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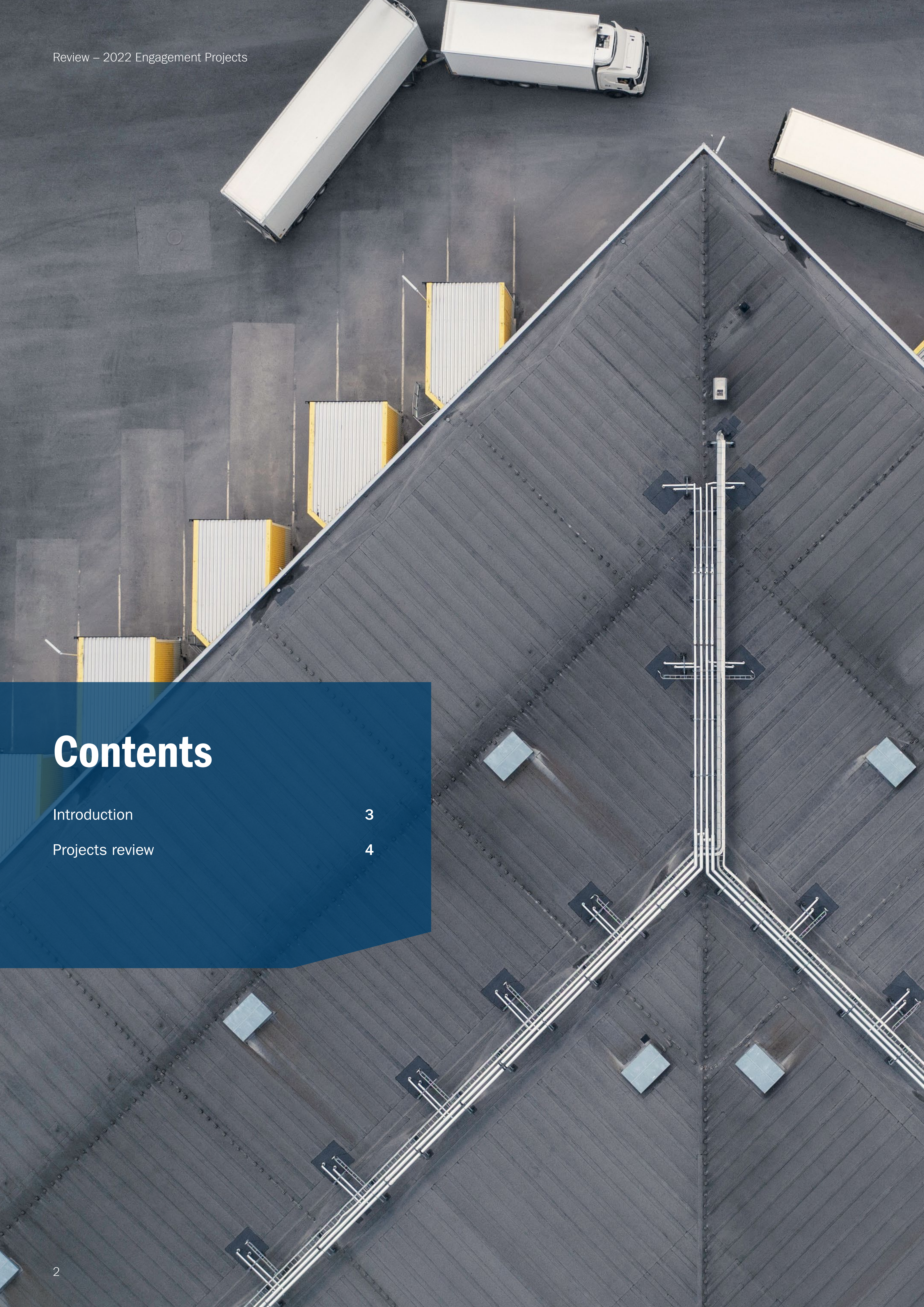
Engagement **Review**

2022 Engagement Projects

COLUMBIA THREADNEEDLE INVESTMENTS



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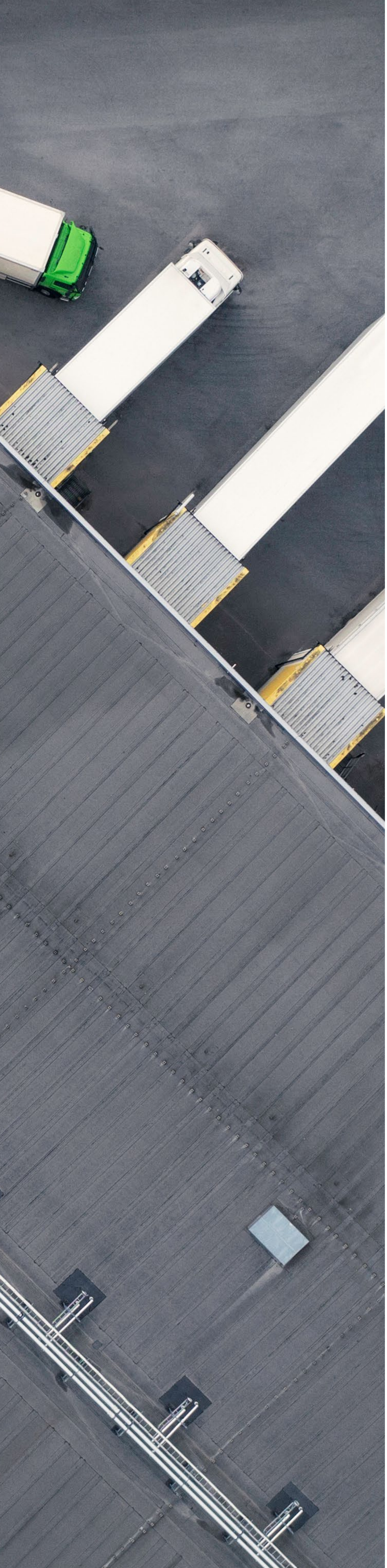


