July 2022

Sustainable Investing Report 2022

ESG 2.0

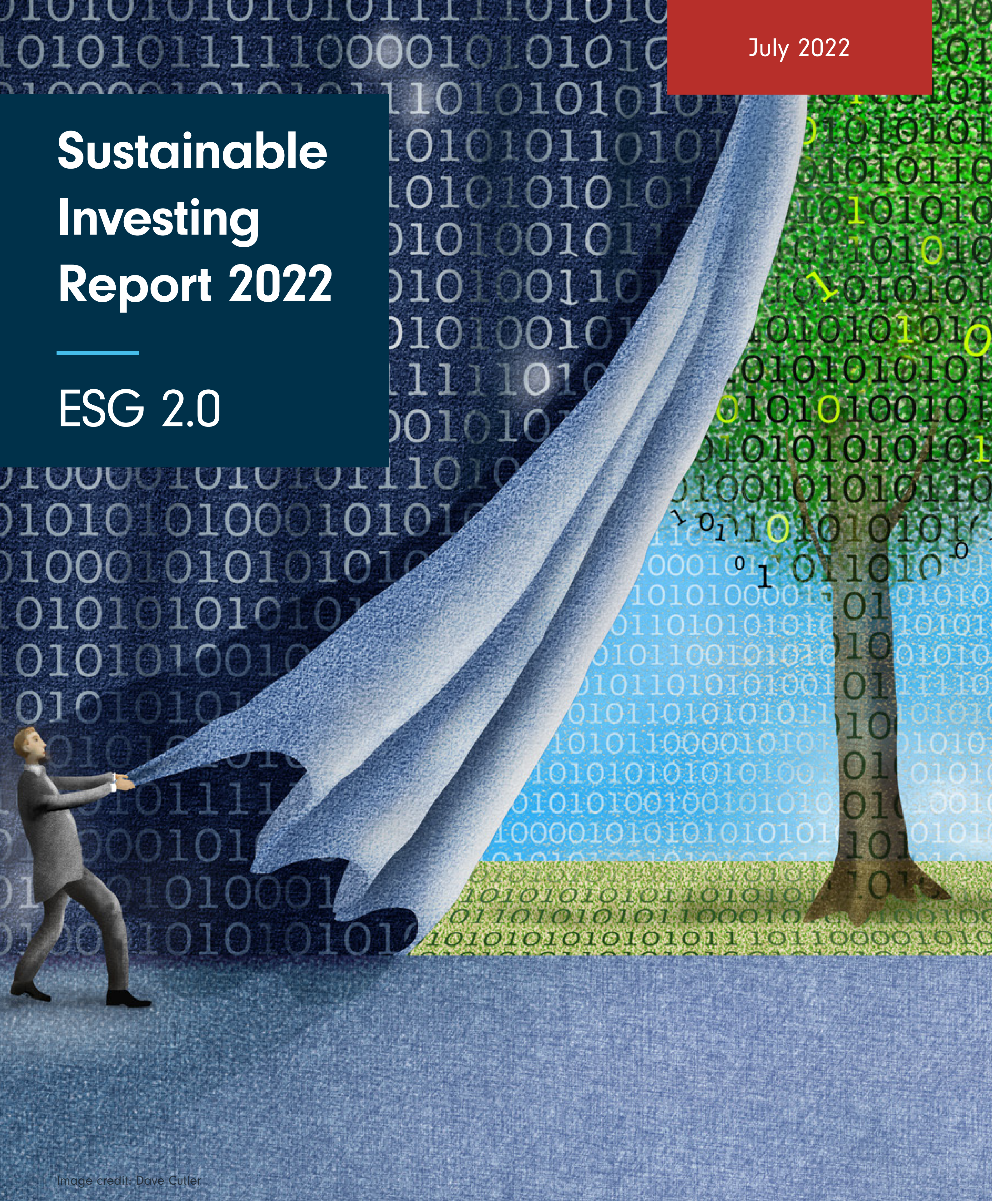


Image credit: Dave Cutler

Fidelity INTERNATIONAL

Who we are

Fidelity International offers investment solutions and services and retirement expertise globally to institutions, individuals, and their advisers. As a purpose-driven, privately held company with over 50 years of heritage, we think generationally and invest for the long term.

Our focus is on delivering sustainable investment returns for our clients, while managing our impact on society and the environment. To achieve this, we incorporate sustainability into our investment process and business operations and work closely with investee companies to help them operate more sustainably.

$812.8bn

Assets under management and administration*

400+

Investment professionals globally including 30+ sustainable investing specialists

26

Locations

30

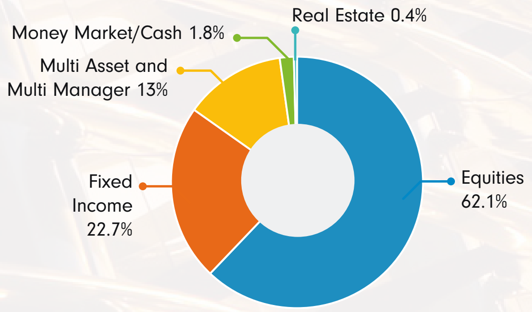
Sustainable strategies across asset classes

*Although combined headline client asset figures (under management and administration) for Fidelity International and Fidelity Canada are reported here, it should be noted that the financial results of Fidelity International and Fidelity Canada are not consolidated from a financial reporting perspective.

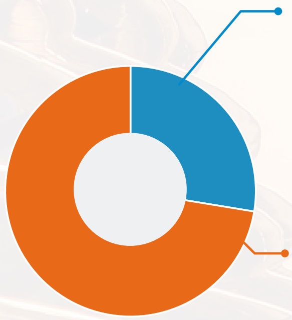
Source: Fidelity International, data as of 31st December 2021.

Assets under management

By asset class



By client origin



Institutional assets	$123.2bn
Europe incl. UK	30.58%
Asia Pacific and Japan	60.35%
Middle East, South America and other	9.07%
Wholesale, Defined Contributions (DC) and Retail	**$323.4bn**
Europe incl. UK	67.86%
Asia Pacific and Japan	29.44%
Middle East, South America and other	2.70%

Source: Fidelity International, December 2021. The institutional asset AUM figure consists of Defined Benefit pension schemes, Government Institutions Group, and corporate cash reserves. This represents assets under management for Fidelity International and excludes funds under administration. This also excludes assets under management and assets under administration for Fidelity Canada. Data as of 31st December 2021.

Foreword

The next step in the response to the climate emergency will be the hardest. Turning pledges and commitments into real action requires effort; however, it is essential now that the scale of the problem is better understood, and the solutions made clearer.

We might well wish for a more stable geopolitical and macroeconomic backdrop for what is a substantial task. But we can't afford to let the urgent distract from the existential and wait for conditions to improve.

With that in mind, and to sharpen our analysis of the progress made by our investee companies, we have enhanced our proprietary sustainability ratings to include assessments of both the financial, and non-financial impacts, of company actions. This is what is known as 'double materiality' and it is crucial to compiling a forward-looking view on the sustainability profiles of corporate issuers.

Asset managers have a choice to engage or divest, or a combination of both. As active managers, we have preferred to engage with companies where their transition plans fall short. Getting from brown to green is the priority, not just in portfolios but in aggregate across the world. To that end we are employing a climate rating to identify the companies with whom we should prioritise engagement to meet our net zero goals.

By working with other investors in this area, through groups such as Climate Action 100+, we can share knowledge and investment policies, engaging directly with management to focus improvements on areas that need it most.

Finally, sustainable investing is as important to private markets as public ones. Private markets give investors access to those smaller-scale firms working on green technology to reshape industries, as well as renewable energy projects.

Sustainability is complex and, like most areas of finance, constantly evolving. It requires us to iterate our own processes to keep pace with change and ensure our investment ambitions remain high.

Anne Richards
CEO, Fidelity International

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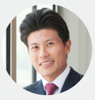


Jenn-Hui Tan
Global Head of Stewardship and Sustainable Investing

Sustainable investing has been put to the test over the past year. The war in Ukraine and the cost-of-living crisis have highlighted the ethical and social risks of complex supply chains, beyond those revealed by the pandemic, and the risks to the net zero transition.

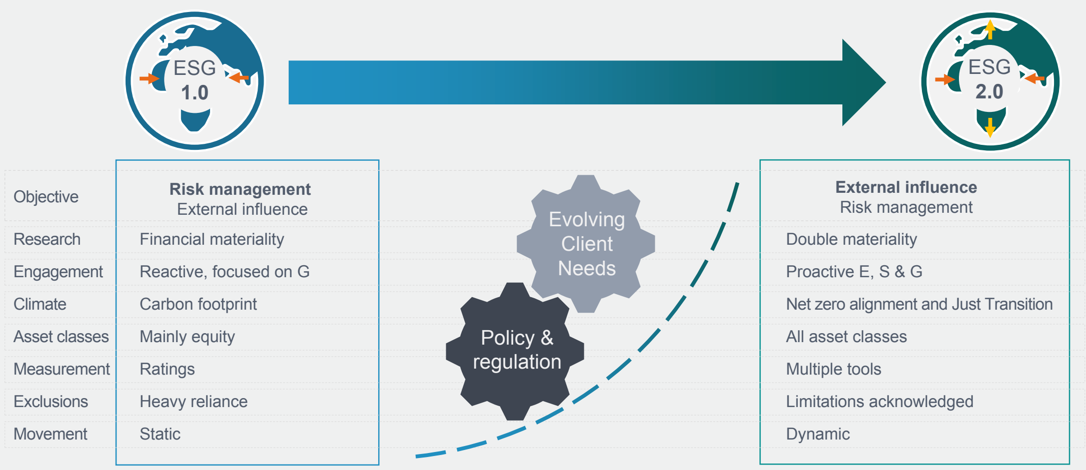
Unfortunately, future climate costs could dwarf today's pressures if the world fails to decarbonise at pace. While COP26 did not deliver all that had been hoped for, agreements on coal, methane, and deforestation, the establishment of international green reporting standards and the adoption of net zero pledges are driving an evolution in sustainable investing. Unlike ESG 1.0, ESG 2.0 is not just a risk management tool but a way of achieving impact.

An ESG evolution

At Fidelity, we see this evolution as the first of many for the industry. ESG is now considered across all asset classes, including private markets, and proactive engagement has become essential to gathering information and instigating positive change. Disclosure too has evolved in anticipation of more climate information being required by the SEC and a new set of reporting norms from the International Sustainability Standards Board. Many more companies are completing Task Force on Climate-related Financial Disclosures (TCFD) reports and providing better quality data - though still not enough.

But the biggest difference between ESG 1.0 and 2.0 is the shift towards incorporating not just those ESG factors that affect a company's ability to operate, but also the potential impact of a firm's activities on the wider community - so-called "double materiality".

Chart 1: The ESG evolution from 1.0 to 2.0
Increased sophistication and focus on influence across the sustainability complex



Source: Fidelity International, April 2022.

Upgrading our ratings

We have changed Fidelity's proprietary ratings system (see page 13) to explicitly include the concept of double materiality. Our ratings are constructed by our investment analysts based on the same fundamental bottom-up research process that drives our investment recommendations. As a result, our ratings take a forward-looking view of a company's sustainability characteristics and its ability to manage negative externalities. We have already completed our assessment of over 3,700 corporate issuers across equities, fixed income, and private credit, and our sovereign and structured credit assessments are on track for full coverage this summer.

At COP26, over 100 countries, accounting for 90% of the world's forests, pledged to halt forest loss and land degradation by 2030.

We have also begun the rollout of our climate rating, introduced in 2021 as part of Fidelity's Climate Investing Policy, which identifies the companies we should engage with first and most as part of our aim to halve portfolio emissions by 2030 and reach net zero by 2050.

Impact matters

Our proprietary tools are vital if we are to deliver outcomes, such as reducing carbon emissions and helping our clients and society achieve net zero in time.

On page 20, we examine what impact means for Fidelity and the multiple ways in which we can act to bring about positive change. These also include a greater focus on Sustainable Finance Disclosure Regulation (SFDR) Article 9 funds which require specific sustainability objectives, developing more strategies aligned to the UN's Sustainable Development Goals (SDGs) and ramping up engagement in three key sustainable investing areas: ending deforestation, ensuring a just transition and, crucially, the principle of double materiality.

Halting forest loss

Deforestation sits at the intersection between climate change and biodiversity, destroying natural carbon sinks and ecosystems that contribute to clean air, water, soil quality and crop pollination.

At COP26, over 100 countries, accounting for 90% of the world's forests, pledged to halt forest loss and land degradation by 2030. Meanwhile, 30 financial institutions, including Fidelity, agreed to eliminate agricultural commodity-driven deforestation risk from their portfolios by 2025. To achieve this, we have assessed group exposure to companies contributing to deforestation along the entire value chain from producers and food retailers to enablers such as banks. We are pushing hard for integrated risk assessments and enhanced traceability of supply chains, while also addressing related issues such as decent working conditions for vulnerable groups of workers (see page 48).

No one left behind

Equally important is ensuring that the energy transition is a just and secure one, with social and financial burdens shared fairly, and with no one left behind. That includes the workers and communities dependent on the fossil fuel industry and developing countries still reliant on carbon-intensive sources of energy. Unless their needs are accounted for and the transition properly reflects historic and current responsibility for climate change, it won't happen fast enough.

Directors held to account

One of the most powerful ways we can bring about change is through our votes, especially where we act alongside other shareholders. Last year we set minimum standards on climate and gender diversity, and subsequently engaged with issuers to provide guidance on how we expect these to be met, allowing time for companies to incorporate our expectations in their FY21 disclosures.

We have now started to vote against the boards and directors of companies where they are not meeting our minimum standards, and already a significant number have made material improvements to their climate change strategies, governance, and disclosures.

Conclusion

Sustainability risks, and opportunities, are often thought of as uncertain and long-term in nature. And in benign times, the apparent importance of transparency and good governance can fade.

However, it is at times of crisis that the need for robust risk management and governance comes to the fore. These are often good indicators of which companies will remain resilient and continue to serve a societal purpose beyond solely profit, to meet the multi-faceted needs of their stakeholders and to deliver the long-term value creation that investors expect.

2021 sustainable investing highlights

Rated A+
across all categories by the UN Principles for Responsible Investment*

12
new sustainable investing team members

Enhanced our proprietary sustainability ratings framework with **over 3,700** corporate issuers rated across equities, fixed income and private credit

CityWire Gender Diversity Awards: Best Retention Rates Award Judges' Choice Contribution to Gender Diversity

Named House of the Year at **Asian Private Banker Asset Management** Awards for Excellence

Named as a Responsible Leader by the **Responsible Investment Association Australasia**

Launched our Climate Investing Policy and our net zero strategy setting the following targets:

2030

- Halve the carbon footprint of our investment portfolios
- Phase out thermal coal exposure for OECD countries
- Achieve net zero emissions across Fidelity's own corporate operations

2040

- Phase out thermal coal globally

2050

- Reach net zero across all investment portfolios

Updated our Voting Principles and Guidelines to include new policies on climate change and gender diversity

Signed the Finance for Biodiversity Pledge which commits to protect and restore biodiversity

Commenced development of our proprietary climate ratings

*Based on 2020 score (2021 score still to be released as at the date of this report)

Fidelity's approach to sustainable investing

At Fidelity, we consider the longer-term consequences of our actions in both financial and societal terms. As global investment managers, how we hold investee issuers to account today can play an important role in shaping a more sustainable tomorrow.

