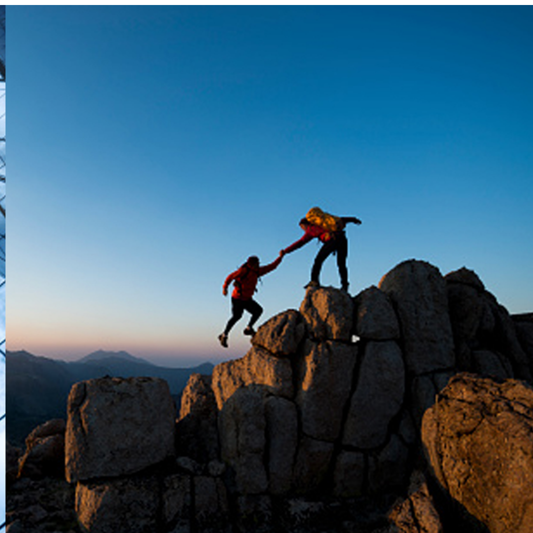
Material Risk Engagement

2024 Q1 Report



Material Risk Engagement promotes and protects long-term value by engaging with high-risk companies on financially-material ESG issues.

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This report summarizes the shareholder engagement activities that Morningstar Sustainalytics performed between January and March 2024. If there is no specific reference to date in graphs and tables, the data is presented as per end of the reporting period. The report has been produced between 1 – 15 April 2024 and uses data for the quarter ending 31 March 2024. Version 1 was disseminated 15 April 2024. Use of and access to this information is limited to clients of Morningstar Sustainalytics and is subject to Morningstar Sustainalytics legal terms and conditions.

Engagement Approach

Morningstar Sustainalytics' Material Risk Engagement (MRE) engages with high-risk companies on the material ESG issues with the greatest levels of unmanaged risks. The purpose is to protect and develop long-term value in our clients' portfolio companies. MRE is an engagement overlay of Sustainalytics' flagship product, ESG Risk Ratings.

The Stewardship team will engage with companies in Sustainalytics' Ratings universe, consisting of more than 4,500 investable issuers in developed and emerging markets, which have an ESG Risk Ratings score of 30 or more. The ESG Risk Ratings score reflects the unmanaged ESG risk, so the higher the score, the more risk the company is exposed to.

The engagement is driven by constructive dialogue. The research from the ESG Risk Ratings and the Controversies research are leveraged to encourage companies to cover gaps in Material ESG Issues risk management. Engagement response, progress, positive developments, and milestones are consistently tracked to measure commitment and capability to change in addition to the engagement activities conducted. When a company improves by bringing the ESG Risk Ratings score to below 28, the MRE case will be considered resolved.

Executive Summary

Palle Ellemann
Director/Product Manager, Stewardship
Engagement 360
Morningstar Sustainalytics

We are delighted to report on the activities and results of the Material Risk Engagement (MRE) programme for Q1 2024. The quarterly report includes an article on materiality concepts and investment strategies as well as case information on all Resolved engagements.

Highlights for the Quarter

The positive trend from 2023 has continued as we have resolved 10 engagements in the first quarter, which occurs when the companies we engage with improve their ESG Risk Rating score below 28, indicating a move into the Medium ESG Risk Rating category and lower unmanager ESG risk. During Q1, the team has:

- Conducted 47 meeting, including 8 meetings in-person in Saudi Arabia and Türkiye. The engagement trip to the two countries also included three site visits.
- Exchanged 304 emails.
- Achieved 30 Positive Developments and 39 Milestones.

Materiality Considerations for Evolving Responsible Investment Strategies

Marta Mancheva and Shane Tiley focus in their article on the key distinctions between financial, impact and double materiality concepts and the related implications for issuers and investors. The double materiality perspective promoted by the European Corporate Sustainability Reporting Directive will provide investors with more issuer disclosure on impact and offer opportunities to align investment strategies with impact-related goals.

Looking Ahead

In Q2, we anticipate our engagement activities will increase as there will be more companies releasing new annual ESG disclosure, and it will be a good time to review company performance and update our suggested actions for the companies. This will also mean that we should be able to record a higher number of Positive Developments as it can be verified in the disclosure.

We will also be able to announce plans for engagement trips later in the year. We use these trips to build relationships with the companies that we engage and in-person meetings can be essential for establishing dialogue with some companies. It will also deepen out understanding of the corporate context and facilitate site visits, where engagement manager obtain very detailed insight to the ESG challenges that the companies are facing and how they mitigate these risks.

For general questions or feedback regarding Material Risk Engagement, please email **MRE@sustainalytics.com** or your client team.

Engagement Overview

1
new engagement

574
companies engaged since March 2020

334
engagements as of 31 March 2024

SDG 13 Climate Action
linked to 61% active engagements

Asia Pacific Region
with the largest number of engagements

Oil & Gas Producers and Utilities
industries with most engagements

Disclosure
top material ESG topic in engagement dialogues

Engagement Status

When we open an engagement, the status is Engage. We will then pursue engagement until we change status to:

Resolved The company has achieved the engagement objective.

Archived Engagement is concluded, the engagement objective has not been achieved.

Disengage Engagement is deemed unlikely to succeed.