Introduction

At Columbia Threadneedle Investments, we strive to be responsible stewards of our clients' assets. As active investors, targeted engagement with issuers is an important part of our investment approach.

Ultimately, we view engagement not only as a tool to identify and manage environmental, social and governance (ESG) risks, but also as a mechanism to create positive impact for the environment and society by supporting the achievement of the United Nations Sustainable Development Goals (SDGs). Our engagement programme strives to build on long-term fundamental challenges that companies face in the ESG space as well as to identify and address new, emerging risks and opportunities.

Our thematic engagement projects are designed to drive real world impact. Priority themes, often linked to specific sectors and/or regions, are worked up into projects, that typically involve an outreach to a group of relevant companies as well as more intensive one-on-one dialogue with higher risk companies and sometimes public policy work.

This report provides a summary review of the engagement projects we undertook in 2022, and the progress we made within.

We publish this report alongside our Engagement Outlook, which details our thematic outlook and engagement projects for 2023.

Claudia Wearmouth

Managing Director,
Global Head of
Responsible Investment

2022 projects in review

Discover the progress we made with our thematic engagement projects over the past year.

Coal phase-out

SDG goal(s)

8 DECENT WORK AND ECONOMIC GROWTH | 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE | 13 CLIMATE ACTION

This project was launched several years ago to engage companies in key countries on the importance of phasing out coal in the energy system. Our activities focused on coal miners and utilities with significant coal exposure, in laggard countries and companies where we saw most potential for change, including the US, Japan and South Korea. With these key three nations having set net zero targets and updated their National Determined Contributions (country-level climate action plans to reduce emissions), our focus then shifted to identifying companies planning on expanding coal mining or power capacity. Given coal-reliant countries' struggles to develop sufficiently ambitious energy strategies, many of the same issuers appear in the second phase of the project.

As renewable energy costs continue to fall and the urgency of phasing out coal grows, identifying companies planning new coal projects in particular is key to avoid locking in high-carbon future stranded assets which hinder global efforts to align with a 1.5C pathway. This has been the focus of engagements with **BHP** and **Glencore**. We have scrutinised planned expansions of coal projects and ongoing capital expenditure on thermal coal respectively, despite their net zero strategies covering scope 3 emissions. **BHP** since decided to shut down their Mount Arthur coal mine in 2030 and we have been pleased by their commitment to ensuring a Just Transition for the workers and local community. **Glencore** have withdrawn from their Valeria project, citing global uncertainty and their net zero ambitions.

From a power generation perspective, **Vedanta** have also committed to not adding more thermal coal power capacity and are expanding their renewables operations. Utilities such as **Tenaga Nasional**, **Duke Energy** and **American Electric Power (AEP)** have coal phase-out plans. However, we continue to press for 1.5C alignment, incorporating this into our director voting decisions at **AEP** and supporting a shareholder resolution at **Kansai Electric Power** on coal phase-out.

Engagement going forward

Given coal phase out is intrinsically linked to all climate engagement with coal-linked issuers, the subject arises across engagements through Climate Action 100+ and bilateral climate calls with utilities, miners and infrastructure firms. We are also linking this project to our engagement on banks' climate strategies, pressing them to engage clients and ensure they develop Paris-aligned coal phase out plans. Improved data availability on the parties involved in expanding coal capacity is also enabling us to focus a next wave of engagements on key companies and projects.

Climate Action 100+

SDG goal(s)

We continue to be heavily involved in the Climate Action 100+ (CA100+) collaborative engagement initiative, acting as co-leads on eight engagement relationships and supporting a further 40. We also contribute to the strategic direction of CA100+ via the new Institutional Investors Group on Climate Change (IIGCC) Corporate Programme Advisory Group.

CA100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. A total of 167 companies that are critical to the transition to a low carbon global economy are being engaged. The three pre-agreed challenges for these companies are:

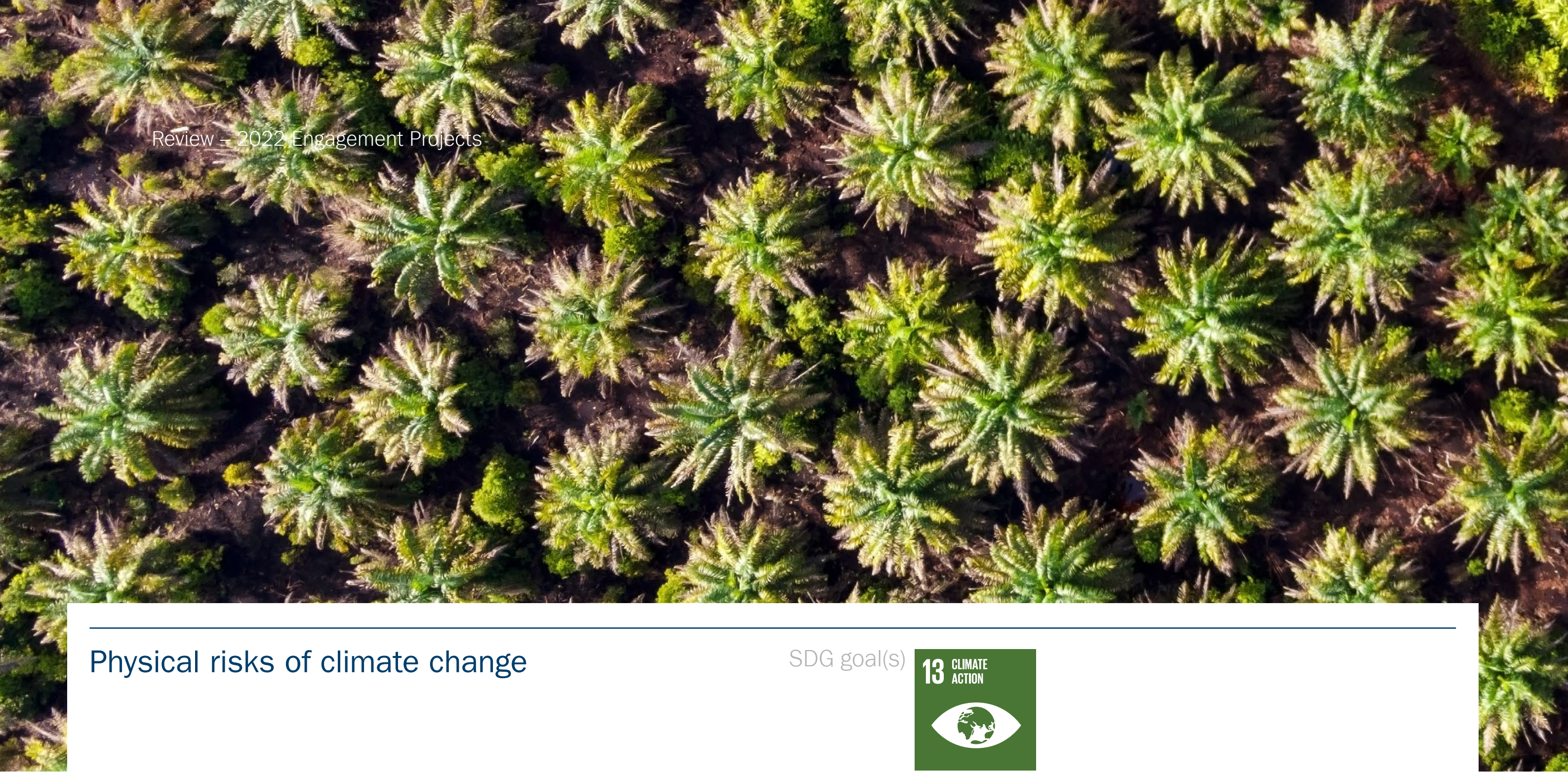
- To implement a strong governance framework on climate change
- To take action to reduce greenhouse gas emissions across the value chain
- To provide enhanced corporate disclosure.

We had more than 50 CA100+ engagement meetings in 2022. This resulted in the achievement of the following key milestones at companies with which we were engaged:

Climate Action 100+ comprises **700 investors** with **$68 trillion in assets**.

- **BP** strengthened their net zero commitment to include the lifecycle (scope 1-3) emissions from all energy produced, sold and physically traded, and forecast oil and gas production to decline by 40% by 2030.
- **Glencore** increased their medium-term absolute emissions reduction target by 10% to a 50% cut by 2050 and introduced a 2026 target.
- In automotives, **Stellantis** released their net zero by 2050 strategy and **Mercedes-Benz** and Toyota released climate lobbying reports.
- **Dominion Energy** expanded the coverage of their net zero target to include its upstream and downstream Scope 3 emissions, which make up 44% of their footprint.

Going forward we will re-classify our CA100+ engagement as regular collaborative engagement, without the context of being an engagement project. Engagement intensity and progress reporting will remain the same.



Physical risks of climate change

SDG goal(s)

This year we engaged a focused set of companies to understand how their current risk systems compare with investors' expectations on physical risk, as set out in the IIGCC Physical Climate Risks and Opportunities statement, and to encourage them to address any gaps. In 2022 we reached out to **Nokia**, **Renesas**, **Infineon**, **Lonza** and **Roche**. We also spoke to construction company **Vinci**, and electric infrastructure company **Quanta Services** about its physical risk and resilience; as well as embedding the topic in several engagements on climate change, including with heavy industry, such as cement and steel.

