Sustainable Finance – The Impact of Regulation

Katarin Wagner

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HSBC

PUBLIC

Agenda

1	**Regulation as a Driver of Sustainable Finance – An Overview**
2	Climate Risk Management, Stress Testing, and Disclosure
3	European Union: Sustainable Finance Action Plan
4	HSBC’s Sustainable Finance Products

Climate action accelerating since 2017 – Regulation an important driver

	From (2017)	To (2020)	In the news
Policy and regulation	▪ Paris agreement national commitments yet to be legislated ▪ Bank of England questionnaire to review banks' activities related to climate change and climate risk	▪ UK and EU policy for **net-zero emissions by 2050** ▪ Central bank network for greening the financial system **(NGFS) with 50+ members** ▪ Bank of England announced **climate stress test** covering 30-year time horizon and expectation to assess temperature alignment of balance sheet	
Investors and civil society	▪ Climate Action 100+ initiative formed by investor representatives from five institutions (Dec 2017)	▪ **Climate Action100+ with 450 members** representing USD40trn AUM ▪ ESG and stewardship job hires double from 2017[1] ▪ Global activism reflected by Extinction Rebellion protests and student climate strikes; David Attenborough and Greta Thunberg global celebrities	
Sustainable Finance market	▪ Sustainable bond market **USD144bn**, <2% of total bond market ▪ UN PRI signatories AUM totalling USD68trn ▪ TCFD launch supported by **102 organisations** (Jun 2017) ▪ Companies with targets aligned to 1.5°C: 20 ▪ One labelled sustainable finance product in market (green bonds)	▪ Sustainable bond market **USD270bn** (2019) with 51% annual growth and 3.7% of total bond market ▪ UN PRI signatories AUM totalling USD89trn (up 31% from 2017) ▪ TCFD supporters totalling **1,027** (Feb 2020) ▪ Companies with targets aligned to 1.5°C: 107 ▪ Diverse labelled sustainable finance products including lending, investments, markets, trade, deposits	Record sums deployed into sustainable investment funds Sustainable debt sees record issuance at $465bn in 2019, up 78% from 2018 Sustainability-linked loans soar as green bond issues slow

1. FT article 'Jobs bonanza in stewardship and sustainable investing teams', 8 Mar 2020

Regulators, governments, and investors are increasing the pace

Examples of catalysts

Regulators

- **Financial Stability Board (FSB)** by **G20** established **TCFD** (2015)
- **Network for Greening the Financial System (NGFS)** brought together central banks and supervisors (2017)
- **3: Recommendations about "Green Finance baseline and targets", ESG investing for Exchange fund, Centre for Green Finance**
- **Climate Stress test announced** (2019)
- **Prudential Regulatory Authority (PRA)** published research on financial risks and a consultation paper on supervisory statement
- **Financial Conduct Authority (FCA)** published a paper on impact of climate change and green finance on financial services (2018)

