HSBC Global Asset Management ETFs

Securities Lending Programme

Management company	HSBC Global Asset Management (UK)
Manufacturer	HIFL
Distributor	HSBC Global Asset Management (France)

HSBC Global Asset Management

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Enhancing investment performance through securities lending

Introduction

Securities lending is a practice within capital markets whereby a holder of a security temporarily lends it out to a borrower, who in return provides agreed collateral and a fee. It is a well-established process within the investment management industry, utilised by pension funds, mutual funds, and ETFs, to enhance fund performance. The main benefit to shareholders is the potential for additional income which is incorporated into the Net Asset Value (NAV) of the ETF, potentially improving risk-adjusted returns over time.

HSBC Global Asset Management's ETFs invest in physical securities with the aim of replicating the performance of a pre-specified benchmark. These physical securities could be considered a pool of lendable securities which, within the appropriate risk framework, could provide additional income, therefore improving the returns of the ETF.

HSBC Global Asset Management has now developed a comprehensive securities lending programme in conjunction with HSBC Securities Services (HSS) as the securities lending agent and is set to introduce the programme for the set of ETF products, aiming to benefit shareholders whilst carefully managing any associated risks.

This brochure provides an introduction to the basics of securities lending, explaining its benefits, risk mitigation, as well as HSBC Global Asset Management's approach to managing a securities lending programme.

The economics

When an ETF lends securities, the borrower pays a fee to compensate ETF investors for loaning their securities. The borrower is contractually obliged to return the loaned securities at the end of the loan period or at any time if recalled by the lender, a practice that is referred to as 're-call'.

All revenues arising from securities lending, net of direct and indirect operational costs, are returned to the lender, the ETF. Direct and indirect costs associated with running and overseeing the programme are taken from the gross revenue and paid to the lending agent (HSS), as well as the Management Company (HSBC Investment Funds Luxembourg – HIFL).

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Why consider securities lending?

Securities lending has been tried and tested through many financial market cycles over the past 30+ years.

There are numerous reasons for counterparties choosing to lend securities which we explore below.

1. Relatively low-risk yield enhancement

- ETF owners can generate incremental "rental" returns from portfolio holdings that are otherwise sitting idle
- Securities on loan are recallable at any time, loaned according to a stringent risk framework which ensures minimum borrower quality and safeguarded by the HSBC Securities Services borrower default indemnification
- Consistent positive lending returns increase competitiveness by offsetting the expense ratio

2. Ownership entitlements unaffected

- Benefits of ownership continue while assets are on loan as ETF owners continue to receive interest, dividends and capital changes without disruption
- ETF managers have discretion on when to recall shares that are on loan to exercise their voting rights. Voting is a key component of HSBC Global Asset Management's stewardship policy and important in effecting positive change in the companies our ETFs invest in

3. Regulatory endorsement

- In recent years, regulators have started pro-actively endorsing the use of securities lending within a prudent and properly managed framework as one of the pillars of well functioning capital markets

4. Improving market liquidity

- Securities lending helps to improve market liquidity, facilitating transactions and also moderating price volatility
- It also helps dealers meet settlement needs, increases price transparency and enables investors to hedge risks which are other important factors for well functioning capital markets
- Securities lending also provides short supply which increases security liquidity and promotes price discovery, ultimately improving capital market efficiency

Why are ETF lenders attractive to borrowers?

Long term holders – stability of lendable supply

Diverse selection of exposure – broad and stable lending inventory

Predictable buy and sell activity concentrated during rebalance periods

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Understanding the fundamentals of securities lending

Securities lending transactions involve the temporary transfer of a security or securities from the lender (in this case an HSBC ETF) to the borrower via the lending agent (HSBC Securities Services) that sits between both parties.

In exchange for the borrowed securities, the borrower transfers either cash or non-cash collateral to the lending agent. All non-cash collateral is held in a segregated account. The purpose of the borrower posting collateral to the lending agent is to provide protection in the event of the failed return of any loaned securities by the borrower. The value of the collateral tends to exceed the value of the underlying stock given a 'haircut' is applied to the collateral amount.

An important question for ETF investors is how dividends are dealt with for securities on loan. Dividends arising during the period of the loan are typically paid by the borrower to the lending agent who then pays these out to the lending party. The borrower also receives interest/dividends on collateral posted to the lending agent.

