east&partners

Sustainable Financing and ESG Investing report

September 2018

HSBC

Contents

Executive summary

A sustainable global economy starts with individual acts of conscience and responsible corporate citizenship. But taking on the climate and social issues that continue to affect people all over the world requires more. To drive fundamental change, individual action must evolve into institutional transformation – where Environmental, Social and Governance (ESG) becomes not simply a moral imperative, but a business imperative as well.

We've been seeing this transformation over the past five years, as investors and issuers have increased their focus on ESG criteria. In its last report, the Global Sustainable Investment Association (GSIA) said that global assets under management incorporating ESG had risen 25% over the previous two years. The GSIA also estimated that 30% of investable assets globally – or over USD$20trn – included sustainability in their investment analysis, according to their 2016 Global Sustainable Investment Review.

The bottom line is, attitudes are changing quickly. That's why we've once again commissioned East & Partners, a leading banking research firm, to help us gain a better understanding of what investors and issuers are doing today and what they're planning for the future as it relates to sustainable investing.

What we've learned this year is that more than 60% of investors and nearly 50% of issuers around the world have an ESG strategy in place.

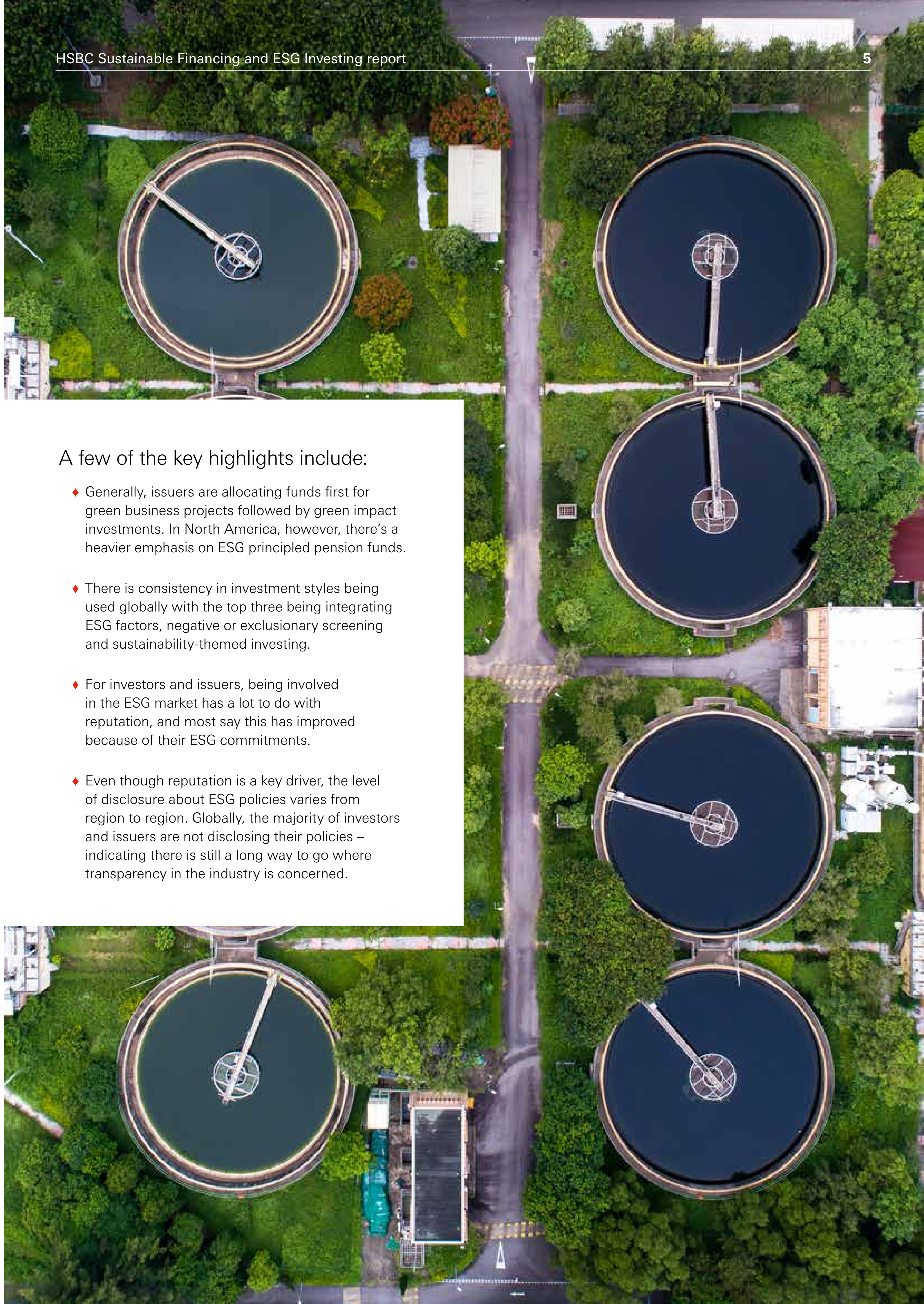
Also, while fewer than 10% of investors currently have ringfenced or dedicated ESG investment structures, they anticipate this will grow by 20% over the course of the next 12 months.

Decisions about ESG investing and financing are increasingly financially driven. 74% of investors cite financial returns as being a key factor in their decisions about ESG, while two-thirds of issuers consider tax incentives important. This, along with shareholder and stakeholder pressure, which still ranks high in the decision-making process, indicates that the ESG market is maturing and sustainable.

Most investors and issuers say they see no barriers to increasing their ESG investing and financing commitments. In some markets, however, there's a disparity between investor and issuer perceptions of potential obstacles. In these cases, investors name a lack of opportunity as the main reason they are not increasing their ESG investments, while issuers say they are not increasing ESG financing because of low investor demand. Other barriers mentioned include inconsistent ESG definitions and time-consuming disclosure requirements.

In the pages that follow, you'll find a deeper analysis of the results from our interviews with more than 1,700 investors and issuers around the world. This includes how actions and viewpoints differ by sector, region and country – such as how nearly 93% of UK issuers report being involved in ESG financing, while just under 60% in Hong Kong say they are.

As the market continues to shift, we believe incorporating ESG factors will become the norm and impact the choices people make about who they do business with and how they invest. That's why HSBC continues to work toward sustainability across all our global businesses and solutions. To learn more about how we can help you build and strengthen your ESG strategy, please contact your Relationship Manager.



A few of the key highlights include:

- Generally, issuers are allocating funds first for green business projects followed by green impact investments. In North America, however, there's a heavier emphasis on ESG principled pension funds.
- There is consistency in investment styles being used globally with the top three being integrating ESG factors, negative or exclusionary screening and sustainability-themed investing.
- For investors and issuers, being involved in the ESG market has a lot to do with reputation, and most say this has improved because of their ESG commitments.
- Even though reputation is a key driver, the level of disclosure about ESG policies varies from region to region. Globally, the majority of investors and issuers are not disclosing their policies – indicating there is still a long way to go where transparency in the industry is concerned.

