The HSBC Bank (UK) Pension Scheme

2019 Taskforce on Climate-related Financial Disclosures (TCFD) Statement

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For members of the HSBC Bank (UK) Pension Scheme

Introduction

The Trustee of the HSBC Bank (UK) Pension Scheme believes that Climate Change is a systemic risk and seeks to manage that risk on behalf of its members. This is especially the case for Defined Contribution members, as the value of their pension pots is directly related to the underlying investments.

The Trustee's focus on Climate Change risk mitigation plays an important role in how investments are managed across all asset classes, in both the DC and DB parts of the Scheme. At a policy level, the Trustee is supportive of initiatives that contribute towards mitigating Climate Change risk on its members' investments.

As such the Trustee is a signatory to the recommendations of the Taskforce on Climate-Related Financial Disclosures (TCFD). This is the Trustee's second disclosure under the framework and follows last year's format with the addition of an aggregate carbon footprint (tonnes of CO_2e/£m invested) metric for equities.

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

The recommendations are structured around four thematic areas:

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

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

The tables below summarise the Trustee's current position with regards to the TCFD recommendations.

Governance

Recommended disclosure A:
Describe the board's oversight of climate-related risks and opportunities.

The Trustee Board's investment strategy is built upon a set of investment beliefs. One of the beliefs is:

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

In this context, in June 2015 the Trustee Board adopted a Trustee Climate Change Risk Policy that is recorded in its Statement of Investment Principles.

The Trustee Board is ultimately responsible for the oversight of climate-related risks and opportunities. However, there are two sub-committees of the Board that oversee the implementation of the Trustee's Climate Change Risk policy:

- The Asset & Liability Committee, which is responsible for ensuring that the Climate Change Risk Policy is implemented into the Trustee's investment policy.
- The Audit & Risk Committee, which is responsible for ensuring that Climate Change risks are incorporated into the Trustee's Risk Framework.

In keeping with this governance structure, this Statement has been reviewed by the Asset & Liability Committee and the Audit & Risk Committee, and approved by the Trustee Board.

Recommended disclosure B:
Describe management's role in assessing and managing climate-related risks and opportunities.

The Trustee Board is non-executive and is supported by a full-time management team – The Pension Scheme Executive (PSE).

Three of the individuals in the PSE structure are specifically responsible for assessing and managing climate-related risks. They are:

- Chief Executive Officer, for policy and covenant monitoring.
- Chief Investment Officer, for investment strategy.
- Head of Finance and Risk Reporting, for the risk management framework and register.

