

Social & Governance

Investing Responsibly – Governance matters

EQUITIES GOVERNANCE

Europe

- ▶ Investors are increasingly using governance data points to flag risk indicators that may impact performance
- ▶ HSBC analysis suggests that improving governance helps companies outperform in both Europe and the US
- ▶ Focusing on governance improvers in Europe and the US is a viable strategy for investors

Governance is increasingly becoming quantified to drive decision making

We believe investors are recognising the materiality of governance as a factor of investment decision making. Given the consequences of governance failure to corporate value we believe investors are looking more closely at indicators of governance quality such as board, compensation and shareholder rights in order to identify risk factors that may impact performance. Within this report we have used Institutional Investor Services quantitative-driven QuickScore product as available via Bloomberg to assess the impact of governance within Europe and the US.

Improving governance helps companies outperform in Europe & the US

Our research suggests that governance can help companies outperform both in Europe and the US. In Europe our analysis shows that the improvement (positive trend) in two sub-scores: board and compensation has a positive impact. In fact we found that European companies with improving board scores outperformed the Stoxx Euro 600 by an average return of 2.5% over a two year period. Additionally companies with improving compensation show the strongest level of outperformance of 3.5% over the same period. Turning to the US, the improvement in the overall governance QuickScore was the only indicator we found (thus far) that drives outperformance. Our analysis found that companies with improved scores outperformed the S&P 100 by 12.7% over a three year period.

Governance matters: Focus on the improvers

Our research suggests that improving governance appears to have a positive performance impact for European and US companies. As such we believe for investors, focusing on companies with improving governance momentum is now potentially a viable strategy.

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Disclosures & Disclaimer

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it.

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Executive Summary

Governance is now a quality driver

Poor governance can lead to ineffective strategic decisions, weak culture and management and therefore increased environmental and social risks.

Poor governance can lead to ineffective strategic decisions, weak culture, and ineffective management which can ultimately lead to increased environmental and social risks. For investors such risks can destroy the value of a business irrespective of the attractiveness or price of its assets or its level of market share.

We believe that increasingly investors are focusing on governance as a quality driver particularly in emerging markets. In our view governance quality begins with the board and in our recent Social & Governance framework piece we called for investors to go back to basics when looking at governance by focusing on board quality and structure which is now of relatively higher importance for investors.

Improving governance is a performance driver

European companies with improved board and compensation outperformed the Stoxx Euro 600 by 2.5% and 3.5% respectively between 2014 and 2016.

Our analysis suggests that improving governance can help companies outperform in both Europe and the US. In Europe we found companies that have significantly improved their board and compensation scores by 3 or more points (on a 2yr average) outperformed the Stoxx Euro 600 index. In fact our research found that companies with improved boards outperformed by 2.5% between 2014 and 2016 while companies with improved compensation outperformed by 3.5%.

US companies with the most improved overall governance score outperformed the S&P 100 by 12.7% on a three year basis

For the US we found that the improvement in the overall governance score mattered and not the sub-scores (Board, Compensation, Audit Practices and Shareholder rights) which is the reverse of what we found in Europe. Our analysis found that US companies which improved their overall governance QuickScore by 3 or more points (on a 3yr average) outperformed the S&P 100 by 12.7% between 2013 and 2016.

Governance should inform investor decision making

Increasingly large asset owners and investment managers are moving towards much longer time horizons. As such we believe governance is increasingly viewed as an overlay that can be useful in spotting factors that may impact risk, performance and profitability over the longer term. We believe that our analysis highlights the positive performance impact of improving governance for European and US companies. We suggest that for investors focusing their engagement on improving governance in both Europe and the US is now a viable strategy.

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The materiality of governance

- ▶ Investors view governance as a component of investment decision making
- ▶ Culture is a key characteristic of governance
- ▶ Governance failure can be costly for investors

Governance increasingly factored into investment

We believe that Governance issues are widely considered by investors given that it remains consistent and material on a sector and regional basis. In a recent study of 300¹ decision makers by Aberdeen Asset management governance was found to be an integral factor when selecting and analysing investments. In addition almost 90% of respondents to Aberdeen's survey considered effective governance to be a critical driver of investment performance. Furthermore in a recent study looking at ESG issues in investing, the CFA institute surveyed 44,131 of its members whose roles predominantly included portfolio managers and research analysts. The report highlighted that 64% of respondents take governance issues into account as part of investment analysis or decision making, while 78% of respondents indicated that the most important ESG issue in their investment analysis/decisions is board accountability followed by human capital (62%) and executive compensation (61%).

But does better governance help companies outperform?

Governance isn't just a simple box ticking exercise; it involves a qualitative, evaluation of corporate practices and of the people involved in its actual development and outcome. It's also concerned with the evaluation of complex issues varying in size and scope from the quality of management to effective risk management.

Increasingly both academic studies and research from investment managers seem to suggest that it does help companies outperform. The most widely cited academic study on governance and its relationship to stock market performance was first published in the quarterly Journal of Economics back in 2003. Within this study Harvard and Wharton² research highlighted that stocks of well governed companies outperformed those of poorly governed firms. In addition a Hermes Investment management study³ has shown that companies with lower-ranked governance scores underperformed the MSCI world index in 62% of the months during a five year performance period. A key feature of a good governance model is a long term perspective and this study and others are beginning to highlight that investing over long horizons benefits both investors and society.

¹ Governance: new risks, new rules, *Thinking aloud* - Aberdeen Asset Management, 23 November 2015

² Eccles, Robert G., and George Serafeim. "The Performance Frontier: Innovating for a Sustainable Strategy." *Harvard Business Review* 91, no. 5 (May 2013): 50–60.

³ Hermes Investment Management –ESG investing January 2014

Culture the main factor of governance failure?

Many of the governance scandals over the last decade have resulted in a re-shaping of the governance landscape on a global basis. Typically reforms have included: revised codes across Europe and the US and increased investor attention to issues such as board independence, accountability and diversity.

Furthermore at the corporate level governance failures have often led to culture change with the introduction of new management and increased accountability and supervision at the board level and the removal or introduction of non-executive directors. Looking at some of the biggest governance failures of the last decade both investors and regulators have highlighted weak risk culture as a primary cause.

“ Nothing moves a business in a direction as powerfully as corporate culture”. It is the challenge of directors and management to ensure that it moves in the right direction.

Justin King former CEO of Sainsbury Plc

In the UK the financial reporting council has launched a market led culture project

The challenge for investors more generally lies in understanding how the culture of an organisation is driving its strategy and risk taking and it is here that the board has a vital role to play.

Unfortunately this is not easily codified within corporate governance regulation. In 2015 the UK's Financial Reporting Council launched a market led culture project designed to gather practical insight into corporate culture and the role of boards; to understand how boards can shape, embed and assess culture; and to identify and promote best practice. The subsequent report on this project will undoubtedly become a tool for both UK and potentially international companies given the UK's position as a leader in corporate governance. In addition we believe investors more generally may find this to be a useful framework for discussing culture with corporates.

Governance failures are costly

When governance fails the consequences for shareholders in terms of value destruction can be costly. Within the following pages we outline some examples of companies that have experienced governance failures. However, the companies we have included do not constitute a scientific selection but are merely some of the most high profile governance failures in the recent past. In addition within each company example we outline the following:

- ▶ The specific events and news flow leading to value destruction for investors
- ▶ The time frame over which governance impact is visible in the share price
- ▶ Duration before share price returns to pre-event levels.

Ahold

On 21 February 2003, Ahold's stock price dropped c50%, based on news flow that the company in the past two years has overstated its earnings by more than USD500m. It took almost a year for the stock to recover back to the February 2003 levels, despite the departure of its CEO in May 2003. In November 2005, Ahold also agreed to pay shareholders USD1.1bn to settle lawsuits related to the accounting scandal and in May 2006, its executives involved in the scandal were also fined by the court.

Ahold news flow

Date	News	Description	Source
27/02/2003	Accounting scandal	Exaggerated earnings by more than USD500m	The Economist, 27 February 2003
01/10/2004	Agreed to pay fine	Agreed to pay USD10m to avoid charges by Dutch public prosecutor in 2003 book keeping scandal	The Globe and Mail, 1 October 2004
29/11/2005	Lawsuit settlement	Agreed to pay USD1.1bn for accounting scandal	Washington Post, 29 November 2005
22/05/2006	Executives fined	Convicted top executives in relation to financial scandal	NBC News, 22 May 2006
21/05/2014	US food customer lawsuit	Agreed to pay USD297m to settle US class action litigation for defrauding hospitals and restaurants through overcharges	Reuters, 21 May 2014

Source: The Economist, The Globe and Mail, Washington Post, NBC News, Reuters

Ahold vs close peers price movement (indexed to 100)



Source: Bloomberg, HSBC

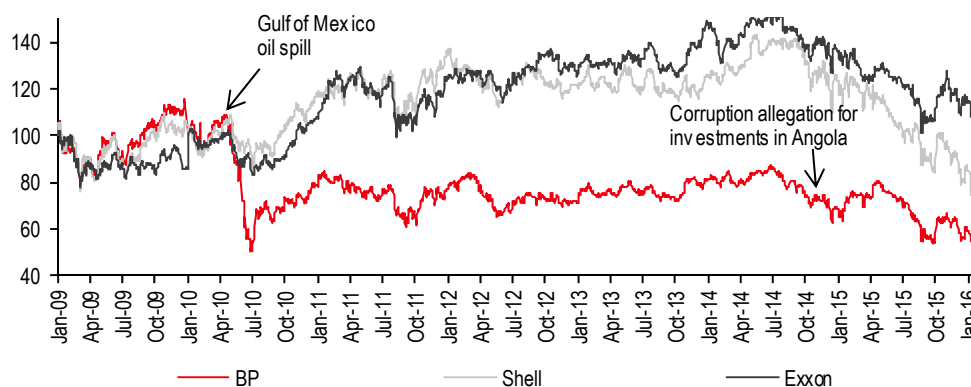
BP Plc

On 20 April 2010, an offshore oil drilling rig exploded in the Gulf of Mexico, with oil leaks continuing for over three months despite all possible attempts to stop leakages. This remains the biggest oil spill in the history. Within five weeks of the incident, the company stock lost one-third of its value. While the stock price started to show some recovery after three months. Six years on from the incident date, the stock has never reached pre-spill levels.