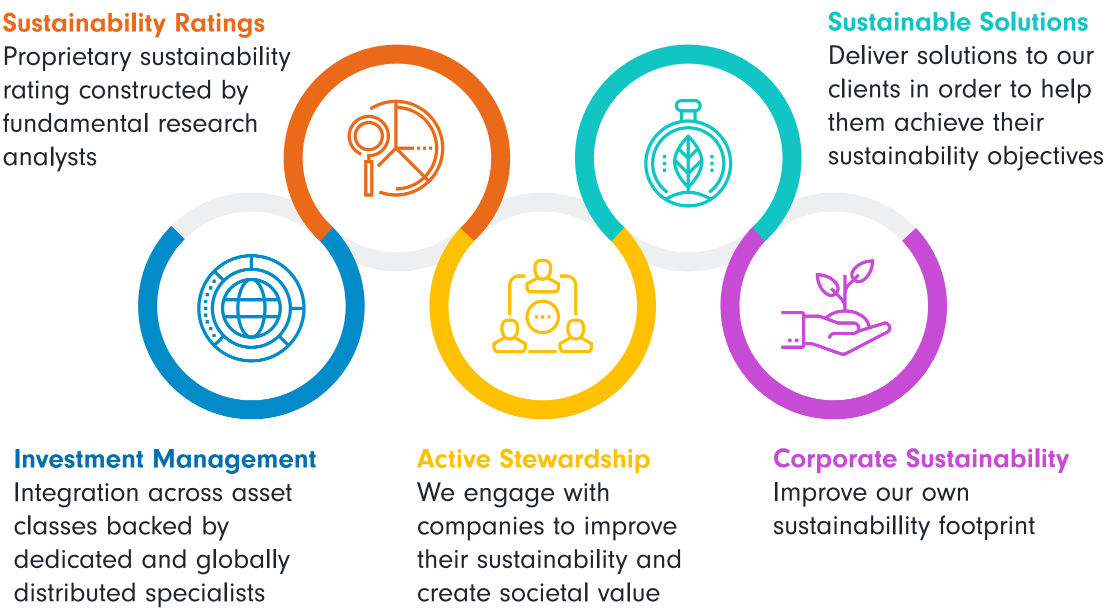
It is important to understand the material sustainability factors that impact long-term value creation. Specifically, we aim to achieve:

1. The integration of sustainability factors into our fundamental investment research and security selection process.
2. An understanding of the non-financial impacts of our investment decisions on investee issuers and their broader stakeholders, including employees, suppliers, customers, regulators, and communities.
3. A local approach to our sustainable investment process, recognising the differences in economic systems, market structures, societal norms, and business models across all the jurisdictions in which we operate and invest.
4. Measurable improvements in the behaviour of the issuers we invest in or lend to, both directly and in collaboration with our peers and clients, by leveraging our tools of selection, engagement, and voting.
5. Mitigation of system-level risks through active ownership and policy advocacy.

Throughout this report we explore how we are making progress on our overarching sustainability aims, focussing in particular on integration and active ownership.

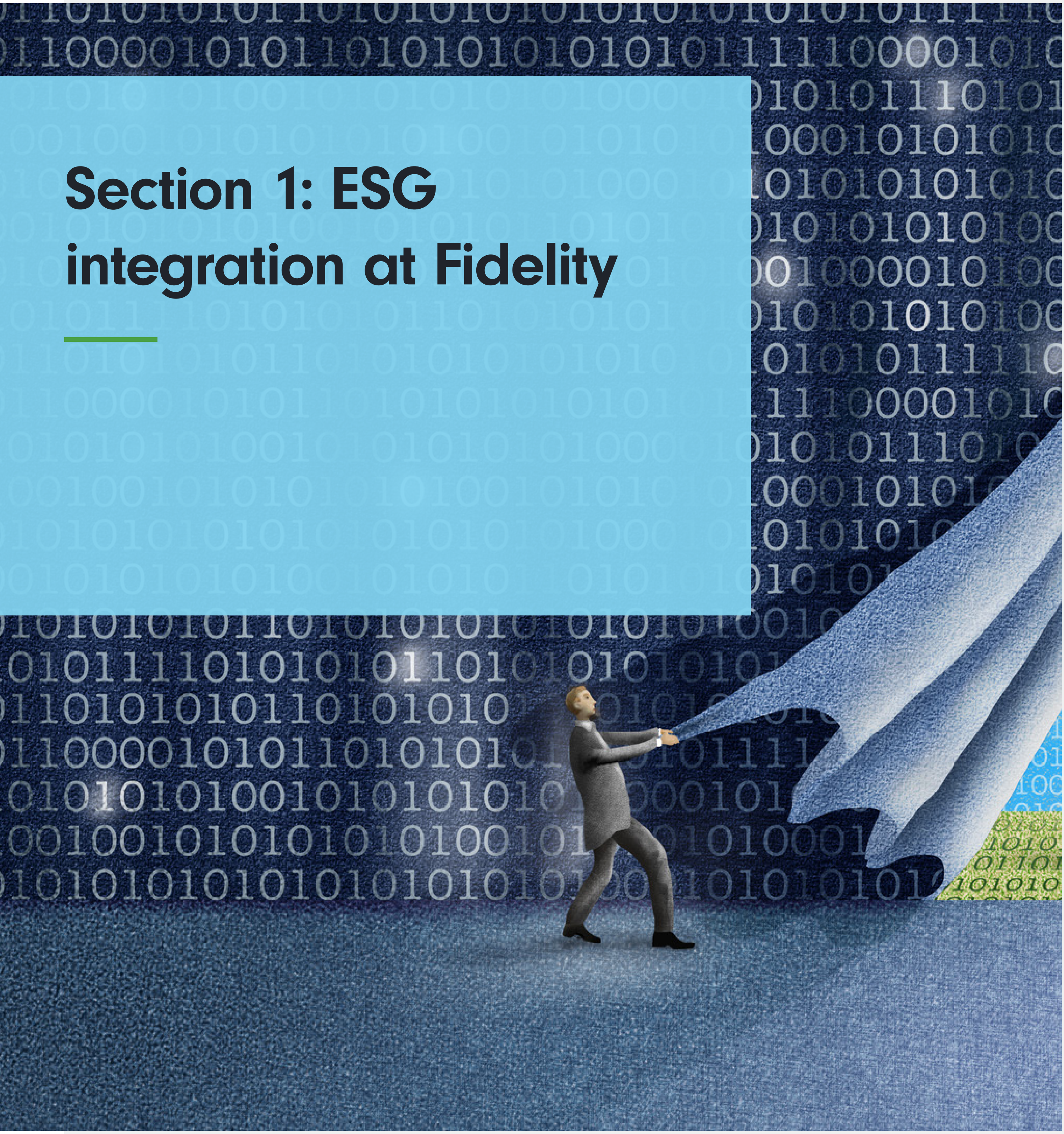
To deliver on the above aims we have five pillars through which we approach sustainable investing:

Fidelity's firm-wide approach to sustainable investing has 5 pillars



Source: Fidelity International, 2022.

Section 1: ESG integration at Fidelity



The integration of sustainability within our investment process is achieved via a three-layered framework. It is designed to be modular in nature to enable Fidelity to deliver investment solutions to clients, while responding to the evolving demands of the regulatory environment. The three layers are outlined below:

Three layers of integration

Frameworks and standards

The foundation of robust sustainable investing practices consists of data, frameworks and standards. This provides a common language to mobilise efforts across Fidelity International to work together in building sustainable financial futures.

Under this layer, we will identify the sustainability classification of our funds and ensure our standards align with relevant sustainability legislation (i.e. SFDR) or sustainability labels, as required. We will also ensure that client requirements and investment team considerations are reflected as part of our framework build-out.

Tools

We have multiple tools to integrate ESG in our investment and stewardship process. These include our sustainability and climate ratings, as well as the insights from previous engagements. These tools are available through a digital platform and can be used by portfolio managers, analysts or members of the sustainable investing team for investment decisions or for engagement purposes. The extent to which these tools are used vary depending on each person or fund's needs.

Communication, products and services

This is the delivery of investment products and tools to clients, while also providing relevant training and support to our partners when approaching sustainability.

Further information on Fidelity's approach to integration can be found in our Sustainable Investing Policy.

2021 update

Throughout 2021, we continued to develop our policies, standards, and tools to support the systematic integration of sustainability considerations into our investments.

Sustainability ratings framework

We developed and launched the second iteration of our proprietary sustainability ratings for equity, fixed income and private credit issuers, while our sovereign and structured credit assessments are on track for full coverage later this year. The ratings provide an absolute assessment of companies' sustainability characteristics across sectors, and integrate third party datapoints to complement our investment analysts' research and engagement insights. We explore the proprietary ratings framework and process in Ratings 2.0: Fidelity's sustainability ratings now doubly material.

> We developed and launched our Climate Investing Policy, which introduced new firm and investment portfolio level commitments to achieve net zero emissions targets.

Private assets

In 2021, we established our private assets business. Clients are increasingly looking to allocate to sustainable strategies and additionally achieve this exposure through private assets. By adding private assets to our global public markets investing capabilities, we can help clients access, manage and think about asset allocation across all asset classes, in which sustainability is deeply integrated throughout the investment process. In High impact: The pursuit of outcomes we examine investing for impact and in particular how impact can be achieved through investing in private assets.

We updated our Sustainable Property Investing Policy, detailing how we integrate sustainability in our real estate investment process, through our principles-based approach. To complement this, we also published our Real Estate Net Zero Carbon Commitment Roadmap, setting out how we will reach our net zero commitments for real estate to achieve operational net zero by 2035 and material net zero by 2050 or sooner.

Climate investing policy

We developed and launched our Climate Investing Policy, which introduced new firm and investment portfolio level commitments to achieve net zero emissions targets. This included a commitment to halve the carbon footprint of our investment portfolio by 2030, from a 2020 baseline, and to reach net zero across all portfolios by 2050. We also set a target to achieve net zero emissions across Fidelity's own corporate operations by 2030. The policy sets out in detail how we intend to achieve our investment portfolio targets through integrating climate factors and investing in net zero issuers, climate stewardship and transition engagement, and by phasing out exposure to thermal coal. We look at our approach to climate stewardship and transition engagement in further detail in the Active Ownership section of this report.

To enable the local implementation of these global policy and targets, a key part of our net zero emissions plan is Fidelity's proprietary climate rating, a tool that assesses companies on their decarbonisation progress and will support our engagements aimed at reducing our portfolio emissions. The tool has been designed to analyse firms in three core areas: net zero ambition, climate governance and capital allocation to the transition. With these assessments we then identify those issuers who are either currently achieving net zero, aligned to a net zero pathway (as demonstrated through emissions reductions over time and robust short-, medium- and long-term targets) or with differing levels of potential to reach alignment with that pathway. The tool reflects the deep integration of sustainability factors in our fundamental bottom-up investment research and security selection process, and our commitment to measurable improvements in the behaviour of the issuers we invest in or lend to.

Finally, in recognition of climate change as a system-level risk, we have developed a framework for assessing the macro implications of different climate scenarios and how these may be altered by policy and technology shifts over time. In Allocating for climate change we also explore how investors can allocate to climate across different asset classes.

In our latest TCFD report we outline how Fidelity is responding to climate risk and opportunities, and provide more information on how we are measuring emissions across the business.

Further information on Fidelity's approach to climate risks and opportunities can be found in our latest TCFD report.

Ratings 2.0: Fidelity's sustainability ratings now doubly material


Heidi Rauber
Consumer Staples Analyst


Gita Bal
Global Head of Research, Fixed Income


Punam Sharma
Director, Equities

Back in 2019, we launched our proprietary sustainability ratings, and incorporated these into our research and investment decision-making process. Third-party ratings, we felt, were often backward-looking, provided insufficient detail and didn't suit our bottom-up approach. Having our own ratings proved to be an effective way to start thinking about how ESG risks might affect company valuations and long-term prospects. During the Covid-19 crash, oil shock and subsequent recovery in 2020, we took a snapshot of performance which showed that companies with better ESG characteristics were likely to be more resilient. See our paper Outrunning a crisis: Sustainability and market performance.

However, the increasing emphasis on real-world outcomes has encouraged us to evolve our proprietary system so that it now embeds "double materiality" (the impact a company has on communities and the planet, and vice versa), giving our analysts deeper insights into material non-financial, as well as financial, factors.

Comprehensive and comparable

We now have 26 environmental, 14 social, and seven governance indicators, supported by 130 underlying data points alongside analysts' qualitative analysis for each indicator. Key indicators are identified and weighted by subsector (not just sector), making their materiality far more granular and relevant. Our scoring

Step 1.
Identify material indicators and weightings for issuer

Customized materiality maps created for **127** individual subsectors

Drawing on up to:
- **26** environmental,
- **14** social,
- **7** governance indicators

>90% coverage of major ESG research provider's frameworks

Step 2.
Score the issuer on individual indicators

- **60+** Environmental datapoints
- **30+** Social datapoints
- **40+** Governance datapoints

Research conducted by Fidelity's team of sector specialist analysts

Qualitative analysis drawing on corporate access c.**20,000** company meetings

Step 3.
Rate the issuer

Actionable outputs for c. **4,000** issuers including:
- Sustainability rating
- Trajectory rating
- Environmental Impact score (+ Underlying indicators)
- Social Impact Score (+ Underlying indicators)
- Governance Score (+ Underlying indicators)

A process which blends quantitative and qualitative input, and produces flexible and actionable insight

Source: Fidelity International, 2022.

methodology, however, remains consistent across key indicators, allowing companies to be compared on an absolute basis rather than just in relation to their peers.

We rolled out the second iteration of the framework in Q1 2022 and have since exceeded our coverage targets by rating over 3,700 issuers. Our aim is to get to c.4000 issuers across equity, sovereigns, corporate bonds, and private credit in the next few months. While the ratings will continue to evolve, the new modular approach means further data points can be added easily.

Fidelity's investment analysts are key to making the ratings work. They gather qualitative data through their research and active engagements with the companies they cover, and quantitative data from a variety of external sources.

Limitations of our approach

The in-depth nature of our approach means that our coverage is not as broad as a third party provider, therefore we continue using third party providers in order to supplement our limited coverage. Further, the ratings framework is being used by some 200 analysts globally with varying degrees of understanding of the different ESG issues covered, which creates variability in the output. We are addressing this challenge by providing training on the ratings framework and on specific themes and sectors.

How the ratings are used

The sustainability ratings are used in a few ways. First, they are used by the analysts to capture their insights on a company's ESG characteristics and can help inform their views on a company and if they recommend a buy, sell, hold position. Secondly, they can also be used by portfolio managers at different stages of their investment process. It is important to note that each portfolio manager has their own approach and the way and extent to which the ratings are used depends on this approach. Thirdly, we can use them for monitoring of a fund's ESG characteristics and the fund's classification within regulatory frameworks like SFDR. On the stewardship front, we can use them to prioritise and guide engagement with companies. Finally, we use the ratings for client communications and reporting.

We asked one of our senior analysts, Heidi Rauber, to describe how she found the ratings process and whether it had made a difference to her analysis.

Q&A with Heidi Rauber, consumer staples analyst

How have Ratings 2.0 made a difference to you?

The second version of the ratings has allowed me to differentiate more between companies, as we now have separate numeric ratings for E, S and G, as well as an overall letter rating A to E, though typically my companies sit in A-C buckets. Having numeric scores for each allows for greater granularity and differentiation as we rate every single factor and subfactor.

My process is first to assign numeric scores to all the companies I cover across the range of factors, then rank them by the sum of the numeric scores to

Case study

Unilever has made environmental sustainability a core part of its strategy. It is the only company I cover that has asked shareholders for an advisory vote on its net zero plans (it wants all its household products to be free of fossil fuels by 2030) and has integrated environmental sustainability into management incentive targets. While the company has set challenging targets, however, it has not consistently met them. The ratings have captured this discrepancy and we've been engaging with the firm to find out why, and what the challenges are in helping consumers make carbon-saving choices, e.g. using lower temperature detergents or dry shampoos that cut down the number of showers taken.

see if my overall letter rating makes sense. Where I find companies with the same score but a different letter, it prompts me to reflect on whether this is justified or not. I have adjusted a couple of ratings on this basis, and the overall result has been a wider distribution and fewer issuers achieving the overall highest A rating.

