June 2023

Sustainable Investing Report 2023

Nature positive

Illustration by Federico Epis

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

Fidelity INTERNATIONAL

Who we are

At Fidelity International, our purpose is to work together to build better financial futures for our clients and we believe that investing over the long term is critical to achieving that. As a family and management-owned company, we think generationally in terms of the services we build and provide and the way in which we invest on our clients' behalf.

Our focus is on delivering sustainable investment returns for our clients, while managing our impact on society and the environment. To do this, we incorporate sustainability into our business operations and our investment process, working with investee companies to help them operate more sustainably in order to deliver those long-term returns and secure a better future for all.

$663bn[1]
Assets under management and administration

492
investment resources globally including 35 sustainable investing specialists

2.87m
clients

27
Locations

[1]Source: Fidelity International, 31 December 2022. Asset figures are rounded to the nearest US$ billion.
Includes assets under management and assets under administration. Although combined headline client asset figures 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.

Foreword

Feedback loops are common factors of most crises, and the crisis of climate change is no different. In this instance, the rapid loss of natural capital is both caused by our changing environment and a driver of it. Biodiverse ecosystems, such as forests, play a crucial role in regulating greenhouse gases and moderating extreme weather events.

As a result, policymakers, investors and their clients will increasingly seek to act in a way that conserves natural capital and protects the economic activity that depends on it. The COP15 biodiversity summit in December 2022 is one such example, with pledges to protect 30 per cent of the planet's lands and oceans by 2030. We wanted to reflect this greater recognition of nature's part in reaching net zero by making it a key theme of this year's Sustainable Investing Report.

The linkages between the environment, the economy and people are complex and require considered engagement. When engaging with companies on climate change, it is important to integrate both the consequences for nature and the principle of a just transition, ensuring companies consider the broader implications of their pathways to decarbonisation. The race to net zero can't afford to leave anyone behind, and it is crucial to address the social and economic challenges for societies impacted by the transition and the need to conserve and replenish large swathes of forest and biodiversity.

As a result, we may be entering a recalibration in how policymakers, companies and markets approach the scarcity of all forms of capital, including the natural, social and environmental resources that form the bedrock of our global economy.

As asset managers, we remain committed to our role in mitigating climate change. We work with policymakers to encourage global alignment on sustainability rules, which cut across areas of corporate behaviour and disclosure, as well as on taxonomies, fund categorisation and emissions targets. Meanwhile, our corporate access, research capabilities and scale put us in a credible position to engage with companies on sustainability issues. These engagements inform our proprietary ESG ratings, which typically cover around 4,000 companies[2].

As outlined in this report, we continue to evolve our approach to active ownership through a range of strategies deployed at corporate, sector and system-wide level that seek to achieve better long-term financial, environmental and social outcomes for our clients and broader stakeholders.

Anne Richards
CEO, Fidelity International

[2]As of 31 December 2022; number of companies covered fluctuates as analysts change and update ratings

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Overview: Nature positive

Jenn-Hui Tan
Global Head of Stewardship and Sustainable Investing

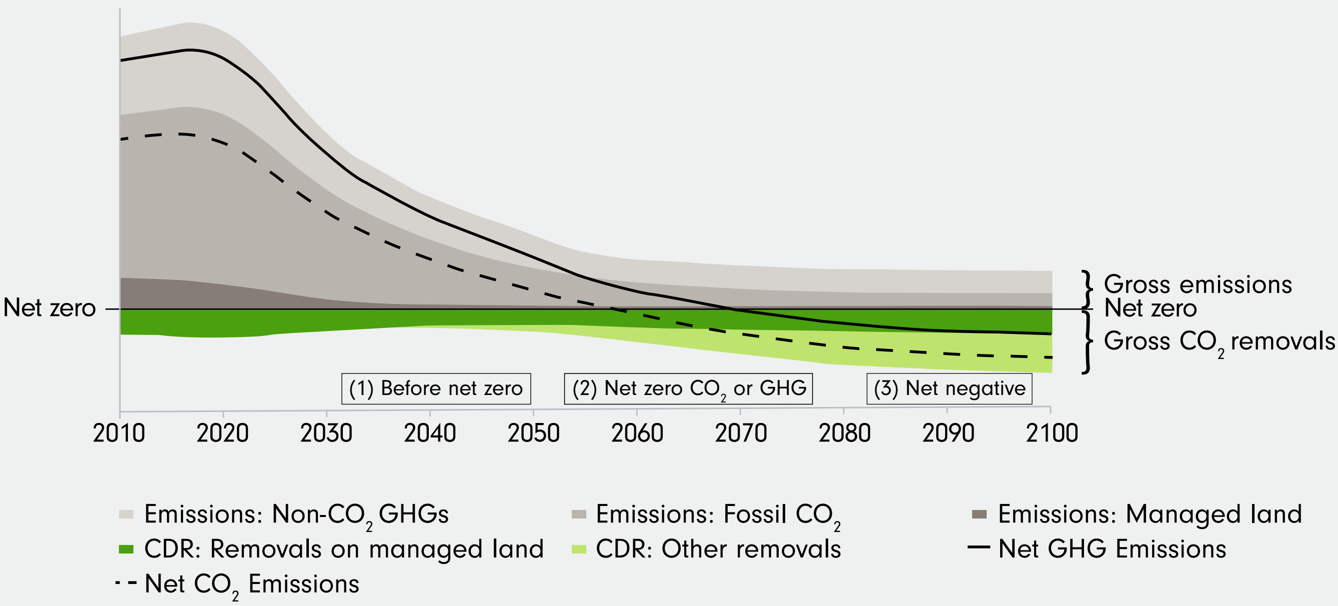
Despite the huge geopolitical and inflationary challenges that beset economies in 2022, sustainable investing continues to evolve at pace, and our approach is evolving with it as systemic themes like nature take on greater prominence.

We seek to contribute to the health and preservation of critical systems by engaging with stakeholders on nature loss, as well as strong and effective governance, climate change and social disparities. These four systemic themes, which we have identified in 2022 (see page 30), are critical to our purpose of building more sustainable financial futures for our clients.

We have introduced an influence framework (see page 30) to identify opportunities to engage with a wider set of stakeholders to encourage change in a more holistic and effective manner that is beneficial to our investee companies and ultimately our clients. We aim to engage on these systemic themes over a multi-year timeframe, and within these address relevant sub-themes.

Many of our engagements are intended to address more than one systemic theme as they often interconnect. For example, biodiversity loss is a key driver of climate change, and vice versa. In 2022, we focused on developing a Deforestation Framework to address the risks of commodity-driven deforestation in our investment portfolios by 2025 and to support investee company efforts to achieve net zero targets.

Chart 1: Nature plays a critical role in achieving net zero through carbon removals
Greenhouse gas emissions (stylised pathways)



Source: Fidelity International 2022, Steffen et al. (2015) Planetary boundaries: Guiding human development on a changing planet. CDR stands for carbon dioxide removal.

The framework builds on previous engagements with those companies most exposed to deforestation caused by agricultural commodities like palm oil and forms a key part of our approach to a theme that is increasingly being discussed in 2023 - nature and biodiversity.

Nature positive

COP15 in late 2022 proved to be a turning point in recognising the importance of nature impacts if the world is to achieve net zero and avoid the worst effects of climate change. Several initiatives have sprung up to translate this concept into decision-useful factors for investors including the Finance for Biodiversity Foundation and the Natural Capital Investment Alliance, of which Fidelity is a member. But policymakers, regulators and investors have been coalescing around the work of the Taskforce on Nature-related Financial Disclosures (TNFD) which is building a framework around 10 core areas for nature-based disclosure.

While there is no easy way to capture risks and opportunities in relation to nature, unlike carbon emissions for climate, the push for greater corporate disclosure more generally through regulation such as the EU's Corporate Sustainability Reporting Directive (CSRD) is bringing this area into scope relatively quickly and it is being considered for inclusion by global standard setters such as the International Sustainability Standards Board (ISSB).

To explain why biodiversity is important from an investment perspective and the associated risks and opportunities, we have created a biodiversity primer. We believe 'nature positive' will be the new 'net zero' in the coming years as climate change increasingly becomes a subset of how we think about risks to biodiversity and natural capital.

Doing the work on net zero

At the same time, we continue to work with investee companies to reach net zero through on-the-ground decarbonisation. Our Climate Investing Policy, published in 2021, sets out our net zero targets and how Fidelity plans to achieve them. At its core is our engagement strategy targeting the highest emitters in different ways.

For the thermal coal sector, for example, we have developed a specific policy to engage intensively with companies on their transition pathways to help them switch to different business models and gradually phase out their carbon-intensive activities.

We aim to end investment in thermal coal by 2030 in OECD countries and in the rest of the world by 2040. In 2022, we began engaging with firms who were more advanced on their journey towards net zero to explore their practices, specifically how they were enabling a just transition through retraining their workforces as they phase out coal.

In 2023, we are focusing on companies with higher risk of new coal development and divestment to private firms with no intention of phasing out coal. We continue to participate in the Asia Transition Platform, run by Asia Research and Engagement (ARE), engaging alongside other investors with over 50 Asian financial institutions and coal-exposed power companies to raise awareness and share best practice on accelerating the transition.

We use our proprietary Climate Rating to assess where a company is on its transition journey and to prompt engagement with laggards. We also develop strategies and building blocks for clients wishing to invest in the transition through climate leaders, solutions providers, or those with the greatest potential for transition and carbon reduction.

Next steps on the net zero pathway include using green revenue tools (e.g. EU Taxonomy or Sustainable Development Goals alignment) to identify climate opportunities. We also use carbon footprints and scenario alignment at asset and portfolio level, in addition to our climate and ESG ratings, to map climate risks. Setting net zero targets at fund level will help further integrate climate considerations into investment decision-making and drive the transition across our fund range.

Our path to net zero

Net Zero Ambition

We are committed to align investment portfolios to the goal of net zero GHG emissions by 2050. We have set an interim target to halve the carbon footprint of our portfolios by 2030.*

Proprietary Climate Ratings

We are rolling out a proprietary assessment of investee companies on net zero to monitor our portfolios and drive our stewardship strategy.

Thermal Coal

We will apply our transition engagement approach to thermal coal and seek to gradually phase out portfolio exposure to thermal coal in OECD markets by 2030 and the rest of the world by 2040.

Stewardship

We have introduced a voting policy whereby we will be voting against the re-election of directors at companies that do not meet minimum climate-related requirements.

Source: Fidelity International, 2022. *From a 2020 baseline, starting with equity and corporate bond holdings and bringing other areas into scope over time. Please see Fidelity's Climate Investing Policy for real estate and other targets. Targets will initially cover scope 1 and 2 emissions of investee companies. Scope 3 will be added as data quality and availability improves and there may be changes in the overall baseline as a result.

Transition plans under construction

In 2022, more and more companies set net zero targets. In 2023, we are seeing much greater focus on how these will be achieved and the development of more granular transition plans. This is being encouraged by investors like Fidelity who demanding greater visibility on corporate plans and associated capex (to mitigate climate risks to portfolios and to enable our own corporate transition plan) and by regulators and policymakers at global, regional, and national level.

For example, the EU is expected to include transition plans in its corporate disclosure requirements for companies when conducting due diligence, while the UK has indicated it could make transition plans mandatory for large companies (see page 15), using a framework designed to complement not only the current Taskforce for Climate-related Financial Disclosure (TCFD) reporting framework, but also the emerging ISSB accounting standards.

Fidelity has contributed to these discussions through our engagements with regulators and standard setters, responding to consultations on the type of disclosure needed to make robust investment decisions and how to build capacity for sustainability reporting across economies. We have encouraged regulators to ensure as much global interoperability as possible and to integrate nature-related metrics as these emerge. The social aspects of the transition remain crucial.

Social matters

While energy prices had begun to fall as we entered 2023, the shock of high inflation to Western economies persists and interest rates continue to rise at the time of writing. As a result, many firms have been dealing with substantial and sustained price rises which have put pressure on other sustainability objectives in the short term.

We have engaged with companies on this topic specifically as it relates to differentials in pay for executives and staff and continued to engage on measures to improve diversity and inclusion across different sectors and geographies, including voting against boards which do not meet the minimum number of female directors required by our voting principles (see page 50).

Effective governance is key

Effective governance at multilateral, national, industry and corporate levels is a precondition of effective action on sustainability. Not only do signs of poor governance raise concerns about sustainability in other areas, we can use governance measures such as voting to encourage changes in corporate behaviour; they offer an opportunity to explain clearly why we have chosen to vote for or against a proposal, or abstain, and share our thinking directly with a company. We therefore consider strong governance to be an essential tool to drive change across our other systemic themes, helping us, our investee companies and our clients make progress towards net zero, while tackling nature loss and facilitating a just transition.

White-tailed eagles monitored ahead of reintroduction project. (Credit: Dan Kitwood/ Staff/ Gety Images)

Sustainable investing highlights in 2022

Rolled out Climate Rating to cover c.2,000 issuers

Introduced quarterly sustainability reviews (QSR) of funds*

Launched our Deforestation Framework to guide engagement and stewardship

Commenced our thermal coal engagement programme

Provided training to employees and clients on key ESG topics including biodiversity, deforestation and ESG regulations

Winner of **15 sustainability-related awards** globally

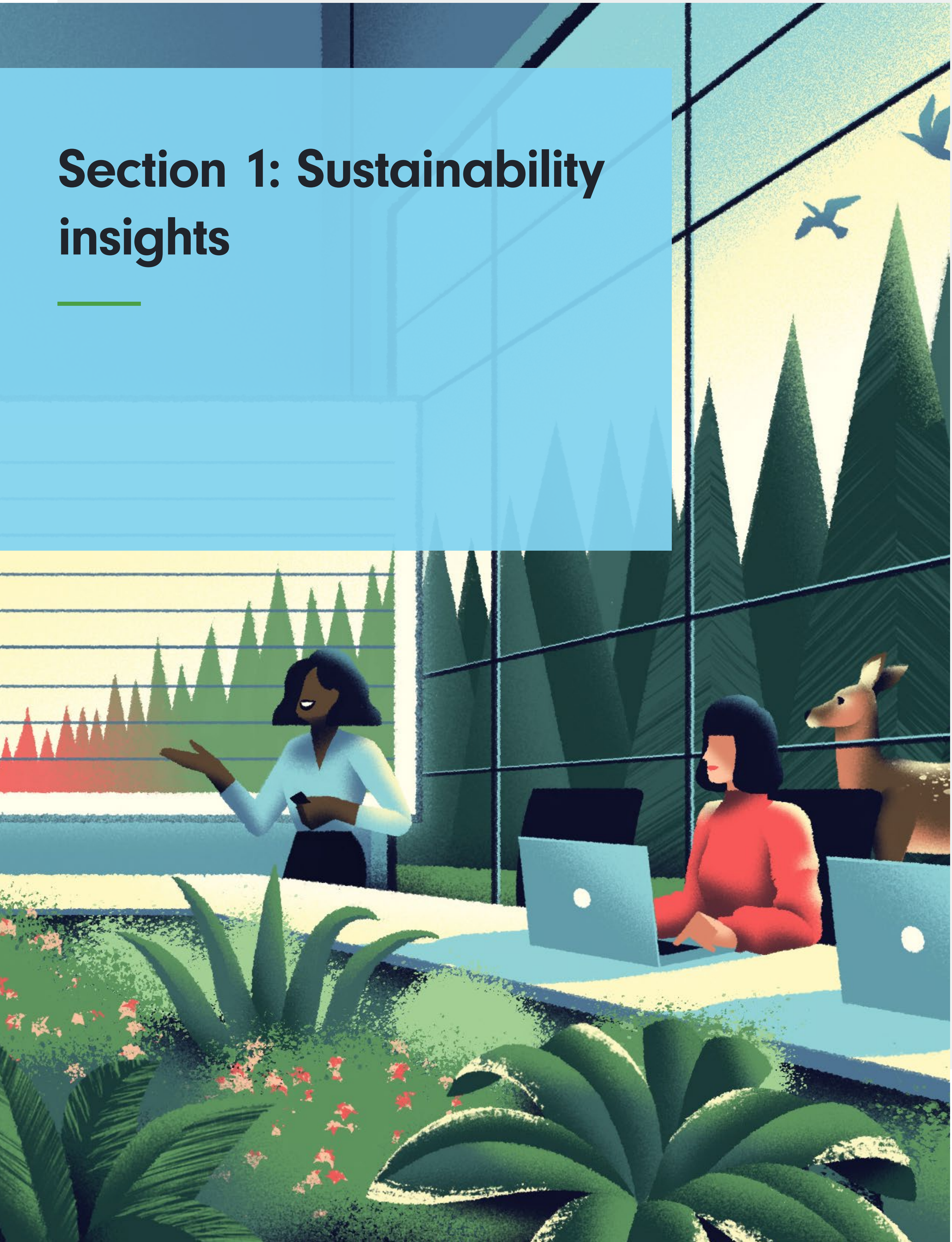
Rated 4 and 5 stars across categories by the **UN Principles for Responsible Investment****

Achieved the **fifth highest** ranking financial institution from Northern Europe and **fifth highest** ranking asset manager in the **World Benchmarking Alliance's inaugural Financial System Benchmark 2022**

Named as a Responsible Leader by the **Responsible Investment Association Australasia** for the second year running

Source: Fidelity International, 31 December 2022. *QSRs rolled out only for Article 8 and 9 funds in 2022. **We completed the PRI questionnaire in 2021 based on 2020 AUM. Due to an overhaul of the previous PRI questionnaire, there were delays in the results which were shared in 2022.