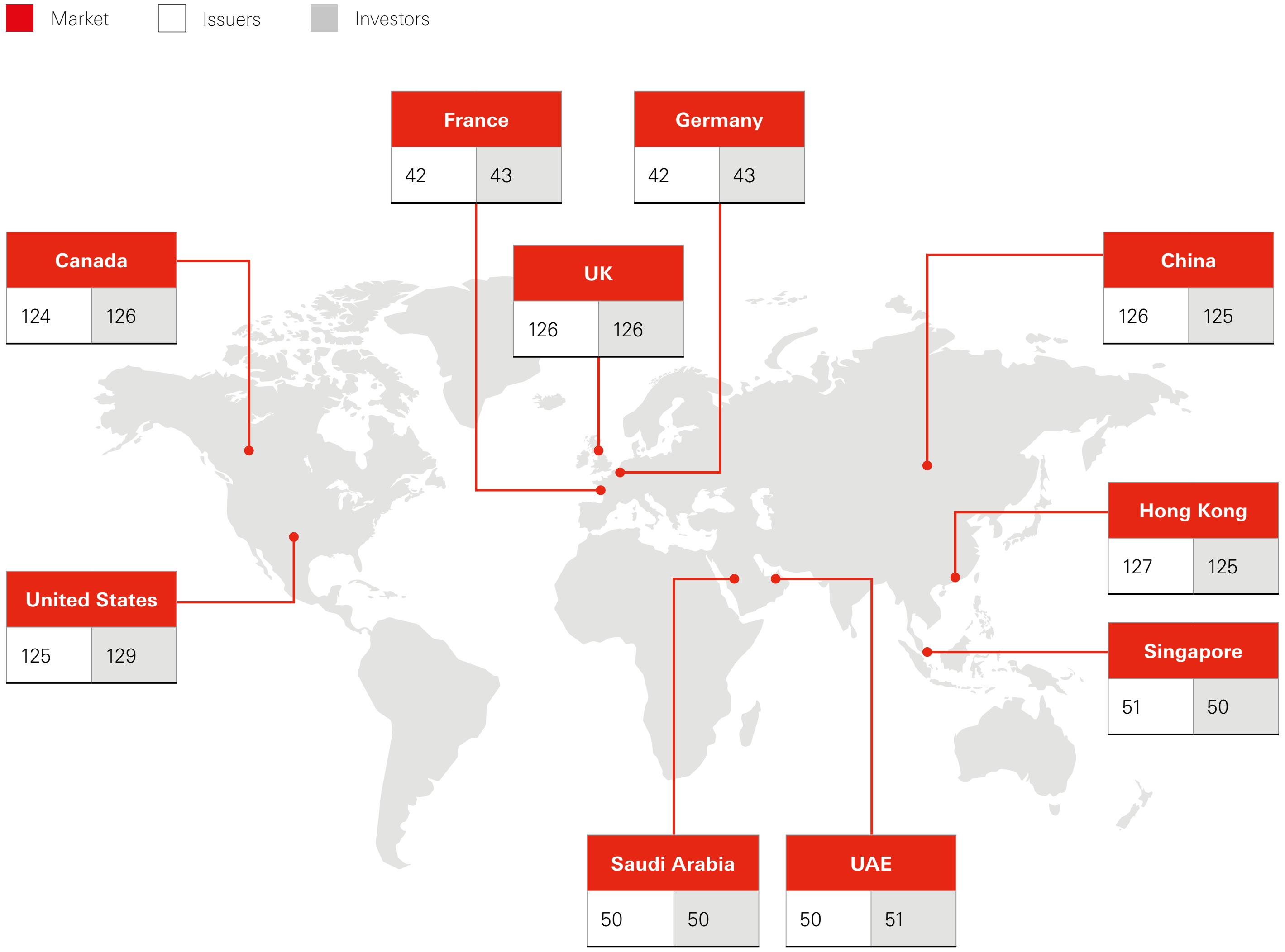
About the report

HSBC has commissioned East & Partners (East) to continue its Sustainable Finance research programme into a third year. The main research objective is to further explore the underlying approach to the sustainable financing and ESG markets across the investor and issuer base in each geography, the importance of disclosure to them, how that has changed, and what the future holds.

The first round of research in 2016 reported on sustainable financing with particular focus on environmental, which was expanded to cover social investing in the next round in 2017. Round III in 2018 has broadened this further to encompass all three ESG factors (environmental, social and governance) pivotal to sustainable and responsible investing.

The reporting is based on direct interviews conducted by East with 1,731 global entities including 863 issuers and 868 investors over a five week period ending 29 June 2018. Among corporate issuers, the average company size was USD$23.8bn, with 54% of issuers with annual turnover under USD$10bn and 46% with turnover in excess of USD$10bn. Among investors, the average assets under management (AUM) were USD$178.8bn, with 43% of investors with AUM under USD$100bn and 57% with AUM in excess of USD$100bn. Group Treasurers, CFOs, CIOs and Heads of Investments Strategy included in the sample frame were located across Europe, North America, Asia and the Middle East.

Geographical Distribution



Key themes

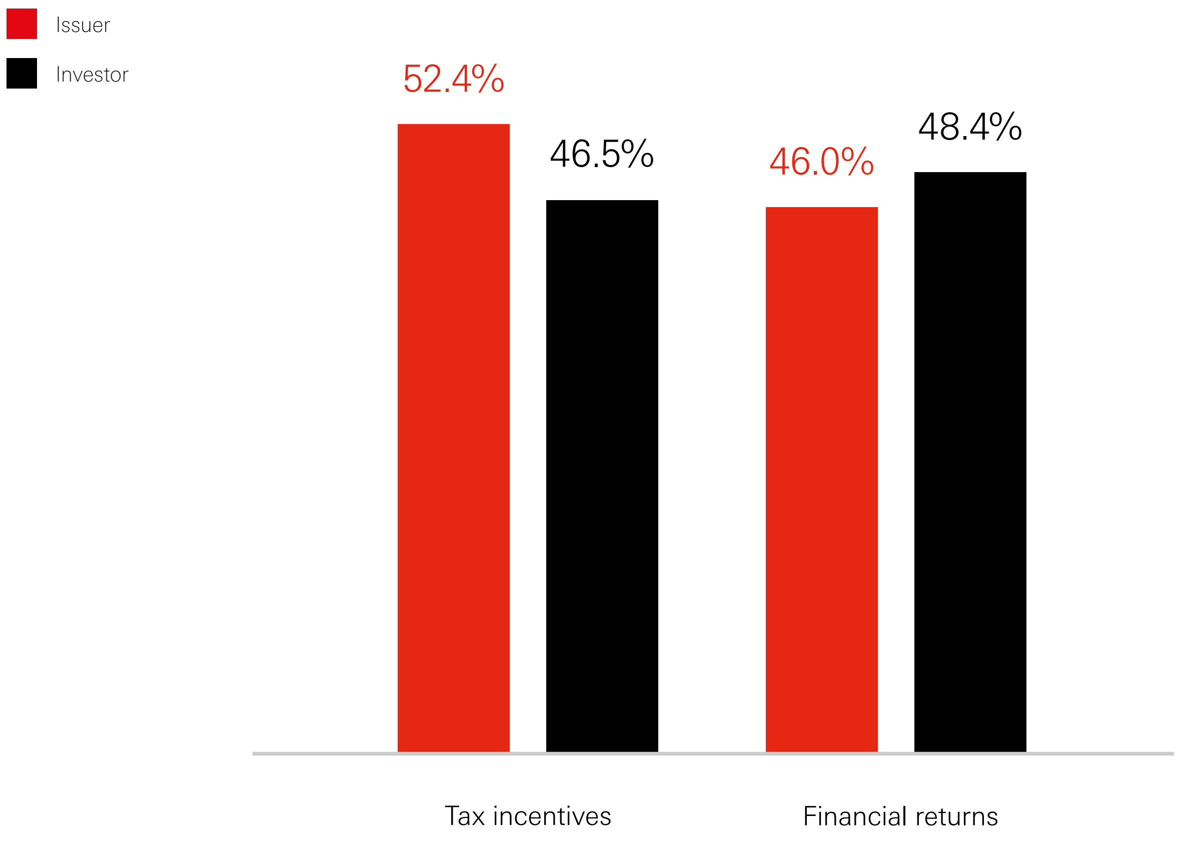
Decisions are increasingly financially driven, proving that the market is sustainable.

Globally, financial returns and tax incentives are the top two drivers of ESG decision making across all issuers and the majority of the investors (pension fund and sovereign wealth fund investors state regulation as their number two driver behind financial returns).

Company policy/strategy/ESG goals also rate highly among issuers, whereas regulation remains a key driver for asset managers.