Once we have identified areas of concern, particularly this year around biodiversity, we can push companies to improve their disclosure and share best practice.

Where do you find the information necessary to score companies on different factors?

I typically start by analysing company publications and complement that with my existing sector knowledge. I further research areas where I have more questions and follow up with investor relations or senior executives. Then I use a range of tools to help me track corporate developments.

I also assess the targets that companies set, how stretching they are, and a firm's track record of achieving past targets. For net zero targets, we look at the level of detail provided in a company's plans, and how they track progress. Some companies have yet to publish net zero plans which I view negatively when it comes to scoring.

The Ratings 2.0 framework allows for greater nuance, e.g. the distinction between the percentage of energy vs electricity derived from renewable sources or where companies are not clear about their water usage or waste management along supply chains. Once we have identified areas of concern, particularly this year around biodiversity, we can push companies to improve their disclosure and share best practice. Many consumer goods firms have a "Sustainable Agriculture Code" that ensures that farmers follow sustainable practices, but the more comprehensive Ratings 2.0 framework details both the leaders and those with whom Fidelity needs to engage more intensively to drive change.

Ratings 2.0 also enables a deeper dive on social factors, so I typically assess a company's safety procedures, code of ethics, supplier code of conduct, privacy policies and marketing policies (particularly important for alcohol, tobacco, and infant formula). I pay special attention to employee engagement scores, turnover rates, whistleblowing policies and workplace fatalities (particularly in beverages), especially where companies claim to survey their employees on these issues but don't publish the results or exclude parts of their workforce.

What extra insights has Ratings 2.0 given you?

The increased granularity and the ability to draw in different data points have given me a more complete picture and helped raise my confidence levels around the ratings, and their impact on valuations and investment cases. One example is that I now spend more time considering employee perceptions of the company they work for. This reflects both whether employees have truly bought into management's agenda at a strategic level, but also whether they feel taken care of.

I have not made any rating changes on this basis, but it has confirmed my view of one company that had already been rated a Sell due to concerns around governance. Ratings 2.0 also allows me to incorporate event-driven news more quickly into my investment recommendation, especially if I've already identified an ESG red flag. Ratings can be reviewed at any time, but we'll often look at them when companies issue annual ESG reports or formal updates. The information we collect helps capture ESG trajectories and provides context for future investment case reviews.

What are the benefits of an investment analyst rating companies as opposed to an ESG analyst?

The main advantage is that the discussion with management becomes much more strategic. As financial analysts, we regularly host meetings with CEOs and CFOs of companies. This allows us to judge their true commitment at the most senior levels and we see it as a red flag if they are not well versed in discussing ESG issues.

Another benefit arises from assessing board composition. Due to our sector coverage, we have often already met with new board members that are industry experts in their previous executive roles, e.g. the previous CEO of Remy joining the board of Danone. We therefore often have direct knowledge of their execution track record and key strengths and can formulate a view of their effectiveness as board members. That said, we work closely with our sustainable investing colleagues on a range of engagements, particularly where they apply across the coverage universe.

Ratings can be reviewed at any time, but we'll often look at them when companies issue annual ESG reports or formal updates.

How do the sustainability ratings sit alongside financial ratings?

The ratings are done completely separately, and I do my best not to bias sustainability assessments towards my stock ratings. However, I have found that the highest quality companies have tended to be the most advanced when it comes to sustainability. I believe this is because they have greater control over their performance, freeing up time to think longer term and more strategically. There are instances where sustainability ratings have filtered through into stock ratings: for example, I recently downgraded a stock where I felt the management incentive programme was not fit for purpose. In tobacco, the commitment to transition consumers to healthier alternatives is critical, and this has influenced my preferences and stock recommendations.

What practices are you looking for in a consumer company that are good or bad ESG wise?

I don't just look for the absence of negatives, but also for positives. For example, Nestle fortifies many products sold to lower income consumers in emerging markets with micro-nutrients, based on their mapping of the most common deficiencies. Equally, companies like Proctor & Gamble haven't signed up to major plastics initiatives such as that organised by the Ellen MacArthur Foundation, but our engagement with Proctor & Gamble revealed credible targets on plastics.

Most of these companies now have ESG far more ingrained in their corporate cultures than those that have adopted it more recently on the back of pressure from capital markets.

I also look for a history of incorporating ESG principles into a company's culture. Some companies have been highlighting ESG topics to investors for many years, especially in relation to diversity and employee welfare. I do recall times when investors used ESG presentations as "Blackberry breaks". But most of these companies now have ESG far more ingrained in their corporate cultures than those that have adopted it more recently on the back of pressure from capital markets. They also tend to have better disclosure, not just around company activities but via transparent product labelling and sustainability awareness campaigns on topics like clothing and plastic.

And finally, I look closely at whether a company is on an improving or deteriorating trajectory in terms of its sustainability rating. This helps me understand the nature of the ESG-related risks or opportunities that are emerging and that could have a significant positive or negative financial and/or non-financial impact.

Visit our website to discover more about our ratings process and watch a walk-through.

High impact: The pursuit of outcomes

Emilie Goodall
Consultant, Impact Investing

Adrian Benedict
Head of Real Estate Solutions

At its essence, impact investing is about delivering outcomes for people and the planet alongside financial outcomes. Investors can have a positive effect across all asset classes, although the nature of influence will vary. Investors are increasingly grappling with the pace of positive change already underway and starting to appreciate the role that real estate can play in accelerating their impact investing ambitions.

Investing is no longer just about managing risk; it is increasingly about having a positive impact. This is partly driven by asset owners, who wish to deploy capital towards solving problems like climate change and biodiversity loss while also generating a financial return, and by regulators, particularly in Europe.

That said, in the absence of a globally accepted framework, investing for impact can mean different things to different people, and investors take a range of approaches depending on their organisation's goals and methods of integration.

Influencing change

At Fidelity, we think of investing for impact in a broad and holistic way. The way in which we integrate sustainability into our bottom-up investment processes for traded securities aims to achieve an impact via the investment decisions we make and the engagements that our ratings prompt or respond to.

This active investing and stewardship approach allows us to have an influence on issuers across asset classes. Indeed, a range of strategies and policies are needed if all products aim to contribute positively to solving broader social or environmental problems alongside generating a financial return.

Influence is a subtle and nuanced part of the process of investing that means we cannot always pinpoint its exact effects on company managements. Nonetheless, we can monitor where companies are making profound changes in the wake of conversations we've had with them. We can also seek to influence change on a system-wide basis, across whole industries and portfolios. Here too identifying the tangible impact can be tricky as system-wide change, such as in public policy, can take time and is often achieved via a set of incremental steps rather than an overnight transformation.

At a portfolio level, our influencing approach is informed by tools such as our sustainability ratings (see page 13), our Principal Adverse Impact analysis, and our SDGs mapping. These direct allocation and engagement decisions are framed by our Climate Investing Policy and our deforestation commitment that are designed to push for change on a system-wide basis.

We also consider the risks of our various approaches to influencing company behaviour in a way that is similar to how we analyse financial risk/return profiles. Primarily, there is a risk that the changes we hope to encourage do not come to pass. This brings with it reputational risk if we engage intensively with a company on a particular issue throughout our investment and it continues its harmful practices. There is also the risk of unintended consequences given the interconnectivity of ESG factors, which we seek to assess and mitigate via our deep research capabilities into individual companies and sectors.

However, these risks must be balanced against the risks of inaction, and the potential return from acting in terms of the societal and environmental benefits. For example, if we have the chance of encouraging a company to improve its environmental status, or to influence a positive system change that influences the 'rules of the game' for a wider group of companies, then even if our original targets for change are not quite met we may still have had a meaningful positive impact.

Our influencing framework is at a nascent stage, and we are looking to expand our stock of influencing tools and to draw stronger threads between possible actions that are mutually supportive across the levels of influence. Importantly, the development of this broader framework is happening alongside and complementing the growth of impact investing in the more narrow and traditional sense within private assets, both at Fidelity International and across the asset management industry.

Spotlight on real estate

More than any other asset class, real estate is perhaps the most tangible ('bricks and mortar') in terms of its potential for impact. When it comes to climate change, for example, not only is the built environment one of the biggest sources of emissions, accounting for around 40% of carbon emissions globally and up to 60% to 70% in cities, but the sector also offers some of the most tangible opportunities to cut those emissions. While investors can buy new assets built to higher environmental standards, the biggest scope for achieving impact lies in the buildings that exist today, most of which are expected to still be around by 2050. Refurbishing and retrofitting these buildings can both reduce the carbon footprint of our built environment and improve the wellbeing of those who use them.

While any sort of building work has financial and environmental costs, retrofitting older assets cuts a significant portion of the upfront embodied carbon (the emissions created from a building's construction) which is irreversible. Improving energy efficiency, using more sustainable materials, and sourcing cleaner forms of energy can also cut existing emissions and have a measurable, verifiable, and additive impact. Not only can we ensure that renovated buildings adhere to the strongest performance standards, such as insisting upon Energy Performance Certificate (EPC) ratings of A or B and Building Research Establishment Environmental Assessment Method (BREEAM) ratings of excellent, but we can also seek to improve how the building is utilised in the long term, by targeting 100% green leases for sustainable use and using a tenant selection process that includes sustainability scoring of the potential lessees.

As with influencing companies more generally, however, impact investing in real estate needs to be a collaborative effort, with landlords and occupiers working in partnership - perhaps through green leases or less formally - to achieve the desired outcomes.

Allocating for climate change

Matthew Quaife
Head of Multi Asset Investment Management, Asia

Eugene Philalithis
Head of Multi Asset Investment Management, Europe

The effects of climate change, and the policies aimed at slowing it, will have profound effects on the global economy for decades to come. As a result, capital allocation within portfolios and across asset classes must consider how best to account for a changing world, aligning with global commitments to reduce greenhouse gas (GHG) emissions and mitigate physical and transition risks.

At Fidelity, we have developed a framework for assessing the macro implications of different climate scenarios and how these may be altered by policy and technology shifts over time. We plan to embed these into our long-term capital market assumption models (read our paper here). At the same time, more ways of allocating to climate are springing up. Here we look at a few of them.

Equities

There are several ways equity investors can seek to avoid the risks and take advantage of the opportunities presented by the transition to net zero. Exclusion is one approach. Investors can use a negative screening overlay to remove the highest emitters from their investment universe. However, by not engaging with these firms, investors have little or no impact on emission cuts.

Another option is a so-called best-in-class approach, in which companies that lack an appropriate set of carbon emission reduction targets are underweighted, while exposure to low emitters, or those with ambitious energy transition plans, is increased relative to a benchmark.

This might appeal to investors that want exposure to those companies least affected by transition and physical risks while maintaining greater diversification than can be provided by excluding sectors or focusing on a narrower universe. However, the impact on emissions and on the pace of the transition may also prove to be limited.

Investors may therefore wish to allocate some of their equity portfolio to strategies that capture different aspects of the environmentally-aware universe via thematic funds that focus on, for example, companies whose products offer climate solutions such as improved water efficiency and waste management, renewable energy technology and energy efficiency. Such approaches may be less diversified than broader equity funds but may appeal to investors seeking clear, positive environmental outcomes from their investments.

Climate investing via equities, as with other asset classes, is not without its pitfalls. Challenges remain in finding clear and verifiable disclosures on Scope 3 emissions, across the entire value chain of the company, which often make up the lion's share of GHG emissions, particularly for the biggest emitters such as energy firms. Therefore investors who want to make a difference often invest with a transition mindset, engaging heavily with issuers on their net zero transition plans and employee reskilling to drive lasting change.

Fixed income

Green debt is different to green equity in that the proceeds can be directly used to finance initiatives to cut GHG emissions and align portfolios to climate targets, such as the 1.5° target agreed at the Paris UN summit.

This can be achieved to a limited extent through investing in green bonds, which must typically finance, or refinance, eligible green projects, and report on use of proceeds. For example, the World Bank has issued green bonds to finance renewable energy and clean transport projects. Meanwhile, climate-aligned bonds are those that are not labelled as green by the issuer but still contribute towards initiatives and projects that support the transition to a lower carbon economy. Sustainability-linked bonds include provisions to penalise the issuer with increased coupons or reinvestment rates if they fail to meet targets linked to, for example, the extent to which green energy is used in their energy mix.

However, such products are still few relative to the size of the global bond market. Instead, investors are increasingly viewing traditional fixed income securities as a means of engaging proactively on climate, whether along the lines of best-in-class or by owning the debt of firms leading the charge on the transition. Often brown bonds finance the same projects as green bonds but with a lower premium, while the more frequent refinancing of brown bonds provides opportunities to engage more intensively, especially with higher emitters in hard-to-mitigate sectors.

As with equities, investors seeking impact may seek to fund the transition by identifying high emitting companies with robust transition plans they can get behind, thereby supporting big reductions in emissions and setting industry best practice.

Private assets

Private markets can be used to access a wide range of investments aimed at reducing carbon emissions, often focused on the infrastructure and energy sectors. Private investment firms offer portfolios of equity stakes in companies that provide renewable energy sources such as solar and wind.

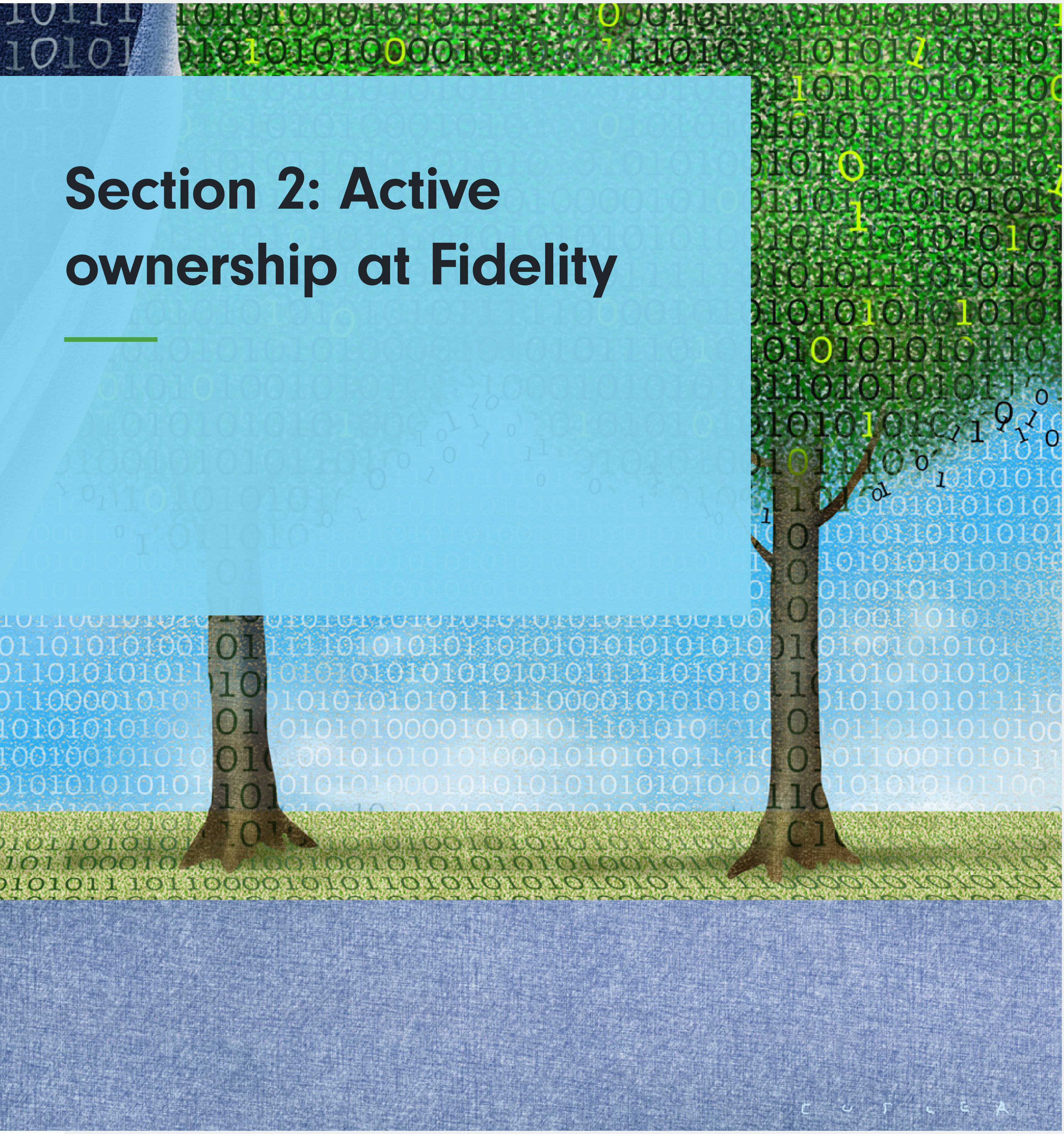
These companies typically have reliable revenue streams derived from long-term contracts to provide energy to corporate or government clients, making returns relatively stable and attractive to investors seeking more predictable income streams.