Governments

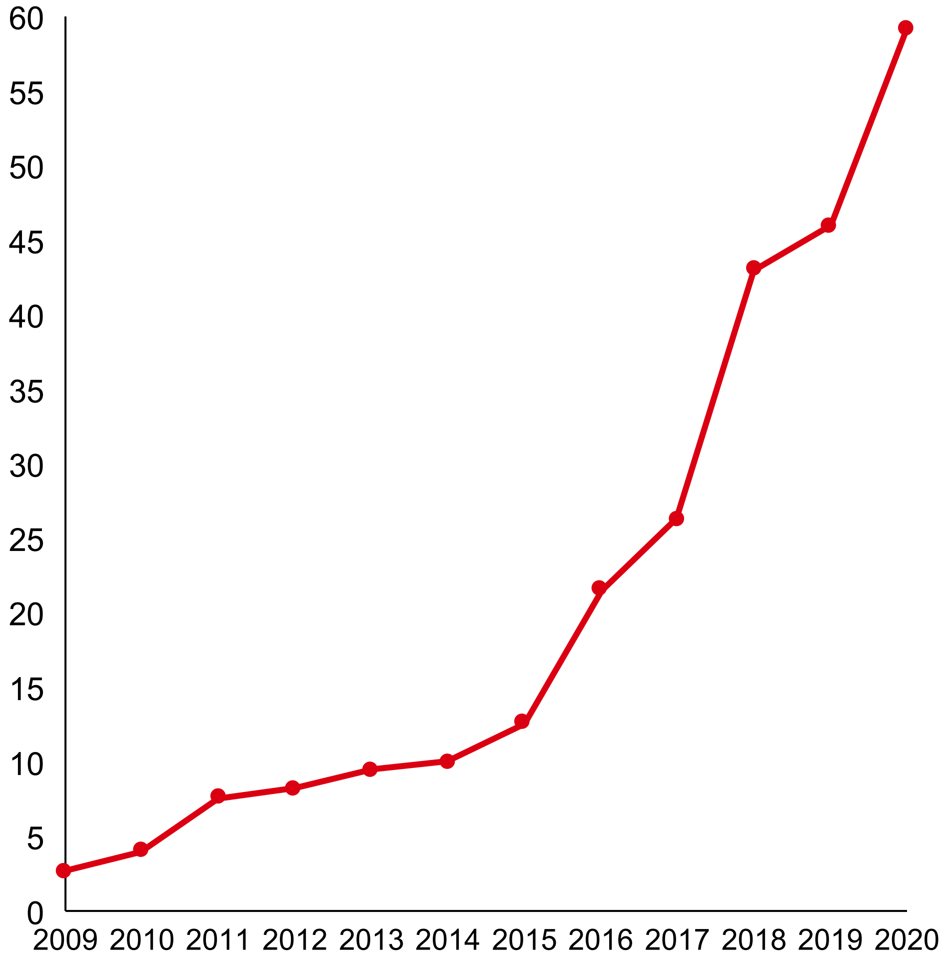
- **Legislated "Net Zero" by 2050** (2019)
- Hosting **COP26** in 2020
- EU present **Sustainable Finance Action Plan** (2018)
- EU presented **European Green Deal** (December 2019)
- France's **Energy Transition Law, Article 173** (2015)
- **French Strategy for Green Finance** (2017)
- **National guidelines** for establishing a green financial system; green investment; green bonds; green Belt and Road (2014-2017)
- HK plans to issue its own **green bond** and establish **grant scheme**

Investors

- Various initiatives and organisations
- **Principles for Responsible Investment**
- **Climate Action 100+**
- **Institutional Investors Group on Climate Change (IIGCC)**
- **Global Impact Investor Network (GIIN)**

Example: Stock exchanges with guidance on ESG disclosure[1]

Sharp increase in guidance after SSE launches Model Guidance (number of exchanges)



1. Source: SSE database, UN Sustainable Stock Exchange initiative: 10 Years of Impact and Progress, 2019

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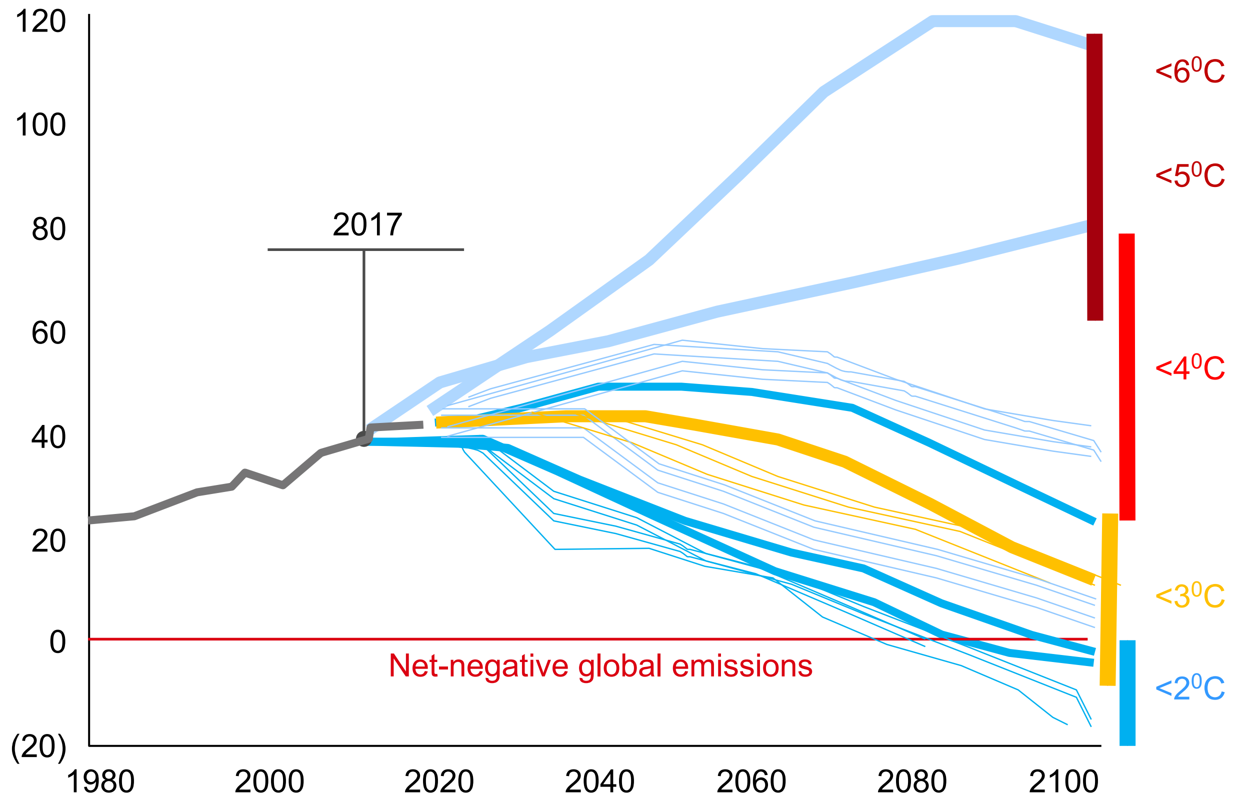
Regulators concern: The financial risks arising from climate change

