HSBC Net Zero Aligned Finance

Approach Update

December 2021

1. Introduction

HSBC announced its ambition to become a net zero bank in October 2020, including an aim to align its financed emissions to net zero by 2050 or sooner.

Following this, the Board presented a special resolution on climate change that was approved by shareholders at HSBC's Annual General Meeting in May 2021. The resolution commits HSBC to set, disclose and implement a strategy with short and medium term targets to align its provision of finance[1] with the goals and timelines of the Paris Agreement[2]. In delivering this approach across all sectors, HSBC will start with Oil & Gas and Power & Utilities ("Power") and use science-based pathways that are aligned with the 1.5°C global warming target and the goals and timelines of the Paris Agreement. HSBC indicated that it would provide further detail on its approach by the end of 2021, including the methodology, scenarios, treatment of negative emissions and core assumptions used.

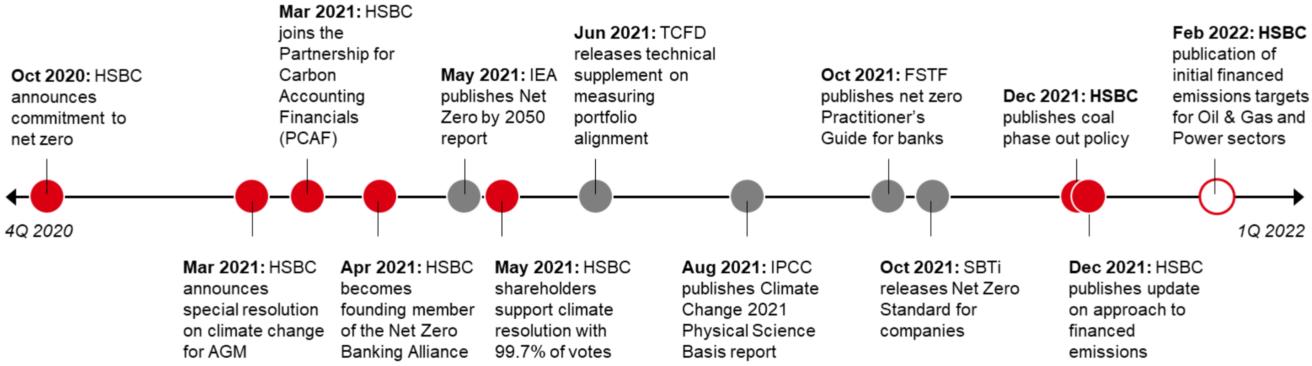
This document provides further details on HSBC's approach to assessing financed emissions and setting targets. It identifies initial areas of focus where HSBC believes engagement and climate action have the greatest potential to effect change. The document also acknowledges the need for further development of industry standards, methodologies, data and tools to measure financed emissions, and HSBC's commitment to supporting these developments.

HSBC intends to publish its baseline financed emissions and initial targets for the Oil & Gas and Power sectors in its 2021 Annual Report and Accounts and related disclosures ("ARA") to be released in February 2022, along with additional information on the methodology applied.

2. Approach and industry engagement

In developing its approach, HSBC has sought to apply industry practice and has engaged with industry initiatives working to develop science-based methodologies and tools for measuring financed emissions and alignment to net zero.

Figure 1: Timeline of HSBC announcements and selected industry references



In March 2021, HSBC joined the Partnership for Carbon Accounting Financials ("PCAF"), an industry-led initiative that has developed an open-source global greenhouse gas ("GHG") measurement and reporting standard for financial institutions[3] (the "PCAF Standard").

