June | 2022

How investors can best help HSBC act on its March 2022 climate commitments

ShareAction»

About ShareAction

ShareAction is a NGO working globally to define the highest standards for responsible investment and drive change until these standards are adopted worldwide. We mobilise investors to take action to improve labour standards, tackle climate change and address pressing global health issues. Over 15 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. Our vision is a world where the financial system serves our planet and its people.

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Authors

Jeanne Martin, Lydia Marsden, Xavier Lerin

Contact

Jeanne Martin
Senior Campaign Manager
jeanne.martin@shareaction.org

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Following constructive investor engagement in 2021 and 2022, HSBC has announced further commitments to deliver on its net-zero by 2050 ambition. This includes the publication of a Climate Transition Plan in 2023, and more ambitious decarbonisation targets and policies in 2022 to underpin its new pledge to phase down fossil fuel finance in alignment with 1.5C.[i]

This briefing outlines recommendations for further engagement with HSBC to ensure these pledges are credible and delivered on time. Some of these recommendations have already been made publicly by ShareAction and investors in a March 2022 letter to HSBC's CEO and Chair of the Board.[ii] We explore these and more in detail in this briefing, focusing on critical aspects of HSBC's transition plan: net-zero targets and fossil fuel policies (oil & gas and thermal coal). HSBC's commitments and our recommendations for engagement are summarised on page 9 (net-zero targets) and page 15 (oil & gas policy) and page 24 (coal policy).

We call on HSBC investors committed to net-zero to discuss these issues with the bank in the next few months to help the bank turn its ambition into concrete action. HSBC currently lags peers on various aspects of its net-zero strategy, but it can rapidly build on the climate framework it has developed in collaboration with investors to increase resilience to climate-related risks and demonstrate leading practice in the banking sector.

ShareAction's history of engagement with HSBC

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In December 2020, ShareAction, 130+ retail shareholders, and 15 institutional shareholders representing US$2.4 trillion in assets (the 'co-filing group') filed a special resolution at HSBC, calling on the bank to reduce its exposure to fossil fuel assets, starting with coal, in line with the goals of the Paris agreement. This followed an extensive history of engagement with HSBC on coal and other climate-related issues, including private meetings with and presentations to HSBC's sustainability and senior management team, yearly AGM questions, and an investor-backed letter asking the bank to strengthen its coal policy.

Following constructive engagement with the co-filing group, the bank committed to **phase out from coal by 2030 in OECD countries and by 2040 in non-OECD countries, and to publish a new coal policy by the end of 2021**, amongst other things. The co-filing group thus decided to withdraw their resolution to recognise the bank's progress. The group outlined its expectations for HSBC's coal policy in a letter to the bank's CEO and Chair of the board and in private engagements with the bank. The letter noted that the group would take further action in 2022 if it was unsatisfied with HSBC's progress. HSBC's commitments took the form of a special resolution, which passed with 99 per cent of the vote at its 2021 AGM. After an extensive period of consultation and engagement between HSBC and the co-filing group, the bank published its new coal policy in December 2021. ShareAction analysed the policy in-depth, highlighting that it failed to meet the red lines previously set out by investors.

As a result, ShareAction, alongside 11 institutional investors and 100+ retail shareholders, filed a second resolution in December 2021 calling on the bank to close its fossil fuel policy loopholes. This resolution was withdrawn following new pledges made by HSBC in March 2022. Following negotiations with ShareAction and the co-filing group, **the bank agreed to phase down financing of fossil fuels in line with limiting global temperature rise to 1.5C**, as well as to update the scope of its oil, gas, and thermal coal policies by the end of 2022, among other things. In a letter sent to HSBC's CEO, Noel Quinn, and Chair of the Board, Mark Tucker, on Tuesday 15th March, the investor group set out its expectations for the bank to act on going forward.

Net-zero targets: becoming a leader in 2022

Net-zero targets: becoming a leader in 2022

HSBC's commitments

- HSBC has set 2030 decarbonisation targets for the oil & gas and power & utilities portfolios, covering on-balance sheet activities.
- HSBC expects to set targets covering capital markets activities for these portfolios in Q4 2022, once the PCAF standard on capital markets instruments is published.

Engagement recommendations

- HSBC should publish financed emissions targets covering capital markets facilitation as soon as possible, preferably before its 2023 AGM.
- HSBC should consider setting targets and/or reporting financed emissions using the committed amount for loans for transparency and in line with leading practice.

HSBC's sectoral targets tick many boxes on the net-zero checklist...

In February 2022, HSBC released targets for its oil & gas and power & utilities portfolios together with its 2021 annual report and ESG review. In line with leading practice,[iii] the benchmarks for both targets are based on the IEA Net Zero Emissions (NZE) scenario. Also aligned with leading practice is the emissions metric used for the oil & gas portfolio – the target is based on absolute emissions and covers the most material greenhouse gases for this sector (CO2 and CH4) across scopes 1, 2, and 3. And while the target for power is based on emissions intensity, we don't see this metric as unsuitable for this particular sector provided that banks also report on progress in absolute terms – something HSBC is doing – and that targets are complemented with robust fossil fuel policies – an area where HSBC has made some important progress[iv] but has significant room for improvement (see section 4).