The results of the first round of engagements indicate that, in general, reporting and management of physical climate risks is nascent and far from the expectations set out by the IIGCC. For example, **Lonza** report that it is still in the process of developing a climate governance framework that considers physical risk, while **Roche** is still grappling with how it should approach reporting, modelling, and assessment of physical risk. **Vinci** report that insurance premiums are already increasing, due to the consideration of physical risks by insurances, and state that it intends to publish comprehensive scenario analyses addressing physical risk in 2023. Semiconductor company **Infineon** has established a governance process on physical climate risk. The issues are fed through to the Board from the Business Continuity Planning team at the local site level. While three of Infineon's sites are in water-stressed regions, the company has set associated water consumption targets.

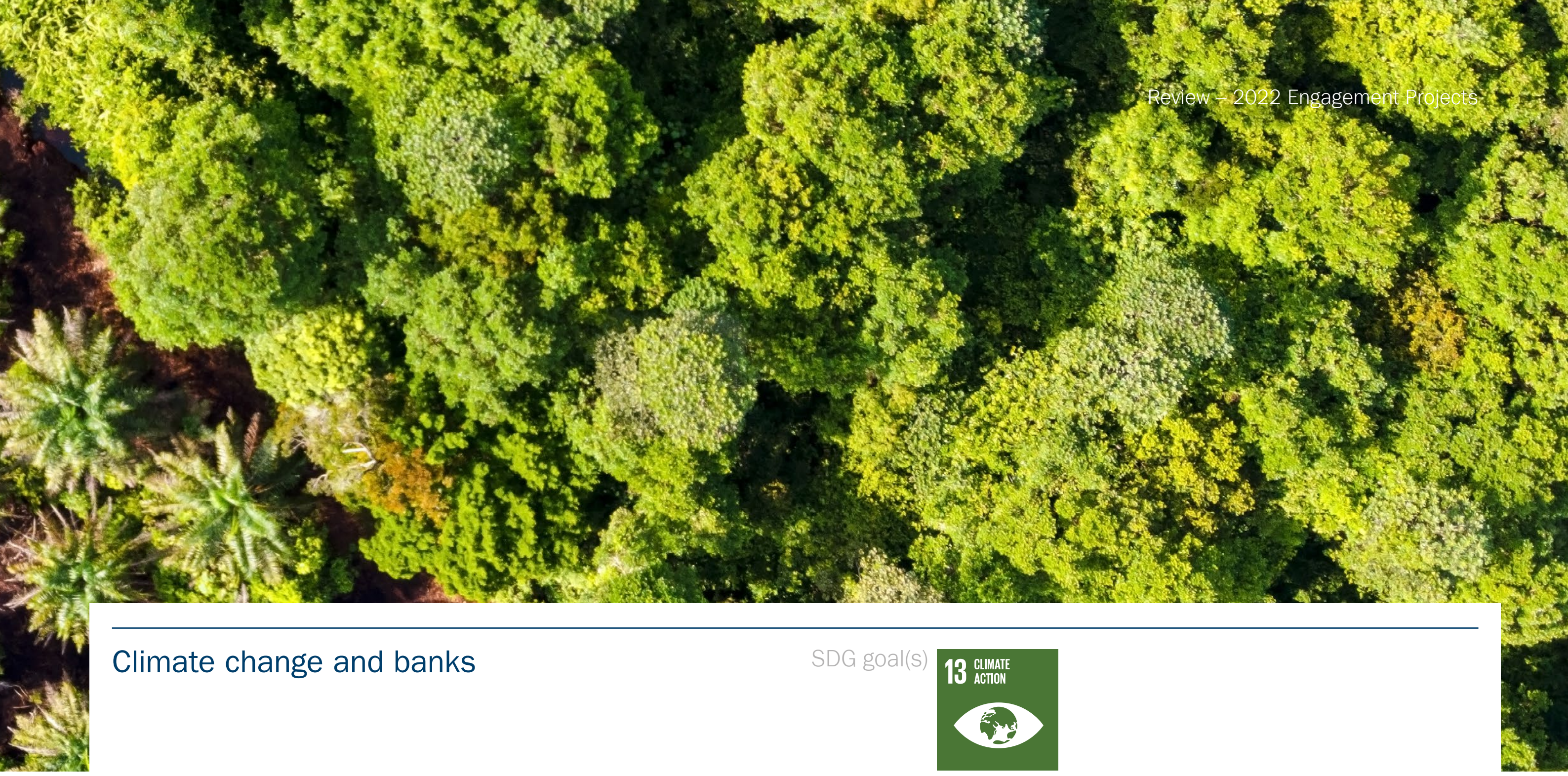
We also published **an insight-piece on the challenges of accounting** for and appraising physical risk exposure and management. This piece is particularly useful in the follow-up communications after engagements on physical risk, as it clarifies several of the more technical pieces of our engagements, including the value of conducting scenario analyses.

Looking ahead to 2023, we have re-designed the project and expanded its scope, anticipating that physical risk will be an area of increased focus. The motivation for our re-designed project was the summer of extremes witnessed in Europe: by August 2022 droughts were affecting ~60% of the UK and Europe, placing agriculture at risk. Major rivers that serve as crucial transport and trade routes, like the Rhine, Po and Thames, experienced abnormally low water leading to severe restrictions of cargo ships. Wildfires caused thousands of evacuations, as an area across Europe equivalent to about one-fifth of Belgium was engulfed. In the UK, TCFD reporting will also become mandatory this year, adding pressure on companies to report scenario analysis in-line with TCFD expectations.