346 engagements as of 01 January 2024

1 new Engage

10 Resolved

5 Archived

0 Disengaged

334 engagements as of 31 March 2024

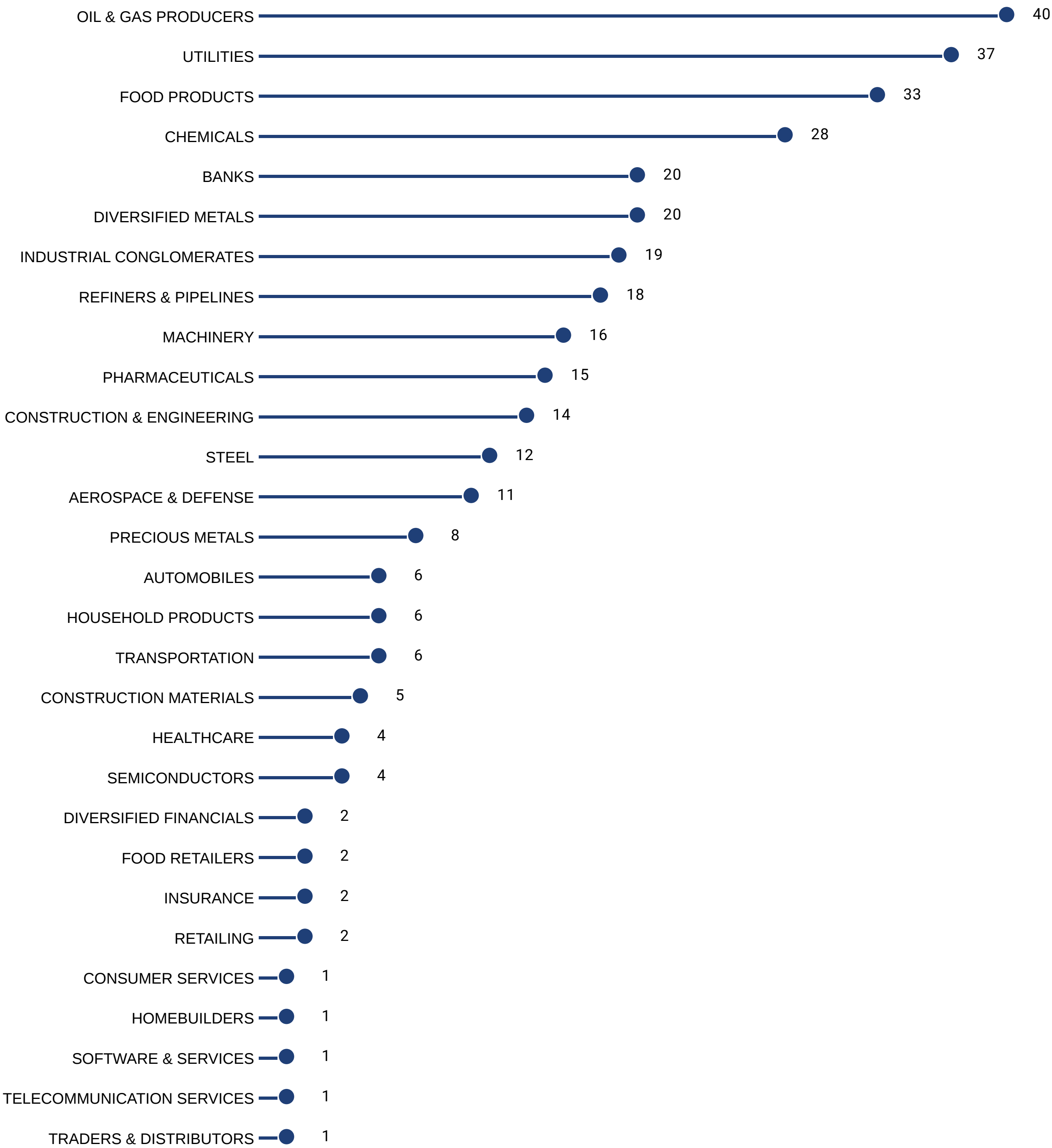
347 engagements during Q1 2024

Active Engagements by ESG Risk Ratings Categories

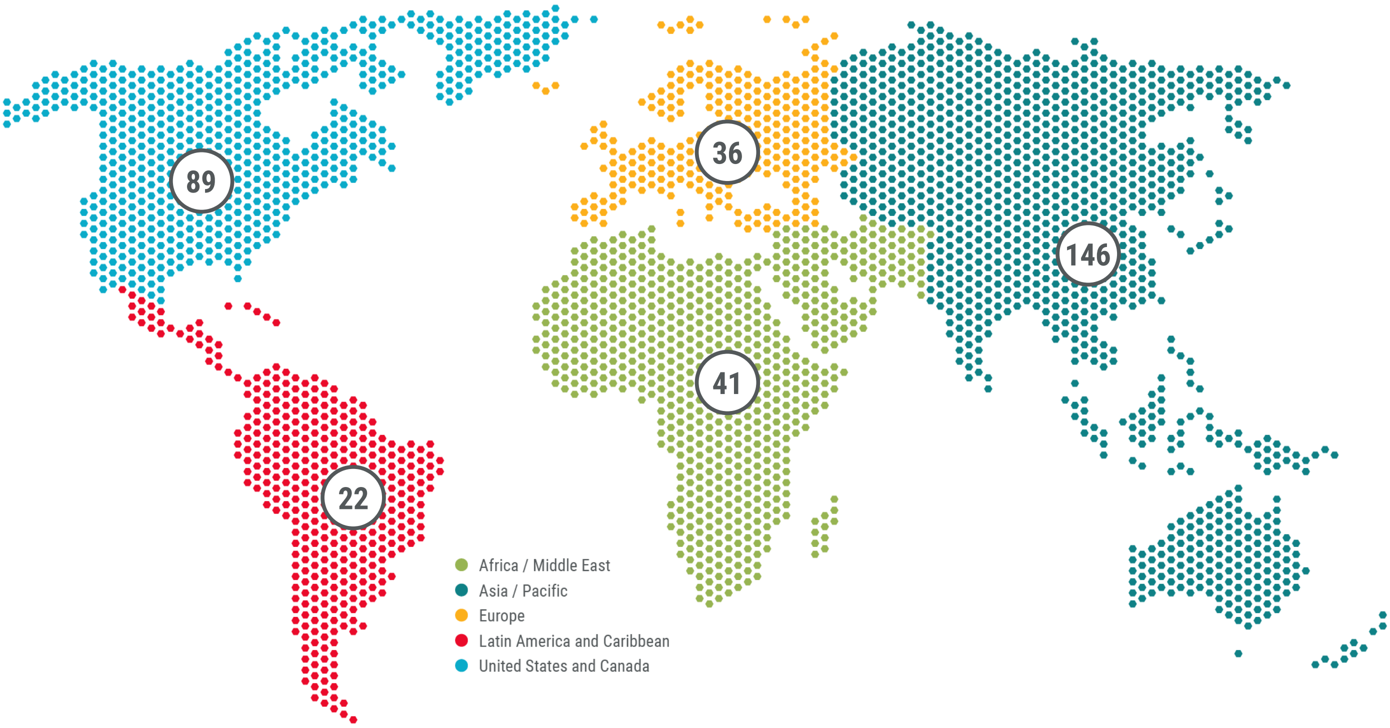
Active Engagements by ESG Risk Ratings Categories

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)
		18% (28-30)	66%	16%

Industry Distribution



Engagements by Headquarter Location



Environmental, Social and Governance Overview

E, S and G Overview

Note : Stewardship can cover one or more issues and objectives reflected in overlapping issue statistics.

Engagement Topics

At the end of the reporting period, our engagements addressed a number of topics across the environmental, social and governance pillars.

ENGAGEMENT TOPICS	ENGAGEMENTS
Disclosure	144
ESG Governance	110
Net Zero Decarbonization	110
Product Quality and Safety	63
Climate Change	45
Human Capital	45
Business Ethics, Bribery and Corruption	41
Community Relations	40
Water Security	39
Occupational Health and Safety	38
Board Composition	26

ENGAGEMENT TOPICS	ENGAGEMENTS
Waste Management	26
Diversity, Equity and Inclusion (DEI)	25
Water Quality	22
Human Rights	17
Biodiversity	16
Deforestation	11
Land Pollution and Spills	11
Natural Resource Use	10
Air Pollutant Emissions	7
Data Privacy and Security	7
Indigenous People	7
Marketing Practices	6
Labour Rights	4
Circular Economy	3
Forced Labour	3
High-Risk Territories	2

Sustainable Development Goals – Mapping Engagements

All engagements are mapped to the 17 UN Sustainable Development Goals (SDGs). The mapping is done by Sustainalytics and refers to the focus and objective(s) of the engagement.

1 No Poverty	1%
2 Zero Hunger	1%
3 Good Health and Well-Being	13%
4 Quality Education	1%
5 Gender Equality	4%
6 Clean Water and Sanitation	6%
7 Affordable and Clean Energy	20%
8 Decent Work and Economic Growth	22%
9 Industry, Innovation and Infrastructure	14%
10 Reduced Inequality	3%
11 Sustainable Cities and Communities	20%
12 Responsible Consumption and Production	46%
13 Climate Action	62%
14 Life Below Water	1%
15 Life on Land	5%
16 Peace and Justice, Strong Institutions	59%
17 Partnerships to Achieve the Goal	4%

Engagement Results

47
meetings, including 8 in-person meeting

304
emails and phone calls exchanged

10
engagements Resolved

39
Milestones achieved

30
Positive Developments

55%
engagements with Good or Excellent Response

44%
engagements with Standard Progress

Engagement Progress

Progress reflects the pace and scope of changes towards the engagement objective that the company is making, assessed on a five-point scale.