Strategy

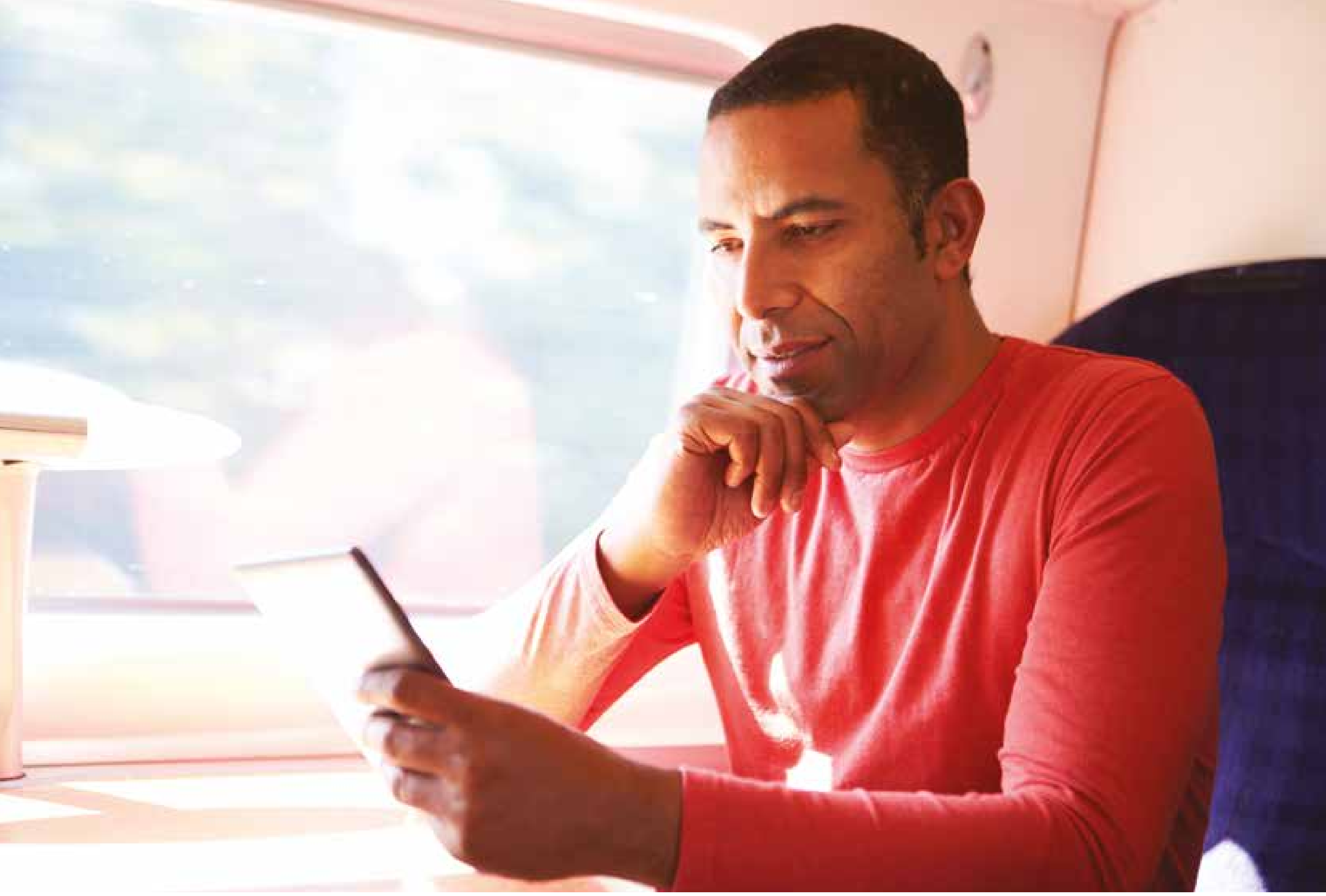
Recommended disclosure A:
Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term.

The Trustee's approach to investment is rooted in its understanding of its fiduciary duty, which is consistent with the 2014 Law Commission Report. The Trustee considers Climate Change risk as a 'Financially Material' factor. As such, the Trustee believes that Climate Change risk could have an impact on the value of the investments that it makes on behalf of its members over the short, medium and long term, and therefore needs to be understood and managed. For example, Climate Change risk could affect:

- The creditworthiness of the issuers of the fixed income assets in which the Trustee invests.
- The rental values of the real estate assets the Trustee owns.
- The dividend paying capability, and therefore the share prices, of companies in which the Trust is either directly or indirectly a beneficial owner.

Mitigating Climate Change risk can also offer attractive investment opportunities, and the Trustee believes that investing in such opportunities is also consistent with its fiduciary responsibility.