Section 1: Sustainability insights



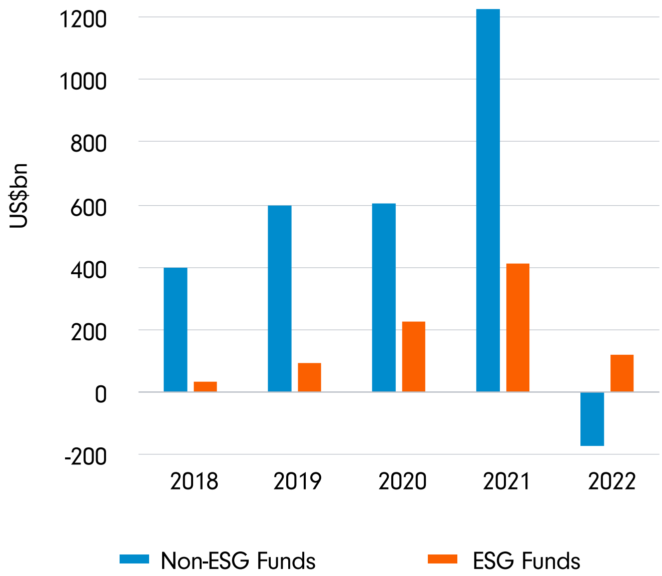
ESG market snapshot

Fund flows show resilience

In recent years, flows into ESG funds have been growing significantly driven by regulation and investor demand. This had been expected to continue going into 2022. But the conflict in Ukraine and the cyclical aftermath of the pandemic weighed on markets generally and on the share prices of ESG leaders given their typical quality bias.

Despite these macro and market headwinds, flows held up well in the ESG funds market in 2022 and they outperformed non-ESG funds with net positive inflows. While this snapshot offers no guide to flows in 2023, we expect this to continue as a long-term trend, albeit with bumps along the way.

Chart 2: Estimated Net Sales into Mutual Funds & ETFs



Source: Broadridge/Fidelity. ESG funds are Fidelity's Sustainable Fund Family and those in the industry classified as 'Responsible Investment - Screened" by Broadridge. Includes all active & passive funds globally except those primarily sold in North America. Excludes money market and fund-of-funds.

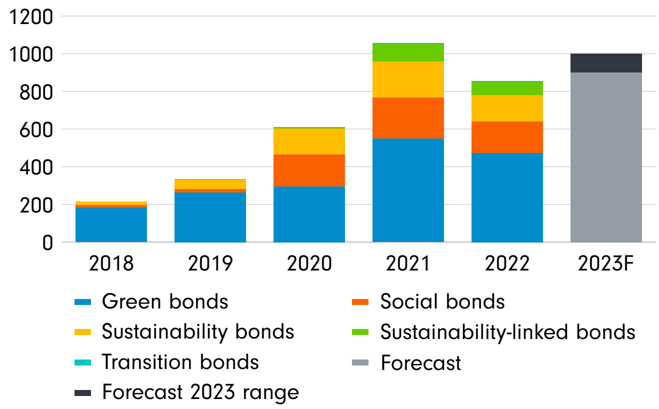
Green and sustainable bond issuance expected to increase, but standards remain a concern

Green and sustainable bonds were similarly affected last year by macro conditions as monetary policy tightened to rein in inflation and issuance fell alongside a global drop in bond issuance. However, S&P Global expects sustainable issuance to return to growth in 2023, reaching US$900bn to US$1 trillion for the year, and to continue increasing its share of the global bond market.

This is driven by greater regulatory activity and demand for sustainable products, but the credibility of issuer standards and use of proceeds remain concerns that could limit demand. The chart below shows the trends in sustainable bond issuance in the last five years and expected activity in 2023.

Chart 3: Global GSSSB issuance forecast to reach US$900 billion to US$1 trillion in 2023

Annual GSSSB issuance by instrument type (US$bn)



Excludes structured finance issuance.

F = S&P Global Ratings forecast; GSSSB = green, social, sustainability and sustainability-linked bonds.

Sources: Environmental Finance Bond Database; S&P Global Ratings.

Regulation is shaping the future of sustainability

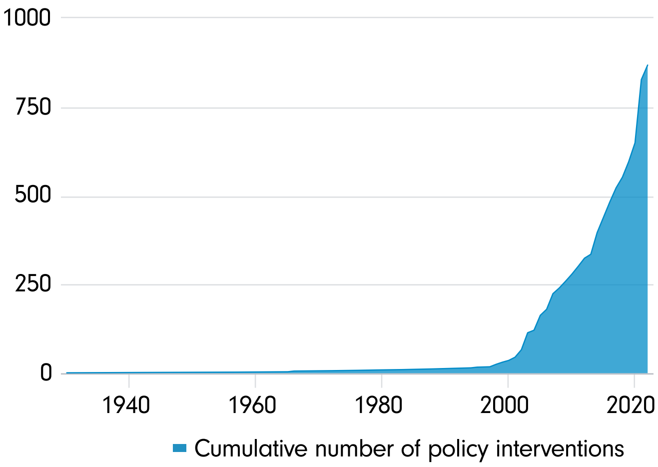
Gabriel Wilson-Otto
Head of Sustainable Investing Strategy

A key driver of ESG flows (total assets under management are now US$1.97trn[3]) continues to be regulation. The latter is responding to the increased frequency and materiality of ESG-related events, attempting to shape the direction of travel and how these issues are managed.

Climate change, cyber security breaches, enhanced focus on racial equity, the drive for "common prosperity" in China and the need to restore and preserve biodiversity have all pushed regulators and policymakers to act.

The resulting wave of rules and incentives are designed to: 1) improve risk management; 2) accelerate funding towards solutions; and 3) enhance consistency and availability of sustainability disclosures. Below we look at some of the key regulations and policies affecting corporates and financial services, and their implications.

Chart 4: Regulation increases to shape the direction of travel



Source: PRI responsible investment regulation database, Fidelity International, May 2023.

Corporate disclosure is high on the regulatory list

Towards the top of the regulatory list is the race to improve corporate disclosure. The European Union is set to implement its comprehensive Corporate Sustainability Reporting Directive (CSRD) to support its attempt to reduce emissions by 55% by 2030. The regulation requires a large proportion of firms, including private companies, to disclose against a new set of European Sustainability Reporting Standards. These seek to embed the concept of "double materiality" by requiring companies to report on metrics, including climate change, biodiversity, circular economy, human rights, and labour conditions, that have a financial impact on the company or an impact on the environment and society.

Climate change, cyber security breaches, enhanced focus on racial equity, the drive for "common prosperity" in China and the need to restore and preserve biodiversity have all pushed regulators and policymakers to act.

At the same time, the International Sustainability Standards Board (ISSB) is creating a general sustainability (S1) reporting standard and a climate (S2) reporting standard as a global baseline for sustainability reporting, which it hopes will be

[3]Source: Broadridge/Fidelity. ESG funds are Fidelity's Sustainable Fund Family and those in the industry classified as 'Responsible Investment - Screened" by Broadridge. Includes all active & passive funds globally except those primarily sold in North America. Excludes money market and fund-of-funds

adopted by regulators and companies globally. The ISSB has adopted an "investor useful" materiality assessment and has indicated it is working with the EU and other jurisdictions to try and align disclosures for companies as much as possible.

The ISSB has integrated existing TCFD metrics into its climate disclosures to make it easier for companies already using TCFD to adopt ISSB standards. The ISSB's proposed disclosures have received robust support within Asia and will likely see a phased adoption with an initial focus on S2 given higher compatibility with existing climate disclosure regulations within the region.

The Securities and Exchange Commission in the US meanwhile is expected to finalise its climate disclosure rules in 2023, which include detailing climate risks that have a financial impact and greenhouse gas emissions reporting.

As a result, we expect sustainability disclosures to increase and begin to be considered more systematically alongside company results. That said, it will take time for companies to build capacity to capture the required data and for consistent methodologies to develop. We note that nature frameworks such as that proposed by the Taskforce on Nature-related Financial Disclosures (TNFD) are still in development.

While a richer data environment is helpful, data alone is not the silver bullet for managing sustainability issues. Fidelity's fundamental investment heritage provides a foundation for its global analyst network and Sustainable Investing team to engage with issuers not only to help bridge data gaps, but to generate actionable insights and drive positive change.

Fund disclosure is a close second

A close second behind corporate disclosure is investment ESG disclosure. In Europe, investors have been implementing the Sustainable Finance Disclosure Regulation (SFDR) since it became applicable in March 2021. Funds with sustainability considerations are required to make specific sustainability disclosures. While SFDR was intended to focus on disclosures, the measures have been adopted by the market as a de-facto labelling regime. EU regulators are now looking at ways to improve SFDR including whether to apply fund labels and minimum investment thresholds.

The UK aims to implement a labelling regime under its Sustainability Disclosure Requirements (SDR). Under the proposals, UK funds could only market themselves as sustainable if they opted for one of three labels: sustainable focus, sustainable improvers, and sustainable impact - all of which come with specific investing and stewardship criteria that are still under discussion.

In Asia Pacific, ESG product labelling rules have been introduced in Hong Kong, Singapore, and Taiwan and are under development in South Korea, India and Mainland China. While Australia does not have a regulatory ESG product labelling regime, the local regulator ASIC has stepped up its focus on preventing greenwashing via enforcement.

Fidelity continues to work with industry associations and regulators globally to help promote practical, harmonised, and informative fund disclosures and requirements.

Taxonomies prove a popular tool

Another tool in the regulatory toolbox is having a green taxonomy, which is proving to be popular globally. According to a December 2022 report by

WWF, several countries have adopted taxonomies and many others are developing guidance, with 12 including or planning to include nature-related aspects. China and the EU are among the most developed but reflect the different priorities for their economies. For example, China's taxonomy has a bigger emphasis on agricultural activities. In the UK, the taxonomy has been delayed until the autumn. Green taxonomies have recently been launched for ASEAN, Singapore and Malaysia; each has different standards and approaches to identifying 'green' investments.

These differences create a risk of fragmentation in what is considered green globally. However, it is worth noting the example of the EU-China Common Ground Taxonomy which was developed to highlight commonalities and differences between the two taxonomies and facilitate international sustainable investing. Over time, it is possible that taxonomies will begin to be interoperable if not fully harmonised.

Taxonomies are proliferating with several including nature

Jurisdictions	Process maturity			
	Initiation phase	Developing phase	Adopted	Paused
G20	Argentina Australia* Turkey	India Indonesia Mexico United Kingdom	Brazil* China European Union (including France Germany, Italy) Russia South Africa South Korea	Canada
Others	Chile Dominican Republic Georgia Hong Kong Kazakhstan Peru Philippines Thailand	ASEAN Bangladesh Singapore	Colombia Malaysia Sri Lanka	

Source: WWF: when_finance_talks_nature.pdf (panda.org). The 29 sustainable finance taxonomies around the world as at December 2022 have different levels of process maturity, but 12 already include or plan to include nature-related aspects. *Industry-led taxonomies.

Transition on the horizon

While regulation is on the rise, policy is also being made. The US has launched its Inflation Reduction Act, a massive incentives programme that is making emerging technologies such as hydrogen and batteries economic with fossil fuels and prompting policy responses from other regions and countries who wish to compete in the race to build green industries and services.

Possibly even more effective over the long term is the growing demand for companies, investors and even governments to adopt clear, credible transition plans. Transition plans aligned to 1.5°C are part of requirements for EU companies under the hotly debated proposed regulation known as the Corporate Sustainability Due Diligence Directive. The proposed rules could make directors and companies liable for prosecution if they fail to show they have done all they can to mitigate and prevent environmental and social harms, including having an insufficient transition plan.

Meanwhile, the UK Transition Plan Taskforce has proposed a broad framework for transition plans that require companies to disclose how they are adapting their business strategy to decarbonise their operations and lean into a whole of economy transition. The UK is seeking to encourage adoption of the framework around the world and transition plans could become mandatory in the UK.

While the regulatory wave can appear somewhat daunting, at Fidelity, we are supportive of the focus on the transition to net zero and sustainability more generally. We continue to engage with regulators and policymakers to build the most favourable policy environment for our investee companies to make the transition and for us to be able to provide sustainable products for our clients.

For more information on how Fidelity is responding to ESG regulations please refer to the Regulatory Landscape section of our Sustainable Investing Principles.

Electric delivery vans at a charging station. (Credit: Yann Schreiber / Contributor, Getty Images)

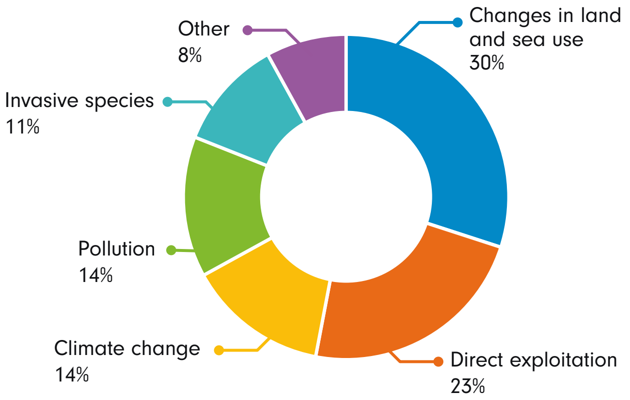
Biodiversity investing Q&A

Velislava Dimitrova
Sustainable Investing Portfolio Manager

Why should biodiversity matter to investors?

Biodiversity comprises the variety of living components of natural capital such as animals, plants, fungi, and micro-organisms. These components interact to provide us with the "ecosystem services", such as pollination, food production, air circulation, medicines, and carbon sequestration, on which our very existence relies. Estimates suggest roughly half of global GDP is either moderately or highly dependent on nature.[4]

Chart 5: Drivers of biodiversity loss



Source: IPBES, Fidelity International, December 2023.

