards achieving the well below 2°C target.

6.7 The Trustee will support ESG organisations or initiatives if it believes that providing such advocacy will be in the long term financial interest of the Scheme’s members and will engage with its appointed fund managers to do the same, where appropriate. The Scheme is currently a member of the Institutional Investors Group on Climate Change (IIGCC) and will consider other collaborations with asset owners, investors, asset managers, advisers and industry bodies on a case-by-case basis.

6.8 The Trustee has a policy of avoiding investments in Controversial Weapons Manufacturers on grounds of financial risk, as it believes this is in the best financial interests of the Scheme and its members. Where the financial implications of excluding Controversial Weapons Manufacturers (either due to increased costs to members or reduced investment opportunities) are, in the opinion of the Trustee, greater than the financial risks of including them, some exposure to Controversial Weapons Manufacturers may be maintained. The Trustee has a policy of requesting
that each of its appointed fund managers’ report on an annual basis as to their exposure to Controversial Weapons Manufacturers, if any.

**Members’ Views and Non-Financial Factors**

6.9 The Trustee does not take into account any non-financial matters in setting the investment strategy for the HBUK Section, the HSBC Bank plc Section and the HGSU Section.

**Stewardship**

6.10 The Trustee has examined how rights, including voting rights, attached to investments should be exercised. The Trustee recognises its responsibilities as shareholders being the owners of capital, and believes that good stewardship practices including monitoring and engaging with investee companies, and exercising voting rights attaching to investments, protects and enhances asset owner value in the long term.

6.11 The Trustee has delegated to its investment managers the exercise of rights attaching to investments, including voting rights, and engagement with issuers of debt and equity and other relevant persons about relevant matters such as performance, strategy, risks, capital structure, conflicts of interest and ESG considerations. The Trustee expects its investment managers to exercise ownership rights and undertake monitoring and engagement in line with the managers’ general policies on stewardship, which reflect the recommendations of the UK Stewardship Code issued by the Financial Reporting Council, and which are provided to the Trustee from time to time, taking into account the financial interests of the beneficiaries.

6.12 The Trustee seeks to appoint managers that have strong stewardship policies and processes. While the Trustee chooses managers with an aim to align their beliefs on stewardship, and there is a degree of influence, the Trustee has less direct influence over the managers’ policies on the exercise of investment rights where assets are held in pooled funds; this is due to the collective nature of these investments.

6.13 The Trustee monitors and regularly reviews the ownership rights that it has delegated to its investment managers as well as how the investment managers have voted and engaged with the companies in which they invest. This process is to ensure the policy is also being carried out effectively and in line with evolving good practice.
Section 7: Risk Management

7.1 The Trustee recognises a number of risks involved in the investment of the Scheme’s Defined Benefit assets:

a. **Solvency risk and mismatching risk:**
   
i. are measured through a qualitative and quantitative assessment of the expected development of the liabilities relative to the current and alternative investment policies

   ii. are managed through assessing the progress of actual growth of the assets relative to the amounts expected to be required to meet the projected liabilities by reference to various assumptions as to future investment returns.

b. **Investment manager risk:**
   
   iii. is measured by the expected deviation of the prospective risk and return, as set out in the manager objectives, relative to the agreed benchmark

   iv. is managed by monitoring the actual deviation of returns relative to the objective as well as factors supporting the manager investment process for each investment manager. It is further managed through the diversification of the Scheme’s assets between active and passive investment managers and negotiation of appropriate investment management agreements.

c. **Concentration risk:**
   
   v. is measured by the level of concentration of any one investment manager, strategy or asset class leading to the risk of an adverse influence on investment values arising from poor performance in that particular manager, strategy or asset class

   vi. is managed by diversifying the set of investment managers within any given strategy and setting and monitoring appropriate limits for assets within each of the mandates that have been given.

d. **Currency risk:**
   
   vii. is measured by the level of concentration of assets denominated in any foreign currency and the translation effect of currencies leading to the risk of an adverse influence on investment values arising from unfavourable conditions affecting that particular currency

   viii. is managed by reducing the translation risk of investing overseas by pursuing and monitoring an appropriate level of hedging of the overseas investments’
currency translation risk for those overseas currencies that can be hedged efficiently.

e  **Liquidity risk:**

ix. is measured by the level of cashflow required for the Scheme over a specific period

x. is managed by the Scheme’s administrators assessing the level of cash held in order to limit the impact of the cashflow requirements on the investment policy.