Physical risks are more visible but transition risks may be more financially relevant

Climate projections extracted from the latest IPCC report

Net CO_2 emissions ($GtCO_2$)
Fossil fuel and land use change



Physical risks

Risks linked to the exposure to the physical consequences of climate change

(sea level rise, heat waves, droughts, etc.)

Less relevant for banks and developed countries, but mind the protection gap

Transition risks

Risks induced by the transition towards a low-carbon economy

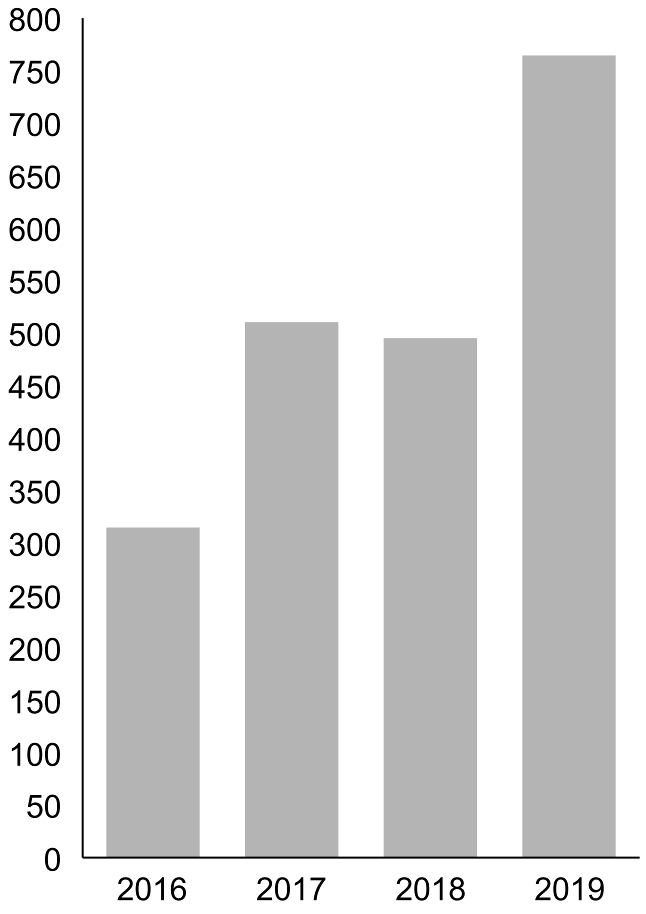
(evolution in regulation, mitigation policies, markets, etc.)

