HSBC

Mary Creagh MP
Chair of the Environmental Audit Committee
House of Commons
London
SW1A 0AA

21 March 2018

Dear Mary,

Many thanks for your letter dated February 2018. Please find below the answers to your questions, as well as a brief update on the HSBC Bank (UK) Pension Scheme with regard to funds under management and membership numbers.

Introduction

The HSBC Bank (UK) Pension Scheme is a hybrid Scheme in that it has both Defined Benefit and Defined Contribution members. The table below shows the approximate funds under management and membership numbers at the end of December 2017.

	Funds under Management £ bn	Members
Defined Benefit	28.1	114,000
Defined Contribution	3.7	80,000

Q1: Do the Trustees accept the TCFD conclusion that pension funds are potentially exposed to financial risks through climate change?

A1: Yes. We believe that climate change is a financial risk which may affect both DB and DC pension funds.

Q2: Which climate-related financial risks are you most concerned about?

A2: Consistent with its fiduciary responsibility, the Trustee is concerned with managing and mitigating all forms of climate-related risk that can have an impact on the Scheme's members' outcomes.

The primary climate-related financial risk we have focussed on is 'transition risk', as this is likely to have the greatest impact on both the DB and DC sections of the Scheme.

Q3: Has your pension scheme formally considered climate change risk at Board (or Investment Committee) level?

A3: Yes. In June 2015, the Trustee adopted the climate change policy below which is contained within the Trustee SIP.

Continued.

HSBC Bank Pension Trust (UK) Limited
Level 33, 8 Canada Square, London E14 5HQ
Tel: 020 7991 9882

HSBC

Trustee Climate Change Policy

Within the context of its fiduciary responsibility, the Trustee is supportive of the United Nations Framework Convention on Climate Change (UNFCCC) agreement to limit temperature rises to 2 degrees centigrade above pre-industrial levels. In this context, the Trustee:

a) *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.*

b) *Has a preference for 'Engagement' rather than 'Exclusion' as a method of incorporating climate change risks into an effective fiduciary framework. However, the Trustees expect investment managers to independently consider whether exclusion or engagement is more appropriate within their investment process.*

c) *Encourages the further development of asset classes that are supportive of obtaining the 2 degree target provided they are all based within the primary fiduciary framework.*

d) *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.*

e) *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.*

f) *Is supportive of policy initiatives that, in its opinion, contribute towards achieving the 2 degree target.*

Q4: If you have considered climate change related risks, what actions have you taken in response to these risks? We are interested, for example, in the development of specific investment strategies on this issue, whether you have taken formal advice, any changes in your investment strategy made or planned, and the exercise of your ownership responsibilities on this issue (either directly, or through your investment managers).

A4: Following the adoption of its Climate Change Policy in June 2015, the Trustee wrote to its fund managers to ask how they, as agents for the Trustee, were mitigating climate change risk in their investment processes. A follow up meeting with each fund manager with the Trustee's CIO was held.

One specific example of where the Trustee has incorporated climate change risk into a specific investment strategy is the Global Equity passive Fund that forms the accumulation fund in the Trustee's Defined Contribution (DC) default investment strategy and the developed market equity exposure in the DB investment strategy.

The Trustee worked with FTSE, Legal & General Investment Management (LGIM) and Redington, the investment consultant, to develop a new global equity index (the FTSE All World (ex-Controversial Weapons) Climate Balanced Factor Index) and a new global equity fund to be managed against that index (the LGIM Future World Fund), which the Trustee seeded in early 2017.

The fund incorporates climate change risk mitigation at two levels:

- **Tilting**

  The index itself has incorporated within it factors that tilt away from companies with high carbon reserves and carbon emissions and tilt towards companies with green revenues.

Continued.

Including these climate tilts resulted in a tracking error of approximately 0.5% against the new index excluding the climate tilts. However, the risk benefit which resulted was a reduction of approximately 70% in carbon reserves, 30% lower carbon emissions and 100% more in green revenues compared to a conventional market capitalisation index.

The Trustee considered that the extra tracking error was not inconsistent with its fiduciary responsibility, especially as around 60% of the Scheme's DC membership was under the age of 40 and would be likely to be invested in the Global Equity passive Fund for the long term.

- **Engagement**

  As you will see from the Trustee's Climate Change policy, the Trustee believes in engagement.

  The Climate Change engagement policy of the LGIM Future World Fund, in which the Scheme invests, benefits from the LGIM Climate Impact Pledge.

  The Climate Impact Pledge identified six global industries that were particularly exposed to the effects of climate change. LGIM wrote to the Board chair of the 84 largest companies in those sectors requesting engagement on how that company was developing plans to ensure the long term sustainability of their business.

  If after a year of engagement the company was not making sufficient progress on developing those plans in the opinion of LGIM, then LGIM would vote against the re-election of the Chairperson at the next AGM with all of its funds under management. However, the Future World Fund would go one step further and divest from such companies, even though they remain a part of the index.

The Trustee believes that the combination of the climate tilting and engagement is an effective way in mitigating climate change risk for the Scheme's members.

Beyond equities, we have discussed physical climate risk in commercial property with our property managers and how climate change risk could be incorporated within credit assessments with our fixed income fund managers.

As the Trustee is supportive of policy initiatives that, in its opinion, contribute towards achieving the 2 degree target, it is a member of both the Institutional Investors Group on Climate Change (IIGCC) and the Cambridge Institute of Sustainable Leadership Investors Leaders Group.

Q5: Are you planning to adopt the TCFD recommendations in your scheme's reporting? If so, please indicate your planned timing.

A5: Yes. We currently plan to make our first TCFD disclosure in a Trustee Stewardship Report which we are developing for publication in Q3 2018.

The Trustee also wrote to all of its fund managers asking how they were intending to incorporate the TCFD recommendations into how they interacted with the issuers of equity and debt which they invest in on behalf of the Trustee.

Q6: How would you suggest the Government and regulators implement the recommendations on climate-risk reporting? Is a voluntary approach sufficient to ensure widespread adoption?

Continued.

HSBC Bank Pension Trust (UK) Limited
Level 33, 8 Canada Square, London E14 5HQ
Tel: 020 7991 9882

A6: We believe that the UK should adopt a voluntary approach to implementing the TCFD recommendations. This is to allow a period of time, perhaps three years, for companies and investors to explore the new disclosures and for agreement to be reached over which recommendations are decision-useful.

The TCFD recommendations should form part of the UK formal reporting framework for companies and asset owners, such as pension funds. For this process to work, all actors within the investment chain need to play their part including that pension schemes seek to make the disclosures in their own accounts and therefore seek such information from the companies via their fund managers.

Q7: Would guidance from Government or regulators on climate-risk reporting be helpful for pension funds?

A7: We suggest that climate risk is specifically required to be considered in every Trustee's Statement of Investment Principles.

Q8: Have you discussed climate change with you actuarial advisers, having regard to the Risk Alert that the Institute and Faculty of Actuaries (IFoA) issued to its members last year?

A8: We are familiar with the Risk Alert issued by the IFoA last year and have discussed climate change risk with our actuarial advisers.

Q9: Please share with us any other information you think may be relevant as we develop our understanding of the approach UK pension funds are taking to climate change and, more generally, green finance.

A9: We have no additional comments to provide.

I look forward to reading the results of your initiative.

Yours sincerely

Best wishes

Russell

Russell Picot
Chair of Trustee Board

HSBC Bank Pension Trust (UK) Limited
Level 33, 8 Canada Square, London E14 5HQ
Tel: 020 7991 9882