We will use the backdrop of this year's events to engage companies on how they are managing and mitigating risks from climate change impacts today; and how they are preparing for the future. Using Moody's Four Twenty Seven physical risk data we identified sectors that are at high risk from water and heat stress in Europe over the next 10 to 30 years. This was matched with CERES materiality of direct operations to water stress, narrowing sectors to: utilities, chemicals, food and beverage. We will also engage with construction companies, due to the crucial role urbanisation will have in mitigating and adapting to risk.

Through this process we have identified 35 companies that we will contact in Q1 2023. We hope to re-assess by Q4 2023, expanding the scope of this engagement beyond Europe.

Approximately 60% of the landmass in UK and Europe was affected by droughts by August 2022.



Climate change and banks

SDG goal(s) 13 CLIMATE ACTION

Financial institutions have a critical role to play in delivering real-world decarbonisation to reach the global goal of net zero emissions by 2050. Through their lending, underwriting, advisory and capital market activities, banks can support the goals of the Paris Agreement, and other environmental outcomes, by reducing their financing of activities not aligned with these goals, while providing financing to low carbon solutions.

Following two years of engagement with more than 60 banks on their climate risk management including seeking commitments to net zero financed emissions, in 2022 we decided to focus our engagement on the implementation of these commitments, with an initial plan to engage with 10 banks as part of this project. Throughout the year we ended up engaging with more banks than we had initially planned, with 40 engagements with 21 different global banks taking place where we discussed their net zero strategies. Through these engagements, we requested banks to set interim financed emissions targets, disclose how they plan to align their financing activities with a net zero 2050 scenario, and clarify how they intend to tighten their fossil fuel financing policies. Additionally, recognising the important links between climate and nature, we also engaged with several banks including **Natwest** and **Credit Suisse** on biodiversity to better understand how they are looking to manage this emerging issue.

Several climate-related shareholder resolutions were filed at banks in the previous year, with a focus on aligning their financing with a net zero 2050 scenario. A number of banks also provided shareholders the opportunity to vote on their climate strategies through 'say on climate' votes. Overall, this reflects the increasing awareness of the important role that banks play in supporting the low carbon transition.

Progress in 2022

2022 saw over 60 banks publish their first set of interim targets financed emissions – part of their requirements as members the Net Zero Banking Alliance. Among the banks that we have engaged with during the year, we have seen significant progress in the implementation of their net zero commitments, including in setting targets, updating fossil fuel financing policies, and supporting clients through transition financing. In October, **Lloyds Banking Group** updated their climate policy, becoming one of a small number of banks to prohibit project financing for greenfield oil and gas developments. **Danske Bank**, in addition to their existing policies on project and corporate financing to oil and gas exploration and production, set a new target to reduce loan exposure to oil and gas production by 50% by 2030. Significant progress has also been made by banks in Asia, for example in Singapore we have seen ambitious and leading sectoral financed emission targets announced by both **DBS** and **United Overseas Bank**, covering a wide range of sectors and significant percentage of their loan books, alongside stringent fossil fuel financing policies and transition finance frameworks.

Engagement going forward

Going forward, we will continue to engage with banks on their management of climate risks and the implementation of their net zero commitments. However, this will focus on bringing financial institutions in line with our climate voting criteria, which will in general seek these companies to commit to net zero financed emissions and encourage them to respond to the Carbon Disclosure Project's (CDP) financial institutions climate change questionnaire.

A 45% reduction in global greenhouse gas emissions is needed in the next 8 years to keep on track to limit the global temperature rise to 1.5°C.

Emissions and plastic waste

SDG goal(s) 12 RESPONSIBLE CONSUMPTION AND PRODUCTION

This new project was aimed at the promotion of a sustainable transition within the chemicals industry. At the very core of this are two interconnected issues: 1) Reducing GHG emissions and 2) product stewardship. Through the former, we expect to see Paris-aligned climate strategies, whilst the latter should see the transition to a greener and safer portfolio of chemicals. Befitting of such a complex and heterogeneous industry, our project companies span a range of different sub-industries. Unsurprisingly, each of these comes with its own unique set of challenges regarding the transition. Kicking off at the start of 2022, we reached out to 20 of the largest chemicals companies globally.

Key learnings in 2022

Whilst the industry still has a long way to go to achieve our desired outcome, receptiveness to our engagement has been, on the whole, positive, with calls held with many of our target companies. Aside from conducting one-to-one engagement, we also engaged collaboratively through initiatives such as ShareAction's Chemicals Working Group – targeting decarbonisation within the European chemicals sector – and ChemSec's ChemScore initiative – looking to promote the sustainable management of hazardous chemicals.

Across the industrial gas companies – among the biggest emitters in the chemicals industry – climate strategies are predominantly focused on reducing emissions within own operations (Scope 1 and 2), where the bulk of their overall emissions lie. Here, we were encouraged to note that both **Linde** and **Air Liquide** had their 2035 emissions reduction targets approved by the SBTi during the year.