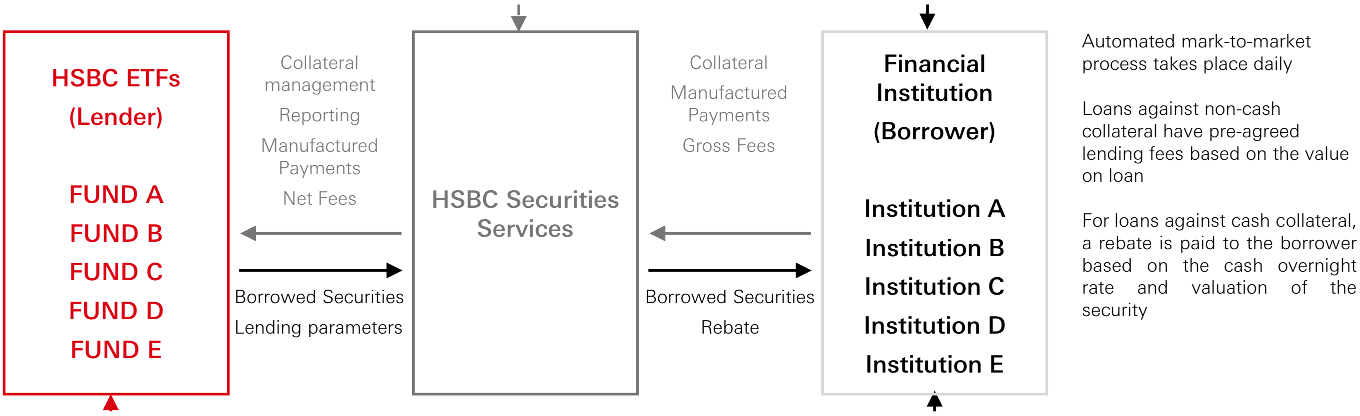
As the right to exercise any voting rights passes to the borrower during the lending period, HSBC Global Asset Management has a strict voting policy covering re-calls, which is implemented by HSBC Securities Services through strict protocols. This ensures the lender remains in control of these rights as the lending agent ensures that all material votes have been submitted.

HSBC Securities Services

- Acts as agent lender and operates collateral management
- Provides Depositary, Custodian, Middle Office, and Fund Administration services

Approved Financial Institutions

- Act as a borrower under industry standard documentation
- HSBC Global Asset Management has the mandate to determine the list of eligible counterparties



Minimal disruption to dealing

- Daily reporting highlighting all outstanding loans, rates, collateral and counterparties
- Contractual payment of all dividends/interest on pay date, as well as any sale proceeds

Collateral

- HSBC Global Asset Management has the mandate to determine the list of eligible collateral
- The loan settlement process is a pre-collateral process, i.e. securities are lent only if there is sufficient borrower collateral to cover the exposure plus the minimum haircut
- Collateral is held in separate accounts, fully segregated from HSBC Bank and other lender assets

Figure 1. Operating flow under the agency lending arrangement
Source: HSBC Global Asset Management. The commentary and analysis presented in this document reflect the opinion of HSBC Global Asset Management on the markets, according to the information available to date. They do not constitute any kind of commitment from HSBC Global Asset Management. For illustrative purposes only. Representative overview of the investment process, which may differ by product, client mandate or market conditions.

Associated risks in securities lending

In the last 5 years, there have been no calls on the indemnification policy offered to clients. The indemnity was invoked in 2008 when Lehman Brothers entered administration.

1 Credit risk

Credit risk exists in the form of counterparty risk. As the ETF lender is dependent upon the borrower meeting its contractual obligations, counterparty failure is the single largest risk in securities lending. HSBC is selective in counterparty inclusion and approved entities are monitored closely for signs of deteriorating credit worthiness both at the HSBC Bank and HSBC Global Asset Management level. HSBC may cease securities lending activity with counterparties on this basis prior to default.

HSBC Securities Services mitigates this risk through its comprehensive borrower default indemnification. In the event of a borrower default, HSBC Bank Plc takes on the defaulting entity's obligations to make the lending client whole. This includes the return of loaned securities, entitlements, distributions and fees owed by the defaulting party.

2 Operational risk

Securities lending operations involve the operational workload of a global custodian plus the securities lending specific functions.

Corporate actions, dividend and interest payments, loan and collateral settlements, daily counterparty reconciliations, external pricing and data vendors all create operational challenges that require a robust operating environment.