f  **Custodian risk:**

xi. is measured by assessing the custodians and the ability of the organisations to settle trades on time and provide secure safekeeping of the assets under custody

xii. is managed by monitoring the custodians’ activities and discussing the performance of the custodians with the investment managers where appropriate. In addition, restrictions are applied as to who can authorise transfers of cash and the accounts to which transfers can be made.

g  **Political risk:**

xiii. is measured by the level of concentration in any one market leading to the risk of an adverse influence on investment values arising from political intervention or other events

xiv. is managed by regular reviews of the actual investments relative to policy and through regular assessment of the levels of diversification within the existing policy.

h  **Counterparty risk:**

xv. is measured through the monitoring of the activities of the investment managers

xvi. is managed through the use of standard ISDA documentation, appropriate Credit Support Annexes and collateral management. In addition, the Scheme does not allow its custodian to engage in any stock lending with the Scheme’s assets.

i  **Sponsor risk:**

xvii. is measured by the level, ability and willingness of the sponsor(s) to support the continuation of the Scheme and to make good any current or future deficit

xviii. is managed by assessing the interaction between the Scheme and the Principal Employer’s (for the HBUK Section, the HSBC Bank plc Section and the HGSU Section) businesses, as measured by a number of factors including the creditworthiness of the Principal Employers and the size of the pension liability relative to a number of metrics reflecting the financial strength of the Principal Employers.
j Climate change risk:

xix. is considered to be a systemic risk by the Trustee, though it is difficult to measure with a single number.

xx. is managed through a combination of both positive and negative tilts where appropriate (Global Equities) as well as a robust engagement policy via the Trustee’s appointed fund managers. (See detailed Climate Change Policy in Section 6)

k Other environmental, social and governance (ESG) risks:

xxi. are sources of risk to the Scheme’s investments which could be financially material over both the short and longer term. The Trustee seeks to appoint investment managers who will manage these risks appropriately on its behalf and regularly reviews how these risks are being managed in practice.

The risks highlighted in this section are considered and monitored on a regular basis by the Asset and Liability Committee or Trustee, which includes a qualitative review of the factors as set out above as well as regular quantitative reviews of investment performance over various periods against benchmark, performance targets and the Scheme actuarial assumptions.
Appendix A: Responsibilities, decision-making and fees

The Trustee has decided on the following division of responsibilities and decision-making for the Scheme. This division is based upon the Trustee’s understanding of the various legal requirements placed upon it, and its view that this division allows for efficient operation of the Scheme overall, with access to an appropriate level of expert advice and service. The Trustee’s investment powers are set out within the Scheme’s governing documentation.

1. Trustee

In broad terms, the Trustee is responsible in respect of investment matters for:

- setting the investment strategy, in consultation with the employers;
- developing a mutual understanding of investment and risk issues with the employers;
- reviewing the investment policy as part of any review of the investment strategy;
- setting the policy for rebalancing between asset classes;
- appointing (and, when necessary, dismissing) investment managers, investment advisers and other service providers;
- monitoring the exercise of the investment powers that they have delegated to the investment managers and monitoring compliance with Section 36 of the Act;
- formulating a policy on taking account of non-financial factors when making investment decisions and a policy on voting rights;
- putting effective governance arrangements in place and documenting these arrangements in a suitable form;
- reviewing the content of this SIP from time to time and modifying it if deemed appropriate; and
- consulting with the employers when reviewing the SIP.

The Trustee has delegated responsibility for a number of investment matters to an Asset and Liability Committee (“ALCo”). This committee is responsible for selecting, monitoring the performance of and, when required, replacing investment managers and ensuring that the high-level strategy and beliefs set by the Trustee are implemented effectively.

The Trustee has appointed a Chief Investment Officer (“CIO”) to the Pension Scheme Executive. It is the responsibility of the CIO to liaise with the Scheme’s advisers to ensure that the procurement of legal and investment advice and their input to the Trustee’s decision making process are optimised from the Trustee’s perspective.

2. Investment managers

In broad terms, the investment managers will be responsible for:
• managing the portfolios of assets according to their stated objectives, and within the guidelines and restrictions set out in their respective investment manager agreements and/or other relevant governing documentation;
• taking account of financially material considerations (including climate change and other ESG considerations) as appropriate when managing the portfolios of assets;
• exercising rights (including voting rights) attaching to investments and undertaking engagement activities in respect of investments;
• having regard to the provisions of Section 36 of the Act insofar as it is necessary to do so.

The custodians of the portfolios (whether there is a direct relationship between the custodian and the Trustee or not) are responsible for safe keeping of the assets and facilitating all transactions within the portfolios.