If we continue to damage these ecosystem services, we will not be able to keep to the 1.5°C 'safe landing' pathway, set out by the Intergovernmental Panel on Climate Change; climate change is also one of the major threats to biodiversity and is expected to become the dominant driver of biodiversity loss – acutely so in tropical regions – in coming decades, creating catastrophic feedback loops that will have a big impact on supply chains, livelihoods, and lives.

Global wildlife populations have fallen an estimated 70 per cent over the last 50 years and a further million animal and plant species (12 per cent of the current 8.1 million in total) are facing extinction. Biodiversity loss is also causing a decline in soil fertility which will make it challenging to meet the still growing global demand for food.

Investors therefore need to consider the types of biodiversity-driven investment risks embedded in portfolios. These include physical, disintermediation, regulatory, legal, transition, and reputation risks.

How are policymakers responding to biodiversity risk?

Policymakers are increasingly focused on biodiversity risks and nature more broadly. COP15 in Montreal in December 2022 delivered agreement of the Global Biodiversity

[4]Source: World Economic Forum (2020) Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy

Framework, an overarching mission to halt and reverse biodiversity loss by 2030 with 23 underlying targets to work towards that goal.

There has also been a wave of deforestation-related legislative initiatives including in the UK and Europe, while reporting and disclosure standards are seeking ways in which to include nature. The Taskforce on Nature-related Financial Disclosure framework (TNFD) has been set up to drive consistency and comparability across biodiversity disclosure, in the same way that the Taskforce on Climate-related Financial Disclosure (TCFD) was. It is due to be finalised in September and the ISSB is considering whether to add biodiversity to its sustainability disclosure standards.

What kind of opportunities could nature investing offer?

Climate solutions such as wind and solar have become economically viable within a relatively short period, and we expect the right policy support for investing in nature could trigger uptake at an even greater rate despite it being a more complex area.

Industry estimates suggest we will need around US$8.8 trillion of cumulative investments in nature between now and 2050 to ensure our biodiversity risk is manageable.[5] Currently, that global annual investment number is only US$146 billion. That is a significant gap and an enormous addressable market for those companies that develop processes and solutions to halt or reverse nature loss and mitigate risks to natural capital. Given we need to spend an estimated US$100 trillion on tackling climate change between now and 2050, and climate change causes nature loss and vice versa, it is possible nature investments may need to be even greater.

[5] Source: UN Environment Programme, State of Finance for Nature report, May 2021

What does it look like in practice?

Biodiversity is a nuanced and multi-faceted investment space and there are a range of approaches.

At Fidelity we seek to address biodiversity as an investment theme in the following ways:

1. Identify key biodiversity risks and their potential impact on portfolios and engage with issuers on managing and mitigating those risks; this includes analysis of the highest impact and dependency sectors and key nature loss drivers
2. Invest in companies leading the way on nature preservation and recovery through their operations
3. Invest in companies building nature-based solutions to help mitigate impacts

We have developed our own proprietary tools to integrate sustainability into our fundamental investment research. Biodiversity is explicitly captured in our proprietary ESG ratings framework for those sectors where our investment teams deem it material, with 78 of the 127 sub-industries mapped to at least one biodiversity indicator.

We have several ongoing thematic and collaborative biodiversity-related engagements, including around climate change, pollution, land and sea use change and direct exploitation (see page 45). Deforestation remains a flagship thematic engagement for Fidelity as more and better data (e.g. from satellites) helps issuers understand the risks to their supply chains.

Finally, we are a member of several industry initiatives including the Finance for Biodiversity Pledge. As a part of this pledge, we have several commitments which include assessing impact and setting targets to report on biodiversity matters before 2025. We are also contributing to discussions around what the TNFD should eventually contain.

Section 2: Integration

Refining our approach to ESG integration

Ellie Tang
Director, Sustainable Investing

In the face of increasing sustainability regulation and growing client demand, we continually review our approach to integrating sustainability into our investment processes to understand where we can improve or adapt them.

These include our top-down frameworks for regulatory compliance and risk management, and our bottom-up research insights and tools that help us engage with and make decisions about our investee companies. We find that having a range of tools gives us more granular and forward-looking insights into which companies are truly sustainable. Employee training and client updates are regularly provided as the tools evolve.

In 2022, we launched our revised proprietary ESG ratings framework and introduced additional tools to support ESG integration, which are used in conjunction with data from third-party providers.

Fidelity's tools for integrating sustainability

- **Fidelity ESG ratings** aim to provide a forward-looking assessment of the extent to which an issuer's performance on material sustainability issues supports or is likely to impair long-term value creation for shareholders. Fidelity's ESG ratings are clearly defined to measure how an issuer manages negative ESG externalities and material business risks.

  The assessment provides a granular and forward-looking view of an issuer's ESG performance with an overall rating, E/S/G pillar score, and a trajectory rating. The ratings are used to inform and supplement our decision to buy, hold or sell a position. They are also used for monitoring a fund's ESG profile to comply with regulations such as SFDR (e.g. reporting principal adverse impacts), prioritising engagement with companies, and client communications and reporting. In 2022, we made further progress on assigning ratings which embed the principles of double materiality to issuers across the equity and fixed income universes driven by the need for better quality information and the changing regulatory environment. We continued to update existing ratings as part of a dynamic process.

- **Climate Rating:** as a founding signatory of the Net Zero Asset Manager Initiative, Fidelity has pledged to halve its investment portfolio emissions by 2030 and achieve net zero by 2050.[6] We aim to achieve this by engaging with investee companies on their transition and their

[6]From a 2020 baseline, starting with equity and corporate bond holdings and bringing other areas into scope over time. Please see Fidelity's Climate Investing Policy for real estate and other targets. Targets will initially cover scope 1 and 2 emissions of investee companies. Scope 3 will be added as data quality and availability improves and there may be changes in the overall baseline as a result.

management of climate risks and opportunities. To that end, we launched the Climate Rating in 2022 to assess the net zero transition potential of issuers based on a 1.5°C decarbonisation pathway. The Climate Rating assesses the entire value chain of companies under three pillars: net zero ambitions (including a credible transition plan), climate governance, and capital allocation.

The top two categories, i.e. achieving net zero and aligning to a net zero path, as well as having a target validated by the Science Based Targets initiative (SBTi) are seen as eligible for a net zero portfolio and we will continue to invest in companies with high or low transition potential while using engagement and our voting rights to encourage further climate action. Companies with no evidence of transition potential will be assessed and considered for divestment.

On an aggregate level, this rating will enable us to assess our portfolio alignment to net zero through bottom-up research. As of December 2022, the Climate Rating covered c. 2,083 issuers. In 2023, we are working to enhance our suite of climate-related tools and solutions to ensure a higher level of consistency and look at companies through a range of different

Companies need to meet minimum criteria, and additional ones for those in high impact sectors, to be considered for one of five categories:

1	2	3	4	5
Achieving or enabling net zero	**Aligning to a net zero path**	**High transition to net zero potential**	**Low transition potential to net zero**	**No evidence of transition potential to net zero**
Issuers already have current emissions intensity performance at, or close to, net zero emissions or issuers are critical enablers of the transition through their products and services	Issuers have committed to robust targets in line with a net zero emissions trajectory with an appropriate governance and investment plan to achieve that goal	Issuers have demonstrated a commitment towards reducing carbon emissions but these still lack credibility to align to net zero	Issuers demonstrate some level of climate awareness but fall short of credible commitments to achieve carbon reduction objectives	Issuers show no indication or willingness to align emissions and business model to a global net zero world
Eligible for a net zero portfolio	**Eligible for a net zero portfolio**	**Continued investment and engagement/voting**	**Continued investment and engagement/voting**	**Continued assessment and ultimately divestment**

lenses as more climate and nature-related data begins to be disclosed. For example, in 2022, we began to engage with companies on their policy and lobbying positions to ensure that their activity was not inconsistent with their stated climate goals.

- **UN Sustainable Development Goals (SDG) tool** was introduced in 2022 to assess a company's positive contribution to environmental and social outcomes as per the investible targets and indicators under the 17 UN SDGs. This standalone tool provides a separate analysis from the Fidelity ESG ratings to avoid offsetting a risk with an unrelated positive contribution (e.g. the risk of poor corporate governance or major business disruption is not offset by selling products that help the energy transition). Fidelity also uses the SDG tool to identify positive environmental or social impact of issuers based on SFDR requirements.

Supplementing with third-party tools

The in-depth nature of our approach means that our ratings coverage is not as broad as a third-party ESG data provider, therefore we continue using third party ESG data providers to supplement our limited coverage. Further, the ESG 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.

Quarterly Sustainability Review

The Quarterly Sustainability Review (QSR) was introduced in Q1 of 2022 to measure and monitor progress of a fund and the respective manager on the integration of sustainability factors. The objective of the QSR is to demonstrate how sustainability is incorporated into fund portfolio construction and how it influences investment decisions. The review process, which sits alongside the Quarterly Financial Review of funds, involves a collaborative effort across various teams and is run by senior management and chief investment officers together with the Sustainable Investing team.

By the end of 2022, 59 QSR sessions had been conducted on 108 equity, fixed income and multi-asset funds, covering Fidelity's Sustainable Family range of funds and all SFDR Article 8 funds. As part of our top-down framework, the scope of the QSR process will be expanded to cover more funds in due course to improve product governance.

Aerial view of wildlife corridor built across road, enabling wildlife to cross safely. (Credit: thianchai sitthikongsak / Contributor, Getty Images)

How to decarbonise portfolios


Tom Jeffery
Co-head of Institutional Sales, Europe


Katie Roberts
Head of Client Solutions


Glenn Anderson
Associate Director, Sustainable Investing

In 2022, companies and countries began taking steps to fulfil their net zero pledges. Investors too have been considering different ways to decarbonise portfolios. While each investor's journey will be different, due to regulation, resources, and investment policy requirements, every net zero pathway must demonstrate real-world emissions reduction to meet the goals of the Paris Agreement. Here we look at possible ways to decarbonise portfolios and the advantages and challenges of each.

The twin pillars of climate investing

Once decarbonisation targets have been set for portfolios, investors can apply the twin pillars of climate-aware investing: 1) increasing exposure to climate solutions and 2) reducing the existing portfolio carbon footprint.

Increasing exposure to climate solutions

Issuers in this category focus on two goals - wider adoption of existing ways to mitigate and adapt to climate change, and innovations required to meet net zero targets. These strategies potentially offer a broader set of opportunities that directly contribute to solving climate change problems alongside attractive risk adjusted return potential. They generally fall into five broad industry groups: transportation, power, industry, buildings, and consumer.

However, these strategies also may have carbon footprint trajectories that temporarily rise in the short term. For example, companies developing battery technologies may increase emissions during the initial growth stages. Furthermore, the risk profile of thematic portfolios may be more concentrated on average. Some can have style tilts, particularly towards growth given the type of companies, increasing volatility risk.

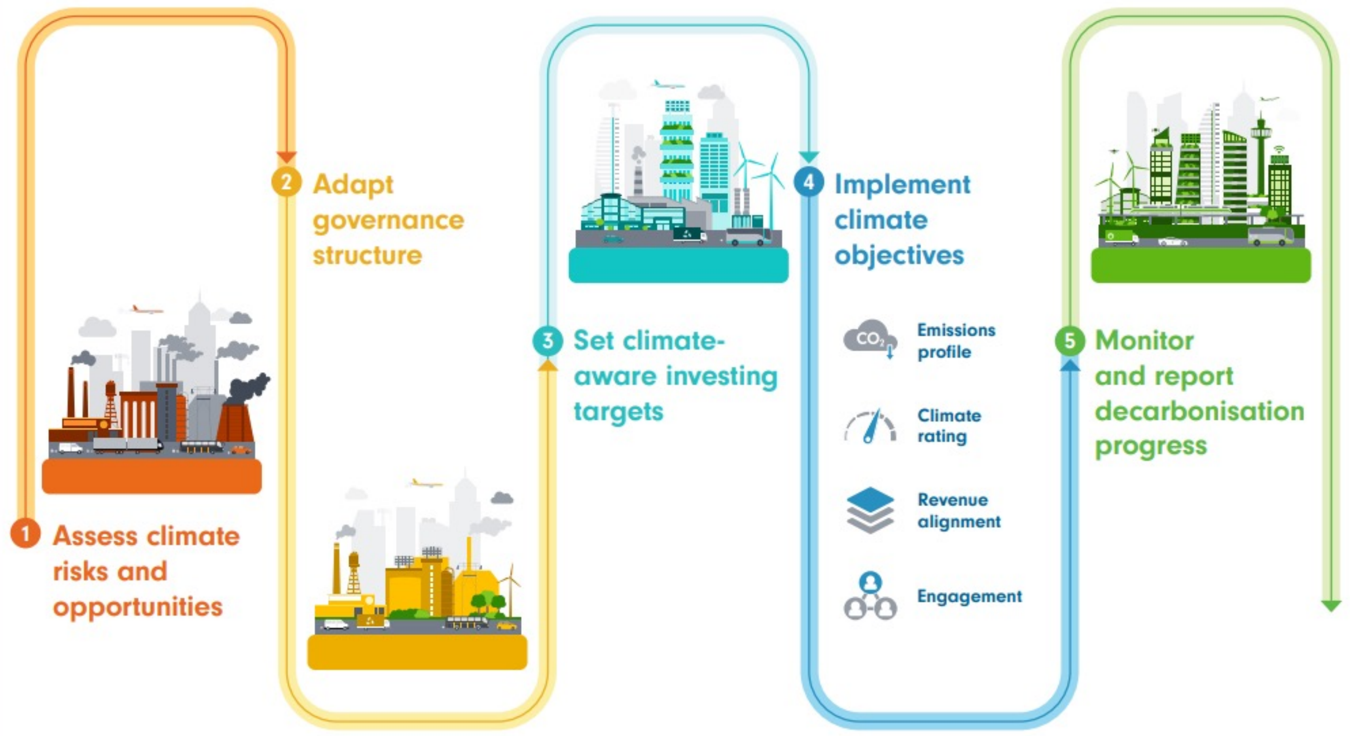
What constitutes green is increasingly under scrutiny, so applying established frameworks such as the EU Taxonomy may help reassure investors about their contribution to solving the climate crisis. Relative to traditional portfolios, risks related to managing assets with net zero ambitions may differ due to the mismatch in the time frame between organisational financial reporting periods and the long-term nature of climate change which must be tackled over a 10 to 20-year period.[7]

Four common levers for transitioning existing portfolios

Where investors opt to transition existing portfolios, there are generally four common levers that they can use: emissions profile, climate rating, revenue alignment, and engagement (see graphic below and page 19 for more details on Fidelity's own approach). These tools can be applied on their own but are generally used together to optimise results.

[7]Source: Patrick Bolton, Marcin Kacperczyk and Frédéric Samana, "Net-zero carbon portfolio alignment", Financial Analysts Journal, March 29, 2022.

Levers for decarbonising portfolios



Source: Fidelity International, September 2022.

Transparency in gauging decarbonisation progress when using these levers to transition a portfolio is crucial. While it is impossible to discuss all the different metrics available to assess decarbonisation, we can distil them roughly into five measures: carbon intensity reduction, absolute emissions reduction, portfolio coverage (more granular decarbonisation goals), sectoral coverage (sector-based goals) and temperature ratings.

These can be used on their own or in combination to meet climate goals but often require interpretation to understand what they mean and whether they make decarbonisation activities across different parts of the portfolio truly comparable or not.