In April 2021, HSBC was one of 43 founding members of the Net Zero Banking Alliance ("NZBA") which seeks to reinforce, accelerate and support the implementation of decarbonisation strategies, providing an internationally coherent framework and guidelines.[4]

[1] For the purposes of the special resolution on climate change, "finance" and "financing" means providing project finance or direct lending to, or underwriting capital markets transactions for, corporate clients of our Global Banking and Commercial Banking businesses.
[2] As set out by Article 2.1(a) and Article 4.1 of the Paris Agreement: https://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf.
[3] http://carbonaccountingfinancials.com/standard
[4] https://www.unepfi.org/net-zero-banking/

The NZBA is convened by the United Nations Environment Programme Finance Initiative and was co-launched by the Prince of Wales' Sustainable Markets Initiative Financial Services Taskforce ("FSTF"). Through the FSTF, chaired by Noel Quinn, HSBC's Group Chief Executive, HSBC has also engaged with other global financial institutions to develop a Practitioner's Guide that sets out considerations for banks in setting a net zero strategy.[5] This work will be taken forward by the Transition Plan workstream of the Glasgow Financial Alliance for Net Zero ("GFANZ"), of which HSBC is a principal member.

3. Sector coverage and timeline

Using the ten sectors identified by the NZBA as a reference, HSBC has developed a plan to address its finance portfolios in the order and timelines described below.

HSBC intends to provide baseline financed emissions and initial targets for two first priority sectors, (1) Oil & Gas and (2) Power, in its 2021 ARA. These two sectors were specified in the special resolution on climate change that HSBC's Board presented to shareholders in May 2021. HSBC published in December 2021 its policy to phase out the financing of coal-fired power and thermal coal mining[6], and will begin reporting thermal coal related financed emissions and initial targets in 2022.

In addition, HSBC plans to begin reporting in its 2022 ARA the baseline financed emissions and initial targets for five additional sectors: (3) Coal Mining[7]; (4) Aluminium; (5) Cement; (6) Iron & Steel; and (7) Transport (including Automotive, Aviation and Shipping).

HSBC plans to cover the remaining three sectors required by the NZBA in its 2023 ARA at the latest. These are (8) Agriculture; (9) Commercial Real Estate; and (10) Residential Real Estate.

Figure 2: HSBC implementation time by sector

No.	Sectors as defined in NZBA guidelines	Year of initial ARA disclosures
1	Oil & Gas	2021
2	Power	2021
3	Coal Mining	2022
4	Aluminium	2022
5	Cement	2022
6	Iron & Steel	2022
7	Transport: Automotive, Aviation, Shipping	2022
8	Agriculture	2023
9	Commercial Real Estate	2023
10	Residential Real Estate	2023

4. Baseline scope and methodology for first priority sectors

In assessing financed emissions, HSBC is focussing its analysis on those parts of the sector that it believes are most material in terms of GHG emissions, and where HSBC believes engagement and climate action have the greatest potential to effect change. HSBC consulted current industry guidance and practice in determining the scope within each sector and GHG emissions considered for each sector. These references include, among others, the Science Based Targets initiative ("SBTi") and the Paris Agreement Capital Transition Assessment ("PACTA") methodology.

The calculation of HSBC's financed emissions considers the share of clients' GHG emissions that can be attributed to the outstanding amount of loans and investments provided by HSBC. HSBC is following the PCAF Standard in performing these calculations.

[5] https://www.sustainable-markets.org/taskforces/financial-services-taskforce/
[6] HSBC published in December 2021 a policy to phase out the financing of coal-fired power and thermal coal mining by 2030 in EU and OECD markets and by 2040 in other markets, as well as an aim to reduce its thermal coal financing exposure by 50% by 2030 (using its 2020 TCFD as its baseline).
[7] HSBC plans to include thermal coal and metallurgical coal as part of its assessment of Coal Mining.