In the context of increasing awareness and responsibility among shareholders and stakeholders it is important to note that pressure from these groups remains vitally important to the sustainability of the ESG market, although this has been tempered somewhat since the last round of research where they were the number one driver of increased ESG financing.

Key Drivers of ESG Decision Making



Disclosure still has a long way to go

Disclosure of ESG strategy and policy is very much an ongoing ‘work in progress’. Globally, 52.4% of issuers and 38.6% of investors do not have an ESG Strategy.

Among issuers, Europe, the UK and Canada buck this trend, particularly among those with turnover exceeding USD$10bn in Europe and the UK, where less than 10% don’t have one with the majority, 65.1% in the UK, disclosing it.

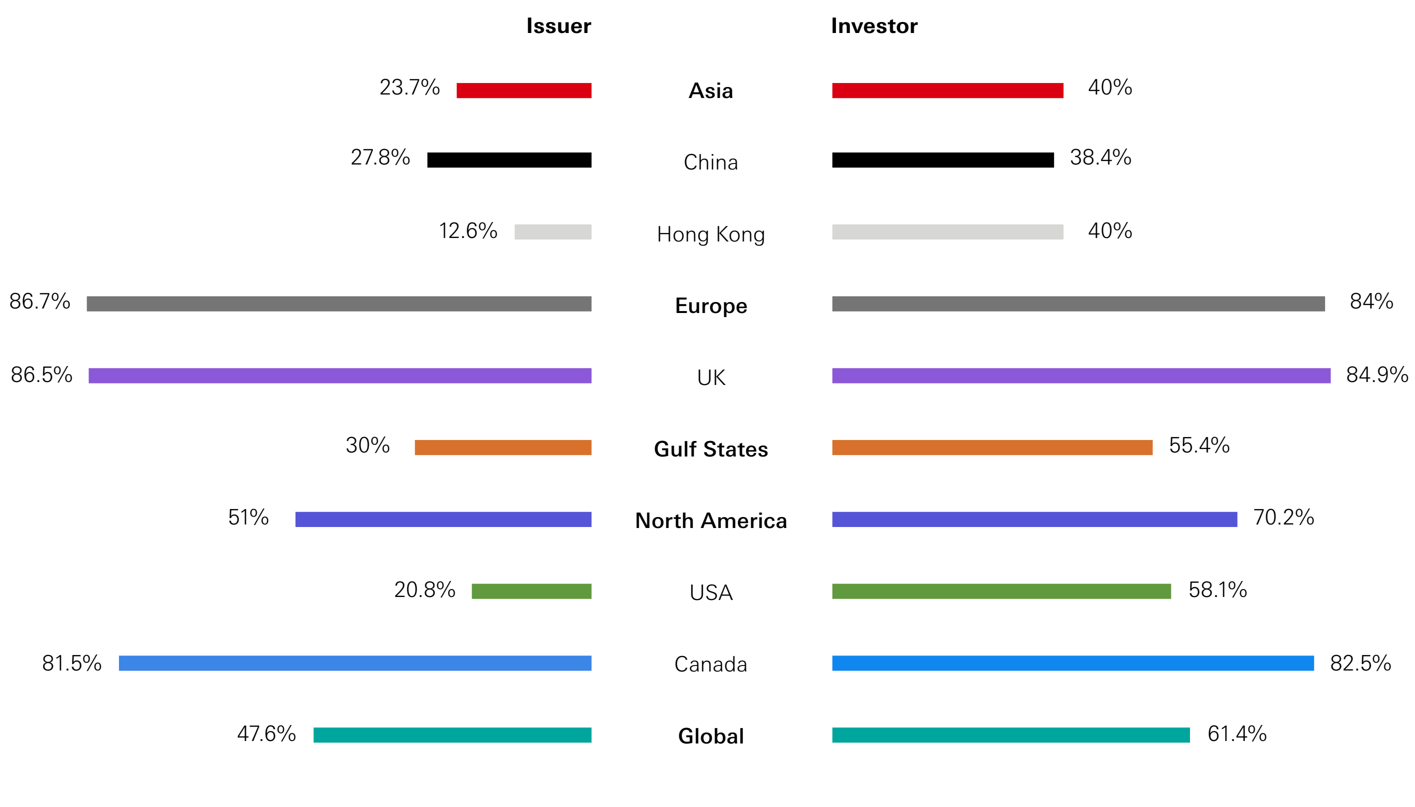
Investors are slightly further advanced with regards to disclosure of their ESG strategy, with 61.4% stating they have one and over 40% of those actively disclosing it. Asian Asset Managers are the exception among investors with almost 70% stating they do not have one in place.

Regulation, financial returns and stakeholder pressure/risk of negative publicity will be key to ensuring the industry continues to work towards full disclosure and transparency.

In terms of ESG Policy, we see a less transparent approach with 68.8% of issuers and 66.7% of investors not disclosing their policies.

There are exceptions led by Europe, pension funds and sovereign wealth funds in the UK and the Gulf States but even in these markets there is a high level of overall non-disclosure.

Do you have an ESG Strategy?



% of issuers & investors who have an ESG Strategy

Key reporting insights

Who’s involved?

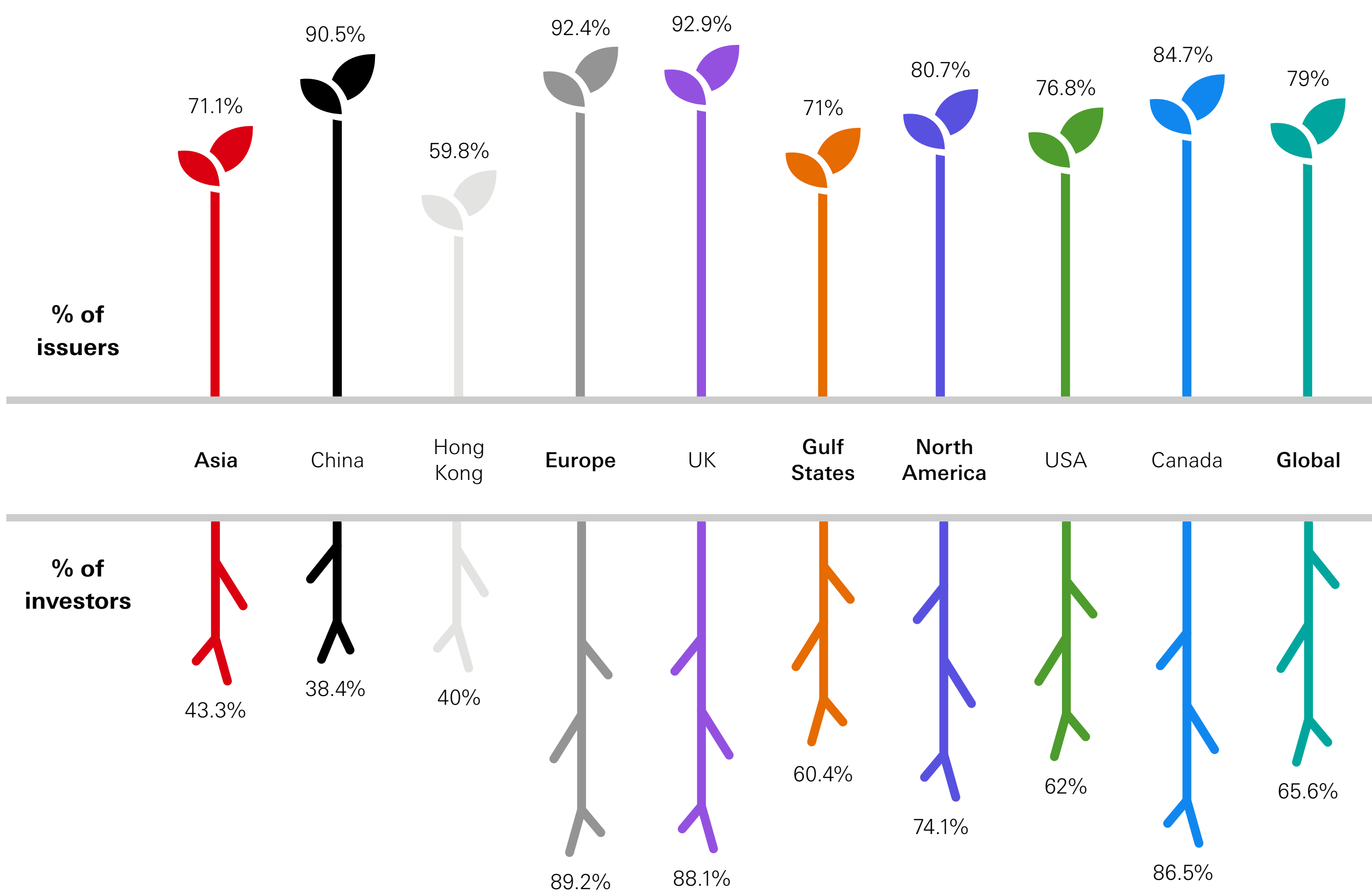
Globally, ESG financial instrument penetration among issuers is 79%. The data shows significant variance across regions, with Asia reporting 71.1% penetration and Hong Kong 59.8%. Conversely, Europe leads the way with 92.4 penetration and the UK with 92.9%.

