Franklin Templeton Emerging Markets Equity

Stewardship Report 2023

Not FDIC Insured | May Lose Value | No Bank Guarantee

> "Our on the ground presence across the emerging world helps us build local relationships and gives us the credibility to engage in effective long-term dialogue with management teams."

Foreword

"Sustainability and governance factors are integral to our investment process, as is our long-term active engagement with companies and policymakers."

Manraj Sekhon
Chief Investment Officer

Welcome to the second Franklin Templeton Emerging Markets Equity (FTEME) Stewardship Report. As CIO and chair of the Stewardship Council, it gives me great pleasure to review the progress made in our approach to stewardship over the past year. This report incorporates the collective efforts and expertise of our 70+ investment professionals in over a dozen countries.

Over the last year, we have witnessed the transition to COVID as an endemic disease, a sharp rise in geo-political uncertainty and higher inflation globally. These challenges reinforce the importance of our fiduciary responsibility, having a long-term perspective, and engaging with companies we invest in through the lens of financial, human, and natural capital.

We have reflected on the best path to fulfill our responsibilities and continue to refine it. Projects we have implemented include developing a climate workflow to support the Net Zero Asset Managers (NZAM) initiative, incorporating a Principal Adverse Impact dashboard (which enables portfolio managers to assess their portfolios through this lens), and the launch of EnSiGnia (a proprietary tool using natural language processing (NLP) to assist in generating governance and sustainability insights on companies we cover).

This year's Stewardship Report includes 32 case studies across 11 markets. They cover engagement, supply chains, climate change as well as our three-pillar ESG framework incorporating: alignment, transition and intentionality. Case studies in our alignment pillar have been mapped to almost all of the six positive outcome areas in the United Nations' Sustainable Development Goals (UN SDGs).

Our approach to stewardship continues to utilize the six Principles for Responsible Investment as a framework. Two new features in this year's report include our portfolio managers' perspectives on stewardship and how it is incorporated into the companies in which we invest. We also highlight our collaboration with Net-Zero Consulting in deepening our understanding of climate change and the transition to a net-zero economy.

Over 2023, we plan to extend the use of our EnSiGnia tool to all companies in our coverage universe. We will also leverage an industry recognized framework in implementing any NZAM commitments and will partner with our clients on this initiative.

Our on the ground presence across the emerging world helps us build local relationships and gives us the credibility to engage in effective long-term dialogue with management teams. Our aim is to generate better outcomes for all stakeholders including customers, communities, and our clients.

Our commitment to clients remains unchanged, governance and sustainability are integral to our investment process, as is our long-term active engagement with companies and policy makers.

Our journey as active investors continues to evolve, and we are committed to learning and adapting to the shifting landscape.

Contents

2022 stewardship in numbers

>8,600
Management proposals voted on

12%
Management proposals voted against

1,863
Company meetings

112
ESG interactions

26%
ESG interactions resolved successfully

6
Components to our Stewardship Programme

70+
Investment professionals in
13
countries

3-pillar
ESG framework

123
Ability to analyze companies using our natural language processing tool

2021
Established the FTEME Stewardship Council

22 years
Average experience of Stewardship Council members

6
The number of positive outcomes areas we link to the
UN SDGs*

*Refer to p. 20 for additional details.
The figures referenced in the report apply to assets managed by the FTEME team and do not reflect statistics for other managers associated with Franklin Templeton. The team's assets under management (AUM) was US$29 billion as at 31st Dec 2022. Note that some of the data in the report may not be representative of the total AUM we manage due to the legal entities captured.

Stewardship at Franklin Templeton Emerging Markets Equity

FTEME is a pioneer in emerging markets investing, setting up its Hong Kong office in 1987.

Scale and expertise

Our 70+ investment professionals in 13 countries, our local relationships and in-depth knowledge of the local regulatory landscape gives us the ability to identify investment opportunities beyond the mainstream, often before they are recognized by our peers.

We are industry leaders with the breadth and reach to cover more than 700 emerging market companies. Our process uses a rigorous bottom-up research approach, drawing on the team's extensive knowledge of individual emerging markets.

With more than 30 years navigating emerging market cycles, we have built considerable expertise in this asset class. There are 20 years' worth of data in our integrated research database, compounding our institutional knowledge on a large selection of companies, and supporting our rigorous, bottom-up, long-term approach to security selection.