Across HSBC, operational support teams and control functions are separate and distinct, applying industry best practices.

3 Legal risk

Legal risk relates to the enforceability of contracts. **HSBC uses industry standard documents when dealing with the borrower community**. These documents are tested for effectiveness and enforceability across multiple jurisdictions on an annual basis in order to give confidence to this linchpin for the proper functioning of the securities lending market.

Industry standard documentation includes the GMSLA, MSLA, AMSLA, GMRA and MRA*. HSBC's Securities Lending Authorisation Agreement ensures all relevant features of collateral/counterparty agreements are appropriately governed.

4 Market risk

As changing securities prices can have an impact on both the securities on loan and the value of collateral, there is a degree of market risk inherent in lending activity.

Securities lending loans and collateral are marked to market on a daily basis with daily settlement of any collateral over/under positions.

The HSBC approved collateral profile has limits regarding concentration and diversification of collateral securities as well as maximum individual positions sizes.

HSBC takes a zero tolerance approach to collateral shortfalls which contributes to reduce the potential impact of adverse market movements. In a worst case scenario whereby market prices have moved against the lending clients (i.e. loaned securities increase in value, collateral value falls to below the loan price and the borrower becomes insolvent), the HSBC Securities Services indemnity protects clients.

5 Regulatory risk

Regulatory risk describes the potential for changes to the regulatory environment that affect securities lending activity.

In recent years, there have been several changes to related areas of regulation that where not targeted at securities lending activity, but nevertheless have had an impact on this activity.

Ongoing engagement with regulators on both a direct basis and through participation in industry associations lessens the likelihood of regulatory misalignment under ESMA, UCITS, CASS, SFTR, or MiFID**.

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*GMSLA: Global Master Securities Lending Agreement; MSLA: Master Securities Lending Agreement; AMSLA: Australian Master Securities Agreement; GMRA: Global Repurchase Agreement; MRA: Master Repurchase Agreement.

**ESMA: European Securities and Markets Authority; UCITS: Undertakings for the Collective Investment in Transferable Securities; CASS: FCA's Client Assets Sourcebook; SFTR: European Union Securities Financing Transaction Regulation; MiFID: Markets in Financial Instruments Directive.

Our approach to securities lending

Robust borrower selection and monitoring

- Only high credit quality financial institutions will be approved as borrowers to the ETFs
- All borrowers undergo a regular and comprehensive due diligence process to ensure they consistently meet minimum HSBC Group standards
- Approved borrowers are subject to continuous and rigorous credit-monitoring, where HSBC Securities Services will also carry out its own credit limit authorisation, as well as market and credit exposure monitoring

Prudent collateral management policy

- Collateral has to be received before the ETF securities are released to the borrowers
- All securities on loan will have to be over-collateralised by a defined minimum margin, and only high quality and liquid assets will be accepted as collateral
- To ensure the safety of the assets, the ETFs hold the legal title over the collateral assets. The collateral is held separately to HSBC Securities Services' own assets
- Cash collateral received and settled will be invested conservatively into HSBC Global Asset Management's money market funds created exclusively for cash liquidity needs associated with the securities lending programme
- Both HSBC Global Asset Management and HSBC Securities Services monitor the collateral policy closely and will apply a more restrictive standard in light of market events or risk concerns
- In the case of deteriorating borrower credit quality, proactive steps will be taken to amend the borrowers credit line and collateral haircut and quality requirements

Engaging with an experienced lending agent

- HSBC Securities Services has been in the securities lending industry for over 40 years
- It is one of the highest credit rated securities lending agents today[1], offering competitive yet relatively low risk returns through its market-leading provision of borrower default indemnification
- As a globally recognised securities lending agent, it provides tailored programmes to a diverse range of clients globally, including ETFs, pension funds, and public sector clients
- With on-the-ground local operational presence, HSBC Securities Services will be lending HSBC ETF sub-funds underlying securities across 38 equity and fixed income markets

40+ Years

1) No capital loss

No participant has ever suffered any capital loss throughout the 40+ year history of the HSBC Securities Services programme

2) Revenue outperformance

Historical return-to lendable outperformance versus peers, via its highly invested automated trading capabilities as tracked by the two largest independent benchmarking firms, IHS Markit and Datalend

3) Risk management

Underpinned by the strength of HSBC Group's balance sheet, HSBC Securities Services will absorb all market and credit risk arising from the programme via its comprehensive borrower default indemnification, with the exception of the capital value of the liquidity fund investment where borrower cash collateral is invested

4) An extra layer of safety

A no-assets-commingling arrangement has been put in place where a completely segregated and bespoke account is offered for each ETF sub-fund
All securities on loan are callable at any time

5) End-to-end services

With sophisticated and cutting-edge infrastructure, HSBC Securities Services handles the full lending cycle operation, from loan structuring to borrower credit analysis and risk monitoring

1. Source: S&P, Moody's, Fitch (Strongest operating entity rating). As at 1 September 2020. For illustrative purposes only. Representative overview of the investment process, which may differ by product, client mandate or market conditions.