Gaining exposure to early-stage clean energy companies, such as those focused on cutting edge battery and hydrogen technology, is often only possible through private investments. The revenue streams for these companies may be more volatile than more traditional clean energy providers, but potentially reap higher rewards. However, investors need to be aware of potential illiquidity risk, alongside investment risk.

Conclusion

Overall, we believe that the huge changes associated with climate change, both physical and transition-related, will become the main driver of global capital flows this century. Getting ahead of these through a multi-vehicle climate allocation with different diversification and risk characteristics will be critical in protecting portfolios against emerging challenges while also enabling them to capitalise on the potential opportunities.

Section 2: Active ownership at Fidelity



Fidelity's approach to active ownership comprises the engagement and voting activity we undertake to gain a deeper understanding of a company's approach to ESG and to use our influence to improve the sustainability practices of the companies we own.

This approach supports the responsible allocation of client assets in two main ways: by informing the investment process at the research and investment decision-making stages and through leveraging our ownership position in companies to effect positive corporate change such as development of policies or targets or improvement of processes.

Engagement and voting at Fidelity

Active engagement forms an integral component of our sustainable investing strategy. We use information gathered from engagements to inform our investment decisions and to encourage company management to improve procedures and policies. We believe engagement is key to improving issuer behaviour and investor outcomes over the long term.

We conduct engagements throughout our investment universe and cover various regions, geographies, and asset classes. For further information on how we approach engagement across different asset classes, please refer to our UK Stewardship Code Submission.

Voting is a fundamental part of our engagement with investee companies and is underpinned by objectives of upholding good corporate governance standards across our equity holdings, preserving shareholder rights and supporting companies that are sustainable, responsible, and accountable to their shareholders. Our voting process is highly collaborative and draws on the experience of our wider investment team to inform our final decision. While voting is mostly limited to our equity holdings, the research and engagement process surrounding our voting activities is leveraged across our investment team.

Read more about our engagement approach in our Engagement Policy.

2021 update to our voting principles and guidelines

In July 2021, we updated our Voting Principles and Guidelines to incorporate sustainability considerations further into our voting decisions at company meetings and to set universal minimum expectations on a range of governance issues.

Two key areas that were updated relate to board diversity and climate change. In the case of board gender diversity, we will consider voting 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, the EU and Australia) and 15% female representation in other markets. This policy aims to improve gender balance at the board level, but also catalyses broader discussions beyond gender diversity and the board.

Our policy also encourages improvement on climate change strategy, governance, and disclosures, providing a clear set of criteria that we believe companies should be achieving to effectively address climate risks and opportunities

The updates also introduce a shift in how we approach shareholder proposals, taking a more holistic view of factors when determining our final decision.

To review the updates and approach in full visit our Voting Principles and Guidelines →

Engagement in 2021

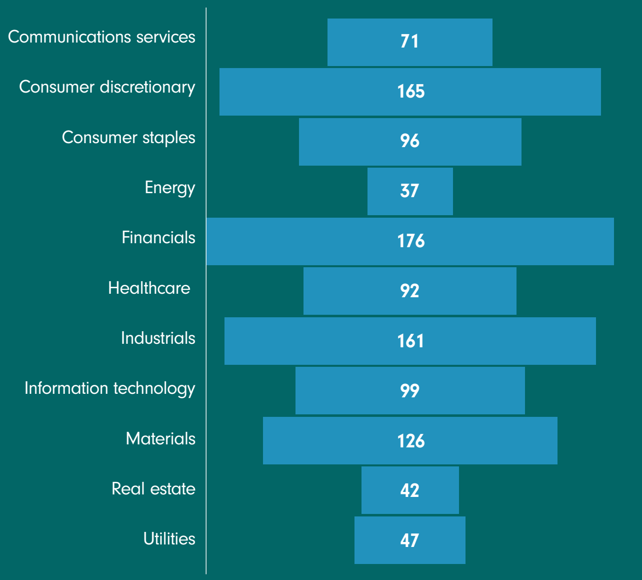
1,464
Number of engagements

1,113
Companies engaged

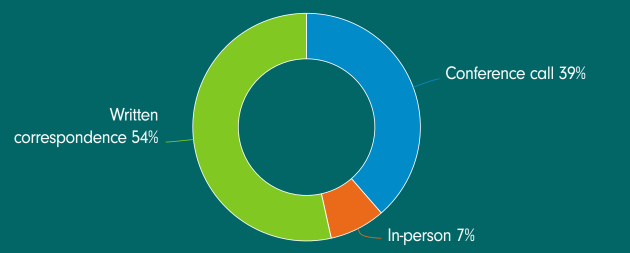
20,000
Number of company meetings*

51%
Share of virtual or in-person engagements held with C-Suite or chair/lead director

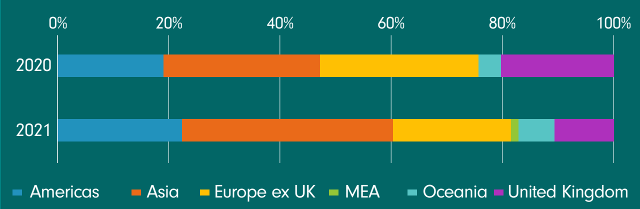
Engagements by sector



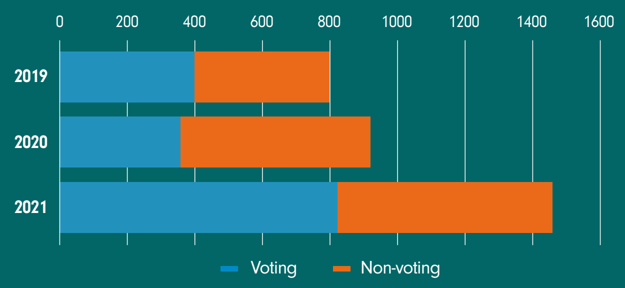
Engagement mode



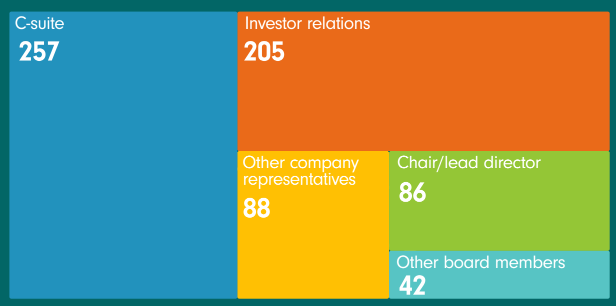
Engagements by region



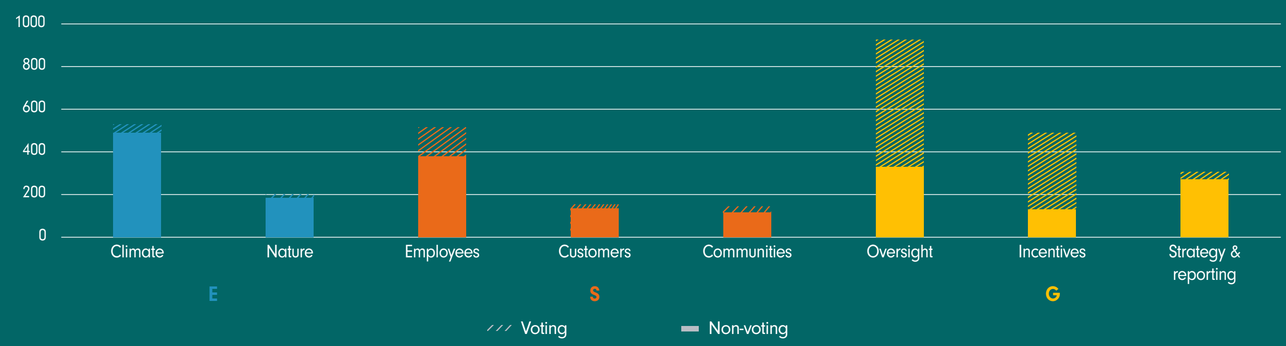
Engagements by year and type



Meetings with company representatives



Topics engaged by theme and type (voting/non-voting)



*While important interactions that inform the investment theses of our analysts and portfolio managers, these meetings do not constitute engagements under the UN PRI's Reporting Framework. 2021 figures include private issuers and meetings undertaken by Fidelity Canada.
Source: Fidelity International, 2022.

Voting in 2021

4,310
Total meetings* (97% of total)

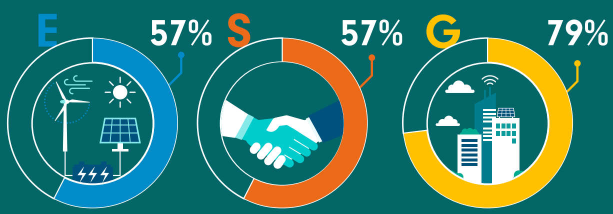
38%
Meetings where we voted against management**

9%
Proposals we voted against

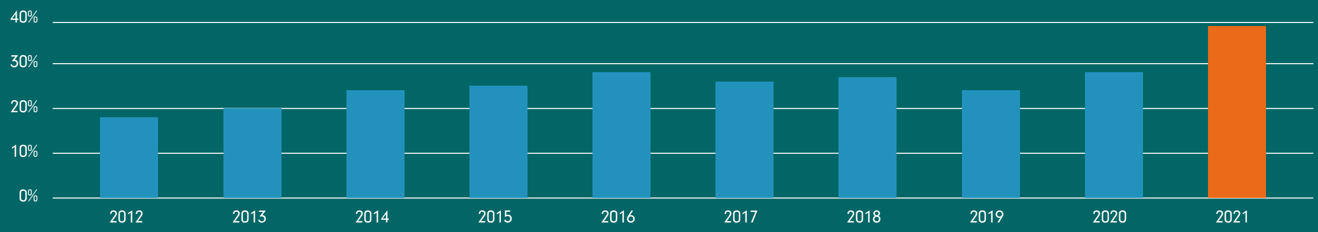
648
Companies where we voted against directors (823 directors at 19% of companies)

Meetings with votes against management by region

Shareholder proposals supported



% of meetings with votes against management over time



How we voted on different proposals

Proposal Type	Votes against management	
Remuneration	1197	22%
Charter Amendments	133	12%
Strategic/Restructuring	69	9%
Board	1483	7%
Capital Structures	338	7%
Routine Business	462	7%
Takeover Related	39	7%
Auditors	119	5%
Total	**3840**	**8%**

Top reasons for voting against directors

Proposal Type	Votes against management
1. Independence	569
2. Diversity	201
3. Conduct	112
4. Remuneration	173
5. Other	99

Further information about our approach to engagement and voting can be found in our latest **UK Stewardship Code Submission**

*Fidelity submitted votes at 4,310 of 4,424 meetings. We did not submit votes in instances where voting impediments prevented us from doing so. For more information, see our Voting Principles and Guidelines.
**Votes against management refers to instances where Fidelity voted contrary to the board or management's recommendation on a given proposal.
Source: Fidelity International (2022), ISS (2022).

Sustainable investing themes

At Fidelity, we continually review how we prioritise and focus our active ownership efforts. As part of this process, we select key themes annually that help guide our engagements. In this section we review the progress made on our 2021 sustainable investing themes and introduce the new focus areas for 2022.

Key themes for 2021

2021 was a year of continued momentum for sustainable investing. The Covid-19 pandemic continued to evolve and have widespread economic and social impacts globally. At the outset, we identified three key sustainable investing themes for 2021 that guided our interactions throughout the year.

Climate and natural capital

Our climate and natural capital engagement considered the growing awareness of the measurable financial risks posed by climate change, resulting in the destruction of natural capital and the loss of biodiversity. In 2021, we continued working with companies to raise the bar on climate-related disclosures; for example, leading engagements with some of the world's largest GHG emitters as part of the Climate Action 100+ group (see page 34). We also increased our work with companies on other specific climate related risks. For example, we took part in a collaborative engagement with several other asset managers to track deforestation across the supply chain using satellite data as well as continuing to engage on palm oil (see page 42). As outlined above, we updated our Voting Policy and Guidelines to serve as a key lever for engagement to hold companies to account in relation to the ambition of their climate strategies. Finally, at COP26, we committed to eliminate the risks of commodity-driven deforestation from our portfolios by 2025, underpinning our commitment to addressing climate change.

Employee welfare

In 2021 the 'S' in ESG sprang to prominence for companies and investors. Social issues stemming from the pandemic became a key component of sustainable post-pandemic recovery plans, as companies faced increased workforce and supply chain pressures. Focusing on modern slavery (see page 53) and employee welfare, during the year we engaged with companies on their Covid-19 remuneration structures (see page 58) and increased engagements on other key social issues.

Digital ethics

Promoting digital ethics as a theme recognised the importance of digital inclusion as a critical factor in the digital economy. While many investors are aware of the tremendous opportunities enabled by the digital economy, there has been less understanding of and attention paid to the potential risks. With this in mind, in 2021 we further developed our engagement framework for "digital ethics" that we had established in 2020. The key pillars of this framework include: cybersecurity, data governance and privacy, misinformation, online welfare, and ethical artificial intelligence. We engaged directly with numerous technology companies on these issues, seeking to better understand their approaches and to promote more disclosure and better practices. We established ourselves as the lead investor on a collaborative engagement initiative that is being launched by the World Benchmarking Alliance (WBA) in 2022 specifically to address concerns related to ethical artificial intelligence.

Key themes for 2022

Outcomes from COP26 and our renewed emphasis on materiality shifted our engagement priorities as we entered 2022. Building on our themes from 2021, we have identified three key themes for our engagement this year:

Deforestation

Forests play a critical role in climate change mitigation and biodiversity preservation: they are home to 80% of the world's biodiversity and serve as carbon sinks, absorbing a third of the CO_2 released from burning fossil fuels. But despite the important role they play, 10m hectares of existing forest cover are still lost each year (this is concentrated in areas where the carbon storage capacity of trees is higher than average) while the rate of reforestation is declining according to the Food and Agriculture Organisation. As a result, there has been an average decline in biodiversity of 68% since 1970 (according to the World Wildlife Fund), while the impacts of climate change become ever more apparent.

As responsible stewards of capital, we have a fiduciary duty to protect our clients' capital and deliver long term sustainable returns. Unabated loss of our forests will undermine the ecosystem services on which over 50% of global gross domestic product (GDP) is moderately or highly dependent (according to the World Economic Forum), and it is inconsistent with our commitments to achieve net zero.