Elsewhere, we saw commodity chemicals company **Lyondellbasell** – a leading producer of basic chemicals for the industry – announce accelerated Scope 1 and 2 targets, as well as an absolute Scope 3 target. Within specialty chemicals, such as paints and coatings companies **PPG Industries** and **Sherwin Williams**, the key theme was embedding product sustainability by design. However, whilst we increasingly see companies track the sustainability of their product portfolio through internal metrics (covering issues such as toxicity, circularity and durability), the challenge remains in formulating an industry standard to allow for comparison of products across the board. We will look to encourage collaborations across the sector as we hope to turn such a standard from a hopeful ask to a realistic aim.

95% of manufactured goods rely on chemicals, and the chemicals industry is the third-highest contributor to carbon emissions in the industrials sector.

Energy efficiency in the real estate industry

SDG goal(s) 11 SUSTAINABLE CITIES AND COMMUNITIES 13 CLIMATE ACTION

Last year we kicked off our project on energy efficiency in residential real estate, which aims to engage issuers on the refurbishment and development of energy efficient homes. Incoming EU climate regulation aims to tackle the nearly 40% of emission that are caused by energy consumption, two thirds of which is in the residential sector. While the US lags on regulation, a shift in government indicates new regulatory risks for real estate investment trusts (REITs).

This year, the project proved more relevant than ever as soaring energy prices across Europe pushed consumers into a cost-of-living crisis and spotlighted energy security and waste. Throughout 2022 we met with 11 companies to discuss how energy and climate is being integrated into their strategies. We also expanded our engagement to cover physical risks and TCFD reporting, as a summer of extremes highlighted the need for better climate resilience of real assets. The results show large divergence in climate disclosure across the REITs. Leading the pack, **Unite Group** (UK student accommodation) and **AvalonBay** (US multi-family housing) had the clearest climate strategies, with targets attached to energy efficiency as well as how to achieve net-zero. We were encouraged by the level of disclosure (both report to the Global Real Estate Sustainability Benchmark and the CDP), as well as their ESG teams' ambition and future vision. Both these issuers report the full scope 3 – made somewhat easier for **Unite Group** as they cover energy bills for students – which is material to REITs as their main emissions profile is related to downstream leased assets. With these two issuers we had in-depth and insightful conversations, including on the potential for a green-premia and the need for better physical risk data.

American Homes 4 Rent, **Invitation Homes** and **Irish Residential** lagged in disclosure and reporting. For these REITs the conversation had to be peeled back to ask for bare due diligence on climate, including CDP reporting, TCFD reporting and setting climate targets. However, we notice clear momentum in the sector, with all three issuers recently hiring sustainability teams, while disclosing to us that climate and sustainability strategies are in the making.

We spoke to two Scandinavian issuers **SBB** (Sweden) and **Kojamo** (Finland), who we view as having relatively good reporting, as well as German REIT **Vonovia**. However, none of these REITs report on tenant-purchased energy which leaves a huge gap in understanding the climate footprint of the issuers. Two of these calls were attended by the firm's CEO, and there was a great deal of curiosity about the strategies of their peers, including on scope 3 emissions.

We believe these conversations gave opportunity for production engagement, and we have followed up with detailed examples of peer practice on scope 3 reporting, net-zero strategies and TCFD reporting. In subsequent engagement with **Vonovia's** in-house expert team we will aim to gather more detail about how climate change is integrated into asset management and acquisitions. With regards to new developments, we note that **Kojamo** exploring the implementation of AI-based systems to monitor energy use, while **SBB** is engaging with tenants on how to reduce scope 3 emissions. In Scandinavia, grid-decarbonisation is happening at pace, putting REITs in a position to benefit from reduced emissions.

Reflections from our engagement

Overall, the main topics of discussion have been about Scope 3 reporting – to allow for a baseline at which to reduce emissions – and the need for actual targets. We have also touched on what energy efficiency measures are pursued as well as more sustainable construction, such as encouraging procurement policies for climate aligned materials. Overall we believe that there is a new momentum in the real estate sector, which has often been overlooked for climate engagement, giving ample opportunity for constructive conversations going forward.

Protecting biodiversity

SDG goal(s)

The biodiversity project started off covering 21 companies across the materials, extractives, finance, consumer staples and transportation, identified as high impact using the ENCORE tool. The aim was to gain better understanding of risks, impacts and best practices across the issue, before expanding the scope of our work. This expansion occurred rapidly, with the team conducting 661 engagements with 409 issuers on nature issues from January-mid December 2022. We have also been able to draw on insights from our engagements to develop **a best practice framework** which will be used to guide both future engagements and the evolution of our modelling capabilities.

A notable engagement theme was land use and deforestation – a key driver of biodiversity loss – building on our multi-year engagement on social issues and emissions . Bringing in new guidance and data sources allowed us to expand above and beyond the typical sectors to those less obvious: an example being our work in **automotive value chains**, where leather production & use is a large source of deforestation risk that has received far less attention than deforestation linked to the food industry. Our work on other drivers of deforestation includes collaborations through the PRI's Soft Commodities Practitioners Group, Ceres' Working Group on Land Use and Climate and the Investor Policy Dialogue on Deforestation.

Highlights of our engagement

There has been significant improvement in nature strategies of extractive industries, with both **Teck Resources** and **BHP** setting nature positive targets. Companies such as **BP** and **TC Energy** have followed our recommendation of joining the TNFD Forum and inform us that they have found it extremely helpful, whilst **Iberdrola** continues to be a leader in the space with a robust strategy and natural capital accounting. **Archer-Daniels-Midland** tightened its zero-deforestation deadline from 2030 to 2025, signifying strengthened efforts to address deforestation and protect biodiversity in its supply chain.