Exposures of banks and insurers are significant

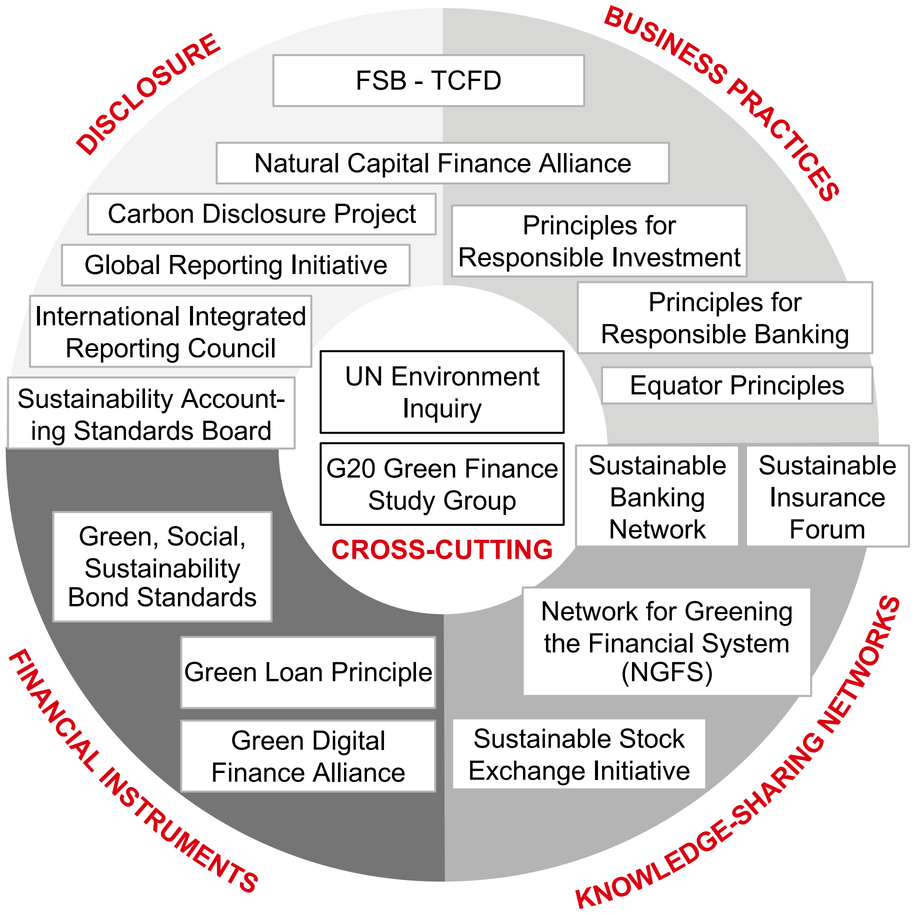
Overview of regulatory agenda

Sustainable finance regulatory development

relating to the SDGs[1]

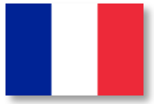


Global initiatives[2]

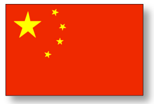


Select national-level actions

- Enhancing banks' and insurers' approaches to managing the financial risks from climate change (SS3/19, BoE PRA)
- 2021 Biennial Exploratory Scenario (BoE)



- Article 173 of French Energy Transition Law
- Climate-related risks assessment in the banking sector (BdF)
- 2013 White Paper on Financing the Ecological Transition



- "Guidelines for Establishing the Green Financial System" (PBoC 2016)
- Key measures on sustainable banking and green finance (HKMA, 2019)

- Stewardship Asia 2016 (MAS)
- Green Finance Action Plan and key measures (2019)
- Sustainable Bond Grant (MAS)

1. Source: ECOFACT
2. Source: UN Environment / WBG Roadmap Team / HSBC Analysis

Bank of England – "A strategic approach to managing the financial risks from climate change" (SS 3/19)

Governance

- **Board** to **understand and assess the financial risks** from climate change that affect the firm, and to be able to **address and oversee these risks within the firm's overall business strategy and risk appetite**
- Evidence of how the firm monitors and manages the financial risks from climate change **in line with its risk appetite statement,** which should include long-term financial interests/ results of stress and scenario testing/ timing and channel/ sensitivity of B/S
- **Clear roles and responsibilities for the board and its relevant sub-committees** in managing the financial risks from climate change

Risk Management

- **Risk identification and measurement** - use **scenario analysis and stress testing** to inform the risk identification; all material exposures and how firms determine the exposure
- **Risk monitoring** - consider a range of quantitative and qualitative **tools and metrics;** use these metrics to **monitor progress**
- **Risk management and mitigation** - a credible plan or policies for mitigating risks and managing exposures; understand the physical and transition risk on clients, counterparties and investment
- Provide the board and relevant sub-committees with **management information** on their exposure to the financial risk

Scenario analysis

- **Conduct scenario analysis** to inform strategic planning and determine the impact of the financial risks
- Scenario analysis to address a range of outcomes and include both **short-term assessment of firm's exposure** to the financial risks from climate change and **longer term assessment** of the firm's exposure of a range of different climate-related scenarios.
- Understand **the impact on solvency, liquidity** and, for **insurers, their ability to pay policyholders**
- **Useful frameworks - Own Risk and Solvency Assessment (ORSA)** for insurers and **Internal Capital Adequacy Assessment Process (ICAAP)** for banks