This year's Stewardship Report includes 32 case studies across 11 markets and sectors. In comparison, last year's report had 18 case studies across eight markets and sectors. It should be noted that the companies discussed have been chosen to demonstrate our process within the FTEME governance and sustainability frameworks and are not indicative of performance.

Local insights with a global perspective

Our analysts speak the local language and are part of the local culture/fabric of the countries in which they conduct research. Our locally generated insights and industry knowledge are enriched by the broad expertise of our globally integrated team. We devote significant time, resources and thought to building our knowledge base via continuous engagement and collaboration across our offices.

What is stewardship, why do we do it and what does it mean to us?

Part of being a responsible steward of our clients' assets is acknowledging that governance and sustainability factors create risks and opportunities for companies. It therefore makes sense to integrate these factors alongside fundamental, bottom-up analysis and engage with companies as active owners on behalf of our clients. Responsible stewardship is not a single act but a continuous process that includes engagement and voting.

Being responsible stewards of our client's capital is reflected in:

- **How we act as investors**
  - ESG integration
  - Company engagement
  - Policy advocacy
- **How we treat our clients**
  - Putting clients first
  - Being responsible fiduciaries of our clients' capital
- **How we behave as a business**
  - Building relationships
  - Achieving quality results
  - Working with integrity

How we act as investors

The three hallmarks of our approach:
ESG integration, company engagement and policy advocacy

ESG integration
How we integrate material governance and sustainability factors into our fundamental research

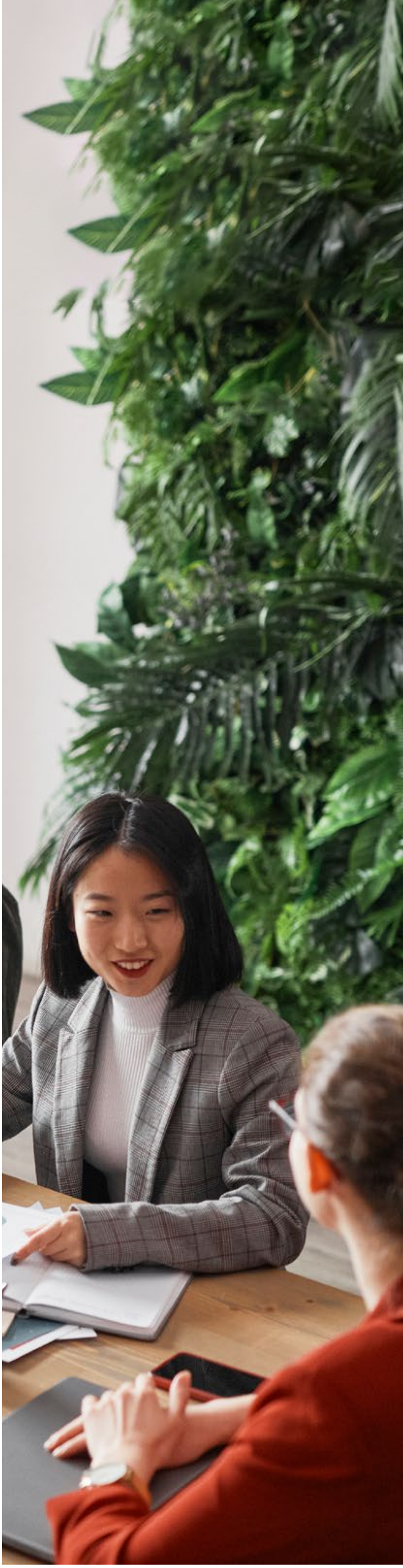
- Generating proprietary insights via long-term engagement with companies, focusing on trends, not single data points.
- Rigorous framework integrating material governance and sustainability factors into our research and valuation models.
- Holistic three-pillar ESG framework focused on intentionality, alignment, and transition.
- Mapping social and environmental outcomes to investable themes related to the UN SDGs.

Company engagement
Engaging with management in a manner that seeks to achieve improved outcomes for all stakeholders

- Long-term owners with >200 companies owned for more than five years.
- >100 companies with ownership of 3% or more of the shares outstanding.
- Active owners who take the time to consider and, where relevant, engage with management on company proposals as part of our proxy-voting responsibility.