The Trustee, the CIO and its adviser will have regular meetings with the investment managers to ensure they continue to carry out their work competently and have the appropriate knowledge and experience to manage the investments of the Scheme.

3. Investment adviser

In broad terms, the investment adviser will be responsible, in respect of investment matters, as requested by the Trustee, for:

• advising on a suitable investment strategy for the Scheme, and how material changes to legislation or within the Scheme’s benefits and membership may impact this;
• advising on the selection, and review, of the investment managers; and
• participating with the Trustee in reviews of this SIP.

4. Fee structures

The Trustee recognises that the provision of investment management and advisory services to the Scheme results in a range of charges to be met. These charges are accounted for in the Scheme’s investment decision making. The Trustee monitors the level of additional expenses charged by managers to ensure that they remain appropriate.

The Trustee has agreed Terms of Engagement with the Scheme’s investment advisers, under which work undertaken is charged for by an agreed fixed fee or on a “time-cost” basis.

5. Performance assessment

The Trustee is satisfied, taking into account the external expertise available, that there are sufficient resources to support its investment responsibilities. The Trustee believes that it has sufficient expertise and appropriate training to carry out its role effectively.

It is the Trustee’s policy to assess the performance of the Scheme’s investments, investment providers and professional advisers from time to time. The Trustee will also carry out periodically an assessment of its own effectiveness as a decision-making body and will decide how this may then be reported to members.
Appendix B: HBUK Section – Asset allocation

Based on advice from the Investment Consultant and Scheme Actuary, the Trustee has agreed to target the asset allocation contained in the table below which is consistent with the 2016 valuation, and is a staging post on the transition towards the Target Matching Portfolio (TMP). The initial TMP allocations are also included in the second table below. The Trustee will undertake to review the strategic asset allocation and the TMP on a regular basis and at least once every three years taking account of prevailing market conditions, investment opportunities and feedback from the Sponsor. It should be noted that some of the classifications below, namely elements of the Illiquid Matching Portfolio, will be built up over time as opportunities present themselves.

Strategic allocation

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Target allocation (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global developed equities</td>
<td>6.8</td>
</tr>
<tr>
<td>Private equity</td>
<td>1.3</td>
</tr>
<tr>
<td>UK commercial property</td>
<td>2.2</td>
</tr>
<tr>
<td>Leveraged (secured) loans</td>
<td>1.9</td>
</tr>
<tr>
<td>Cash Generating Portfolio</td>
<td>0.9</td>
</tr>
<tr>
<td>Volatility premium</td>
<td>0.5</td>
</tr>
<tr>
<td>Sterling credit</td>
<td>7.6</td>
</tr>
<tr>
<td>Global credit</td>
<td>13.7</td>
</tr>
<tr>
<td>Global sovereign credit</td>
<td>1.4</td>
</tr>
<tr>
<td>Liability matching portfolio (GBP core portfolio\1, gilts\2, swaps, cash\2)</td>
<td>54.4</td>
</tr>
<tr>
<td>USD Core Credit (5A) portfolio</td>
<td>3.7</td>
</tr>
<tr>
<td>Index linked Sterling credit\3</td>
<td>1.5</td>
</tr>
<tr>
<td>UK matching property\3</td>
<td>1.7</td>
</tr>
<tr>
<td>Infrastructure debt\3</td>
<td>1.4</td>
</tr>
<tr>
<td>Ground rents</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

1 Core portfolio of high quality sovereigns, sub-sovereigns and supranationals.
2 Gilts and cash to satisfy collateral and liquidity needs.
3 High quality illiquid assets to offset return drag of Liquids.
## Target Matching Portfolio

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Target initial allocation (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit</td>
<td>44.6</td>
</tr>
<tr>
<td>LDI (Gilts/Cash)</td>
<td>46.4</td>
</tr>
<tr>
<td>Illiquid Matching</td>
<td>9.0</td>
</tr>
<tr>
<td><strong>Total physical assets</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>
Appendix C: HBUK Section – Manager Structure

The table below identifies the current managers appointed, indices used as a performance measurement benchmark for each asset class and each manager’s target performance. The manager line-up will change as the Scheme moves towards the benchmark allocations shown above.

The Liability matching portfolio maintains liquid assets at a level considered sufficient to meet the Scheme’s cashflow requirements with respect to on-going benefit payments and other investment commitments. This portfolio is also used as initial repositories of cash generated by the Cash Generating Portfolio.