Company news flow

Date	Issue	Description	Source
15/03/2006	Pollution	Oil spill detected in Alaska	NY Times, 15 March 2006
8/5/2008	Pollution	Oil giants agreed to pay USD423m for ground water contamination in US	NY Times, 8 May 2008
20/04/2010	Pollution	Gulf of Mexico Oil spill	News basics, 20 April 2010
3/8/2010	Pollution	USD10bn lawsuit filed for toxic chemical release in Texas	Telegraph, 3 August 2010
3/11/2011	Pollution	Fined USD50m for Texas city pollution	Bizjournals, 3 November 2011
15/03/2012	Corruption	Preferential treatment of suppliers	Huffington Post, 15 March 2012
7/9/2013	Corruption	Corruption in Gulf of Mexico settlement	Telegraph, 7 September 2013
23/09/2013	Freeze settlement	Freeze settlement pay out	Law 360, 23 September 2013
6/11/2013	Mine pollution	Fined USD19.5m for leaking toxic chemicals in US	RT, 6 November 2013
4/8/2014	Corruption Allegation	Mysterious investment in Angola	Global Witness, 4 August 2014
15/10/2014	Farmers claim damage	Columbian farmers sue BP for claims	IB Times, 15 October 2014
6/10/2015	Settles Gulf spill	USD20bn claim	CNN, 6 October 2015

Source: NY Times, News basics, Hubspot, Telegraph, Bizjournals, Huffington Post, Law 360, RT, Global Witness, CNN, IB Times

BP share price impact 2009-2016 as against price performance of peers

Source: Bloomberg, HSBC

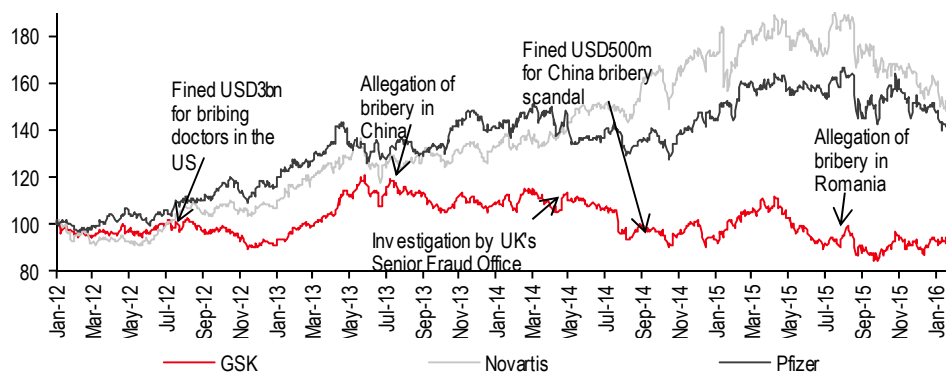
GlaxoSmithKline (GSK)

In July 2013, China accused GSK for bribing doctors with cash and other benefits in return for prescribing GSK drugs. Chinese officials held investigations and detained senior executives of the company over estimated deals of RMB3bn. GSK was also accused of using more than 700 middlemen and travel agencies for bribing the doctors. The stock price was down 2% on the same day following the negative news announcement and was down by more than 4% in the same week. The stock returned to its previous price level 5 months after the incident.

Company news flow

Date	Issue	Description	Source
3/7/2012	Bribery scandal	Fined USD3bn after admitting bribing doctors in US	The Guardian, 3 July 2012
15/07/2013	Bribery scandal	Allegation of bribing doctors in China	The Guardian, 15 July 2013
14/04/2014	Bribery scandal	Allegation of bribing doctors in Europe	Telegraph, 14 April 2014
28/05/2014	Regulatory investigation	UK's Senior Fraud Office examined medical practices	Herald Scotland, 28 May 2014
19/09/2014	Bribery scandal	Fined USD500m for bribery scandal in China	WSJ, 19 September 2014
30/07/2015	Bribery scandal	Allegation of bribing doctors in Romania	Fierce Pharma, 30 July 2015

Source: Justice, The Guardian, Telegraph, Herald Scotland, WSJ, Fierce Pharma

GSK Share price impact 2012-2016 compared with share price performance of peers

Source: Bloomberg, HSBC

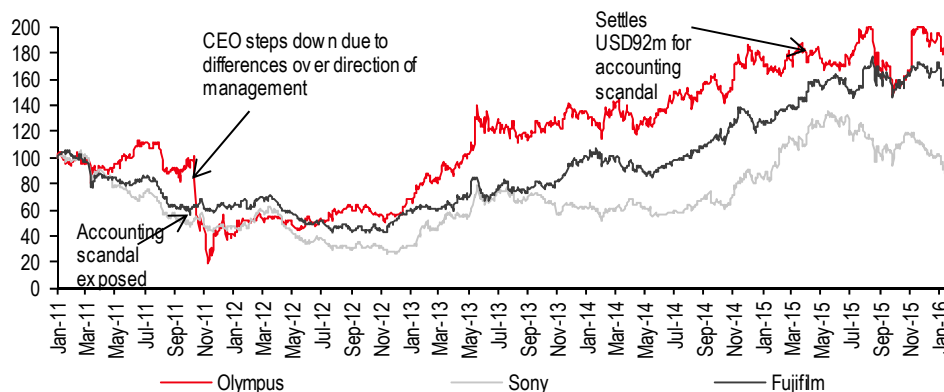
Olympus

On 13 October 2011, news came that the CEO has stepped down due to some differences with the management team. On 3 November 2011, an accounting scandal was exposed whereby the company had forged its accounts and hidden losses from investments. There were mysterious payments and write down of some acquisitions. Within a month (13 October -13 November 2011), the stock was down c65%. Olympus took around 1.5 years to recover to its pre-incident level.

Date	Issue	Description	Source
13/10/2011	Management departure	CEO steps down due to difference in direction of management	Reuters, 13 October 2011
3/11/2011	Accounting scandal	Forged accounts and hid losses from investments	The Guardian, 3 November 2011
1/12/2011	Management departure	Michael Woodford steps down from board	NY Times, 1 December 2011
12/6/2012	Settlement for dismissed director	EUR10m pay out to be given to dismissed director Michael Woodford following his whistleblowing regarding accounting scandal	Independent, 12 June 2012
1/8/2012	Bribery scandal	Allegation of bribery in Brazil for medical equipment sales	WSJ, 1 August 2012
31/03/2015	Settlement	Agreed to pay USD92m to settle accounting scandal	Fierce Medical Devices, 31 March 2015
2/4/2015	Shareholder	Sony decided to half its shareholding (5% from 10% before) following fines paid by Olympus	CityAM, 2 April 2015

Source: Reuters, The Guardian, NY Times, Independent, WSJ, Fierce Medical Devices, City AM

Olympus share price impact 2011-2016 compared with price performance of peers



Source: Bloomberg, HSBC

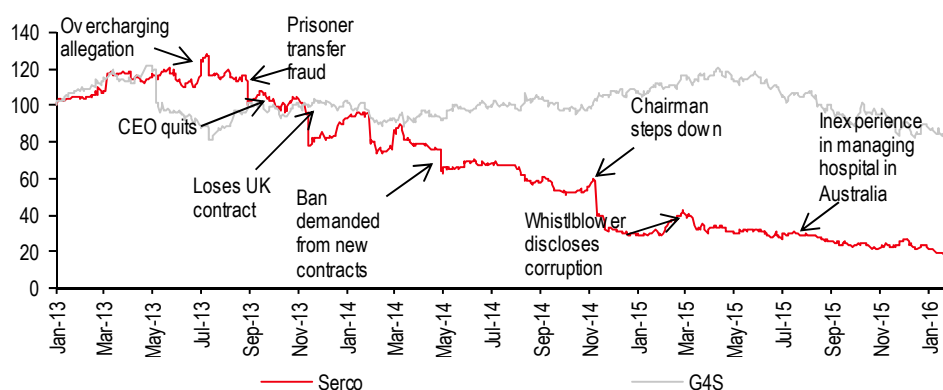
Serco plc

On 11 July 2013, Serco was involved in overcharging tax payers by up to GBP50m in electronic tagging contracts. It was alleged that both Serco and G4S charged to monitor non-existent electronic tags. On 28 August 2013, Serco agreed to repay GBP68m to the government. Following the controversy, in November 2013 Serco lost a UK Government prisons contract and post controversy, Serco's stock price has not reached its pre-event levels.

Company news flow

Date	Issue	Description	Source
11/7/2013	Overcharging	Overcharged tax payers by up to GBP50m, on electronic tagging contracts	Independent, 11 July 2013
28/08/2013	Fraud allegations	Prisoner transfer contract fraud	BBC, 28 August 2013
25/10/2013	Management departure	CEO resigns following scandal	The Guardian, 25 October 2013
22/11/2013	Contract loss	UK government deal lost	Telegraph, 22 November 2013
19/12/2013	Settlement	Agreed to repay government for overcharging	Sky News, 19 December 2013
17/11/2014	Board departure	Alastair Lloyd resigned	Independent, 17 November 2014
26/02/2015	Business Ethics	Whistle-blower announced company turned blind eye to corruption in UK immigration jail	RT, 26 February 2015
19/8/2015	Inexperience	Staff resign in an Australian hospital allegedly owing to inexperienced Serco employees	WA Today, 19 August 2015

Source: Independent, BBC, The Guardian, Telegraph, Sky News, RT, WA Today

Serco Share price impact 2013-2016 compared to price performance of peer

Source: Bloomberg, HSBC

Siemens

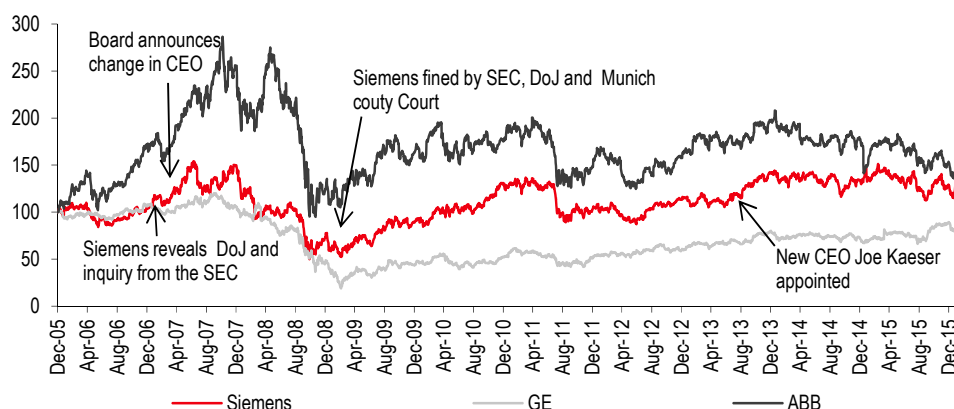
Towards the end of 2006 Siemens was fined for bribery in its telecommunication equipment business (COM, ICN) and shortly after for price fixing in its power transmission and distribution business. This triggered an investigation by the US Department of Justice (DoJ) and an inquiry by the Securities and Exchange Commission (SEC). As a consequence the chairman, the CEO and several other top managers had to leave and found themselves as defendants in criminal and civil courts. The required changes to the organization proved to be disruptive and led to poor operating performance, significant charges and share price underperformance.

Company news flow

Date	Issue	Description	Source
04/10/2006	Fine	A Munich District Court imposes fine of EUR201m for bribes at COM. Siemens settles with related tax matters with authorities.	Siemens
15/11/2006	Bribery	Siemens offices raided by police for suspected fraud at ICN	Siemens
23/11/2006	Bribery	Siemens establishes taskforce to tackle illegal business practices	Siemens
24/01/2007	Price fixing	Siemens takes legal action against anti trust charges of EUR396m for alleged price fixing in GIS between 1988-2004	Siemens
25/01/2007	Bribery	Q1 report and AGM. Siemens reveals investigation by the DoJ and inquiry from the SEC	Financial Times
13/02/2007	Price fixing	Siemens suspends 3 employees related to price fixing at PTD between 1999-2003	Siemens
14/02/2007	Price fixing	Further searches in Nuremberg and Erlangen	Siemens
19/04/2007	Corp Governance	Chairman Dr. von Pierer announces resignation	Siemens
20/05/2007	Corp Governance	Board announces change in CEO. Siemens lifer Dr. Kleinfeld to be replaced by company outsider Peter Loescher	Siemens
28/06/2007	Governance	Chief Compliance Officer Daniel Noa leaves	Siemens
01/10/2007	Governance	Peter Y Solmssen appointed General Counsel in the Management Board	Siemens
15/12/2008	Fine	Siemens fined USD350m by SEC, USD450m by DoJ and a total of USD854m (EUR395m + cEUR200m) by the Prosecutor General in Munich	SEC
19/05/2011	Breach of contract	Siemens ordered to pay Areva EUR648m plus interest for breach of contractual obligations	Siemens
05/04/2012	Settlement	Siemens agrees to settle with Greece for approximately EUR270m	Siemens
31/07/2013	Chg in mgmt	CEO Peter Loescher resigns to be replaced by Joe Kaeser	Siemens
28/02/2014	Ban	Siemens banned from government contract bidding in Brazil for 5 years	Bloomberg