Policy advocacy
Proposals on best international practice and active participation in response to public-private consultations

- Our on-the-ground presence and our local relationships give us the credibility to engage in active ongoing engagements with policymakers and regulators. Both as advocates for using best practice in the development of emerging capital markets as well as participating in industry responses to consultation documents.
- Seeking to improve client understanding of the emerging market investment landscape via webinars and producing investor education materials.
- Our deep long-term presence in emerging markets and investment knowledge gained over the last 30+ years gives us a sense of history and experience to act as an advocate for emerging market investing.



This report discusses ESG capabilities available at FTEME, however, not all strategies at FTEME have ESG-oriented objectives or utilize these capabilities.

How we treat our clients

Franklin Templeton has a client centric mindset and strict compliance requirements to ensure clients always come first. Our conflicts of interest policy is regularly reviewed and all employees are required to participate in conflicts of interest training and read and sign the policy annually.

This is a complex world for active investors and we acknowledge conflicts of interests can arise, including:

- The investee company is a client of the asset manager.
- The investee company is a vendor supplying material products or services to the asset manager.
- The investee company is a material distributor of proprietary investment products and/or responsible for executing investment transactions for the asset manager.
- A covered employee or immediate family member is a director, trustee or officer of company.

Where conflicts of interest do arise, they are resolved in the best interests of our clients.

How we behave as a business

At FTEME, our primary focus is on being responsible and effective stewards of client assets. This involves adhering to the frameworks and process we have built up over 30+ years. As well as embracing new developments in the asset management business including our focus on sustainable investing as well as embracing new technologies that will shape the investment landscape of tomorrow.

Our attention to building client relationships is reflected in the long tenure than many have been invested with us. This in turn reflects our achievement of quality results based on our bottom-up focus for stock selection. Our integrity is reflected in how we behave as a business, where client outcomes come first.

We do not believe, however, that stewardship is limited to how we manage our clients' assets. It includes how we value our employees and the communities we are active in, including flexible working arrangements and employee volunteering.

Our commitment to stewardship in practice

Stewardship is not just about making responsible investment choices. It's about engaging with the investee companies and other key stakeholders who have the potential to help us solve the real and pressing social and environmental challenges of our time.

Three key strengths driving our commitment to stewardship

- **Structures:** Building up and ingraining the implementation of sustainability, governance factors and stewardship over time.
- **Technology:** Continuing investment in technology—our research database—to ensure engagement on ESG issues with companies is trackable and individual company progress is verifiable over time.
- **Employees:** Dedicated ESG team, analysts and other investment professionals are all working to ensure stewardship is central to everything we do.

Responsible stewardship of our clients' capital is crucial to delivering their desired outcomes. The consideration of governance and sustainability factors in our investment process is a central component of that. We believe this approach makes us better investors and leads to better client outcomes.

In addition, to be most effective, stewardship must include engagement with the companies and the responsible exercising of voting rights.

Engagement is a dialogue between our analysts and investee companies, including their management teams and boards. However, not all issues are easily resolved, and where necessary our engagement will be escalated.

FTEME Stewardship Council

"The Stewardship Council is central to ensuring consistency in how we exercise care with client assets. It binds our team together with a holistic focus on what is right for clients."

Andrew Ness
Portfolio Manager and Deputy Director of Research

We established the FTEME Stewardship Council in 2021. The group brings together experts with extensive experience in portfolio management, fundamental research, and ESG to effectively carry out its purpose.

The primary focus of the Council is oversight, coordination and relevance, leveraging the resources of our parent, Franklin Templeton, to ensure we are adhering to best practices. Our Council members are responsible for setting the strategy and providing a roadmap for execution.

The Council's purpose is to govern and set strategy regarding the implementation of the group's stewardship activities as part of its investment management duties.

Stewardship Council purpose

- To set group policy and strategy around stewardship, with execution oversight.
- To serve as a center of excellence and provide strategic guidance on ESG issues.
- To act as an escalation mechanism for contentious issues and provide consistency in resolutions.
- To provide proxy voting guidance, particularly on key/contentious issues.
- To ensure market relevancy for the group in this space.
- To plan for regulatory demands, including reporting.
- To discuss effective resourcing to execute on strategy e.g., data, personnel.

The Council meets quarterly and engages in continuous informal interaction to share best practices and progress on agreed goals. Proposals on setting or amending policies and strategy are discussed with the investment team with a clear feedback loop prior to implementation.