On the investor side of the fence, 65.6% are involved in ESG investing. Again, Asia has the lowest level of penetration at 43.3% with just 38.4% of Chinese investors reporting ESG investments.

The report shows a much higher proportion of issuers involved in the ESG instruments – for example in China 90.5% of issuers are using ESG financing compared to 38.4% of investors who have ESG investments. This gap is narrowest in Europe where 92.4% of issuers have ESG financing with 89.2% of investors similarly involved.

This trend is only reversed in Canada, where slightly more investors, 86.5%, have ESG investments compared to the 84.7% of issuers who are involved with ESG financing.

Penetration of ESG Financing and Investing



ESG decision drivers

Globally, among those involved in the ESG market, Financial Returns and Tax Incentives are the top two drivers of ESG decision making, with 66.3% of issuers stating tax incentives as the number one driver, and 73.8% of investors noting financial returns.

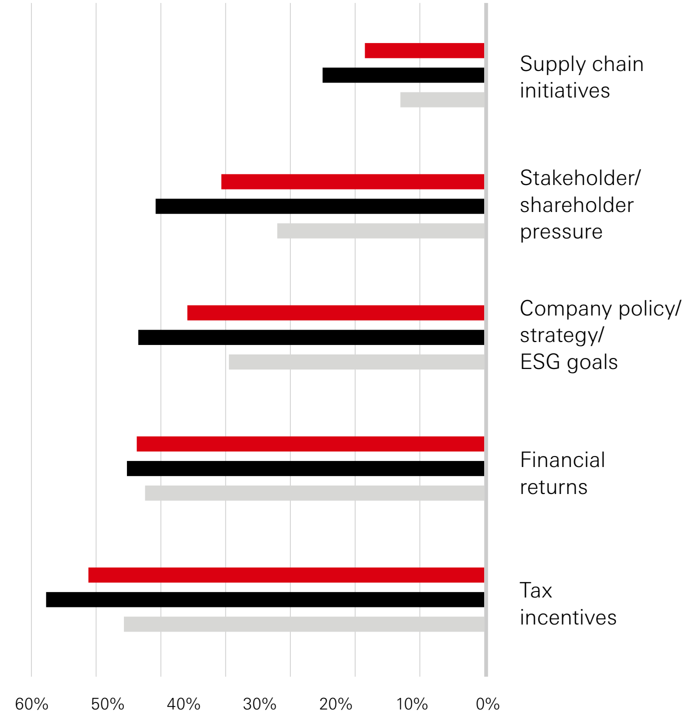
There are some interesting, market-specific differences though, as issuers with turnover exceeding USD$10Bn in China and Hong Kong list supply chain initiatives as their number two driver for ESG financing.

Issuers in Europe, the UK and Canada also put company policy, strategy, ESG goals and stakeholder pressure at the top of their list, which reflects the fact that these markets are leading the charge on ESG related issues.

Regulation must also be noted as a strong driver, as the issues it can overcome, such as consistent ESG definitions and disclosure, are linked to the barriers issuers and investors are facing when looking to increase their presence in the ESG space.