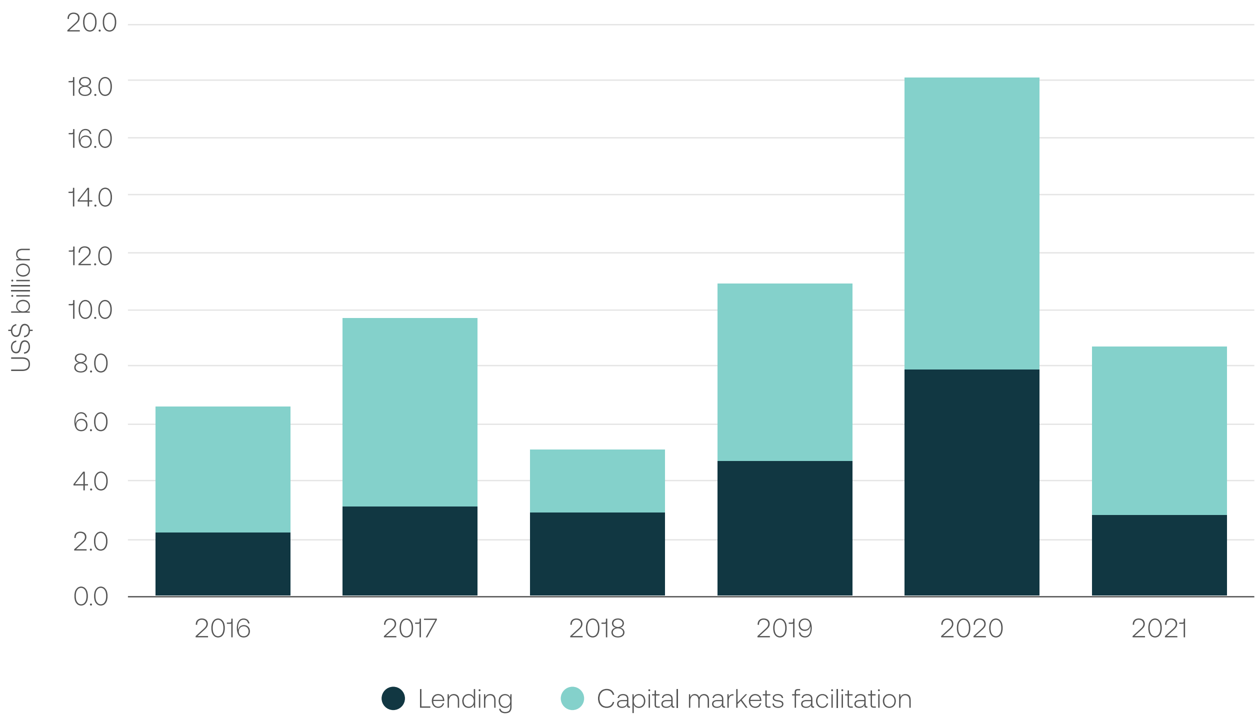
These important steps are the result of robust engagement by investors, including the climate resolution coordinated by ShareAction in 2021, and the bank's willingness to listen and engage constructively.

…but they omit capital markets activities, a significant portion of the bank's financial support to carbon-intensive sectors

HSBC has also started reporting "facilitated emissions" – financed emissions from capital markets facilitation – together with financed emissions from on-balance sheet activities. These additional disclosures are welcome, and the bank is ahead of many peers in this area. However, it has refrained from including facilitated emissions in its sectoral targets at this stage. In our view, this was a breach of the spirit of the 2021 climate resolution proposed by the board in response to the shareholder resolution. HSBC committed to implement a strategy with short- and medium-term targets to align its provision of finance – defined as lending or underwriting or capital markets transactions – with the goals and timelines of the Paris Agreement.[v] HSBC has since clarified that it expects to update the scope of its targets by Q4 2022.

At present, HSBC's targets exclude the bulk of its financial support to the fossil fuel sector. Our data shows that 60 per cent of the bank's financing to top oil & gas companies with expansion plans incompatible with 1.5C is in the form of capital markets facilitation (see figure 1).[vi] According to HSBC's own estimates, its facilitated emissions represented over 40 per cent of its 2019 financed emissions (79.8 Mt CO_2e) for the oil & gas and power & utilities sectors.[vii]

Figure 1: Financing provided by HSBC to the top 50 oil & gas companies by upstream expansion plans



Source: ShareAction (2022). Oil & gas expansion A lose-lose bet for banks and their investors.

We fully understand that lending and capital markets facilitation are fundamentally different activities. However, omitting the latter underestimates the bank's impact on climate and climate-related risks for the bank, especially transition risks (e.g. market or reputational risk) in the short to medium term. Given that HSBC already includes capital markets facilitation in its US$750 billion to US$1 trillion of sustainable finance and investment by 2030 target,[viii] it should cover these activities in its decarbonisation targets for the oil & gas and power & utilities sectors.

HSBC should publish financed emissions targets covering capital markets facilitation as soon as possible, preferably before its 2023 AGM

HSBC is not the only bank that has omitted capital markets activities in its first round of sectoral targets. This group of banks usually argue that the methodology is yet to be defined and often aim to expand scope once a standard is agreed. This is the case of HSBC, who "expect(s) to publish financed emissions targets to capture capital markets activities […] once the Partnership for Carbon Accounting Financials (PCAF) accounting standard for capital markets is published." HSBC expects the methodology to be published "later in 2022"[1]. Together with a group of investors, we are encouraging HSBC to engage with us during this process and publish these targets ahead of the publication of the final PCAF standard if it is expected to be significantly delayed.

We acknowledge that portfolio modelling is not an easy task and requires a robust methodology, preferably a standardised one. However, we see compelling reasons for banks not to delay this process much further, the most pressing of which is the IPCC's warning that the window to prevent the most catastrophic consequences of climate change is rapidly closing.[ix] Other banks in HSBC's peer group have already included capital markets facilitation in their first round of sectoral targets (see figure 2). We also note that even though PCAF has published a standard for lending activities, many banks are already deviating from it (see discussion below). And while the target setting process has important implications and should be carefully calibrated, we believe adjustments will be almost inevitable as climate science and methodologies evolve. What will be key in our view is communicating transparently on what is driving progress towards the target (changes in the real economy or changes in methodology, enterprise value, M&A activity, etc.).