Part of the Council's mandate is deciding on the digital infrastructure and people resources needed to meet regulatory requirements, client expectations and ensure best-in-class reporting of our stewardship activities. At the same time, we need to further embed ESG into the investment process while deepening our research in this area.

The Council is also supported by two dedicated ESG specialists embedded into the research team. Their role is to support and execute the programme.

Council membership

Manraj Sekhon
Chief Investment Officer
27 years of industry experience

Andrew Ness
Portfolio Manager and
Deputy Director of Research
27 years of industry experience

Bassel Khatoun
Portfolio Manager and
Director of Research
19 years of industry experience

Yu-Jen Shih
Portfolio Manager and
Deputy Director of Research
19 years of industry experience

Preyesh Patel
Senior ESG Analyst
15 years of industry experience

In 2022, the Council discussed the varying components of its Stewardship Programme

FTEME Stewardship Programme

Component	Initiatives
Strategy	• Partnering with the firm on its corporate sustainability journey • Adhering to upcoming global regulations • Understanding future client requirements
Policies	• Enhancing our proxy voting process • Introducing a climate workflow
Embedded Investment Process	• Adjusting our engagement process and capture • Principal adverse impact data integration • Identifying new areas of sustainability research • Continued learning through participation of industry experts at our research calls and dedicated offsites
Product	• Presenting Sustainable Finance Disclosure Regulation 2019/2088 (SFDR) upgrade requirements • Discussing potential for new capabilities
Marketing	• Thought leadership roadmap
Client Reporting	• Meeting client requirements

In addition, Council members took part in two dedicated two-day stewardship offsites to discuss the execution of our stewardship strategy. The team was also excited to take on two interns, who undertook projects related to biodiversity and corporate governance in emerging markets, to further support the execution of its Stewardship Programme.

Global Sustainability Strategy Team (GSST)

The team is further supported by independent risk consultants from our Investment Risk Management Group, as well as the GSST in firm-wide strategic priorities, including those on climate and data.

The risk management group uses industry-leading tools to provide a top-down, portfolio-level perspective on governance and sustainability issues. Meanwhile, the GSST spearheads and supports the implementation of organization-wide priorities on sustainability.

The mandate of the FTEME Stewardship Council is strengthened by the GSST, led by Anne Simpson our Global Head of Sustainability, with the goal of developing sustainability priorities and best practices in collaboration with the Franklin Templeton Stewardship and Sustainability Council. Together they propose strategies to drive and embed sustainability across the organization.

> **“At the heart of it, sustainability means meeting our generation’s needs without compromising the ability of future generations to meet theirs. It’s a lens we apply to our investment thinking in terms of the intersection between human capital, natural capital, and financial capital.”**

Anne Simpson
Global Head of Sustainability

Key areas of collaboration

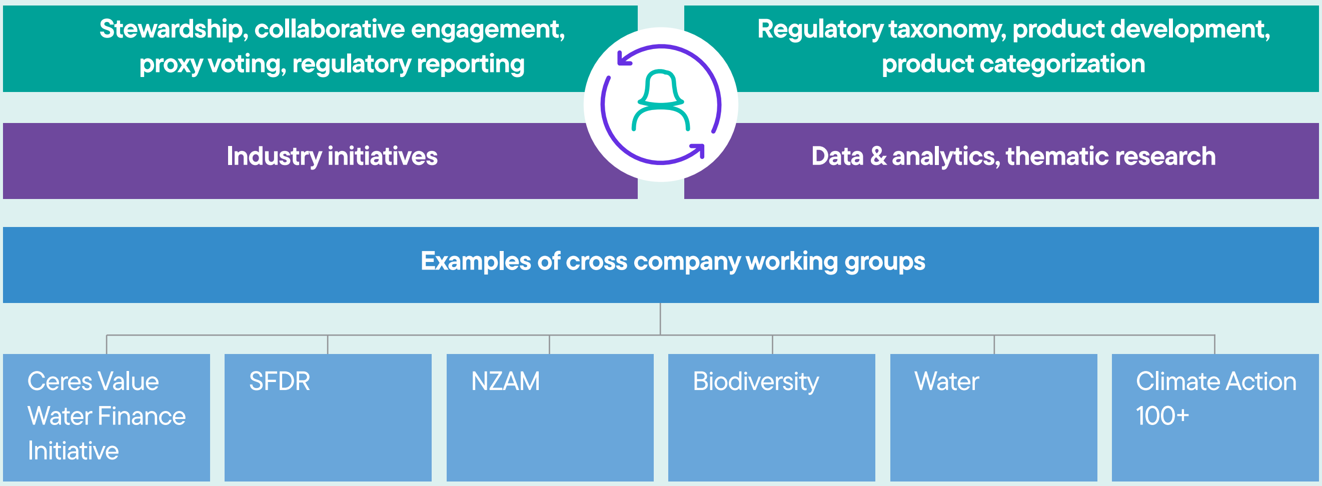
Sustainable investing data
The GSST supports our investment teams directly with a central sustainability data hub, helping to source and integrate data from a wide variety of vendors.