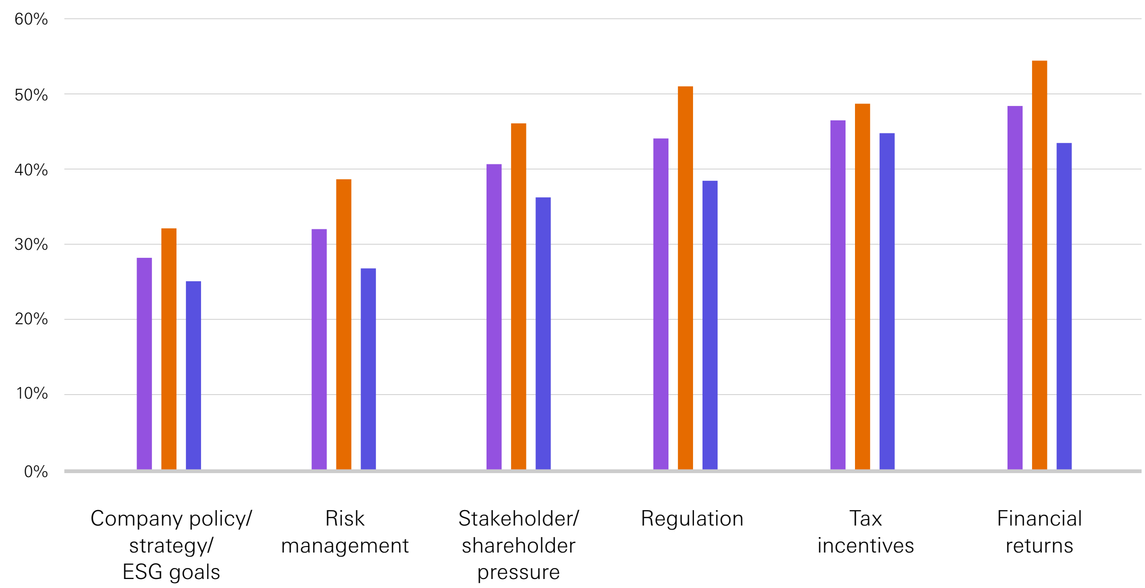
Driver of ESG decision making – issuers

Total USD$10bn Plus T/O Up to USD$10bn T/O



Driver of ESG decision making – investors

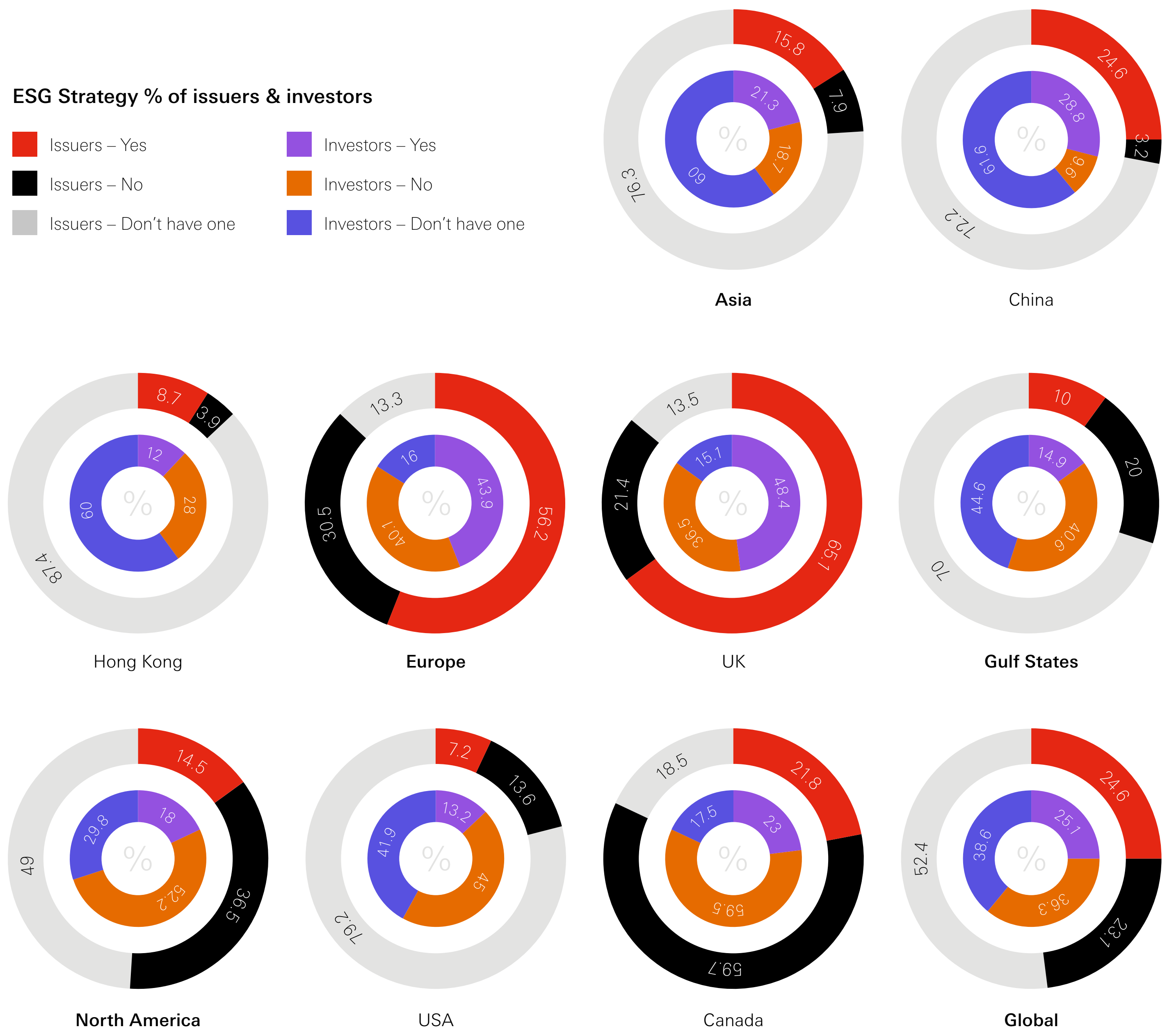
Total Pensions & Sovereigns Asset Managers



Disclosure

Globally, 47.6% of issuers and 61.4% of investors have an ESG strategy. Among issuers, this indifferent view is led by Asia, the Gulf States and the US, with Asia again proving most agnostic among investors.

The highest levels of ESG strategy being incorporated into overall company strategy is claimed by Europe, particularly in the UK, which also report both the highest level of issuers and investors actually disclosing their ESG strategy to the market.



The role of international regulation

International regulation is the number one driver to increase levels of disclosure globally. Stakeholder pressure, predominantly on the issuer side, tied in with reputation/risk of negative publicity, which is higher on the investor side, shows that the ESG market is still very much in its infancy while the market seeks to clearly define itself. However, the focus being placed on financial returns as a driver of increased disclosure makes it clear that pressure is also being applied to the commercial reality of the global marketplace.

For issuers, the relative importance of these drivers has changed since 2017, where 83.2% of issuers said investor pressure was the number one driver, followed by regulation and risk of negative publicity. This shift indicates that the market has responded over the past year through improved investor engagement and is now looking increasingly to regulation to clarify and define the future.

When exploring issuer disclosure further, insight can be gained from understanding what industry sectors are experiencing the most pressure.

Globally, more than 95% of the non-bank financial institution and mining and resource sectors see levels of disclosure increasing.

However, when considering the average number of drivers per issuer, it is those in the Media & Telco sector reporting the most pressure with scores of 4.2.

Allocation of funds by issuers

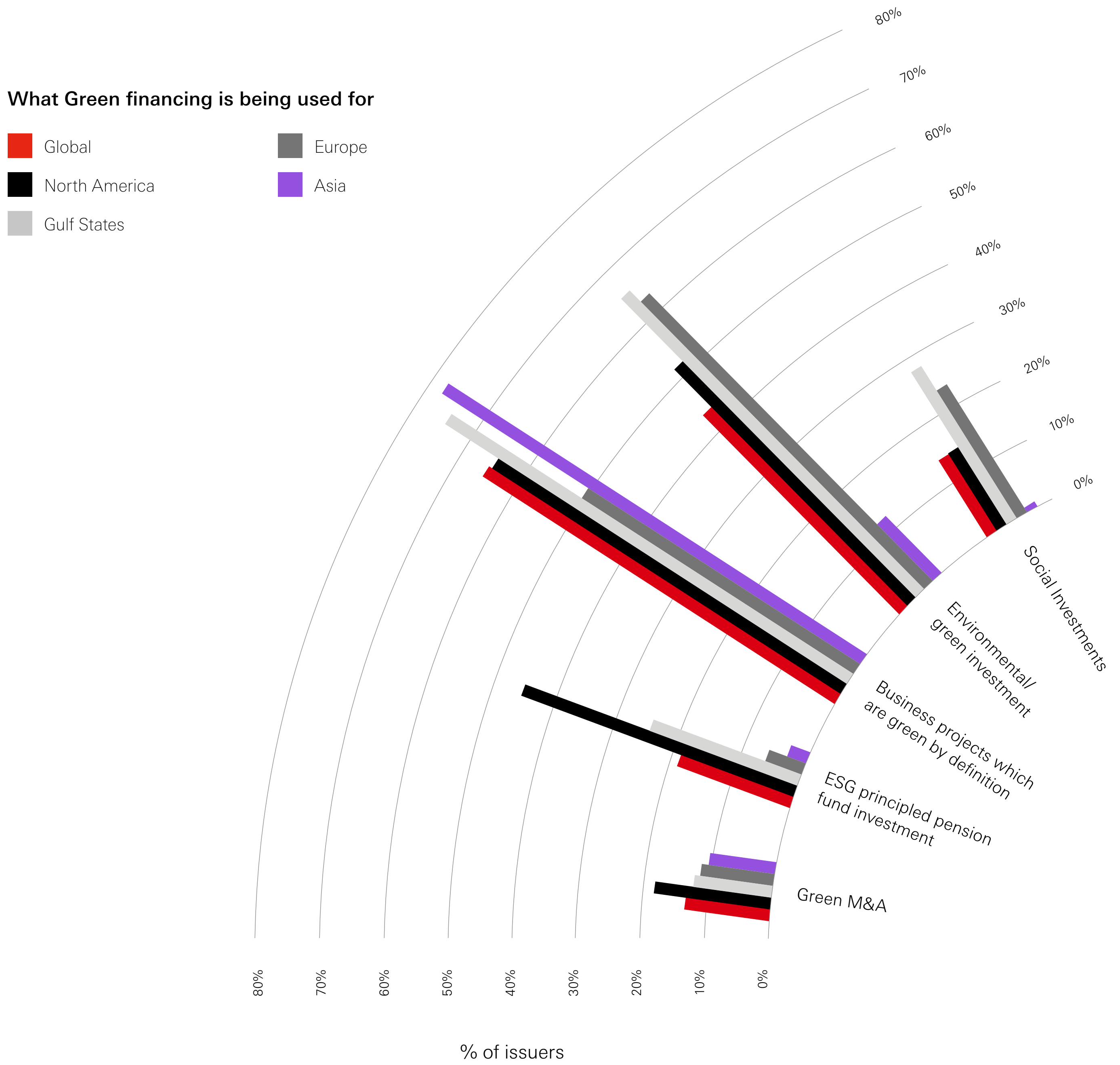
Issuers have been very consistent with respect to where they invest their financing. Globally, 65.5% have invested in "business projects which are green by definition" and 43.5% have chosen impact investing through "environmental/green investments".