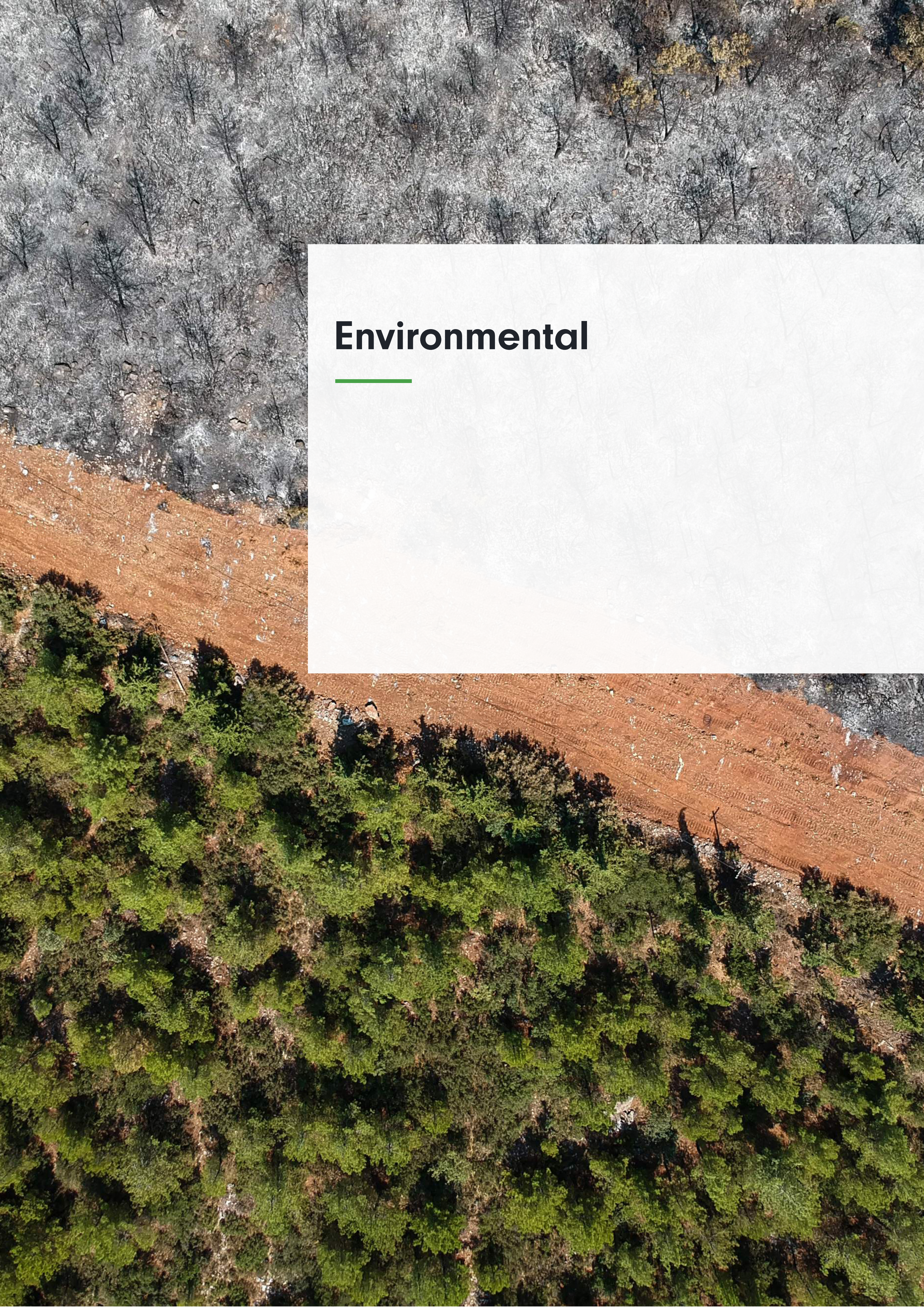
Just transition

Across the globe, we must work collaboratively to decarbonise as rapidly as possible if we are to stem the fallouts from climate change. But efforts to decarbonise should not leave certain groups of individuals or communities whose livelihoods are dependent on fossil fuels or carbon intensive industries behind, either economically or socially. When engaging with companies on climate change and implementing our own decarbonisation strategy, we explicitly integrate the principle of a "Just Transition", pushing companies to consider the social implications of their decarbonisation approach. A Just Transition also forms a core aspect of our thematic engagement on thermal coal, where energy security implications and inclusivity are embedded in the engagement's objectives (see page 39).

Double materiality

Double materiality recognises that companies are not only responsible for managing the financial risk of the social and environmental factors upon which they depend. Companies are also responsible for the actual impact that their business has on people and the planet. The concept of double materiality forms the foundation of our proprietary sustainability ratings and engagement activities. Double materiality also speaks to how we view Fidelity's own sustainability footprint. It is embedded in what we do, rather than standing as a distinct concept on its own.

Environmental



Climate

A large and growing share of our stewardship activity is focused on climate change and its related risks, which we believe is the most significant long-term systemic risk facing investee companies.

As outlined above, in 2021, we launched our Climate Investing Policy and to meet the ambitious goals outlined in our policy we emphasised the crucial role of climate stewardship. From routine company dialogues and proxy voting to focussed transition engagements, we believe embedding climate change in our investment stewardship will be critical to catalyse and accelerate the transition to net zero.

Our policy explicitly identifies minimum standards that we expect issuers to adhere to including setting and reporting on ambitious targets aligned to the UN's Paris Agreement on climate change.

2021 also saw the announcement of our revised Voting Principles and Guidelines, with a commitment to vote against directors at companies that we believe are failing to adequately address the risks and opportunities posed by climate change.

We expect investee issuers to have policies in place to reduce carbon and other GHG emissions. They should also be able to adhere to potential regulation on climate change, as well as have a strategy to reduce Scope 3 emissions and to make assumptions about carbon pricing.

Our policy explicitly identifies minimum standards that we expect issuers to adhere to including setting and reporting on ambitious targets aligned to the UN's Paris Agreement on climate change. The expectations captured in our policy are applicable to all issuers in which we invest, extending to a range of asset classes beyond equities including fixed income and private assets, where we may not have voting rights.

Through our engagement, voting, and collaboration in industry initiatives, we are determined to ensure that the decarbonisation of our investment portfolios is aligned to the goals of the Paris Agreement.

For more information about our climate stewardship approach, visit our Climate Investing Policy and Voting Principles and Guidelines. →

528

Engagements on climate change, including energy consumption and GHG emissions.

Committed to phase-out thermal coal from our portfolios by 2030 in OECD markets and by 2040 globally, via intensive and time-bound **transition engagements**.*

Source: Fidelity International, 2022.

Climate change is a key and increasing focus of our corporate engagements. In 2021, our fundamental and sustainable investing analysts engaged extensively with companies to improve the ambition of climate change strategies and quality of disclosures in over five hundred engagements.

In these interactions, we promote decarbonisation strategies aligned with the Paris Agreement goals and disclosures of GHG emissions data across all scopes. We also advocate for TCFD-aligned reporting that clearly defines oversight and responsibilities for climate strategy, and assessments of climate-related financial risks and opportunities.

Beyond direct dialogues, we believe industry collaboration is imperative to support our ambition of a low-carbon transition. Our involvement with the Institutional Investors Group on Climate Change (IIGCC) and Climate Action 100+ initiatives is a critical aspect of our collaborative engagement on climate, and examples of this are detailed in two case studies below. Our engagement also extends to policymakers, where we regularly contribute to public consultations on financing the transition to net zero and the role that asset managers can play.

5

Climate Action 100+ engagements where Fidelity is a co-lead or participant.

*For further information refer to our Climate Investing Policy.
Source: Fidelity International, 2022.

Case study

BHP Group

Reason for Engagement:
Fidelity's managed funds have a substantial combined position in the company. We meet with company representatives regularly in the context of our active management and analysis. In 2021 our engagements focused on the development of the company's climate strategy, following extensive engagement in 2020 on its work with its communities.

Details of Engagement:
In July 2021, Fidelity's investment team met with the chair of BHP. We discussed the company's climate scenario analysis, decarbonisation target-setting, and its engagement with industry associations over climate policy. The board's view is that the company's exposure to copper, nickel, and steel/iron ore holdings means it is well positioned for the shifting demand patterns associated with the low-carbon transition.

While the company has set Scope 1 and 2 carbon reduction targets, it has found it challenging to set meaningful Scope 3 (i.e. indirect emissions reduction) targets, reasoning that there is not yet a clear pathway to achieving them (although they have set targets around product shipping and procurement). We advised there is a need for metals & mining companies to set Scope 3 targets and that this requires greater attention at the industry association level, and we strongly encouraged the company to pursue setting science-based targets, noting that many of the company's Asia-based steel producing clients are starting to set their own targets. The chair agreed that greater client uptake of target setting would help but suggested that the public's attention needed to shift from a focus on targets to outcomes.

We also expressed concern about the market-wide failure to factor carbon impact into commodity prices. BHP operates with its own internal carbon price, but the chair agreed that disclosure on product carbon intensity needed to improve.

Following our discussions earlier in the year, during Q4 we took the decision to abstain on BHP's climate transition plan, which the board submitted to a shareholder vote at the AGM. While we assessed the company as having made substantial progress on its climate disclosures, governance, and target setting during the past several years, we did not believe that its Scope 3 emissions reduction targets were ambitious enough to merit support, particularly since the company envisaged providing shareholders with a vote on its climate plan only once every three years. At the AGM, we supported a shareholder resolution asking the board to report on how its capital allocation to various types of fossil fuel assets will align with a 2050 net zero emissions scenario.

Following the vote, we have been engaging with the company and other iron ore miners to see how they can play a bigger role in the reduction of their Scope 3 emissions, including exploring practical solutions whereby Scope 3 target setting could become fully controllable. These efforts are ongoing.

We also hosted a call with BHP in December 2021 to discuss the issues surrounding the diesel fuel rebates scheme in Australia. We highlighted the pressure we were seeing from activists, superannuation funds, and industry groups on this issue, and encouraged the company to move proactively with other major miners to address this emerging risk to their social license to operate. These are ongoing conversations, which we will continue to report on as they evolve.

Climate Action 100+

Involvement
Climate Action 100+ signatory and participant in collaborative engagements.

Details and Outcomes of Engagement
We are co-lead investors in the collaborative engagement with Sasol, South Africa's largest integrated energy and chemicals company, which commenced in 2020. So far, the company has been receptive to our feedback. It has made significant progress in developing and implementing its climate strategy, notably releasing its 2030 and 2050 decarbonisation roadmaps in 2021.

Sasol is one of the highest emitters in Africa and hence its combined Scope 1, 2 and 3 emissions make it systematically important in the global transition to net zero. The company plays a central role in the South African economy, providing energy security as well as many jobs. Therefore, the company's decarbonisation plans must consider the broader socio-economic consequences, to achieve a just transition.

In the first half of 2021, Sasol announced that it planned to increase the ambition of its transition plan, with publication of updates expected at its Capital Markets Day in September. Throughout 2021, leading up to the publication of the updated plan, Fidelity and the Climate Action 100+ investors engaged in constructive ongoing discussions with the company. Ahead of the Capital Markets Day, we communicated our expectations for Sasol's decarbonisation strategy to the company's board and executive leadership team. This included our expectation that Sasol publish a transition plan through to at least 2030 consistent with the 'Just Transition', plus details of how the company's capital allocation will support the transition. We also called on Sasol to align with the Climate Action 100+ Net-Zero Company Benchmark.

When Sasol published its 2021 Climate Change Report at its Capital Markets Day, we were pleased to see that the report addressed several of the key areas that we had highlighted, indicating a marked increase in the ambition of its climate strategy.

The report included a commitment to achieve net zero by 2050, as well as increased ambition of the company's Scope 1 and 2 targets from a 10% reduction by 2030 to a 30% reduction (vs 2017 baseline). The company has also set a target to reduce its Scope 3 emissions from the company's energy business by 20% by 2030 (vs 2019 baseline). In addition, the company laid out roadmaps to guide on GHG emissions reductions for its Energy and Chemicals business and a 2050 roadmap for the Energy Business.

While the Climate Change Report demonstrated encouraging progress for Sasol, we believe that gaps remain in the company's transition plans. Crucially, Sasol's decarbonisation roadmaps are still not consistent with a 1.5°C pathway. Climate Action 100+ investors continue to engage with Sasol, shifting their focus to the execution of the company's decarbonisation plans and the inclusion of short-term (pre-2026) milestones. In the near term, our discussions will also look to highlight the impact that GHG emissions could have on the company's cost of debt, with a major refinancing of Sasol's capital structure pending in 2022.

During the year, we have also been monitoring the progress of Grupo Mexico as we initiated engagement in 2020. The company released its 2020 Sustainability Report in July 2021, which included more information on governance. Responsibilities of the chair of the board of directors and the Sustainable Development Committee management are now explicitly outlined. The company has also aligned its reporting to the TCFD recommendation. It conducted a physical risk analysis as well as an analysis of the potential impact of increased carbon prices based on three scenarios including International Energy Agency, Sustainable Development Scenario and Intergovernmental Panel on Climate Change 1.5. Whilst several engagement milestones were met, we will continue our discussions with the company regarding their plan for reducing carbon emissions and setting robust targets.

1,300+

Letters sent to companies about our new voting policy, including our expectations for climate change strategy, disclosures and oversight.

58%

Votes against management on climate -related shareholder proposals* (40/69).

*Including abstentions
Source: Fidelity International (2022), ISS (2022).

Through our revised Voting Principles and Guidelines we committed to vote against directors at companies that we believe are failing to adequately address the risks and opportunities posed by climate change.

While we implemented this policy from January 2022, we launched an extensive programme of engagements in the second half of 2021 to identify and address companies that fell short of our expectations. This included a letter sent by our Global Head of Research to over 1,300 companies outlining our expectations, which in turn led to a significant number of company dialogues.

We also witnessed a marked increase in the number of climate-related shareholder proposals at company meetings in 2021. Considering the universal materiality of climate change, we are broadly supportive of proposals that seek to increase disclosure and prompt more ambitious decarbonisation strategies, while avoiding overly prescriptive demands. We tend to apply an even higher standard to high emitters, recognising the significant transition and physical risks faced and perpetuated by these companies.

2021 also saw the emergence of several Say-on-Climate proposals, where companies offered shareholders an advisory vote on the current climate strategy, or progress against it. We are broadly supportive of the initiative as we believe the proposals offer another mechanism for shareholders to signal their views around transition strategy. However, as exemplified in our case study with BHP outlined in this report, we think it is important to appropriately scrutinise plans for these mechanisms to have the intended effect.

Looking ahead: Climate stewardship and thermal coal engagement

We made significant steps forward on climate change stewardship in 2021 and our efforts are accelerating throughout 2022. Two major milestones of our climate stewardship efforts have been the implementation of our Voting Principles and Guidelines focussed on climate change and our first transition engagements tackling thermal coal exposures in our portfolios in the second half of 2022.

Holding directors accountable on climate change

We have been engaging extensively with companies since the launch of our new Voting Principles and Guidelines to ensure companies understand Fidelity's principles and expectations for corporate behaviour across a variety of environmental, social, and governance-related issues. As part of this process, we have focussed on companies falling short of our expectations on the management of climate-related risks and opportunities, arranging one-to-one engagements with input from across our investment team (including analysts and portfolio managers) to promote action by companies on this urgent aspect of strategy.