1 PCAF has already published a discussion paper outlining various approaches to model facilitated emissions.

Figure 2: Sectoral decarbonisation targets set by HSBC and peers

	Sector	Target	Target date	Base year	Scenario	Emissions Metric	Emissions Scope	Lending	Capital markets	Planned targets
HSBC	Oil & Gas	-34%	2030	2019	IEA NZE	Absolute	1,2,3	Drawn amount	Not included	2023: coal mining, aluminium, cement, iron & steel, transport (automotive, aviation and shipping) 2024: agriculture, commercial and residential real estate
HSBC	Power	-75%	2030	2019	IEA NZE	Intensity	1,2	Drawn amount	Not included	
Bank of America	Oil & Gas	-42% / -29%	2030	2019	IEA NZE	Intensity	1,2 / 3	Committed amount	Not included	2024: “other key sectors”
Bank of America	Power	-70%	2030	2019	IEA NZE	Intensity	1			
Bank of America	Automotive	-44%	2030	2019	IEA NZE	Intensity	1,2,3			
Barclays	Oil, Gas, Coal	-15% / -40%	2025 / 2030	2020	IEA SDS / NZE	Absolute	1,2,3	Committed amount	33% pro-rata share	2023: automotive, residential real estate
Barclays	Power	-30% / -69% (1)	2025 / 2030	2020	IEA SDS / NZE	Intensity	1			
Barclays	Cement	-26% (1)	2030	2021	IEA NZE	Intensity	1,2			
Barclays	Steel	-40% (1)	2030	2021	IEA NZE	Intensity	1,2			
BNP Paribas	Oil & Gas (2)	-10%	2025	2020	IEA NZE	Intensity	1,2,3	Committed amount	Not included	2024: “seven other carbon-intensive sectors”
BNP Paribas	Power (2)	-30%	2025	2020	IEA NZE	Intensity	1			
BNP Paribas	Automotive (2)	-25%	2025	2020	IEA NZE	Intensity	3			
Citi	Oil & Gas	-29%	2030	2020	IEA NZE	Absolute	1,2,3	Committed amount	Not included	From 2022: automotive, steel, thermal coal mining, commercial real estate From 2023-2024: aluminium, aviation, cement, agriculture
Citi	Power	-63%	2030	2020	IEA SDS	Intensity	1			
JPMorgan Chase	Oil & Gas	-35% / -15%	2030	2019	IEA SDS	Intensity	1,2 / 3	Committed amount	Pro-rata share	Date TBC: aviation, pulp & paper
JPMorgan Chase	Power	-69%	2030	2019	IEA SDS	Intensity	1			
JPMorgan Chase	Automotive	-41%	2030	2019	IEA B2DS	Intensity	1,2,3			
Standard Chartered	Oil & Gas	-30%	2030	2020	IEA NZE (3)	Intensity	1,2,3	Drawn amount	Not included	2023: aviation, shipping, and road transport 2024: cement, mortgages, aluminium 2025: corporate real estate, agriculture
Standard Chartered	Power	-63%	2030	2020	IEA NZE (3)	Intensity	1,2			
Standard Chartered	Mining (coal)	-85%	2030	2020	IEA NZE (3)	Absolute	1,2,3			
Standard Chartered	Mining (other)	-33%	2030	2020	IEA NZE (3)	Intensity	1,2			
Standard Chartered	Steel	-33%	2030	2020	IEA NZE (3)	Intensity	1,2			
UBS	Oil & Gas	-71%	2030	2020	IEA NZE	Absolute	1,2,3	Committed amount	Not included	Not disclosed
UBS	Power	-49%	2030	2020	IEA NZE	Intensity	1,2,3			
UBS	Residential RE	-42%	2030	2020	IEA NZE	Intensity	1,2			
UBS	Commercial RE	-44%	2030	2020	IEA NZE	Intensity	1,2			

Source: Company disclosures. The peer group is based on banks identified as such by HSBC in its share analytics tool, excluding banks that have not yet set sectoral targets. Barclays and Standard Chartered were added for comparison with major UK and emerging markets players, respectively.

(1) Barclays has defined target ranges for its power, cement, and steel portfolios[x]. The figures in this table only reflect the upper end of that range. The lower end is not based on IEA scenarios.

(2) BNP Paribas has also set “operational KPIs” for the oil & gas, power, and automotive sectors[xi]. This includes an objective to reduce credit exposure to upstream oil & gas by 12 per cent by 2025.

(3) Standard Charted uses a variation of the IEA NZE developed in-house.[xii]

Discussion: what loan indicator should banks rely on to model financed emissions?

HSBC had modelled financed emissions using "the drawn amount of funds provided to counterparties based on the end of year balance sheet (31 December 2021)." In the bank's view, this approach "better reflects current financing and funds currently contributing to activity in the real economy".[xiii] We don't necessarily disagree with this statement, and this approach aligns with the PCAF standard. However, we believe this assumption presents significant flaws.

In our view, using drawn amounts as the loan book indicator does not paint an accurate picture of a bank's relationship with its corporate clients and has therefore the potential to underplay transition risks and level of support to carbon-intensive sectors. Among other things, this indicator does not reflect the amount a bank has committed to provide (with various implications for the bank and the client in terms of access to capital) or even the amount that it is actually providing (e.g. if a company draws on the loan and repays before year end). This indicator can also lead to artificial volatility in the portfolio, as financed emissions could increase or decrease with very little correlation to a company's emissions. Other factors also make the modelling process inherently flawed (i.e. the use of enterprise value as an allocation factor), but using drawn amounts adds another layer of complexity to operationalise targets, in our view.

This modelling choice can have material implications. Barclays acknowledges that the "majority of [its] lending is in the form of Revolving Credit Facilities (RCF) which are typically undrawn, particularly in the Investment Bank."[xiv] Barclays and several other banks in HSBC's peer group have thus opted to set targets using committed amounts. This approach isn't perfect either – it can lead to overallocation of emissions and double counting – but it has the merit to be transparent and, as Citi puts it, "better capture how changes in [the bank's] lending practices over time alter [the bank's] exposure to climate risk and can contribute to the net zero transition."[xv]

In conclusion, we believe that at this stage it is prudent for banks to set targets using committed amounts and report financed emissions using both drawn amounts (in line with PCAF) and committed amounts for transparency.

Fossil fuel policies: building on recent progress

Fossil fuel policies: building on recent progress

Oil & gas

HSBC's commitments

- HSBC will update its energy policy in 2022 addressing both conventional and unconventional oil & gas.
- HSBC will request and review transition plans from oil & gas clients:
  - For major oil & gas producers (90 per cent of financed emissions in HSBC's portfolio), the bank will request transition plans by year-end 2022.
  - Assessment for compatibility with HSBC's net zero target will include, among other factors, exploration and expansion plans, and among other references, the IEA decarbonisation pathways.
  - HSBC will set timelines for clients to develop acceptable transition plans as a matter of course.
  - If a client's transition plan is not compatible with its net zero target, HSBC will formally assess whether it will continue to provide financing for that client.

Engagement recommendations – oil & gas expansion

- HSBC should commit to cease any direct financing of new oil & gas fields (both conventional and unconventional) not approved for development as of 2021.
- HSBC should require – not expect – major oil & gas clients to have transition plans in place that are in line with the bank's commitment to phase down its financing of fossil fuels in line with 1.5C by a specific date. This must be in line with IEA/IPCC guidance on oil & gas supply and include explicit expansion criteria. To assess the transition plans of these clients, HSBC should:
  - Publish a set of core red lines that oil & gas companies will have to meet in order to access financing. These should at apply at both client level and parent level where relevant.
  - Publish a set of decarbonisation expectations, along with a clear framework outlining what steps HSBC will take if clients fail to meet these expectations and by when.