However, at a market level there are some significant outliers. In China issuers appear to have bypassed impact investing with 8.8% focusing on green M&A – more than double those reporting an interest in impact investing.

The Gulf States and North America, including both the US and Canada, have a relatively high number of issuers allocating their financing to 'ESG principled pension fund investments' and this is particularly true in Canada where 57.4% of issuers with turnover exceeding USD$10bn are allocating funds to this asset class.

An interesting evolution can be seen in Europe and the Gulf States where issuers allocating funds to impact investing aimed at social Investments account for 23.2% and 28.2% respectively. It is also important to note that the proportion of issuers with turnover exceeding USD$10bn allocating fund to this asset class is 30% higher than those with turnover less than USD$10bn.

What Green financing is being used for



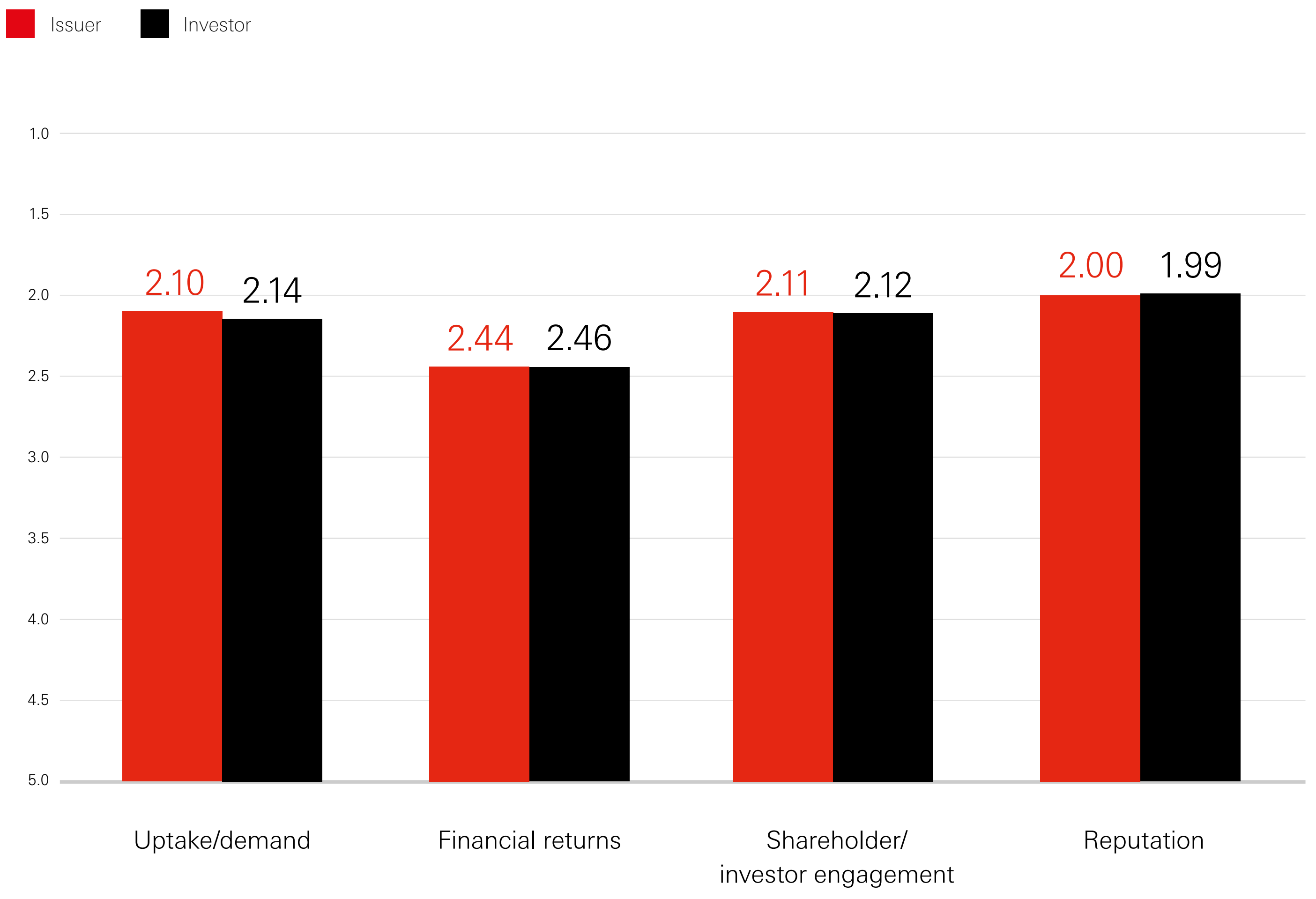
Performance compared to traditional products

Both issuers and investors rated their reputational performance as being far better as a result of their ESG commitments.

Based on a 1 to 5 scale where 1 is better and 5 is worse, issuers rated the reputational performance of their ESG commitments at 2.00 and investors at 1.99. This reputational performance is also seen in the ratings attributed to shareholder/ investor engagement and uptake/demand of products on offer, with the implication that one leads the other.

This can also be linked to the shift seen towards ESG decisions being made on financial outcomes, as performance here is rated least favourably and requires improvement as historical stakeholder pressure has turned to positive engagement. This shift is also seen in drivers of increased disclosure where the relative importance of investor pressure on issuers has declined over the past year.

Relative performance of ESG financing and investing compared to traditional financing and investment instruments



Investment styles by investors

The Global Sustainable Investment Alliance (GSIA) defines seven styles of investment. Three of these styles are being utilised by investors globally:

- Integration of ESG factors: 47.5%
- Negative/exclusionary screening: 42.2%
- Sustainability themed investing: 41.8%

Again, it is the inconsistencies and market specific differences that provide a higher level of insight.

The majority of Asian investors, 67.7%, do not use these GSIA investment styles and this is led by Hong Kong, where over three quarters are not considering these in their investment decisions.