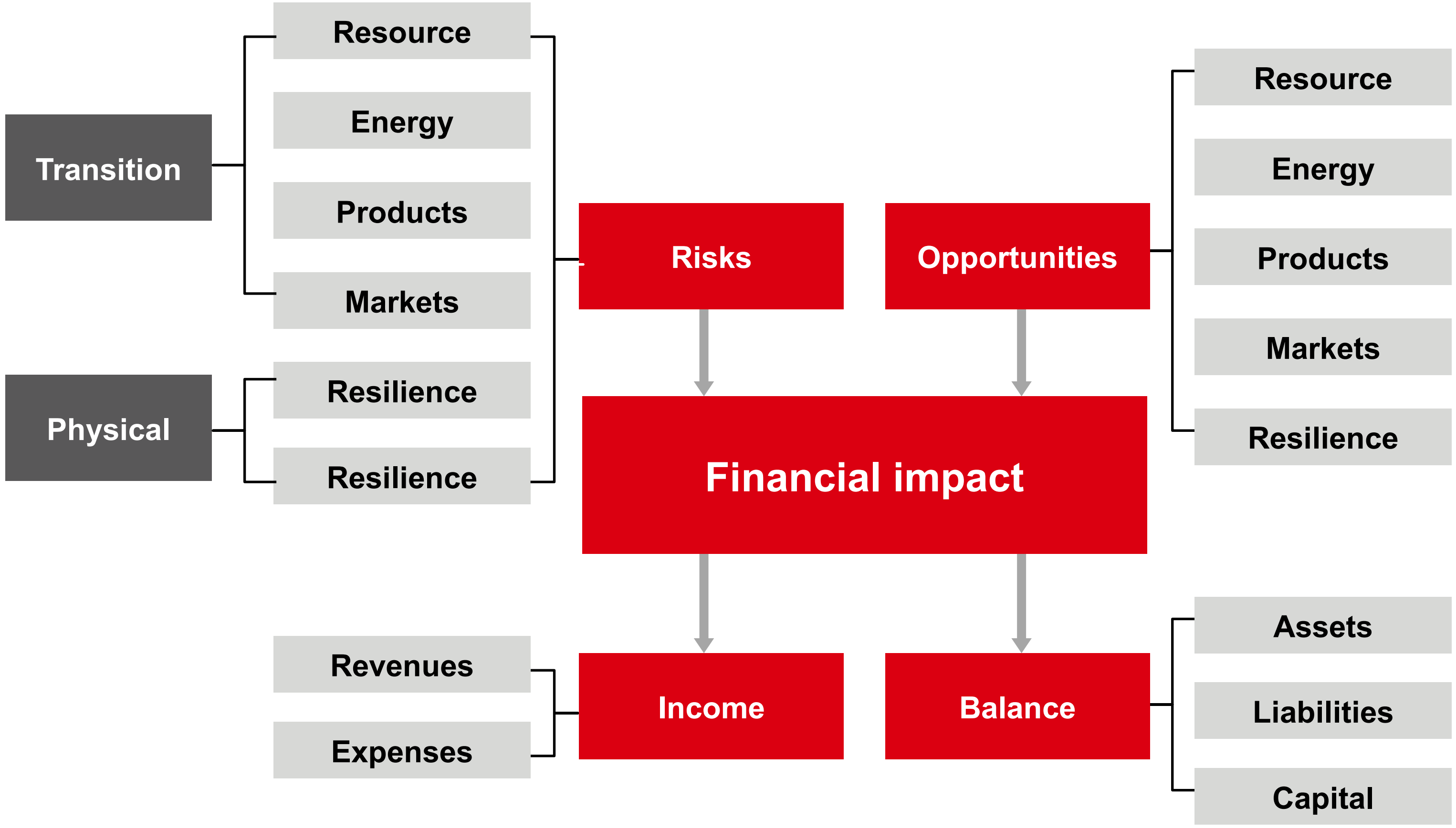
Disclosure

- Existing requirements to disclose information on **material risks within Pillar 3 disclosures** and **on principal risks and uncertainties in Strategic Report**
- Develop and maintain **an appropriate approach to disclosure**, reflective of the distinctive elements of the financial risks from climate change
- **Engage with wider initiatives** on climate-related financial disclosures and to take into account the benefits of disclosures that are comparable across firms, i.e. **TCFD**

Source: Supervisory Statement | SS3/19 Enhancing banks' and insurers' approaches to managing the financial risks from climate change, April 2019

Task Force for Climate-related Financial Disclosure (TCFD)

Task Force for Climate Related Financial Disclosure framework



> 1000 global companies and financial institutions signed up to implement TCFD

Recommendations

- **Governance**
  – Disclose the organisation's governance around climate related risks and opportunities
- **Strategy**
  – Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material
- **Risk management**
  – Disclose how the organization identifies, assesses, and manages climate-related risks
- **Metrics and targets**
  – Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material
- **Scenario analysis**
  – Assess impact of different transition scenarios on business model and size the financial impact