Engagement recommendations – unconventional oil & gas

- HSBC should identify and set phase-out dates for unconventional oil & gas, recognising these activities should be wound down on an accelerated timeline given their typically higher costs and significant environmental and social impacts.
- The bank should set corporate finance thresholds (relative and absolute) for unconventional oil & gas activities (upstream and midstream) that ratchet down over time, and that are stringent enough to cover companies that have a diversified asset base but remain large unconventional producers/developers.
- HSBC should update its definition of the Arctic to the one set by the Arctic Monitoring and Assessment Programme (AMAP), covering both onshore and offshore areas.

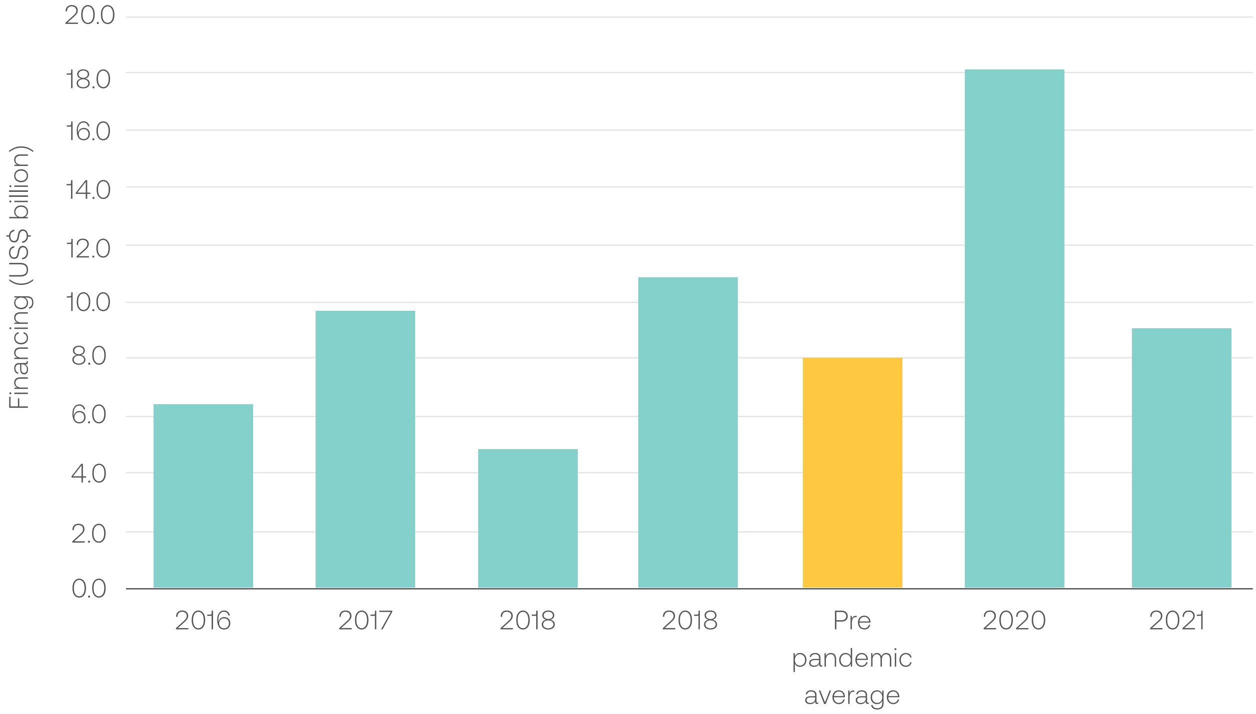
Oil & gas expansion

The IEA's guidance released in 2021 – that a 50 per cent chance to reach 1.5C meant no new oil & gas fields and no further fossil fuel exploration after the end of that year - firmly placed banks' financing of the oil & gas sector on the investor agenda. Banks have started to announce financing restrictions on oil & gas developers. With the update of its energy policy, HSBC can demonstrate leadership on oil & gas expansion, including through its commitment to engage with major oil & gas clients on their transition plans.

HSBC is a top financier of upstream oil & gas expanders

HSBC is Europe's largest financier of upstream oil & gas expanders. The bank's support to oil & gas expansion will undermine its commitment to net-zero if it continues unabated. Whilst HSBC reduced its financing to the top 50 oil & gas expanders by 50 per cent between 2020 and 2021, in 2021 it remained consistent with pre-pandemic levels (see figure 3). Given that 2020 and 2021 were unusual years for energy financing due to the COVID-19 pandemic, any year-on-year decreases in financing should be interpreted with caution. Recent spikes in energy prices have flooded oil & gas companies with cash, meaning they have less need to turn to banks and capital markets to finance their activities.[xvi]

Figure 3: HSBC's financing to top upstream oil & gas expanders in 2021 remained above pre-pandemic levels



Source: ShareAction (2022). Oil & gas expansion: A lose-lose bet for banks and their investors.[xvii]

HSBC's top expansion clients include ExxonMobil and Saudi Aramco, companies planning the third and fourth-most upstream oil and gas expansion of any in the world.[xviii] HSBC is second only to Citi in its financing for Saudi Aramco, the world's biggest polluter.[xix] Just this year, HSBC approved a US$10 billion revolving credit facility to the company, shortly after which Saudi Aramco announced a major ramp up in oil & gas production.

Case study: HSBC is a core relationship bank of ExxonMobil – a company developing new "carbon bombs" opposed by local communities in Guyana

In its last Nationally Determined Contribution (NDC), Guyana emphasised it was one of the world's few carbon sinks. Recent offshore oil & gas development puts this status at risk. The Stabroek Block offshore of Guyana is ExxonMobil's largest oil development outside of the Permian Basin and a key source for the company's further production. Its first two projects in the region – Liza-1 and Liza-2 – have been identified as "carbon bombs", fossil fuel projects that would each result in at least 1bn tonnes of CO2 emissions over their lifetimes. In April 2022, ExxonMobil made a Final Investment Decision (FID) on its fourth and largest Guyana offshore project – Yellowtail, another "carbon bomb". ExxonMobil's progressive oil & gas expansion off the coast of Guyana has drawn fierce opposition from local communities. Citizens filed the first constitutional climate case in the Caribbean charging that the ExxonMobil-led oil and gas buildout violates the government's legal duties. Residents claim the activities are impacting marine life and their livelihoods. This is yet another example of how reputational risks are increasing for fossil fuel companies and their financiers.