Generally, we have seen promising signs from the majority of companies in focus, with many substantially enhancing their disclosures, target-setting and governance around climate change in their FY21 reporting. Yet despite signs of progress, we are aware that many companies are still failing to adequately respond to the threats that climate change poses to their businesses, whether transitional or physical in nature. To ensure a transition to net zero which is aligned with the goals of the Paris Agreement, we will continue to engage with these companies to encourage greater ambition in their climate strategies.

Systematically engaging on thermal coal exposures in our portfolios

With the launch of our Climate Investing Policy in September, Fidelity announced a commitment to phase out issuers exposed to thermal coal by 2030 in OECD markets and by 2040 globally, consistent with the International Energy Agency's "Net Zero Emissions by 2050" (NZE) scenario.

In line with our investment philosophy, we have decided to take an active engagement approach to tackle thermal coal exposures in our portfolios. The global thermal coal value chain and its incentive structures are highly complex, and we fear the unintended consequences of an exclusively exclusion-led approach could be disastrous for our overarching aim: to achieve an inclusive decarbonisation of the global energy system which is aligned with the goals of the Paris Agreement.

Our engagement, which is commencing in 2022, will focus on identifying the systemic drivers behind the continued role of thermal coal in our energy mix and will seek to influence an expedited phase-out of unabated coal throughout our portfolios (and beyond) in a manner consistent with the Paris Agreement.

For more information about our approach to climate change, view our TCFD report.

Nature

Our economic system and the benefits we derive from it are highly dependent on the Earth's natural capital, from which we derive key ecosystem services. Natural capital is a complex dynamic system in which biodiversity, the diversity of living species, interacts with the non-living environment defined by hydrological, geological, chemical, climate-related and geographical parameters.

Since 1970, there has been an estimated 68% decline in biodiversity. Further, it is estimated that approximately 50% of global GDP is moderately or highly dependent on nature according to the World Economic Forum. As such, the preservation of biodiversity and ultimately the reversal of this loss is critical to ensuring the long-term prosperity of the world's global economy.

We expect issuers to understand their dependencies and impacts on biodiversity. Issuers must conduct biodiversity impact assessments of their operations and supply chains and where relevant commit to achieve net zero deforestation within clear timeframes.

Moreover, biodiversity loss and climate change are closely linked. Climate change is one of the major threats to biodiversity and is expected to become the dominant driver in coming decades, acutely so in tropical regions. On the other hand, preserving biodiversity and natural capital can play a key role in mitigating climate change.

Given the dependence on ecosystem services for the functioning of the global economy, we expect issuers to understand their dependencies and impacts on biodiversity. Issuers must conduct biodiversity impact assessments of their operations and supply chains and where relevant commit to achieve net zero deforestation within clear timeframes. This extends across the supply chain, from producers of key deforestation risk commodities, such as palm oil, beef, soy, timber and pulp, to food manufacturers, fast-moving consumer goods (FMCGs), as well as key enablers, such as financial institutions.

We expect issuers to minimise the negative externalities caused by their businesses including but not limited to water usage, waste management, product quality, chemical safety and deforestation.

At COP-26 we committed **to eliminate commodity-driven deforestation from our investments by 2025**, on a best-efforts basis as part of a broader investor coalition. →

Natural capital featured as one of our key themes for 2021, and we have undertaken engagement on several nature-related topics throughout the year.

One example has been our plastics thematic engagement, where we have engaged with several FMCGs on plastic packaging. The primary objective of this engagement is to encourage FMCG companies to embed the principles of the circular economy into their business models, with the ultimate goal of reducing the impact of plastic pollution on biodiversity. We also seek to identify and assess the risks and opportunities these companies are exposed to as a result of their use of plastics.

Other highlights during 2021 were our public support of the Business Call for a UN Treaty on Plastics at the United Nations Environment Assembly 5.2 and our signing of the Finance for Biodiversity Pledge. Of particular note was our commitment at COP26 to eliminate commodity-driven deforestation from our investments by 2025 on a best-efforts basis. As part of this commitment, we will also provide enhanced disclosure of exposures and mitigation activities for managing deforestation risk by 2023.

In our voting activities, we encountered relatively few nature-related shareholder proposals, however, we largely supported items we perceived to address material risks while remaining non-prescriptive.

198

Engagements related to nature including biodiversity, waste management and water usage.

73%

Support for nature-related shareholder proposals, including those focussed on plastics, terrestrial biodiversity, and water management (8/11)*.

*Including abstentions
Source: Fidelity International (2022), ISS (2022).

Case study

Biodiversity

Involvement
Fidelity has partnered with ACTIAM, a Dutch asset manager, on two collaborative engagement initiatives addressing biodiversity impacts. This engagement addresses deforestation across the supply chain, based on satellite data.

Details and Outcomes of Engagement
In 2020 we joined a collaborative engagement programme, led by ACTIAM, in partnership with Satelligence, a geodata-analytics company, to measure and reduce company-specific deforestation.

The group conducted engagements with multiple companies to address cases of deforestation, detected through the use of satellite data, calling for companies to implement policies and improve governance to eliminate deforestation from their activities.

Following the first phase of engagement in late 2020, we acted as co-leads on a series of engagements focused on companies that source palm oil from Indonesia and Malaysia.

Adopting a similar structure to the first phase, our engagements comprised two target groups:

- Group A: Companies which do not disclose their supplier lists for soft commodities. Given the lack of transparency, it is not possible to source satellite data for these companies to assess deforestation impacts. Often, the base level of understanding of deforestation impacts and risks is limited. Hence for this group of companies, engagement is initially focused on education and encouraging companies to increase transparency.
- Group B: Companies that do disclose their supplier lists for soft commodities. Satellite imagery is used to capture incidents and rates of deforestation, using data from Satelligence. This data informs our conversations with the companies, addressing these impacts and encouraging companies to implement policies and controls to eliminate deforestation impacts from their operations.

We were able to engage in constructive dialogue with companies. In Europe, major FMCGs are well aware of the challenges associated with deforestation and have clear policies and controls in place to address them including monitoring and verification systems for their palm oil supply chains, as well as grievance systems for reporting deforestation incidents. There is increasing awareness of the need for greater transparency. Many companies which do not yet disclose their supplier lists have plans in place to do so.

Best practice is where companies hold suppliers accountable for incidents of deforestation and suspend relationships with suppliers who breach deforestation policies. Roundtable on Sustainable Palm Oil (RSPO) certification remains the industry standard, and some companies are setting associated targets to reach full certification.

However, challenges remain. A lot of palm oil is grown on small holder farms, which poses a challenge to traceability. In Indonesia and Malaysia, approximately 40% of palm oil production comes from farms smaller than 50 hectares. The fragmented nature of the supply chain means that there are many players contributing to the issue. However, given the spotlight has been on palm oil for some years, deforestation risks associated with palm oil are more high profile than other soft commodities, such as beef, timber and soy.

The group will continue its ongoing engagements, while also engaging with more companies, across a broader range of sectors, across the supply chain. Fidelity is leading engagements with three companies based in China, where issues of deforestation are not widely addressed.

While progress has been made to address deforestation risks associated with palm oil, a lot remains to be done. At COP26, we joined a group of 30 financial institutions committing to implement best efforts to eliminate deforestation triggered by agricultural commodities from investment and lending portfolios by 2025. Engagement will play a critical role in achieving our goals, and collective action by investors can be an effective means to steer companies towards better practices.

Big brands need to clean up on plastics

Alexander Laing
Analyst & Portfolio Manager

Matthew Jennings
Investment Director
Sustainable Investing

Harriet Wildgoose
Sustainable Investing Analyst

Growing exponentially since the 1980s, the volume of plastic we discard has become one of the world's biggest problems. Cheap, light, and often less carbon intensive than glass, plastic has huge advantages for manufacturers, but less than 9 per cent of the 400 million tonnes produced annually is ever recycled. Around one rubbish truck of plastic leaks into the ocean every minute, with disastrous consequences for marine life.

As a part of our broader push on biodiversity and building a circular economy, therefore, Fidelity engaged late in 2021 with nine major consumer goods producers who themselves use thousands of tonnes of plastic a day, on their plans to reduce pollution. The companies were chosen based on the amount of their packaging that leaks into the environment and most are holdings within Fidelity's funds. The results show many of the companies will struggle to meet at least some of the targets they have set themselves. However, they also suggest that firms from Nestle to Unilever to Coca-Cola are making progress. Promoting the adoption of targets and holding companies to them will be central to Fidelity's efforts to drive sustainable outcomes in the years ahead.

Most of the companies we met with are signatories to the Ellen MacArthur Foundation's Global Commitment on plastic reduction, whose targets and methodology for measuring progress towards a circular economy we also recommend using. The following are selected highlights from the engagement meetings with the companies.

Coca-Cola

The consumer world's biggest plastic user, Coca-Cola, long ago outsourced its bottling to a web of regional providers. Their performance on sustainability varies, but Coca-Cola has committed to making all plastic bottles recyclable, compostable or reusable by 2025 and most of its bottlers are already close to those targets.

However, while the plastic packaging used by Coca-Cola may be recyclable, only a fraction is ever actually reprocessed. So new approaches are needed for the company to reduce the number of its bottles and cans that wind up as waste in the long term.

Unilever

All of the corporates we engaged with target some level of reduction in virgin plastic use, but Unilever is the only large fast-moving consumer goods company to have set an overall plastic reduction target, i.e. both virgin, newly-produced plastic and recycled plastic.

This should be best practice for the industry. Chemical and mechanical recycling, which use different techniques to reuse material, are important, but in the longer run the overall volume of plastic being used must fall.

Unilever's target for 2025 is a 100,000 tonne-reduction in the 700,000 tonnes it used in 2020, including a 50 per cent reduction in virgin plastic. While the numbers are not directly comparable, other companies we engage with are only targeting reductions in virgin plastic in the range of 5-33 per cent.

Colgate/Mondelez/Proctor & Gamble

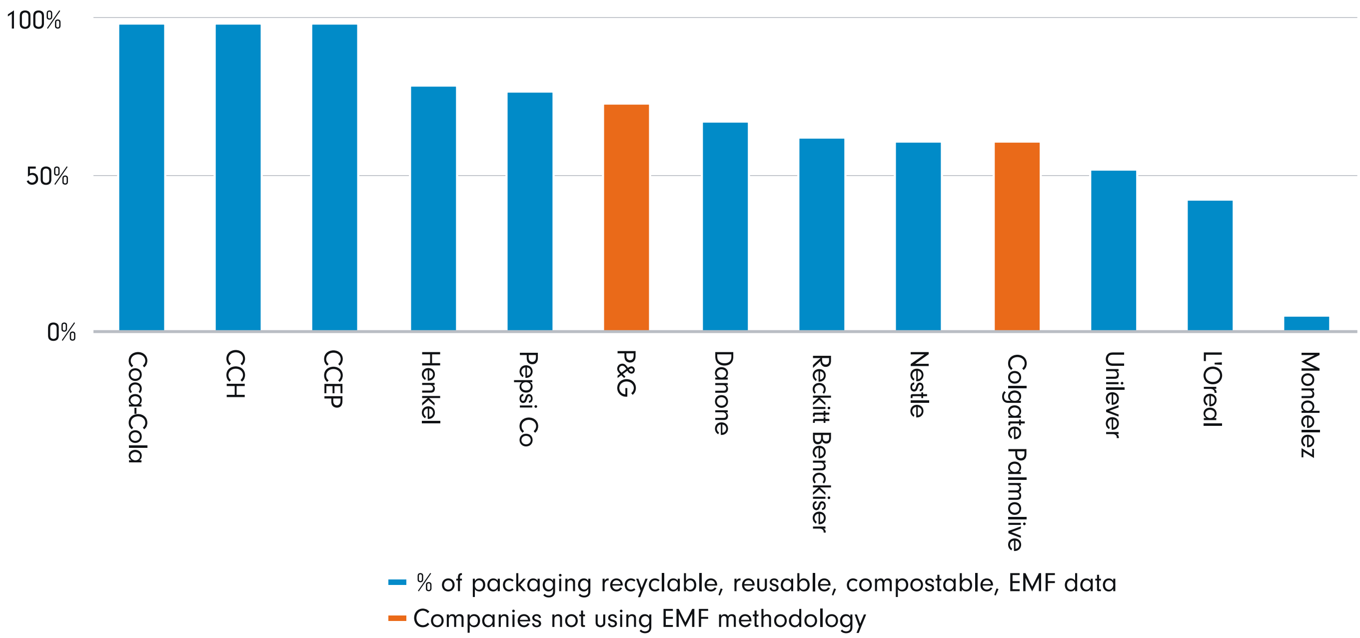
Colgate just last year launched the first recyclable toothpaste tube, eliminating the aluminium foil which had historically made tubes difficult to reprocess. Importantly, it has shared the innovation with competitors - a move we applaud and encourage others to follow.

On the other hand, Oreo-cookie maker Mondelez trails its peers largely because it uses flexible, thin packaging that is not currently recyclable in the way a Coca-Cola bottle or an ice-cream tub is. This is a long road: currently, only five of the 17 types of plastic used in packaging are recyclable at scale. Progress depends on technological innovation and possibly broader changes to how or where products are sold and used.

The world's biggest FMCG group, Procter & Gamble, showed evidence of a thoughtful approach, developing promising technological solutions such as chemical recycling and digital watermarking of packaging and partnering with materials firm Eastman on its "molecular" recycling.

Many of those we engaged with listed supply of quality rPET - the plastic used, for example, in soft drink bottles - as a challenge. Food-grade PCR (post-consumer recycled plastic) is being bought by the fashion industry, which doesn't need food-grade, driving up the price for these plastics. Fashion items are generally not recycled after use, so potentially recyclable plastic is in effect removed from the circular system. Our team of analysts is now raising this in engagements with fashion companies.

Chart 7: Per cent of packaging that is recyclable, reusable, compostable



Source: Ellen Macarthur Foundation, company reports, Fidelity International, May 2022.

Looking ahead: Forests and fashion in focus

2021 was an important year in framing Fidelity's approach towards natural capital stewardship. Moving into 2022 we hope to continue progress on our plastic packaging thematic engagement. We will also be focusing attention on the development, and implementation, of two new engagements tackling deforestation and fashion's environmental sustainability.

Deforestation exposures in our portfolios

Since 2018, Fidelity has run a thematic engagement on palm oil, advocating for an end to tropical deforestation. We have engaged across the value chain, with a particular focus on palm oil growers in Southeast Asia. We are also widening the scope of our palm oil thematic engagement to cover all key forest risk commodities: palm oil, beef, soy, and paper/timber.

Our deforestation engagement will focus on companies and financial institutions where we have material holdings and which we have identified as being highly exposed to tropical deforestation risk. To eliminate agricultural commodity-driven deforestation risks across our investment portfolios by 2025 we will focus on encouraging boards to act on the issue as a matter of urgency, through timebound zero deforestation commitments and improved supply chain management. We will also continue to participate in several collaborative initiatives and investor working groups, helping to develop standards and address deforestation at the system level. Fidelity will be leading at least three of the phase II engagements as part of ACTIAM's satellite-based engagement towards zero deforestation.

Championing the circular economy: plastic packaging & sustainable raw materials

In January 2022 we completed the first round of our thematic engagement on plastic packaging pollution. In order to focus our engagement with FMCG companies going forward, we met with the Ellen MacArthur Foundation in February to discuss how our ongoing engagement can encourage companies to embed the principles of the circular economy into their business models. As we continue our engagement efforts in 2022, we will be encouraging the harmonisation of reporting standards; we believe that the comparability of information is key for investors. There is still plenty that companies can do to reduce their total use of plastics and improving the transparency of disclosures is a big part of the challenge. Moving forward, we will be pushing for more disclosure around the level of investment in research and development and lobbying activity in plastic packaging.