Stewardship
Franklin Templeton’s Stewardship team covers both engagement, and the execution of proxy votes and policy advocacy. The firm-level stewardship team seeks to enhance the effectiveness of the Franklin Templeton investment team’s active ownership through providing thematic expertise on corporate governance and sustainability, collaborative engagement resources, best practice resources for engagement and escalation alongside voting research and execution.

Investment categorization
The team’s sustainability product experts are working on a framework to categorize all Franklin Templeton’s products, globally and across asset classes and the sustainable investing spectrum. Such a categorization will reflect FT’s standards and provide all stakeholders—from clients to regulators—with clarity and comparability when navigating the firm’s line up.

GSST

The GSST is a multi-disciplined group of 14* sustainable investment professionals with a broad range of experience across investments, sales, product, marketing and risk who actively support our independent investment teams and spearhead the implementation of organization-wide priorities such as climate reporting and data. The GSST is also actively involved in various industry and cross-company working groups and initiatives, including the Ceres Value Water Finance Initiative, the Net Zero Asset Managers initiative (NZAM), the Stewardship and Sustainability Council, the Global Public Policy Council and the Sustainable Investment Governance Committee. The team is led by Anne Simpson, our Global Head of Sustainability who is also a member of the firm's Stewardship and Sustainability Council.



* As at 31 March 2023.

Overcoming the information gap in emerging markets

FTEME's extensive experience in emerging markets and engagement with company managements provide us with deep insights into companies' sustainability journeys and the incremental changes they are experiencing.

Corporate disclosures in emerging markets are uneven and broadly lag those in developed markets. Investors relying solely on published information to assess emerging market companies' sustainability plans risk missing the incremental change in trends. Our on-the-ground presence and local relationships give us the edge when it comes to spotting these changes ahead of others.

Observations on disclosures by emerging market companies

- Emerging market companies are not always behind their developed market peers in ESG disclosure. Firms in some markets can be even more transparent. We observe increasing openness among emerging market companies in recent years.
- Market-wide governance and sustainability policies and initiatives are gaining ground in the developing world. We expect this trend to encourage companies to improve their disclosures and public accountability.
- The relationships of trust we have built often give us the leeway to discuss material issues and help drive change. We believe that some of the most overlooked sustainable investment opportunities in emerging markets lie with companies making incremental improvements on these factors.

Incorporating our on-the-ground presence into our engagement efforts

Seeking companies with incremental improvements in ESG scores is challenging for investors without the resources and relationships to make well-informed assessments. ESG disclosures across emerging markets are uneven. While third-party ESG ratings are available, research agencies differ in the scope and focus of company coverage. Research has shown that ESG scores amongst third-party research providers have a very low level of correlation (Source: Kevin Prall CFA, "ESG Investing: Navigating Through the Haze," cfainstitute.org, 2021). This puts investors without an on-the-ground presence in a challenging position.

We use published information as a starting point for research, then incorporate our own findings to form forward-looking views on companies' ESG prospects. Our research requires in-depth local studies of individual markets and companies, as well as first-hand access to management and other stakeholders. Our over 30-year history of direct engagement with companies enables us to evaluate their sustainability commitment, understand their ESG strategies, and anticipate the potential and direction for incremental change in their ESG trajectories.

In the process, we are often given the opportunity to work with companies on their ESG disclosures and support other improvements. Many businesses that learned of our commitment to stewardship, sustainability and our long-term investment mindset have turned to us as trusted partners, seeking our feedback and suggestions.

Our focus is on the material governance and sustainability issues that are most likely to affect companies' operational or financial health. Common issues include resource efficiency, labor practices and capital allocation, though considerations differ across industries, countries and companies.

