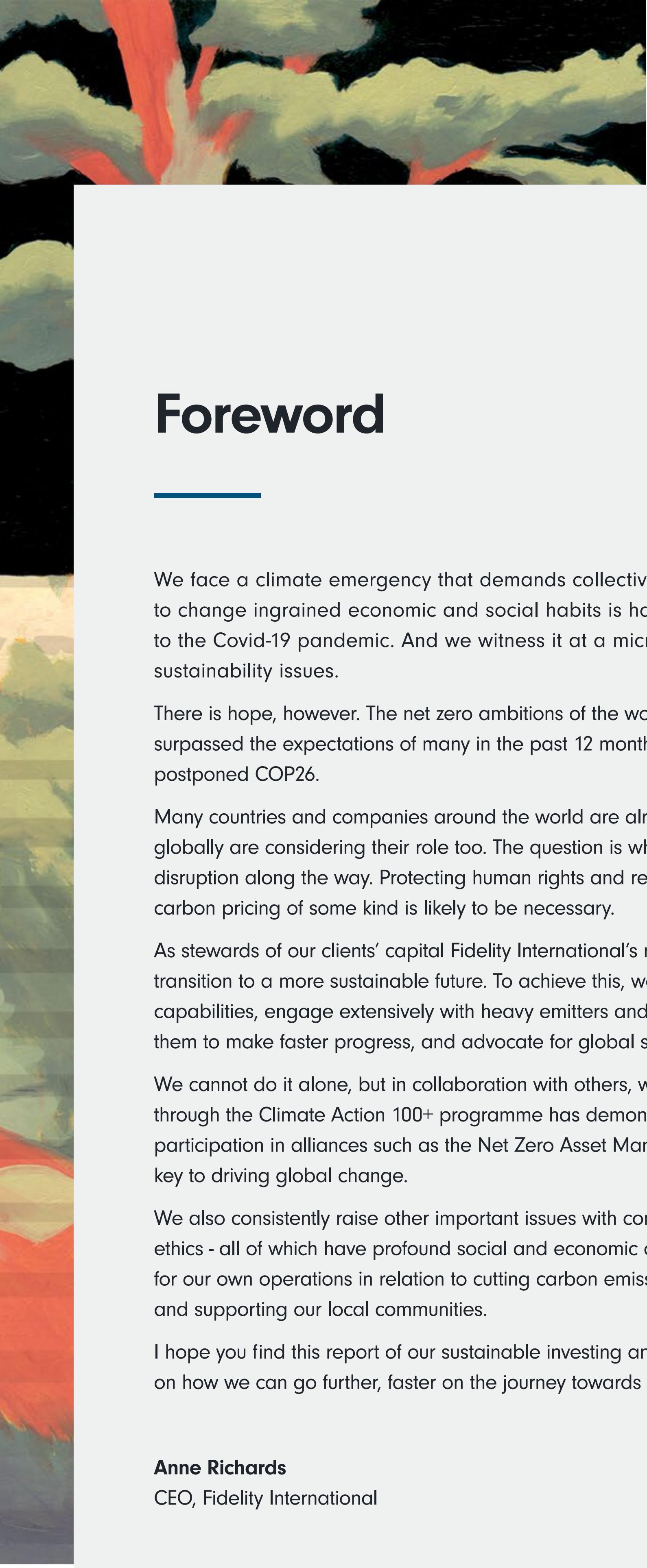
July 2021

Sustainable Investing Report 2021

Time to step up

Image credit: David de las Heras

This is for investment professionals only and should not be relied upon by private investors



Foreword

We face a climate emergency that demands collective action. But persuading an entire world to come together to change ingrained economic and social habits is hard. That was apparent at a global scale in the response to the Covid-19 pandemic. And we witness it at a micro level in our active engagements with companies on sustainability issues.

There is hope, however. The net zero ambitions of the world's two largest economies - the US and China - have surpassed the expectations of many in the past 12 months, and there is real momentum as we approach the UN's postponed COP26.

Many countries and companies around the world are already on a pathway to a lower carbon world and central banks globally are considering their role too. The question is whether we can get there quickly enough, and mitigate social disruption along the way. Protecting human rights and reskilling labour forces in legacy industries will be crucial, and carbon pricing of some kind is likely to be necessary.

As stewards of our clients' capital Fidelity International's role is to ensure that our capital allocation decisions reflect this transition to a more sustainable future. To achieve this, we continue to build on our sustainable investment and research capabilities, engage extensively with heavy emitters and companies that need to protect biodiversity to encourage them to make faster progress, and advocate for global standards.

We cannot do it alone, but in collaboration with others, we can make a real difference. Our work with other investors through the Climate Action 100+ programme has demonstrated the power of group engagements, and our participation in alliances such as the Net Zero Asset Managers Initiative and the Sustainable Markets Initiative will be key to driving global change.

We also consistently raise other important issues with companies including diversity, employee welfare and digital ethics - all of which have profound social and economic consequences. And we have scaled up sustainability ambitions for our own operations in relation to cutting carbon emissions, promoting diversity and inclusion across the business, and supporting our local communities.

I hope you find this report of our sustainable investing and engagement activities useful and welcome your feedback on how we can go further, faster on the journey towards net zero.

Anne Richards
CEO, Fidelity International

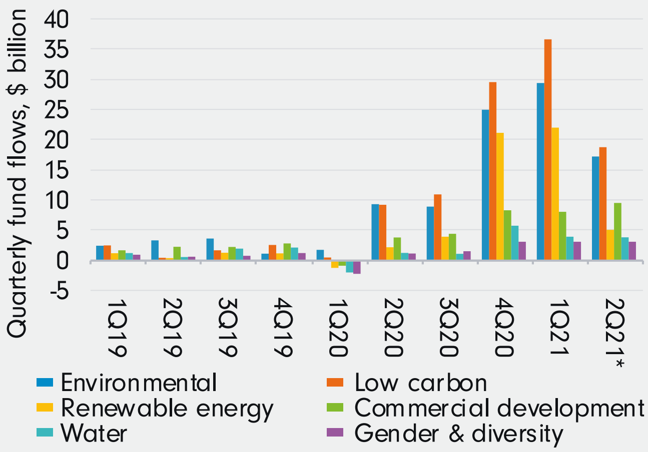
Contents

Introduction: Time to step up

Jenn-Hui Tan
Global Head of Stewardship and Sustainable Investing

Sustainable investing is developing fast, driven by the Covid-19 pandemic and the urgent need to tackle climate change. Simply pledging to reach net zero emissions by 2050 is no longer enough, and 2030 has become the new target for much of the necessary economic overhaul. The participation of governments, companies, investors, and consumers is vital, as the effects of global warming manifest today through wildfires, flooding, drought, and the loss of habitat that gives rise to new diseases.

Chart 1: Sustainable investing is developing fast, with huge growth in environmental fund flows



Source: Morningstar, Goldman Sachs Global Investment Research, April 2021.
*Only through April 2021

Tackling emissions as a company and an asset manager

At Fidelity International, we are taking action on behalf of our clients and society. We have brought forward our company net zero pledge from 2040 to 2030 (see our Corporate Sustainability Report for details). We have called on governments to use policy signals to speed up the transition, and have committed to net zero alliances, including those supporting the UN climate conference (COP26) later this year. But the biggest contribution we can make is through urging our investee companies to decarbonise more quickly.

In the last year, we have done just that with some of the world's heaviest emitters through the collaborative Climate Action 100+ initiative (page 35). We have persuaded more banks to end coal financing, highlighted the social costs of climate change, and challenged companies to preserve biodiversity (page 18).

We prefer engagement over exclusion as it often leads more effectively to real-world decarbonisation as opposed to just reducing an investment portfolio's carbon footprint. But where companies refuse to change, we do divest; and we continue to review fossil fuel sectors to see where divestment can be effective. The International Energy Agency says ending all new oil and gas exploration by the end of 2021 is essential to achieving net zero, which could further quicken the move to cleaner forms of energy.

As environmental, social and governance (ESG) regulation gathers pace, we support efforts to improve disclosure and set a global reporting standard. We have adopted the European SFDR rules within our fund range (page 11). In 2020, we published our first Taskforce for Climate-Related Financial Disclosures report (TCFD), and we encourage companies around the world to do likewise.

Using our climate alignment assessment and ESG ratings

With climate a global priority and a need for green financing, we believe there is greater scope to work urgently with companies to cut emissions. In 2020, we were a founding signatory of the Net Zero Asset Managers Initiative which supports investments that get us to net zero by 2050. Now we are exploring an interim target to halve the carbon footprint of the portfolios we manage by 2030.

To help achieve net zero, we are introducing a climate alignment assessment for each company that shows how far their business aligns or plans to align with a 1.5°C warming pathway. This sits alongside our 'Environmental' rating that grades 4000+ companies on characteristics such as emissions reduction, water usage, biodiversity, and climate risk, within our proprietary ESG ratings framework.

Our unique approach allows us to leverage the expertise of our research analysts. They conduct the ESG ratings assessments of companies and ensure that sustainability considerations are authentically integrated into their investment analysis.

These forward-looking ratings then form the backbone of how we fully embed ESG factors into our fund range. We continuously look for ways to enhance them using more comprehensive data sets (e.g. climate analytics) and real-world observations from our analysts. Separately, our macro team is modelling how climate risks affect long-term capital market forecasts for different economies, and monitoring carbon price developments (page 9).

We continue to expand our range of climate-focussed and sustainable strategies to give clients greater access (across asset class and vehicle type) to low-carbon opportunities and to help them mitigate climate risks. Within our real estate franchise, impact investing could soon be the only kind, given the sector's high emission levels (page 20).

Finally, we have changed our voting policy to set minimum climate standards for investee companies, including board oversight of climate risks and emissions reduction targets. We will vote against the directors of companies that do not meet these standards. These are just the steps we are taking today. There will be many more in the years to come as we seek to play our part in averting this global threat.

Employee welfare and online inclusion during the pandemic

Other issues came to the fore in 2020, most notably how companies responded to Covid-19 (page 31). Governments sought our advice on how to assist companies financially, and we discussed with companies how they were supporting employees and dealing with supply chain disruptions. This included situations where human rights, for example those of seafarers (page 43), were infringed or where incidents of modern slavery were uncovered. Later in the year, we called on companies to limit executive pay if they had received emergency government support.

Workforce inequality rose as a result of Covid-19. We regularly engaged with companies on narrowing the social divide and improving diversity, and set more ambitious targets for ourselves. We plan to vote against the election of board directors where female representation does not meet our requirements (page 42).

Lives moved further online due to Covid-19 and concerns about digital safety increased, while for the other half of the world that doesn't have internet access, concerns focussed on inclusion. So we broadened our engagements on cyber security to include online welfare, accuracy of information and ethical AI design (page 49). Government intervention in the technology sector will only grow as it becomes ever more integral to our way of life, including areas of national security and the transition to a low carbon economy.

2020 was a year of global existential threat, and we have all had to adapt. But from it has emerged a near-universal desire for a more sustainable world. This is pushing all of us to do more, together, and more quickly, this year and beyond. It's time to step up.

A man wearing a protective face mask cleans ticket barriers. (Photo by Ronaldo Schemidt / Contributor Images via Getty images)

Engagement in 2020 at a glance

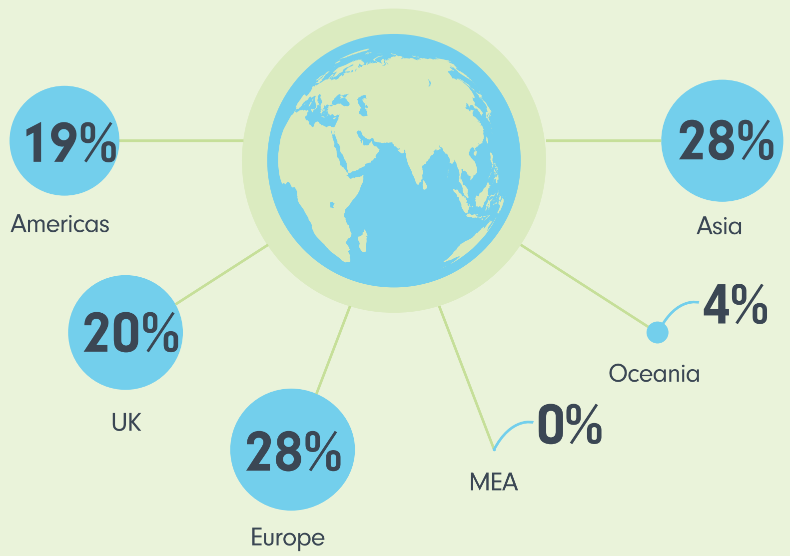
923
Engagements*

716
Companies actively engaged with

16,000+
Meetings conducted with companies

*Engagements are specific interactions designed to improve ESG practices. Meetings cover all interactions with companies, many of which refer to ESG topics.