ExxonMobil, a top client for HSBC, is planning the fourth most oil & gas expansion of any company in the world. In its latest climate progress report, the oil major argues that fossil fuels will continue to provide over 70 per cent of the energy mix by 2050. This is at odds with the IEA net-zero roadmap that sees the share of fossil fuels fall from 80 per cent in 2020 to just over 20 per cent in 2050.[xx] Despite extensive engagement by investors, including HSBC Global Asset Management, over many years, ExxonMobil has moved very little and has failed to outline a credible transition plan. Its net-zero ambition only covers its operational emissions, and, as shown above, the major continues to have significant expansion plans. HSBC's engagement only approach with companies such as ExxonMobil - which lack credible transition plans and have been resisting climate action for decades – is questionable. HSBC's assessment of oil & gas companies' transition plans should cover expansion of upstream activities and whether or not they are aligned with credible net-zero scenarios. The bank must make clear to clients that are misaligned with 1.5C that if they do not meet its red lines they will be unable to access financing.

European peers have started to move to restrict financing oil & gas expansion – HSBC should follow suit

Other European banks have started to update their oil & gas policies in line with the IEA findings (see figure 4). For example, several banks including ING have announced they will no longer provide dedicated financing for new oil & gas fields. Whilst our data shows that only eight per cent of finance to the top 50 oil & gas expanders is in the form of project finance or dedicated financing, our view is that these commitments still send a strong signal to the market.[xxi]

Several banks are also requiring corporate oil & gas clients to submit transition plans by set deadlines, somewhat in line with HSBC's request to clients by end 2022. However, Danske Bank, Lloyds Banking Group, and La Banque Postale have set credible transition plans as a condition for clients to be able to access financing. Two of the banks are still working on assessment frameworks for these plans, but these policies are still more binding than HSBC's commitment, since HSBC has so far failed to outline consequences for clients that provide it with inadequate transition plans. This points again to the hierarchy of words used by banks in their sector policies - "require" is more binding that "request" or "expect".

La Banque Postale's policy is currently the strongest on expansion in the European banking sector – it will no longer finance companies listed in the GOGEL unless the company has published a credible plan to phase out of oil & gas by 2040 that is in line with the IEA guidance on expansion.[xxii] The bank will also no longer finance oil & gas projects and plans to exit the sector by 2030.

Figure 4: High-level comparison of HSBC's policy on oil & gas expansion with European leading practice

Bank	Asset Finance		Corporate Finance		Client transition plan		Phase-out
	Upstream	Transport	Upstream	Transport	Required	By	
HSBC	N	N	N	N	N	-	N
Crédit Mutuel	Y	Y	N (1)	N	N	-	N
Danske Bank	Y	N	N	N	Y** (1)	2023	N
ING	Y	N	N	N	N	-	N
La Banque Postale	Y	Y	Y*	Y*	Y	2021 (2)	Y*
Lloyds Banking Group	Y** (3)	N	Y** (3)	N	Y	2023	N
UniCredit	Y	Y*	N	N	N	-	N

*indicates exceptions; **indicates material exceptions. Examples of material exceptions include: new clients only; specific region, country or product (e.g., only oil or only gas); limited activities (e.g., extraction but not exploration).

(1) Crédit Mutuel has committed to restrict corporate financing for clients who undertake explorations of new oil & gas fields.

(2) In October 2021, La Banque Postale committed to only provide financing services to companies that have published transition plans going forward.

(3) Lloyds Banking Group will not support direct financing for the development of new oil fields (gas not covered) that did not receive approval from the regulator before the end of 2021. It will not provide financing to new clients in the oil and gas sector unless it is for viable projects into renewable energies and transition plans at the point of onboarding.

Discussion: Invasion of Ukraine, the energy crisis, and oil & gas expansion

The Russian Federation's invasion of Ukraine has led to a tragic humanitarian crisis. It is also having a profound impact on global energy prices, generating significant concerns around energy security. As a result, the European Union and the UK have designed plans to reduce dependence on Russia for fuel supplies. Throughout, some banks and politicians have argued that there is a need for new oil & gas fields to be developed and fast-tracked in response to the crisis. But Fatih Birol, the executive director of the IEA, has emphasised that "some countries may look at new fossil fuels, but it takes many years to start production" and that "[such projects] are not the solution to our urgent energy security needs and they lock in fossil fuel use." In other words, developing new oil & gas fields now would only make the transition even more challenging by locking in high-carbon infrastructure, leading to even more stranded assets as the energy transition progresses in line with the goals of the Paris Agreement.

We recognise that the energy crisis may introduce volatility into banks' climate metrics and make progress against targets more difficult to evidence in the near-term. However, we believe it shouldn't prevent banks from acting to restrict financing to new oil & gas fields and require oil & gas companies to produce transition plans aligned with net-zero. The most effective way for banks to support the economy in addressing short-term energy supply concerns, long-term energy security, and climate change is through a sustained programme of financing renewable energy, energy efficiency, and demand-side measures to reduce reliance oil & gas.

HSBC's target for its power & utilities portfolio is a first step on this front and we expect to see the bank take further action to support the decarbonisation of the power sector. We also note that, in its statement on advancing its transition to net zero, HSBC recognised that "the current crisis demonstrates the need to accelerate investment into the clean energy transition, both to address the climate crisis and to build resilience to withstand future energy crises" and that "overarching imperative…to transition to a net zero future remains critical". We expect the bank to respond to this imperative when it updates its energy policy by the end of the year, to support long-term energy security and urgent decarbonisation of the global economy.