We tap our proprietary governance and sustainability sector framework guides and investment experience to highlight material ESG issues in our conversations with companies, sharing the market's expectations—and ours—in these areas.

An integrated approach

FTEME decided early on in our stewardship and sustainability journey to keep ESG analysis integrated in the work of our research teams. This contrasts with others that structure the ESG research function in a separate silo. While there is no right or wrong approach, we believe that integrating our ESG analysis within our investment team works best for our clients.

As a part of their ongoing research activities, for example, analysts monitor any material governance and sustainability considerations relevant to stocks they cover. They incorporate their insights into updated research notes and recommendations, which are discussed with the team as part of the decision-making process and portfolio construction. Our dedicated ESG analyst resource supports the team through:

- Additional ESG-related analysis
- Additional training
- Thematic research
- Enhancements to our research database

Integrating ESG factors

Analyses of governance and sustainability factors are embedded components of our rigorous fundamental bottom-up research. The driving factors of the decision to purchase or sell a stock center on the following:

1) Its sustainable earnings power and whether its price is at a discount to intrinsic worth.

2) The sustainability of its business model, which is critical to maintaining its competitive positioning.

Governance and sustainability influence each of these areas and are assessed during our research process.

Except for dedicated products based on client preferences, our core belief is not to exclude or divest from companies purely because they operate in industries that negatively contribute to climate change or activities that are deemed harmful to society. Our focus is on the quality of management and engaging for incremental change in governance and sustainability factors.

When do we add or hold a company operating in an industry perceived as undesirable from a sustainability perspective?

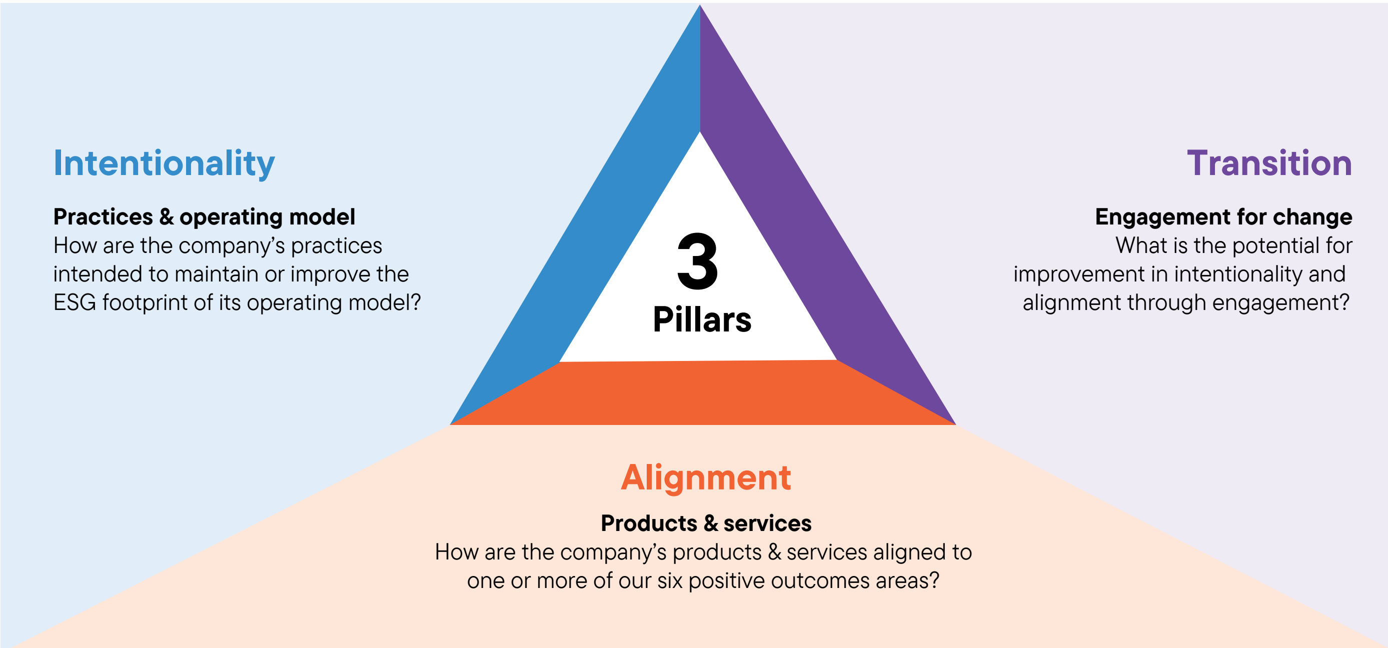
- If an investee company is operating in a country with weak labor rights, has it improved its employment policies since our last engagement?
- Are those investee companies in the carbon-intensive energy sector adhering to their decarbonization plans and/or making progress on net-zero commitments?
- Has a potential investment improved its corporate governance since our last engagement? And are there more independent non-executive directors on the board and/or has the board linked remuneration policies to specific sustainability outcomes?