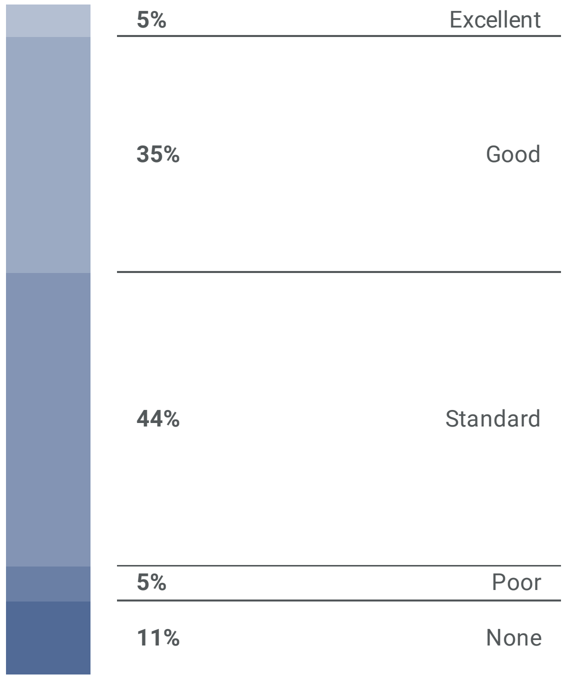
Excellent The company has adopted a proactive approach and addressed the issues related to the change objective.

Good The company has taken sufficient measures to address the issues related to the change objective.

Standard The company has undertaken a number of measures to address the issues related to the change objective.

Poor The company has indicated willingness to addressing the issues related to the change objective, but no measures have been taken yet.

None The company has not made any progress against the engagement objective.



Engagement Response

Response reflects the company's willingness to engagement diaolgue with investors, assessed on a five-point scale.

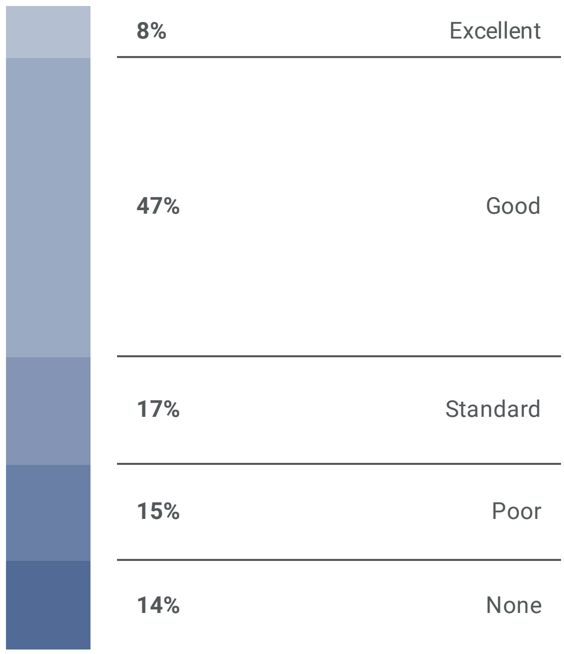
Excellent The company is proactive in communicating around the issues related to the change objective.

Good The company addresses all the issues related to the change objective.

Standard The company provides responses to some of the issues related to the change objective.

Poor The company has initially responded but not properly addressed the issues related to the change objective and is unwilling to engage further with us.

None The company has not responded to the inquiries.



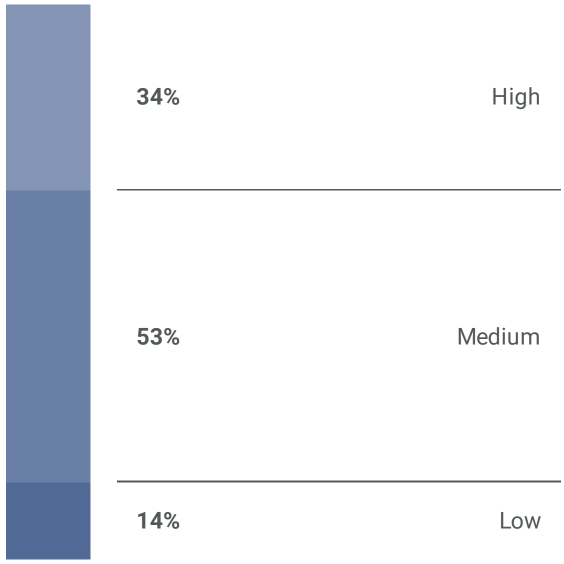
Engagement Performance

Performance describes the combined company Progress and Response.

High Good or Excellent Progress in combination with Good or Excellent Response.

Medium Standard level of Response and Progress.

Poor Poor or None Progress in combination with Poor or None Response.



Engagement Milestones

Milestones are our five-stage tracking of Progress in achieving the engagement objective.

39
Milestones achieved in
Q1 2024

Milestone Framework Structure

Milestone 5 Change objective is considered fulfilled.

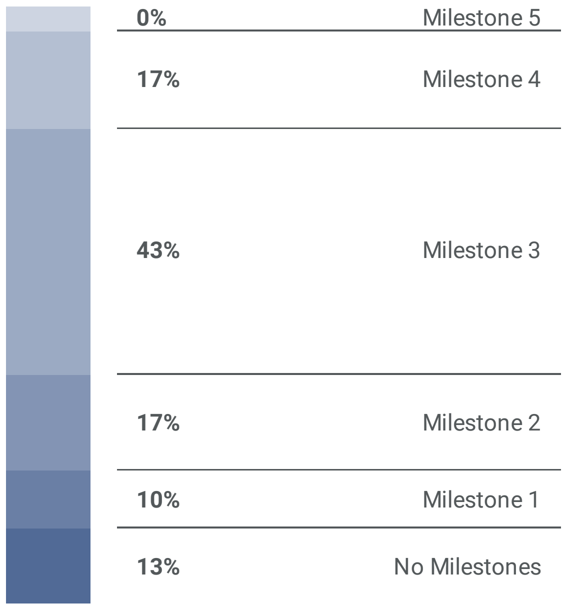
Milestone 4 Implementation of strategy has advanced meaningfully, and related issuer disclosure maturing.

Milestone 3 Strategy is well formed and has moved into early stages of implementation.

Milestone 2 ESG risk management and strategy established.

Milestone 1 Acknowledge of issue(s) and commitment to mitigation.

