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
<table>
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<th>Policy and regulation</th>
<th>Investors and civil society</th>
<th>Sustainable Finance market</th>
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<tbody>
<tr>
<td>▪ Paris agreement national commitments yet to be legislated</td>
<td>▪ Climate Action 100+ initiative formed by investor representatives from five institutions (Dec 2017)</td>
<td>▪ Sustainable bond market <strong>USD144bn</strong>, &lt;2% of total bond market</td>
</tr>
<tr>
<td>▪ Bank of England questionnaire to review banks’ activities related to climate change and climate risk</td>
<td></td>
<td>▪ UN PRI signatories AUM totalling <strong>USD68trn</strong></td>
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<tr>
<td></td>
<td></td>
<td>▪ TCFD launch supported by 102 organisations (Jun 2017)</td>
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<tr>
<td></td>
<td></td>
<td>▪ Companies with targets aligned to 1.5°C: 20</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ One labelled sustainable finance product in market (green bonds)</td>
</tr>
<tr>
<td>From (2017)</td>
<td>To (2020)</td>
<td>In the news</td>
</tr>
<tr>
<td></td>
<td>▪ UK and EU policy for <strong>net-zero emissions by 2050</strong></td>
<td>▪ Climate Action 100+ with 450 members representing USD40trn AUM</td>
</tr>
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<td></td>
<td>▪ Central bank network for greening the financial system (NGFS) with 50+ members</td>
<td>▪ ESG and stewardship job hires double from 2017¹</td>
</tr>
<tr>
<td></td>
<td>▪ Bank of England announced <strong>climate stress test</strong> covering 30-year time horizon and expectation to assess temperature alignment of balance sheet</td>
<td>▪ Global activism reflected by Extinction Rebellion protests and student climate strikes; David Attenborough and Greta Thunberg global celebrities</td>
</tr>
<tr>
<td></td>
<td>▪ Companies with targets aligned to 1.5°C: 107</td>
<td>▪ Sustainable bond market <strong>USD270bn</strong> (2019) with 51% annual growth and 3.7% of total bond market</td>
</tr>
<tr>
<td></td>
<td>▪ Diverse labelled sustainable finance products including lending, investments, markets, trade, deposits</td>
<td>▪ UN PRI signatories AUM totalling USD89trn (up 31% from 2017)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ TCFD supporters totalling <strong>1,027</strong> (Feb 2020)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Companies with targets aligned to 1.5°C: 107</td>
</tr>
<tr>
<td>¹ FT article ‘Jobs bonanza in stewardship and sustainable investing teams’, 8 Mar 2020</td>
<td>Sustainable debt sees record issuance at $465bn in 2019, up 78% from 2018</td>
<td></td>
</tr>
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</table>

**In the news**

- Record sums deployed into sustainable investment funds
- Sustainability-linked loans soar as green bond issues slow
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**
- 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)
- 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)

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

Example: Stock exchanges with guidance on ESG disclosure
Sharp increase in guidance after SSE launches Model Guidance (number of exchanges)
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</table>
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 CO₂ emissions (GtCO₂)
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. Source: ECOFACT
2. Source: UN Environment / WBG Roadmap Team / HSBC Analysis

**Global initiatives**

- FSB - TCFD
- Natural Capital Finance Alliance
- Carbon Disclosure Project
- Global Reporting Initiative
- International Integrated Reporting Council
- UN Environment Inquiry
- G20 Green Finance Study Group
- Principles for Responsible Investment
- Principles for Responsible Banking
- Equator Principles
- Sustainable Banking Network
- Sustainable Insurance Forum
- Network for Greening the Financial System (NGFS)
- Sustainability Accounting Standards Board
- Green, Social, Sustainability Bond Standards
- Green Loan Principle
- Green Digital Finance Alliance
- Sustainable Stock Exchange Initiative
- Cross-cutting

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

<table>
<thead>
<tr>
<th>Governance</th>
<th>Risk Management</th>
<th>Scenario analysis</th>
<th>Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 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</td>
<td>- Risk identification and measurement - use scenario analysis and stress testing to inform the risk identification; all material exposures and how firms determine the exposure</td>
<td>- Conduct scenario analysis to inform strategic planning and determine the impact of the financial risks</td>
<td>- Existing requirements to disclose information on material risks within Pillar 3 disclosures and on principal risks and uncertainties in Strategic Report</td>
</tr>
<tr>
<td>- 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</td>
<td>- Risk monitoring - consider a range of quantitative and qualitative tools and metrics; use these metrics to monitor progress</td>
<td>- 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.</td>
<td>- Develop and maintain an appropriate approach to disclosure, reflective of the distinctive elements of the financial risks from climate change</td>
</tr>
<tr>
<td>- Clear roles and responsibilities for the board and its relevant sub-committees in managing the financial risks from climate change</td>
<td>- 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</td>
<td>- Understand the impact on solvency, liquidity and, for insurers, their ability to pay policyholders</td>
<td>- 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</td>
</tr>
<tr>
<td></td>
<td>- Provide the board and relevant sub-committees with management information on their exposure to the financial risk</td>
<td>- Useful frameworks - Own Risk and Solvency Assessment (ORSA) for insurers and Internal Capital Adequacy Assessment Process (ICAAP) for banks</td>
<td></td>
</tr>
</tbody>
</table>
Task Force for Climate-related Financial Disclosure (TCFD)