<table>
<thead>
<tr>
<th>Mandate</th>
<th>Manager</th>
<th>Benchmark/Index</th>
<th>Performance target (for active management)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global equities</td>
<td>Legal &amp; General Investment Management</td>
<td>FTSE All-World ex Controversial Weapons Climate Balanced Factor Index</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(50% Dev Mkt exposure GBP hedged)</td>
<td></td>
</tr>
<tr>
<td>Private equity</td>
<td>Pathway Capital Management</td>
<td>30% FTSE All-Share, 70% S&amp;P 500</td>
<td>4.0% per year over the long term</td>
</tr>
<tr>
<td>UK commercial property</td>
<td>LaSalle Investment Management</td>
<td>IPD Pension Funds and Life Companies £0.3 to £2.0 billion</td>
<td>1.0% per year over rolling three years</td>
</tr>
<tr>
<td>Leveraged (secured) loans</td>
<td>M&amp;G Investments</td>
<td>N/A – Mandate in run-off</td>
<td>N/A</td>
</tr>
<tr>
<td>UK corporate bonds</td>
<td>Aberdeen Standard Life</td>
<td>N/A – Mandate in run-off</td>
<td>N/A</td>
</tr>
<tr>
<td>UK corporate bonds (screened)</td>
<td>BlackRock Investment Management (UK) Limited</td>
<td>iBoxx Sterling Corporates Index (Customised)</td>
<td>N/A</td>
</tr>
<tr>
<td>Global credit</td>
<td>AXA Investment Management</td>
<td>Custom mandate</td>
<td>N/A</td>
</tr>
<tr>
<td>UK corporate bonds</td>
<td>M&amp;G Investments</td>
<td>iBoxx Sterling Non Gilts</td>
<td>0.8% per year over rolling three years</td>
</tr>
<tr>
<td>Global credit</td>
<td>Loomis, Sayles &amp; Company</td>
<td>Barclays Capital Global Aggregate Credit Index, (Dev Mkt GBP hedged)</td>
<td>1.2% per year over rolling three years</td>
</tr>
<tr>
<td>Global corporate bonds (screened)</td>
<td>BlackRock Investment Management (UK) Limited</td>
<td>Barclays Global Agg 500MM Index limited to USD/EUR/GBP Corporate Issue Components with a 1% Issuer Cap</td>
<td>N/A</td>
</tr>
<tr>
<td>Asset-backed securities (US)</td>
<td>Wellington Management</td>
<td>Composite® (GBP unhedged)</td>
<td>0.5% over market cycle</td>
</tr>
<tr>
<td>Liquid Matching Assets</td>
<td>Insight Investments</td>
<td>Custom mandate</td>
<td>N/A</td>
</tr>
<tr>
<td>(USD Core Portfolio)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquid Matching Assets</td>
<td>Insight Investments</td>
<td>Custom mandate</td>
<td>N/A</td>
</tr>
<tr>
<td>(index-linked corporates)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash – liquidity</td>
<td>HSBC Global Asset Management</td>
<td>GBP 7-day LIBID</td>
<td>N/A</td>
</tr>
<tr>
<td>Illiquid Matching Assets (index-</td>
<td>Standard Life</td>
<td>Custom mandate</td>
<td>N/A</td>
</tr>
<tr>
<td>linked corporates)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Illiquid Matching Assets (property)</td>
<td>LaSalle Investment Management</td>
<td>Custom mandate</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Hedging

The Trustee also operates two hedging policies designed to mitigate risk (some rewarded, some unrewarded), as follows:

- **Currency hedging**: The Trustee’s policy is that a proportion of the Scheme’s foreign currency exposure generated by its overseas investments should be hedged back to sterling. The amount of foreign currency exposure hedged varies according to the characteristics of the asset class in question. Less volatile asset classes (such as bonds) have higher proportions of currency exposure hedged, whilst more volatile asset classes (such as equities) have lower proportions hedged. Insight Investments operates a significant proportion of the currency hedging programme, by managing a portfolio of foreign exchange forwards designed to overlay unhedged portfolios, where desired. In addition, some of the bond portfolios and the Legal & General Investment Management global equity portfolio are operated against currency hedged benchmarks, in which case the manager in question will undertake the currency hedging of its own portfolio.

- **Liability hedging**: The Trustee considers that the volatility of the Scheme’s funding level brought about by changes in the present value of the liabilities caused by changing inflation and interest rates, is, in large part, an unrewarded risk. Therefore it is the Trustee’s policy that a significant proportion of the interest rate and inflation risk generated by the Scheme’s liabilities should be hedged. In order to do so, the Scheme holds a portfolio of derivatives and gilts which, in aggregate, hedge a proportion of the interest and inflation sensitivity of the Scheme’s liabilities. It is also anticipated that a portion of the illiquid matching assets (such as property) and corporate bonds will have some matching characteristics over the long term, but to a lesser extent than gilts and derivatives.
Appendix D: HSBC Bank plc Section – Asset allocation and structure

Asset allocation

Based on advice from the Investment Consultant and Scheme Actuary, the Trustee has agreed to invest the HSBC Bank plc Section assets in a low-risk Diversified Growth Fund and a passive index-linked gilt fund. The Trustee will undertake to review the asset allocation on a regular basis and at least once every three years taking account of prevailing market conditions, investment opportunities and feedback from the Sponsor.