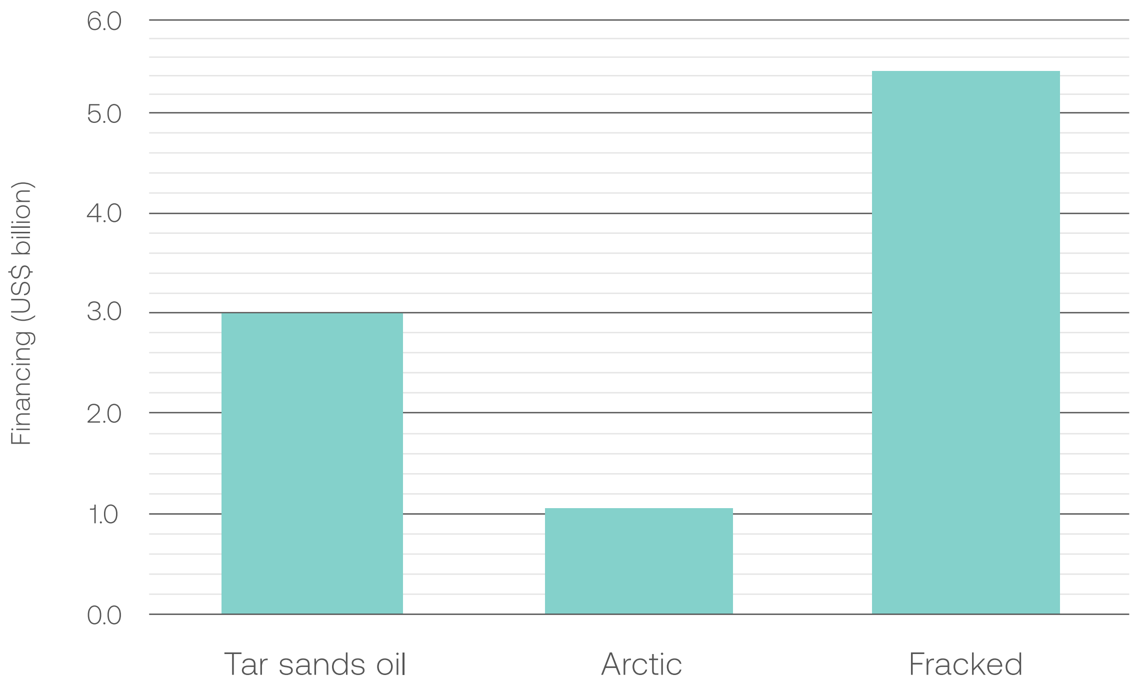
Unconventional oil & gas

'Unconventional' oil & gas[2] carries significant environmental and social risks and can be more costly to develop than conventional types of oil.[xxiii] Many banks have ramped up commitments to address these issues in recent years. HSBC's policy currently lags European peers, but the bank can demonstrate leading practice when it updates its oil & gas policy by end 2022.

HSBC's unconventional oil & gas policy is currently insufficient to limit the bank's exposure to risks arising from these activities

Between 2016 and 2021, HSBC was the 10th largest financier of oil sands (2nd European), 15th largest financier of Arctic oil & gas (8th European), and 20th largest financier of fracked oil & gas (6th European).[xxiv]

Figure 5: HSBC's total financing to three unconventional oil & gas segments between 2016 and 2021



Source: Rainforest Action Network (2022). Banking on Climate Chaos 2022

2 Unconventional oil & gas includes Arctic oil & gas, Fracking, oil sands, and ultra-deepwater oil & gas for the purpose of this analysis.

Below, we outline what is currently included in HSBC's policy – and what it should do next.

- **Oil sands:** asset finance exclusions apply to new greenfield projects, which should be more broadly defined. HSBC does add some exceptions to its provision of corporate lending and capital market transaction support to companies involved in oil sands extraction or infrastructure - it will not provide new financing/lending "where the majority of such lending is to be used for new greenfield oil sands projects". The bank's financing to oil sands has reduced significantly since it introduced these restrictions, but without a general corporate purpose restriction there is no guarantee it won't rise again.
- **Arctic oil & gas:** asset finance restrictions are limited to new projects only if they are offshore in a narrow definition of the Arctic. Less than 20 per cent of the fields under production in the Arctic are offshore and HSBC's exclusion zone would fail to cover at least 168 of the assets located in the region.[xxv]

HSBC has no financing restrictions for fracking or ultra-deepwater oil & gas, despite these activities having been shown to be one of the most at risk of asset stranding in a 1.5C pathway.[xxvi] Fracking was HSBC's most financed unconventional segment between 2016 and 2021 and its financing increased between 2020 and 2021.[xxvii] Moreover, HSBC is now one of the very few banks in Europe that has not yet adopted any corporate finance thresholds to limit its exposure to unconventional activities – eighteen of Europe's largest 25 banks now have corporate thresholds in place for at least one segment.[xxviii]

This should be of concern to investors as our data shows that HSBC is among the largest financiers of Occidental Petroleum (6th largest financier globally with US$3.2bn), Petrobras (8th largest financier globally with US$4.4bn), and Vår Energi (13th largest financier globally with US$483m) between 2016 and 2021. According to the GOGEL, more than 50 per cent of their 2020 production came from fracking, ultra-deepwater, and Arctic activities, respectively. These companies are also planning to add significant volumes to their upstream portfolio through new fields or fields already approved for development in the coming years, and most of these volumes will come from unconventional sources. Peers like BNP Paribas are now restricting financing for unconventional projects and companies with significant exposure to these segments. Three banks have committed to phase-out their exposure to these risky segments (Intesa SanPaolo, La Banque Postale, Nordea).

Figure 6: High-level comparison of HSBC's policies on unconventional oil & gas with European leading practice

Bank	UNCONVENTIONAL OIL & GAS (oil sands (O), fracking (F), Arctic (A), Ultra-deepwater (D)								
	Asset finance		Corporate finance			Expansion		Phase-out	Arctic Definition
	Upstream	Transport	Relative threshold		Transport	Asset	Corporate	Bank	
HSBC	(O,A)** (2)	(O*)	N	-	N	N	N	N	Y** (2)
BNP Paribas	(O,F,A)	(O,F,A)*	(O,F,A)	10% res, rev (1)	(O,F,A)*	N	N	N	Y*
Intesa SanPaolo	(O,F,A**) (3)	(O,F,A)*	(O,F,A)**	30% revenues	(O,F,A)** (3)	(O,F,A**) (3)	N	(O,F,A)*	Y*
Lloyds Banking Group	(O,F,A)	(O,A)	N (4)	-	N	(O,F,A)	(O)	N	Y** (4)
Nordea	(O,F)** (5)	(O,F)	(O,F,A)**	5% revenues	(O,F)*	(O,F,A)** (5)	N	(O,F,A)** (5)	Y** (5)

*indicate exceptions; ** indicates material exceptions; ()* and ()** indicate exceptions or material exceptions that apply to all segments in brackets. For the definition of the Arctic region specifically, Y indicates a definition aligned with the AMAP, Y* indicates a narrower definition including onshore and offshore activities, ** indicates a narrower definition with limited coverage of offshore and/or onshore activities. Examples of material exceptions: restrictions applying only to a certain category of clients (e.g. new clients), to a certain region or country, or to a specific activity (e.g. oil but not gas).