Engagements by Highest Milestone Achieved



Engagements Resolved

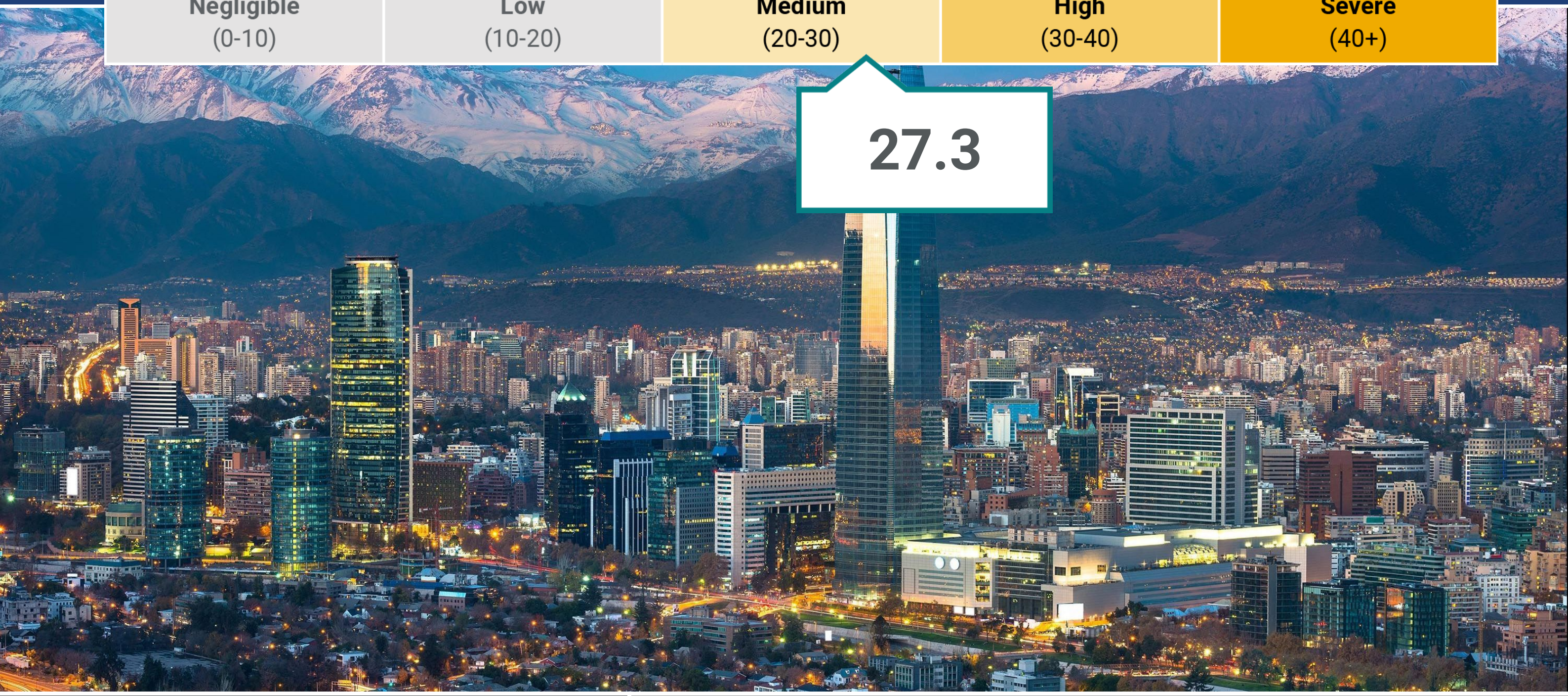
COMPANY	COUNTRY	INDUSTRY	ISSUE
Banco de Credito e Inversiones SA	Chile	Banks	Focus on ESG Integration Financials
BRF SA	Brazel	Food Products	Focus on E&S Impact of Products and Services; Land Use and Biodiversity
China Construction Bank Corp.	China	Banks	Focus on ESG Integration Financials
Hitachi Ltd.	Japan	Industrial Conglomerates	Focus on Product Governance
Kumho Petrochemical Co., Ltd.	South Korea	Chemicals	Focus on Carbon Own Operations
Mahindra & Mahindra Ltd.	India	Automobiles	Focus on Risk Assessment; ESG Disclosure
Metropolitan Bank & Trust Co.	Philippines	Banks	Focus on ESG Integration Financials
NovoCure Ltd.	United Kingdom	Healthcare	Focus on Risk Assessment; ESG Disclosure
Stryker Corp.	United States	Healthcare	Focus on Product Governance
Teva Pharmaceutical Industries Ltd.	Israel	Pharmaceuticals	Focus on Business Ethics

Resolved - Banco de Credito e Inversiones SA

ESG Risk Ratings Score

Negligible	Low	Medium	High	Severe
(0-10)	(10-20)	(20-30)	(30-40)	(40+)

27.3



INDUSTRY:
Diversified Banks

BASE LOCATION:
Chile

ENGAGEMENT FOCUS:
ESG Integration in Credit and Investment
Corporate Governance
Sustainable Financing

RATIONALE FOR RESOLVED STATUS:
Banco de Credito e Inversiones SA has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- BCI is reporting on the number of customer complaints compared with the number of customers. The relative number of complaints have been reduced since 2019, in 2022 it was 3.1% of customers on average making a complaint.
- The BCI board has approved an ESG appetite framework and started integration of ESG in credit and investment processes, among other things using a sustainability scorecard.
- BCI employees receive several courses on compliance and ethics every year. Each employee would typically have 15-20 courses per year.

In the latest ESG Risk Rating update, BCI's score improved by more than 8 points, bringing the company into the medium risk category and below the 28-point threshold for engagement.

Resolved - BRF SA

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)

21.4

INDUSTRY:
Packaged Foods

BASE LOCATION:
Brazil

ENGAGEMENT FOCUS:
Product Governance
Corporate Governance
Land Use and Biodiversity
Water

RATIONALE FOR RESOLVED STATUS:
BRF SA has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- BRF is tracking production of foods manufactured at operational units certified in internationally recognized food safety management regulations by an independent organization and provides disclosure on fines and penalities for non-compliance relating to impacts on health and safety caused by products and services.
- BRF has updated its materiality analysis with extensive stakeholder consultation and taking a double materiality into account. There is a very good alignment with the material ESG issues highlighted by Morningstar Sustainalytics.
- BRF has significantly expanded its disclosure on the use and outcome of the Transparency channel, so there is now insight to most common issues and report outcomes.

In the latest ESG Risk Rating update, BRF's score improved by more than 9 points, bringing the company into the medium risk category and below the 28-point threshold for engagement.

Resolved - China Construction Bank Corp.

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)

26.4

INDUSTRY:
Diversified Banks

BASE LOCATION:
China

ENGAGEMENT FOCUS:
ESG Integration in Credit and Investment
Corporate Governance
Sustainable Finance
Anti-Corruption

RATIONALE FOR RESOLVED STATUS:
China Construction Bank Corp (CCB) has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- CCB is now disclosing the Anti-Bribery and Anti-Corruption policyand is providing whistleblowers an opportunity to report anonymously with a no retaliations guarantee.
- CCB has established a board committee with governance oversight of the ESG area. The board has well-established processes in place to monitor ESG performance.
- CCB has enhanced transparency of ESG criteria used in credit approval and sectoral approach.
- The 2021 TCFD Report has disclosed CCB's approach to providing financing to eight out of the 75 sectors that the bank has a credit policy on. The second TCFD-aligned report covering 2022 provides overview and insight into the climate-related risk that the bank is exposed to and the management practices in place to mitigate these risks, including stress-test and ESG integration in credit.