Source: Siemens, FT and Bloomberg

Siemens share price impact 2006-2016 compared with price performance of peers



Source: Bloomberg, HSBC

Toshiba

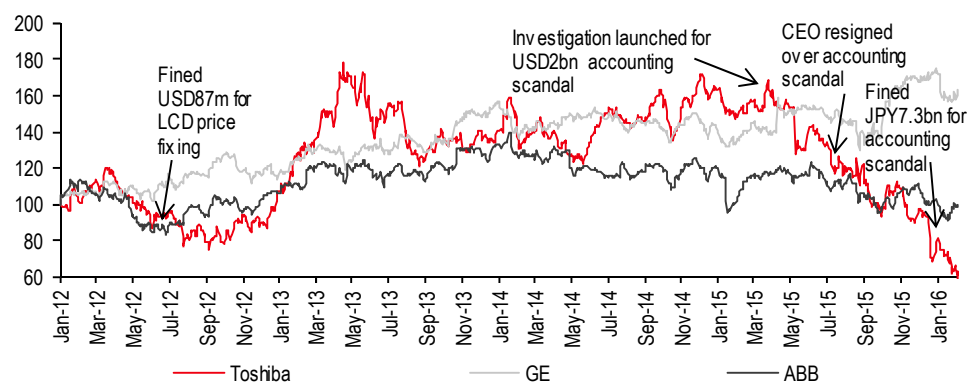
On 8 April 2015, investigations were launched into Toshiba's accounting practices. This also led to a delay in the announcement of annual results. On 21 July 2015, the CEO resigned following the scandal and on 8 September 2015, Toshiba admitted that it had overstated profits by more than USD2bn over 7 years. By this time, the stock was down 31% from early April 2015 levels. On 25 December 2015, Toshiba was fined JPY7.3bn (USD 60 million) by the Financial Services Agency (FSA) for the accounting scandal. The stock price is now down 64% since 8th April 2015 levels with no signs of recovery yet.

Company news flow

Date	News	Description	Source
4/7/2012	LCD price fixing	USD87m fine for price fixing LCD panels and keeping them artificially high	BBC, 4 July 2012
8/4/2015	Investigation launched	Investigation launched following troubled accounts	Strata, 4 August 2015
21/07/2015	CEO resigned	CEO Hisao Tanaka resigned following accounting scandal	BBC, 21 July 2015
8/9/2015	Agreed for accounting scandal	Admitted that it overstated profit by USD2bn over 7 years	Fortune, 8 September 2015
21/12/2015	Job cut following scandal	Cuts 7,800 jobs following scandal	Fortune, 21 December 2015
25/12/2015	Fined for accounting scandal	JPY7.3bn fined for accounting scandal by FSA	Wall Street Journal, 9 December 2015

Source: BBC, Strata, Fortune, Wall Street Journal

Toshiba share price impact 2012-2016 compared with price performance of peers



Source: Bloomberg, HSBC

Volkswagen

On 20 October 2008, the news flow of Porsche secretly buying Volkswagen shares became public as the German financial regulators did not require Porsche to disclose this information. Porsche disclosed that it owned 42.6% of Volkswagen and has options to purchase another 31.5%, which raised concerns among shareholders and led to investigation. Volkswagen's stock price was down 5% on the same day and the downtrend in prices continued with the share price down by 50% in the two weeks following the news. However, the share price rebounded to its previous levels after 7 months.

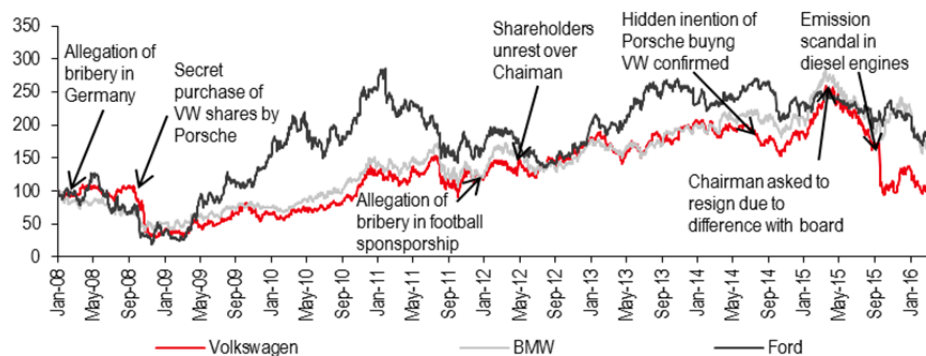
More recently on 18th September 2015, Volkswagen acknowledged that it has been deploying software to cheat emission tests in the US. The stock price was down 19% on a single day and was down over 40% in total within two weeks following the news. Volkswagen also witnessed the resignation of its CEO and various senior executives. After approximately four months the stock price remains approximately down 38% from the pre-controversy level.

Company news flow

Date	Issue	Description	Source
13/01/2008	Bribery scandal	EUR2.5m affair unfolded and involved bribes by the management to get the support of union officials and shop floor workers.	The Guardian, 13 January 2008
29/10/2008	Porsche stake	Porsche had been building 74% stake in VW through intermediaries. Germany's financial regulations did not require Porsche to disclose this	Telegraph, 29 October 2008
18/04/2012	Shareholder unrest	Shareholders felt that they had negligible say in managing the company.	Financial Times, 18 April 2012
16/08/2014	Court confirmed hidden intension of Porsche in VW deal	Porsche's Ex CEO and CFO to stand trial on market manipulation charges. Court said Porsche board may have approved the deal seven months before publicly announcing	Bloomberg, 16 August 2014
27/04/2015	Board departure	Chairman Ferdinand Piech had a confrontation with senior board members which triggered a leadership crisis	Reuters, 27 April 2015
22/09/2015	Emission scandal	Company sets aside USD7.3bn to cover the fallout from the emission scandal	Business Insider, 22 September 2015
23/09/2015	Management resignation	VW's CEO, Martin Winterkorn resignation comes a day after he vowed to stay and repair the damage of the emission scandal	Bloomberg, 23 September 2015

Source: The Guardian, Telegraph, Bloomberg, Financial Times, Business Insider, Reuters

Volkswagen Share price impact 2008-2016 compared with share price performance of peers



Source: Bloomberg, HSBC

Europe: The 2 score effect

- ▶ Positive momentum in board and compensation can help companies outperform
- ▶ Score volatility is higher for average companies
- ▶ Investors should focus on the improving board and compensation scores for average companies

Understanding the data

ISS QuickScore (QuickScore) methodology

The QuickScore product uses a numeric, decile-based score that indicates a company's governance risk relative to their index or region. A score of 1 indicates relatively lower governance risk, and, conversely, a score of 10 indicates relatively higher governance risk.

Companies receive an overall QuickScore and are also assessed across four pillars: Board Structure, Compensation/Remuneration, Shareholder Rights and Audit practices.

There are nearly 200 factors analysed, with the specific factors under analysis varying by region. Each governance factor is assigned a weight, based on the input from ISS' global team of governance experts and understanding the impact of governance practices and ISS voting policy, along with the prevailing governance standards within each region. QuickScore offers year-round focus, with event-driven data updates to capture changes to a company's governance structure on an ongoing basis.



Source: Institutional Shareholder Services Inc.

ISS QuickScore was started in 2013 however data only started to appear on the Bloomberg terminal in 2014 limiting our analysis to a two year period 2014-2016. We opted to use the QuickScore product for three reasons. First, its sole focus on governance, second it's global coverage and finally the fact that it consists of an overall governance score in addition to four separate sub-scores on Board, Compensation, Audit and Shareholder rights. This allowed us to test whether there was a correlation between the overall governance score and investment performance or whether the sub-scores are more significant in terms of investment performance.

Improving board and compensation structures drives outperformance

Looking at the data on a European regional basis we could see evidence that the four pillar scores: Board, Compensation, shareholder Rights and Audit Practices appeared to have a clear effect in terms of driving the total governance score although we don't have access to the (proprietary) weightings ISS uses to determine the pillar scores on a regional basis.

“ European Companies with improving boards outperformed by an average return of 2.5% vs the Stoxx Euro 600 over a two year period. In contrast companies with improved compensation outperformed by 3.5% on average.

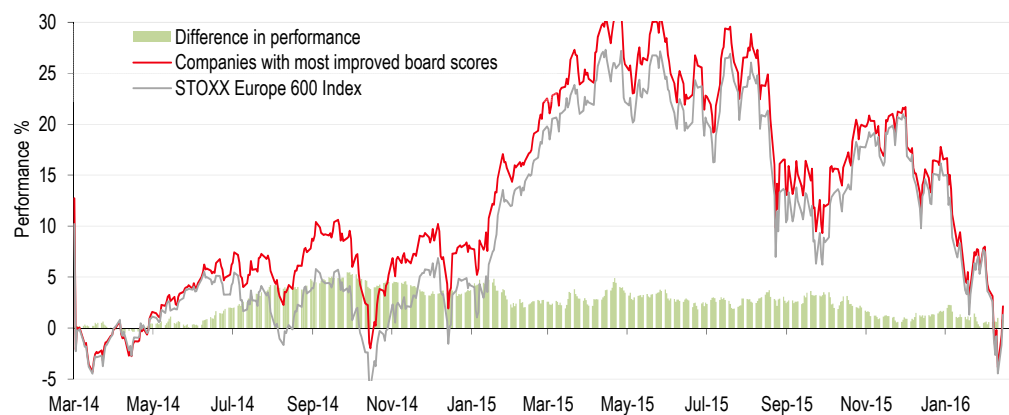
We compared all of the ISS pillar scores over a two year performance period beginning Feb 2014 to February 2016. We selected companies where their pillar scores had improved by more than 3 or deteriorated by more than 3 within the STOXX Europe 600 index (SXXP). This allowed us to identify firms that had changed their pillar scores in a meaningful and significant way towards lower concern or average as well as companies that had seen significant deterioration in their scores towards high concern. We then, constructed a portfolio for each group separately based on improving and deteriorating and tracked their performance against the SXXP over a two year period. Our analysis shows that both board and compensation pillar scores appear to drive outperformance with improved compensation showing the strongest outperformance signal.

We note that companies with improving boards outperformed by an average return of 2.5% compared with companies with deteriorating board scores, which underperformed by 3.9% on average. In contrast companies with improved compensation outperformed the SXXP by 3.5%, vs those with deteriorating compensation scores, which underperformed by 5.3%.

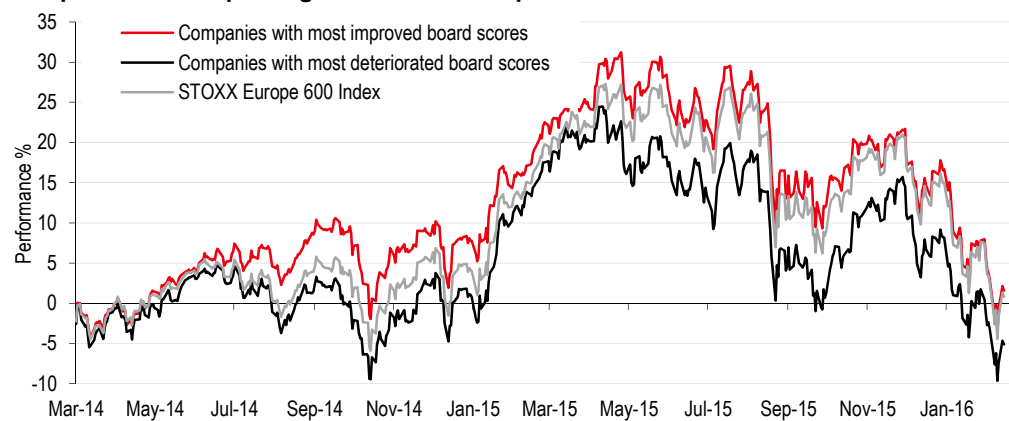
Assessing board quality more art than science

Board effectiveness and quality appear to be high on the radar of investors and board quality (particularly board composition) could be viewed as a signal of how companies are performing before it becomes evident in the financials. The importance of the board reinforces our belief that it is time to go back to basics. Understanding board quality, structure and diversity is critical when making investment decisions, but perhaps requires more nuance in driving change because it's ultimately more qualitative than quantitative and therefore perhaps more art than science. Compensation in contrast tends to be a hard data point and this might explain why compensation shows a stronger signal in terms of outperformance. Nevertheless the high level of legislation requiring improvements in board diversity across Europe will spur investors to focus more on this issue going forward.