We also reached out to 15 banks in emerging markets to highlight the importance of managing biodiversity risks. Many banks in Asia already have policies relating to palm oil, however improvement is needed on their broader biodiversity approach.

Nature Action 100

As a natural progression from our biodiversity project and Environmental Stewardship approach we have also been part of the Lead Investor Group setting up the Nature Action 100 collaborative engagement initiative, which had a soft launch at COP15. Nature Action 100 aims to drive greater corporate ambition and action on tackling nature loss and biodiversity decline. Investors intend to engage companies in key sectors that are deemed to be systemically important to the goal of reversing nature and biodiversity loss by 2030, ensuring companies are taking timely and necessary actions to protect and restore nature and ecosystems, whilst simultaneously engaging policymakers on the outcomes of COP15.

Tens of billions of dollars in assets could be at risk of stranding over the next 5 to 10 years if companies continue to produce deforestation-linked commodities.

Human rights and indigenous people's rights in the energy industries

SDG goal(s) 16 PEACE, JUSTICE AND STRONG INSTITUTIONS

Our project on Human rights and Indigenous Peoples' rights in the energy and extractives industries started in 2021 through deepening our awareness and approach to the issue as well as developing best practices in the sector through engagement with companies and key stakeholders globally. In total we held 37 engagements with 25 companies on the subject of indigenous peoples' rights, including several with companies in the oil and gas sector.

Whilst Australian mining companies' actions precipitated wider investor awareness of indigenous rights issues, the energy transition also poses a challenge as companies develop new sites to extract transition metals. The destruction of the Juukan Gorge site in Western Australia led to investor backlash that resulted in significant leadership change at **Rio Tinto** and a review by most peers of their indigenous rights policies and processes.

BHP have developed a new approach focused on ongoing engagement with communities through a team made up of primarily indigenous employees that bring local awareness but operate along a global framework to ensure consistency. Lessons learnt from Australian operations are being transferred to sites elsewhere, particularly in emerging markets where Indigenous Peoples often have weaker legal protection. A similar approach is being taken by **Fortescue Future Industries**, who are looking to transfer strong processes such as geo-tagging sensitive sites, simple and rapid communication between community leaders and staff and locally appropriate grievance mechanisms to an international context as they develop new projects in support of the energy transition.

A focus on nature loss

Given nature is inherently tied to many indigenous peoples' way of life and culture, we have also sought to enhance companies' efforts to take a holistic approach to managing both indigenous rights and nature loss. For example, during conversations with **BP**, **Shell** and **ConocoPhillips** we highlighted the importance of engaging local communities whilst developing biodiversity management plans.

Differences by sector

Whilst the mining sector appears to have greatly improved their standards due to the spotlight placed upon them, the oil and gas sector continues to lag. **Rio Tinto's** second Communities and Social Performance report exemplifies this, with the most important stakeholders, Traditional Owners, indicating they believe the company is making progress on their commitments. Overall, we believe the extractives sectors have made significant strides since Juukan Gorge but we will continue to monitor the implementation of improved policies.

In November 2022, Rio Tinto signed a remedy agreement with the Puutu Kunti Kurrama and Pinikura Aboriginal Corporation, and agreed to create the Juukan Gorge Legacy Foundation, which will be led and controlled by Traditional Owners.

Human rights Due Diligence

SDG goal(s)

8 DECENT WORK AND ECONOMIC GROWTH

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

As investors, we face increasing scrutiny to evidence how we mitigate the negative impacts of our investments, particularly in relation to social risk management, which is gaining prominence. Often, due to a lack of sufficient disclosure, it is difficult to assess the social risk mitigation approach utilised by our investee companies. In this regard, we are increasingly reliant on information from ESG data providers and company rankings on social benchmarks.

We initiated our Mandatory Human Rights Due Diligence project in Q1 2022, where our initial focus was on 26 companies from both developed and emerging markets, covering the extractives, automotive, technology, food retail, agriculture and apparel sectors. Specifically, we are seeking to engage these companies as they have scored zero on the human rights due diligence indicator of the Corporate Human Rights Benchmark (CHRB). As a result of the war in Ukraine, we removed Russian companies from the project in Q2 and moved forward with 23 companies.

At the start of the project, the most recent iteration of the CHRB was published in 2020. Since then, benchmarks covering companies in the automotive, information and communication technology, food and agricultural sectors have been updated with updated benchmarks for apparel and extractives companies expected in 2023. Whilst we note some improvements in the implementation of human rights due diligence standards through our engagement, **Infineon Technologies**, **Costco**, **Tyson Foods**, **Shoprite**, **Suzuki** and **Yili Group** all continue to score 0 on the human rights due diligence indicator, while **Carlsberg**, **Starbucks**, **BRF**, **Yum! Brands** and **Falabella** have improved.