Engagement by region



Engagements by theme

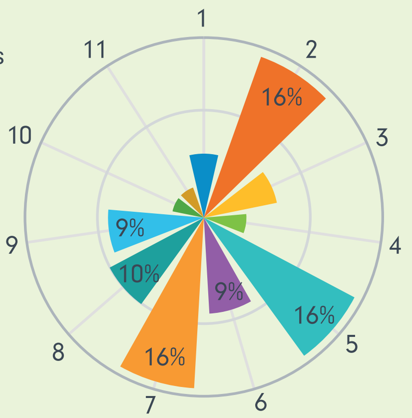
Topics discussed during engagement meetings with companies

Governance	40%
Climate change	39%
Executive remuneration	32%
Human capital	18%
Environmental opportunity	18%
Corporate strategy/Business model	17%
Covid-19	14%
Capital allocation	12%
Supply chain management	11%
Other	10%
Corporate behaviour	9%
Waste & pollution	9%
Health and safety	8%
Social opportunity	7%
Data privacy and security	6%

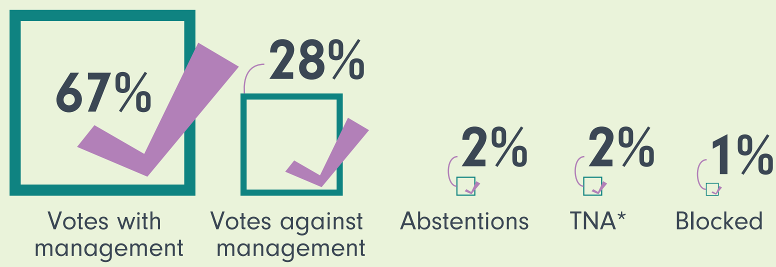
Source: Fidelity International, July 2021. Note: Excludes written correspondence.

Engagement by industry

1 Communication Services
2 Consumer Discretionary
3 Consumer Staples
4 Energy
5 Financials
6 Healthcare
7 Industrials
8 Information Technology
9 Materials
10 Real Estate
11 Utilities



How Fidelity voted at AGMs



Source: Fidelity International, July 2021. Note: *Took no action

Sustainable investing across Fidelity

Planetary risk: Mapping climate pathways to macro and strategic asset allocation

By Salman Ahmed Global Head of Macro and SAA and Anna Stupnytska Global Macro Economist

Climate change, and the policies aimed at slowing it, will shape the path of economic growth this century.

Policymakers face a trade-off between the high upfront cost of moving quickly towards net-zero carbon targets, and the long-term physical damage to economies and societal cohesion caused by rising temperatures and extreme weather events if they delay action.

As a result, macroeconomic projections at the core of Fidelity International's capital market assumptions (CMAs) must incorporate both these physical climate risks and policy transition risks for a more complete picture of long-term returns in the 21st century.

Global macroeconomic growth has been fuelled by cheap sources of carbon-based energy for over a century. Transition risks refer to the effects of restructuring the economy, for example through new rules or surcharges that limit carbon emissions or through changes in consumer behaviour, to respond to the threat of climate change.

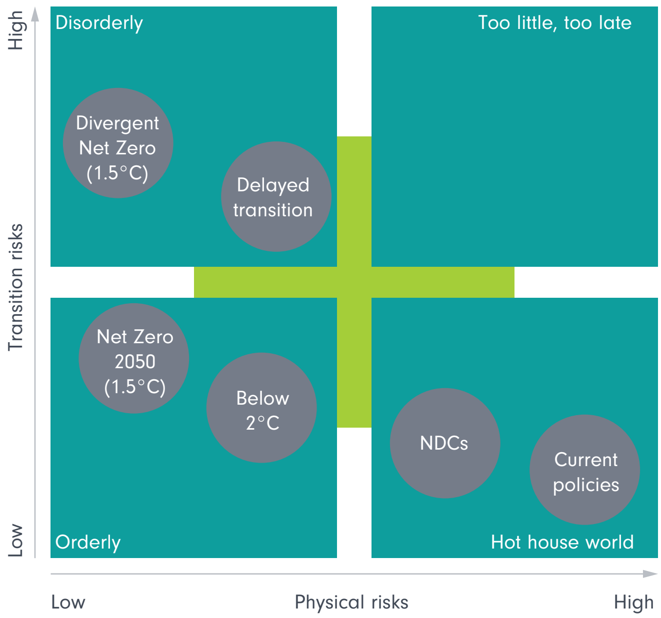
Physical risks refer to the effects of extreme weather events, such as hurricanes and floods, as well as the effects of gradual warming on our ecological system. The two are connected and cannot be considered in isolation. For example, physical risks decline relative to pessimistic warming scenarios, if measures to reduce emissions and slow temperature rises are taken decisively and early on.

Our approach

Our approach to incorporating climate risks into our CMA calculations starts by choosing a set of scenarios run by the climate modelling community, with different assumptions about greenhouse gas emissions, societal choices, technology, adaptation and mitigation policies.

We use the climate scenarios produced by the Network for Greening the Financial System (NGFS) - a network of central banks and supervisors - to get macroeconomic projections for key economies to 2100 under the chosen scenarios.

Chart 2: The NGFS scenario framework



Positioning of scenarios is approximate, based on an assessment of physical and transition risks out to 2100. NDCs are nationally determined contributions.

Source: Fidelity International, July 2021.

The scenarios are broadly divided into: "orderly", in which climate policies are introduced early minimising both transition and physical risks, "disorderly," in which policy changes are delayed increasing transition costs, and "hot house world," under which global efforts are insufficient to halt significant global warming leading to severe physical risks. We chose the NGFS framework to ensure that our tools are consistent with those used by central banks and supervisors to perform their own climate stress tests.

The GDP, inflation and interest rate trajectories produced by these scenarios will then be mapped onto our models for estimating the potential effect of transition and physical risks of climate change on long-term capital market assumptions and strategic asset allocation.

Climate change uncertainty and policy credibility

Nobody knows for sure what path climate change and emissions policy will take in the next decade, let alone the century. With this in mind, our aim is to create a flexible, scenario-led framework, to gauge possible investment implications in different states of the world.

In order to gauge the probability of different outcomes, we will be working closely with our bottom-up research colleagues - around 150 Fidelity analysts monitoring the actions of more than 3,000 companies - to narrow down the range of potential scenarios and change our working assumptions as the facts on the ground change, especially when it comes to assessing the credibility of a net-zero world.

This will allow us to gauge over time how our baseline scenario for GDP growth, inflation and rates, which feeds into our CMA models, needs to be adjusted depending on the progress made towards net zero at a corporate, national and global level.

Read the full paper on this topic here:

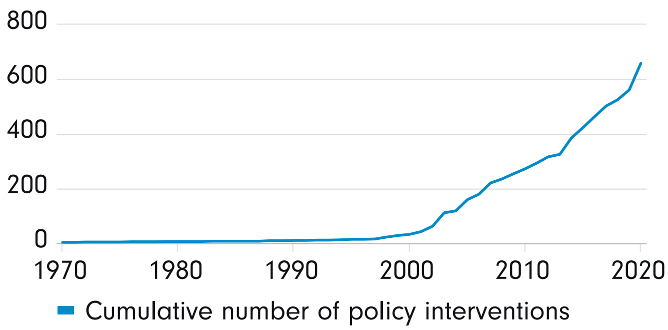
Coal power plant, with new carbon capture unit. (Photo by Saul Loeb / Stringer Images via Getty images)

Riding the regulatory wave

By Allan Pelvang General Counsel and Head of Bermuda and Matthew Jennings Investment Director and Natalie Westerbarkey Head of EU Public Policy

Net zero pledges have come thick and fast from governments and companies in the last year, most notably from China and a re-engaged US. We now expect a surge in regulation and incentives to help achieve these emissions reduction targets, initially through better disclosure. The European Union is ahead of the pack, but other regions are catching up. Companies and investors with strong ESG credentials will be poised to ride this wave, making the most of the opportunities it presents, while others will be left behind in the wash. Some may even drown as assets are left stranded.

Chart 3: The beginnings of a surge in ESG regulation



Source: PRI Responsible Investment Regulation Database, Fidelity International, July 2021.

Disclosure is the common thread

ESG data remains a fraught issue. It's no surprise that regulators are focussed on increasing the quality and consistency of the information available to investors, rather than banning specific investments outright. Investors expect to receive high quality information about a company's non-financial performance, just as they do for financial performance.

Europe has led the way, creating regulatory blueprints it hopes others will adopt and turn into global ESG standards. By studying what happens there, investors can see what may appear elsewhere. For example, the Taskforce for Climate-Related Financial Disclosures standard is being adopted in several countries around the world, but the EU has its own more stringent climate reporting (the Corporate Sustainability Reporting Directive) that could eventually become the norm.

Current disclosure rules are already beginning to influence investment decisions made by asset managers and companies. This will only increase and ESG will become a decisive factor in attracting funding. Only investment managers who offer high-scoring ESG strategies will attract and retain clients, and it will become harder to justify owning carbon-intensive companies with no plans to clean up their act. Companies without a net zero strategy risk losing investors, suppliers and customers, and being lumped with stranded assets. These forces could alter fund flows and market valuations, and ultimately, accelerate the low-carbon transition.

Table 1: Europe has the highest rate of ESG disclosure

	Published sustainability /ESG report	Use international guidelines (i.e. GRI)	External audit of sustainability /ESG report
US	72%	50%	30%
Europe	97%	74%	78%
Asia Pacific	79%	50%	33%
China	70%	34%	10%
India	97%	46%	45%
Japan	87%	57%	53%

Source: Morgan Stanley Research, Refinitiv, Fidelity International, May 2021. Table shows proportion of companies in each region.

Ensuring investments are sustainable

Europe may have a reputation for sometimes being overly bureaucratic, but its sharp focus on ESG has made it a world leader on sustainability, with the highest climate-related disclosure rates. It has designed a green taxonomy to establish what is and is not a sustainable investment, and - building on this - it has created the Sustainable Finance Disclosure Regulation (SFDR) which aims to limit greenwashing by increasing transparency for investors.

To date, the green taxonomy only covers the first two of the EU's six environmental goals listed below, but it is expected that future taxonomies will cover the remaining four climate goals, plus additional social goals. The taxonomy includes a reference to the UN Human Rights Charter and International Labour Organisation labour rights (its core principles), so investments that wish to be labelled as sustainable must also meet these social benchmarks.

Table 2: The EU's environmental goals

	Goal
1	Climate change mitigation
2	Climate change adaptation
3	Sustainable use and protection of water and marine resources
4	Transition to a circular economy
5	Pollution prevention and control
6	Protection and restoration of biodiversity and ecosystems

Source: Fidelity International, July 2021.

SFDR requires asset managers to disclose how they incorporate sustainability factors into their investment process at a general and fund specific level, using the taxonomy. Funds must be put into four separate bands - Article 6, Article 8, Article 9 and non-ESG - so investors know what level of sustainability they are getting. Article 6 funds must consider sustainability risks as a minimum. However, only Article 8 and 9 funds qualify as ESG-labelled funds, either by integrating sustainability factors into the investment process or by demonstrating a sustainable impact. They must report their alignment with the two climate goals, and not invest in companies that "do significant harm", though it is not yet clear what significant harm means.

So far, this regulation only affects EU-listed firms and those with EU-based operations, which will have to report their alignment as a percentage of revenues, capital expenditure and operating expenditure. However, the EU is encouraging global convergence through its International Platform on Sustainable Finance which already includes large Asian countries such as China and India.[1]

In January, the UK became a member and was instrumental in creating the EU's green taxonomy, so it could adopt something similar. Companies which get this right in Europe therefore should find it easier to adapt to regulation elsewhere.

Significant change expected in the US

This includes the US, where the change in political leadership has changed the guard at the Securities and Exchange Commission. The country is now poised to accelerate ESG regulation, after years of lagging behind. The SEC has set up a new ESG taskforce and website to consult on climate disclosures. Depending on the support that President Biden can muster, a number of Trump-era constraints on the development of standardised disclosures and ESG strategies could be removed. It is possible that the US too will soon require standardised TCFD disclosures. Given the dominant role that the US plays in global capital markets, this would have global consequences.