The environmental impact of the fashion industry is significant, with the industry accounting for up to 10% of global GHG emissions. This year we have started engaging with several investee fashion brands to encourage increased disclosure and target setting surrounding raw materials sourcing and supply chain mapping. Generally, there is no consistent approach to raw material

Social

Employees

We believe that inclusive organisations that hire, foster, promote, and remunerate employees on the basis of merit and without regard for gender, age, race, ethnicity, religion, sexual orientation, economic background, disability or other factors make better use of their human capital.

By effectively managing the needs of their stakeholders, companies experience enhanced organisational performance in the long run. Whether focussed on diversity, equity, and inclusion (DEI) or human rights and modern slavery, our engagements aim to promote best practice in human capital management with this tenet in mind.

As mentioned earlier in this report, our revised Voting Principles and Guidelines outlines expectations for firms in developed markets to ensure female representation of at least 30% on the board, and 15% in other markets. We held numerous conducive discussions with boards following the launch of the policy with some notable positive outcomes already witnessed.

While board diversity served as the impetus for engagement in several circumstances, our focus during these engagements often extended beyond the boardroom. We encourage investee companies to establish comprehensive and effective non-discrimination policies and actively ensure that these policies are upheld. They are also encouraged to regularly review their hiring and promotion practices to ensure against bias, and to set ambitious diversity targets appropriate to the business. We expect companies to demonstrate alignment with our belief that diversity helps deliver long-term shareholder value. A later case study, covering our work as part of the 40:40 Vision initiative, provides some insight into our engagement on this topic.

515

Topics covered during employee-related engagements, including diversity, employee management, supply chain management and operation safety.

54%

Votes against management on employee-related shareholder proposals, including those focussed on pay equity, civil rights audits, workplace sexual harassment and modern slavery (39/72)*.

201

Votes against directors for failing to address a gender imbalance in their board membership, and meet board diversity targets of 30% in developed markets and 15% globally*.

*Including abstentions
Source: Fidelity International (2022), ISS (2022).

Another critical focus of our engagement in this area is human rights and modern slavery. Inadequate management of a company's supply chain can expose it to reputational, operational and legal/regulatory risks as well as hidden and uncontrollable risks, such as human rights abuses and corruption. Fidelity plays a key role in several long-running initiatives that focus on human rights and modern slavery, an example of one such collaborative engagement with Investors Against Slavery and Trafficking, APAC (IAST) is detailed later in this section.

We expect issuers to practice fair treatment of workers, including contractors and sub-contractors, and we look for decent wages, collective bargaining policies, freedom of association and grievance mechanisms. These expectations also apply to issuers' supply chains, to the extent that they should take responsibility, and be able to account for both the human and materials sourcing side of their supply chains. Issuers should have measures in place to ensure suppliers meet a code of conduct, applicable to tier 1 and 2 (at the minimum with a plan to apply it to beyond tier 2) suppliers, with robust policies and training in place to help find and mitigate against instances of modern slavery.

We also encourage companies to examine the risks of modern slavery and the broader risks of labour exploitation, as this is a leading indicator of modern slavery, by running a risk-based mapping exercise of their supply chain that could help companies to achieve better visibility of the supply chain across sectors and geographies and identify the more at-risk suppliers to prioritise their focus.

Customers and communities

Fidelity also engages with a range of companies on other social issues that we broadly define as affecting either customers or communities. Examples range from responsible marketing or product/service quality (customer-related impacts) to broadened access for basic goods/services (community-related impacts).

During 2021, a notable focus in this domain was access to medicine. In April 2021, Fidelity joined the Access to Medicine Foundation's collaborative effort in accelerating an equitable Covid-19 medical response. This focused on encouraging high-income companies to increase their financing of the Access to Covid-19 Tools (ACT) Accelerator, as well as working alongside 157 investors and peers to devise innovative financing tools. By leveraging Fidelity's existing healthcare stewardship activities with investee companies, we started to engage with large pharmaceutical and biotechnology companies to promote the ACT Accelerator and the need to enhance research and development, the manufacturing of the vaccine and other related solutions. During the third quarter, we met with four companies (Eisai, Otsuka, Novo Nordisk and Wuxi Apptec).

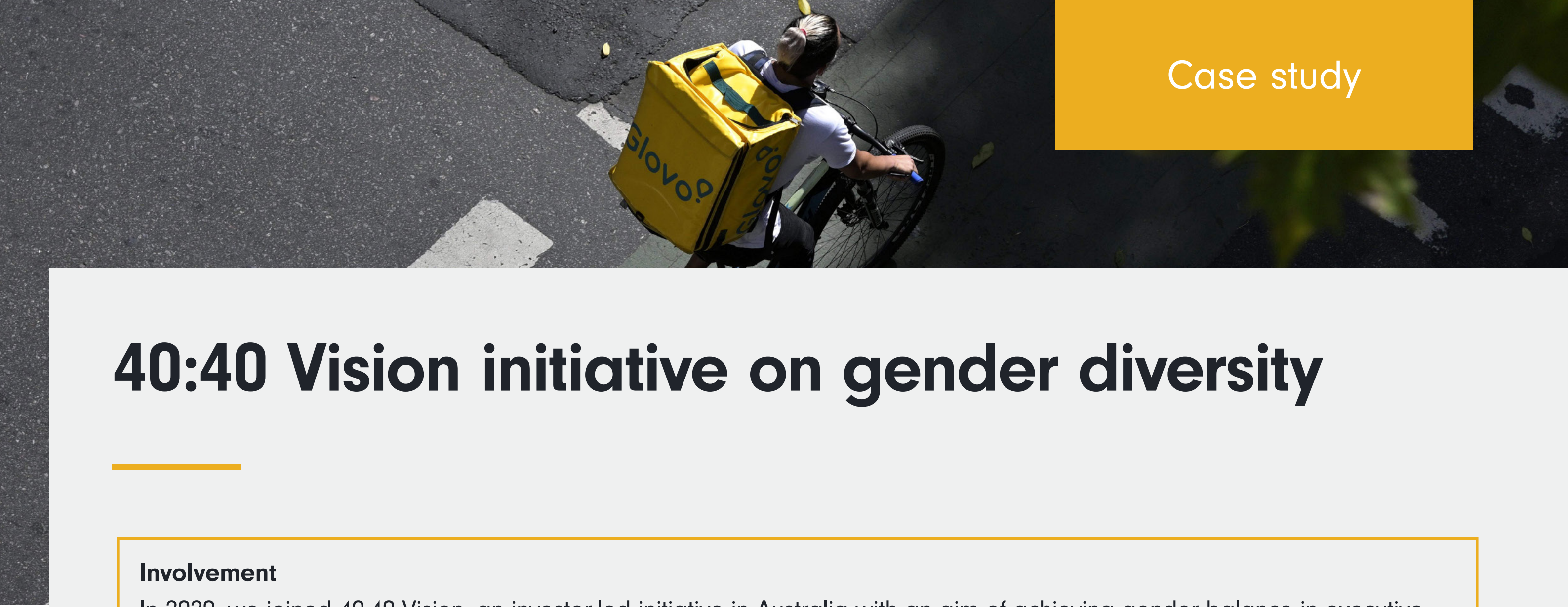
297

Topics covered during customer and community-related engagements.

56%

Votes against management on shareholder proposals related to customers and communities, including those focussed on political lobbying, public health and community impacts (53/95)*.

*Including abstentions
Source: Fidelity International (2022), ISS (2022).



Case study

40:40 Vision initiative on gender diversity

Involvement
In 2020, we joined 40:40 Vision, an investor-led initiative in Australia with an aim of achieving gender balance in executive leadership across all ASX200 companies by 2030. The initiative is actively encouraging companies to set and publicly report on their progress against composition targets (40% women, 40% men and 20% any gender) for executive leadership (CEO -1). An investor letter was sent to the ASX200 at the end of 2020 explaining the 40:40 Vision goals and requesting companies to sign up to the initiative and publish their composition targets. We have led engagements with several companies associated with the initiative, and have also discussed the initiative with several companies in our pre-AGM engagements, including Charter Hall, Blackmores, Lendlease, Evolution Mining, and Channel 9.

Details and Outcomes of Engagement
At the very end of 2020, we initiated our first engagement in association with the initiative, with Domino's Pizza Enterprises Limited, a franchise license owner of Domino's Pizza operating in Australia, New Zealand, France, Belgium, the Netherlands and the Principality of Monaco. The meeting was initiated following the letter that was sent to the ASX200 companies. The company has not historically had company-wide targets or gender quotas, but it does have board level targets. When we spoke to the company, the leadership team was all male, although the company did have one female joining in February 2021.

Following the receipt of the letter, the company informed us that it has committed to setting the 40:40:20 targets. The company is also looking to address gender diversity at the company level, ensuring they there is 50:50 representation during the recruitment process. It is also looking at peer practices to understand and establish best practice. The company faces some structural headwinds; much of the senior management team come from franchisees, where most of the employees are drivers, who are predominantly male. To address this, the company has set up internal groups to review the current talent pool of women in the franchises and has recently elected the first female to their Franchise Advisory Council.

In 2021, following our engagement, the company announced its target to achieve at least 40% female representation on the board of directors, for global leadership and for country/regional leadership, publicly pledging its support for the 40:40 Vision. The company is also a member of the 30% Club, committing to achieve at least 30% representation of women on all boards and C-suites, a threshold the company has already reached. The company has shown strong progress in committing to improve gender diversity at all levels of the firm. We will continue to monitor progress towards the 40:40 Vision target and diversity at the company wide level.

The second company that we have engaged with is PolyNovo Ltd, following the engagement letter that we sent to the company under the 40:40 Vision scheme.

The company stated that they historically have not had targets or quotas for gender diversity at any level within the company, but they do track this data internally on top of other diversity factors such as race and religion. Their company's board consists of approx. 30% females, while managerial positions (CEO-1) have 55% female representation. The company appreciates the value of gender diversity at the board level, and while their primary focus is on hiring board members with the relevant skill sets, gender diversity is an important consideration when reviewing board composition.

The company hires firstly based on competence and performance and does not bias any single role towards a particular gender. While the company is supportive of the 40:40 Vision and has already aligned with the objectives of the initiative, it was not in a position to set short-term targets at the time of our engagement. We will continue our dialogue with the company and encourage improvements.

Case study

40:40 Vision initiative (continued)

We also engaged with CSR Limited, a manufacturer and supplier of building materials. The company confirmed that it is moving to 50% female representation at board level. In relation to the executive leadership team, it is moving towards 37% female representation on the back of a pending director replacement. However, gender diversity more broadly across the workforce remains a challenge.

At CEO-2 level, females represent just 27% of the workforce, while across the entire company just 21% of employees are female. The company has set in place a target to increase the CEO-2 level to be in line with the executive leadership.

The company recognised the positive feedback loop associated with increasing gender diversity: the more women that they recruit into senior roles, the more female talent the company will attract. However, there are structural challenges that CSR faces. The manufacturing industry on average has just 27.5% female representation. The company is aware of this challenge and is concentrating on creating a female talent pipeline for the future, with diversity being a strategic focus area for the company in 2021. It was encouraging to see that the company has a number of initiatives in place to promote improved female representation, including its recruitment practices and career development programmes. The company was receptive to the idea of signing up to the 40:40 Vision and we plan to follow up our engagement with the company soon to monitor progress.

From our engagements and pre-AGM discussions, companies have been generally supportive of the idea behind the 40:40 Vision. At the board and executive level, many companies have already implemented targets and have made progress to encourage increased gender diversity. At the company level, the dynamic is more nuanced. Companies may face structural headwinds, recruiting from a pool of talent which lacks gender diversity. In these instances, it is important that companies implement controls to prevent bias in their recruiting process and develop schemes to support the development of more diverse talent at all levels of the organisation.

We see 40:40 Vision as part of our overall diversity and human capital engagement and will continue to embed it into conversations with companies. Beyond that we will follow up with companies where Fidelity is a company lead and encourage them to set targets and join the initiative.

China Gender Diversity Report

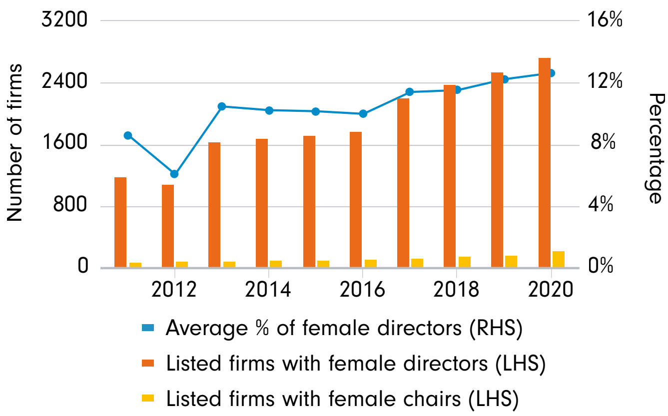
China's steps towards greater gender diversity have lagged its remarkable economic growth of recent decades, and women today remain on the periphery of company boards and top managements.

However, there are signs of progress, as reflected in recently improving gender ratios. A new generation of female executives is rising slowly through the corporate ranks, while gender equality in education is improving and public acceptance of female leadership is growing.

At Fidelity, we believe a diverse leadership team can better steer a company on a sustainable path and we seek to promote gender diversity both internally and at our investee companies. To better guide our work with Chinese investees, we have taken a close look at the policies and measures of China's top 50 companies and presented key findings in our first China gender diversity report.

We used the number of female directors as a key gauge of corporate gender diversity. As in most parts of Asia, public awareness in China over the importance of gender diversity has generally lagged the West - although China in many respects still fares better than neighbours like Japan, South Korea and Indonesia. Our inaugural report on gender diversity in corporate China finds a slow but steady rise in gender inclusivity at listed Chinese firms, with the improvements more notable as younger generations rise through the ranks.

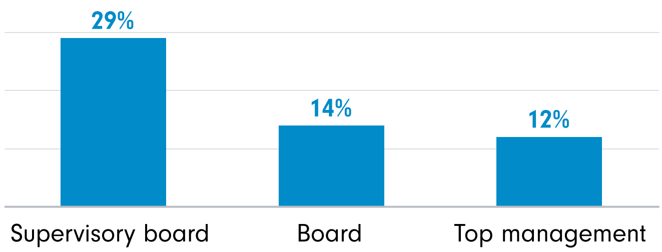
Chart 8: Female directors and chairs rise in China



Source: Nankai University, Fidelity International, December 2021.

Our analysis of A50 stocks found that women accounted for 14% of directors, while at the supervisory board level, female ratios average 29% for the 50 firms. Under China's Companies Law, at least one third of supervisory board seats must be held by ordinary workers, whose more balanced gender divide often helps boost the supervisory board's female representation.

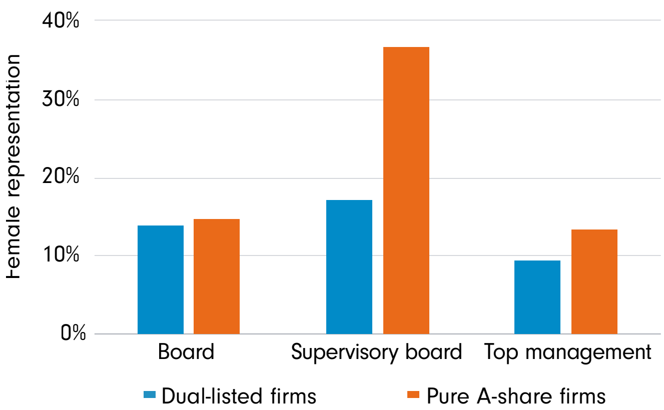
Chart 9: Average female ratios for China's A50 firms



Source: Fidelity International, December 2021.

We also found that companies cross-listed in mainland China and Hong Kong are usually less diverse than purely onshore firms. One possible explanation for the gap is that dual-listed Chinese firms are often state-owned enterprises (SOEs). And those SOEs, which account for about one third of China's economy, have lagged significantly behind the country's private-and foreign-invested firms when it comes to gender diversity.