Default indemnification

- HSBC Securities Services is committed to offering securities lending clients, comprehensive borrower default indemnification
- Backed by one of the industry's strongest balance sheets, HSBC Securities Services lending programme has a proven track record in this regard, with no lending clients having suffered capital loss since inception
- Full borrower default indemnification is included at no additional cost

- The indemnity provision is underpinned by HSBC Bank Plc's stringent credit review of borrowers, as well as robust collateral management policies accepting only liquid collateral which has been approved by the HSBC Securities Services risk team
- HSBC Securities Services is confident that through close and careful credit monitoring of all counterparties, together with rapid responses should any be required, the likelihood of any default scenarios will be absolutely minimal

HSBC Global Asset Management has the flexibility to tailor its collateral requirements

Collateral

- The typical collateral profile consists of high quality and liquid non-cash collateral as outlined in the table below as well as cash collateral
- A margin is added to the value of the loaned security resulting in a minimum required collateral value in excess of 100%. An average margin of 5% for non cash collateral and 2% for cash will be maintained daily
- This protects the ETF lending client from daily price fluctuations between the loaned security and any collateral received from the borrower

Eligible collateral and margins

Type	Market				HSBC minimum requirements	Indemnification provided
Government Debt	USA Canada	Austria Belgium Denmark Finland France Germany	Netherlands Norway Sweden Switzerland UK	Australia Japan	102%	Yes
Supranational Debt	European Bank for Reconstruction and Development (EBRD) European Investment Bank (EIB) International Bank for Reconstruction and Development (IBRD)				102%	
Equities (Main Index)	USA Canada	Austria Belgium Denmark Finland France	Germany Netherlands Norway Sweden Switzerland UK	Australia Hong Kong Japan Singapore	105%	
ETFs					105%	
Cash	USD	GBP	EUR		102%	No

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Frequently discussed topics

Securities lending revenue and fee arrangements

- To compensate the ETF lender for lending their securities to the banks and broker dealer market, the borrowing counterparty pays a gross basis point fee to HSBC Securities Services
- The value of the loan, agreed fee rate and duration of the loan will determine the total income of the ETF lender. The resulting revenue is accrued daily to the fund
- Any revenue generated by securities lending transactions, reduced by the applicable fee split between the lending ETF, HSBC Securities Services and HIFL will be payable to the fund
- We offer a competitive revenue sharing arrangement with 75% of the securities lending revenue being returned to ETF investors and the remaining 25% used to cover the fees of the securities lending agent HSBC Securities Services (15%) and the ETF Management Company, HSBC Investment Funds Luxembourg (10%)

Conflicts of interest policy

- The appointment of HSBC Securities Services took place after a rigorous request-for-proposal procedure and due diligence process, as per HSBC Global Asset Management's service provider selection programme
- In accordance with regulatory requirements and the HSBC Group's conflict of interest policy, HSBC Global Asset Management (as investment manager) and HSBC Securities Services (as securities lending agent) will be "at arm's length" with a robust 'Chinese Wall' in operation between their respective oversight or securities lending operations obligations
- HSBC Securities Services also has a Conflicts of Interest Policy and must act fairly to ensure transactions are effected on terms which are not materially less favorable to the ETF than if the conflict or potential conflict had not existed

Transparency of the programme

- The Annual Report and Audited Financial Statements disclose the securities lending fees and the revenue generated, the value of the securities on loan, and the amount of collateral held
- More detailed securities lending information is also published daily on the website: www.etf.hsbc.com

Cash collateral reinvestment

- Received cash collateral will be invested conservatively into HSBC Global Asset Management's money market funds ensuring the risk of capital loss is minimised. Where not invested in money market funds, the cash collateral is held in a segregated account

Product Eligibility

- HSBC Global Asset Management has the flexibility to decide which funds engage in securities lending at any given time. Our aim is to ensure we calibrate the securities lending programme to client needs, taking into account individual criteria on a per fund basis such as local regulatory requirements, special circumstances of the underlying market, or label requirements associated with particular products. We commit to reviewing these regularly to ensure we continue to offer investors the best value outcomes. A list of ETFs included in the programme can be found on page 11.