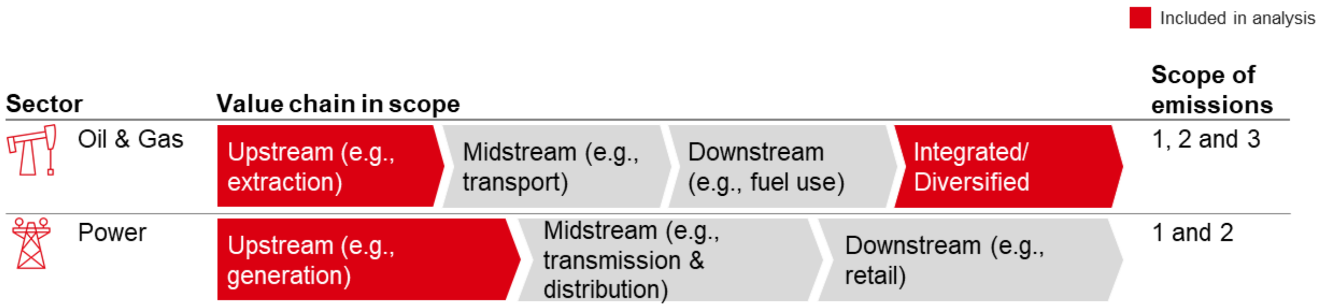
For Oil & Gas, HSBC's analysis will be focused on upstream companies (e.g. extraction) and integrated or diversified energy companies. The assessment of this sector includes scopes 1, 2 and 3 GHG emissions of financed counterparties.

By focussing on upstream and diversified energy producers and including scope 3 GHG emissions, HSBC believes this will account for the majority of emissions across the sector. This includes emissions associated with the ultimate use of oil and gas products as a fuel source. HSBC has excluded midstream and downstream companies within the Oil & Gas sector in order to limit double counting within the sector level analysis and to concentrate engagement with counterparties whose products contribute most to GHG emissions in the global economy.

For Power, the analysis focuses on upstream (e.g. power generation) companies, with scopes 1 and 2 GHG emissions of financed counterparties included in the assessment. HSBC believes power generation is where the majority of sector emissions occur through the use of fossil fuels (oil, gas and coal) as a source of energy. For power generation companies, these are scope 1 GHG emissions. In analysing the Power sector, HSBC does not take account of scope 3 GHG emissions because it believes them to be immaterial. HSBC believes upstream power producers have the most potential to reduce GHG emissions by shifting to renewables and other sources of low-emissions power generation.

HSBC has used internationally recognised sector classification NACE codes[8] to define each sector and sub-sector for the wholesale lending portfolio, and to identify counterparties in scope for its analysis. For capital markets activities, HSBC used NAICS[9] industry classifications. Both NACE and NAICS are considered acceptable sector taxonomies by the NZBA. The use of different classification taxonomies is based on availability of data to perform the analysis.

Figure 3: Scope of sectors and emissions



In terms of the scope of financing considered, HSBC intends to include on-balance sheet financing and capital markets underwriting in its analysis, described further below. For on-balance sheet activities, HSBC plans to use drawn balances as of 31 December 2019 related to business loans, project financing, and trade and receivables finance.

For capital markets activities, HSBC plans to use the apportioned value of underwriting for debt, equity and syndicated loan issuances in 2019 and apply the same methodology as for on-balance sheet financing to attribute counterparties' emissions to these capital raising activities. HSBC plans to report these separately as 'facilitated emissions'. Consistent with industry practices, HSBC plans to disclose emissions metrics related to capital markets financing using its own methodology, while supporting the development of an industry standard. HSBC endorses the view that facilitated emissions should be measured and reported as a separate metric for transparency given the potential for double counting between originating banks and investors.[10] HSBC intends to refresh its facilitated emissions baseline and set interim targets in line with industry adopted methodologies, as these become available.[11]

HSBC intends to perform this baseline analysis using data for the year ended 31 December 2019, having taken into consideration potential distortions caused by the Covid-19 pandemic during 2020. HSBC plans to annually

[8] NACE (Nomenclature of Economic Activities) is the European statistical classification of economic activities. NACE groups organisations according to their business activities.

[9] NAICS (North American Industry Classification System) is the standard used by Federal statistical agencies in classifying business establishments for the purpose of collecting, analysing, and publishing statistical data related to the U.S. business economy.

[10] https://a.storyblok.com/f/109506/x/a2be4f2b85/20211015_practitioners-guide-vfinal.pdf; see pages 17-19 for further details on recommended industry practices.