Understanding board quality, structure and diversity is critical when making investment decisions, but perhaps requires more nuance in driving change

Improvement in board scores drives outperformance

Source: Bloomberg, ISS, HSBC

Companies with improving board scores outperform most deteriorated

Source: Bloomberg, ISS, HSBC

Companies with most improved board structure scores 2014-2016

Company	Ticker	Momentum in board*	Resulting score**	Country	Sector	Mkt cap (local ccy bn)	Close Price (local ccy)	HSBC Rating
Lancashire Holdings Ltd	LRE LN	+9	1	Bermuda	Financials	1.1	555.00	Hold
HUGO BOSS AG	BOSS GR	+8	1	Germany	Consumer Discretionary	3.8	53.84	Buy
Pennon Group PLC	PNN LN	+8	2	Britain	Utilities	3.3	802.00	Buy
Reckitt Benckiser Group PLC	RB/ LN	+8	1	Britain	Consumer Staples	45.6	6458.00	Buy
Standard Chartered PLC	STAN LN	+8	2	Britain	Financials	15.7	469.95	Hold
STMicroelectronics NV	STM IM	+8	2	Netherlands	Information Technology	5.0	5.45	Not covered
Gecina SA	GFC FP	+7	1	France	Financials	7.2	113.00	Hold
John Wood Group PLC	WG/ LN	+7	2	Britain	Energy	2.5	651.50	Buy
Jupiter Fund Management PLC	JUP LN	+7	1	Britain	Financials	1.9	414.60	Not covered
Metso OYJ	MEO1V FH	+7	3	Finland	Industrials	3.3	21.66	Not covered
Nokian Renkaat OYJ	NRE1V FH	+7	3	Finland	Consumer Discretionary	4.0	30.02	Hold
OMV AG	OMV AV	+7	3	Austria	Energy	8.2	24.88	Not covered
Rentokil Initial PLC	RTO LN	+7	2	Britain	Industrials	3.0	164.20	Reduce
Telenor ASA	TEL NO	+7	4	Norway	Telecommunication Services	202.7	134.50	Hold
Anglo American PLC	AAL LN	+6	1	Britain	Materials	7.1	533.00	Hold
Ashtead Group PLC	AHT LN	+6	4	Britain	Industrials	4.4	864.50	Buy
Cobham PLC	COB LN	+6	2	Britain	Industrials	2.7	239.30	Not covered
DSV A/S	DSV DC	+6	3	Denmark	Industrials	54.1	280.00	Not covered
Glencore PLC	GLEN LN	+6	4	Jersey	Materials	21.5	143.00	Not covered
Henderson Group PLC	HGG LN	+6	1	Jersey	Financials	2.8	245.50	Not covered
Imperial Tobacco Group PLC	IMT LN	+6	2	Britain	Consumer Staples	35.3	3692.50	Not covered
Inchcape PLC	INCH LN	+6	2	Britain	Consumer Discretionary	3.1	716.00	Buy
Next PLC	NXT LN	+6	1	Britain	Consumer Discretionary	9.7	6680.00	Hold
OCI NV	OCI NA	+6	4	Netherlands	Materials	3.6	17.12	Buy
ProSiebenSat.1 Media SE	PSM GR	+6	2	Germany	Consumer Discretionary	10.3	46.72	Buy
Provident Financial PLC	PFG LN	+6	2	Britain	Financials	4.8	3263.00	Not covered
Travis Perkins PLC	TPK LN	+6	2	Britain	Industrials	4.6	1849.00	Not covered
Banco de Sabadell SA	SAB SM	+5	5	Spain	Financials	8.5	1.58	Buy
BNP Paribas SA	BNP FP	+5	3	France	Financials	57.6	45.74	Buy
Elementis PLC	ELM LN	+5	4	Britain	Materials	1.0	225.70	Not covered
Eni SpA	ENI IM	+5	1	Italy	Energy	49.7	13.63	Hold
Erste Group Bank AG	EBS AV	+5	2	Austria	Financials	10.4	24.00	Buy
Georg Fischer AG	FI/N SE	+5	2	Switzerland	Industrials	2.9	707.50	Not covered
Meggitt PLC	MGGT LN	+5	2	Britain	Industrials	3.2	415.20	Not covered
Pandora A/S	PNDORA DC	+5	3	Denmark	Consumer Discretionary	105.1	860.50	Buy
Roche Holding AG	ROG VX	+5	4	Switzerland	Health Care	216.3	251.50	Buy
Rubis SCA	RUI FP	+5	4	France	Utilities	3.0	68.84	Buy
SABMiller PLC	SAB LN	+5	3	Britain	Consumer Staples	68.2	4211.50	Not covered
Sage Group PLC/The	SGE LN	+5	2	Britain	Information Technology	6.4	596.00	Not covered
SKF AB	SKFB SS	+5	2	Sweden	Industrials	68.2	148.40	Hold
Societe Generale SA	GLE FP	+5	1	France	Financials	28.1	34.46	Buy
Tele2 AB	TEL2B SS	+5	4	Sweden	Telecommunication Services	33.7	73.80	Hold
3i Group PLC	III LN	+4	1	Britain	Financials	4.3	444.70	Not covered
AstraZeneca PLC	AZN LN	+4	1	Britain	Health Care	50.7	4000.00	Hold
Booker Group PLC	BOK LN	+4	4	Britain	Consumer Staples	3.0	167.60	Buy
British Land Co PLC/The	BLND LN	+4	1	Britain	Financials	7.1	685.00	Hold
Cap Gemini SA	CAP FP	+4	4	France	Information Technology	13.3	76.93	Buy
Compass Group PLC	CPG LN	+4	1	Britain	Consumer Discretionary	20.4	1241.00	Not covered
EDP - Energias de Portugal SA	EDP PL	+4	5	Portugal	Utilities	10.7	2.93	Hold

Source: Bloomberg, ISS, HSBC. Price and HSBC rating as close of 3 Mar 2016.

*Note: Momentum is measured by the difference of board scores between Feb 2014 and Feb 2016

**Note: Resulting scores: 1-3 means low governance concern, 4-7 means average, 8-10 means high governance concern

Companies with most improved board structure scores 2014-2016

Company	Ticker	Momentum in board*	Resulting score**	Country	Sector	Mkt cap (local ccy bn)	Close Price (local ccy)	HSBC Rating
Elisa OYJ	ELI1V FH	+4	3	Finland	Telecommunication Services	5.4	32.19	Reduce
Griifols SA	GRF SA	+4	4	Spain	Health Care	12.2	20.02	Hold
Intu Properties PLC	INTU LN	+4	1	Britain	Financials	4.0	298.60	Hold
Investor AB	INVEB SS	+4	1	Sweden	Financials	221.0	289.00	Buy
ITV PLC	ITV LN	+4	5	Britain	Consumer Discretionary	9.4	232.60	Buy
Legal & General Group PLC	LGEN LN	+4	1	Britain	Financials	14.0	235.90	Buy
National Grid PLC	NG/ LN	+4	1	Britain	Utilities	35.2	938.50	Buy
Natixis SA	KN FP	+4	3	France	Financials	16.4	5.20	Hold
QIAGEN NV	QIA GR	+4	5	Netherlands	Health Care	4.7	20.18	Hold
Rolls-Royce Holdings PLC	RR/ LN	+4	1	Britain	Industrials	13.3	716.00	Not covered
Royal Dutch Shell PLC	RDSA NA	+4	1	Britain	Energy	172.9	21.58	Buy
Safran SA	SAF FP	+4	2	France	Industrials	24.3	58.25	Not covered
Shire PLC	SHP LN	+4	4	Jersey	Health Care	22.3	3755.00	Buy
Skandinaviska Enskilda Banken AB	SEBA SS	+4	1	Sweden	Financials	189.5	85.70	Hold
Smith & Nephew PLC	SN/ LN	+4	1	Britain	Health Care	10.3	1145.00	Not covered
Suez Environnement Co	SEV FP	+4	5	France	Utilities	8.6	15.73	Buy
WS Atkins PLC	ATK LN	+4	1	Britain	Industrials	1.3	1291.00	Not covered
Accor SA	AC FP	+3	5	France	Consumer Discretionary	9.4	39.48	Not covered
Amadeus IT Holding SA	AMS SM	+3	2	Spain	Information Technology	16.5	37.51	Hold
Amec Foster Wheeler PLC	AMFW LN	+3	2	Britain	Energy	1.8	434.30	Hold
BBA Aviation PLC	BBA LN	+3	4	Britain	Industrials	2.1	192.10	Not covered
Bellway PLC	BWY LN	+3	7	Britain	Consumer Discretionary	3.0	2453.00	Not covered
Berendsen PLC	BRSN LN	+3	2	Britain	Industrials	2.0	1164.00	Buy
Bunzl PLC	BNZL LN	+3	2	Britain	Industrials	6.6	1953.00	Buy
Clariant AG	CLN VX	+3	4	Switzerland	Materials	5.6	16.96	Hold
Croda International PLC	CRDA LN	+3	2	Britain	Materials	4.1	2982.00	Buy
Danone SA	BN FP	+3	2	France	Consumer Staples	41.3	63.04	Buy
Derwent London PLC	DLN LN	+3	6	Britain	Financials	3.4	3088.00	Hold
DS Smith PLC	SMDS LN	+3	2	Britain	Materials	3.6	378.60	Not covered
Eiffage SA	FGR FP	+3	6	France	Industrials	6.0	63.12	Buy
Elekta AB	EKTAB SS	+3	1	Sweden	Health Care	22.4	59.10	Hold
Engie SA	ENGI FP	+3	7	France	Utilities	34.8	14.19	Reduce
Essentra PLC	ESNT LN	+3	4	Britain	Materials	2.2	831.00	Not covered
Experian PLC	EXPN LN	+3	6	Jersey	Industrials	11.5	1190.00	Buy
Fonciere Des Regions	FDR FP	+3	7	France	Financials	5.1	76.60	Hold
GN Store Nord A/S	GN DC	+3	3	Denmark	Health Care	22.0	135.90	Buy
Hargreaves Lansdown PLC	HL/ LN	+3	2	Britain	Financials	6.0	1254.00	Not covered
Industria de Diseno Textil SA	ITX SM	+3	6	Spain	Consumer Discretionary	91.3	29.33	Hold
Kerry Group PLC	KYG ID	+3	7	Ireland	Consumer Staples	14.0	79.00	Not covered
Man Group PLC	EMG LN	+3	4	Britain	Financials	2.7	156.90	Not covered
Michael Page International PLC	MPI LN	+3	2	Britain	Industrials	1.3	392.90	Buy
Novartis AG	NOVN VX	+3	1	Switzerland	Health Care	192.7	72.00	Buy
Partners Group Holding AG	PGHN SE	+3	7	Switzerland	Financials	9.8	368.25	Not covered
Persimmon PLC	PSN LN	+3	2	Britain	Consumer Discretionary	6.1	1998.00	Not covered
Phoenix Group Holdings	PHNX LN	+3	2	KY	Financials	2.0	880.00	Hold
Randgold Resources Ltd	GOLD US	+3	2	Jersey	Materials	6.0	6335.00	Hold
Rotork PLC	ROR LN	+3	2	Britain	Industrials	1.6	183.90	Hold
Schibsted ASA	SCHA NO	+3	2	Norway	Consumer Discretionary	54.3	241.70	Not covered
Severn Trent PLC	SVT LN	+3	2	Britain	Utilities	5.0	2119.00	Hold
Sky PLC	SKY LN	+3	2	Britain	Consumer Discretionary	17.8	1030.00	Hold
Stora Enso OYJ	STERV FH	+3	3	Finland	Materials	6.3	7.90	Not covered
Telecom Italia SpA	TIT IM	+3	2	Italy	Telecommunication Services	18.3	1.00	Buy

Source: Bloomberg, ISS, HSBC. Price and HSBC rating as close of 3 Mar 2016.