Moreover, the underlying data and processes supporting the decarbonisation journey should be periodically reviewed as a raft of new climate-related issuer data is expected to come through as corporate disclosure improves, driven by regulatory measures like CSRD. According to the Science Based Targets initiative, key corporate actions like mergers and acquisitions, divestments and restructurings, and new product offerings should also trigger ad hoc reviews.

What to decarbonise first

Data and framework availability, regulatory support, and organisational constraints dictate that investors often do not have the resources to implement a decarbonisation strategy for the aggregate portfolio all at once. Therefore, they need to prioritise investment mandates deemed to be the most achievable to decarbonise.

Of all asset classes, listed equities - particularly in developed economies - are perhaps the starting point to decarbonise for most organisations due to relative availability, comparability and reliability of data, more established investment best practices and regulatory and corporate support frameworks.

However, listed equities account for less than a quarter of total emissions, according to estimates by the Climate Accountability Institute. The global fixed income market also offers investors attractive decarbonisation opportunities and is bigger in dollar terms than the equity market, with far greater annual issuance. Furthermore, managing a climate-aware portfolio cannot be limited to public markets. Standards must be just as rigorous when investing in private markets. Otherwise, issuers and asset owners can sidestep public scrutiny by shifting into the private sphere - undermining long-term sustainability goals along the way.

Active, passive or both

Choosing indexing, systematic (rules-based) or active fundamental vehicles to implement decarbonisation strategies will depend on factors such as climate ambitions, implementation budgets and risk-return objectives. We believe every decision is an active one, whether investors use indexing, systematic or active fundamental strategies.

Even when tracking an index, investors must decide whether to use a Paris-Aligned Benchmark (PAB), a Climate Transition Benchmark (CTB) or a bespoke benchmark among other options. These decisions involve trade-offs between, for example, the pace of decarbonising the portfolio and the risk appetite, tracking error and volatility limits.

Below we compare three common types of implementation strategies against specific outcomes.

Common allocation strategies vs. portfolio decarbonisation outcomes

Outcomes	Indexing	Systematic	Active fundamental
Confidence to meet portfolio CO2 target at any given point in time	High	High	Low
Confidence to contribute to real-world decarbonisation in the global economy	Medium	Medium	High
Ease of access to broad market exposures when decarbonising	High	High	Medium
Capacity to tailor engagement, including divestment if necessary	Low	Medium	High
Ease of monitoring asset managers to align with organisational CO2 goals	High	High	Low
Ability to customise climate solutions* such as access to niche technologies	Low	Medium	High
Potential to generate alpha from forward-looking environmental assessments	Low	Medium	High

Lower cost → Higher cost

High   Medium   Low

Source: Fidelity International, September 2022. *Ability to customise climate solutions refers to a range of options to help institutions tailor investments aimed at mitigating or adapting to climate change. They can work with index providers to customise their indices or set 'customised' investment guidelines, for example, for active climate solutions strategies.

One of the difficulties when indexing, for example, is how to divest an issuer if engagement fails within a certain period; in general, neither the asset manager nor the asset owner has direct control over the construction of most indices.

One solution is to underweight, and some asset managers are exploring ways to use shorting to influence corporate behaviours. On the other hand, active fundamental strategies require closer monitoring of asset managers to ensure alignment to investors' climate goals, relative to indexing and systematic approaches.

As the urgency and frequency of climate-related events increase, there is no time to waste when it comes to decarbonising portfolios.

However, regulatory changes combined with technological advances are potentially making that task easier and more granular. For example, reporting to clients increasingly includes data on the extent to which a portfolio contributes to mitigating and adapting to climate change under the EU Taxonomy framework. Other reporting mechanisms may be aligned to the UN SDGs and/or temperature pathways depending on client preferences.

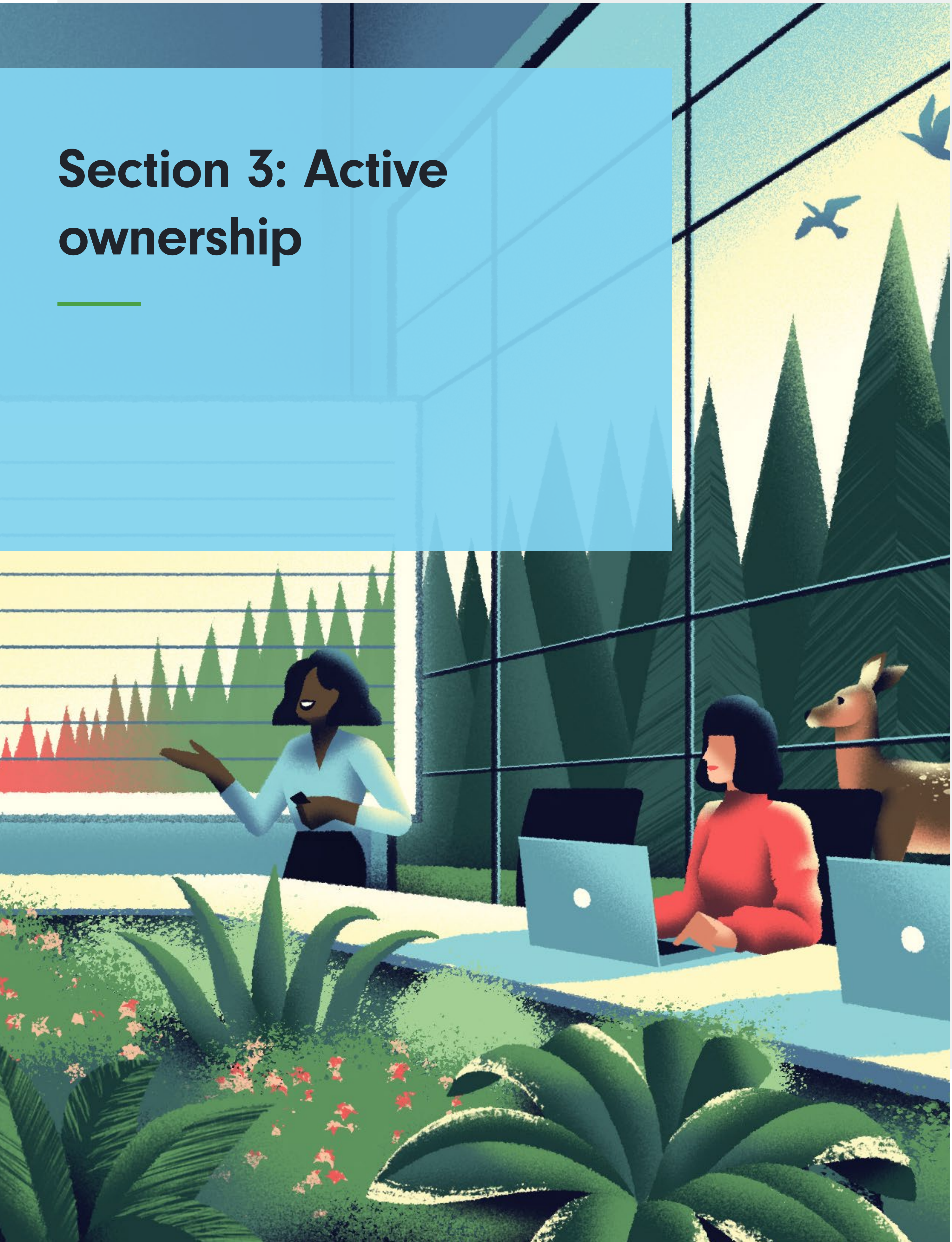
Urgency to act to ensure financial security

As the urgency and frequency of climate-related events increase, there is no time to waste when it comes to decarbonising portfolios. Those with the resources to align their entire investment portfolio should do so. If they cannot, then they can define which portion of the portfolio can be decarbonised and map out a clear, timebound transition strategy. Careful consideration of the challenges and advantages at each stage of the decision-making process will help investors reduce the carbon footprint of the portfolio while meeting other financial goals, ensuring financial security both for beneficiaries today and for the next generation, in alignment with long-term fiduciary interests.

This article is part of Fidelity's Race to Net Zero series that also covers real estate, fixed income, and insurance among other topics. To access other articles in the series, please contact your local advisor.

For more information on Fidelity's approach to ESG integration please see our Sustainable Investing Principles.

Section 3: Active ownership



Active ownership

Active owners engage with companies on environmental, social and governance issues with the aim of improving long-term investment outcomes. Investors play an important role in encouraging companies to improve their ESG practices and have many tools at their disposal to support companies in their transition strategies, ultimately in the long-term interest of clients.

Fidelity's scale affords us a significant level of corporate access. We use this to influence corporate behaviours through shareholder dialogue with companies and voting at company annual general meetings (AGMs), and we seek to engage with policy makers and regulators, in instances for example where there are common market barriers to companies progressing towards their sustainability goals.

Sustainable investing beliefs

In 2022, we updated our sustainable investing beliefs to reflect the evolution in our approach to active ownership. As a large and diversified investment manager across multiple geographies, sectors, and asset classes, we are exposed to systemic environmental and social issues. Our belief is that effective and outcomes-focused stewardship combines bottom-up corporate engagement, top-down thematic engagement, and system-wide stewardship:

- **Bottom-up corporate engagement**. Fidelity's stewardship activities support 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. When it comes to pursuing positive change, our engagement edge continues to rely significantly on the firm's integrated fundamental research process. Our scale and long-standing company relationships give us the opportunity to engage directly with senior decision-makers; in 2022, Fidelity conducted over 2,100 engagements (interactions with companies on ESG issues, including meetings and written communication). 47% of these interactions were with C-suite or Lead Directors.

As a large and diversified investment manager across multiple geographies, sectors, and asset classes, we are exposed to systemic environmental and social issues.

- **Top-down thematic engagement**, where we identify sustainability issues that are relevant to multiple issuers or to specific sectors. The Sustainable Investing team launched a thematic engagement programme in 2018 to accelerate progress on priority ESG issues affecting multiple issuers in which we have current or potential investment interests. In 2022, we engaged on a range of themes including thermal coal and deforestation (see page 32 for more detail.)

- **System-wide stewardship** recognises that healthy capital markets rely on a healthy economy, society, and environment. These are interrelated; our economy is dependent on the environment and society, which are in turn impacted by the economy. As an active investment manager, this involves us taking actions 'within the system' (e.g. the corporate engagement activities described above) but also, where critical to long-term healthy capital markets, taking actions to 'influence the system'. This can include building shared knowledge bases, setting industry standards, or taking part in consultations that may inform regulation in the markets in which we invest.

Where companies' actions and efforts are deemed inadequate, we intensify our dialogue and can also express our position through voting and shareholder resolutions. Equally, through our voting, our aim is to support companies that are making progress.

All the above can be pursued individually, or in close collaboration with other investors and stakeholders. Where companies' actions and efforts are deemed inadequate, we intensify our dialogue and can also express our position through voting and shareholder resolutions. Equally, through our voting, our aim is to support companies that are making progress. The execution of ownership rights, including voting, can improve the performance and lower the risk of investments over time. Our recently updated Voting Principles and Guidelines include policies on setting minimum standards for climate change and gender diversity, reflecting our belief that these pose system-wide risks and therefore require a portfolio-wide active ownership response, involving collaboration wherever possible. For more information on our approach to active ownership, please see our Sustainable Investing Principles.

As an international investment manager, we closely monitor stewardship and governance trends across global markets. We note that issuers in emerging markets may display different attitudes towards investment stewardship as compared to developed market counterparts. To gain a better understanding of specific market trends, we conducted a joint proprietary study with a proxy shareholder service provider on shareholding voting and engagement trends in China and released the "Fidelity International China Stewardship Report 2022".

The study shows that more Chinese companies are publishing ESG reports and actively increasing shareholder communication. Despite an overall increase in proposals at shareholder meetings, plans floated by minority investors remain insignificant in number. Governance related proposals outnumbered environmental and social ones. These local insights allow us to tailor our communication with local companies and improve the effectiveness of engagement and voting activities.

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 sustainable investing themes for 2022 and introduce the systemic themes (mentioned in Overview) that will inform our engagements in 2023 and beyond.

Systemic themes

At Fidelity, we believe that we have a responsibility to play a central role in addressing risks that affect financial markets, and to work with others to improve how markets function. This is in the best interests of our clients, our firm, and the market as a whole. In 2022, we identified four systemic themes where we see opportunities to contribute to the health and preservation of critical systems, namely, by seeking to engage with stakeholders to address climate change, nature loss and social disparities, and to ensure strong and effective governance.

Governance

Effective governance - at multilateral, national, industry and corporate levels - is considered a precondition of effective action on sustainability

Climate

Physical and transition impacts will be reflected in financial performance and asset pricing

Nature loss

Economic activity is demanding more from natural capital than it can sustain

Social disparities

Multi-stakeholder participation - within and between nations - is key to ensuring broad participation in economic growth

Our stewardship priorities will increasingly sit at the intersection of two more of these systemic themes, as was reflected in our 2022 focus themes: just transition and deforestation. On page 32, we review activity for some of the key engagement themes for 2022 and look ahead to how these will evolve in 2023.

Influence framework

Over the year, our stewardship efforts have evolved as we put updated firmwide policies, standards, and tools into practice. To aid this evolution, we introduced an influence framework. This is a tool to help us identify where and how we can align and further our engagement efforts in relation to the systemic themes.

The framework pulls together the various activities we are pursuing in relation to a specific systemic theme. Below is an illustration of the framework in relation to nature, and includes specific activities undertaken in 2022.

Fidelity's spheres of influence

Aiming to effect **real-world change** on **biodiversity** through a range of connected, influencing strategies.

Levels of influence	Examples of Fidelity's actions	
System level Our economic, social and ecological systems are interconnected, and affected by the loss of biodiversity and natural capital in ways that are not yet fully understood but that have wide-ranging implications for capital markets.	▪ Finance for Biodiversity pledge signatory and foundation member ▪ Financial Sector Commitment Letter on Eliminating Commodity-Driven Deforestation signatory ▪ Signatory to the Financial Sector Statement on Biodiversity for COP15	▪ Taskforce on Nature-related Financial Disclosures (TNFD) forum member ▪ Natural Capital Investment Alliance (NCIA) member ▪ Member of the Business Coalition for a Global Plastics Treaty
Industry/sector/cross-portfolio Addressing global biodiversity loss is already starting to inform change across industries, particularly in high-impact sectors. This change requires collaborative efforts to accelerate the necessary transition.	▪ **Thematic engagement:** plastic packaging, deforestation ▪ **Collaborative engagement:** satellite engagement; sustainable proteins: FAIRR & ARE[8] ▪ **Research:** Bioacoustics study	▪ Advocate for sectoral decarbonisation pathways[9] ▪ Member of Principles for Responsible Investment (PRI) Plastics Investor Working Group ▪ Thought leadership
Firm/entity Capital allocation, engagement, and voting inform company behaviour change.	▪ Fidelity's proprietary ESG Rating ▪ Company engagement ▪ Voting	▪ Fidelity's proprietary Climate Rating ▪ Sustainably-linked and green bonds ▪ Deforestation Framework
Individuals Individuals' knowledge, skills, and experience are key to effecting and informing change.	▪ Internal training webinars ▪ Primers ▪ Client engagement	▪ Quarterly internal sustainable investing townhalls ▪ Sustainable investing team collaboration with portfolio managers and analysts

Source: Fidelity International 2022.

The framework reflects four distinct but connected levels of influence we expect to have as an active investor; each level can cover many different types of activities. These range from proactive regulatory engagement (the 'system' level) to more traditional company engagements ('firm/entity' level). The actions illustrated in this example are all targeted towards Fidelity's overall net zero goals (which are intended as a market signal, so ultimately sit under 'system' level).