(1) At BNP Paribas, pure oil and gas players will be assessed based on their reserves whereas diversified oil and gas companies are assessed based on nonconventional reserves multiplied by revenues from the upstream activities.

(2) HSBC will not provide financing to new greenfield oil sands projects, defined as "completely new mines or new 'in situ' operations in geographically separate locations to existing ones but exclude the incremental development of existing mines and 'in situ' operations."

(3) Intesa SanPaolo's asset finance restriction for Arctic projects does not apply to onshore gas projects. Its corporate finance restriction relates only to any increase in exposure relating to general purpose financial products or services.

(4) Lloyds Banking Group does not have a corporate threshold for unconventional oil and gas but it will not support financing to companies involved in the exploration or development of oil sands, outside of fields already approved for development as of 2021.

(5) Nordea's policy does not cover exploration for unconventional oil & gas at the asset- or corporate-level or within its phase-out.

Thermal coal

HSBC's commitments

- Further to its coal phase-out commitment and other financing restrictions implemented in December 2021, HSBC will publish an updated thermal coal policy by year-end 2022.

Engagement recommendations

- HSBC must reinforce its coal policy to ensure that financing is not provided for additional thermal coal capacity, either to a specific asset or to the companies developing these assets. As part of this, HSBC should:
    - Apply all thermal coal expansion exclusions at both client and group-level, and/or require groups to not develop additional coal capacity as part of transition plan requirements.
    - Widen its definition of coal developers to exclude any companies developing new thermal coal assets regardless of whether this increases total coal capacity (policy currently relying on 'net' metrics).
    - Consider acquisition of thermal coal assets as expansion unless the company commits to cease operating the assets within a timeframe consistent with HSBC's own phase out.
    - Close the loophole whereby thermal coal expansion is not restricted if it comes from mines where primary output is metallurgical coal.
- Introduce financing restrictions to its existing client base operating in non-OECD markets, using a suitably ambitious ratchet mechanism to manage down its exposure to thermal coal in these regions.
- Update materiality thresholds to use thermal coal share of power production and/or place absolute limits on thermal coal production volumes and thermal coal generating capacity.
- Publish its definition of 'clean technology or infrastructure as part of the client's transition' in the context of thermal coal mining and power generation.
- Require clients to publish clearly defined coal phase out plans in line with the bank's own 2030/40 phase out by a specific date, failing which HSBC will prohibit new financing and phase out its exposure to them. This should include a plan to "close not sell" coal assets and explicitly prohibit development of additional coal capacity.
- Expand its definition of coal infrastructure to cover the entire value chain and all activities outlined in the GCEL.
- Apply the core principles of its coal phase-out policy across all products and services, including asset management.

HSBC has a unique opportunity to be a leader amongst banks with a high exposure to Asia, the region that will largely determine the future of coal.[xxix] However, our previous briefing highlighted important loopholes in HSBC's new coal policy across several areas – summarised below.

Despite progress, HSBC's policy contains material loopholes on coal expansion

The IEA found, when modelling its pathway to 1.5C from 2021, that "no new coal mines or mine extensions are needed in the NZE" and "no additional new final investment decisions should be taken for new unabated coal plants".[xxx] Despite important progress on coal expansion, the policy presents some weaknesses that could allow HSBC to continue to support:

- **Groups developing thermal coal capacity,** as the policy only applies to "clients", and explicitly not to the client group. HSBC can continue relationships with a group owning an entity developing thermal coal if the particular entity is not receiving financing from HSBC. Whilst HSBC commits to seek assurances from the group, it is technically impossible for the bank to know if its proceeds are still enabling coal development through subsidiaries. Indirect exposure to thermal coal expansion at this stage could be material.
- **Companies expanding thermal coal through inorganic growth,** as the policy explicitly excludes mergers and acquisitions. This is not necessarily incompatible with a net-zero strategy, but without clear redlines to ensure a managed phase-out, it would allow HSBC to support clients such as EPH, who have been shown to increase reliance on thermal coal without regard for the terminal decline needed to stay below 1.5C.[xxxi]
- **Companies developing new thermal coal assets without increasing total coal capacity** due to a definition of coal expansion relying on 'net' metrics. This contradicts HSBC's restriction of new thermal coal power plants and mines at project-level.
- **A significant pipeline of thermal coal expansion projects,** as the policy only applies to development plans announced after 1 January 2021 or those starting after that date only if they were not already contractually committed. Thermal coal power generation from existing assets has been shown to be above what is required not only in the IEA NZE (aligned with 1.5C), but also in the IEA's Stated Policies Scenario (STEPS – aligned with 2.6C) and Announced Pledges Scenario (APS – aligned with 2.1C).[xxxii] Any additions to the thermal coal pipeline beyond existing capacity will result in increased stranded assets under these scenarios.
- **Expansion of thermal coal mining in hybrid mines,** since HSBC's definition of a thermal coal mine allows those dedicated to both metallurgical and thermal coal to expand with up to 30 per cent capacity dedicated to thermal coal. HSBC will not seek assurances from thermal coal mining companies that the thermal coal portion of "hybrid" mines will not expand, despite this being incompatible with a 1.5C pathway.[xxxiii]

Case study: Adaro Energy

HSBC has been a long-time financier of Adaro Energy, Indonesia's second largest coal company. Adaro Energy is made up of eight sub-businesses including Adaro Energy, Adaro Power, and Adaro Services. Currently 90 per cent of the groups revenues come from coal related activities.[xxxiv] Adaro Energy doesn't have a credible transition plan - its management quality received the second lowest rating from the Transition Pathway Initiative. It has no greenhouse gas reduction targets and does not recognise climate change as a risk to its business. In its 2019 annual report, the company said "maintain (thermal coal) profitability as the group's cash cow." Despite a change in rhetoric, thermal coal mining is still the group's core business pillar.