*Note: Momentum is measured by the difference of board scores between Feb 2014 and Feb 2016

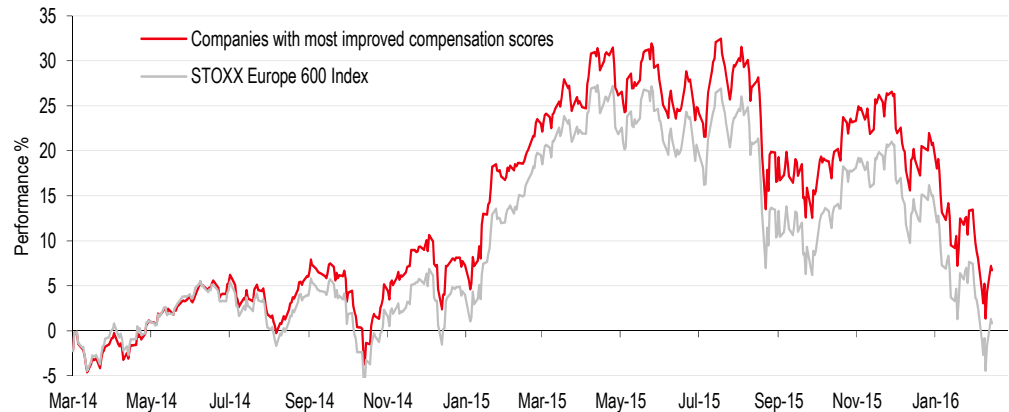
**Note: Resulting scores: 1-3 means low governance concern, 4-7 means average, 8-10 means high governance concern

Investors pay more attention to compensation structures...

Across Europe executive compensation continues to be an issue of concern for both investors and society

The compensation sub-pillar scores appear to be driven by changes in a number of factors such as pay for performance, quality of disclosure; pay controversies and use of equity (see pg. 14). Our analysis suggests that across Europe executive compensation continues to be an issue of concern for both investors and society. As such European companies in recent years have seen a raft of legislation and initiatives designed to increase reporting on remuneration to allow investors to make informed decisions on director compensation. One of the biggest drivers has been towards ensuring that European companies offer investors a binding vote on remuneration. For example from late 2013 UK listed companies by law must offer UK Shareholders a three yearly, forward-looking binding vote on the remuneration policy and an annual, advisory vote on all remuneration realised over the financial year. Many other European countries have introduced their own legislation on binding remuneration which inevitably has ensured a much higher focus from investors and governance stakeholders concerning executive compensation.

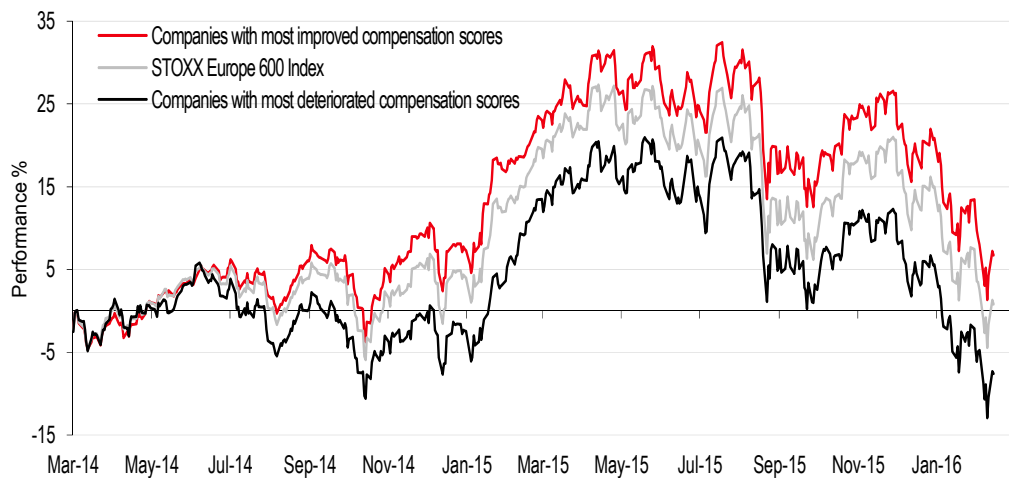
Improvement in compensation scores has a stronger signal than board improvement



Source: Bloomberg, ISS, HSBC

Companies with improved compensation scores outperformed the Stoxx Europe 600 index by 3.5% on average over a 2yr period

Companies with improved compensation outperform those with deteriorating scores



Source: Bloomberg, ISS, HSBC

Companies with most improved compensation structure scores 2014-2016

Company	Ticker	Momentum in comp*	Resulting score**	Country	Sector	Mkt cap (local ccy bn)	Close Price (local ccy)	HSBC Rating
Carlsberg A/S	CARLB DC	+8	2	Denmark	Consumer Staples	91.7	598.50	Reduce
Heineken NV	HEIA NA	+8	2	Netherlands	Consumer Staples	43.3	74.91	Buy
Phoenix Group Holdings	PHNX LN	+8	1	Kayman	Financials	2.0	880.00	Hold
Hiscox Ltd	HSX LN	+8	2	Bermuda	Financials	2.7	963.50	Hold
Hammerson PLC	HMSO LN	+7	2	Britain	Financials	4.4	558.00	Buy
Prudential PLC	PRU LN	+7	3	Britain	Financials	34.4	1340.50	Buy
International Consolidated Airlines Grou	IAG LN	+7	2	Spain	Industrials	10.8	533.00	Hold
easyJet PLC	EZJ LN	+7	1	Britain	Industrials	5.9	1485.00	Hold
Aggreko PLC	AGK LN	+7	2	Britain	Industrials	2.6	1008.00	Reduce
WPP PLC	WPP LN	+7	3	Jersey	Consumer Discretionary	20.4	1539.00	Hold
Publicis Groupe SA	PUB FP	+7	3	France	Consumer Discretionary	13.0	58.33	Buy
Michael Page International PLC	MPI LN	+7	1	Britain	Industrials	1.3	392.90	Buy
Rubis SCA	RUI FP	+7	2	France	Utilities	3.0	68.84	Buy
Seadrill Ltd	SDRL NO	+6	4	Bermuda	Energy	11.7	21.03	Not covered
Halma PLC	HLMA LN	+6	3	Britain	Information Technology	3.4	887.00	Buy
Sika AG	SIK VX	+6	4	Switzerland	Materials	9.7	3786.00	Buy
Firstgroup PLC	FGP LN	+6	1	Britain	Industrials	1.1	94.45	Hold
BG Group PLC	BG/ LN	+6	1	Britain	Energy	NA!	NA	Not covered
William Hill PLC	WMH LN	+6	1	Britain	Consumer Discretionary	3.4	399.40	Reduce
Carillion PLC	CLLN LN	+6	3	Britain	Industrials	1.2	291.00	Not covered
Air Liquide SA	AI FP	+6	4	France	Materials	33.5	96.96	Hold
Burberry Group PLC	BRBY LN	+6	3	Britain	Consumer Discretionary	6.1	1364.00	Buy
Lagardere SCA	MMB FP	+6	3	France	Consumer Discretionary	3.4	26.17	Hold
AXA SA	CS FP	+6	1	France	Financials	52.3	21.59	Buy
J Sainsbury PLC	SBRY LN	+6	1	Britain	Consumer Staples	5.1	264.30	Reduce
Julius Baer Group Ltd	BAER VX	+6	2	Switzerland	Financials	9.5	42.41	Not covered
Wolseley PLC	WOS LN	+6	2	Jersey	Industrials	9.8	3820.00	Buy
Iliad SA	ILD FP	+6	3	France	Telecommunication Services	12.7	215.25	Buy
Stagecoach Group PLC	SGC LN	+6	2	Britain	Industrials	1.5	266.50	Hold
CaixaBank SA	CABK SM	+6	3	Spain	Financials	15.8	2.71	Buy
Novartis AG	NOVN VX	+6	1	Switzerland	Health Care	193.4	72.00	Buy
Amadeus IT Holding SA	AMS SM	+6	3	Spain	Information Technology	16.5	37.51	Hold
BNP Paribas SA	BNP FP	+6	2	France	Financials	57.2	45.74	Buy
Mediobanca SpA	MB IM	+5	3	Italy	Financials	5.9	6.79	Not covered
TDC A/S	TDC DC	+5	1	Denmark	Telecommunication Services	24.3	29.79	Hold
Tesco PLC	TSCO LN	+5	2	Britain	Consumer Staples	15.2	186.15	Buy
Dassault Systemes	DSY FP	+5	4	France	Information Technology	17.8	68.75	Hold
Banca Monte dei Paschi di Siena SpA	BMPS IM	+5	1	Italy	Financials	1.6	0.57	Hold
BT Group PLC	BT/A LN	+5	2	Britain	Telecommunication Services	47.5	475.25	Buy
Prysmian SpA	PRY IM	+5	1	Italy	Industrials	4.1	19.02	Hold

Source: Bloomberg, ISS, HSBC. Price and HSBC rating as close of 3 Mar 2016.

*Note: Momentum is measured by the difference of compensation scores between Feb 2014 and Feb 2016