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Appendix

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Appendix

Eligible Collateral and Margins

Type						Loan & collateral (Same currency)	Loan & collateral (Cross currency)
Cash	USD	GBP	EUR	AUD	CAD	102	105
	Cash collateral may be held for the benefit of lender in an account at Custodian, unless otherwise directed by Lender						
	Government and Sovereign Debt of countries listed below with a minimum issuer rating of:						
	AAA / Aaa						
	Australia	Austria	Denmark	Finland	Ireland		
	Italy	Luxembourg	Netherlands	New Zealand	Norway		
	Portugal	Spain	Sweden	Switzerland			
Government Debt	AA+ / Aa1					102	105
	Belgium						
	AA / Aa2						
	Canada	France	Germany	UK	USA		
	A+ / A1						
	Japan						
Government Agency	Securities issued by United States Government Agencies with a minimum issuer rating of AA / Aa2					102	105
Other Debt	Canadian Provincial debt issued by the provincial governments of Alberta, British Columbia, Manitoba, Ontario, Quebec and Saskatchewan with a minimum issuer rating of AA- / Aa3					102	105
	Canadian Covered Bonds with a minimum rating of AA+ / Aa1 that are issued by Canadian banks with minimum issuer rating of AA- / Aa3 and are backed by pool of mortgages insured by Canada Mortgage and Housing Corp						
	Canadian Mortgage Bonds with a minimum rating of AA+ / Aa1 guaranteed directly by Canada Mortgage and Housing Corp						
	Danish and Swedish Mortgage Covered Bonds with a minimum rating of AAA / Aaa, provided that the Approved Borrower and issuer are not the same entity and that no single issue represents more than 10% of the Collateral pledged by an Approved Borrower to Lender, on an aggregate basis across all loans outstanding from Lender to such Approved Borrower						
	Equities listed in the following indices provided that (i) no issuer represents more than 15% of amount of Collateral pledged by an Approved Borrower to Lender, on an aggregate basis across all loans outstanding from Lender to such Approved Borrower, and (ii) the number of shares of a specific equity security pledged by an Approved Borrower to Lender, on an aggregate basis across all loans outstanding from Lender to such Approved Borrower may not exceed 1 times the 90 day average trading volume of such equity security:					105	105
	Tier 1						
	S&P 500/US SPX	FTSE 100/ UKX	Eurostoxx 50/SX5E	Russell 3000/US RAY			
	FTSE 350/UK NMX	CAC40/FR CAC	DAX/GR DAX	Swiss Market/CH SMI			
Equities	Equities listed in the following indices provided that no issuer represents more than 5% of amount of Collateral pledged by an Approved Borrower to Lender, on an aggregate basis across all loans outstanding from Lender to such Approved Borrower:						
	Tier 2						
	FTSE MIB/ITFTSEMIB	NIKKEI225 JP/NKY	S&P/TSX 60/CA TSX	IBEX 35/ES IBEX		110	110
	AEX NL/AEX	BEL 20/BE BEL20	PSI 20 PT/PSI20	OMX SE 30/SE OMX			
	OMX 20 DK/KFX	OMX 25 FI/ HEX25	NZX 50/NZSE50FG	S&P/ASX200/AUAS51			
	Hang Seng/HK HSI						
	Short-Term Money Market Funds as defined by ESMA, with a AAA money market fund rating from at least one of Moody's, Standard and Poor's, and Fitch. This includes "Prime" money market funds as well as Public Debt money market funds. The Agent is authorised to use the following money market funds:						
	HSBC Global Liquidity Funds plc						
Money Market Instrument	HSBC Monetaire (France) – EUR only					105	Not allowed
	HSBC Monetaire Etat (France) – EUR only						
	Other, including non-HSBC, money market funds may only be used by the Agent when authorised by (*AMG/Fund/Board)						
	Shares of the following Exchange-Traded Funds provided that (i) no issuer represents more than 15% of amount of Collateral pledged by an Approved Borrower to Lender, on an aggregate basis across all loans outstanding from Lender to such Approved Borrower and (ii) the number of shares of a specific Exchange Traded Fund pledged by an Approved Borrower to Lender, on an aggregate basis across all loans outstanding from Lender to such Approved Borrower may not exceed 1 times the 90 day average trading volume of such Exchange-Traded Fund:						
	Tier 1						
	Deka DAX (R) UCITS ETF ETFDAX GY	iShares Core DAX UCITS ETF (DE) DAXEX GY				105	105
	iShares Core FTSE 100 UCITS ETF (Inc)	ISF LN iShares Core S&P 500 ETF IVV US					
	iShares S&P 100 ETF OEF	Xtrackers DAX UCITS ETF 1C XDAX GY					
Exchange-Traded Funds	CAC 40 -D- EUR CAC FP	SPDR S&P 500 ETF SPY US					
	US iShares SMI (R) (CH) CSSMI SW Lyxor UCITS ETF						
	Equities listed in the following indices provided that no issuer represents more than 5% of amount of Collateral pledged by an Approved Borrower to Lender, on an aggregate basis across all loans outstanding from Lender to such Approved Borrower:						
	Tier 2						
	Daiwa ETF Nikkei 225 1320 JT	iShares Nikkei 225 1329 JT				110	110
	iShares S&P/TSX 60 Index Fund XIU CN						
	Nikko Exchange Traded Index Fund 225 1330 JT						
	Nomura Nikkei 225 Stock Index Listed Fund 1321 JT						