Information sources

Our primary sources for gathering information on governance and sustainability factors is through:

- Engagement with management
- Financial statement analysis
- Corporate reports
- Reference to third-party providers of dedicated ESG research such as MSCI and Sustainalytics

Our proprietary three-pillar ESG framework



> Our proprietary three-pillar ESG framework is a key component of how we aim to achieve our goal of being an emerging market leader in sustainable investing.

Intentionality

Assessing companies' intentionality toward managing material ESG factors with our proprietary scoring system and linking ESG factors into our valuation models.

Alignment

Mapping the alignment of companies' products and services to positive social and environmental outcomes and UN SDGs.

Transition

Identifying companies' transition potential linked to their incremental progress, using our on-the-ground capabilities and experience as active owners to foster positive change.

Our proprietary three-pillar ESG framework is an assessment tool that has further enhanced our approach to sustainability and is codified within our analytical database. We began rolling this enhanced framework out across our research coverage of over 700 companies in 2021.

Basis of intentionality

How are a company's practices intended to maintain or improve the ESG footprint of its operating model?
By integrating ESG analysis with traditional business and financial analysis, we seek to gain insights into the quality and risks of the companies we invest in. This allows us to identify those business models most likely to resist competitive pressure and maintain high returns.

We can also better understand management's ability to generate sustainable earnings, understand their motivations and determine whether their interests are aligned with minority investors.

Guided by our ESG Sector Framework Guides, our analysts seek to identify material governance and sustainability issues. The frameworks have been informed by the Sustainability Accountings Standards Board (SASB) and identify the minimum amount of governance and sustainability issues most likely to materially impact the operating performance or financial condition of a typical company in its industry group. Our analysts assess an individual company's intentionality to manage the ESG footprint of its operating model, based on material risks and opportunities.

ESG sector framework: Utilities

The utilities industry is made up of companies that generate, distribute and sell power, gas and water. Power is generated from several different sources, including coal, natural gas, nuclear energy, hydropower, solar, wind, and other renewable energy sources. The industry comprises companies operating in both regulated and unregulated business structures.

Examples of governance and sustainability factors that can be taken into consideration when assessing a company's intentionality include:

- Environmental priorities. Due to the large quantities of water used in their processes, both water and electric utilities are highly exposed to the stewardship and responsible discharge of used water. For water utilities, providing safe, reliable drinking water, and treating wastewater effectively to avoid releasing potentially harmful effluents back into the environment is critical. Many utilities have been criticized for inadequate water impact assessment and mitigation designs.
- Social priorities. The high-impact nature of the utilities sector, characterized by investment in capital intensive assets such as power plants, dams and other infrastructure, creates significant potential for community disruption, including negative impacts on air quality, land and water availability. Affordability and access are also key social issues utilities must contend with.
- Governance priorities. Government regulation and incentivization affect the profitability of utility assets, the fuel mix chosen, and the volume of energy sold. The management of the legal and regulatory environment is a critical role of the executive team and board.

The case studies that follow show the intentionality pillar through the lens of our ESG sector framework. We focus our attention on material factors within the framework to ensure we focus on what matters for the company and our assessment of the opportunities and risk.

Environmental	Social	Governance
Environmental footprint Emissions, effluents & waste	**Consumer trends** Workforce health & safety	**Company culture** Management and costs
Waste management Intensity and quality management	**Community relations** Stakeholder impact	**Product sustainability** Technology and regulation disruption
	Cyber Security Security of data and grid vulnerability	

Topic	Impact	Signals
Water management	Severe controversies are often related to water issues. Drinking water and wastewater standards impact operating and capital expenditures and expose companies to significant fines and liabilities.	• Water usage data. • Water intensity indicators. • Water stress management programmes—reporting and progress. • Fines and penalties.

Governance

We systematically assess corporate governance factors as part of our intentionality assessment.