Task Force for Climate Related Financial Disclosure framework

- **Transition**
  - Resource
  - Energy
  - Products
  - Markets
  - Resilience

- **Physical**
  - Revenues
  - Expenses

- **Risks**
- **Opportunities**

- **Financial impact**

- **Income**
- **Balance**

- **Resource**
- **Energy**
- **Products**
- **Markets**
- **Resilience**
- **Assets**
- **Liabilities**
- **Capital**

### 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

---

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

Source: TCFD
Example: HSBC’s 2019 TCFD disclosure (published FEB2020)

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

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Table 1: Wholesale loan exposure to transition risk sectors

<table>
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<tr>
<th></th>
<th>Oil and gas</th>
<th>Building and construction</th>
<th>Chemicals</th>
<th>Automotive</th>
<th>Power and utilities</th>
<th>Metals and mining</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of total wholesale loans and advances in customers and banks in 2019</td>
<td>≤ 3.8%</td>
<td>≤ 3.9%</td>
<td>≤ 3.9%</td>
<td>≤ 3.2%</td>
<td>≤ 3.2%</td>
<td>≤ 2.7%</td>
<td>≤ 20.6%</td>
</tr>
</tbody>
</table>

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| % of total wholesale loans and advances in customers and banks in 2019 | ≤ 3.9%      | ≤ 3.8%                     | ≤ 3.9%    | ≤ 3.4%     | ≤ 3.0%             | ≤ 2.8%           | ≤ 20.8% |

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

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<tr>
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<tr>
<td>Proportion of sector for which questionnaires were completed</td>
<td>33%</td>
<td>37%</td>
<td>27%</td>
<td>39%</td>
<td>30%</td>
<td>44%</td>
<td>34%</td>
</tr>
<tr>
<td>Proportion of questionnaire responses that reported either having a board policy or a management plan</td>
<td>84%</td>
<td>61%</td>
<td>86%</td>
<td>64%</td>
<td>94%</td>
<td>62%</td>
<td>72%</td>
</tr>
<tr>
<td>Sector weight as proportion of high transition risk sector</td>
<td>18%</td>
<td>19%</td>
<td>19%</td>
<td>15%</td>
<td>15%</td>
<td>13%</td>
<td>100%</td>
</tr>
<tr>
<td>Pilot as % of total sector</td>
<td>38%</td>
<td>41%</td>
<td>30%</td>
<td>52%</td>
<td>42%</td>
<td>48%</td>
<td>41%</td>
</tr>
<tr>
<td>Proportion of pilot that report carbon intensity metric through CDP</td>
<td>49%</td>
<td>53%</td>
<td>38%</td>
<td>48%</td>
<td>38%</td>
<td>30%</td>
<td>44%</td>
</tr>
</tbody>
</table>

Weighted average carbon emissions per million dollars of revenue (total client emissions/revenue weighted by exposure): 688, 408, 517, 301, 7,235, 767
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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)

**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

**Due diligence (ESG risk management)**

| Does the activity pass DO NO SIGNIFICANT HARM? | Yes |
| Does the activity pass minimum social safeguards? | Yes |
| Company’s activity passes due diligence | Yes |

**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

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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 Principles1, 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 (ROFs)**, 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:
- Renewable energy, including storage & smart grids
- Green buildings
- Green transportation
- Energy efficiency
- Eco-efficient &/or circular economy adapted products: production technologies & processes
- 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 Principles2, 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 SLL SPtS:
- Reductions in Green House Gas Emissions relating to products
- Improving the energy efficiency rating of owned buildings
- Water savings made by the borrower in amounts of renewable energy generated or used by the Borrower
- Increases in amounts 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.

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1. GLP launched by APMA, LMA and LSTA. [https://www.bloomberg.com/pressrelease/10156895657-glp-green-loan-principles-v01.pdf]
2. Please refer to HSBC UK’s Green Lending Guidance for HSBC UK’s Green Loans which can be accessed at: [https://www.bloomberg.com/promo/10156895657-sustainability-linked-loan-principles-v01.pdf]
4. LMA - Loan Market Association in EUR and APMA - Loan Market Association in ASP, engage with its members, market participants and various stakeholders to tackle industry-wide issues and concerns and continue to work directly with tax authorities, government bodies and national, European, US and Asian regulators. HSBC engaged with the LMA in EUR and APMA to help develop GLP and SLL.

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PUBLIC