Source: HSBC Global Asset Management. For illustrative purposes only.

Appendix

Eligible HSBC ETFs

PEA eligible products will be included in the programme given the securities lending agent (HSS) has a defined framework for ensuring that PEA eligible products do not violate any of the eligibility criteria as a result of the programme.

The programme has a defined framework to ensure all ETFs continually comply with the German Investment Tax Act (GITA) requirements as laid down in the HSBC ETF prospectus.

Fund	ISIN
HSBC EURO STOXX 50 UCITS ETF	IE00B4K6B022
HSBC MSCI China UCITS ETF	IE00B44T3H88
HSBC MSCI Emerging Markets UCITS ETF	IE00B5SSQT16
HSBC MSCI Japan UCITS ETF	IE00B5VX7566
HSBC MSCI Pacific ex Japan UCITS ETF	IE00B5SG8Z57
HSBC MSCI World UCITS ETF	IE00B4X9L533

Source: HSBC Global Asset Management.

Important information

Key risks

The value of an investment in the portfolios and any income from them can go down as well as up and as with any investment you may not receive back the amount originally invested.

- **Concentration Risk:** The Fund may be concentrated in a limited number of securities, economic sectors and/or countries. As a result, it may be more volatile and have a greater risk of loss than more broadly diversified funds.
- **Counterparty Risk:** The possibility that the counterparty to a transaction may be unwilling or unable to meet its obligations.
- **Derivatives Risk:** Derivatives can behave unexpectedly. The pricing and volatility of many derivatives may diverge from strictly reflecting the pricing or volatility of their underlying reference(s), instrument or asset.
- **Emerging Markets Risk:** Emerging markets are less established, and often more volatile, than developed markets and involve higher risks, particularly market, liquidity and currency risks.
- **Exchange Rate Risk:** Changes in currency exchange rates could reduce or increase investment gains or investment losses, in some cases significantly.
- **Index Tracking Risk:** To the extent that the Fund seeks to replicate index performance by holding individual securities, there is no guarantee that its composition or performance will exactly match that of the target index at any given time ("tracking error").
- **Investment Fund Risk:** Investing in other funds involves certain risks an investor would not face if investing in markets directly. Governance of underlying assets can be the responsibility of third-party managers.
- **Investment Leverage Risk:** Investment Leverage occurs when the economic exposure is greater than the amount invested, such as when derivatives are used. A Fund that employs leverage may experience greater gains and/or losses due to the amplification effect from a movement in the price of the reference source.
- **Liquidity Risk:** Liquidity Risk is the risk that a Fund may encounter difficulties meeting its obligations in respect of financial liabilities that are settled by delivering cash or other financial assets, thereby compromising existing or remaining investors.
- **Operational Risk:** Operational risks may subject the Fund to errors affecting transactions, valuation, accounting, and financial reporting, among other things.
- **Real Estate Investments Risk:** Real estate and related investments can be negatively impacted by any factor that makes an area or individual property less valuable.

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