Asia has multiple approaches, but the direction of travel is similar

Asian countries have adopted a range of approaches, but the overall trajectory is similar: more focus on ESG and more disclosure. Japan, Singapore, Hong Kong, Australia and New Zealand have already introduced TCFD disclosures, or are planning to. Chinese regulators are expected to enforce mandatory disclosures at some point in the near future. China is a signatory to the Paris Climate Agreement. It has committed to reaching net zero by 2060 and has shown leadership in introducing financial initiatives to tackle sustainability, such as the emissions trading scheme launched earlier this year.

Regulatory wave will soon sort winners from losers

With the fight against climate change becoming more urgent by the day, we are in the foothills of a period of global regulatory change that is likely to accelerate. This could revolutionise the way investment portfolios are managed and how companies invest. Well-managed companies with strong risk management have often outperformed during such turbulent periods, but the bias towards quality, good risk management and green growth prospects will be even stronger through this far-reaching economic transition; winners and losers will become increasingly apparent over a much shorter timeframe than in the past.

[1]Source: EU, International platform on sustainable finance | European Commission (europa.eu)

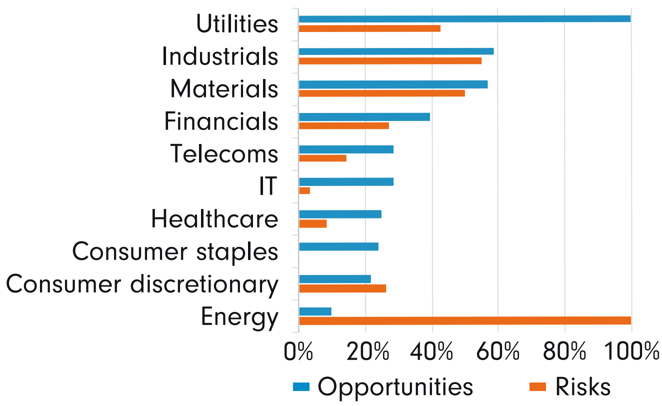
ESG Analyst Survey 2021: Net zero opportunities now outweigh risks

By Terry Raven Director, European Equities and Gita Bal Global Head of Research, Fixed Income

Government policy, technological advances, and investor action are forcing change on our carbon-dependent way of life. This transition to a low-carbon world, alongside physical climate risk, introduces potential for losses. But our survey of 151 Fidelity analysts reveals that the path to net zero now offers some sectors more opportunities to profit.

> The capital goods subsector should benefit from increased demand for renewable energy equipment and electric vehicle charging points.

Chart 4: Opportunities and risks from the energy transition across different sectors



Proportion of analysts reporting opportunities and risks arising from the energy transition

"How significant are the risks to your companies' current business models as a result of the transition to a low carbon economy?" and "How significant are the potential business opportunities arising for your companies as a result of the transition to a low carbon economy?" Scale of 1-7, where 1 is not significant and 7 is very significant. Chart shows the proportion answering 5-7 (there are risks and opportunities). Source: Fidelity ESG Analyst Survey 2021.

Our analysts believe the utilities sector currently enjoys the best opportunities, given the scale of investment being pumped into green energy. One fixed income analyst says that the transition could also lower the sector's risks, as long-term renewable power contracts help utilities companies strengthen their credit profiles and reduce their cost of debt.

Perhaps unsurprisingly, energy companies face the biggest risks as fossil fuels are phased out. Yet our analysts expect these sharp differences between the two sectors to diminish over time, as utility and energy firms blur together through M&A into the clean powerhouses of the future.

After utilities, our analysts believe industrials have the brightest prospects from the transition, but with the second highest level of risk. According to one Europe-based capital goods analyst, the subsector should benefit from increased demand for renewable energy equipment and electric vehicle charging points. However, industrials companies also face risks posed by regulation, supply chain disruption and legacy businesses.

Information technology ranks in the middle of the pack, but some opportunities are emerging here too. Software will become ever more essential to managing a grid powered by renewables and batteries, while general decarbonisation will require a host of new applications. One analyst points to a forthcoming carbon calculator from a leading German developer that will help companies capture and analyse their carbon footprints.

Consumer discretionary companies offer fewer opportunities and our analysts say that the pandemic means that much of the sector remains in 'survival mode', with often less reason to think about decarbonisation. Cruise liners and airlines are obvious exceptions. They too are focussed on staying afloat amid Covid-19 travel restrictions but, as heavy emitters, cannot avoid the transition.

Companies can help accelerate the low-carbon transition by linking executive pay to reductions in greenhouse gas emissions.

More ambitious targets are needed

While transition opportunities are on the rise, variations between company emissions reduction targets are stark. Three-quarters of analysts covering Europe believe companies have the right targets in place to get them to net zero by 2050, but the figure is zero for Latin America and Emerging Europe, the Middle East and Africa.

Only half of our analysts believe companies globally are making a big effort to help the transition, although some countries are changing faster than others. Analysts say there is a six percentage-point shortfall between the amount of capex companies need to allocate to the transition and the proportion they expect them to allocate. China has the lowest shortfall, with more companies there increasing their transition-related investment after President Xi's announcement that China would reach net zero by 2060.

Companies can help accelerate the low-carbon transition by linking executive pay to reductions in greenhouse gas emissions. Analysts report that only a third of companies currently do this, and only half require their boards to consider ESG issues. The companies that do both should be well placed to capitalise on the immense range of opportunities that will arise as the global economy gravitates towards net zero industries, while mitigating the very real risks.

Asia could become a top destination for investors driving sustainable change

By Paras Anand CIO, Asset Management, Asia Pacific and Flora Wang Director, Sustainable Investing & Portfolio Manager

Asia has been among the top destinations for growth investors in recent decades. Now we believe it could become one of the top markets for investors driving sustainable change. With the right sort of research, engagement and understanding of local issues, sustainability-focussed investors can work with Asian companies to improve their ESG credentials, thereby increasing their longer-term return potential.

Two types of ESG investing

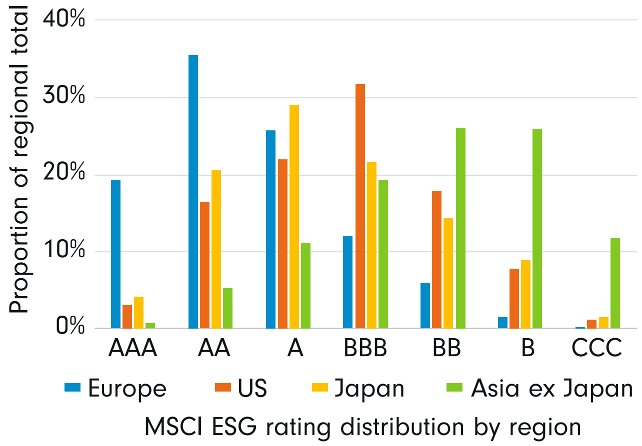
Research has shown that robust sustainability practices and non-financial improvements of environmental and social factors tend to lead to higher business valuations over the long term, a topic we have written about previously.

Investors can seek to capitalise on this tendency in two ways: 1) by allocating capital to existing ESG leaders and 2) by allocating capital to companies making a genuine effort to improve their sustainability and which are open to consistent levels of engagement. In the latter case, investors can often help drive the change - for example, by encouraging greater energy efficiency or better employee safety protocols - which should ultimately lead to more sustainable investment returns.

Asian companies offer scope for big ESG changes

Many Asian companies fall into the second category of those firms seeking to improve their ESG profiles. Based on the distribution of current MSCI ESG ratings, Asia excluding Japan has a smaller proportion of companies regarded as ESG leaders than Europe does (although Japan outperforms the US by this measure).

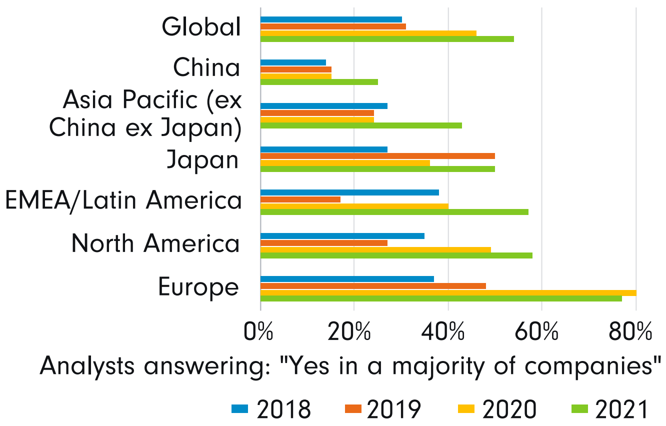
Chart 5: Asia has fewer ESG leaders than Europe



Source: MSCI, Fidelity International, July 2021.

This creates opportunities, as Asia has a large universe of firms that could benefit from improving their ESG credentials. ESG awareness has been rising rapidly in Asia in recent years, as evidenced in our 2021 Fidelity Analyst Survey. Climate change and the Covid-19 pandemic have brought ESG considerations to the fore even in markets where economic growth has been the main priority.

Chart 6: ESG awareness has been rising rapidly in Asia



"Have you seen a growing emphasis among your companies to implement and communicate ESG policies in the last year?" Source: Fidelity Analyst Survey 2021.

Across the board, environmental and social protection measures have increased, and more consumers are voting with their wallets and opting for sustainable products. People are seeking to work for firms that are more aligned with their own values and investors are rewarding good ESG companies with cheaper financing.

ESG due diligence and effective engagement are key

Finding the companies that really are making ESG improvements, however, is not easy. Greenwashing remains a risk globally and investors need to be able to conduct thorough ESG due diligence that goes beyond a simplistic ranking based on company disclosures, especially as disclosure is not mandatory in many Asian markets and can be patchy.

Fidelity's proprietary ESG ratings help address these issues, as they are drawn from our regular interactions with investee companies, conversations with stakeholders (past employees, suppliers etc.) during our due diligence process, and the industry expertise of our 160+ global sector analysts. These factors allow our ratings to be forward-looking, closely tied to business fundamentals, and often ahead of market perception.

Our experience shows that companies are more likely to adopt an ESG suggestion when made in the context of business development.

Once investors have identified the right companies, they can engage with them regularly and offer advice and feedback to ensure that progress on ESG is achieved. Our experience shows that companies are more likely to adopt an ESG suggestion when made in the context of business development. This requires investors to have a deep understanding of the company's business, its history and future plans, and the people behind it. For those investors that do, and who understand the local context or better yet have a local presence, Asia is poised to be a major market for decades to come in terms of driving sustainable development.

Biodiversity bond plants seed for engagement

By Kris Atkinson Portfolio Manager, Aela Cozic Sustainable Investing Analyst & Portfolio Manager and Mike Dolan Director of Research

The devastation caused by human encroachment into natural habitats, exacerbated by climate change, is a key engagement theme for Fidelity. Paper and pulp production is just such an encroachment. In a landmark move, a Brazilian paper company recently launched the first 'transition' bond with a specific rewilding target, prompting us to engage with its competitor on biodiversity and emissions.

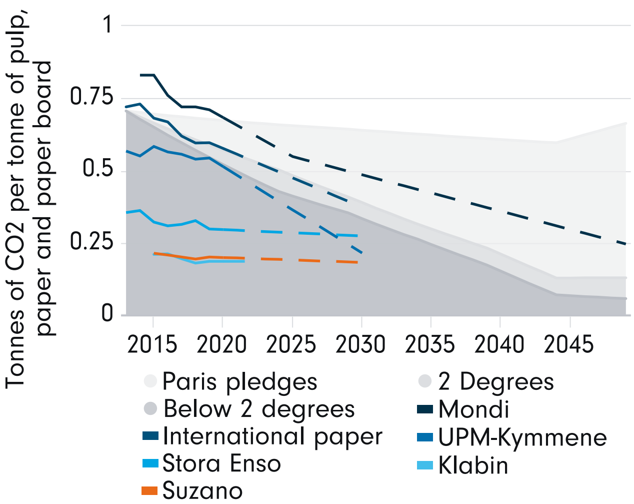
Biodiversity is most at risk in Latin America due to deforestation and climate change. Paper and pulp companies in the region rely on fast-growing monoculture plantations which are seen by some as 'green deserts' that threaten ecosystems. Although plantations are also carbon sinks, NGOs argue they store less carbon than native forests.

Several pulp makers have sought to preserve natural capital but only a handful have tied it to their financing. Brazilian manufacturer Suzano launched a transition bond with emissions targets in 2020 and its competitor, Klabin, issued one with a rewilding target this year, planting a seed for broader engagements on emissions and biodiversity with other paper companies.