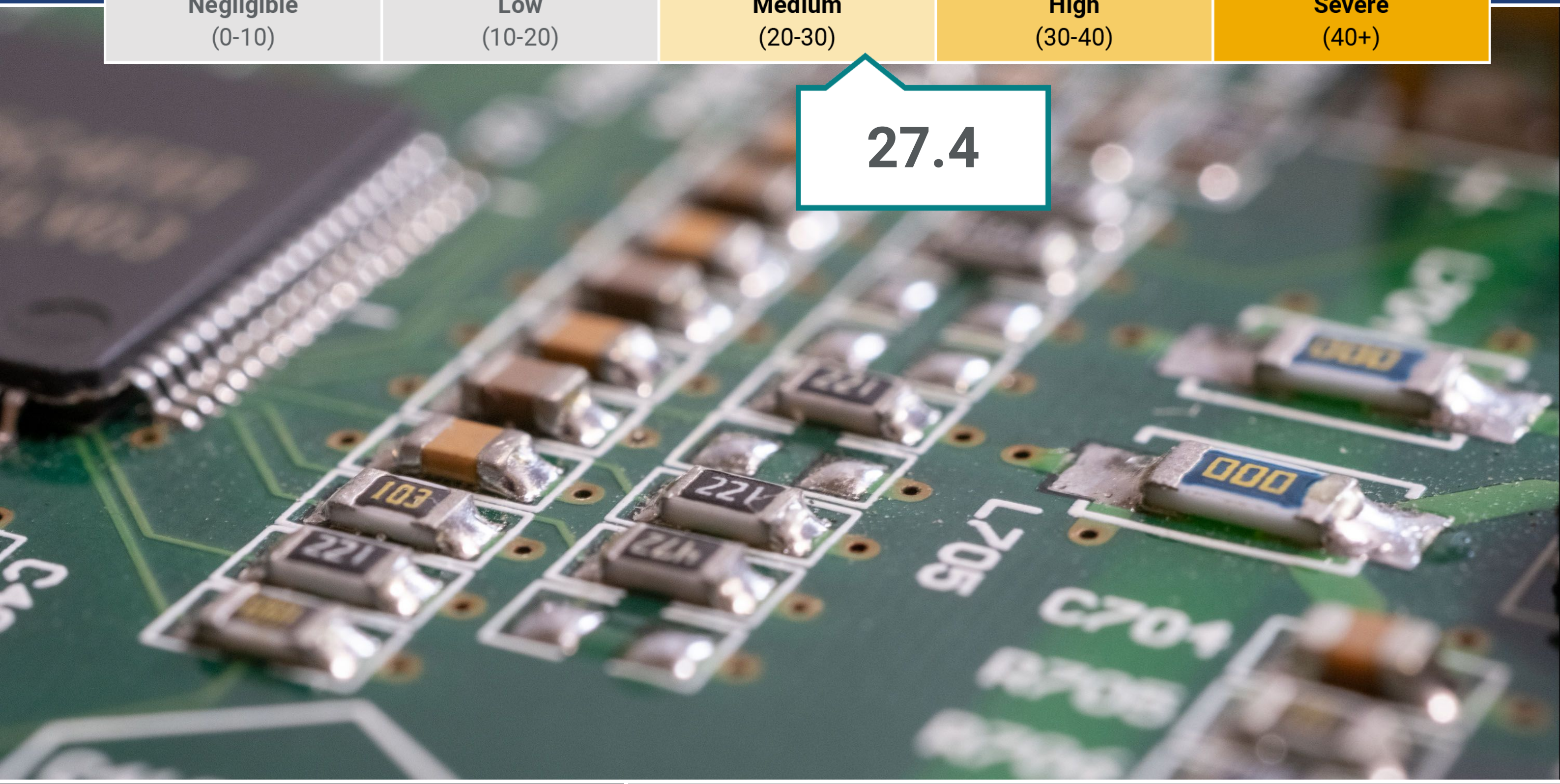
In the latest ESG Risk Rating update, CCB's score improved by more than 10 points, bringing the company into the medium risk category and below the 28-point threshold for engagement.

Resolved - Hitachi Ltd.

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)

27.4



INDUSTRY:
Industrial Conglomerates

BASE LOCATION:
Japan

ENGAGEMENT FOCUS:
Product Governance
Human Capital
Corporate Governance

RATIONALE FOR RESOLVED STATUS:
Hitachi Ltd. has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- Hitachi made clear a risk assessment on bribery and corruption on a regular basis in the Sustainability Report.
- Hitachi has disclosed the number of its sites that have obtained external certifications for quality management.
- Hitachi has disclosed the management system for compliance programmes.
- Hitachi has updated material ESG issues focusing on its top six issues (areas).

In the latest ESG Risk Rating update, Hitachi's score improved by 4.1 points, bringing the company into the medium risk category and below the 28-point threshold for engagement.

Resolved - Kumho Petrochemical Co., Ltd.

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)

18.4

INDUSTRY:
Chemicals

BASE LOCATION:
South Korea

ENGAGEMENT FOCUS:
ESG Governance
Carbon – Own Operations
Corporate Governance
Business Ethics

RATIONALE FOR RESOLVED STATUS:
Kumho Petrochemical Co., Ltd. has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- Kumho Petrochemical has disclosed the number of reports received via the reporting channels and the number of disciplinary actions taken.
- Kumho Petrochemical has disclosed the scope of stakeholders for which the whistleblower channel is available.
- Kumho Petrochemical has set the ESG metrics (GHG emissions targets) in directors' remunerations.

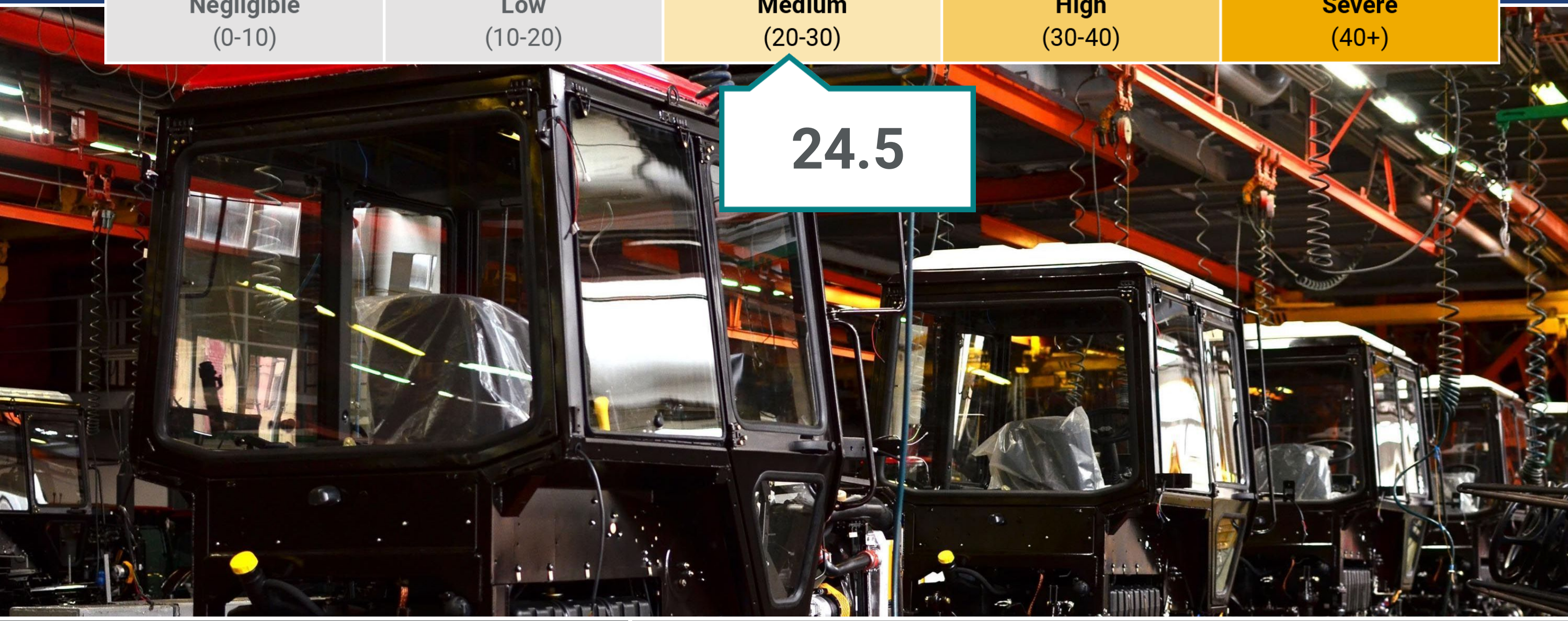
In the latest ESG Risk Rating update, Kumho's score improved by more than 26 points, bringing the company into the low risk category and below the 28-point threshold for engagement.

Resolved - Mahindra & Mahindra Ltd.