[8] Farm Animal Investment Risk and Return (FAIRR) and Asia Re-engage (ARE) collaborative engagements
[9] Signatory to the investor letter, coordinated by FAIRR calling for the Food & Agriculture Organisation (FAO) to produce a global roadmap to 1.5 degrees

In this way, the framework relates closely to the three stewardship approaches outlined above: system-level requires system-wide stewardship, industry/sector/cross-portfolio level often involves thematic engagements, and 'firm/entity' level covers bottom-up company engagement. The final, cornerstone layer of the influence framework is 'individuals', who are considered key to any transformative or transitional change, so any commitment to a systemic theme requires educational and training efforts.

We intentionally refer to the framework as an influence rather than impact framework. Fidelity International can act with intent to influence but cannot always pinpoint the real-world outcomes of these actions, nor always the causality or additionality. The framework can help us to continuously review whether the actions we are taking are the most efficient and effective deployment of resources.

Engagement themes in 2022

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 began to integrate the principle of a "just transition" in 2022, encouraging companies to consider the social implications of their decarbonisation approach. A just transition forms a core aspect of our thematic engagement on thermal coal, where energy security implications and inclusivity are embedded in the engagement's objectives.

Our approach to thermal coal

In 2022, Fidelity devised and launched its thermal coal thematic engagement programme, designed to phase out our thermal coal exposure by 2030 in OECD markets and 2040 globally in line with the International Energy Agency's (IEA) Net Zero by 2050 scenario. Thermal coal is one of the biggest contributors to emissions and therefore to climate change. The engagement targets cover over 90% of Fidelity's direct, material exposure to the thermal coal value chain with highly focused, time-bound engagement. Each target has also been subject to a detailed assessment that reflects its progress in meeting our phaseout commitment. These assessments have informed a broad categorisation system, which in turn has defined a common set of engagement objectives across the programme:

1. **Entities developing new capacity**
   We expect these entities to immediately cease the development of new projects.
2. **Entities expected to operate or support plants beyond 2030 in OECD markets and 2040 globally**
   We ask these entities to commit to shut down or substantially abate their existing assets by the timelines set out in our policy (guided by the IEA's Net Zero by 2050 scenario), supported by enhanced disclosures.
3. **Entities with strategies aligned to our long-term goals**
   We focus on encouraging that phaseout strategies that are just and inclusive and limit any adverse impacts on wider stakeholders. We also prioritise biodiversity, ensuring plant or mine remediations are responsibly managed.

Thermal coal engagement in 2022

In 2022, we conducted our first round of corporate engagements focused predominantly on EMEA, Oceania and the Americas, covering roughly half of the engagement targets globally. These engagements have been highly constructive, allowing us to hear first-hand some of the key challenges to coal phaseouts experienced by plant operators, mine owners and freight companies, that have helped us to identify potential solutions from those in more advanced stages of transition. The engagements have also afforded us the opportunity to introduce our approach and communicate our expectations to corporates.

2022 has been a significant year for many companies in our engagement universe and we are seeing promising signs of progress. Compelling examples of this are **RWE's** announcement in October to accelerate its coal phaseout from 2038 to 2030, **Origin Energy's** plan to accelerate the retirement of its last remaining coal plant to 2025, and **Glencore's** announcement to withdraw from a major greenfield coal project, Valeria. We also publicly supported **BHP's** decision to wind down its Mount Arthur coal mine, abandoning plans to sell the asset to a third party which may have jeopardised hopes for a timely, just and inclusive closure. In Asia, we have also seen promising signals from Indonesia with the announcement of a Just Energy Transition Partnership (JETP) during COP27 and an early retirement for the first coal plant under the Asia Development Bank's (ADB) Energy Transition Mechanism (ETM). And in the US, we expect potentially significant revisions to Integrated Resource Plans (IRPs) at the likes of **Ameren** and other regulated utilities in response to the substantial tax credits offered by the Inflation Reduction Act.

Deforestation

Nature loss presents substantial risks for society and our funds' portfolio holdings. Our overall approach is detailed in a Deforestation Framework published in December 2022. We have been engaging companies on palm oil use since 2019 mainly in South-East Asia. For example, in 2021, we engaged with five upstream growers in Indonesia and Malaysia, where palm oil production accounts for over 80% of global output, to understand their progress and approach towards achieving sustainable palm oil. Moving forward, we continue to encourage companies to align with the seven principles of the Roundtable on Sustainable Palm Oil (RSPO) through better disclosures and best-in-class management practices.

In late 2021, Fidelity signed the Financial Sector Commitment Letter on Eliminating Commodity-Driven Deforestation unveiled at COP26, an initiative now named Financial Sector Deforestation Action (FSDA). As a signatory, Fidelity committed to use best efforts towards the goal of eliminating agricultural commodity-driven deforestation activities in investment portfolios via engagement and stewardship by 2025. In 2022, therefore, we widened the scope of our existing palm oil thematic engagement to create a deforestation thematic engagement covering the key forest risk commodities identified by the pledge: palm oil, beef/leather, soy, and timber products.

Our deforestation thematic engagement prioritises companies with weak practices that are materially exposed to potential tropical deforestation risk. We also prioritise our engagements based on our holdings. To identify our target list of companies, we leverage third-party data, including Global Canopy's Forest 500 data, to determine those companies most exposed and able to influence tropical deforestation risk, complemented by bottom-up due diligence by our analysts. Below are examples of some of the companies we engaged with in 2022.

- Brazil-based **JBS**, the world's largest meat processing company, is the focus of ESG related scrutiny, owing to its position in the beef market in Brazil and alleged deforestation related controversies. We had a constructive two-way dialogue, indicating areas where enhanced and more transparent disclosures, underpinned by clear commitments and quantitative targets, would be preferable, while the company was able to highlight some initiatives where it is making progress.

- In Europe, we also engaged with a large forestry company (**UPM**). Reassuringly, the company is ahead of the curve in managing their deforestation risk across the supply chain and broader impacts on biodiversity. The firm has a long-established policy of zero deforestation with full supply chain traceability to ensure monitoring and oversight. The company engages across the supply chain and more broadly at the system level to encourage better standards, including its engagement program with small farmers to help facilitate certification. Following the engagement, we believe that the company is managing its deforestation risk and can be used as a case study for peers, while ongoing monitoring is needed to ensure that they continue to adhere to best practice.
- One of the greatest challenges in addressing deforestation risk is supply chain traceability. In Q3, we engaged with a luxury goods company (**Prada**) on deforestation risk and modern slavery in the supply chain. We identified areas where the company's disclosures, policy, and targets could improve. Positively, they were clearly aware of the work that needs to be done, with the company in the process of making changes in line with many of the points we addressed. Importantly, as a part of their public commitment to the Fashion Pact, they flagged that they have already made a commitment to support zero deforestation and sustainable forest management by 2025 and will be looking to disclose their efforts more clearly in their own reporting.
- In Japan, deforestation is a more nascent topic for companies and investors alike. When engaging with Japanese companies, we emphasised the level of urgency with which companies should be tackling deforestation risk given that the UK and EU have introduced laws to combat deforestation risk for imports, with pending legislation in the US, as well as increased investor scrutiny on the topic, which could affect their access to capital. We also emphasised that reducing deforestation risk could be an effective lever with which to reduce upstream scope 3 emissions. We explained how a good traceability system can lift other areas such as managing supply chain risks and ensuring human rights, as well as reducing the carbon footprint of products. We believe the multi-faceted benefits of tackling deforestation in the supply chain resonated with the companies, with one promising to share quantitative metrics soon on their traceability initiative. In the short term, we will be monitoring enhanced disclosure such as responding to the CDP Forests initiative and improving traceability, so that companies can commit to an No-deforestation, No-peat, No-exploitation (NDPE) policy over the medium term.

Double materiality

In 2022, we updated our proprietary ESG ratings so that they could be applied to firms through a "double materiality" lens, assessing both the financial impact of ESG factors like climate risk on a company but also the company's management of negative ESG externalities (see page 19). We also sought to understand how our investee companies were thinking about double materiality.

It has been a point of contention between European and global standard setters about what companies should disclose in this area. While climate risk is increasingly financial risk in our view, we continue to believe having both viewpoints reflected in our analysis gives us a better understanding of longer-term physical and transition risks a company might face, for example, if carbon emissions emitted by a company begin to be priced in a significant manner or companies become liable to be sued for their impact on the planet. This approach also reflects the changing regulatory environment.

Engagement themes for 2023

In line with our new systemic approach outlined above, we will continue to engage with companies across our four main systemic themes on a multi-year basis, but the focus on sub-themes within those may change. We continue to engage with firms on their governance structures, remuneration and culture, using engagement on governance issues and voting to drive change in the three other thematic areas. Below we set out the sub-themes we intend to focus on in 2023 and how they connect to the systemic themes.

Climate: Just transition and high emitters

Under the systemic climate theme for 2023, we will continue to pursue our key sub-theme around the just transition, with thermal coal remaining the priority as we roll out our corporate engagement programme in Asia Pacific and extend our policy engagement efforts, which will be informed by our learnings from discussions with our investee companies.

Continued dependence on thermal coal for power generation despite warnings and increasingly viable alternatives reflects the highly complex systems of incentives and interests involved. We are therefore looking beyond engagement with our direct exposure at the extremes of the value chain (power generation and mining) to other enablers and interested parties who can unlock the opportunities needed to decarbonise, tackling the issue systemically. In 2022, we contributed to various policy consultations and workstreams including those run by the Glasgow Financial Alliance for Net Zero (GFANZ) and the Powering Past Coal Alliance (PPCA).

We are also a founding participant of the Just Transition Finance Challenge, which aims to mobilise more public and private capital into investments that support a just transition through development of a voluntary product label. The criteria for the label were unveiled following public consultation in 2023 and aim to ensure three critical elements of a just transition: advancing climate and environmental action, improving socio-economic distribution and equity, and increasing community voice.

In 2023, we aim to carry over some of this experience to our top 70% emitters across all sectors and engage with them on their transition pathways, supporting adoption of clean alternatives through existing technologies such as wind and solar and emerging technologies such as hydrogen and batteries. We are also engaging at policymaker level on forthcoming disclosure frameworks such as the ISSB and the European Sustainability Reporting Standards prescribed by CSRD and highlighting the need for global compliance carbon markets. As more companies disclose transition plans, we expect more of a spotlight on policy barriers to achieving net zero.

Nature: Deforestation, biodiversity, and natural capital

As mentioned above, we consider that deforestation sits at the intersection between climate change and nature; given the importance of trying to eliminate it from our portfolios, we will continue to engage with companies on ending deforestation across agricultural commodities that pose the greatest risk.

This includes expanding on an engagement that began in 2022 with financial institutions. These engagements highlighted the uphill battle banks have with respect to addressing deforestation risk in their portfolios. Limited traceability across supply chains, lack of transparency, inconsistency of client disclosures, and lack of supportive policy are key challenges that were highlighted.

The banks acknowledged the need to address deforestation risk as part of their net zero commitments, and subsequently are working on updating their existing deforestation policies, with one of the banks in question expanding the scope of their policy to include downstream players. Until these policies are finalised, implemented and reported on, there is uncertainty as to how banks will hold clients to account on deforestation risks in the face of limited traceability of supply chains and lack of transparency.

In 2023, we will also be encouraging boards to show a greater understanding of their companies' deforestation risk. We recently amended our voting guidelines to support this engagement. The amendment will enable us to escalate concerns on deforestation risk to votes against members of the board at companies in high-risk sectors that do not adequately meet our deforestation-related expectations.

While biodiversity is still emerging as a theme, we are beginning to see policies develop that go beyond mitigating deforestation risk and actively encourage changes to farming and land use to promote nature recovery and introduce more regenerative farming techniques. More regulation on pesticide use is also expected as countries seek to respond to ambitions expressed at COP15 and we will be monitoring closely the corporate disclosures on nature that emerge. It is likely that these will begin with areas that are easier to measure such as risks to natural capital including water supply.

Farmers attend regenerative farming training which aim to holistically rehabilitate farm ecosystems. (Credit: Mario Tama / Staff, Getty Images)

Engagement and voting in 2022

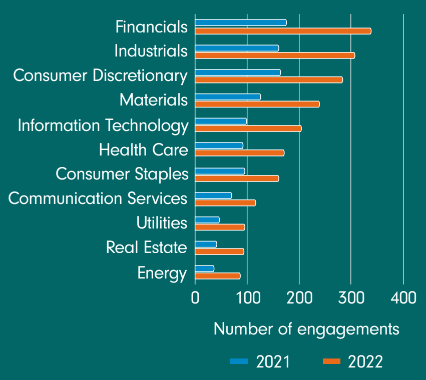
Engagement

2,118
Number of engagements*

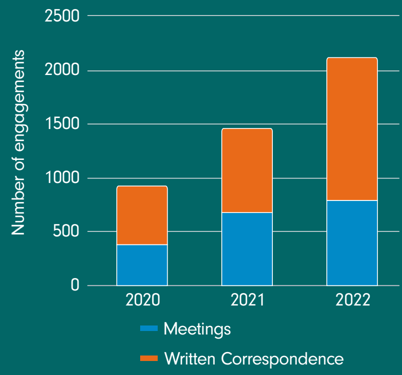
1,548
Companies actively engaged

19,000
Number of company meetings with analysts**

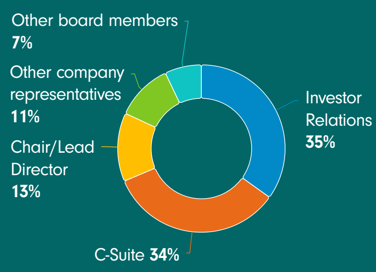
Engagements by sector



Engagements by year and mode



Engagements by company representatives



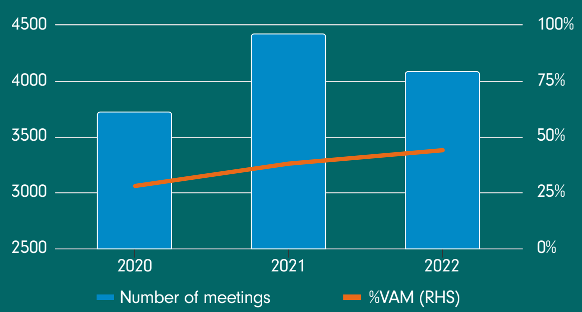
Voting

4,090
Total meetings at which we had a vote***

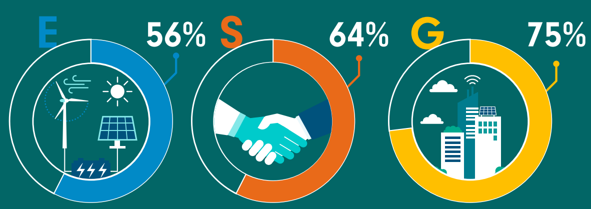
44%
Meetings where we voted against management

58
Companies where we voted against/abstained directors for not meeting minimum climate standards

Meetings voted and %VAM****



Shareholder proposals supported



*The 2,118 figure refers to interactions with companies on ESG issues for the purpose of influencing their ESG practices or improving their ESG disclosure and include meetings (in-person or remote) and written forms of communication.

**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. 2022 figures include private issuers and meetings undertaken by Fidelity Canada.