Raising carbon ambitions

Suzano is the world's largest pulp producer and a natural candidate for our first thematic engagement. We pressed the company on the targets in its transition bond, which put it on track to reduce emissions by just 15 per cent between 2015 and 2030 - a goal it had already achieved 40 per cent of by 2020. Suzano explained that it was a low emitter (see chart 7). Although its emissions are consistent with limiting global warming to 2°C above pre-industrial times by 2040, we encouraged it to raise its ambitions and adopt an externally validated 1.5°C goal.

Chart 7: Suzano's emissions lead the sector



Source: Transition Pathway Initiative, March 2021. Dotted line shows targeted emissions.

A thornier issue

Biodiversity is a thornier issue and was absent from Suzano's 2020 sustainability targets. We engaged on the topic and Suzano explained that setting a biodiversity target required cooperating with neighbouring plantations, communities, and academics, and it had plans to do so. In June

2021, the company unveiled its goal of linking 500,000 hectares of priority areas for biodiversity conservation by 2030.

Suzano told us it was preserving species in surrounding areas and intersperses its plantations with actively restored native forest. It has a zero-deforestation policy and plants eucalyptus on degraded pastureland, creating food and shelter for animals (albeit less than native forests provide).

We asked Suzano how it measures success and it told us that about 80 per cent of its land is certified by the Forestry Stewardship Council. As Suzano grows more eucalyptus, it will aim to keep the share of preserved forest stable at about 40 per cent. It is not clear whether this percentage is enough to prevent species loss and is something we intend to explore further.

Launching transition bonds with concrete targets is increasingly a way that companies can help prevent species loss, boost their ESG credentials and attract investor capital.

Work in progress

We continue to encourage Suzano to be bolder on emissions and are investigating how ambitious its new biodiversity target is and what kind of impact it will have. But these steps should help improve its external ESG ratings and we have already raised our own rating of the company. Launching transition bonds with concrete targets is increasingly a way that companies can help prevent species loss, boost their ESG credentials and attract investor capital.

Impact just got real

By Neil Cable Head of European Real Estate Investments

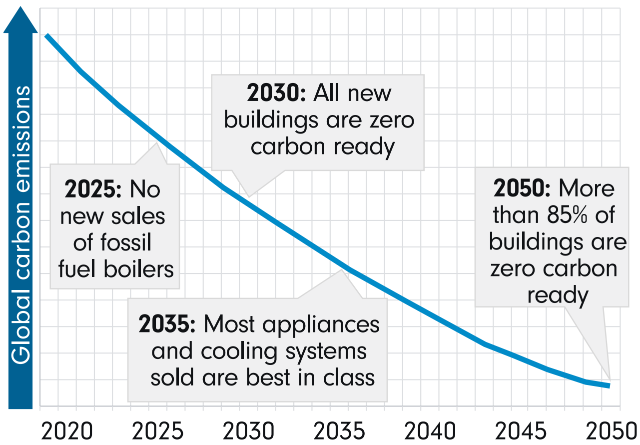
'Impact investing' is fast becoming a big focus for real estate investors, but ironically, in a few short years, may also be an outdated term; every real estate fund will ultimately have environmental and social 'impact' at its core. Not only do 40 per cent of greenhouse gas (GHG) emissions in developed economies come from buildings, but the pandemic has changed how retail and office space is used. From now on, success will be measured not just by the size of financial returns, but by carbon emission and energy use levels, the wellbeing of employees and overall societal impact.

A net zero strategy is essential

More than 110 countries (around 70 per cent of the world's economy) now have explicit plans to achieve net zero carbon emissions by 2050 (and China by 2060). Companies, suppliers, distributors, property developers and fund managers are following suit, adopting detailed strategies for becoming climate neutral. Some, such as the property firm Hammerson, are even committing to 'climate positive' carbon emissions (i.e. emissions avoided exceeding, not just equalling, emissions generated).

Companies with no net zero strategy will soon begin to be excluded from tenders, and the impact on growth prospects will be tangible. This in turn will drive down prices for new decarbonisation technologies and make it easier to adapt to a low-carbon world. This could happen sooner in the real estate sector than elsewhere, as the buildings used for work, leisure or living in need to be part of the solution within the next 5-10 years to avoid a climate crisis.

Chart 8: A hypothetical net zero pathway for real estate in line with 1.5°C



Source: Fidelity International, July 2021. For illustrative purposes only.

The renovation wave

Historically, the real estate industry has been slower to innovate than other sectors. It has taken longer than public markets to gather data and produce performance benchmarks, and to adopt new technologies and ways of operating. Now, it quickly has to become a leader. It has to measure a whole new set of different environmental and social metrics that have become as, if not more, important than traditional measures like cashflows. It has to ensure that less energy efficient property assets do not become 'stranded'.

The risk of stranded assets is high because around 97 per cent of the buildings in Western Europe are not up to the required sustainability standards for the industry to achieve net zero. Only 1-2 per cent of the entire building stock is renewed each year, so existing buildings have to be renovated. Hence why the EU has listed 'green buildings' as a key area and estimates that by 2030, 35 million buildings could be refurbished across Europe in a wave of renovation similar to the rebuilding that followed the devastation of WWII.

Back then, the US-led Marshall Plan ($12 billion of state aid - $134 billion at 2021 prices[2]) alongside policy incentives and private investment helped Europe to rebuild and enjoy the fastest ever expansion in European economic growth from 1948 to 1952. We could well be on the cusp of something similar.

Demonstrating impact

To participate in this wave and drive improvements, real estate investors will need to map out a path to net zero for every building and measure the impact in many areas, including:

- **Building materials:** Using wood from certified sustainable sources and minimising the use of plastics when refurbishing are easy ways to reduce carbon footprints, but negating 'embedded carbon' (i.e. the damage already done in the original building process) will also be necessary.
- **Energy use:** Installing energy efficient lighting in buildings is fast becoming standard; phasing out gas boilers and only using electricity from renewable sources is a much bigger challenge.
- **Transport:** Charging points for electric cars and plenty of bike racks are now a minimum requirement for new office buildings, but ways of collecting so-called 'Scope 3' emissions data, such as customer supply chain and visitor/employee transport emissions, will also have to become standard.
- **Water use and waste recycling:** Ensuring efficient use of water and having robust recycling systems in place is essential.

Playing our part

Fidelity International is playing its part, both as a company with office buildings across the world and as a European real estate portfolio manager. Our funds contribute to the GRESB (Global Real Estate Sustainability Benchmark) initiative and we have improved our GRESB scores by 25 to 40 per cent across our funds over the past three years.

But we have to go faster even to stand still. The GRESB bar gets raised as the industry improves so we have set 13 specific sustainability targets for areas such as energy and carbon reduction, water and waste, and improvements in green building certification. Our team will also publish our own net zero plan later in 2021, alongside the overall Fidelity operations goal of reaching net zero by 2030.

[2]Source: US State Department: https://history.state.gov/milestones/1945-1952/marshall-plan

Engagement with investee companies

Raising the bar for engagement

Jenn-Hui Tan
Global Head of Stewardship and Sustainable Investing

2020 was a watershed year for ESG, and for engagement. As we moved through the Covid-19 crisis, engagement took on an even bigger role than before, both in terms of how we fulfil our social purpose as a fund manager and how we help our clients achieve better financial and social returns from the companies in which they invest.

Environmental issues were already high on the agenda before the pandemic struck, but the damage caused by Covid-19 amplified awareness of social issues. Governance has been critical for many years, but varying lockdown measures challenged the capabilities of boards and management teams to navigate extraordinary circumstances.

Investee companies and asset managers alike are growing in our understanding of, and expectations for, the characteristics that make up a sustainable society and sustainable markets.

Throughout this period, Fidelity International continued to engage with our investee companies on a range of ESG issues in even greater depth than previously. In this report, we highlight examples of our diverse and increasingly sophisticated engagements, from a campaign to scrutinise and limit executive compensation during Covid (page 31) to our efforts to halt modern slavery (page 38).

Engagements that bring real change

Over time, the benefits of our long-term commitment to sustainability are becoming clearer. We are able to effect real change (such as ending coal financing, see page 45) and our outstanding analyst team can more quickly identify and address major issues across industries and geographies, such as the seafarers' crisis (page 43) and diversity in global financials (page 40).

While 1:1 engagements with companies can be very effective, there is also tremendous power in global investors collaborating to help companies focus on what they need to do. Our participation in the collective Climate Action 100+ initiative is a good example of this and has brought significant benefits to investors, companies, and society as a whole.

However, the bar is being raised on sustainability for everyone. Investee companies and asset managers alike are growing in our understanding of, and expectations for, the characteristics that make up a sustainable society and sustainable markets.

Our engagements on climate, for example, have become more detailed and our expectations are higher. At a minimum, we want to see that a company has a stated policy on climate change. Is it aligned with the UN Paris Agreement? What is the company's approach to net zero, and what are their disclosures on emissions, including Scope 3? Does the board have discussion and oversight of climate change?

Trends around climate and employee welfare will only accelerate

Looking ahead, we believe that trends around climate and employee welfare will only accelerate. When identifying our key themes to engage on in 2021, we focussed on building back greener, stronger and more inclusively from the pandemic in anticipation of what the next decade may bring. This means pushing companies to decarbonise as quickly and as sustainably as they can. It means expecting companies to fulfil meaningful diversity goals and to ensure human rights are protected for all workers. Finally, we also believe companies should consider digital ethics and inclusion as critical sustainability issues.

Ways we engage with companies

Company meetings and formal correspondence	Shareholder resolutions	Collaborative engagement	Proxy voting	Public policy

Engagement themes in 2020

Climate change	Covid-19	Modern slavery	Diversity	Executive pay

Engagement and voting summary 2020

Engagement summary

Overview

When the spread of Covid-19 forced offices to close and business travel to cease in 2020, Fidelity shifted rapidly to virtual meetings to ensure our engagements could continue as normal. As a result, we managed to conduct more engagements than in the previous year, meeting with hundreds of companies during the period. Strikingly, while a quarter of our engagements in 2019 occurred face-to-face, just 5% were in-person during 2020.

An engagement is...

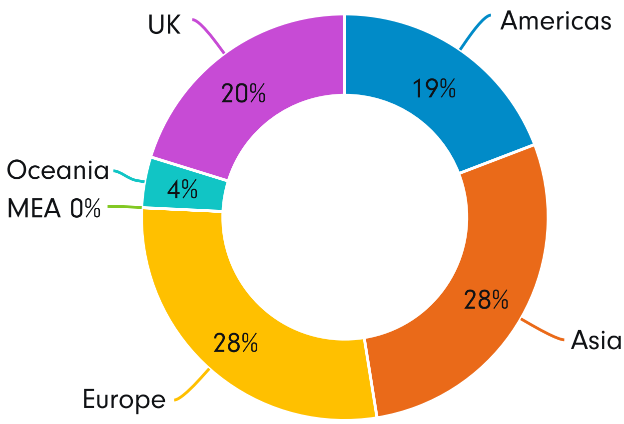
- A specific interaction with a company on ESG issues
- Aimed at influencing ESG practices and/or improving ESG disclosure

An engagement is not...

- Attendance at a company presentation or at company meetings
- Interactions for data collection or research purposes related to investment decisions

Throughout the year, Fidelity conducted 923 ESG-focussed engagements with 716 companies (2019: 681). This included 152 meetings with company chairs and other non-executive directors (2019: 75) and 81 meetings with CEOs, CFOs and other executive directors. Approximately 10% of the 923 company meetings related to collaborative engagements, with the remainder consisting of direct engagements conducted by the sustainable investing team, fund managers and investment analysts. Over the same period, our team of investment analysts covered a range of material ESG factors in discussions with the companies they cover, in over 16,000 meetings.

Chart 9: 2020 engagements per region



Source: Fidelity International, June 2021.

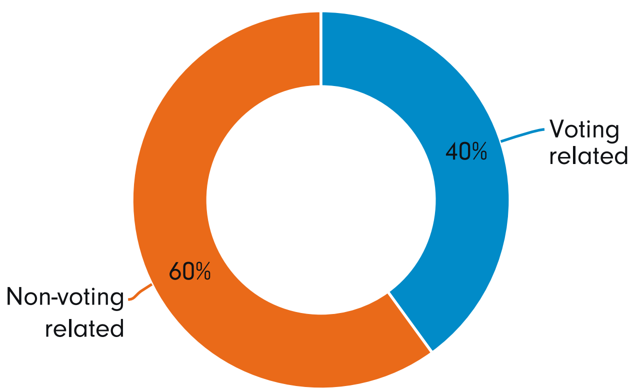
Our engagement activities in 2020 spanned a number of geographies, reflecting the global nature of our business. The largest share of ESG engagements took place in Asia (c. 28%) and

Europe ex-UK (28%), followed by the UK (20%), and the Americas (19%). In Asia, we have grown our engagement efforts, with the region's share increasing from 23% in 2019 to 28% in 2020.