<table>
<thead>
<tr>
<th>Mandate</th>
<th>Manager</th>
<th>Benchmark/Index</th>
<th>Performance target (for active management)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diversified Growth Fund</td>
<td>Legal &amp; General Investment Management</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Index-linked gilts</td>
<td>Legal &amp; General Investment Management</td>
<td>FTSE-A UK Index-linked Gilts Over 15 Years Index</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Appendix E: HSBC Global Services (UK) Ltd (HGSU) Section – Asset allocation and structure

Asset allocation

Based on advice from the Investment Consultant and Scheme Actuary, the Trustee has agreed to invest the HGSU Section assets in a low-risk Diversified Growth Fund and a passive index-linked gilt fund. The Trustee will undertake to review the asset allocation on a regular basis and at least once every three years taking account of prevailing market conditions, investment opportunities and feedback from the Sponsor.

<table>
<thead>
<tr>
<th>Mandate</th>
<th>Manager</th>
<th>Benchmark/Index</th>
<th>Performance target (for active management)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diversified Growth Fund</td>
<td>Legal &amp; General Investment Management</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Index-linked gilts</td>
<td>Legal &amp; General Investment Management</td>
<td>FTSE-A UK Index-linked Gilts Over 15 Years Index</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Appendix F: Risk and return assumptions

**Risk and return assumptions**

The asset class assumptions utilised in the latest strategy work feeding into the 2016 Actuarial Valuation are shown below (effective 30 September 2017).

<table>
<thead>
<tr>
<th>Asset classes</th>
<th>10 year median real return % pa</th>
<th>10 year median returns over Gilts % pa</th>
<th>10 year standard deviation (relative to RPI) % pa</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Return Seeking Portfolio</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Global equities</td>
<td>2.5%</td>
<td>4.1%</td>
<td>5.3%</td>
</tr>
<tr>
<td>Emerging market equities (unhedged)</td>
<td>3.3%</td>
<td>4.9%</td>
<td>7.4%</td>
</tr>
<tr>
<td>Private equity</td>
<td>0.9%</td>
<td>2.5%</td>
<td>7.5%</td>
</tr>
<tr>
<td>UK property</td>
<td>0.9%</td>
<td>2.6%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Cash generating portfolio</td>
<td>-0.8%</td>
<td>0.8%</td>
<td>1.2%</td>
</tr>
<tr>
<td>Loans</td>
<td>-0.3%</td>
<td>1.3%</td>
<td>1.3%</td>
</tr>
<tr>
<td>UK credit</td>
<td>-0.8%</td>
<td>0.8%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Global credit</td>
<td>-0.9%</td>
<td>0.7%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Global sovereign credit</td>
<td>-0.6%</td>
<td>1.0%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Volatility premium</td>
<td>0.0%</td>
<td>1.6%</td>
<td>2.5%</td>
</tr>
<tr>
<td><strong>Matching Portfolio</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liability matching portfolio</td>
<td>-1.5%</td>
<td>0.0%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Infrastructure debt</td>
<td>0.4%</td>
<td>2.0%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Ground rents</td>
<td>-0.7%</td>
<td>0.9%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Matching property</td>
<td>0.3%</td>
<td>1.9%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Gilts (real return)</td>
<td>-1.6%</td>
<td>0.0%</td>
<td>0.7%</td>
</tr>
</tbody>
</table>
Appendix G: Value at Risk

A key means by which the Trustee controls the risk of the HBUK Section portfolio relative to liabilities is through the liability hedging programme. This involves using derivatives and physical bonds to hedge the interest rate and inflation risks inherent in the Scheme’s liabilities.

The Trustee considers a range of different risk measures in the context of different liability valuation bases. The Trustee’s medium-term objective is to ensure that the assets are managed such that the Solvency VaR95 does not exceed 11.5% of the Scheme’s solvency liabilities. The Trustee recognises that, in the short-term, VaR95 may exceed this medium-term objective due to short-term market conditions, and may not warrant an immediate change to the Total Portfolio. Consequently, the Trustee will keep this objective under regular review.