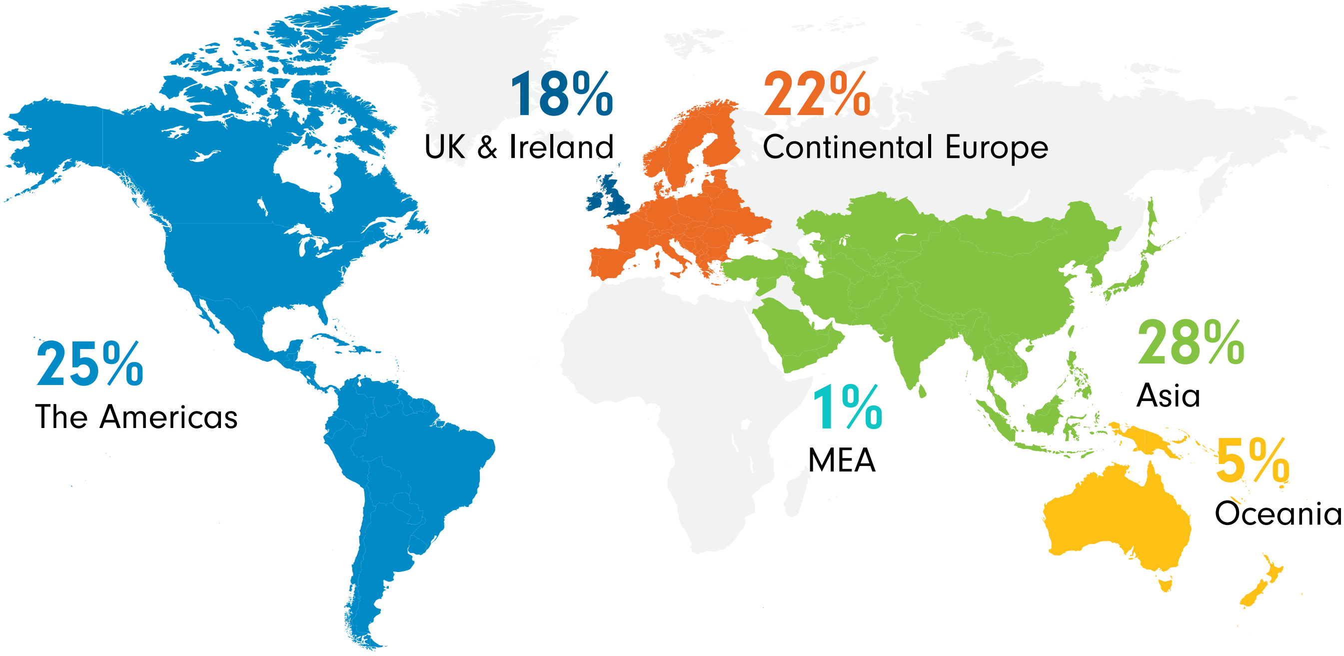
***Fidelity submitted votes at 3,916 of 4,090 meetings. We did not submit votes in instances where voting impediments prevented us from doing so. For more information, see our Voting Principles and Guidelines.

****VAM = Vote against management recommendation. Refers to instances where Fidelity voted contrary to the board or management's recommendation on a given proposal.

Engagement in 2022

Fidelity conducted 2,118 ESG engagement activities[10] with 1,548 companies during 2022. This comprised 791 in-person or remote engagement meetings with companies and 1,327 written communications, including letters and communications related to voting. This included 192 meetings with chairs and other non-executive directors and 267 meetings with CEOs, CFOs, and other executive directors. The largest share of ESG engagement activities were with companies based in Asia (c. 28%) followed by the Americas (25%), Continental Europe (22%), UK and Ireland (18%) and Oceania (5%).

Engagement by region



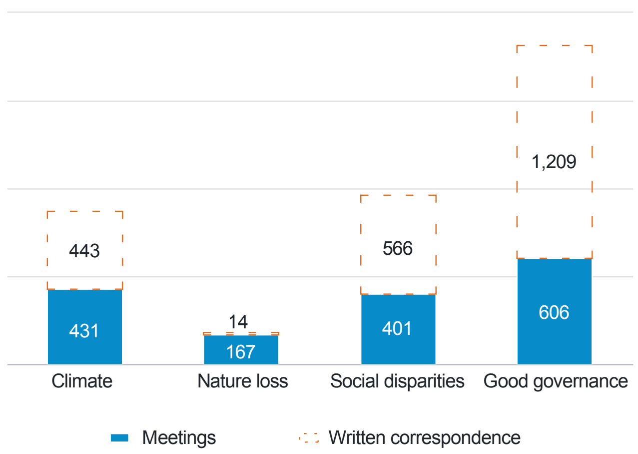
Source: Fidelity International, March 2023. Percentages may not add up to 100% due to rounding.

We track and report our ESG engagement activities across four broad systemic themes: climate, nature loss, social disparities, and good governance. For our engagement in-person or remote meetings: 77% of meetings discussed good governance, 54% climate, 51% social disparities and 21% nature loss.

For all engagement interactions, including written communication, 86% covered good governance, 46% social disparities, 41% climate and 9% nature loss. Written communications predominately relate to communications on our shareholder voting for the purpose of improving a company's ESG practices. Note that many of our ESG engagement activities may cover more than one of the four systemic themes. While nature engagements (meetings and correspondence) have been fewer than other systemic themes in 2022, we have seen a significant increase on like-for-like 2021 figures and we expect the topic to remain relevant for firms in 2023 and beyond.

[10]This refers to interactions with companies on ESG issues for the purpose of influencing their ESG practices or improving their ESG disclosure and include meetings (in-person or remote) and written forms of communication.

Chart 6: Engagement by systemic theme



Source: Fidelity International, March 2023.

Generally, a large proportion of our engagements take the form of face-to-face dialogue, and these types of meetings increased in 2022 as Covid-19 pandemic restrictions were lifted in many regions. Written correspondence includes letter-writing campaigns and email correspondence, often related to voting at shareholder meetings.

Monitoring the progress of engagements is as important as initiating them to assess change and calibrate success against milestones and objectives.

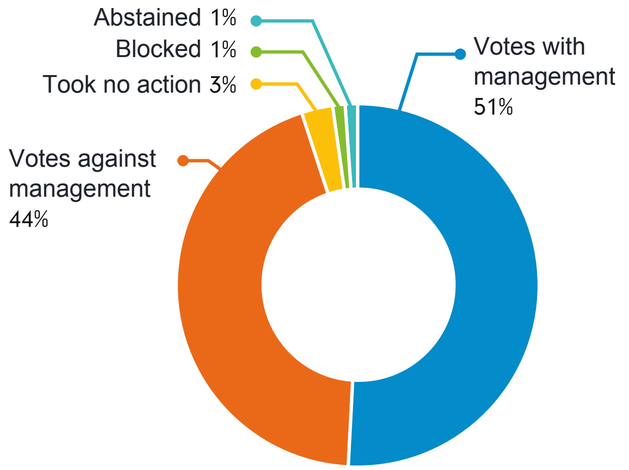
Our analysts, portfolio managers and sustainable investing specialists document all engagements with issuers on our centralised research platform, which has a dedicated functionality to tag ESG engagements, including key topics, milestones, form of engagement (thematic, reactive etc), as well as various other characteristics. Recording engagements in this way enables efficient access to relevant information for our investment teams across sectors, themes and asset classes. It also accommodates effective reporting and monitoring of progress on engagements (see below for case studies).

Voting in 2022

Fidelity analysed 4,090 shareholder meetings in 2022. Of these, we voted at 95.7%. We did not vote at 4.3%; this generally related to meetings where share blocking was applied to our fund holdings, or to voting events for Fidelity funds, at which we do not vote as per our conflict-of-interest policy. We also ceased voting related to Russian securities in 2022 after the Russian invasion of Ukraine, in line with our policy to wind down Russian holdings.

We voted against management on at least one resolution at 44% of the meetings we covered, and we abstained on at least one item at 1%. We generally abstain when there is not enough information to make an informed voting decision, or on occasion to send a cautionary message to the company.

Chart 7: Summary of votes cast (meeting-level)

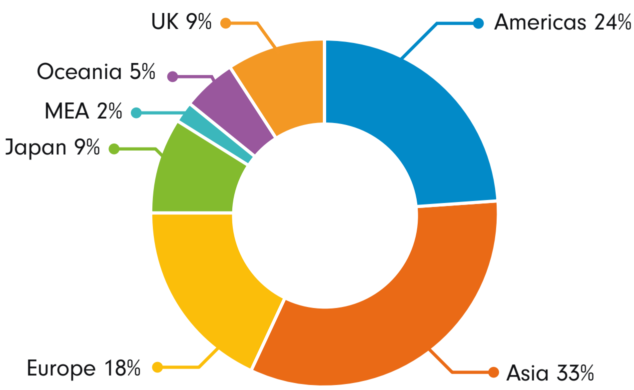


Source: Fidelity International, December 2022.

Our voting reflects the global nature of our fund products. 42% of votes cast by Fidelity were for Asian (including Japanese) companies in 2022. This next two most prominent voting regions were Europe incl. UK (27%) and the Americas

(24%). 2022 was the first full year we applied our new voting guidelines, and the evolution of our approach encompassing E&S themes is reflected in our voting record.

Chart 8: Summary of meetings by region



Source: Fidelity International, December 2022.

In 2022, we voted against or abstained on director elections at over 400 companies globally to reflect concerns on board diversity (c. 10% of all meetings at which Fidelity voted). Diversity concern was the second most common reason we voted against the board's recommendation on director elections last year behind director independence.

We also voted against or abstained on directors at 58 companies last year which failed to meet our minimum expectations on climate change governance, disclosures, and strategy, and we supported c. 55% of climate shareholder proposals we voted on. We also voted against the board's recommendation on c. 30% of proposals related to climate action (otherwise known as 'say on climate'), reflecting the high standard we set for companies seeking shareholder endorsement of their climate strategy. Overall, we cast a vote against the board's recommendation (incl. abstentions) on at least one resolution for climate reasons at 20% of AGMs that we voted at for high impact companies in 2022.[11]

Votes against management by proposal type

Proposal Type	Votes against management*	
Remuneration	969	18%
Charter Amendments	107	8%
Strategic/Restructuring	33	3%
Board	1363	6%
Capital Structures	294	5%
Routine Business	165	4%
Takeover Related	25	7%
Auditors	386	14%
Shareholder Proposals	440	36%

Reasons for voting against directors

Proposal Type	Votes against management
1. Independence	651
2. Diversity	408
3. Conduct	96
4. Remuneration	128
5. Climate	52

We have two substantial changes planned to our voting disclosures that are expected to go live in 2023: (i) a new voting disclosures website where our voting records will be disclosed on a rolling basis closer to the date of the vote, and (ii) voting bulletins providing in-depth narrative on significant votes (previously, significant votes for the purposes of the EU Shareholder Rights Directive II have been provided in our stewardship code report).

*Votes against management refers to instances where Fidelity voted contrary to the board or management's recommendation on a given proposal. Percentages in this table show the proportion of votes against management relative to overall votes cast on that particular proposal type.

Source: Fidelity International (2022), ISS (2022).

[11]Issuers Fidelity has defined as high impact. This includes Climate Action 100+ focus issuers, and issuers' operations in the following sectors where Fidelity had a significant holding (>$20m or 1% ISC): Automobiles & Components, Banks, Capital Goods, Consumer Durables & Apparel, Diversified Financials, Energy, Food, Beverage & Tobacco, Insurance, Materials, Real Estate, Technology Hardware & Equipment, Transportation and Utilities.

Engagement examples

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

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

During 2022, in addition to rolling out our Climate Rating we launched our thematic engagement on thermal coal. As allocators of capital, we have a responsibility to provide transition financing that takes into consideration the effects of the transition on those who are most vulnerable: workers, communities and consumers, particularly in emerging markets (see page 32 for more details).

We also began engaging with our investee companies on their public policy positions in relation to sustainability and specifically our systemic themes and signed up to the Global Standard on Responsible Climate Lobbying. As part of our Climate Rating, Fidelity's fundamental and sustainable investing analysts assess each company's policy stance on specific sustainability issues and where they differ from peers.

Where companies score poorly on their policy approach, it affects their overall Climate Rating. Lower ratings may prompt greater engagement or in the event of no progress within a specific period, divestment can be an option.

Climate-related engagement

In 2022, our fundamental and sustainable investing analysts engaged extensively with companies to improve the ambition of climate change strategies and quality of disclosures in over 500 engagements.

We also began engaging with our investee companies on their public policy positions in relation to sustainability and specifically our systemic themes and signed up to the Global Standard on Responsible Climate Lobbying.

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 IIGCC and Climate Action 100+ initiatives outlined below is a critical aspect of our collaborative engagement on climate. 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.

Climate-related voting

2022 was the first full year we applied our new voting guidelines on climate change as set out in our Voting Principles and Guidelines. In 2022, we voted against or abstained on directors at 58 companies which failed to meet our minimum expectations on climate change governance, disclosures, and strategy. We engaged with companies on our new voting guidelines before the AGM season and we have seen many companies committing to improve their disclosure or to introduce reduction targets as a result. In these instances, we did not lodge climate-related concerns at the AGM. Going forward, we will continue to evolve our voting guidelines and will be looking to elevate our requirements, especially for high emitters. We remain committed to voting against directors at companies that we believe are failing to adequately address the risks and opportunities posed by climate change.

Lake Oroville reservoir during the California drought emergency. (Credit: Patrick T. Fallon / Contributor Gety Images)

Case study

Wind turbines stand on the edge of a mine. (Credit: Bernd Lauter / Contributor, Getty Images)

Climate Action 100+

As a member of Climate Action 100+, we are co-leads on four collaborative engagements, targeted at addressing decarbonisation amongst the world's largest GHG emitters, and are also supporting investors on six other engagements.

Chinese Oil and Gas Company

In November 2022, Fidelity acted as co-lead on the Climate Action 100+ (CA100+) engagement with a top Chinese Oil & Gas company. This is the second CA100+ engagement Fidelity has co-led with this company over the last three years.

Prior to engagement, the company had fared poorly in past CA100+ Net Zero Company Benchmark assessments, falling short of its domestic and international peers. After three years of ongoing communication and engagement, the company has advanced its climate agenda evidenced by an enhanced climate governance structure, linking green transition KPIs to executive remuneration, setting more detailed dual-carbon goals, and further substantiating its sustainability reporting. From our conversation, it was also very clear that the company plans to invest more into new energy and business types, and continue its research and development around carbon capture, utilisation, and storage (CCUS), and hydrogen technology to enable a greener transition.

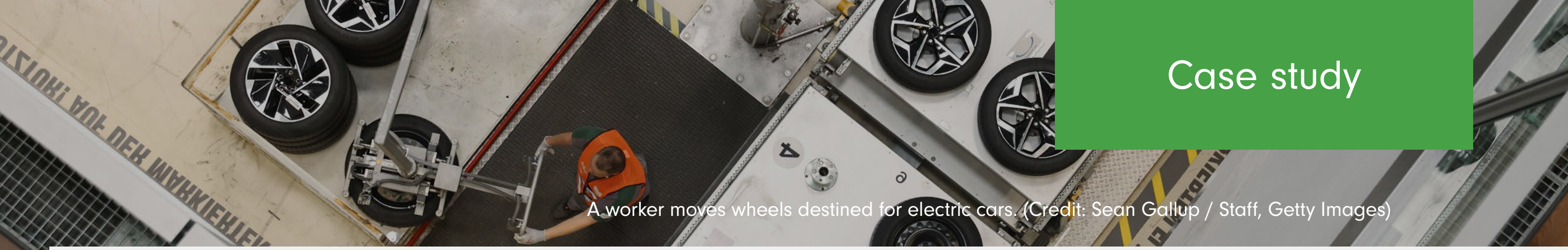
Nevertheless, there we identified and shared key areas that needed improvement, such as the role that "crude oil-to-chemicals" and "oil to special products conversion" will play in lowering the company's overall GHG emissions in the long term, and how it plans to achieve the ideal output capacity breakdown by 2035. The company agreed to a follow up meeting in 2023.