In virtual engagements, governance and climate change dominated the agenda, with 40% and 39% of meetings tackling these topics respectively.

As discussed in later sections of this report, Fidelity launched several engagement programmes in 2020 focussed on tackling the most pressing ESG issues facing the companies in which we invest. This increased focus on proactive, thematic engagements can be seen throughout 2020 with the rise of engagements unrelated to company meetings: 60% of our engagements were unrelated to company meetings during 2020, up from 40% the year before.

Chart 10: 2020 engagements by type



Source: Fidelity International, June 2021.

Throughout the year, our analysts covered a host of environmental, social and governance topics at meetings with company representatives. In many cases, the focus of our engagements spanned all three ESG areas, as our analysts capitalised on the opportunity to address multiple sustainability-related topics in a single meeting. In 29% of engagements, our analysts addressed environmental issues, while 22% centred around social issues.

Overall, the primary engagement themes for 2021 were executive remuneration (41%), governance (35%) and climate change (24%). This focus on executive remuneration is explained by Fidelity's extensive programme of engagements relating to the Covid-19 pandemic, including our letters to major companies concerning executive pay practices (outlined later in this report).

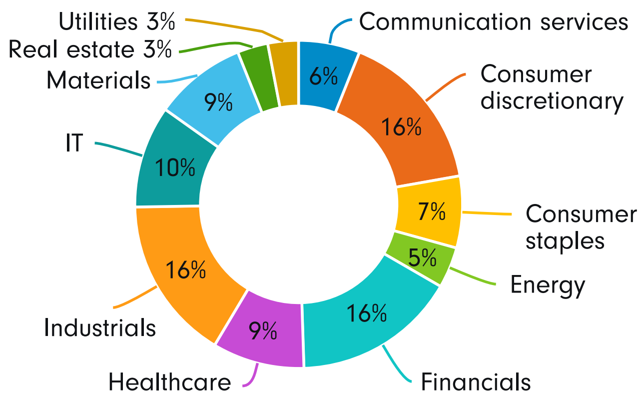
Covid-19 also featured prominently in our discussions with companies during virtual engagements, with human capital raised in 18% of these meetings, where our analysts sought to encourage companies to ensure the wellbeing of their employees and customers throughout the crisis.

In virtual engagements, governance and climate change dominated the agenda, with 40% and 39% of meetings tackling these topics respectively.

Chart 11: All engagements by topic

Source: Fidelity International, June 2021. Note: Includes written correspondence.

Chart 12: Engaged companies by industry 2020



Source: Fidelity International, June 2021.

For the first time, we provide a breakdown of our engagements by industry. Our engagement efforts were widely dispersed across industries, with slight leaders being in the consumer discretionary (16%), financials (16%) and industrials sectors (16%) in 2020, while information technology (10%), healthcare (9%) and materials (9%) were also strongly represented. Our analysts' interest in industrials are reflected in the results of our recent ESG Analyst Survey, where 60% of analysts perceived there to be both opportunities and risks arising from the energy transition. The survey offers further insights into how different sectors are managing ESG issues and where engagement has been most effective, and can be found here.

716	3,828	16,000+
Companies we actively engaged with	Shareholder meetings at which we voted	Meetings conducted with companies

Voting summary

Overview

During 2020, Fidelity's sustainable investing team analysed 3,828 shareholder meetings at companies in which Fidelity is invested. The tables below provide a geographic breakdown of the votes by region for the reporting period and an overview of how Fidelity voted on various topics.

Table 3: Votes against management by category (as a % of total votes by region + category)

Category	UK	Rest of Europe	Americas	Japan	Rest of Asia Pacific	Oceania	MEA
Auditors	0.0%	0.0%	0.0%	0.0%	0.5%	0.0%	0.0%
Board	0.3%	2.3%	0.5%	4.9%	7.7%	1.0%	1.6%
Capital structures	0.9%	11.3%	5.6%	0.0%	0.4%	0.9%	5.2%
Charter amendments	0.0%	5.4%	8.3%	1.7%	5.1%	0.0%	0.0%
Remuneration	9.3%	30.8%	17.9%	9.1%	8.6%	15.3%	6.6%
Routine business	0.2%	0.3%	1.0%	0.5%	0.7%	0.0%	0.0%
Strategic/Restructuring	2.0%	10.9%	5.3%	0.0%	3.7%	4.5%	8.3%
Takeover related	0.0%	46.9%	15.0%	100.0%	25.0%	0.0%	0.0%
Shareholder proposals	0.0%	16.9%	57.7%	26.2%	0.7%	45.5%	0.0%
Total	1.3%	8.4%	4.8%	5.2%	3.9%	7.9%	3.7%

5-10% 10-20% More than 20%

Source: Fidelity International, 2021.

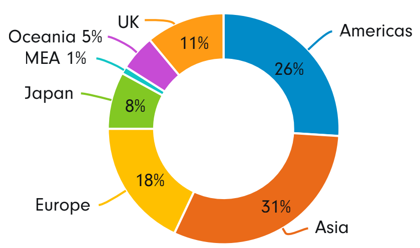
Fidelity voted against management on at least one resolution at 28% of the meetings that were analysed, an increase from 24% the year before. We voted with management on all items at 67% of the meetings we covered, down from 71% in 2019. At 2% of meetings, we abstained on at least one item; generally, this occurs when there is not enough information to make an informed voting decision or, on occasion, to send a cautionary message to the company.

Table 4: How Fidelity voted across different regions (by number of meetings)

	Votes with management	Votes against management	Abstain*	Blocked	Took no action**	Total
Americas	633	343	7	0	13	996
Asia	958	221	10	0	6	1195
Europe	270	308	70	33	7	688
Japan	207	103	0	0	0	310
MEA	28	16	0	0	0	44
Oceania	112	51	1	0	29	193
UK	339	44	4	3	12	402
Total	2547	1086	92	36	67	3828

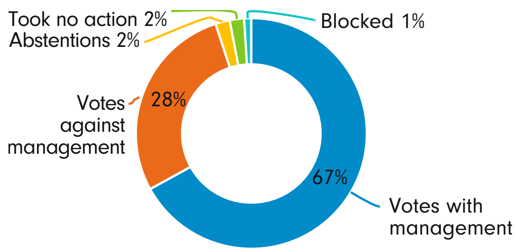
Source: Fidelity International, 2021.
*Includes all meetings where Fidelity abstained or voted against management in respect of one or more resolutions.
**Includes a small number of meetings where Fidelity's votes were rejected.

Chart 13: Summary of shareholder meetings by region



Source: Fidelity International, 2021.

Chart 14: How we voted across all shareholder meetings/resolutions



Source: Fidelity International, 2021.

Voting activity highlights

Overview

Fidelity's voting activities are a cornerstone of our active investor philosophy and key to our role as a responsible steward of client funds. We strongly believe that voting is an essential tool for working with companies to enhance sustainable returns and create value for a broad range of stakeholders.

In 2020, our voting patterns represented both a continuation and an extension of previous years, with remuneration, shareholder proposals and, in some markets, takeover defences receiving the bulk of votes against management. We also designed and implemented a new voting policy to address the Covid-19 pandemic and payment of executive bonuses at companies that relied on government support during the crisis. Below we provide detail on our voting activities in 2020 and outline our key areas of focus during the year.

Executive remuneration

In the UK, Continental Europe and the Americas, executive remuneration continued to be one of the principal areas where we voted against management. The major drivers in these cases were our red line remuneration voting policies, which vary by region.

In the UK and Europe, we require long-term incentive plans to provide a share retention/ exposure period of at least five years from grant as a means of discouraging executive short-termism. This policy was the biggest driver of our remuneration votes against management in Europe (30.8%) and the UK (9.3%), where levels were broadly in line with 2019 voting (31.9% and 10.2%, respectively). The moderate reductions in voting against remuneration items in these markets can be attributed to the steady progress of improving executive pay practices in the region. In particular, we continue to see a reduction in the number of UK companies that do not comply with our share retention requirement rule, following the UK Corporate Governance Code's update in 2018.

In North America, where free shares continue to represent a substantial portion of executives' pay packages and share plans tend to be much more dilutive than in Europe, we require at least 40% of equity awards to have performance hurdles to encourage greater pay-for-performance alignment. In 2020, we voted against 17.9% of remuneration-related items at company meetings, compared with 22.6% the year before. This downward trend in the number of remuneration-related votes against management follows a series of multi-year engagements with companies to explain our expectation that equity pay must be at least partially performance-conditioned. We are pleased with this continued downward trajectory and will continue to focus our efforts on improving remuneration standards in North America.

In both Europe and North America, we continue to apply our escalation policy of voting against the Compensation Committee Chair if remuneration concerns remain unaddressed from the previous year.

While we do not apply the abovementioned red line voting policies to other regions of the world, our global voting approach places considerable emphasis on good remuneration practices. We therefore had substantial levels of votes against management in this category across all regions, as has also been the case in previous years. In Japan and Asia Pacific, we voted against 9.1% and 8.6% of companies, respectively, down from 10.3% the year before in Japan but an increase of 2.2% in APAC. In APAC, this pronounced uptick resulted from a more robust approach to remuneration practices at companies with the aim of improving market practice.

For all companies within our universe, we perceive climate transition risks as highly material and compelling grounds to support heightened disclosure, or commitments to an accelerated decarbonisation strategy.

Covid-19 remuneration approach

In H2 2020, we sent letters to our larger holdings in the FTSE 350 (UK), ASX 200 (Australia), and STOXX 100 (Continental Europe) setting out our expectations on how investee companies should approach executive pay decisions in the wake of Covid-19. We advised that companies which had taken emergency state aid under wage subsidy or employee furlough schemes should cancel short-term bonuses to lead executives for the years in which such aid was received. We also recommended restraint on executive pay increases generally, and advocated cutting the long-term incentive where necessary to avoid potential windfalls owing to temporary falls in the share price. We discussed the letter in our corporate engagements on executive pay during H2 and rolled out the new voting approach later in the year.

Shareholder proposals

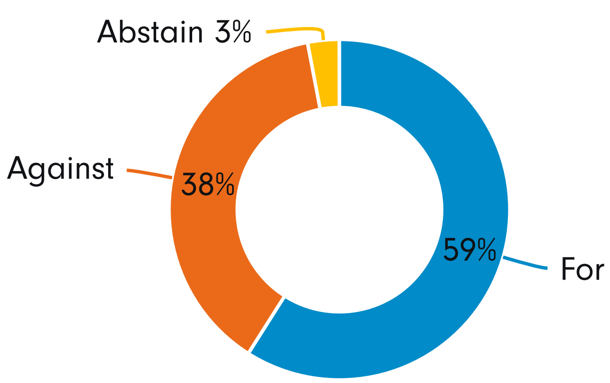
We supported shareholder proposals across the majority of regions during 2020, which typically meant voting against the recommendation of company management. A substantial proportion of our support can be attributed to ESG-related proposals, which are most prevalent in North America but are also seen in Europe, Australia, and Japan. In both Europe and North America, we supported considerably more shareholder proposals than the year before: voting against management on 57.7% of proposals in North America (2019: 51.9%) and 16.9% in Europe (2019: 2.5%). Fundamentally, we believe shareholder proposals are an important tool for investors to promote managerial accountability and drive change, both at an individual company and systemic level. Our increasing support of these proposals reflects our desire to address issues of material importance to all stakeholders, and is formalised in our new voting policy.

Climate shareholder proposals

Compared to the year before, a growing proportion of shareholder proposals in 2020 related to climate change, reflecting increased investor scrutiny of companies on this critical issue. For all companies within our universe, we perceive climate transition risks as highly material and compelling grounds to support heightened disclosure, or commitments to an accelerated decarbonisation strategy. For those companies we deem "Most Affected", we apply an even higher standard, considering the greater risk that climate change poses to the value of our investments in these companies.

The net effect of this approach is a high level of support for observed climate-related shareholder proposals throughout the year, at 59%. Where we did not support a proposal, we considered management's proposals more credible, or did so in recognition of their progress towards decarbonisation. We continue to advance our analysis of key proposals on this topic and will not hesitate to use our vote to hold companies' climate strategies to account.

Chart 15: Climate shareholder proposal votes



Source: Fidelity International, July 2021. Note: These are proposals Fidelity has defined as climate-related.

Japanese board independence

In Japan, where low board independence is a market-wide phenomenon and a key focus of our shareholder voting, we have a policy to target nominally independent directors who have conflicts or affiliations which compromise their objectivity. Consequently, votes against directors are comparatively higher than in other markets, at 4.9% in 2020. This was also the case for some other Asian markets, where we voted against management on board items at 7.7% of meetings.