Source: TCFD

Example: HSBC's 2019 TCFD disclosure (published FEB2020)

Table 1: Wholesale loan exposure to transition risk sectors

	Oil and gas	Building and construction	Chemicals	Automotive	Power and utilities	Metals and mining	Total
% of total wholesale loans and advances to customers and banks in 2019[1,2,3]	**≤ 3.8%**	**≤ 3.9%**	**≤ 3.9%**	**≤ 3.2%**	**≤ 3.2%**	**≤ 2.7%**	**≤ 20.6%**
% of total wholesale loans and advances to customers and banks in 2018[1,2,3]	≤ 3.9%	≤ 3.8%	≤ 3.9%	≤ 3.4%	≤ 3.0%	≤ 2.8%	≤ 20.8%

Table 2: Customers' questionnaire responses and pilot carbon intensity metrics

	Oil and gas	Building and construction	Chemicals	Automotive	Power and utilities	Metals and mining	Total
Proportion of sector for which questionnaires were completed[4]	33%	37%	27%	39%	30%	44%	34%
Proportion of questionnaire responses that reported either having a board policy or a management plan[4]	84%	51%	85%	64%	94%	62%	72%
Sector weight as proportion of high transition risk sector[4]	18%	19%	19%	15%	15%	13%	100%
Pilot as % of total sector[4]	38%	41%	30%	52%	42%	46%	41%
Proportion of pilot that report carbon intensity metric through CDP[4]	49%	53%	38%	48%	38%	30%	44%
Weighted average carbon emissions per million dollars of revenue (total client emissions/revenue weighted by exposure)[4,5]	688	408	517	301	7,235	787	

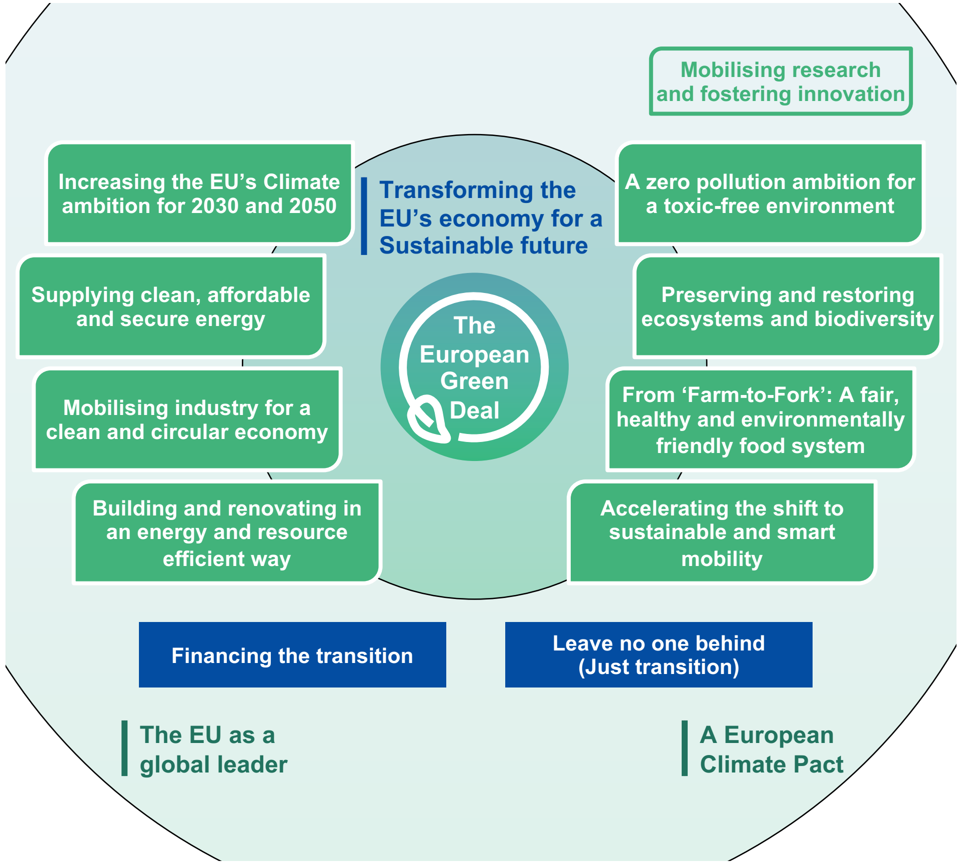
HSBC highlights

- **Governance**
  - Board is advised by Climate Business Councils, Risk Management Meeting, ESG Steering committee, etc.
- **Strategy**
  - USD100bn financing commitment; work with customers and industry to improve measurement
- **Risk management**
  - Incorporating climate-related risks into overall risk management; over 800 employees trained
- **Transition risk**
  - Disclose the exposure to six higher transition risk sectors; 3,000 engagement and transition questionnaire from over 750 clients
  - Pilot scheme on new transition metrics, i.e. weighted carbon-intensity ratio calculated for over 900 clients
- **Next Steps**
  - Review clients' portfolio emission, retail exposure, policies and procedures of physical risks for buildings and branches.
  - More qualitative information on climate stress testing