Chart 10: Pure A-share A50 firms outperform dual-listed ones on gender diversity



Source: Fidelity International, December 2021.

Moreover, our findings point to the top Chinese companies taking a compliance-driven approach to gender diversity. Hong Kong-listed firms are required to say in their annual reports whether they have a board diversity policy. Nineteen members of the A50 index have done so, albeit 17 of them are dual-listed in Hong Kong. The implication is that few companies seem to have taken a step beyond the minimum regulatory disclosure requirements.

Based on our engagement with some of the leading companies on this issue in China and globally, we think there are measures Chinese companies can consider that would advance corporate gender diversity. First is to develop systematic support measures for female workers. This includes setting specific gender targets for recruiting C-suite members and appointing board directors and committing themselves to non-discrimination practices for promotion and pay. Second, we believe setting up a nomination committee for the board of directors, ideally chaired by a woman, could also lead to more organised efforts to achieve a more diversified board. It is equally important to offer adequate maternity leave and support for childcare.

Engaging companies in a dialogue and using our shareholder votes have proved to be the most effective means by which we can articulate our views on diversity and push for change. For example, we engaged with a large food and beverage company in China in 2021 which had no female directors on its board despite most of its customers being female. We emphasised the importance of having female representation on its board especially given its customer base. Disappointingly, at the annual shareholder meeting subsequent to our engagement, the company failed to appoint any female directors. This led us to vote against the re-election of the board chair and several other directors we believe should be held accountable for the poor board composition.

Since the annual shareholder meeting, however, the firm appointed its first ever female director to the board in December 2021. While we were preparing this report, the Chinese government announced its new 10-year national plan on the development of women and children, setting out some 200 objectives and measures for advancing women's rights in areas such as employment, healthcare, and education. Against this favourable policy backdrop, we are confident that corporate gender diversity will keep improving in China, as we remain committed to engaging on the issue.

Case study

Investors Against Slavery and Trafficking

Involvement
In 2020 we became a founding member of IAST working with companies in the Asia Pacific region on how they can more effectively take action on human rights risks within their operations, specifically focusing on modern slavery and labour exploitation in the supply chain.

Details and Outcomes of Engagement
We engaged with a consumer discretionary company in China to assess progress on increased disclosure on supplier audits and human rights assessment following an earlier letter sent to the board on the topic.

The company had recently appointed a sustainability lead, initiating a review of their sustainability policies and procedures, including their supply chain management and human rights monitoring policies.

While these initiatives were encouraging, the company must focus on effectively executing these plans and reporting on progress, which will be the focus of future engagements.

In 2021, we also engaged with a palm oil company as part of a collaborative initiative. Overall, the company was very open with regards to discussing their current progress towards addressing human rights issues in the supply chain and their own operations. The company is aware of key issues and has undertaken several projects to improve transparency and mitigate risk. However, gaps remain, and the nature of the industry makes 100% transparency challenging. Potential areas of improvement relate to the behaviour of smallholders, their buyers and suppliers; a more structured risk assessment; and enhanced disclosure regarding instances of breaches and remedial action taken, which will be the focus of future engagements.

Developments in engagement on modern slavery

Q3 2020
- Joined Find it, Fix it, Prevent it*

Q4 2020
- Became a founding member of IAST
- Commenced engagement as part of Find it, Fix it, Prevent it, focusing on the UK hospitality sector

Q2 2021
- Commenced modern slavery engagements as part of IAST

*An initiative which aims to bring together the investment management industry to push for meaningful, effective corporate action to end modern slavery.

Looking ahead: Diversity and human rights

In 2021 we conducted extensive engagements with Japanese companies in relation to achieving at least 15% female board representation. In 2022 we will continue to engage with those firms that are still failing to meet the 15% board gender diversity target and encourage firms overall to build a pipeline of diverse talent.

Building further on a range of initiatives

Through our involvement in the 40:40 Vision initiative we will look to continue to encourage diversity at the board level across ASX300 companies with a particular focus on developing opportunities for diverse candidates across organisations.

As part of Find it, Fix it, Prevent it, in 2022 our engagements will extend from the hospitality industry to the construction industry with a view to engaging with construction companies to develop and implement better processes for finding, fixing and preventing modern slavery.

With IAST we will continue our engagement efforts working with companies in the APAC region on how they can address human rights risks within their operations.

Governance

Oversight

We expect companies to have a robust corporate governance framework that can define long-term, innovative strategies and implement them for the benefit of all stakeholders. Vision and effective oversight are key to building a company with sustainable long-term success.

Effective boards play a critical role in the strategic direction of an issuer, and overseeing risk management processes. We expect the majority of board members to be independent with the suitable skills to fulfil supervisory duties as well as provide guidance and constructive challenges to executive management. We expect boards to reflect or demonstrate a plan for improving gender, ethnic and cognitive diversity.

Issuers should promote an ethical culture and code of conduct that permeates throughout the organisation. Corrupt business practices represent a significant investment risk and create negative externalities for the broader economy and society. The board should ensure that the issuer fosters a culture of acting lawfully, ethically and responsibly. To this end, the board should ensure that the issuer has adequate whistle blower, anti-bribery and corruption policies in place and is actively monitoring the application of those policies.

In 2021, we set out expectations for the number of boards directors should serve on and encouraged companies to be mindful about director refreshment. We also asked companies to consider periodic refreshment of their auditor as a matter of best practice and, particularly in the US where audit tenures can be decades long, we have been engaging and starting to vote against companies that have not made the requisite changes.

For more information on our approach to oversight and investor rights, visit our latest UK Stewardship Code Submission or Voting Principles and Guidelines. →

915

Oversight topics raised during engagements.

569

Votes against directors owing to independence concerns*.

*Including abstentions
Source: Fidelity International, 2022. ISS, 2022.

Incentives

At Fidelity, we believe that how management teams are paid plays a powerful role in creating value for our clients and ensuring equitable outcomes for a range of stakeholders. We promote clear, simple and well-designed remuneration structures that incentivise senior managers to deliver on company strategy while aligning with the interests of shareholders and other key stakeholders.

We engage extensively with board members and company management on executive pay to drive best practice and deliver positive outcomes for our clients. The topic was the centre of over 488 engagements with companies in 2021, often occurring in the lead-up to an AGM or during remuneration consultations with board members. To guide our engagement, in 2021 we published our Voting Principles and Guidelines, outlining our expectations and minimum requirements for executive pay in a transparent manner.

The fundamental principles we seek to promote during engagement on management incentivisation are long-termism, transparency, and outcomes that appropriately reflect stakeholders' experiences. A number of our policies aim to explicitly address these principles, for instance minimum requirements around the retention period of equity awards or aligned executive pay during the pandemic at recipients of government support. Where appropriate, we consider market and industry context when evaluating remuneration arrangements, across both our sustainability ratings and stewardship activities. And where appropriate, we escalate our concerns by voting against directors at companies unresponsive to our requests.

Increasingly, we view management incentivisation as a critical influence on progress towards sustainable outcomes. When effectively structured, remuneration may help to internalise the negative externalities arising from corporate activities: ranging from decarbonisation agendas to DEI performance. To this end, we expect remuneration policies to be consistent with effective risk management, including the management of sustainability risks.

For more information on our approach to oversight and investor rights, visit our latest UK Stewardship Code Submission or Voting Principles and Guidelines. →

488

Engagements focussed on incentives.

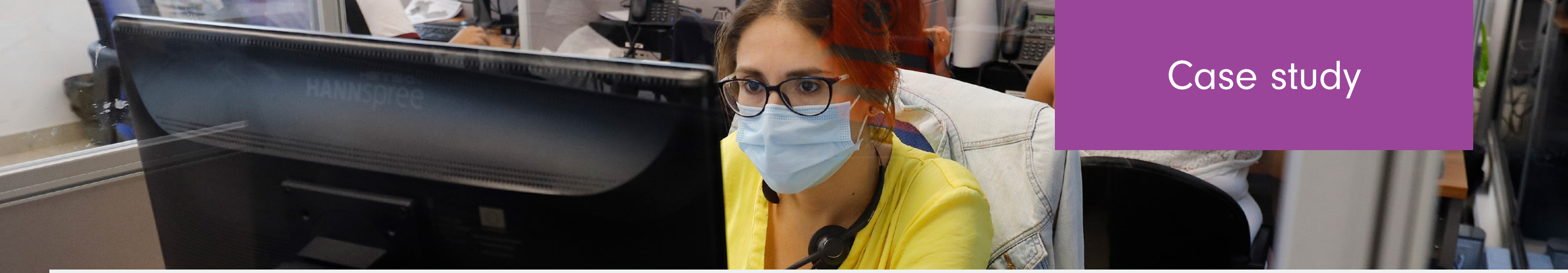
25%

Votes against management on remuneration-related proposals (1,155/4,590)*.

173

Number of times we escalated our remuneration concerns and voted against a director.

*Including abstentions
Source: Fidelity International, 2022. ISS, 2022.



Case study

Covid-19 and executive remuneration

Background

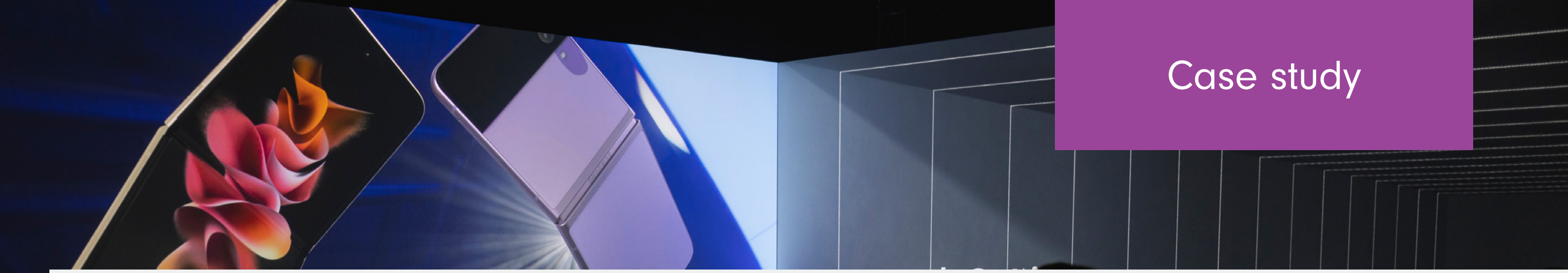
Subsequent to our letter writing campaign in 2020 where we sent letters to a number of our larger holdings (in the UK, Australia and Continental Europe) outlining our expectations on executive pay decisions in the wake of Covid-19, we opened dialogues with a number of investee companies to explain our position, encourage best practice, and discuss pay decisions the board had reached.

Outcome

For those companies where we concluded that remuneration outcomes did not appropriately align with stakeholders' experience during the pandemic, we sought to escalate our concern through our voting. During the period from Q4 2020 through Q3 2021, we voted against 109 companies globally based on concerns around remuneration practices related to the Covid-19 pandemic. The majority of these cases were companies that received taxpayer support under government furlough or wage subsidy schemes and then went on to pay bonuses to senior management.

> We opened dialogues with a number of investee companies to explain our position, encourage best practice, and discuss pay decisions the board had reached.

We believe that our engagement contributed to corporate behaviour in some markets. In the UK, where the broader investment community has been closely engaged on this issue, many companies that experienced only temporary disruption toward the beginning of the pandemic paid back their furlough support funds. Also, we observed a number of Australian companies paying back JobKeeper (wage subsidy) support prior to the 2021 AGM season in Q4. We had encouraged investee companies to do this in engagements prior to and during the 2020 Australian AGM season, and the issue received broad attention after several companies which had paid substantial executive bonuses but had refused to pay back subsidies were publicly 'named and shamed' by members of parliament and other stakeholders. In other markets (e.g. continental Europe), the issue received less public attention - in some cases because taxpayer supported 'short time work' schemes and similar arrangements are longstanding in certain countries and industries - and consequently our engagement appeared to have less impact on corporate behaviour.



Samsung Electronics Co. Ltd.

We are a long-time shareholder of the company and engage regularly through various means. Following the publication of the company's three-year shareholder returns policy and a meeting in February 2021 to discuss ESG issues with the company, we wrote a letter to the chair in April to express concerns about executive remuneration and capital allocation practices and to advocate for change.

Historically, the influence of the controlling shareholder family has led to weaker corporate governance not aligned with best practice, but steps have been taken in recent years to address this. In light of the 2020 announcement that management control would not be passed down to the controlling family's heirs, we told the chair that we believed the time was right for senior executives to begin regularly receiving equity-settled remuneration to build up ownership stakes and align their personal interests with shareholders. We suggested setting a meaningful portion of long-term incentives in stock, preferably with a minimum holding period of three years. We also expressed our belief that the board's capital return policy did not appropriately reflect the company's strong cash position and projected future cash flows, and that capital returns to shareholders should be increased in the absence of compelling alternatives.

In reply, the chair wrote that while the company recognised the benefits of stock-based remuneration and noted that a majority of the executive team are shareholders, it has opted for cash-settled incentive plans after having encountered problems with stock option plans previously. He noted that the current incentive scheme includes targets relating to stock performance and other financial metrics (ROE and EBIT margin) and said that the board was willing to continue looking for possible solutions. Regarding capital allocation, he explained that the excess cash on the balance sheet was there to allow management to execute capital expenditures in the challenging Covid-19 environment, and that returning cash from overseas to Korea was difficult due to tax considerations. We were told that the company planned to increase research and development, capital expenditure, and mergers and acquisitions expenditure going forward to maintain leadership in key areas.

Although the response indicated that the board will not be adopting our suggestions at this time, we appreciated the board's responsiveness and recognised that it has been making substantial improvements to the company's governance in recent years, for instance by splitting the CEO and chair roles, appointing a new external auditor, and forming a new independent committee to oversee compliance issues. We plan to continue engaging going forward.

Glossary

Double materiality: The requirement (as set out by the European Commission Non-Financial Reporting Directive) for companies to report both on how sustainability issues affect their performance, position and development (the 'outside-in' perspective), and on their impact on people and the environment (the 'inside-out' perspective)

Engagement: the active ongoing process of constructive dialogue with an issuer during which changes may be sought in relation to that issuer. This can involve frequent and lengthy dialogue with representatives of the company. For more general information regarding engagement please refer to page 54 of the UK Stewardship Code

ESG: means environmental, social and governance factors considered by companies, investors, public sector and other organisations in a wide range of decision-making processes and situations including, but not limited to, strategy, purpose financing, company reporting and supply chain management

ESG integration: the inclusion of ESG issues in investment research and analysis

Impact: positive and negative, primary and secondary long-term effects produced by an intervention, directly or indirectly, intended or unintended. (Source: Impact Management Project)

Negative externalities: a broad term which refers to negative effects or consequences of an act beyond a particular situation and includes, but is not limited to, the cost of an economic activity to an unrelated third party

Outcomes: the likely or achieved short-term and medium-term effects of an intervention's outputs (Source: Impact Management Project)

Paris Agreement: an international treaty that came into force in November 2016. The agreement is to limit the global rise in temperature from pre-industrial levels to below 2°C this century and ideally below 1.5°C

Stewardship (or active ownership): a broad term which refers to the use of influence by an active institutional investor seeking to maximise and preserve value including, but not limited to, overall long-term value for the benefit and in the best interests of clients and beneficiaries

UNFCCC: means United Nations Framework Convention on Climate Change

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Climate Investing Policy

Engagement Policy

Exclusions Policy

Real Estate Net Zero Carbon Commitment Roadmap

Sustainable Investing Policy

Sustainable Property Investing Policy

TCFD Report

UK Stewardship Code Submission

Voting Principles and Guidelines

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