[11] https://carbonaccountingfinancials.com/files/consultation-2021/pcaf-capital-market-instruments-paper.pdf. Feedback from the discussion paper will be developed into official guidance.

measure and report current financed emissions in its ARA. The baseline may be updated in line with any revisions made to data or methodology over time. Baseline years used for target setting may differ, though are not expected to be more than two full reporting years prior to the setting of the target for sectors not included in the 2021 ARA.

5. Reference scenario

HSBC plans to use the IEA Net-Zero Emissions by 2050 ("NZE") scenario as a reference pathway to assess its financed emissions and to inform the targets it sets to align the provision of finance at a sector portfolio level globally to science-based pathways that are aligned with the 1.5°C global warming target and the goals and timelines of the Paris Agreement.

The NZE scenario "aims to ensure that energy-related and industrial process CO2 emissions to 2030 are in line with reductions in 1.5°C scenarios with no or low or limited temperature overshoot assessed by the Intergovernmental Panel on Climate Change (IPCC) in its Special Report on Global Warming of 1.5°C".[12]

HSBC reviewed the NZE scenario against other available 1.5°C scenarios and believes it provides the greatest level of detail across relevant sectors. However, for certain sectors further detail may be needed for which HSBC may need to incorporate additional references.[13]

The NZE scenario is endorsed by GFANZ and the NZBA in their target setting guidance. The NZBA recommends the use of reference scenarios with "no-overshoot" or "low-overshoot", that rely conservatively on negative emissions technologies and have reasonable assumptions on carbon sequestration achieved through nature-based solutions and land use change. Key assumptions underpinning the NZE scenario are publicly available.

6. Targets and metrics

HSBC plans to publish initial targets for 2030, and in five year increments thereafter, in accordance with NZBA Guidelines. HSBC intends to report progress on its net zero aligned finance strategy on an annual basis, starting with the 2021 ARA which is to be published in February 2022. HSBC intends to review its baseline and targets annually to help ensure that they are aligned with market practice and current climate science.

HSBC plans to use an absolute emissions metric for setting the Oil & Gas sector target, and an emissions intensity metric for the Power sector. The decision to use an emissions intensity metric for the Power sector accounts for the anticipated increase in electricity demand over the decade to 2030 given the critical role of electrification in the net zero transition, and the need to rapidly grow the proportion of renewable energy in electricity generation.

As part of the annual refresh of its financed emissions analysis, HSBC will consider the merits of providing a combined energy system target (e.g. Oil, Gas & Power) rather than individual sector targets. As more clients transition and diversify their business into low carbon activities (either becoming integrated companies or dedicated low carbon companies) HSBC believes a broader energy system classification may become more appropriate to track decarbonisation performance.

HSBC's approach to aligning financed emissions to science-based pathways that are aligned with the 1.5°C global warming target and the goals and timelines of the Paris Agreement does not rely on purchasing offsets to achieve its targets. This is consistent with guidance recently published by the SBTi in its Net Zero Standard.[14]

7. Managing methodology and data limitations

HSBC relies on a number of internal and external data sources to calculate finance emissions using guidance provided in the PCAF Standard. HSBC intends to publish the PCAF defined data quality score for its analysis of the Oil & Gas and Power portfolios in its 2021 ARA.

While HSBC is currently using the PCAF Standard for attribution, methodologies may develop over time and may be subject to change in line with market practice and regulation. Any such developments could result in revisions in the reported figures going forward, and such figures may not be reconcilable or comparable year-on-year.

While GHG emission reporting has improved over time, data remains of limited quality and consistency. Availability of reported data and changes in data quality over time could lead to differences year-on-year in the data reported in future years as compared to prior years.

[12] IEA 'Net Zero by 2050" report; see pages 48-49 of the report for further detail on NZE scenario design.
[13] For example, the IEA NZE scenario does not currently provide detail on decarbonisation pathways for Agriculture and Aluminium.
[14] https://sciencebasedtargets.org/net-zero

Limited detail in reported emissions-related data has required that HSBC calculate financed and facilitated emissions at the consolidated parent level, or the closest equivalent, of each counterparty. Sector classification is also assigned at the consolidated parent level based on the main activities of the relevant group.