Recommended disclosure B: Describe the impact of climate–related risks and opportunities on the organisation's business, strategy and financial planning.	Climate-related risks influence the Trustee's business and financial planning insofar as mitigating them, and indeed wider Environmental, Social and Governance (ESG) risks, is integrated into its investment strategy in a number of overlapping ways. For example: • In establishing investment mandates with its appointed fund managers, the Trustee assesses how the manager incorporates the management of climate-related risks within its approach in a manner consistent with the asset class in question and the Trustee's fiduciary responsibility. • Consistent with its long-term horizon and strategic approach, the Trustee's Pension Scheme Executive (PSE), often accompanied by individual Trustees, reviews each appointed fund manager at least annually in their premises. A core part of such meetings is reviewing how the manager is incorporating ESG risk mitigation, and within that, climate-related risk, within its process. In 2015 following the adoption of its Climate Change risk policy, the Trustee engaged with all of its appointed fund managers to understand how climate-related risks were being mitigated. These engagements continue, as both the Trustee and its appointed fund managers recognise this is an area of ongoing development for the industry. • The Trustee delegates voting to its appointed fund managers and expects the managers to vote consistently with the Trustee's fiduciary responsibility. The Trustee receives quarterly reports from its appointed quoted equity fund managers on their voting and engagement activities. The reports are collated, reviewed by the Trustee and may be used to engage with the fund manager if the Trustee disagrees with fund manager policy or how it is implemented. As an Asset Owner, the Trustee believes it is important that it engages with its agents (the fund managers) to continually push to evolve best practice, as it believes this is in its members' best interests.
Recommended disclosure C: Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios including a 2 degree or lower scenario.	Historically, the Trustee has undertaken analysis to estimate the financial impact on the Scheme's Defined Benefit assets of different future climate scenarios, as well as considering mitigating investment actions that could be undertaken. While the Trustee found the analysis useful in developing its thinking with regard to climate-related risks, the effectiveness of the scenario analysis was limited in part due to the inadequate disclosure from portfolio companies. The analysis of bond portfolios is particularly affected by disclosure issues and complex interdependencies; as the DB Section now invests a significant portion of its assets into credit portfolios (as part of its de-risking strategy), this limits the usefulness of scenario analysis. Furthermore, there is no industry consensus on the usage of climate scenarios for DC assets (which now form the bulk of the Scheme's equity holdings). In light of current limitations, but recognising the value of rigorous analytical tools, the Trustee is supportive of greater disclosure of climate-related risk data from issuers of equity and debt, and will continue to monitor and assess improvements in climate-related scenario analysis. Nonetheless, the earlier scenario analysis did allow the Trustee to consider the impact on the Scheme's assets of more extreme climate scenarios. In a climate breakdown scenario there was little in the way of mitigating investment actions the Trustee could take to preserve members' investment values. This analysis gave the Trustee the fiduciary justification to be advocates of public policy that seeks to limit the risk of rising global temperatures because climate breakdown would have a significant negative effect on the valuation of Scheme assets. In this context, the Trustee has become a member of Institutional Investors Group on Climate Change (IIGCC), the strategic objectives of which are: • Changing market signals by encouraging the adoption of strong and credible public policy solutions that ensure an orderly and efficient move to a low carbon economy as well as measures for adaption. • Informing investment practices to preserve and enhance long-term investment values. In addition, the Trustee is also a member of the University of Cambridge's Institute for Sustainable Leadership – Investment Leaders Group. The Trustee will continue to monitor the effectiveness of scenario analysis in the context of Climate Change in light of market developments.



Risk Management

Recommended disclosure A:

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

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

The Trustee has a preference for engagement, rather than exclusion, as a means to encourage greater disclosures and better practices with regard to climate-related risks. An example of such engagement is:

Example

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

With regards to engagement on climate-related issues, the Future World Fund has two aspects. Firstly, it benefits from the LGIM Climate Impact Pledge. The six global industries with the greatest potential impact on Climate Change were identified and LGIM wrote to the Chairs of over 80 amongst the largest companies in those sectors requesting to engage with them on the plans they were developing for a sustainable future. If after a year of engagement, the companies were not implementing viable plans to transition to a sustainable future, LGIM pledged to vote against the re-election of the companies' Chairs at the next annual general meeting – with the voting interests deriving from all LGIM assets under management. Secondly, the Future World Fund would go one step further and divest from such companies, even though they remain part of the benchmark index. The eleven companies that were divested from as at 30 June 2019 are shown in Appendix C.

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

While the Trustee considers the impact of climate-related risks on all of the assets within which it invests, the primary focus has been on its equity exposure (although steps are being taken to extend this to the Scheme's holdings in publicly-traded corporate credit). The section above explained how the Trustee have co-developed the LGIM Future World Fund, its climate-related engagement activities and how the fund is used in both DB and DC strategies.

