We believe climate change is among the most significant threats to economic and social development worldwide – particularly in emerging markets. Tackling the climate crisis requires an extensive economic transformation, especially in areas such as energy, power, manufacturing, transport and food systems. However, this process must deliver benefits to the largest possible number of people for it to be sustainable. That's why the concept of a just transition – greening the economy in a way that is as fair and inclusive as possible – is so important.

Too often, the focus on climate change means we lose sight of the overall goal of building a greener, more inclusive and more equitable world. We cannot look at climate goals in isolation; we have to combine them with actions that help all members of society. If we don't strive for that just transition, our ambitions for the environment will be at risk.

**– Fatima Hadj, Climate Investment Strategist, HSBC AM**

## The importance of the 'S' in ESG

Ensuring a just transition is crucial in supporting social cohesion and economic stability over the long term, underpinning the operating environment of the companies that we invest in. We are convinced that incorporating the notion of just transition into our investment philosophy and processes will inform our decision-making when investing. Concretely, it means that we have to monitor and assess the potential externalities that can have a negative impact if not managed well, e.g. poorly managed redundancies leading to low morale, operational disruptions from union strikes, and community protests. This is crucial since they could eventually become systemic detractors to the development of a company.

When transitioning to a greener business model, a company can, for example, neglect the potential impact it will have on local communities and its employment practices, potentially leading to negative outcomes for these groups. This could eventually reduce the company's ability to maintain or develop margins, shrink its customer base, detract its brand, and more.

That is why, when we evaluate companies, we look beyond the financial performance and environmental impact, and pay specific attention to the 'S' of ESG. Since the scope of potential societal issues is especially large, assessing them in an exhaustive way remains a challenge. Nevertheless, there are indicators that can help us to measure a company's societal footprint. Among others, labour policies, gender diversity and supply chain management are valuable inputs.

## Supporting a just transition through engagement and stewardship

Effective engagement helps provide greater transparency and insights on the climate strategies of companies, as well as material societal and governance factors. This may help us identify companies with better sustainability profiles or, conversely, discover issues that pose a risk to a company's sustainability and investment potential. Indeed, there are many examples of businesses that have high environmental scores but lag in terms of the 'S' and 'G' criteria. A just transition lens brings together these considerations in a more holistic perspective.

Consequently, we have further developed our Stewardship Plan and created a specific thematic module on just transition under the climate change theme. During the year, we initiated just transition discussions with a number of portfolio companies, both to have a better perspective on their strategies on the topic and to share our expectations. As part of these engagements, we encouraged companies to consider including factors such as employee reskilling, engagement, mediation, and community investment in their climate strategy, as well as plans to repurpose and decommission assets in a responsible manner. We encouraged the disclosure of social risks and considerations associated with the energy transition in reporting, and shared best practices around supply chain engagement.

Stewardship, as realised through voting and engagement activities, is one of the most powerful tools asset managers and investors have available to influence corporate behaviour. As we continue to assess and engage with investee companies on their net zero strategies, we expect to see improved disclosures of their just transition considerations, and how these could impact their key stakeholders including workers and local communities.

**– William Ng, Senior ESG Engagement Analyst, HSBC AM**

Indeed, engagement activity is sensitive to regional and sectoral differences while still respecting global standards for companies and assets. As Asia continues full steam with its energy transition and decarbonisation journey, we expect our investee companies to further develop their climate commitments, with more details of their strategies and targets. We expect these strategies to include a social impact component, to consider the equity and inclusivity of the company's transition plans, and their engagement with relevant stakeholders.

### A just and inclusive climate transition: An investment stewardship perspective

> We have laid out our stewardship vision to help shape a sustainable world that is fair and inclusive in one of our Responsible Investment Insights.

## Collective action for a just transition

At a global level, we expect more climate and just transition commitments from governments in 2023, having already seen social impact included in one of the key pillars of the G20 Transition Finance Framework[18], announced during the G20 Summit in November 2022.

In the private sector, more groundwork in corporate disclosures will be necessary to improve market transparency and just transition related data and metrics. We expect 2023 will bring more concerted efforts to join the dots between social impacts and environmental objectives, whether through investment policies, stewardship activities, or product innovation.

We believe that financing a just transition requires collaboration and partnerships between industry, financial institutions, policymakers, civil society, and multilateral organisations.

During 2022, we are proud to have joined the Impact Investing Institute Just Transition Finance Challenge[19], actively participating in roundtables and sharing our feedback on draft criteria that will underpin the just transition label for investment products. We continue to collaborate with the Impact Investing Institute to develop the label and drive industry standards to enable a just and orderly climate transition.

We also joined Advance[20], an investor-led stewardship initiative coordinated by UNPRI to address human rights and labour risks, focusing on the renewable energy and metals and mining sectors. As we collaborate with other investors, we expect this will be a good opportunity to engage with target companies on human rights topics broadly, and on including just transition considerations in their climate strategies.

## Mobilising the funding needed for a just transition

> As an asset manager operating in both developed and emerging markets, we know that directing financial flows only to the most advanced countries will not address the overarching problems that we are seeking to resolve collectively. So, we are proactively developing investment solutions that aim to speed up the transition globally, rather than only in those countries that are already well placed to transition their economies and societies.

Overall, we think that many investment opportunities will arise from the net zero transition, and that our focus on a just transition is an opportunity for us to allocate capital in driving positive change.

**– Andrea Griffin, Head of Responsible Investment Specialists, HSBC AM**

18. https://g20sfwg.org/wp-content/uploads/2022/10/2022-G20-Sustainable-Finance-Report-2.pdf
19. https://www.impactinvest.org.uk/project/just-transition-finance-challenge/
20. https://www.unpri.org/investment-tools/stewardship/advance

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