**Note: Resulting scores: 1-3 means low governance concern, 4-7 means average, 8-10 means high governance concern

Companies with most improved compensation structure scores 2014-2016

Company	Ticker	Momentum in comp*	Resulting score**	Country	Sector	Mkt cap (local ccy bn)	Close Price (local ccy)	HSBC Rating
United Utilities Group PLC	UU/ LN	+5	1	Britain	Utilities	6.3	920.50	Buy
Telefonica SA	TEF SM	+5	5	Spain	Telecommunication Services	49.1	9.83	Buy
Tryg A/S	TRYG DC	+5	1	Denmark	Financials	36.8	127.10	Hold
Arkema SA	AKE FP	+5	2	France	Materials	4.7	63.00	Buy
QinetiQ Group PLC	QQ/ LN	+5	4	Britain	Industrials	1.4	236.40	Not covered
Persimmon PLC	PSN LN	+5	4	Britain	Consumer Discretionary	6.1	1998.00	Not covered
Berendsen PLC	BRSN LN	+5	5	Britain	Industrials	2.0	1164.00	Buy
Severn Trent PLC	SVT LN	+5	3	Britain	Utilities	5.0	2119.00	Hold
Safran SA	SAF FP	+5	3	France	Industrials	24.4	58.25	Not covered
Meggitt PLC	MGGT LN	+5	3	Britain	Industrials	3.2	415.20	Not covered
OCI NV	OCI NA	+5	3	Netherlands	Materials	3.6	17.12	Buy
Ingenico Group SA	ING FP	+5	5	France	Information Technology	5.7	93.17	Buy
Teleperformance	RCF FP	+5	5	France	Industrials	4.1	71.77	Buy
FLSmidth & Co A/S	FLS DC	+5	4	Denmark	Industrials	13.1	261.00	Not covered
Bilfinger SE	GBF GR	+5	3	Germany	Industrials	2.0	42.84	Hold
dorma+kaba Holding AG	DOKA SE	+5	5	Switzerland	Industrials	2.5	600.50	Not covered
STADA Arzneimittel AG	SAZ GR	+5	5	Germany	Health Care	1.9	31.24	Hold
Vestas Wind Systems A/S	VWS DC	+5	2	Denmark	Industrials	105.5	469.70	Hold
Sodexo SA	SW FP	+4	4	France	Consumer Discretionary	14.6	92.55	Not covered
Unione di Banche Italiane SpA	UBI IM	+4	1	Italy	Financials	3.5	3.90	Buy
ICADE	ICAD FP	+4	5	France	Financials	4.7	63.97	Hold
Securitas AB	SECUB SS	+4	6	Sweden	Industrials	46.8	128.00	Reduce
St James's Place PLC	STJ LN	+4	2	Britain	Financials	4.5	856.00	Not covered
Assicurazioni Generali SpA	G IM	+4	3	Italy	Financials	20.5	13.10	Hold
Repsol SA	REP SQ	+4	4	Spain	Energy	15.4	10.56	Hold
Diageo PLC	DGE LN	+4	3	Britain	Consumer Staples	46.9	1853.00	Hold
Unilever PLC	ULVR LN	+4	1	Britain	Consumer Staples	92.7	3057.50	Buy
Whitbread PLC	WTB LN	+4	1	Britain	Consumer Discretionary	6.9	3800.00	Buy
Barratt Developments PLC	BDEV LN	+4	2	Britain	Consumer Discretionary	5.6	564.00	Not covered
Johnson Matthey PLC	JMAT LN	+4	2	Britain	Materials	5.0	2567.00	Buy
Taylor Wimpey PLC	TW/ LN	+4	1	Britain	Consumer Discretionary	5.8	178.20	Not covered
Actelion Ltd	ATLN SW	+4	4	Switzerland	Health Care	15.9	138.60	Buy
Alstom SA	ALOT FP	+4	1	France	Industrials	4.6	20.86	Not covered
Banco Popular Espanol SA	POP SM	+4	1	Spain	Financials	5.2	2.36	Buy
Investec PLC	INVP LN	+4	6	Britain	Financials	4.4	488.80	Buy
Swiss Re AG	SREN VX	+4	1	Switzerland	Financials	33.5	90.25	Buy
SGS SA	SGSN VX	+4	5	Switzerland	Industrials	15.6	2010.00	Reduce
Cie Generale des Etablissements Michelin	ML FP	+4	5	France	Consumer Discretionary	15.8	86.61	Buy
Legrand SA	LR FP	+4	1	France	Industrials	12.4	46.28	Hold
Edenred	EDEN FP	+4	2	France	Industrials	4.0	17.23	Not covered
Adecco SA	ADEN VX	+4	4	Switzerland	Industrials	10.6	60.75	Buy
SSE PLC	SSE LN	+4	2	Britain	Utilities	14.4	1430.00	Hold
Sky PLC	SKY LN	+4	3	Britain	Consumer Discretionary	17.7	1030.00	Hold
Derwent London PLC	DLN LN	+4	2	Britain	Financials	3.4	3088.00	Hold

Source: Bloomberg, ISS, HSBC. Price and HSBC rating as close of 3 Mar 2016.

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Companies with most improved compensation structure scores 2014-2016

Company	Ticker	Momentum in comp*	Resulting score**	Country	Sector	Mkt cap (local ccy bn)	Close Price (local ccy)	HSBC Rating
Croda International PLC	CRDA LN	+4	2	Britain	Materials	4.1	2982.00	Buy
AstraZeneca PLC	AZN LN	+4	1	Britain	Health Care	51.0	4000.00	Hold
Shire PLC	SHP LN	+4	1	Jersey	Health Care	22.3	3755.00	Buy
Roche Holding AG	ROG VX	+4	4	Switzerland	Health Care	217.0	251.50	Buy
Anglo American PLC	AAL LN	+4	1	Britain	Materials	7.0	533.00	Hold
TGS Nopec Geophysical Co ASA	TGS NO	+4	6	Norway	Energy	13.9	132.30	Not covered
Galenica AG	GALN VX	+4	3	Switzerland	Health Care	9.7	1495.00	Not covered
Logitech International SA	LOGN SE	+4	2	Switzerland	Information Technology	2.8	15.80	Not covered
Flughafen Zuerich AG	FHZN SE	+4	2	Switzerland	Industrials	4.9	785.50	Not covered
Gerresheimer AG	GXI GR	+4	4	Germany	Health Care	2.1	65.79	Hold
Electrolux AB	ELUXB SS	+3	2	Sweden	Consumer Discretionary	63.1	202.90	Not covered
Atlantia SpA	ATL IM	+3	5	Italy	Industrials	19.6	23.51	Not covered
Standard Life PLC	SL/ LN	+3	1	Britain	Financials	6.9	348.00	Buy
Informa PLC	INF LN	+3	4	Britain	Consumer Discretionary	4.5	691.00	Not covered
DCC PLC	DCC LN	+3	3	Ireland	Industrials	5.1	5705.00	Not covered
Marks & Spencer Group PLC	MKS LN	+3	2	Britain	Consumer Discretionary	6.9	428.40	Buy
ABB Ltd	ABBN VX	+3	3	Switzerland	Industrials	42.3	18.30	Buy
Glanbia PLC	GLB ID	+3	2	Ireland	Consumer Staples	5.5	18.54	Not covered
Nestle SA	NESN VX	+3	1	Switzerland	Consumer Staples	226.4	70.80	Hold
Electricite de France SA	EDF FP	+3	3	France	Utilities	20.4	10.60	Reduce
GKN PLC	GKN LN	+3	1	Britain	Consumer Discretionary	5.0	294.30	Not covered
Fresnillo PLC	FRES LN	+3	7	Britain	Materials	7.0	954.00	Buy
Ultra Electronics Holdings PLC	ULE LN	+3	6	Britain	Industrials	1.2	1783.00	Not covered
TOTAL SA	FP FP	+3	2	France	Energy	103.8	42.20	Buy
L'Oreal SA	OR FP	+3	2	France	Consumer Staples	86.2	153.20	Hold
Vodafone Group PLC	VOD LN	+3	5	Britain	Telecommunication Services	58.9	221.25	Buy
Abertis Infraestructuras SA	ABE SM	+3	6	Spain	Industrials	13.1	13.89	Not covered
Groupe Eurotunnel SE	GET FP	+3	4	France	Industrials	5.4	9.82	Buy
Eutelsat Communications SA	ETL FP	+3	4	France	Consumer Discretionary	6.5	27.87	Buy
3i Group PLC	III LN	+3	2	Britain	Financials	4.3	444.70	Not covered
Natixis SA	KN FP	+3	6	France	Financials	16.3	5.20	Hold
Intu Properties PLC	INTU LN	+3	2	Britain	Financials	4.0	298.60	Hold
Legal & General Group PLC	LGEN LN	+3	2	Britain	Financials	14.0	235.90	Buy
National Grid PLC	NG/ LN	+3	1	Britain	Utilities	35.2	938.50	Buy
Cap Gemini SA	CAP FP	+3	2	France	Information Technology	13.3	76.93	Buy
QIAGEN NV	QIA GR	+3	7	Netherlands	Health Care	4.7	20.18	Hold
Erste Group Bank AG	EBS AV	+3	7	Austria	Financials	10.3	24.00	Buy
Elementis PLC	ELM LN	+3	6	Britain	Materials	1.0	225.70	Not covered
Next PLC	NXT LN	+3	4	Britain	Consumer Discretionary	9.7	6680.00	Hold
Jupiter Fund Management PLC	JUP LN	+3	7	Britain	Financials	1.9	414.60	Not covered

Source: Bloomberg, ISS, HSBC. Price and HSBC rating as close of 3 Mar 2016.

*Note: Momentum is measured by the difference of compensation scores between Feb 2014 and Feb 2016

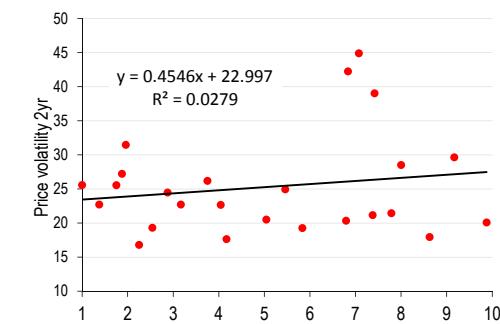
**Note: Resulting scores: 1-3 means low governance concern, 4-7 means average, 8-10 means high governance concern

Governance can impact volatility on the sector level

Investors continue to view governance as a risk factor particularly where poor governance has destroyed value. As such we wanted to test whether there was a relationship between governance standards and share price volatility with better governance leading to lower volatility.

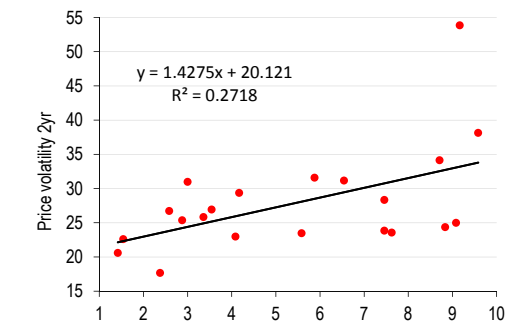
We compared overall governance QuickScore (QS) to the volatility of the Stoxx Euro 600 on a two year basis and we found no correlation in terms of the governance QS or any of the four pillar scores and volatility. However, when we looked at the sector level we did find evidence of a correlation between the overall governance QS and volatility. We found the strongest correlation in four sectors (see below) and each graph highlights a correlation and positive trend between lower QS's and volatility.

Utilities – ISS QuickScore vs volatility



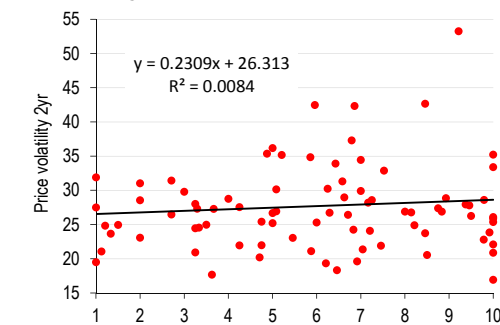
Source: HSBC, Bloomberg, ISS

Telecommunication – ISS QuickScore vs volatility



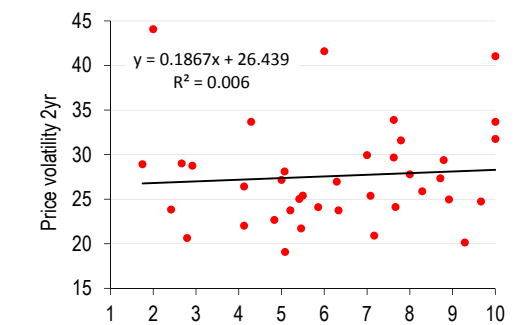
Source: HSBC, Bloomberg, ISS

Consumer discretionary – ISS QuickScore vs volatility



Source: HSBC, Bloomberg, ISS

Healthcare – ISS QuickScores vs volatility

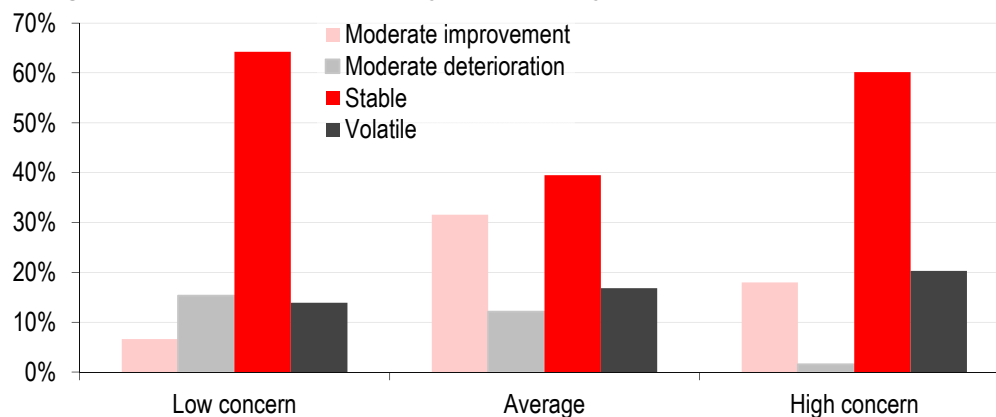


Source: HSBC, Bloomberg, ISS

Focus on the middle ground

Good corporate governance could be viewed as hard to win but even harder to get back once lost. This maxim appears to be true when it comes to corporate governance trends based on QuickScore. Our analysis highlights that 60% of companies which scored higher than 7 (high concern) and 64% of companies that scored lower than 4 (low concern) at the beginning of 2014 barely moved after two years (see chart below).