Anti-takeover devices

We oppose anti-takeover measures across all our holdings, but our votes against management in this category differ by region due to the relative prevalence of such entrenchment devices. In Japan, for example, we have consistently voted against 100% of takeover-related items in both 2020 and 2019, whereas we voted against no such issues at companies in the UK and Oceania in both periods.

Our new voting policy

From H2 2021, we are implementing our new voting policy that aims to progress our active stewardship and sustainability agenda, with key new policies around climate and diversity.

Under the policy, we will vote against members of the board at companies that do not meet our expectations for board gender diversity, while from Q1 2022, we will begin to vote against directors at companies that do not meet our minimum climate change-related standards. In particular, our climate policy targets industries most affected by climate change and the degree of urgency with which we believe they should be addressing these issues. We look forward to discussing the outcome of these new policies in future reports.

Engagements by theme

Responding to Covid-19

The Covid-19 pandemic was the defining event for global financial markets during 2020, and consequently, was a key focus point for our engagement activities during the year.

Our analysts in Asia alerted us to the risk of an emerging virus at a relatively early stage in late 2019. We drew on our investment team's experience of SARS (severe acute respiratory syndrome disease) to help inform our assessment of the potential market risks. As the virus started to spread around the world, we rapidly adapted our approach to reflect Covid-19 as a market-wide and systemic risk, with major investment and operational implications.

Throughout the pandemic, we gathered and analysed epidemiological and market data, and periodically disseminated our research and thought leadership, both internally and to our clients, to facilitate well-informed investment decision-making.

Our investment analyst team formed a cross-functional Covid-19 working group which regularly reported on infection analysis, medical innovations, vaccine development and deployment forecasts, macroeconomic impacts, as well as sector-wide trends and the impact on individual companies. Our sustainable investing team developed a framework to guide investment analysts on how they should engage with investee companies about their response to Covid-19. One focus was on governance effectiveness and stakeholder impact. This helped to shape our dialogue with investee companies during the year and informed our fundamental and sustainability research.

We also worked closely with market regulators and other financial organisations to consider the short and long-term implications of the pandemic on markets and possible solutions. In the short term, this included providing data and insight requests to supervisors (e.g. the Bank of England, the Financial Conduct Authority and HM Treasury) and advising governments on emergency corporate financing and reducing regulatory barriers to accessing capital. In addition to our regulatory engagement, we proactively engaged with corporates, both on our own and in collaboration with other investors, to address Covid-related systemic risks.

Fidelity also reflected upon the experience of the 2007/08 financial crisis and realised that misalignment between executive pay and stakeholders' experience had the potential to cause substantial reputational harm for investee companies and undermine public trust in business. In H2 2020, we launched a letter campaign to investee companies in the FTSE 350, ASX 200, and STOXX 100 setting out guidance on how we would expect them to treat executive pay in light of the Covid-19 pandemic. A key point we raised was that companies that had participated in taxpayer-supported furlough schemes should waive executive bonuses for the year. We also urged restraint on pay rises and warned against the risk of windfall payments for LTIP awards. We continued to engage on this during the second half of 2020 and into 2021; it also became a major theme for our voting programme.

Below are examples demonstrating how we engaged with companies during the Covid crisis. Often, we used the context of Covid discussions to raise broader questions around long-term sustainability topics.

Italy

Fidelity's sustainable investing team, investment analysts and a fund manager engaged with a leading Italian multi-line insurance company on several topics, including the company's response to the Covid-19 pandemic, human capital and executive remuneration.

> The company had committed not to make any redundancies during this period and had not put employees on furlough, and we discussed a number of measures the company had taken to support employees and monitor their health and wellbeing.

The company informed us that all group employees worked from home throughout the pandemic and the company did not apply to any furlough scheme. The company affirmed that improving employees' welfare had been a priority for a number of years, especially with regards to flexible working, and this had allowed them to minimise disruption during these months as they already had the infrastructure to support remote working.

The company also launched several initiatives to improve customers' experience and assist them during the unprecedented times while also supporting local hospitals and health services to deal with the pandemic. They decided to give all motor customers who renewed their policy a month's premium for free and to extend grace periods for late payments to 15-30 days in line with government guidance. The company noticed a slowdown in auto premiums, but also informed us that top line impact was offset by a reduction in claims in both their auto and health businesses.

The company expected an increase in health insurance demand in the mid- to long-term, while the Covid crisis only exacerbated fundamental shifts in the auto business.

With regard to executive remuneration, the company decided to suspend bonus payments as an additional way to deal with the crisis. We questioned the company about a discretionary bonus awarded to the general management, and they informed us that this had already been paid out at the beginning of the year before the pandemic began. We decided to organise a follow up call to further discuss elements of remuneration including metrics and peer group selection.

UK

Also in the insurance sector, Fidelity spoke with the chairman of a UK insurance company shortly after the onset of the Covid-19 crisis. The company had cut its dividend as a matter of prudence but was not experiencing a rush of claims at the time we spoke. The company had committed not to make any redundancies during this period and had not put employees on furlough, and we discussed a number of measures the company had taken to support employees and monitor their health and wellbeing.

The board was aware of the industry facing a public perception problem, as most Covid-19 related losses would evidently not be covered under standard insurance arrangements, and the company was working on cross-industry initiatives aimed at raising awareness, though it was too early to comment on these. The chairman acknowledged that board activity had ramped up following Covid-19 and that he was personally quite stretched as he is also the chairman of a large listed UK supermarket chain.

The company took the opportunity to request feedback on how Fidelity International views board renewal, diversity targets, and ESG analysis.

Fidelity held a conference call with the chairman of a British aerospace company to discuss strategic and governance matters during the initial months of the pandemic. As a supplier to the aerospace industry, the company's client base had been severely impacted by the Covid-19 crisis. After reviewing the company's liquidity situation, the board decided on a headcount reduction of c. 15% and accessed furlough schemes where available; the company was also topping up pay for employees on furlough.

The company has a highly skilled workforce, and the board was worried that further cuts could cause lasting damage by taking critical knowhow out of the business. The chairman was particularly adamant that the graduate programme should not be harmed. The company introduced Covid-19 workplace safety measures, which mostly affected the warehouses rather than the assembly line. The board did not believe that the resilience of the company's supply chain was at risk, and it said that it would not exacerbate any suppliers' problems by delaying or withholding payments.

Canada

In Q3, Fidelity equity analysts, other investment team members and sustainable investing analysts met with representatives of a Canadian food retailer to review how they had been weathering the Covid crisis, along with other sustainability topics. The board's view was that the crisis had demonstrated the strength of the company's leadership team. Indeed, the CEO was recently recognised as "Canada's Outstanding CEO of the Year" by a leading Canadian newspaper.

During the early months of Covid, the company was considered an essential service and suffered no store closures. Worker safety was supported with plexiglass installed in over 600 stores within one week. PPE was obtained, greeters were hired and hourly cleaning was implemented. Although the situation was difficult and complex, they felt it became a rallying moment that improved relationships with unions, as everyone focussed on remaining open and keeping people safe. The company took the opportunity to request feedback on how Fidelity International views board renewal, diversity targets, and ESG analysis.

Japan

Fidelity's Tokyo engagement team had a meeting with a Japanese railway company in June 2020. Regarding the impact of Covid-19, they told us that although the number of commuting passengers had been gradually recovering, the bullet train was currently operating with social distancing. We suggested making more efforts to address prevailing concerns about public transportation caused by Covid-19. We also discussed the sustainability bond issued in January 2020 which would be used to invest in a new type of vehicle that is better for the environment with lower GHG emissions than diesel. We urged them to be more aggressive in marketing the next sustainable bond issue as the existing one failed to achieve a premium.

We did not think the board's decision to apply positive discretion to executive bonuses was appropriate in light of the company's receipt of wage subsidies during the year.

Australia

In Q4, we voted against the remuneration report of an automotive parts and solutions provider due to their approach to executive bonuses. We did not think the board's decision to apply positive discretion to executive bonuses was appropriate in light of the company's receipt of wage subsidies during the year, as well as staff redundancies and a substantial capital raise the company had conducted to meet challenges it faced because of Covid-19.

In July 2020, we had sent a letter to the company asking for executive bonuses to be cancelled if taxpayer support had been taken to meet wage costs during the year. We engaged with the company before voting, and we acknowledged that there were some mitigating factors e.g. the CEO had taken a 30% pay cut when Covid-19 shutdowns occurred, and the company had performed relatively well through the crisis to date. We nevertheless concluded that a vote against the remuneration report was appropriate. The remuneration report was voted down at the AGM. Under Australia's two-strike rule, the company will be required to hold a 'spill resolution' on potentially removing board members if the remuneration report receives more than 25% votes against at next year's AGM.

Collaboration: Climate Action 100+

While most of Fidelity's almost 1,000 engagements in 2020 were direct 1:1 interactions with investee companies, approximately 10% of our engagements were part of collaborative efforts. Indeed, engagement through collaboration is an important and growing trend. While financial services firms can be highly competitive, increasingly we see the benefits of joining forces to speak collectively on key sustainability issues and achieve real impact.

One example of our collaborative efforts in 2020 is the work we have done as part of Climate Action 100+, an investor initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. CA100+ is made up of over 500 global investors responsible for over $50 trillion in assets under management across 33 markets. Fidelity International, as an investor participant of CA100+, is a signatory to the initiative and takes responsibility for direct engagements with focus companies, individually and/or collaboratively.

Below are some case studies from our collaborative engagement work with Climate Action 100+.

China

As one of the lead investors for CA100+ engagements with two Chinese integrated oil and gas companies, Fidelity conducted a series of discussions with each firm during the year. In H1, we met virtually with the companies to discuss their governance, strategy and climate change management disclosure. Both companies acknowledged the importance of effectively addressing the challenges posed by climate change to their long-term success while explaining that, over the medium term, the strategy is centred around using natural gas as a transition energy while seeking commercially sensible renewable energy projects as a way to diversify.

Later in the year, Fidelity organised and led another round of meetings with these companies. The main objective was to understand how each company plans to align its business strategy with China's 2060 carbon neutral pledge that had been announced by President Xi in September 2020.

While both companies acknowledged their critical roles in helping China to achieve its climate ambition and their intention to become carbon neutral before 2060, one was able to provide a clearer outline of its action plans, which include further improving its product mix to produce even more energy efficient and low emitting fuels, and stepping up its investment in hydrogen. This company recently partnered with two American firms to conduct R&D into electrolysis technology to lay the groundwork for green hydrogen production. Following the conclusion of another research initiative, expected to take about a year, the company plans to announce its carbon peaking and carbon neutral targets and pathway publicly.

Both companies welcomed our outreach under the umbrella of CA100+ and expressed the desire to continue the dialogue with us. They also appreciated our offer to work with them to improve their climate disclosure in their sustainability reports in 2021, and to provide materials and insights to facilitate TCFD reporting, particularly around scenario analysis and physical risk assessment.

South Africa

An engagement with a South African integrated energy and chemical company was conducted by one of our sustainable investment analysts alongside colleagues from five investors collaborating on the group engagement.

> We were pleased to learn of the progress made by the company, including their commitments to introduce a decarbonisation strategy and to improve disclosure in line with the TCFD recommendations in their next sustainability report.

The company has released its 2030 climate targets, with many NGOs raising concerns that the targets are not sufficiently ambitious. The company explained the key challenge to transitioning their business: South Africa does not have the requisite natural gas infrastructure, and the regulations were not renewables-friendly until extremely recently (just two months previously). The company says that they will be in a position to transition to gas only by 2030 as they have to build the pipelines and infrastructure. Otherwise, the company believes it is on the same page as investors on the climate transition, and it has a strategy to reduce emissions: it has already cut emissions by 10m tonnes, and the targets post-2030 will be a lot more significant. Further engagement was planned for Q1 2021 to review the company's environmental scorecards, which were being finalised.

Mexico

As the lead investor for an engagement with a Mexican mining company, Fidelity International led a first call with the company's sustainability manager. During this session, we introduced the Climate Action 100+ initiative and discussed progress made to date by the company on climate change.

We were pleased to learn of the progress made by the company, including their commitments to introduce a decarbonisation strategy and to improve disclosure in line with the TCFD recommendations in their next sustainability report. In terms of governance, the company confirmed that the board will be given formal responsibility for climate-related issues.

Planned further reductions in GHG emissions will come from an increased use of renewables, electrification, process optimisation, and potentially some more innovative technologies such as lower emissions trucks. However, the method(s) of reducing emissions from smelters and refineries is yet to be determined. In relation to Scope 3 emissions, the company expects to publish a new code for suppliers next year in order to address climate change.