Agenda

The European Green Deal and the EU sustainable road map

In December 2019, the European Commission presented its Green Deal, an ambitious package of measures aimed at enabling European citizens and businesses to benefit from sustainable green transition. Measures accompanied with an initial roadmap of key policies range from cutting emissions, to investing in research and innovation, to preserving Europe's natural environment



Action plan for sustainable finance, MAR18

- Redirect capital flows towards sustainable investments with a view to financing sustainable and inclusive economy
- Manage the financial risks induced by climate change, resource depletion, environmental degradation and social issues

EU Commission action plan for financing sustainable growth

1. **Taxonomy:** Establishing a common language for sustainable finance
2. Creating EU labels for green financial products on the basis of this taxonomy
3. **Disclosure:** Clarifying the duty of asset managers and institutional investors to take sustainability into account in the investment process and enhance disclosure requirements
4. Requiring insurance and investment firms to advise clients on the basis of their preferences on sustainability
5. **Incentives / disincentives:** Incorporating sustainability in prudential requirements:
6. **Enhancing transparency in corporate reporting:** Seek alignment with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD)

Climate stress tests

- **Bank of England – PRA**

  2021 Biennial Exploratory Scenario (BES) on the financial risks from climate change

- **Banque de France – ACPR**

  Climate Stress test in 2020; publication of results 2021

EU Taxonomy

Two objectives will apply from 31DEC21

1. Mitigation of climate change
2. Adaptation to climate change

Four objectives will apply from 31DEC22

1. Sustainable use and protection of water and marine resources
2. The transition to a circular economy
3. Pollution prevention and control
4. Protection and restoration of the biodiversity of ecosystems

The EU Taxonomy

Definition

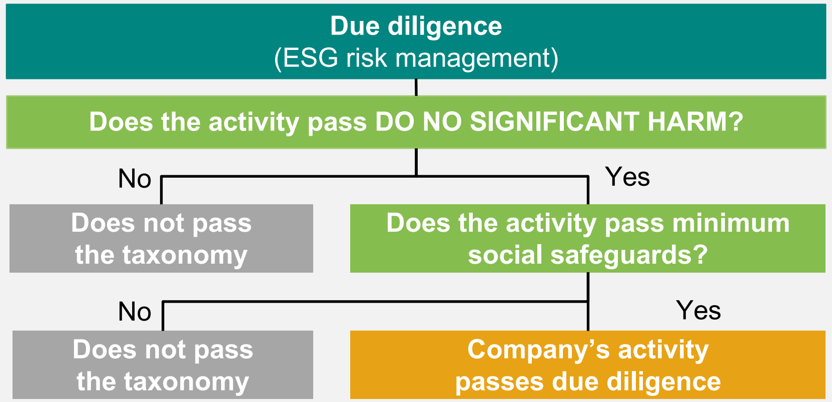
- ✓ The EU Taxonomy is a tool developed by the European Commission Technical expert group on sustainable finance (TEG) to understand **whether an economic activity is environmentally sustainable**

Environmental objectives

- ✓ Two **objectives (develop by 2020)**:
  - **Climate change mitigation**
  - **Climate change adaptation**
- ✓ **Other four objectives (develop by 2021):**
  - Sustainable use and protection of water, and marine resources
  - Transition to a circular economy
  - Pollution prevention
  - Protection of healthy ecosystems

Eligibility Criteria

- ✓ For an activity to be Taxonomy-eligible it must
  - **Contribute substantially to one or more of the environmental objectives**
  - **Do no significant harm (DNSH)** to any other environmental objective
  - Comply with the **technical screening criteria**
  - The activity must also meet minimum **social safeguards**, defined in reference to the UN Guiding Principles on Human Rights and the OECD guidelines
- ✓ Must avoid significant harm to climate change adaptation and the other four environmental objectives



Scope of the Taxonomy

- ✓ Apply to all financial products and issuers which are subject to the Accounting Directive. If a product does not meet the taxonomy, it will need to explicitly disclose that
- ✓ Member States or the EU when adopting measures or setting requirements on market actors in respect to financial products or corporate bonds that are marketed as environmentally sustainable

Sources: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-taxonomy_en.pdf
https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-using-the-taxonomy_en.pdf
https://data.consilium.europa.eu/doc/document/ST-14970-2019-ADD-1/en/pdf

Agenda

Helping to build a more sustainable business

Green Loan Principles | Facilitation of funding directly to the borrower

HSBC UK has aligned its Green Loan offering to the Loan Market Association's, Asia Pacific Loan Market Association's, Loan Syndications & Trading Association's Green Loan Principles[1], which aim to create market standards and guidelines, providing a consistent methodology for use across the green loan market.