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)

24.5



INDUSTRY:
Automobiles

BASE LOCATION:
India

ENGAGEMENT FOCUS:
ESG Governance
Carbon – Own Operations
Product Governance

RATIONALE FOR RESOLVED STATUS:
Mahindra & Mahindra Ltd. (M&M) has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- M&M has established ten time bound commitments labelled "Our 10 Commitments" towards ESG, including Water positivity at group level, educating 1 million children by 2026, zero waste to landfill by 2030, carbon neutrality by 2040, energy positivity by 2026 and many other SBTIs. It has already met their 2026 target of supporting 1 million women through work, capacity building, community engagement and women's empowerment activities.
- M&M has reached two-thirds market share of all electric three wheelers across India, underpinning it's commitment to environmental developments, well-positioning its thought leadership with environmental ESG risk performance and examples.
- All Scope 1, 2 and 3 disclosures show that the company is well ahead of its 2040 carbon neutrality target.
- M&M is the first Indian company to establish an internal carbon price for directly funding carbon emission reductions.

In the latest ESG Risk Rating update, M&M's score improved by more than 10 points, bringing the company into the medium risk category and below the 28-point threshold for engagement.

Resolved - Metropolitan Bank & Trust Co.

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)

21.9

INDUSTRY:
Banks

BASE LOCATION:
Philippines

ENGAGEMENT FOCUS:
ESG Governance
ESG Integration in Credit and Investment
Sustainable Finance

RATIONALE FOR RESOLVED STATUS:
Metropolitan Bank & Trust Co. has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- Metrobank has improved the internal reporting to the Executive Committee and the Risk Oversight Committee on ESG, so on a quarterly basis, it includes portfolio and credit risk exposure to ESG and other operational sustainability updates.
- Metrobank has conducted a comprehensive stakeholder consultation to update the materiality assessment. There is a good alignment with the material ESG issues highlighted by Morningstar Sustainalytics.
- Metrobank has released its first sustainability report with reference to the Core version of GRI.

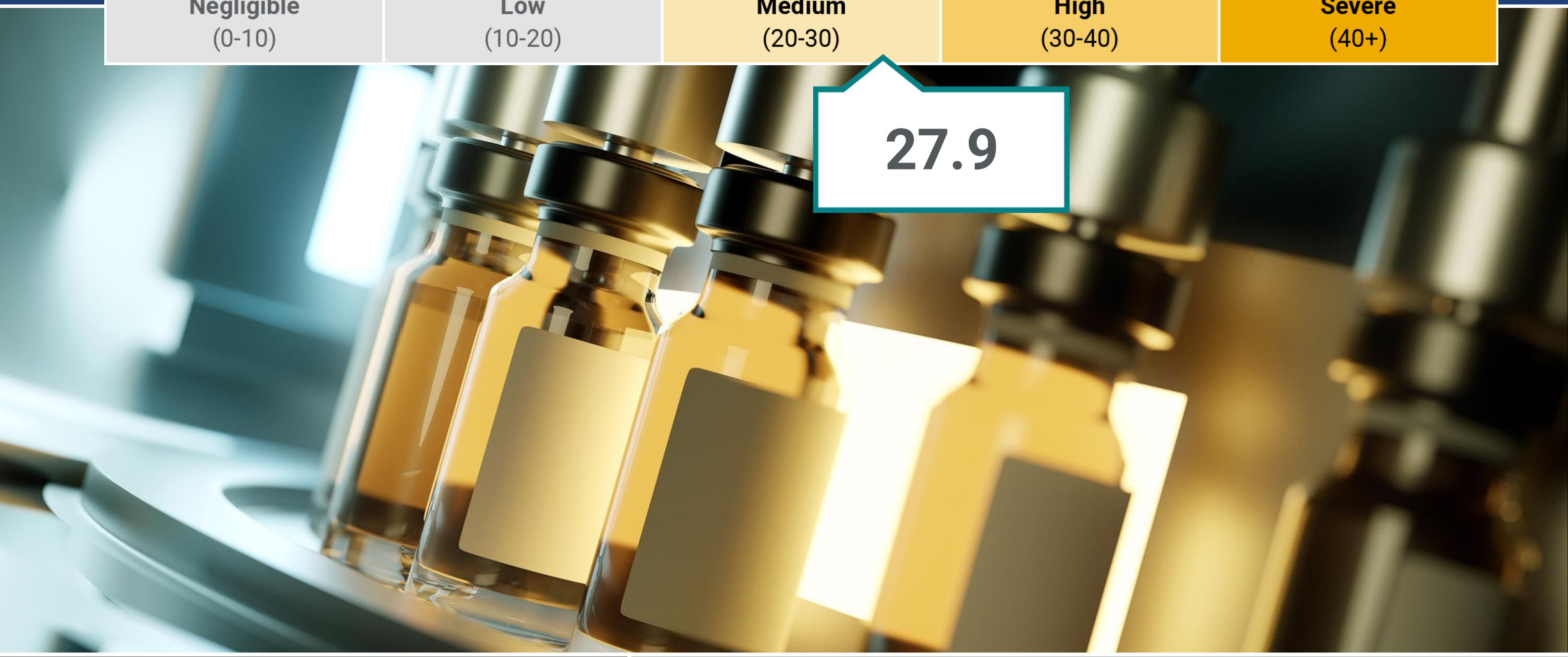
In the latest ESG Risk Rating update, Metrobank's score improved by more than 6 points, bringing the company into the medium risk category and below the 28-point threshold for engagement.

Resolved - NovoCure Ltd.

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)

27.9



INDUSTRY:
Medical Devices

BASE LOCATION:
United Kingdom

ENGAGEMENT FOCUS:
Risk Assessment and ESG Disclosure
Product Governance
Business Ethics
Human Capital

RATIONALE FOR RESOLVED STATUS:
NovoCure Ltd. has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- NovoCure has significantly expanded its reporting on product quality and safety, including oversight, risk management, monitoring systems, and the scope of external certifications (e.g., ISO 13485, 21 CFR part 820, MDR regulation 2017/745, JPAL MHLW Ministerial Ordinance #169, ISO/IEC 27001 and ISO 14155). Additionally, NovoCure has detailed its approach to patient grievances and product recall risks.
- NovoCure has enhanced transparency in its clinical trials, specifically by clarifying how it obtains patients' free, prior and informed consent.
- NovoCure has extended its disclosure on employee performance management, talent development, and employee benefits programs.
- NovoCure has begun reporting in alignment with the SASB Standard for Medical Equipment and Supplies.

In the latest ESG Risk Rating update, NovoCure's score improved by 4.6 points, bringing the company below the 28-point threshold for engagement.

Resolved - Stryker Corp.

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	**Medium (20-30)**	**High (30-40)**	**Severe (40+)**

24.6

INDUSTRY:
Medical Devices

BASE LOCATION:
United States

ENGAGEMENT FOCUS:
Product Governance
Corporate Governance
Human Capital

RATIONALE FOR RESOLVED STATUS:
Stryker Corp. has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- Stryker's sustainability strategy is underpinned by several goals and performances are reported on.
- The Governance and Nominating Committee has oversight responsibility of corporate responsibility matters. A Corporate Responsibility Steering Committee reporting to the CEO is also in place to drive sustainability management efforts.
- Stryker released the Animal Welfare Directive, authored by the Managing Director of Global Quality and Operations QRC, in 2023. The document describes Stryker's commitment to the 3 Rs: replace, reduce and refine the use of animal in research. The company also commits to limit the use of animals everywhere possible.