We agreed to follow-up with the company in a few months' time, ahead of the publication of their sustainability report.

Australia

As a supporting investor on the CA100+ engagement with a leading Australian energy provider, Fidelity actively participated in a group discussion with the company regarding its recently released sustainability report, which included some ambitious targets relating to climate change.

The company have linked a new climate change target to their short-term incentive (STI) plan within their executive remuneration programme for key executives (including the CEO), defined as a percentage reduction in their Scope 1 emissions. FY2021 targets range from a minimum of 4% to a stretch target of 10%, with an expectation to achieve a 6% reduction from a FY2017 baseline. Short-term targets call for reduction in Scope 1 emissions by 10% on average for FY 2021-23. Medium-term targets envision reducing Scope 1 & 2 emissions by 50%, and Scope 3 by 25%, by 2032.

> The company aims to achieve net zero emissions by 2050. It has until 2025 to complete the planning, but will start the process this year.

The company has committed to updating its scenario planning in line with the Science Based Targets initiative (SBTi) targets based on a 1.5-degree pathway for the oil and gas sector and net-zero targets for the corporate sector once they are released by the SBTi. The company aims to achieve net zero emissions by 2050. It has until 2025 to complete the planning, but will start the process this year.

We discussed the use of gas as part of the company's transition plans. The company looks to the UK as a good example of what Australia could do in this transition. The UK reduced their coal capacity by relying more on renewables and energy efficiency. The big difference between Australia and the UK though is capacity: Australia doesn't have the same reserve capacity as the UK to facilitate the transition. The UK is also more proactive around having a carbon price and capacity payments. With regards to renewable energy, the company continues to target 25% of their owned and contracted generation capacity being made up of renewables and storage by the end of 2020, subject to development and commissioning timelines.

Modern slavery

We significantly broadened and deepened our engagements concerning modern slavery in 2020. Modern slavery covers a variety of situations in which people are forcibly or financially controlled for the purpose of exploitation. This includes human trafficking, forced labour and forced marriage, child labour, deceptive recruiting and debt bondage. Over 40 million people currently live in such conditions of slavery: more than ever before in history, and currently only 1% are ever rescued.

Fidelity International has purposefully made this an active focus of our engagement efforts, working in both 1:1 and increasingly in collaborative engagements to seek to effect change in this area. Some examples of our engagement are included below. They demonstrate the value of Fidelity International's global scope; we are able to engage and draw on experiences and perspectives from different regions to inform effective active stewardship throughout the world.

Australia leads the way

Australia has been a leader in identifying and seeking to eradicate modern slavery, notably with the passage of the 2018 Australian Modern Slavery Act. Under this Act, companies in Australia are required to report annually on modern slavery in their own operations and among their suppliers. Our investment team in Australia, together with our sustainable investing team, initiated engagements with investee companies impacted by the Act to get a view as to how they are performing when it comes to monitoring modern slavery throughout their operations and to encourage them to publish thoroughly on the topic.

In one representative case, we reviewed an Australian steel company's modern slavery report for 2020, which included a risk assessment, as well as a description of their supplier assessment, training and monitoring processes. We found that the supplier assessments included a labour rights assessment, but without a specific weighting for slavery concerns. The company had engaged an external consultant to work on remediation of human rights violations in the supply chain, and the company had encountered poor recruitment practices among some suppliers. In the course of our engagement, the company committed to pilot a new supplier questionnaire to achieve more quantifiable outcomes, and to increase on-site assessments. They agreed to track progress of corrective actions among suppliers and to engage with suppliers in order to improve recruitment practices.

"Find it, Fix it, Prevent it" initiative

We are participating in the "Find it, Fix it, Prevent it" initiative on modern slavery. The objective of this collaborative engagement is to help companies develop and implement better processes for finding, fixing, and preventing modern slavery in companies' supply chains. The UK hospitality sector is the first focus area of the campaign, which got under way in 2H 2020.

As part of this initiative, we are leading the engagement with the UK business of a globally branded fast-food chain regarding their suppliers' oversight of modern slavery. The company acknowledged that the extent of its suppliers' due diligence was limited. They have been relying on SEDEX (collaborative platforms for sharing responsible sourcing data on supply chains) and focussing on tier 1 suppliers. Despite this limited current visibility, it was encouraging to hear that the company is dedicating more resources to this area with a new team in charge of setting up a supply chain management program. Being able to monitor employment practices across franchises is another area of potential progress.

After our initial discussion to understand the company's current practices and provide some suggestions, we agreed with the company to follow-up after the release of their updated modern slavery statement on several areas, including their audit programme of suppliers, collaboration with other companies or third-party organisations, and working with franchisees on their practices and disclosures.

Investors Against Slavery and Trafficking (IAST) APAC

Drawing upon our experience from the above initiative in the UK, in Q4 2020 we became a founding member of Investors Against Slavery and Trafficking (IAST) in the Asia Pacific region (APAC). The purpose of this collaborative engagement initiative is to drive effective action among companies to find and stop modern-day slavery, including labour exploitation and human trafficking. IAST APAC is now a coalition of leading investors with collective assets under management of over US$4.27 trillion.

We recognise that insufficient management of ESG factors in a company's supply chain can result in reputational, operational and legal risks, as well as unsustainable business models. The implications for investors are significant if modern day slavery issues are left unaddressed. Therefore the initiative has identified two work streams:

- **Investor statement** - IAST sent an investor statement to the ASX100 setting out the group's expectations of reporting companies under the Australian Modern Slavery Act. We are seeking to influence the way these companies report by setting clear expectations to go beyond the legal requirements and address labour exploitation as a leading indicator of modern-day slavery. We plan to expand the reach to ASX200 in 2021.
- **Collaborative engagement** - we are embarking on a multi-year initiative to address complex and systematic human rights issues in the value chain through collaborative engagement with companies at risk across Asia Pacific.

As co-chair of the collaborative engagement working group and the lead on three company engagements, we are running the initial engagements from Q2 2021.

Promoting diversity

Through the second half of 2020, we engaged with a select number of key financial companies in one of our global funds about their approach to gender diversity. Overall, we were pleased to confirm that most are employing good practice, such as setting gender diversity targets, using recruitment shortlists with at least one female candidate and training staff in unconscious bias. But although we saw high levels of diversity at the junior levels and increasingly on the board, there is a drop off at the management and executive layers. We encouraged them to embrace a mix of policies that could help them improve their gender diversity.

Gender diversity: A no-brainer

The business case for gender diversity is compelling. Logically, if we want the best people to be in the most influential positions, we need to provide equal opportunities for all groups at all stages of their careers. While it may be difficult to isolate its impact, multiple studies show that over time, improved financial performance is linked to diversity. A recent study by McKinsey found that companies in the top quartile for gender diversity on executive teams were more likely to have above-average profitability than companies in the fourth quartile. The study also notes that the case for ethnic and cultural diversity is equally compelling. As investors, we want to share the message with our investee companies that it is important they are adopting policies to boost diversity.

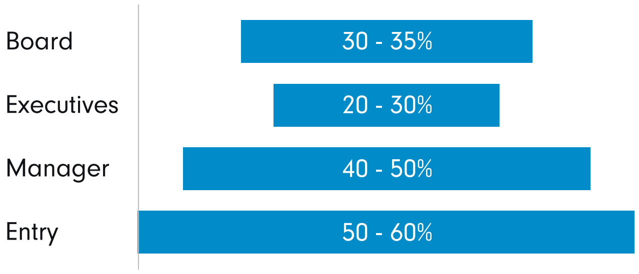
We engaged with the key financial holdings in one of our global portfolios on the topic of gender diversity. We picked financials - a mix of banks, insurers and insurance brokers - because these industries are traditionally male-dominated, and we suspected that this is one of the sectors where the most work needs to be done. We wanted to promote diversity in a number of ways including: initiating dialogues about how companies are addressing the issue; facilitating a sharing of best practices and nudging the laggards to raise their standards.

The gender diversity funnel

While some companies have gender mix aspirations or specific targets, these targets are currently typically at the board level. At the same time, many organisations have diversity recruitment programmes for university graduates and entry level staff. This results in a strong gender mix at the junior level and improving diversity in the boardroom. But it’s the middle and executive management ranks that are given less attention and where we see a sharp drop off in female representation.

At the financial companies we surveyed, we noted a gender diversity funnel shape that is represented in the diagram below. Businesses define roles differently, so categorisation is not straightforward, but the pattern and implications are clear. Once companies get women through the door, they need to create policies and practices not just to retain, but also to enable women to progress through their organisations.

Chart 16: Gender diversity falls at the management and executive levels



Source: Fidelity International, March 2021.

Policies to maintain diversity through the hierarchy

The funnel shape of diversity has been observed in a number of industries, and many companies are aware of and attempting to widen the middle of the funnel, so to speak. All the companies we spoke to acknowledged that there is much more to do to improve gender diversity. Moreover, many of the adopted policies have only been in place for a few years, suggesting that the benefits should come to fruition in the coming years.

Our discussions focussed on a variety of policies and practices. Of these, three stood out as most widespread: gender diversity targets, recruitment shortlists and unconscious bias training.

Targets for gender diversity

We found that just over half of the companies we engaged with had some form of gender diversity targets. Most of these targets were at the board level, aiming for 30-35% female members - a figure that most companies in our engagement achieved. While boardroom diversity is an important signal of intent, boards are generally comprised of only around a dozen people and the figures may not reflect diversity across the firm. We believe additional policies are needed. Below the board level, most companies that we talked to hope to increase female representation in the senior cohorts by implementing a range of policies at the manager level. We encourage companies to set targets at these middle levels as well, and to link managers' compensation to achieving these goals.

Recruitment shortlists

Around 70% of the companies engaged have recruitment policies that ensure that hiring candidate shortlists include at least one woman. Two companies went further, requiring at least two or half of the candidates to be women. These kinds of policies can be very effective because they focus on the management layers where the funnel constricts most dramatically and therefore can have the greatest impact. However, having female candidates on the shortlist obviously does not necessarily mean they will be hired; other actions are also needed.

Unconscious bias training

Unconscious bias training is another tool that helps, among other things, to give women and other underrepresented groups equal opportunities to be hired and progress through an organisation. The training helps employees recognise that they may have inherent biases that unknowingly confer upon certain groups unfair advantages or disadvantages. The programmes seek to provide staff with tools to address these issues. We found that 70%

of the companies in our dialogues offered unconscious bias training either company-wide or for managers. We are hopeful that, over time, such training helps to make everyone more aware of the beneficial differences that diverse workforces bring to companies.

Other practices

We learned that the financial companies with which we engaged are deploying a range of other practices in attempts to spread more diversity throughout their firms. These include formal and informal mentoring schemes for managers, flexible working arrangements, diversity officers, diversity among interviewer panels, pay gap monitoring and initiatives such as fostering networks for women.

Companies need a mix of diversity policies

While these programmes are useful, it is clearly unlikely that any one of them individually will produce dramatic results. Instead, companies need to adopt a range of policies and practices that together promote diversity across the firm. Only a sustained and authentic culture that supports diversity and inclusivity will create substantive and lasting results throughout companies. We thus encourage target-setting and implementation of such policies and practices that will help to embed this culture throughout a firm.

Furthermore, gender diversity is also just one piece of the broader diversity puzzle. While our work focussed on gender diversity in this engagement, companies can adapt and tailor these approaches to address other vital diversity initiatives in their workplaces. Indeed, in the past year we have seen a strong uptick in the conscious realisation of the importance of, and efforts being taken to increase, diversity across racial and ethnic dimensions, in addition to gender. We look forward to continuing to engage with our investee companies on the important issues of workplace diversity in all its forms.

Backing our engagement with our new voting policy

In addition to our engagement on diversity, Fidelity International is implementing a new voting policy in 2021 with regards to gender diversity at the board level of all our investee companies. We support gender diversity on a company's board and will vote against the election of directors where boards do not have at least 30% female representation at companies in the most developed markets (including the UK, EU, USA and Australia). We will also vote against boards in markets where standards on gender diversity are still developing and the level of female representation is not aligned with our minimum expectation for the market or the local best practice standards.

Crisis at sea

The emergence of Covid-19 produced a plethora of crises around the globe. One that might have gone without the attention it deserved was the plight of seafarers stranded at sea due to the extraordinary circumstances of the pandemic.

A brewing humanitarian crisis and a threat to global supply chains

In spring 2020, as the crisis deepened, our Hong Kong-based shipping analyst became aware of disruptions to global maritime activity. Restrictions on travel and trade were closing off ports and cancelling flights, causing severe delays to the ordinary rotation of cargo vessel crews between their ships and home ports.

