We believe that our deep understanding of environmental, social and governance issues enriches our investment decision-making and contributes to sustainable long-term investment performance. As such, HSBC Alternatives seeks to identify and assess material ESG issues as part of our investment process, and aims to ensure that these issues are properly managed over the lifetime of our investments. We are, however, cognisant of the specific challenges involved with implementing responsible investment best practices in alternative asset classes due to the idiosyncratic nature of the asset classes, the lack of data and standard market frameworks.

Consequently, we mobilised our resources to build our own framework, with a clear articulation of what is endeavoured and how this process will be managed and governed. Our alternatives-specific responsible investment policy, published in 2022, provides the overarching charter for our responsible investment approach across all alternative capabilities. The ESG integration framework is customised to each alternative asset class, and ESG issues are considered throughout the whole investment process – from sourcing through to exit. Although the implementation in each asset class differs, there are common pillars that apply across the Alternatives platform, such as materiality risk assessment, engagement, reporting, and oversight.

Successful implementation of responsible investment best practices within alternatives requires strategic coherence, ongoing governance, and continual evolution and improvement of integration processes. With this ethos in place as a foundational driver for our alternative capabilities, 2022 saw each team continue to enhance their respective process and in so doing we created more client solutions to meet increasing demand.

– Michelle Hilliman, Head of Responsible Investment and Business Management, HSBC Alternatives

Real assets

In 2022, we prioritised real assets for early action. Real assets account for over 60 per cent of greenhouse gas emissions in the OECD[12]. Given this, cross-investment team working groups in Infrastructure and Real Estate were established, with investment specialists from the direct and indirect teams across geographic locations. These knowledge forums help us embed market best practices into our investment decision-making and support the enhancement of existing strategies along with the development of new ones.

12. Financing Climate Futures: Rethinking Infrastructure – OECD

Infrastructure

During the year, we expanded our infrastructure capabilities, unleashing greater potential to support a net zero transition. In March, we added a listed infrastructure equity team, increasing our sustainable infrastructure solutions to investors and giving them access to a highly diversified portfolio of infrastructure companies that support a just transition with daily liquidity. After joining, the team undertook a review of their ESG scoring process with the support of our responsible investment resources. They have built an ESG database of 400+ variables to inform enhanced due diligence undertaken by the analysts. The team also undertook several ESG driven engagements, in conjunction with the Stewardship team, aimed at understanding ESG challenges faced by investees and encouraging management teams to improve practices and outcomes.

We also plan to extend our Asia coverage with the acquisition a Hong Kong energy transition infrastructure team specialising in direct equity investments. The Asian infrastructure sector is a strategic priority due to the region's large share of global greenhouse gas emissions and the scale of the impact we can potentially generate. Asia Pacific accounts for more than half of global energy consumption, with 85 per cent of that regional consumption sourced from fossil fuels [13]. In 2023, HSBC Alternatives aims to launch two energy infrastructure transition solutions in Asia.

On the credit side, the infrastructure debt investment team continues to invest in energy decarbonisation across the globe. Through the year, the team enhanced and refined their proprietary asset class-specific ESG scorecards which now cover power and utilities, telecommunications, oil and gas, transportation, and social infrastructure. Each sector has its own materiality factors and specific weightings for those factors. In 2022, around 95 per cent of total investments made by the team were in assets rated 'good' or 'strong' under the enhanced ESG rating system, which means these investments generate neutral to positive impacts on the environment and society.

Real Estate

The real estate sector alone currently consumes a third of global energy and contributes nearly 40 per cent to global greenhouse gas emissions[14]. The key priority to achieve sector decarbonisation targets is renovation of existing building stock to a zero-carbon-ready level – 20 per cent of the existing building stock needs to be converted by 2030 to be on the path to Net Zero by 2050. This is equivalent to an annual deep renovation rate of over two per cent from now to 2030 and beyond[15]. Our Real Estate teams focus on identifying attractive investment opportunities that can be economically refurbished to improve their sustainability features throughout the life of the asset to realise value creation.

In 2022, our team in France obtained the Socially Responsible Investment label for their flagship real estate fund. This label, created by the French Ministry of the Economy and Finance, aims to identify investment funds with a proven socially responsible investment methodology with measurable and concrete results.

13. International Renewable Energy Agency (IRENA) Asia and Pacific (irena.org)
14. World Green Building Council.
15. International Energy Agency (IEA).
Renovation of near 20% of existing building stock to zero-carbon-ready by 2030 is ambitious but necessary – Analysis - IEA

Direct lending: a case study

Partnering with HSBC UK, our team developed a UK Direct Lending strategy allowing our client to access loan origination opportunities. We have the right, but not the obligation, to invest alongside the Bank in each deal. Our process also allows pre-investment engagement with companies. As an illustration, there was an opportunity to refinance an existing company loan via a sustainability-linked loan (SLL). These loans achieve their sustainability impact by linking pricing to the attainment of measurable goals, usually though interest rate 'step-ups' or 'step-downs'. These SLLs enable borrowers to credibly signal their ESG commitments to external stakeholders, while lenders supply financing with the downside protection that good ESG practices can provide.

Our engagement, coupled the expertise of HSBC Commercial Banking's Sustainability team, helped the company to define ambitious performance targets around three pillars: climate action, waste reduction and making charitable donations. These annual targets will be published in the company's annual report and verified by an independent third party, and the company will receive a margin discount, or penalty.

Venture capital

As we get closer to the 2030 interim checkpoint, the role of innovation becomes more crucial than ever. Investment in technology focused on climate change reached historic highs in 2022. Venture funding for climate tech start-ups totaled $52 billion during the first three quarters of 2022, representing more than a quarter of total venture funds[16].

Over the year, our Venture Capital team made great strides in building our responsible investment propositions, with the first closing of a fintech fund and the deployment of long-term capital in a climate-tech fund. To support decision-making and negate the dearth of data for early-stage companies, we utilise specialised ESG data providers to prepare independent ESG due diligence reports and assess the alignment of investments to the UN Sustainable Development Goals. Given the nature of venture capital investing, engagements with prospective investee companies are also critical. As such, the investment team actively engages with portfolio companies about the ESG risks identified and emerging, often as a member or an observer on the company's board.

16. PWC Climate Tech 2022 Report.

Hedge funds and private market solutions

Our Indirect Alternative investment teams invest in third-party manager strategies to provide clients with private equity and hedge fund asset class solutions, amongst others. Strict due diligence is undertaken to monitor ESG risks and engage with third-party managers as appropriate. We developed a proprietary ESG questionnaire which is completed by all third-party managers with whom we invest. In addition, dedicated ESG interviews with each manager by the investment and operations due diligence teams are required to determine our final ESG ratings. During 2022, the ESG framework was refined further by including Principal Adverse Impacts requirements and more policy-related documents as well as a continued refinement of the weighting scheme used.

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