As part of that same development process, the Trustee and LGIM worked with FTSE Russell to develop a new index that became the benchmark for the Future World Fund.

Recommendation disclosure B:

Describe the organisation's process for managing climate-related risks

Asset owners should describe how they consider the positioning of their portfolio with respect to the transition to a lower carbon energy supply production and use. This could include explaining how asset owners actively manage their portfolio's positioning relative to this transition.

The new index was built in three stages:

- Firstly, Controversial Weapons Manufacturers were excluded from the universe of stocks that make up the FTSE All World Index universe, as the Trustee has a financial preference for avoiding such stocks where possible.
- Secondly, a four-factor index was created (Value, Quality, Low Volatility and Low Size) that rebalances regularly through time to create a 'Balanced Factor' index with more attractive risk-return characteristics than the standard market capitalisation index.
- Finally, three climate-related tilts were applied to the 'Balanced Factor' index to create a 'Climate Balanced Factor' index. The FTSE All World (ex CW) Climate Balanced Factor Index tilts away from Carbon Reserves and Carbon Emissions, whilst positively tilting towards Green Revenues. The tilts are set such that the inclusion of the climate-related tilts introduces a relatively modest tracking error compared to the Balanced Factor index without climate tilts. This allowed the Trustee to conclude that the new index was consistent with its fiduciary duty and provided an element of Climate Change protection.

Comparing the carbon-optimised fund index with the underlying factor index led to marked reductions to Carbon Reserves (81%) and Carbon Emission (28%) and a greater exposure to Green Revenues (38%) as at 31 December 2018.

Source: FTSE Russell

As mentioned above, while the primary focus of the Trustee has been on Global Equities with regard to mitigating climate-related risks, a considerable amount of activity has occurred in other asset classes in which the Scheme invests. Examples of this include:

- Engaging with the Trustee's Real Estate managers to ascertain how the mitigation of the physical risks of Climate Change, as well as regulatory changes, are incorporated into the property portfolios.
- Working with the Trustee's corporate credit managers to understand how Climate Change risk is factored into the assessment of the quality of an issuer's credit. In light of strategic changes in the DB Section (which over the year has switched a considerable portion of its assets into credit holdings), ongoing collaboration with the credit managers will become a key focus of climate risk mitigation.
- Incorporating exposure to Renewables, such as solar parks and wind farms, within the Trustee's Infrastructure Equity and Debt portfolios.

Recommendation disclosure C:

Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management.

Climate Change risk is explicitly identified as a Scheme risk on the Trustee's Risk Register, as overseen by the Audit & Risk Committee, and reported to the Board on a quarterly basis.

At a more granular level:

- Where feasible within its fiduciary responsibility, mitigation of climate-related risks is factored into the mandates the Trustee has with its appointed fund managers (e.g. Future World Fund).
- For all appointed fund managers evaluation of ESG risk management, which includes climate-related risks, is an explicit part of both the on-boarding process and continued due diligence or monitoring that the Trustee undertakes.
- Through memberships of organisation such as the IIGCC, the Trustee aims to contribute towards wider public policy solutions that ensure an orderly transition to a low carbon economy.