In April 2021 HSBC was a Mandated Arranger on a USD400m loan to Adaro Energy. The group is currently expanding thermal coal power and mining capacity through different subsidiaries such as PT Adaro Indonesia and PT Adaro Power.[xxxv] Since HSBC financed Adaro Energy at the group-level, rather than these subsidiaries, this financing would still be permitted under HSBC's new coal phase-out policy. Financing at the group-level can free up capacity for companies to fund expansion through their own balance sheet or improve the group finances to allow it to access financing from other institutions that have no coal guardrails in place. Moreover, as discussed below, HSBC has no coal revenue thresholds for non-OECD markets like those that Adaro Energy operates in. Without closing these loopholes, HSBC could continue to support Adaro Energy and similar players until 2040.

Corporate finance thresholds – time for HSBC to complete the job

Corporate finance thresholds for clients operating in thermal coal are essential for HSBC to manage its exposure to transition risks, since most energy investments are financed primarily from company balance sheets. The corporate finance thresholds for OECD clients and new relationships implemented by HSBC in Q4 2021 are an important first step. However, HSBC's controls contain material exceptions that we outline in our previous analysis of its coal policy. In summary:

- **HSBC has not set any materiality thresholds to exclude non-OECD markets,** where thermal coal is primarily concentrated,[xxxvi] as it wants to support the transition of its clients in these regions. This means the bank could continue to finance pureplay coal companies in non-OECD markets for the next 18 years. It is unclear why the bank remains so cautious on this point, given that it still plans to waive thresholds set for OECD markets if financing is "specifically directed towards clean technology or infrastructure as part of the client's transition" i.e., the bank can still finance the transition of these companies. We recognise that non-OECD markets face obstacles compared to developed market peers. However, coal supply and use must still decline steeply in these regions that face some of the most challenging gaps between potential generation and Paris Agreement benchmarks.[xxxvii]

- **HSBC uses an inadequate metric to define a client's reliance on thermal coal power,** which introduces economic volatility unrelated to declining coal use. A revenue-based metric will become distorted over time, as the profitability of coal will be impacted by the low-carbon transition and 2030/40 are years away.
- **HSBC will waive materiality thresholds in the EU/OECD if financing is specifically directed towards "clean technology or infrastructure as part of the client's transition", without any transparent definitions.** This could leave the door open for financing of coal-related activities that are less carbon-intensive but still incompatible with limited-to-no overshoot pathways to 1.5C (such as coal-to-gas switching in the power sector[xxxviii]).
- **Thresholds on existing clients in non-OECD countries are limited to 'Enhanced Due Diligence' (EDD),** and even this will be waived where the financing is "specifically provided for activities unrelated to thermal coal".

HSBC has made suitably stringent thresholds for new relationships with clients. It should look to implement a similar structure for existing clients to properly manage thermal coal transition risks over the next two decades.

HSBC's approach to coal clients' transition plans needs strengthening if it wants to drive real economy change

HSBC's updated policy confirmed its intention to phase out its exposure to thermal coal by 2030 in OECD countries and by 2040, defining its phase-out for each date as exposure to clients that are not generating revenues greater than 5 per cent of total revenues. This was a huge step forward for the bank and for the Asian banking sector.[xxxix] It will also encourage its clients to transition away from coal by asking them to publish transition plans by set dates. However:

- **HSBC only 'expects' clients to formulate and publish transition plans that are compatible with its own net-zero target.** This is less binding than 'requires' (which sets mandatory conditions to be able to access financing) and HSBC has failed to outline consequences for clients that provide it with inadequate transition plans.
- **HSBC does not set out what it would consider to be an inadequate transition plan and does not prioritise coal phase-out in its assessment.** The bank outlines several factors that will be taken into consideration but offers no expectations or red lines for each. Particularly concerning is that HSBC will consider 'proposed post 2030/40 coal-fired power generation' but does not ask clients to phase-out in line with its own 2030/40 dates.

The policy does not cover a substantial enough portion of the value chain to manage the full transition risks presented by the declining coal sector

HSBC includes some types of infrastructure in its coal phase-out policy, however:

- **It does not cover many activities critical to the development of thermal coal,** as it is limited to "assets dedicated to support thermal coal assets, such as coal terminals or coal railways". The Global Coal Exit List (GCEL) considers all components of the coal value chain, listed in our previous analysis.[xl]

HSBC Global Asset management should implement the core tenets of the bank's coal policy

HSBC indicates that all relevant HSBC entities, products, and businesses, including asset management, will "seek to implement policies that support the transition from coal-fired power and thermal coal mining within HSBC's 2030/40 timelines". We therefore expect HSBC GAM – the UK's fourth largest coal investor according to the GCEL – to publish an updated thermal coal policy before the end of the year. We believe that the core principles of HSBC's thermal coal policy should be reflected in HSBC GAM's new policy.

At present, HSBC GAM has no relative or absolute thresholds to exclude companies with high exposure to coal, or dates and definitions for a phase-out, in contrast to the bank division. Moreover, HSBC does not implement its position on coal expansion into its asset management division. According to the GCEL, HSBC holds US$125 million in debt issued by Power Finance Corp Ltd – a company planning 16GW of coal power expansion in India.[xli] Major asset managers including Axa Investment Managers and Amundi are already taking strong action on coal.

Conclusion

Conclusion

HSBC made significant progress on climate in 2021 and the new steps it committed to publicly in 2022 are a testament to continued productive engagement with investors. Our focus is on ensuring the bank operationalises and implements its commitments in a way that is robust, science-based and in line with or exceeding leading practice in the sector. We have outlined the steps the bank should take to ensure its new targets and updated policies are compatible with its net zero by 2050 target. We encourage HSBC – Europe's third largest fossil fuel financier and a top provider of financing to oil & gas expanders – to set a standard for global systemically important banks. A failure to do so would leave the bank exposed to critical financial, regulatory and reputational risks. It will also influence whether the 1.5C goal of the Paris Agreement can be met. We call on HSBC investors committed to net zero to engage with the bank on these issues and support HSBC to turn its ambition into concrete action and into a climate strategy that is leading practice in the sector.

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Authors

Jeanne Martin, Lydia Marsden, Xavier Lerin

ShareAction»

shareaction.org
info@shareaction.org
+44 (0)20 7403 7800

63/66 Hatton Garden
Fifth Floor, Suite 23
London
EC1N 8LE

Registered Charity Number: 1117244

EU Transparency Register number: 75791956264-20