The HSBC UK's Green Lending proposition is available for:
- ✓ Green Term Loans, for a minimum loan of £300,000
- ✓ Green Revolving Credit Facilities (RCFs), for a minimum loan value of £1,000,000
- ✓ Green Asset Finance, for a minimum loan of £300,000

Some examples of HSBC eligible green projects[2]:
- Renewable energy, including storage & smart grids
- Clean transportation
- Eco-efficient &/or circular economy adapted products; production technologies & processes
- Green buildings
- Energy efficiency
- Waste reduction, recycling; waste to energy

Sustainability Linked Loan Principles | Providing ESG margin-linked lending

HSBC UK has aligned its Sustainability Linked Loan (SLL) offering to the Loan Market Association's, Asia Pacific Loan Market Association's, Loan Syndications & Trading Association's Sustainability Linked Loan Principles[3], which aim to facilitate and support environmentally and socially sustainable economic activity and growth.

The HSBC UK's SLL is currently available under LIBOR Loan (or equivalent), Revolving Credit Facility, Hire Purchase, Leasing and Asset Finance.

The HSBC UK's SLL offers the borrower an interest margin that is agreed and adjusted by a pre-determined amount, if the Borrower improves or falls short of pre-defined sustainability performance targets (SPTs).

Some examples of SLLP SPTs:
- Reductions in Green House Gas Emissions relating to products
- Water savings made by the borrower
- Improving the energy efficiency rating of owned buildings
- Increases in amount of renewable energy generated or used by the Borrower

Sustainable Supply Chains | Facilitation of funding to the key Suppliers of large Buyers

At HSBC, our global network across 50+ countries and the largest range of customer size, enables us to engage and influence the Sustainability practices of businesses in the supply chain. We are currently piloting a **preferential funding solution:**

Term Lending | Provision of **preferential** Term Lending direct to the Buyer's supply chain to address their CapEx needs, through a **programme of lending**

Supply Chain Financing | Addressing **Working Capital** needs through a bespoke, **incentivised pricing solution** based on the **Buyer's own mechanism** for measuring Supplier performance on Sustainability metrics

As the world's leading trade bank, HSBC is well placed to help businesses manage global supply chains in sustainable ways

Green Deposits | Sustainable solution for excess liquidity

The HSBC UK's Green Deposit gives corporate clients a simple way to support environmentally-beneficial projects.

The HSBC UK's Green Deposit clients will receive a quarterly, portfolio-level view of how their funds have been used to support green projects.

Depositor	HSBC UK	HSBC UK's Green Financing
Depositor opens a deposit account with HSBC UK ("HSBC UK Green Deposit")	HSBC UK commits to make reasonable effort to use 100% of Green Deposits to finance projects that benefit the environment	HSBC UK's lending customer receives Green Loan from HSBC UK to finance green projects

[1] GLP launched by APLMA, LMA and LSTA : https://www.lma.eu.com/application/files/1815/8866/8537/Green_Loan_Principles_V03.pdf
[2] Please refer to HSBC UK Green Eligibility Guide for HSBC UK's Green Loans which can be accessed at https://www.business.hsbc.uk/corporate/-/media/library/markets/cmb-uk/pdfs/hsbc-eligible-criteria-for-green-activities.pdf
[3] SLLP launched by APLMA, LMA and LSTA : https://www.lma.eu.com/application/files/5115/8866/8901/Sustainability_Linked_Loan_Principles_V032.pdf
[4] https://www.unglobalcompact.org/take-action/action-platforms/decent-work-supply-chains
[5] LMA – Loan Market Association in EUR and APLMA – Loan Market Association in ASP – engage with its members, market participants and various stakeholders to tackle industry-wide issues and concerns; and continues to work directly with tax authorities, government bodies and national, European, US and Asian regulators. HSBC engaged with the LMA in EUR and ASP to help develop the GLP and SLLP.
All offers of financing, products and services are subject to status. Terms and conditions apply.