HSBC will continue to engage with our customers, market data providers and standard setters to improve the quality and completeness of reported emissions data.

8. Non-banking activities

The NZBA allows for entities within the group structure that carry out other types of business such as insurance, pension funds or asset management to follow alternative frameworks.[15] Currently, HSBC Asset Management and HSBC Bank (UK) Pension Scheme plan to follow an industry approach and may report separately. Financed emissions for these activities will not be incorporated into the financed emissions calculation and reporting related to HSBC's financing portfolios.

HSBC Asset Management joined the Net Zero Asset Managers Initiative ("NZAMI") in July 2021. HSBC Asset Management will seek to follow industry practice to assess the financed emissions of asset management products it provides to clients and plans to set interim targets for these activities in its 2022 disclosures.

HSBC Bank (UK) Pension Scheme, one of the largest corporate pension schemes in the UK, announced its ambition to achieve net zero by 2050 or sooner and target real economy emissions reduction of 50% by 2030 or sooner for its equity and corporate bond portfolios.[16]

9. Forward-looking considerations

HSBC will continue to seek to engage in the development of industry standards to help shape methodologies and tools to measure financed emissions and assess alignment to science-based pathways that are aligned with the 1.5°C global warming target and the goals and timelines of the Paris Agreement.

As HSBC builds its target setting and portfolio alignment capabilities, it will continue to engage with peers, clients, regulators and industry bodies to help improve both data availability and consistency.

HSBC plans to annually measure and report its financed and facilitated emissions profile, for the sectors covered, in line with industry standards and emerging best practices to help enable comparability and transparency for external stakeholders.

HSBC expects to publish a technical supplement providing further detail on the methodological choices for baselining and target setting for the Oil & Gas and Power sectors alongside its ARA in February 2022 to support greater transparency and comparability of results.

Metrics reported will be used to draw out science-based insights that seek to focus engagement efforts, inform capital allocation and enable the development of solutions for timely, climate-positive action.

[15] UNEPFI 'Guidelines for Climate Target Setting for Banks', page 6.
[16] https://www.about.hsbc.co.uk/news-and-media/hsbc-bank-uk-pension-scheme-sets-out-plans-to-achieve-net-zero-by-2050-or-sooner

Cautionary statement

This communication contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. Forward-looking statements may be identified by the use of terms such as 'may,' 'intends,' 'aims,' 'ambition,' 'plan,' 'target,' 'will,' 'should,' 'potential,' 'reasonably possible' or 'anticipates' or the negative thereof or similar expressions, or by discussions of strategy. These forward-looking statements include statements relating to becoming a net zero bank and targets and methodologies for measuring financed emissions.

Achieving these aims is inherently uncertain and is subject to a number of risks and uncertainties, including the efficacy of government, customer, and HSBC's actions in managing and mitigating climate change; societal shifts in customer financing and investment needs; delays to the pace of change; development and use of new technology; ability to exploit growth or investment opportunities; changes in public expectations and other changes to business conditions; adverse changes in regulatory capital and tax regimes; data quality and the availability and development of methodologies for measuring financed and facilitated emissions; and the other risks, uncertainties and assumptions about HSBC, as described under 'Cautionary statement regarding forward-looking statements' and 'Risk factors' contained in the HSBC Holdings plc Annual Report on Form 20-F for the year ended 31 December 2020, filed with the SEC on 24 February 2021 (the '2020 Form 20-F'), and in other reports on Form 6-K furnished to or filed with the SEC subsequent to the 2020 Form 20-F ('Subsequent Form 6-Ks'). HSBC Holdings plc undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed herein might not occur. Investors are cautioned not to place undue reliance on any forward-looking statements, which speak only as of their dates. Additional information, including information on factors which may affect the HSBC Group's business, is contained in the 2020 Form 20-F and Subsequent Form 6-Ks.