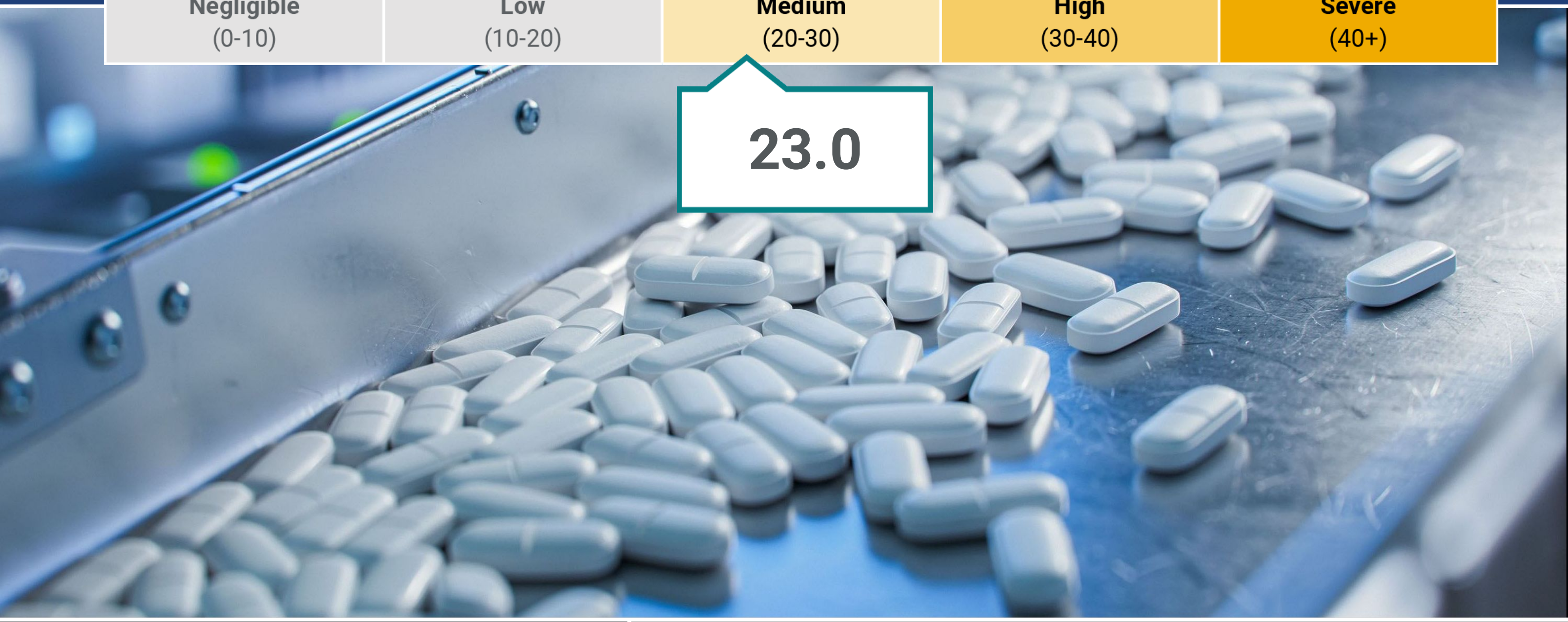
In the latest update of the ESG Risk Rating update, Stryker's score improved by 3.9 points, bringing it into the medium risk category and below our 28-point threshold for engagement.

Resolved - Teva Pharmaceutical Industries Ltd.

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)

23.0



INDUSTRY:
Pharmaceuticals

BASE LOCATION:
Israel

ENGAGEMENT FOCUS:
Product Governance
Corporate Governance
Human Capital

RATIONALE FOR RESOLVED STATUS:
Teva Pharmaceutical Industries Ltd. has improved its ESG Risk

Positive Development Highlights:

- Teva has established an ESG monitoring process for all tier 1 suppliers, entailing their ESG responsibilities and standards they must meet. This combined effort between their Chief Procurement Officer and their Head of ESG will set the pathways for their Scope 3 emissions and increased accountability as an industry leader.
- The focus on ESG at the executive and managerial levels have been integrated systematically with the Board, Head of HR Committee and Chai meeting on ESG Strategy, a new role of ESG Business Partner embedded with the Finance Team, and CEO leading a ESG Steering Committee from late last year.
- Teva have become the first pharmaceutical company to include ESG KPIs in their industry-leading (largest ever) sustainability linked bond (5B initially, then additional 2.5B USD), which contributed to their increased focus on nature and biodiversity as a (new) core material issue in their materiality assessment, and in their commitment to establishing net zero targets as a part of their "ESG Strategy Refresh".

In the latest ESG Risk Rating update, Teva’s score improved by 6.7 points, bringing it into the medium risk category and below our 28-point threshold for engagement.

Materiality Considerations for Evolving Responsible Investment Strategies

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Introduction

As responsible investment strategies move beyond ESG integration to impact investing, it's important to consider how newly standardized ESG reporting requirements align with investor preferences. At the core of all ESG reporting frameworks is the materiality assessment. This article focuses on the key distinctions between financial, impact, and double materiality concepts and the related implications for issuers and investors.

Materiality, in the view of ESG reporting, is a concept which provides criteria for determination of whether a sustainability topic or information should be included in an ESG disclosure. The debate on global alignment of sustainability disclosure rules revolves around the concept of materiality.

The inaugural International Sustainability Standards Board (ISSB) disclosure standards and the U.S. Securities and Exchange Commission (SEC) climate disclosure rules both define materiality based on an assessment of the financial risks and impacts that a sustainability issue poses to cash flow and enterprise value. In contrast, the recently enforced EU Corporate Sustainability Reporting Directive (CSRD) and the EU Sustainable Finance Disclosure Regulation (SFDR) adopt a double materiality approach, which includes both financial and impact materiality.

Doubling Down on Materiality

In financial reporting, companies typically assess materiality with a focus on the information needs of potential and existing investors and lenders as the primary users of financial statements. According to the International Financial Reporting Standards (IFRS), information is financially material if omitting, obscuring, or misstating it could be reasonably expected to influence investor decisions.[1] The use of financial materiality is rooted in several core legal principles, starting with fiduciary duty. However, as investors begin to shift focus from ESG integration to impact investment strategies, issuers who limit sustainability and climate disclosures to align only with financially material ESG topics may also be limiting opportunities to demonstrate their performance in line with external impact.

According to guidance issued by the European Financial Reporting Advisory Group (EFRAG), a sustainability topic or information is material from an impact perspective if the undertaking is connected to actual or potential significant impacts on people or the environment and is related to the sustainability topic over the short, medium, or long term. Double materiality is the combination of impact materiality and financial materiality. A sustainability topic or information meets the criteria of double materiality if it is material from the impact perspective or from the financial perspective, or from both perspectives.[2] SFDR, which mandates the disclosure of sustainability information by financial services firms, also requires that firms disclose how they manage ESG risks that impact the financial performance, as well as how investment decisions impact on sustainability factors.

Getting to Impact

Fiduciary duty, as the primary responsibility of investors, is subject to interpretation across different regulatory environments. Traditionally, fiduciary duty prioritizes investment factors with direct financial impacts, while the progressive model applies a broader lens that balances long-term financial liabilities with ESG factors that could impact value over long time horizons.

As the concept of fiduciary duty evolves globally, there is a parallel emergent investment trend towards a greater emphasis on sustainability outcomes and impact, reflecting a broader interpretation of value beyond immediate financial returns. Double materiality assessments are key to adopt an impact perspective. This method not only uncovers potential risks and opportunities that may be missed by taking a financial focus only, but also contributes to evaluating investments' impacts.