Hundreds of thousands of seafarers became stranded aboard their vessels, as stringent quarantine measures across the world made it impossible to disembark at designated ports or return home by air. At the height of the crisis in September 2020, over 400,000 seafarers were stranded at sea, with many working long beyond their contracts. This became a liability for the commercial shipping sector as well as a brewing humanitarian crisis for the hundreds of thousands of seafarers who are the engines of global trade.

Driving change through investor engagement

Shipping is responsible for 90% of global trade. It is essential not just to a global economic recovery from Covid-19, but to maintaining our current way of life. To protect global supply chains and seafarers' health and safety, therefore, Fidelity's sustainable investing team and shipping analysts sounded the alarm by actively engaging with our investee companies on the issue.

Fidelity launched a mass email campaign targeting our portfolio companies engaged in the shipping business and those benefiting from their services. We asked for their immediate attention on this issue and for them to work collaboratively by being flexible with route deviation to facilitate crew changes. We also urged them to lobby governments to label these seafarers as "essential workers".

We also reached out to other investors to do the same. In December 2020, a consortium of international investors, led by Fidelity, representing US$2 trillion of assets under management called for urgent action to end this humanitarian crisis in an open letter to the UN. In consultation with key marine organisations such as the International Labour Organisation and the International Transport Workers' Federation, the signatories to the letter identified the clear need for several measures to be put into effect. We reiterated the need to classify seafarers as 'key workers' to enable them to continue to perform their essential services in a safe and secure manner. We also recommended that seafarers have access to vaccines with immediate effect. We additionally launched a media campaign to raise awareness of this urgent matter.

Improvement, but the issue remains

More than a year after Fidelity International first raised the plight of seafarers stranded due to Covid-19 measures, some things have improved. The number of seafarers stranded aboard their ships has halved to 200,000 and the UN recently launched an initiative designed to safeguard seafarers' rights that covered many of the points we had raised.

Each seafarer represents a link in the chain of global trade, and their situation risks potential disruption of the kind we witnessed when the giant cargo ship Ever Given blocked the Suez Canal in March 2021.

However, despite these improvements, the issue has not been fully resolved and the threat of new Covid-19 variants could quickly reverse the tide. Today, fewer than 60 countries have responded to the UN's initiative and designated seafarers as key workers. Seafarers still stuck far from home are often not part of local vaccine programmes and continue to face pandemic-related restrictions. Each seafarer represents a link in the chain of global trade, and their situation risks potential disruption of the kind we witnessed when the giant cargo ship Ever Given blocked the Suez Canal in March 2021.

Therefore it remains critical that this crisis be fully resolved and soon. We continue to engage and urge fellow investors to engage with companies on this issue, and to keep up the pressure on governments to take the necessary actions and the media to keep raising awareness of the seafarers' plight.

Financing climate change

As our engagement efforts on sustainability matters continue and deepen over time, we are able to see the advantages of our long-term approach and our global presence. A good case in point is our work on engagement with banks regarding financing climate change: a thematic engagement we have been pursuing now for over two years. This commitment to continuing engagement on key topics has enabled us to expand the geographic reach of our engagement, and to evolve our conversations with companies and hold them accountable for making improvements.

Readers with a good memory will recall that in our Sustainability Report last year, we discussed our engagement efforts when, in 2019, we initiated an extensive thematic engagement on banks and climate change. We were looking specifically at policies on financing coal-fired power plants (CFPPs) in Asia, and we focussed initially on banks in Singapore. From these engagements, we were encouraged to see the major banks in the country tightening their coal policies to cease financing CFPPs globally.

All of these banks have since tightened their coal policies (reducing the exceptions that were previously allowable) and stating that they would not finance new construction of coal power.

In 2020, we expanded the conversation with Singaporean banks, engaging directly and through collaborative efforts with a greater number of banks. These engagements have moved the discussions forward and resulted in further disclosure and improved target-setting in many cases.

In early 2020, we extended our focus on this theme to Japanese banks. We wrote to the largest commercial banks in Japan specifically encouraging them to tighten their coal policies further to cease financing new CFPPs globally. We also requested further disclosure on their climate change ambitions and reporting in alignment with TCFD (Taskforce on Climate-Related Financial Disclosures).

We received detailed responses from all three banks and have engaged directly with two of them. All of these banks have since tightened their coal policies (reducing the exceptions that were previously allowable) and stating that they would not finance new construction of coal power. Yet, each bank has still allowed for some exceptions, for example, they might consider financing projects which use environmentally friendly technologies, such as ultra-supercritical pressure power plants.

We also supported a shareholder resolution at one of the banks requesting them to disclose their plan to align their business strategy with the Paris Agreement. The proposal received over 34% of the vote at the meeting. All three banks are committed to reporting in line with the TCFD guidelines and we intend to continue our engagements with them as they develop their climate-related reporting and coal financing policies.

At the end of 2020, we further expanded our engagement efforts on financing climate change to Chinese banks (on both collaborative and 1:1 bases). We joined a collaborative engagement run by an ESG consultancy called Asia Research and Engagement (ARE) and we participated in a letter written to five large Chinese banks requesting an engagement with them to discuss their ESG risk management practices, lending policies to high environmental risk sectors and climate risk scenario analysis, among other related topics. In 2021, we are conducting collaborative engagements with these banks, and look forward to sharing our progress in next year's report.

We also engaged with banks in other geographies, such as Korea, Italy and the UK, on the topic of financing climate change. In 2021 and beyond, we continue our work with banks globally on this topic to leverage our experience and our influence to promote positive practices in these areas.

50MW molten salt solar thermal power plant built in China. (Photo by VCG / Contributor Images via Getty images)

Governance

Throughout this annual Sustainable Investing report, we have highlighted the 'E' and the 'S' stories more than the 'G'. In part, this is because in 2020 - the unforgettable year of Covid-19 - awareness of social issues as matters of sustainability ramped up sharply, while the lead up to (and postponement of) COP26 sharpened the focus on environmental issues. Additionally, we will be publishing a full-length, stand-alone Stewardship Report that will include details of our work related to corporate governance in due course.

Nonetheless, we include in this report a sampling of our work in the 'G' arena throughout the year 2020. As seen below, some 'G' topics are perennial (such as quantum of pay), while others emerge and continue to evolve (such as linking compensation to ESG issues). Our governance engagements took on both more breadth and depth in 2020, trends that we expect to continue in 2021.

Executive compensation

We met with a **Philippines holding company** that had been identified as substandard on disclosure of executive compensation. The company stated that they adhere to Philippine SEC guidelines while bundling compensation of CEO and other senior executives, and don't disclose on an individual basis because of security issues. We pressed them to improve in compensation transparency, as well as other governance issues such as board committee independence.

We carried on conversations from previous years with a **Canadian telecoms services provider** on the subject of 'Say-on-Pay', which we planned to vote against for a second year in a row, because the company didn't meet our red line policy on executive remuneration, requiring at least 40% of Long Term Awards to be performance-based. Following the initial engagement, the company got back to us guaranteeing to conduct a comprehensive review of the LTIP (long-term incentive plan), and implement changes resulting from the review effective with the 2021 grant. Given the company's commitment in aligning their remuneration practices to our proxy guidelines, we changed our voting recommendation to support these items at the 2020 AGM.

Our governance engagements took on both more breadth and depth in 2020, trends that we expect to continue in 2021.

Indeed, Fidelity International has had an engagement campaign since 2012 aimed at encouraging European investee companies to adopt senior management LTIPs with a minimum share release period of five years. The intention is to focus management's attention beyond the quarterly reporting cycle by linking a substantial portion of their remuneration with shareholders over a five-year time horizon. In 2020, several **European investee companies** adopted five-year LTIPs following our multi-year engagements.

Other topics of executive compensation discussed include, as mentioned above, pay quantum (i.e. size of pay), on which we engaged with an **Australian bank** and a **UK publisher**, among others. A topic that became a go-to sustainability question during the year was that of linking compensation to ESG performance. During a meeting with the chair of a **multinational commodity trading company**, Fidelity encouraged the board to link a significant portion of management incentives to material ESG issues. We followed up with a **UK supplier to the defence industry** which, following health and safety concerns, have set quant targets that will also be linked to executive compensation.

Our ESG engagements gave us opportunities during the year to discuss a number of matters relating to corporate and board structures.

Board oversight and ESG reporting

We regularly engage with companies regarding their board-level oversight of ESG concerns, in order to understand the board's understanding and governance of sustainability-related risks and opportunities. We engaged with an **Indian bank** regarding their plans to report in line with TCFD recommendations, as the company had very limited disclosure on their ESG practices; the company also committed to introduce more formal environmental analysis in their project financing activities. Following years of engagement with a **Korean convenience store** operator during which we repeatedly emphasised the importance of ESG issues and urged the company to provide better transparency, the company published its first ESG report this year and reached out to us to seek our feedback: we continue to provide detailed recommendations to improve the company's ESG reporting.

Board and shareholding structures

Our ESG engagements gave us opportunities during the year to discuss a number of matters relating to corporate and board structures; we discussed, for example, dual class share structure with a **Latin American retail chain** that allows controlling shareholders to hold 61% of the voting rights with just 40% of the shares. Although the issue is "not top of mind" for the company, at least it is being discussed.

Board independence was also an area of our engagement, at companies ranging from a **Korean tech company** to a **European eyewear provider**. Another topic of concern in our engagements has increasingly been that of diversity - at board and firm levels. We raised the issue of board gender diversity with a **Chinese technology company**, noting there is currently no woman on the board. The company acknowledged the importance of diversity, and apart from gender is also looking to improve the diversity of director experience and expertise.

We queried a **Canadian grocer** on ethnic diversity: the company feels that its relatively narrow geographic exposure limits the diversity of the communities it serves. We believe that attention to diversity in all its forms will continue to grow at the governance level, if with different features given various markets' characteristics. Other board issues we keep an eye on include over-boarding and board entrenchment (board members potentially serving on too many boards and serving for too long), as suboptimal practices in these areas can be a red flag for other governance issues.

A significant and growing topic for us is digital ethics, i.e. understanding and ensuring that companies do the right thing in the digital world.

Corporate conduct and digital ethics

Throughout the year, our engagement activities explored various aspects of corporate conduct. In one example, we engaged directly with the chairman of an **Australian mining company** to investigate the company's destruction of an indigenous cultural site, which in turn caused significant reputational damage to the company; an independent investigation was launched into the matter and the company has said that if the investigation concludes that legislative reform is necessary, it will advocate for it.

A significant and growing topic for us is **digital ethics**, i.e. understanding and ensuring that companies do the right thing in the digital world. On this theme, we began to engage with more companies more comprehensively on questions of **cybersecurity, data privacy and ethical AI** (artificial intelligence). Engaging with a **Swiss software company**, we learned that their extensive materiality analysis had shown cybersecurity to be their most material ESG issue, both for internal and external stakeholders. In terms of governance of this critical issue, they have a CISO (Chief Information Security Officer) who reports into the Chief Financial Officer and holds meetings with the broader executive team every two months. Additionally, every year (or more often if required), the CISO reports to the board's audit committee, while several board members have expertise in the cyber domain and the company's policies in this area are updated on an annual basis.

We engaged on this topic with a **UK multi-channel retailer**, where cybersecurity is top of the board's agenda and the senior independent director seemed very knowledgeable on the risks and work needed in that area. During one of our engagements with a **major US Internet company**, we sought an update on governance issues, and held a lengthy discussion about data privacy and AI issues. We will continue to monitor these areas and report on our engagements, as digital ethics is one of our top sustainable investing themes for 2021.

Contributors

Investment:

Daniel Missen, Marketing and Design Senior Manager

Sustainable Investing:

Christine Brueschke, Sustainable Investing Analyst

Ally Chin, Sustainable Investing Graduate

Aela Cozic, Sustainable Investing Analyst & Portfolio Manager

Tomohiro Ikawa, Head of Engagement & Portfolio Manager

Marion O'Donnell, Director, Sustainable Investing

Maxim Palmer, Sustainable Investing Intern

Ana Victoria Quaas, Sustainable Investing Analyst

Matthew Roberts, Stewardship Analyst

Robert Rosenberg, Sustainable Investing Analyst

Flora Wang, Director, Sustainable Investing & Portfolio Manager

Ben White, Associate Director, Corporate Governance

Editorial:

Richard Edgar, Editor in Chief

Sophie Brodie, Europe Editor

Amber Stevenson, Investment Writer

Mark Hamilton, Senior Graphic Designer

Important Information

ED21-093

Fidelity INTERNATIONAL