A focus on the retail sector

Despite the limited progress under the CHRB assessment, we note a modicum of improvement amongst retailers. At **TJX**, we had encouraged the strengthening of the Company's commitment to human rights and are pleased to see that wording in their recent Corporate Social Responsibility report had been strengthened. We also note improved narrative on the benefits of their partnership with multi-stakeholder initiatives. At **Ralph Lauren**, we are impressed by the Company's improved disclosures since the last CHRB assessment, where key highlights include the provision of extensive narrative on their due diligence framework, disclosure of senior management and day-to-day responsibility for human rights matters in the business, the use of a global risk assessment tool and the incorporation and emphasis on supply chain traceability as a mitigant to social risks.

Engagement going forward

We look forward to the publication of the updated CHRB assessments for the apparel and extractives sectors. We will continue to engage companies in the project on their human rights due diligence approaches. A key theme for engagement in 2023 will be an expectation that companies move from policy to action and provide further details on the effectiveness of their efforts.

The CHRB provides a comparative snapshot year-on-year of the largest companies globally, looking at their policies, processes, and practices to systematise their human rights approach and how they respond to serious allegations.

Social audit assurance

SDG goal(s) 1 NO POVERTY 8 DECENT WORK AND ECONOMIC GROWTH

This year we began a two-pronged project focusing on the audit practices of retailers and the audit and audit assurance services of ESG audit providers. Through this project we have gained key insights into how audits are used to promote positive labour standards and mitigate human rights risks. Throughout our engagement, a key theme has been to encourage retailers to broaden their supply chain due diligence approach beyond audits and to highlight the additional responsibilities of audit service providers to promote holistic due diligence frameworks.

For retailers, we note varying degrees of dependency on audits and most companies deployed more than just audits in their due diligence framework. For companies at the start of their supply chain risk management journey, we note a focus on stated policy commitments, building capacity and understanding through multi-stakeholder initiatives and the commissioning of human rights impact assessments (such as we saw at **Pandora**) to understand supply chain risks. However, in terms of the pillars of the UN Guiding Principles on Business and Human Rights relating to the mitigation and remedy of human rights impacts, evidence was limited. Where companies benefit from heavily vertically integrated supply chains, they are able to more easily utilise their leverage to ensure non-compliances are remediated. At **Hanes Brands**, we noted the application of the company's own audit scorecard to both own-operated factories and that of sourcing partners. This allows it to track ESG risks across the supply chain and helps inform purchasing decisions.

In our last update, we highlighted particular sentiment amongst audit providers that audits generally only provide an indication of risk to clients but corrective actions to resolve issues are solely the responsibility of those commissioning the audit. This rang true in our call with **Intertek**, where we were advised that an audit can only be as robust as what is commissioned by the client. Further, due to the voluntary nature of ESG disclosures, clients may request only basic levels of service. Beyond training on best practice, for client employees or suppliers, it is not their role to provide remedy for issues identified. Across audit providers we spoke to, education on salient social and environmental risks is an inherent part of audit service provision.

Engagement going forward

In terms of audit assurance, with the advent of legislation that may hold company directors liable for a lack of supply chain due diligence, third-party verification has become critical. A theme we will explore in 2023 is a perceived over-reliance on limited assurance vs reasonable assurance – the latter of which has a broader scope higher frequency, and requires significant access to data. We will ask companies for further clarity on the scope, outcomes and remedial action pursuant to their audit and supply chain due diligence programs. Additionally, given our focus on social due diligence in 2022, we will aim to identify differences in the due diligence approach utilised for environmental supply chain risks.

As labour standards and human rights concerns rise the social agenda, issuers are under increased scrutiny to ensure appropriate mitigation of social harms taking place in their supply chains.

ESG metrics in pay

No SDG

The objective of incorporating ESG metrics into executive directors' remuneration structure is to drive leadership behaviour and intrinsically link material ESG issues with the way management is incentivised to execute business strategy.

In particular, companies where remuneration policies are due for renewal are taking the opportunity to review performance conditions and include ESG-related metrics where appropriate. This includes in both the short-term incentive plans (e.g. annual bonus) as well as the long-term incentive schemes (e.g. employee share ownership plans).

During the year, we consulted with 23 companies from a range of sectors on the issue of remuneration and learned that the variety of methods to incorporate ESG metrics is growing. This includes as part of a basket/scorecard mechanism, as a standalone metric, as a prerequisite to rewards being released and as a modifier to final payouts. The exact mechanism varies between companies, and ultimately is dependent on how ESG is measured and its perceived materiality to financial performance.

As an example, the housebuilder, **Vistry Group**, is looking to include a sustainability scorecard in its annual bonus plan which will make up 5% of the scheme. This scorecard sits alongside other financial performance conditions (e.g. Profit and Capital Employed) and includes sustainability metrics such as affordable housing, skills academy enrolment and carbon reduction figures. In addition, for 2023, under its long-term incentive plan, the company will be seeking to include ESG targets aligned with its strategy.

Alongside the inclusion of ESG metrics in executive pay, there has also been a huge shift in the alignment of executive pensions with that of the workforce. We expect this to continue in 2023, buoyed by the increased scrutiny from investors on the very size of executive remuneration, given current economic conditions (e.g. cost of living crisis in UK).

In 2021, more than half of S&P 500 issuers – and nearly half of FTSE 100 issuers – included at least one ESG metric in executive incentive plans.

Source: Semler Brossy, **ESG and Incentives 2021 Report**

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