The European sustainable debt market, valued at EUR 1.7 trillion in 2022,[3] grew 130% over 2021 and 2022 signaling a broader global shift toward sustainable finance, which is projected to reach USD 30.9 trillion by 2032.[4] Such growth, driven by steady demand for sustainable finance products like green bonds and sustainability-linked loans, underscores the increasing interest in impact-oriented investments. The rising appetite for sustainable investment products highlights the need for issuer double materiality assessments, and issuers across the globe are taking note.

In 2024, large financial institutions and listed companies in the EU will conduct their materiality assessments under the CSRD's double materiality standard and begin to collect data for reporting in 2025. As part of the double materiality exercise, European issuers need to engage meaningfully with stakeholders and understand material sustainability risks, impacts and opportunities in their value chains. Driven by regulatory push in the EU, the first wave of CSRD reporting will provide valuable learnings on the double materiality approach for issuers globally.

In Canada, an October 2023 ESG disclosure study of 227 S&P/TSX Composite Index constituents showed that 19% of materiality assessments undertaken by Canadian issuers are currently applying a double materiality approach.[5] And in February 2024, an ESG Sentiment Study of Canadian Institutional Investors[6] showed that 43% of asset managers interviewed were planning to launch impact-oriented products that year. However, the Canadian Sustainability Standards Board (CSSB) announced on 14 March the release of new proposed standards for companies to report sustainability and climate-related information based on the ISSB disclosure standards, which only focuses on financial materiality. Following the release of the proposed CSSB standards, the Canadian Securities Administrators (CSA) said that it would consider the final CSSB standards, with potential capital markets-focused modifications, for incorporation into a CSA rule.[7]

China has also issued draft guidelines for a mandatory climate disclosure regime including a double materiality approach, requiring its biggest listed companies to report on a broad range of sustainability-related risks and impacts from 2025. The Shanghai, Shenzhen, and Beijing exchanges are requiring issuers to report on the impact of their activities on the environment as well as the risks and impact of environmental factors on their businesses.[8]

Promoting Long-Term Value

There is mounting evidence[9] that financially immaterial sustainability issues may become financially material over time. For instance, investors increasingly factor in climate-related risks and impacts, previously considered immaterial, to mitigate exposure to climate-related financial risks in portfolios. The concept of dynamic materiality[10] argues that sustainability issues, which are only material from an impact perspective, will eventually become financially-material. As a result, investors might not be sufficiently informed about potential and emerging financial risks if issuers' ESG disclosures are limited to financially-material information. A forward-looking approach to integrating dynamic ESG issues in portfolio construction and security selection may enable investors to better anticipate and respond to future material issues.

Integrating real-world impact into investment strategies further offers an opportunity to address systemic ESG issues, thereby promoting long-term value. By considering impact, investors can assess and respond to risks and opportunities associated with systemic environmental and social issues before they become apparent to the broader market. This proactive approach allows for the early identification of potential issues, enabling investors to make better-informed decisions that mitigate risks and capture emerging opportunities. Ultimately, considering impact in investment decision-making helps investors proactively manage systemic risks that could materially affect investment returns at the portfolio level.

Engagement Events and Industry Initiatives

In January 2024, Associate Director Matthew Gray conducted an engagement trip to Türkiye and Saudi Arabia for Material Risk Engagement. On this trip he met with eight companies and toured two sites, including Aramco's headquarters. These companies were selected because they are amongst the most at risk per Sustainalytics' ESG Risk Ratings and among the largest and most influential companies in the countries. The meetings gave deep insight into the ESG focus and trends of the country due to the companies' influence and dependence with the government's regulations, and because these companies are the main clients of the medium sized companies through the value chains.

With this trip, our team aimed to build trust and expand our network so we can have wider and deeper engagements with these companies and more engagements with other companies. We also wanted to provide investors with a more contextually driven understanding of the challenges facing these companies. At an in-person meeting, it is also much easier to have the full attention of stakeholders and this adds to collaboration and offers an opportunity to contribute where you might not have been able to virtually. When you meet someone once, the next time you meet them they have a stronger reference point for the relationship. You can also develop more of an offline relationship in a less formal setting which can allow you to breach more challenging topics in the future, and in that region it's very important.

Most of the companies we visited don't have decarbonization pathways for 2050 and 2060. It is clear that they are depending on new technology to achieve carbon neutrality. In the short-medium term, they are dependent on green ammonia / green steel to be imported and the viability of carbon capture and storage.

Today, Saudi Arabia and Türkiye both reflect the emerging markets' ESG momentum towards increased government buy-in, as well as corporate action. Both countries are now committed to making ESG disclosures mandatory for large cap public and private companies, with both using International Sustainability Standards Board (ISSB) standards as the primary disclosure requirements, yet with their own local adjustments. Türkiye's reporting requirements will take effect in 2025, while Saudi Arabia is targeting 2027 or sooner.

Endnotes

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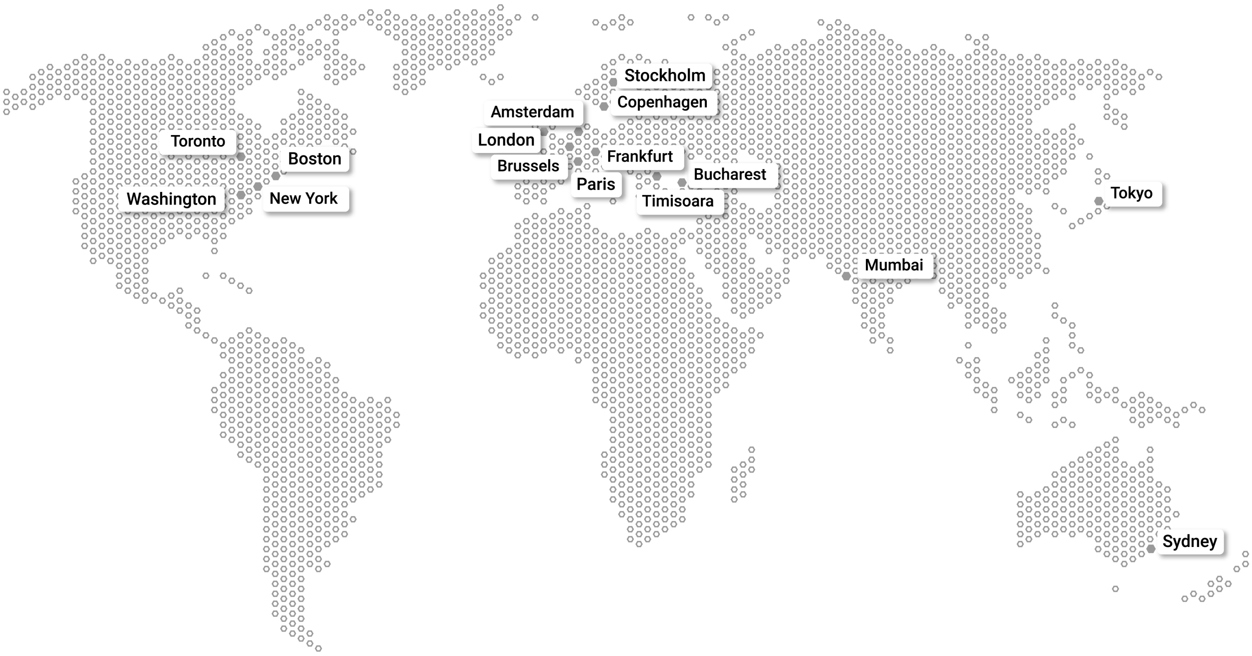

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