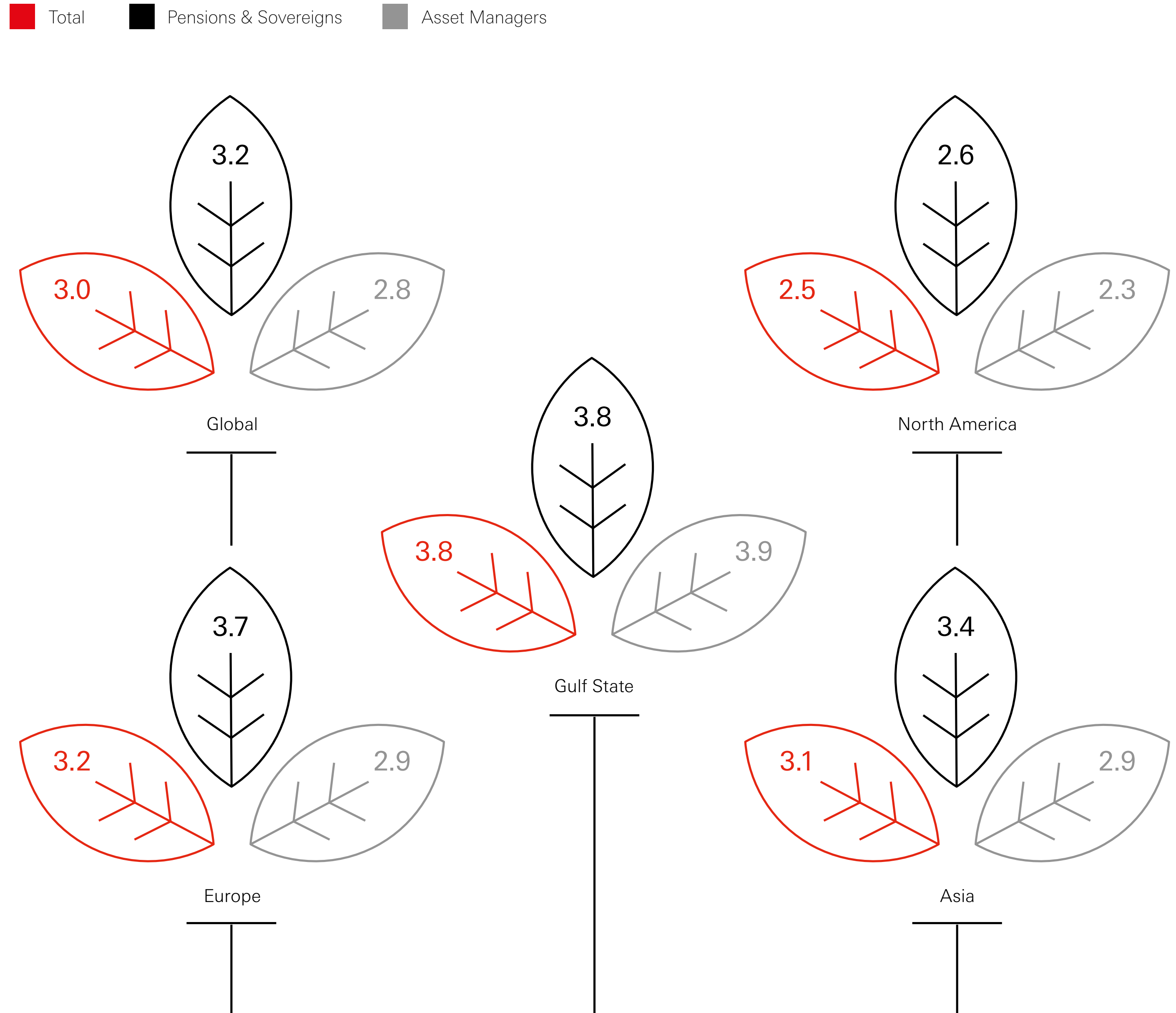
A high proportion of investors in the Gulf States, 41%, are looking at Impact/Community investing, which is especially pertinent considering issuers in the region are allocating a high level of sustainable funds raised to social impact investments.

Investors in Europe and the UK have a higher level of focus on positive/best in class screening and norms-based screening than their international peers.

Corporate engagement and shareholder action is being used by Europe, the UK and Canada's pension funds and sovereign wealth funds.

Globally, investors who use these investment styles apply an average of 3.0 split between Asset Managers who average 2.8 and pension funds, and sovereign wealth funds who average 3.2. Regionally and by market this ranges from US Asset Managers using an average of 1.9, and Hong Kong pension funds and sovereign wealth funds who use an average of 4.4.

Average number of investment styles per investor

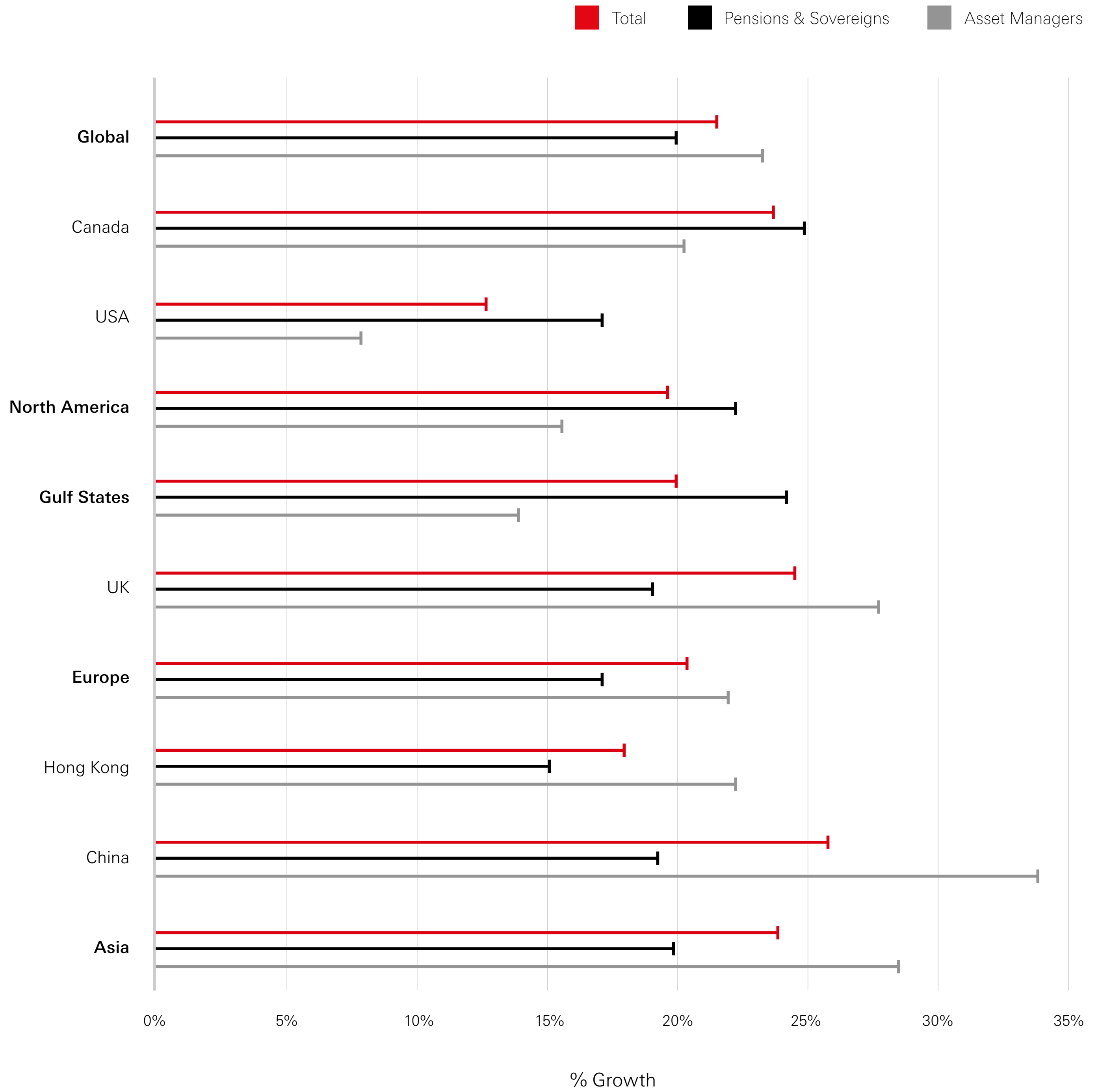


Structure of ESG investments

The proportion of ESG investments structured in a ring fenced/dedicated manner is currently low, 9.8% globally, and is led by pension funds and sovereign wealth funds across all regions and markets. Encouragingly, this is forecast to increase more than 20% globally with US Asset Managers the only segment forecasting single digit growth in the coming 12 months.

This increased transparency is crucial for an investor market that has experienced its share of cynicism. With over 40% of investors stating stakeholder pressure as a driver of ESG decision making, and almost 62% stating the avoidance of the risk of negative publicity as a driver to increase disclosure, it's not surprising that this trend towards dedicated funds is growing rapidly.