Metrics and Targets

Recommended disclosure A: Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process. Asset Owners should describe metrics used to assess climate-related risks and opportunities in each fund or investment strategy. Where relevant, asset owners should also describe how these metrics have changed over time. Where appropriate asset owners should provide metrics considered in investment decision making and monitoring.	With regards to quantitative metrics, the Trustee commissions the calculation of the weighted average carbon intensity of DB and DC Equity mandates on an annual basis, with plans to expand annual analysis to Credit portfolios for the 2020 TCFD Disclosure Statement. These do not form part of a formulaic decision-making process, but are taken into account holistically when monitoring and reviewing the DB and DC investment strategies.
Recommended disclosure B: Disclose Scope 1, Scope 2 and if appropriate Scope 3 greenhouse gas (GHG) emissions and the related risks. Asset owners should provide the weighted average carbon intensity, where data are available or can be reasonably estimated for each fund or investment strategy. In addition, assets owners should provide other metrics they believe are useful for decision making along with a description of the methodology used.	See Appendix B for analysis of the Scheme's Equity holdings, as conducted by FTSE Russell.
Recommended disclosure C: Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	The Fund is not currently using quantitative targets as part of its Climate Change risk mitigation strategy, but will regularly review this situation should it become apparent how this would be additive to its desire to transition the portfolio to a sustainable future within a fiduciary framework. Qualitatively, the Trustee wishes to see the carbon emissions associated to its DB and DC assets decrease over time, in a manner consistent with the successful de-carbonisation of the global economy.

Appendix A: Climate Change Risk Policy

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.

Appendix B

The tables below give the carbon emissions intensity (Weighted Average Carbon Intensity – Scope 1 and 2 as recommended by the TFCD) as calculated by FTSE Russell for the main equity exposures of both the DB and DC assets of the Scheme as at 31 December 2018.

DB	31/12/2018				31/12/2017			
	FUM £m	Carbon emissions intensity (Weighted Average Carbon Intensity – Scope 1 & 2) – tonnes CO_2e/mUSD revenue			FUM £m	Carbon emissions intensity (Weighted Average Carbon Intensity – Scope 1 & 2) – tonnes CO_2e/mUSD revenue		
		Fund	Bmk	Diff		Fund	Bmk	Diff
Global Equities[1]	1,969	209	297	-30%	2,245	185	296	-38%

DC	31/12/2018				31/12/2017			
	FUM £m	Carbon emissions intensity (Weighted Average Carbon Intensity – Scope 1 & 2) – tonnes CO_2e/mUSD revenue			FUM £m	Carbon emissions intensity (Weighted Average Carbon Intensity – Scope 1 & 2) – tonnes CO_2e/mUSD revenue		
		Fund	Bmk	Diff		Fund	Bmk	Diff
Global Equities - Passive[1]	2,373	209	297	-30%	2,400	185	296	-38%
Global equities – Active	383	154	214	-28%	433	301	489	-38%
Emerging Market Equities – Active	74	150	392	-62%	77	207	437	-53%
UK Equities – Active	72	175	138	+26%	83	194	152	+28%
Sustainable & Responsible Equities – Active	24	292	189	+55%	27	233	544	-57%
Shariah Law Equities – Passive	24	72	72	0%	20	84	84	0%
UK Equities – Passive	17	138	138	0%	18	152	152	0%
North American Equities – Passive	11	180	180	0%	Not previously analysed			
Asia ex Japan Equities – Passive	3	238	238	0%				
Europe ex UK Equities – Passive	3	171	171	0%				
Japan Equities – Passive	2	141	141	0%				

The FTSE Russell carbon emissions analysis uses modelled data for those companies that do not report on their carbon emissions.

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

Aggregate carbon footprint (tonnes CO_2e/£m invested) metric for equities

For the first time we have estimated the CO_2e emissions associated with each £m invested in the equity portfolios.

These are:

DB Aggregate: 153 tCO_2e/£m

DC Aggregate: 97 tCO_2e/£m

Appendix C – Exclusions & engagement.

LGIM excluded the following eleven companies from the Scheme's Global Equity exposure as at 30 June 2019.

- China Construction Bank
- Japan Post Holdings
- Loblaw Companies
- Rosneft Oil
- Subaru
- Sysco Corp
- ExxonMobil
- Hormel Foods
- Kroger
- MetLife
- Kepco

This is an ongoing process. These companies could be repurchased if their engagement on climate change improves sufficiently; conversely other companies could be divested if the reverse is true.

Two companies listed as excluded in the previous TCFD Statement have now been re-included in the portfolio following improved disclosures and emissions targets. These are:

- Occidental Petroleum
- Dominion Energy

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

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