Grupo Mexico SAB de CV

As part of our CA100+ engagement, Fidelity hosted two calls during the year with several representatives of the Grupo Mexico SAB de CV mining company, including the CFO, the CEO of the infrastructure division and the Chief Sustainability Officer. We welcomed the opportunity to engage with various parts of the business and the additional details provided by the company during our last discussion. The company will be disclosing its new emissions reduction targets in the next Sustainability Report . They are also considering setting interim targets for all three divisions and including climate performance into executive remuneration.

They have set up a sustainability committee at the mining division and are now considering doing the same at the main board level. The company's climate roadmap is expected to focus on four areas: electrification of mining vehicles (25% of their emissions), construction of renewable energy projects, fuel substitution in trains (25% emissions) and energy efficiency.

Their main renewable project (Fenicias wind farm, a US$250m investment) is not operating yet due to a dispute with the government on interconnection costs. Other technologies are at exploratory stage. We encouraged them to enhance their disclosure and provide more details on their progress and technologies explored by division. We will be monitoring their progress and the release of the GHG emissions reduction target.


A worker moves wheels destined for electric cars. (Credit: Sean Gallup / Staff, Getty Images)

Case study

IIGCC/Ceres banking initiative

Fidelity International has been an active participant in the IIGCC Banking Workstream since 2021. In 2022, to complement this collaborative European-based engagement initiative, we joined the Ceres Banking Workstream, focused on engagement with North American banks, aligned to the work of IIGCC. Both engagement initiatives are targeted at aligning the banking sector with the goals of the Paris Agreement, guided by the Transition Pathway Initiative Net Zero Transition Framework, which has been developed in parallel, and to which Fidelity has contributed feedback.

Fidelity is acting as supporting shareholder on two of the engagements with European banks. The first bank we are engaging with has made good progress in the last 12 months, setting short-term 2025 targets to reduce financed emissions across three high-impact sectors: power generation, oil & gas and automotive, while also implementing a coal phaseout commitment by 2030 in OECD countries and 2040 globally. We acknowledged the good progress that the bank has made, while also highlighting key areas where we expect incremental progress, including comprehensive scope 3 financed emissions disclosures, extending to include capital markets activity, advancing their oil & gas emissions reduction targets to include absolute reductions, in addition to the intensity-based target, as well as the need to set additional sectoral targets.

The second bank that we are engaging with has also made progress towards their net zero commitment, although there is still significant room for improvement. The bank has set sectoral emissions reduction targets for its coal and oil & gas portfolios. However, these targets fail to include capital markets activity, which accounts for most of the bank's oil & gas exposure. Therefore, we strongly advised that the bank increases the scope of targets to include capital markets, as some peers already have. In addition, the bank has developed its 'Client Energy Transition Framework' (CETF), classifying clients according to their awareness of the transition and committing to stop financing clients who are classified as 'unaware'. However, the group provides no visibility on the criteria they use to assess transition awareness. Another issue that we flagged to the bank is that as part of their coal policy there is an exception for financing to companies that have a 'credible transition strategy'. However, the bank fails to define the criteria that they use to assess credibility. The team acknowledged that greater transparency is warranted here, and with respect to the CETF framework. We also encouraged the bank to disclose more information on its lobbying activities and industry associations in the context of aligning to the Paris Agreement.

While this is the first time the bank had come across this request from investors, they welcomed the suggestion. The Ceres engagement initiative was launched in the autumn of 2022. Fidelity has signed up to lead on an engagement with one US Super-Regional bank that we consider to be a climate laggard. The bank has yet to implement a net zero commitment or disclose information on its scope 3 financed emissions data. Our engagement will focus on both the risks and opportunities the bank may face in the climate transition, tailored to its unique business model. The engagement is due to commence in the first half of 2023.

Nature

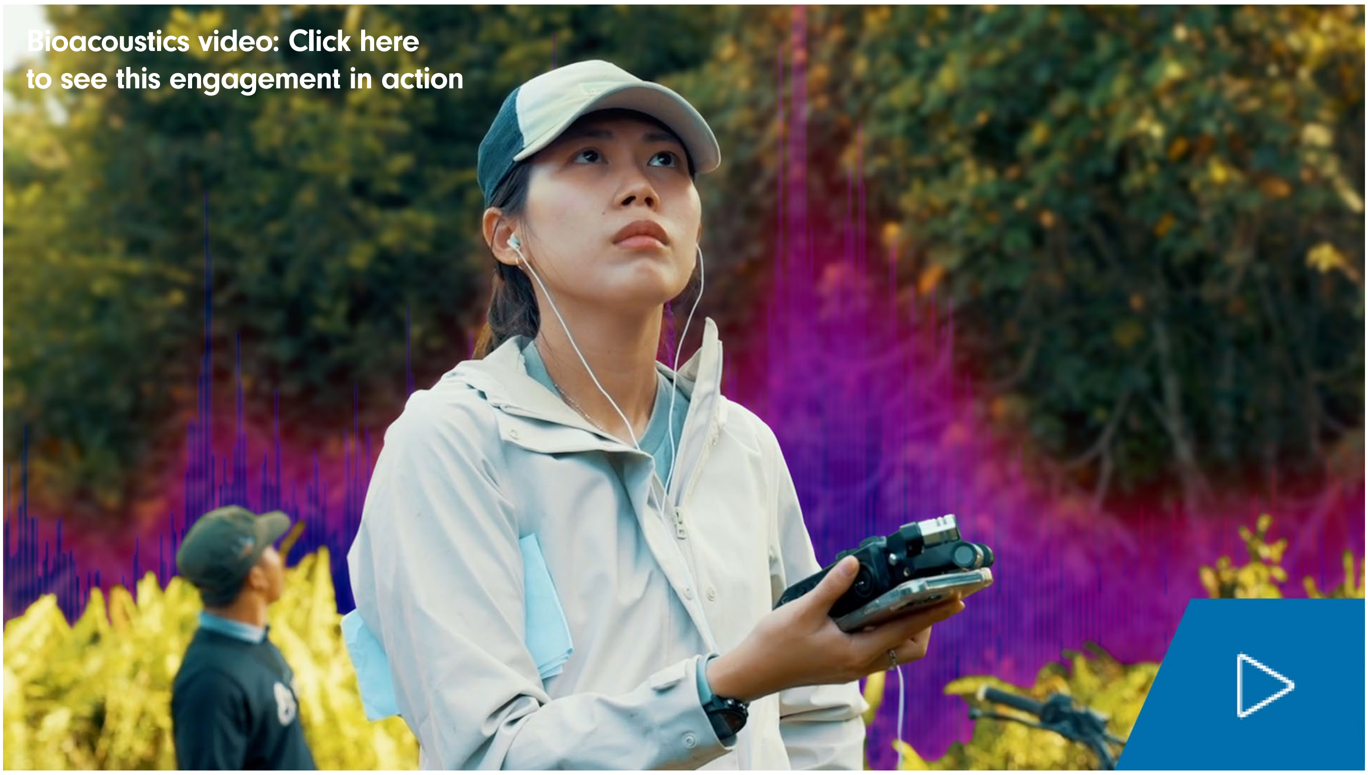
As mentioned above, nature and biodiversity are emerging as key themes for investors. In 2022, we began to explore ways to approach this broad topic. Unlike climate change and GHG emissions, biodiversity loss is hard to measure with a single metric. However, there are innovative solutions to measurement and monitoring of actual biodiversity loss emerging to address this challenge. Below we outline a case study in which Fidelity partnered with an initiative seeking to measure species through the sounds they make.

Collaborative bioacoustics project

In collaboration with ACTIAM and two other asset managers, Fidelity co-sponsored a pilot bioacoustics project with Green PRAXIS, a nature-based solutions provider, exploring the use case for bioacoustics technology to measure and monitor biodiversity.

Bioacoustics monitoring is a low-cost, non-invasive technology, which combines sound recording with artificial intelligence to gain insight into the state of species health in any given location. Other more commonly used methods to measure biodiversity include counting the number of species (richness) and the number of individuals of each species (abundance) which requires time and expertise and may be intrusive to the local ecosystem. In contrast, bioacoustics has the potential to provide a fast and scalable alternative.

Its use could provide a baseline against which to measure biodiversity over time and across different land uses, informing more sustainable land use. The



aim of the project is to develop a fast, affordable and reliable way for users, including companies that we may invest in, to measure and monitor biodiversity. These insights can help companies better understand their impact on biodiversity and how to adopt more sustainable practices.

In autumn 2022, the team at Green PRAXIS gathered raw data from palm oil plantations in Indonesia, taking sound recordings across conservation and production plots. The analysis of the data is still in its early phases, with no conclusive results to show yet. However, initial analysis shows clear differences between the conservation and production plots of land. Full results from the first pilot study are due to be published in late spring of 2023 with the hope of conducting a second pilot to demonstrate the scalability potential of this technology as a means of understanding and monitoring biodiversity intactness.

Results of Bioacoustic data discussed. (Credit: Fidelity International, May 2023)

Social

Social concerns were aggravated in 2022 by substantial increases in the cost of living that came hard on the heels of the pandemic and the Russia-Ukraine conflict. In addition to engaging with senior executives on pay levels during the crisis (see Governance section), we continued to build on our engagements in other areas such as the social license to provide transition metals where pricing pressures typically heighten associated risks, modern slavery, and digital ethics.

Social license to operate

In 2022, one of our research projects led us to identify that maintaining the social license to operate for the mining sector is key to the sector and the world being able to decarbonise. Fidelity analysts' research, and bodies such as the IEA, have identified that demand for transition minerals and some enabling metals like steel is likely to increase as companies deploy the technologies and infrastructure considered to be required for a low-carbon economy.

We wrote an article to raise awareness about this topic and shared it with other investors, the media and wider community: The decarbonisation and mining paradox: Challenges and long-term opportunities for investors. We had multiple conversations with companies such as BHP, Rio Tinto and Mineral Resources about the need to work as a sector to strengthen the social license of mining as a whole.

We did a specific deep dive on the Australian mining sector's ability to access talent, particularly in a tight labour environment. Through engagement with the Minerals Council of Australia (MCA) and the International Council on Mining and Metals (ICMM), we identified that the sector is increasingly losing its appeal to younger generations, which is leading to universities closing their mining programs or activists sabotaging the sector. This presents a medium to long-term bottleneck for the sector and we are engaging with corporate, university and local stakeholders focused on developing the skills required for a sustainable Australia to address this.

Modern slavery

During 2022, we strengthened how we capture and conduct due diligence on companies' exposure to modern slavery risk through changes in the second iteration of our ESG rating. We undertook a risk-based analysis of sections of portfolios and built capacity internally with key analysts and portfolio managers on the subject.

Case study


Female workers packing fresh strawberries into trays on fruit farm / Monty Rakusen, Getty Images)

Modern Slavery

Find it, Fix it, Prevent it

Since 2020, Fidelity International has been participating in a collaborative engagement initiative called ‘Find it, Fix it, Prevent it’ led by UK asset manager CCLA, initially focusing on the UK hospitality sector. This year, the initiative is expanding to the construction materials sector and Fidelity will be leading on two company engagements.

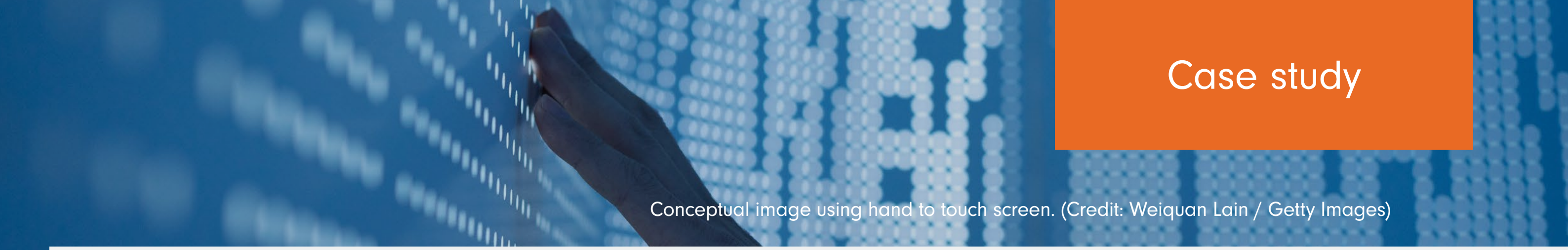
In 2022, Fidelity’s investment team had a call with several non-executive directors to discuss one company’s progress in this area. Among other topics, we discussed the company’s approach to monitoring its thousands of suppliers. In 2022, the company launched a “Sustainable Procurement Project” where the procurement team aims to assess its largest suppliers on sustainability. It has approached its 450 largest suppliers and asked them to complete an Ecovadis assessment. As of end of August 2022, 200 suppliers were rated, and no issue had been uncovered. About 100 suppliers declined to respond, mainly due to a lack of capacity or data.

The company has not decided yet on the next steps for suppliers who declined to respond but noted that it will put them at a disadvantage in the next tender processes. We made suggestions to improve their disclosure and provide details on the characteristics of their supply chain and the results of their risk assessment on modern slavery. We will also monitor their progress on suppliers’ assessments and how it impacts their purchasing decisions.

IAST APAC

We are part of the Investors Against Slavery and Trafficking initiative in Asia-Pacific known as IAST APAC. It was established by asset owners and managers in 2020 to promote effective action by companies to find, fix and prevent modern slavery, labour exploitation and human trafficking. It comprises 37 asset owner and asset manager members, representing AU$8.2 trillion in assets under management (AUM)*. Members are based in APAC countries, including Australia, Hong Kong, Japan and Singapore and focus on investor advocacy and company engagement.

In 2020-21, the group sent a statement to leading Australian listed companies (ASX 200). The statement set out investor expectations regarding company action to assess and address modern slavery, going beyond the requirements of the Australian Modern Slavery Act. In 2022, IAST APAC followed this up with a submission to the Australian Modern Slavery Act Review, making recommendations to strengthen the law to provide stronger disclosure of modern slavery risk in future and contributing to a range of consultations on similar relevant issues. The group helps investors improve their engagements with companies by sharing best practice and useful frameworks, and we will continue to work with it in 2023.



Case study

Conceptual image using hand to touch screen. (Credit: Weiquan Lain / Getty Images)

Digital ethics: WBA Collective Impact Coalition (CIC) for digital inclusion

Digital ethics is another area which interconnects two systemic themes: social and governance. This year, we have chosen to include it in the 'Social' section as new types of artificial intelligence increasingly have widespread social implications.

Fidelity is working to lead the investor group of the cross-stakeholder Collective Impact Coalition (CIC) focusing on ethical AI, which formally launched in September 2022. This collaborative investor engagement is informed by the World Benchmarking Alliance (WBA)'s Digital Inclusion Benchmark (DIB), which rates 150 digital economy companies on a range of digital ethics and inclusion factors, including ethical AI. The DIB found that 130 companies currently do not make public commitments to ethical AI; therefore, we have brought together approximately 30 institutional investors to engage with digital economy companies on issues of ethical AI.