Growth of Ring fenced/dedicated ESG investment structures



Barriers to financing and investing

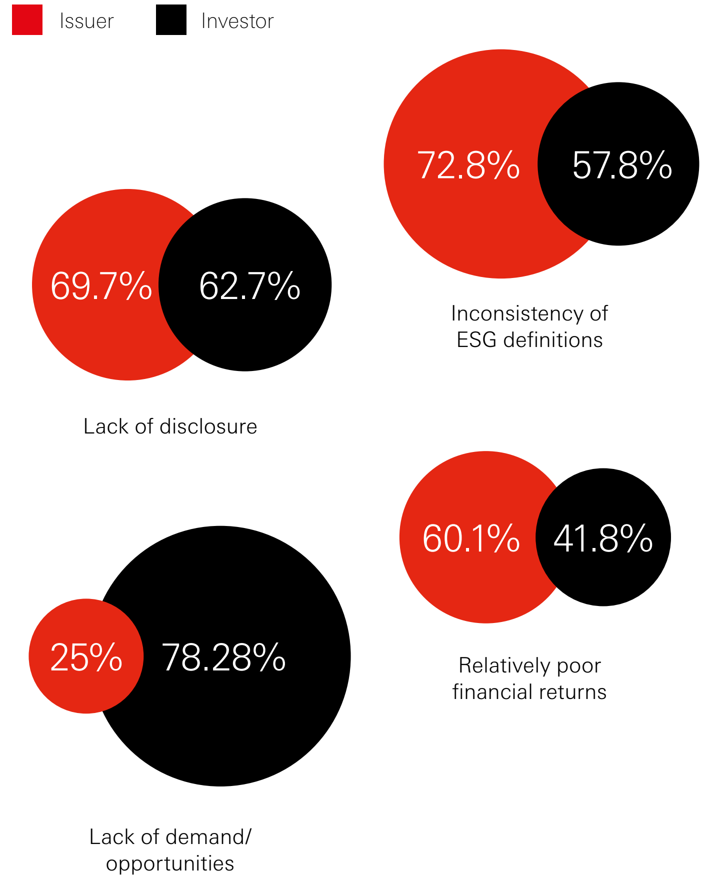
A further positive for the market is seen with 66.6% of issuers and 57.1% of investors respectively stating there are no barriers to increasing their ESG commitments.

However, of those that do see barriers, inconsistency of ESG definitions is an issue for all parties, and at 72.8% this is the number one barrier for issuers and highest for both issuers and investors across the UK.

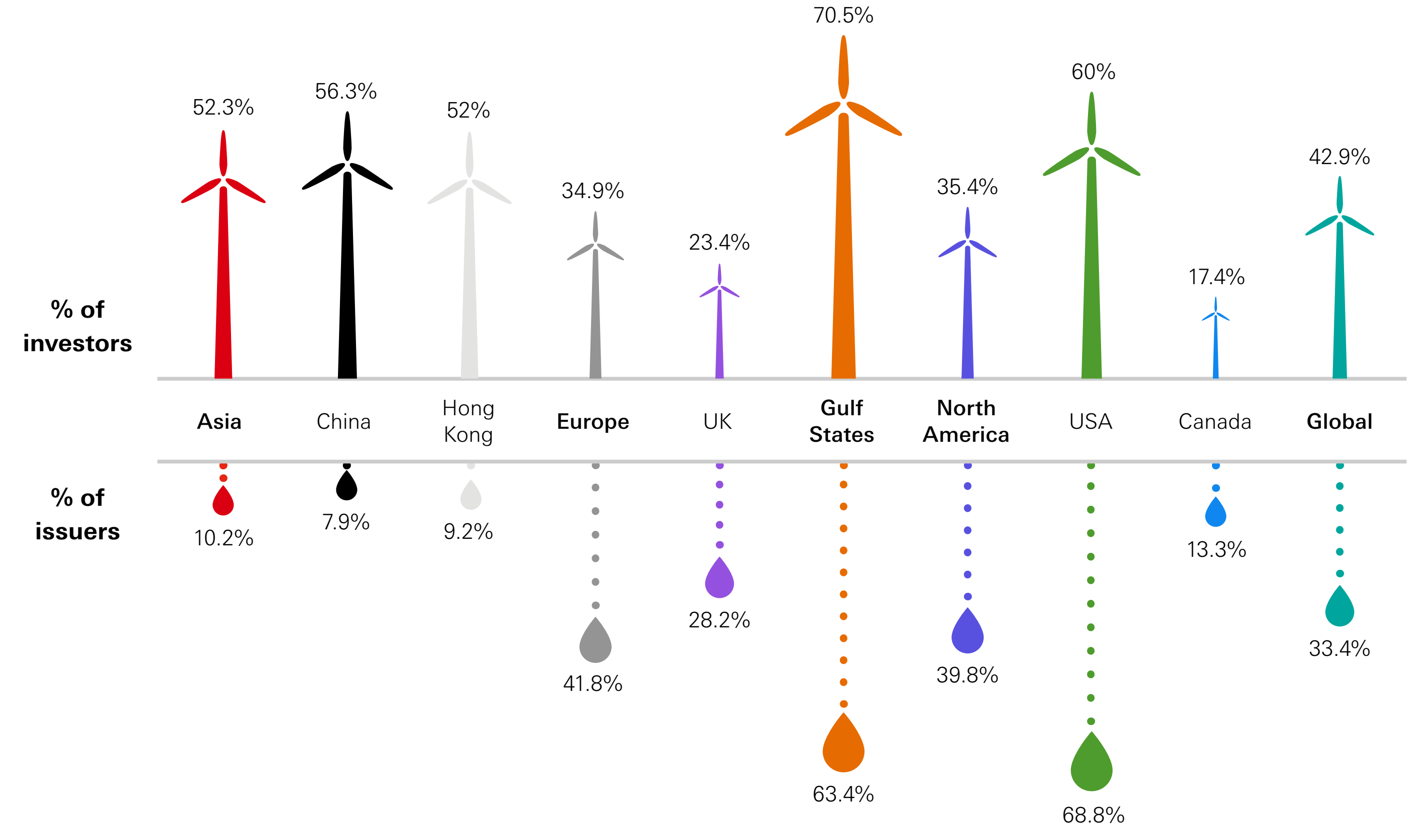
The data also shows some clear gaps between issuer and investor perspectives. On one hand, 70 percent of issuers globally, led by Europe and the UK, are stating disclosure requirements are too onerous but lack of disclosure is a consistently high barrier across the investor market, with over 62 percent noting it as a barrier.

If we take the investor perspective, a lack of investment opportunities, exacerbated by low ESG data quality, both of which are consistent with previous years, appears to be contradicted to a degree by the lack of investor demand shown in some issuers' markets. This is best highlighted by the US where over 88% of investors see a lack of opportunity and, conversely, almost 29% of issuers see a lack of demand. How this gap is bridged will be important, as a perceived lack of opportunity is really the cumulative result of all reported 'barriers'.

Key Barriers to increasing ESG financing/investment



Who sees barriers to increased financing/investment



Key headlines

Who's involved?

- Over 50% of issuers and investors engaged with ESG financing and investing with the exception of Asian investors.

ESG Decision drivers

- Decisions are increasingly being based on commercial returns indicating a developing maturity within the market.

Disclosure

- Large regional variances among those who have an ESG strategy with Europe continuing to lead the way.
- Regulation seen as the key driver to improve this.

Allocation of funds by issuers

- Green business projects followed by green impact investments lead the use of funds.
- North America also highly focused on ESG principled pension funds.

Performance compared to traditional products

- Improved reputation and the subsequent impact this has on shareholder/investor engagement highlights the importance of being involved in the ESG market.

Investment styles by investors

- Clear consistency in investment styles being used globally.
- Concern in the high proportion of investors not ascribing to these industry standards, which further highlights the importance of regulation and clear ESG definitions.

Structure of ESG investments

- Increasing transparency through dedicated investment structures shows investors listening to stakeholder demand.

Barriers to financing/investing

- Barriers aligned between issuers and investors with the exception of investment opportunities.
- Asian issuers and investors disconnected with regard to the proportion who see barriers existing.

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