Average companies scores more likely to moderately improve



Source: Bloomberg, ISS, HSBC

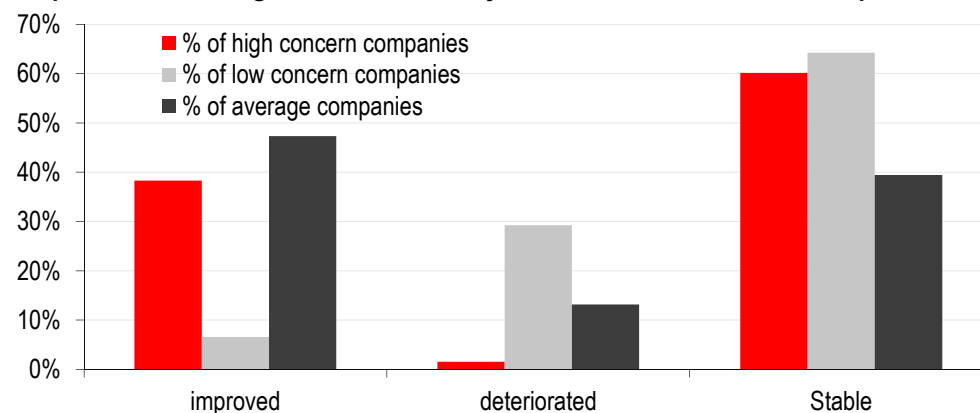
Note: Based on changes in ISS QuickScore from Feb 2014 to Feb 2016. "moderate improvement" means scores improved by 2 or 3; "moderate deterioration" means scores deteriorated by 2 or 3; same score, +1 or -1 are deemed "stable" and changes bigger than or equal to 4 regarded as "volatile"

Note: "High concern" refers to companies with ISS QuickScore > 7, "low concern" refers to those ISS QuickScore < 4; companies in-between are average

This makes sense in that for companies where governance is perceived as high concern the issues tend to be based on factors that may be difficult for investors to change and therefore becomes part of the investment case for investors.

In addition for companies with good governance there is a point where governance can no longer be improved and the quality of governance also becomes priced in. This leaves the companies in the middle as the most fertile for investors with average governance scores that may move between low or high concern based in part on investor engagement.

Companies with average scores moderately deteriorate but are the most improved



Source: Bloomberg, ISS, HSBC

Note: Based on changes in ISS QuickScore from Feb 2014 to Feb 2016. Stable means scores remained the same or improved/deteriorated by 1.

Note: "High concern" refers to companies with ISS QuickScore > 7, "low concern" refers to those ISS QuickScore < 4; companies in-between are average

Investor engagement strategy

Improving board and compensation a viable strategy

Companies that fall in the middle (average scores) are more susceptible to change and where their scores do move, c80% of the time historically they move towards better governance.

We acknowledge that the QuickScore data set of two years is relatively small. However, our analysis show similarities to a previous note [*Investing responsibly – the ESG handbook published in December 2015*](#). In this report we looked at ESG performance over a five year period using a Thomson Reuters dataset. Our analysis highlighted that the change in scores (or the trend) was the most important driver of ESG out-performance rather than simply high scores alone.

The signal that momentum matters more than high scores is clearly of interest and appears to be relevant across two completely different data sets.

We acknowledge that the dataset in this report looks only at governance and not environmental or social issues. However the signal that momentum matters more than high scores is clearly of interest and appears to be relevant across two completely different datasets. Our analysis appears to suggest that investors' engagement on improving board and compensation standards can help companies outperform.

Furthermore our analysis highlights that well governed firms are the most likely to deteriorate, with a chance as high as 30%. In addition given the difficulty of well governed companies to further improve their governance, investors need to be vigilant to ensure that these companies at least maintain standards and prevent deterioration.

However, counterintuitively, companies with significant overall governance deterioration should be viewed by investors as a strong engagement play where the bad governance is fully priced in and when investors have the confidence and resources to exert an impact.

Our analysis suggests that cases where companies which had governance viewed as high concern did move, 95% of the time they managed to get better, equally split between a mild improvement and a significant one. This strategy may require excessive input from investors and can be risky as the worst score a company could possibly get is 10 but there is no cap on how much a stock could decline should a scandal occur.

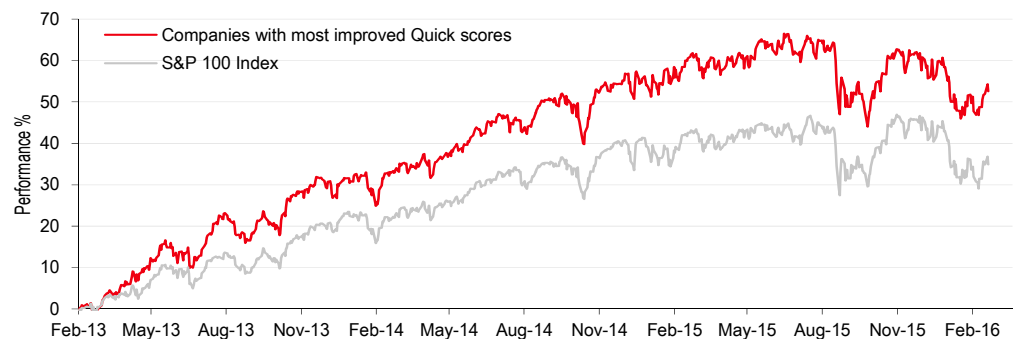
US: Focus on good quality

- ▶ Momentum in overall governance score drivers outperformance
- ▶ Overall scores appear to be in decline vs Europe
- ▶ Investors should focus on low concern and most improved

Our assessment of the US followed the same methodology as for Europe albeit with a smaller universe of 100 companies (S&P 100) and our data for scores ran from 2013-2016⁴. However, unlike in Europe where two sub pillars board and compensation matter we found that for the US it's the overall QuickScore (QS) that appears to have a positive performance effect. Our analysis highlighted that companies in the S&P 100 with a QS that improved by more than 3 points (on a 3yr average) from Feb 2013 to Feb 2016 outperformed. In fact within our market-cap weighted portfolio these companies outperformed the S&P 100 index by 12.7%. However, companies with the most deteriorated QS underperformed by 3.1% on a three year basis.

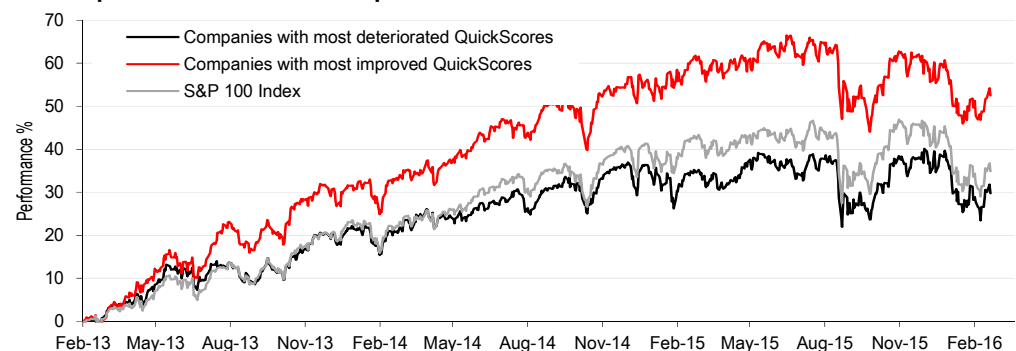
Improvement in QuickScores drives outperformance

Companies in the S&P 100 whose ISS QuickScore improved (by more than 3) on average from Feb 2013 to Feb 2016 outperformed the S&P 100 index by 12.7%.



Source: ISS, HSBC

Most improved QuickScores outperforms most deteriorated...



Source: ISS, HSBC

⁴ For US companies Bloomberg provided scores from 2013-2016. For Europe scores were provided for 2014-2016 only.

US Companies with most improved governance scores 2013-2016

Company	Ticker	Momentum in QuickScore*	Resulting score**	Country	Sector	Mkt cap (local ccy bn)	Close price (local ccy)	HSBC Rating
Devon Energy Corp	DVN US	+7	3	US	Energy	11.2	21.52	Not covered
Exelon Corp	EXC US	+6	3	US	Utilities	30.4	32.32	Not covered
Johnson & Johnson	JNJ US	+6	2	US	Health Care	294.3	107.04	Not covered
United Technologies Corp	UTX US	+6	4	US	Industrials	80.4	95.53	Not covered
Gilead Sciences Inc	GILD US	+5	3	US	Health Care	120.1	88.8	Not covered
Medtronic PLC	MDT US	+5	4	Ireland	Health Care	105.3	74.59	Not covered
CVS Health Corp	CVS US	+4	4	US	Consumer Staples	109.2	98.63	Not covered
Bank of New York Mellon Corp/The	BK US	+4	3	US	Financials	40.5	37.42	Not covered
Starbucks Corp	SBUX US	+4	1	US	Consumer Discretionary	87.3	59.56	Not covered
Occidental Petroleum Corp	OXY US	+3	2	US	Energy	53.8	71.61	Not covered
Abbott Laboratories	ABT US	+3	5	US	Health Care	57.2	39.34	Not covered
Lockheed Martin Corp	LMT US	+3	2	US	Industrials	66.8	217.2	Not covered
BlackRock Inc	BLK US	+3	3	US	Financials	53.7	326.73	Not covered

Source: Bloomberg, ISS, HSBC Price and HSBC rating as close of 3 Mar 2016

*Note: Momentum is measured by the difference of QuickScores between Feb 2013-Feb 2016

** Note: 1-3 means low governance concern, 4-7 means average, 8-10 means high governance concern

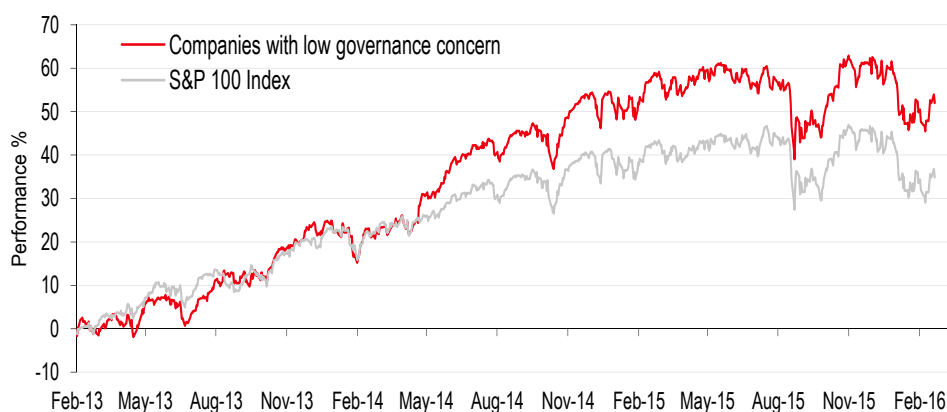
Pay attention to the good and improving

For Europe we found that only the improvers matter and in fact on a two year basis companies with low concern governance actually underperformed vs high concern companies. However, in the US our analysis highlights that it's not just the improvers in the S&P 100 that outperform but it appears that overall governance quality itself also has a positive signal.