Our objectives are to:

- Raise awareness of the importance of responsible and ethical artificial intelligence: AI should be developed and deployed with well-developed and well-communicated ethical principles
- Increase understanding of the state of play and leading best practices on ethical AI
- Increase the number of companies making public commitments to ethical AI principles by the world's most influential tech and digital economy companies

The four foundational questions we are using to structure our dialogues with companies are:

1. How does the company consider, define, develop and deploy artificial intelligence in its business operations and strategy
2. How and whether ethical considerations are integrated and operationalised in the development and deployment of AI
3. Who is responsible for and how are ethical considerations of AI monitored and governed in the company
4. Whether the company would consider making a public commitment to ethical AI (or is perhaps already in the process of doing so).

Within this framework, Fidelity began engaging with individual companies in 2022, including a Chinese internet platform, a global social media company and a US networking and cybersecurity solutions provider. We find a range of company activities within ethical AI, as well as a wide dispersion of willingness to discuss the topic with investors: with some companies valuing transparency, and others apparently very lagging and/or secretive. Developments such as the arrival of ChatGPT have transformed the AI landscape in 2022 and it has yet to become clear exactly what the societal implications of this type of technology will be.

In 2023, we are therefore continuing our dialogues with companies on ethical AI: engaging newly with some companies and in many cases carrying on follow-up discussions on how companies are tackling this issue as we seek continuous improvement in this area.

Conceptual image using hand to touch screen. (Credit: Weiquan Lain / Getty Images)

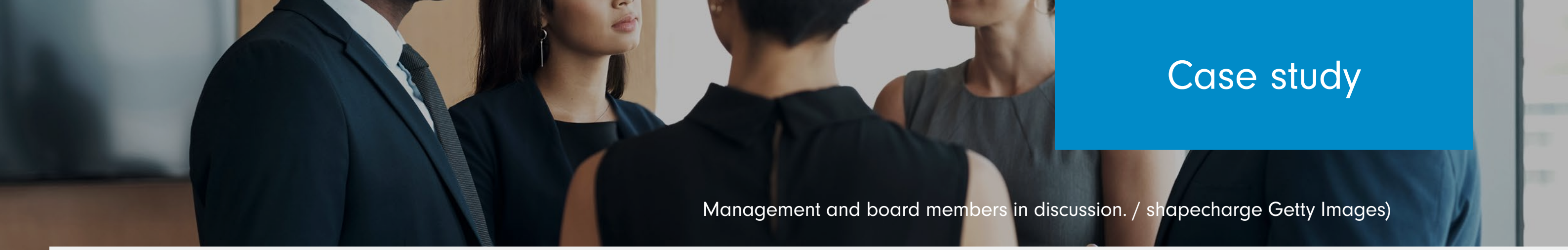
Governance

In recent years the concept of governance as an ESG risk has expanded. While we continue to engage on core governance issues such as the make-up of boards (e.g. encouraging independent directors), appropriate capital allocation and evaluation of bids, we also look at board diversity and, in 2022, executive pay during a period of significant and sustained inflation.

Rising living costs

In 2022, many of our investee companies had supply chain issues and felt the effects of high inflation as the global economy began to emerge from the Covid-19 pandemic and Russia invaded Ukraine. We recognised that high inflation was having a particularly acute impact on low paid workers. This posed several risks for companies, including potential loss of key workers, lower productivity, and reputational damage.

Consequently, in Q4 2022, Fidelity wrote to 330 companies in major UK and Continental European indices to highlight the importance of responsible corporate responses to the challenges posed by the cost-of living and energy crises. We subsequently held calls with companies to discuss how their support for lower paid staff in the current economic environment aligned with pay decisions affecting the C-suite. We intend to reflect upon our engagement, and the views expressed in our letter to companies, during the 2023 AGM season.



Case study

Management and board members in discussion. / shapecharge Getty Images)

Board diversity: Financial services

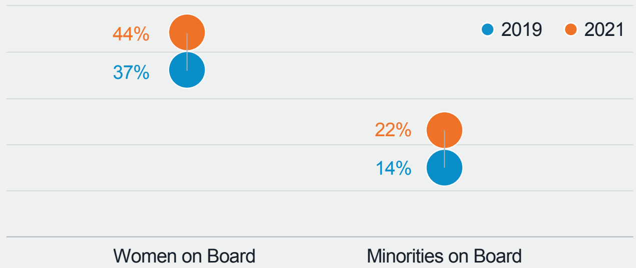
While gender diversity is often considered a social issue, at Fidelity, we consider it both a social and governance risk. Having greater diversity through gender or background reduces group think, encourages a more professional approach to recruitment and gives the company access to a broader talent pool.

In 2020, under the leadership of a portfolio manager managing a global equity income fund, Fidelity conducted a thematic engagement 'mini module' to learn more about and hopefully encourage improvement in diversity at several key financial companies. In 2022, we re-engaged with largely the same group of eight companies (banks, insurers and reinsurers) to understand how far they had come on their diversity journey over the past two years. While two years is not a long time when considering the challenging issues of improving diversity, especially at board level, progress has in fact been made. As a result of our engagement, we've been able to measure both the companies' progress on their goals, as well as how their thinking in these areas has evolved. We have also continued to encourage prompt improving practices in our discussions with investee companies.

Board representation: The diagram below shows the average percentage representation of women and minorities on the boards of the eight companies at the end of 2019 and 2021. As we can see, the increases are quite significant across both segments - 7 percentage points in terms of female representation and 8 percentage points in terms of improvement of minorities. While boards are typically small and therefore one or two changes can materially affect the percentages, we maintain that this strong result reflects the tone of the leadership of our companies and the policies they began to put in place a few years ago.

A key takeaway from this exercise is that companies need to go on improving the collection and robustness of their data. This will help companies better understand the current state of diversity and inclusion in their organisations and inform future initiatives like this engagement, which we believe are necessary to continue to drive change.

Chart 9: Average percentage representation of women and minorities on company boards



Source: Fidelity International, March 2023. Chart shows representation on boards of eight companies.

Stock index with Tokyo stock exchange - stock photo / Hiroshi Watanabe Getty Images)

Case study

Corporate change: Tokyo Stock Exchange

One example of our system-wide stewardship was our engagement with the Tokyo Stock Exchange (TSE) on two occasions in 2022 to push for rule-based changes by the exchange for listed companies so that they may better act in the interest of shareholders.

We believe many Japanese companies today pay too little heed to their cost of capital and long-term growth, so called ‘value-traps’. The TSE reform introduced in April 2022 which created the Prime, Standard and Growth sections was designed to address this but did not meet market expectations. We presented to the TSE and again as a guest to the Follow-Up Council of Experts (a council of economists, investors, academic experts etc. established by the TSE to advise them on improving the effectiveness of the implemented reform), to share our views and suggestions for improvement.

We highlighted the consistently high proportion of TOPIX companies trading below P/B ratios of 1x over the last decade. We attributed this to the lack of revision to the constituents, thereby stifling corporate value creation, as evidenced by older companies tending to perform worse likely due to complacency. While the introduction of the Corporate Governance Code in 2015 and subsequent revisions have improved governance, we expressed a view that substance was still lacking, with many boilerplate disclosures and external directors refusing to meet investors.

Our suggestions for improvement included requiring companies that continuously trade below P/B ratios of 1x to disclose improvement plans and where there was no material progress, they should be considered for removal from the Prime section. Also, qualitative measures, such as enhanced governance, should be included as prerequisites for a Prime listing.

In January 2023, the TSE announced their “Future Actions in Response” to the main issues identified by the Follow-Up Council. To motivate corporates to think of long-term corporate value, they said they would require c.3000 companies (those belonging in Prime and Standard sections) but especially those trading below P/B ratio of 1x to disclose an analysis of the current situation and an improvement plan with subsequent follow-ups. Additional measures include the monitoring of companies whose “Comply or Explain” is a formality, mandating English disclosure, and promoting the role of constructive dialogue between management and investors to increase long-term corporate value - all things that we originally proposed.

Our hope is that these measures will foster a lasting change in Japanese corporate mentality. Rather than ending in a flurry of one-off share buybacks, we envisage this as just the beginning of a gradual revitalisation of the market, with system-wide implications for investors.

Investment decision implications

As an active investment manager, our portfolio managers generally have discretion to manage the investments for their funds within a set of predefined investment guidelines. Portfolio managers consider a broad range of factors, including our proprietary ESG ratings and third party ESG ratings where available, to inform their investment decisions.

Decisions to purchase or exit an investment are typically influenced by multiple factors and are unlikely to be driven by a single factor. ESG considerations are as important as financial ones. In certain circumstances they can be the determining factor; for example, where corporate activity results in the breach of an exclusion commitment or, in the case of some sustainable mandates, a company's ESG score falls below a certain threshold and the company's sustainability characteristics are unlikely to improve significantly. Our clients often ask us how our stewardship and ESG activities interact with investment decisions and below we have set out a few examples from 2022:

- One of our funds divested from a North American renewable energy company in 2022 due to its exposure to thermal coal following its acquisition of a coal asset. The Fidelity fund owned a position in the renewable energy company prior to the company's acquisition of the thermal coal asset and engaged with the company to express the view that such acquisition would not be compatible with our sustainability goals. The company proceeded to purchase the asset, and the portfolio managers again engaged with the company. Unconvinced of the compatibility of the company's approach with sustainability, the managers divested of their position.
- One of our funds exited its position in a southeast Asian tech conglomerate involved in gaming and e-commerce during the year. One driver of that decision was lack of progress on key sustainability issues Fidelity had discussed with the company over multiple engagements, including a formal letter to the board in which we had explained how we think the company could improve its board structure, ESG disclosures, and protections of shareholder rights.
- One of our funds exited a position in a Japanese apparel company in early 2022 after a breakdown of dialogue about director remuneration and concerns about the company's climate change and supply chain human rights policies.
- At another Japanese company, this time in the software sector our engagement led to a change in our investment case. Contrary to its previous explanations to investors, management had increased upfront investment, which had resulted in a significant downward revision of the company's medium-term plan. On the other hand, management's own performance-linked share-based compensation was not affected by the downward revision, as it was linked to performance in a single year. In the

dialogue with management, we pointed out this inconsistency with general shareholder interests and told them that the share-based compensation should be linked to the new medium-term plan.

> Insights from our corporate engagements were disseminated to the entire investment team via our internal research platform and ESG application.

The company showed an understanding of our proposals at the meeting but informed us that it would not review the compensation structure before the General Meeting of Shareholders. Therefore, we escalated our concern to a vote against all five members of the Compensation Committee, which is responsible for the executive compensation scheme. Concerns about the loss of trust in the management team and dysfunctional governance to oversee the management team also led to the sale of our position.

As in past years, our corporate monitoring activity, including routine information-gathering engagements, was conducted to track theses and test conviction in the companies we hold. Our portfolio managers were often involved in these meetings. Insights from our corporate engagements were disseminated to the entire investment team via our internal research platform and ESG application. This monitoring activity regularly helps portfolio managers make decisions on fund investments, including at the pre-investment phase, and continued to do so in 2022. Information gathered during these activities supported investment decision making by providing evidence or refuting our portfolio managers' conviction in the sustainability characteristics of the affected companies.

Glossary

Active ownership: A form of stewardship whereby shareholder power is used to influence corporate behaviour through direct corporate engagement, filing or co-filing shareholder proposals, and proxy voting. This is typically guided by comprehensive guidelines, see for example Fidelity's Voting Principles and Guidelines.

Best-in-class: An investment approach whereby investments are included based on certain sustainability criteria to focus exposure on sector-leading companies. This can vary from selecting amongst the best-performing companies (e.g. the lowest carbon/most energy efficient energy producers) to excluding the worst-performing companies relative to peers.

Carbon footprint: The total carbon emissions for a portfolio normalised by the market value of the portfolio, expressed in tonnes CO2e / $M invested.

Carbon intensity: The volume of carbon emissions per million dollars of revenue (carbon efficiency of a portfolio), expressed in tonnes CO2e / $M revenue.

Corporate 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 issuer.

CSRD: The Corporate Sustainability Reporting Directive, an EU directive which requires certain companies to disclose non-financial information.

Double materiality: The requirement 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.

ESG: Environmental, social and governance. ESG is used as shorthand for a range of factors considered by companies, investors, public sector and other organisations in a wide range of decision-making processes and situations. By way of illustration, environmental factors include climate change, resource depletion, waste, pollution and deforestation. Social factors include human rights, modern slavery, child labour, working conditions and employee relations. Corporate governance factors include bribery and corruption, executive pay, board diversity and structure, political lobbying/ donations and tax strategy.

ESG integration: The inclusion of ESG issues in investment research and analysis. At Fidelity, this happens through Fidelity's internal research process and includes consideration of third-party and Fidelity's ESG ratings and our active ownership approach, covering individual and collaborative engagements, and voting.

Glossary (cont.)

Exclusions: The practice of excluding certain sectors, themes or companies based on their ESG performance or as per the UN PRI definition: "Excluding certain sectors, companies or projects for their poor ESG performance relative to industry peers or based on specific ESG criteria (e.g. avoiding particular products, services or business practices)."

GHG: Greenhouse gas emissions.

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

Just transition: A process of transition from a high-carbon to a low carbon economy using a set of principles, processes and practices designed to ensure that no people, workers, places, sectors, countries or regions are left behind in that transition.

Negative externalities: A broad term which refers to the 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.

Net zero: Achieving an overall balance between anthropogenic emissions (greenhouse gases) produced and those taken out of the atmosphere. A net zero commitment refers to organisations that have pledged to reduce the sum of their anthropogenic greenhouse gas emissions to 'net zero'.

OECD: The Organisation for Economic Co-operation and Development is an intergovernmental organisation with 38 member countries, founded in 1961 to stimulate economic progress and world trade.

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

Paris Agreement: The 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.

Science Based Targets Initiative (SBTi): A partnership between CDP, the United Nations Global Compact, World Resources Institute (WRI) and the World Wide Fund for Nature (WWF).

Sustainable Family (SF): In 2019, Fidelity launched a cross-asset class fund range with a focus on environmental, social and governance (ESG) factors. The SF funds' investment universe is driven by selecting issuers with favourable and/or improving ESG characteristics, whilst aiming to achieve compelling long- term financial performance and outperformance of their benchmarks.

SFDR: Sustainable Finance Disclosure Regulation (EU) launched in 2019 but has since been revised and remains under review. SFDR focuses on sustainability-related disclosures in the financial services sector.

Stewardship: 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. See also Active ownership.

Glossary (cont.)

Sustainable investing: Sustainable investing considers environmental, social and corporate governance (ESG) factors in the investment decision-making process.

System-wide stewardship: System-wide stewardship recognises that healthy capital markets rely on a healthy economy, society and environment. Our economy is dependent on the environment and society, which are in turn impacted by the economy. As an active investment manager, this involves us taking actions 'within the system' (such as direct corporate engagement) but also, where critical to long-term healthy capital markets, taking actions to 'influence the system' (via capital allocation at scale, broad and ambitious thematic engagements, building shared knowledge bases, setting industry standards, or engaging in public consultations, individually and in collaboration with others).

Task Force on Climate-related Financial Disclosures (TCFD): Created in 2015 by the Financial Stability Board (FSB) to develop consistent climate-related financial risk disclosures for use by companies, banks, and investors in providing information to stakeholders. Increasing the amount of reliable information on financial institutions' exposure to climate-related risks and opportunities will strengthen the stability of the financial system, contribute to greater understanding of climate risks and facilitate financing the transition to a more stable and sustainable economy.

Thematic engagement: Engagements intended to accelerate progress on priority ESG issues affecting multiple companies in which we have current or potential investment interests. Each theme is underpinned by specific objectives and milestones that are tracked over time.

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Useful links:

Climate Investing Policy

Engagement Policy

Sustainable Investing Principles

TCFD Report

Voting Principles and Guidelines

Important Information