We created an additional portfolio consisting of companies in the S&P 100 which on a 3yr average simply had a QS that indicated low governance concern (scores of 1-3) and we compared this to companies which had a score that indicated high concern (scores of 8-10). We found that on a 3-year average, companies rated low concern outperformed the S&P 100 index by 7.6% between 2013 and 2016.

Companies in S&P 100 with low governance concern (3yr avg.) outperformed the S&P 100 index by 7.6% between 2013 and 2016.

Low concern companies outperform S&P 100



Source: ISS, HSBC

US Companies with low governance concern (QuickScore between 1-3) 2013-2016

Company	Ticker	Avg QuickScore*	Country	Sector	Mkt cap (local ccy bn)	Close Price (local ccy)	HSBC Rating
Allstate Corp/The	ALL US	1	US	Financials	24.7	65.41	Not covered
Union Pacific Corp	USP US	1	US	Industrials	67.7	79.5	Not covered
Schlumberger Ltd	SLB US	1	Curacao	Energy	93.8	74.41	Buy
Cisco Systems Inc	CSCO US	1	US	Information Technology	135.2	26.9	Not covered
Home Depot Inc/The	HD US	1	US	Consumer Discretionary	160.8	125.59	Not covered
UnitedHealth Group Inc	USH US	1	US	Health Care	115.8	121.27	Not covered
3M Co	MMM US	1	US	Industrials	96.4	159.41	Not covered
El du Pont de Nemours & Co	DD US	1	US	Materials	54.0	62.15	Not covered
Merck & Co Inc	MRK US	1	US	Health Care	144.6	52.27	Not covered
Procter & Gamble Co/The	PG US	1	US	Consumer Staples	224.0	82.55	Not covered
Chevron Corp	CVX US	2	US	Energy	164.8	87.14	Buy
Apple Inc	AAPL US	2	US	Information Technology	562.8	100.75	Not covered
PepsiCo Inc	PEP US	2	US	Consumer Staples	143.3	98.33	Hold
Southern Co/The	SO US	2	US	Utilities	44.0	47.98	Not covered
Biogen Inc	BIIB US	2	US	Health Care	58.7	273.66	Not covered
Pfizer Inc	PFE US	2	US	Health Care	184.8	29.98	Not covered
Bank of New York Mellon Corp/The	BK US	2	US	Financials	40.5	37.42	Not covered
Colgate-Palmolive Co	CL US	2	US	Consumer Staples	60.4	67.08	Not covered
Wells Fargo & Co	WFC US	2	US	Financials	252.7	49.57	Not covered
Johnson & Johnson	JNJ US	2	US	Health Care	294.3	107.04	Not covered
American International Group Inc	AIG US	2	US	Financials	60.1	51.83	Not covered
General Motors Co	GM US	2	US	Consumer Discretionary	48.0	30.15	Not covered
Amgen Inc	AMGN US	3	US	Health Care	109.7	147.49	Not covered
Priceline Group Inc/The	PCLN US	3	US	Consumer Discretionary	64.7	1301.37	Not covered
Starbucks Corp	SBUX US	3	US	Consumer Discretionary	87.3	59.56	Not covered
General Dynamics Corp	GD US	3	US	Industrials	42.2	135.61	Not covered
Accenture PLC	ACN US	3	Ireland	Information Technology	67.6	102.66	Not covered
NIKE Inc	NKE US	3	US	Consumer Discretionary	104.7	62.22	Hold
Walgreens Boots Alliance Inc	WBA US	3	US	Consumer Staples	86.2	79.46	Not covered
AT&T Inc	T US	3	US	Telecommunication Services	233.7	37.69	Reduce
Lowe's Cos Inc	LOW US	3	US	Consumer Discretionary	64.0	69.09	Not covered
Altria Group Inc	MO US	3	US	Consumer Staples	121.8	61.5	Not covered
Dow Chemical Co/The	DOW US	3	US	Materials	55.4	49.62	Not covered
General Electric Co	GE US	3	US	Industrials	282.0	30.18	Not covered
Texas Instruments Inc	TXN US	3	US	Information Technology	55.2	54.42	Not covered
Raytheon Co	RTN US	3	US	Industrials	37.3	125.13	Not covered
International Business Machines Corp	IBM US	3	US	Information Technology	132.4	136.3	Not covered
Time Warner Inc	TWX US	3	US	Consumer Discretionary	54.4	66.76	Not covered
Microsoft Corp	MSFT US	3	US	Information Technology	414.1	52.95	Not covered
Target Corp	TGT US	3	US	Consumer Discretionary	49.1	81.1	Not covered
Intel Corp	INTC US	3	US	Information Technology	144.5	30.54	Not covered

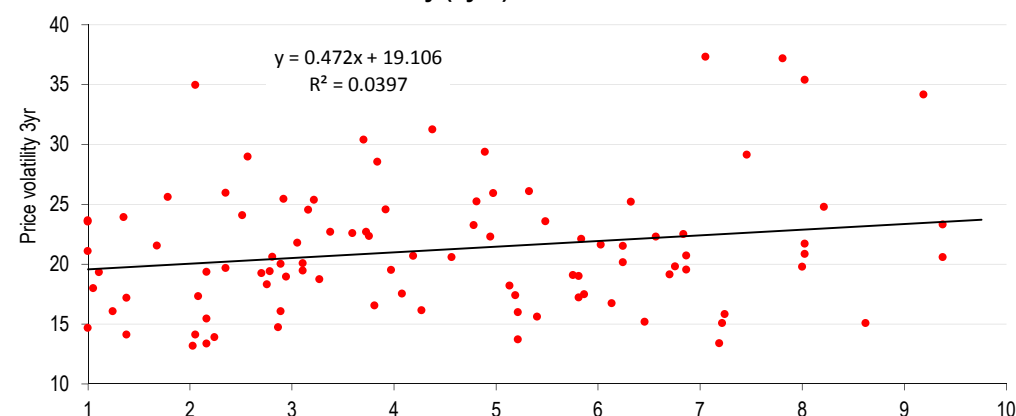
Source: Bloomberg, ISS, HSBC Price and HSBC rating as close of 3 Mar 2016

*Note: Avg QuickScore: 1-3 means low governance concern, 4-7 means average, 8-10 means high governance concern

Governance quality impacts volatility

As with Europe we believe that investors look at governance standards as a measurement of risk and we therefore wanted to assess if the overall governance QuickScores (QS) for US companies had any correlation to share price volatility. We compared the 3yr average QS of the S&P 100 universe to the 3yr volatility of the S&P 100. The graph below highlights the correlation between QS and the volatility of the S&P 100 with a positive trend between good governance (lower scores) and lower volatility.

S&P 100: ISS QuickScore vs volatility (3yrs)



Source: Bloomberg, ISS, HSBC

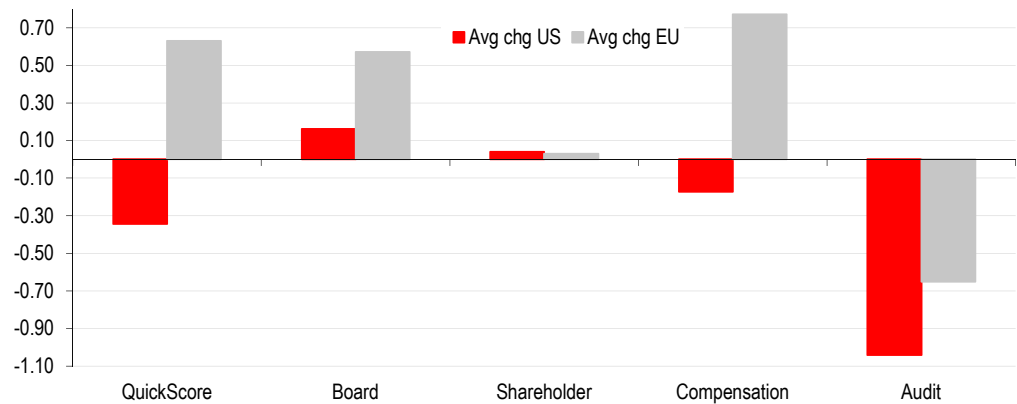
US scores declining vs Europe

Our analysis of the volatility of the overall QuickScore and sub-pillar scores suggests that on average governance change has been negative over the past three years. In fact there appear to be more companies deteriorating than improving. This in stark contrast to Europe where the trend (although on a 2yr basis) appears to be fairly positive with average companies showing the greatest potential to move towards better governance.

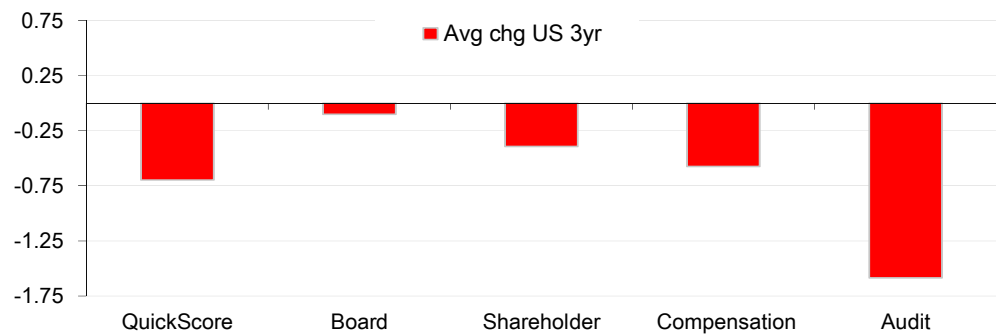
Pillar analysis: 2yr average change in pillar scores in US

	QuickScore	Board	Shareholder	Compensation	Audit
Improve	30%	41%	22%	40%	30%
Same	22%	15%	34%	15%	22%
Deteriorate	47%	43%	43%	44%	0%
Avg change 2014-16	-0.34	0.16	0.04	-0.17	-1.04

Source: ISS, HSBC

US governance QuickScores deteriorating vs European 2yr average

Source: ISS, HSBC

US governance QuickScore deterioration more significant over 3yrs

Source: ISS, HSBC

Investor engagement strategy**Ignore the average; focus on improvers and low concern**

When looking at US S&P 100 company scores based on low, average or high concern, our analysis suggests that companies with high governance concern appear to be more susceptible to positive changes than one would think. Companies with low concern appear to have only a 5% chance of deterioration, (vs average or high concern companies) which is the lowest of the three. In addition they also have a 65% chance of improvement, vs average or high concern companies.

Investors should either engage with high concern firms to improve their overall governance or stay with low concern companies to enjoy quality

However, from the quality perspective, low concern companies would seem 'relatively safe' play as historically they have exhibited almost a 50-50 chance to remain where they are and benefitted from a sizeable performance reward. Furthermore even if they deteriorate, underperformance is much smaller according to our analysis. In brief, we believe investors should either engage with high concern firms in order to improve their overall governance and (potentially) capture the outperformance if their governance improves or stay with low concern companies to enjoy quality.

Notes

Notes

Disclosure appendix

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The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

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Upside/Downside is the percentage difference between the target price and the share price.

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For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

As of 04 March 2016, the distribution of all ratings published is as follows:

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