Corporate governance is a broad subject with varying definitions depending on whether one looks at it from a company or country lens. We think, at its core, corporate governance determines how well companies are able to operate in the longer-term interests of all shareholders.

We see few substitutes for first-hand, bottom-up research when it comes to assessing corporate governance. Through local company visits, face-to-face interactions with management and other forms of fieldwork, active investors are more likely to gain a richer understanding of companies' attitudes to governance and their appetites for reform.

Governance can also have an impact on stock valuations. The market has typically discounted companies with poor governance conduct. Conversely, companies perceived by the market as having best-in-class governance can benefit from premium valuations.

Corporate governance is just one factor out of many that can affect a company's prospects and valuation. We think investors should assess a firm's governance alongside traditional financial measures to form a comprehensive view of the potential investment returns and risks.

As part of our three-pillar ESG framework, under intentionality we systematically assess corporate governance factors irrespective of the industry a company operates in.

Governance factors

Board

- Effectiveness/skills/oversight.
- Independence/tenure/over boarding.
- Diversity.

Leadership

- Management quality (inc. diversity) and sustainability (inc. climate) strategy.

Controversies

- Past scandals.

Ownership structure

- Ownership structure (e.g., related party transactions, cross shareholdings, dual class shares).
- Takeover provisions.
- Capital issuance/dilution.

Accounting

- Audit & reporting (e.g., aggressive accounting practices).

Executive pay

- Alignment to shareholder interests.

Intentionality case study	Aguas Andinas

Aguas Andinas S.A. is the largest water utility in Chile. Its core business includes delivering drinking water, sewerage and wastewater treatment services to more than two million residential, commercial, and industrial clients.

ESG topic	**Environmental footprint**
Materiality and risk	Product governance in the utilities industry refers to the reliability of service and the safe operation of the company's assets, as well as effective customer/community service. For water utilities, this primarily relates to drinking water contamination risk. Broader water and environmental management are also key considerations.
Strategies and targets on improving their environmental footprint	**Environmental management** • During the 2021 United Nations Climate Change Conference (COP26), Aguas Andinas was the only Chilean company to integrate "50 to 1 billion"—in which the 50 largest water utilities will accelerate work to build resilient water supplies and wastewater services for more than 1.2 billion people by 2030. In 2021, 68% of the energy consumed came from renewable sources. • Aguas Andinas was the first company in the sanitation sector in the world to establish emission reduction goals approved by the Science Based Targets Initiative (SBTi). **Water management** • As part of efforts to monitor and manage the quality of water supplied, the company's operations are certified to the ISO 9001 quality management system. Since 2007, Aguas Andinas has had an Integrated Management System, which includes procedures for certification under the international ISO 14001 standard. Through their application, the company can ensure high standards in its systems and support the global management of its operations and processes.
ESG thesis	Aguas Andinas has developed active environmental management, with operations based on circular economy and emissions reduction. They have initiatives on reuse/water treatment, securing water from other sources and processes to manage existing resources better. 98% of operations from its business lines are less prone to environmental disturbance. The company's disclosure is very strong, signaling a high degree of accountability to investors and the public. Its policies and programmes to manage material ESG issues follow best practice for its subindustry. These ESG issues are reflected on the discount rate used in our discounted cash flow (DCF) model, on sustainable long-term margins levels as well as on perpetuity growth assumptions.

The case studies discussed in this report were chosen to reflect the investment process at FTEME. They do not constitute recommendations. This is not a complete analysis of every material fact regarding an industry or security. It should not be assumed that any securities transactions were or will be profitable. The analysis and opinions of the security discussed herein may change at any time. Factual statements are from sources deemed reliable but have not been independently verified for completeness or accuracy. These opinions may not be relied upon as investment advice or recommendations or an offer for a particular security or as an indication of trading intent for any FTEME strategy. Case studies are used for illustrative purposes only and should not be construed as an endorsement of or affiliation with Franklin Templeton.

Intentionality case study	WuXi Biologics

WuXi Biologics (Cayman) Incorporated provides a comprehensive, integrated and highly customizable range of services for the discovery, development and manufacturing of biologics.

ESG topic	**Data privacy and security**
Materiality and risk	In order to maintain the trust and confidence of their global pharmaceutical partners, biologic technology platforms need to establish stringent policies and procedures for data protection and security.
No concerns with the management of data	• The company adopts an intellectual property protection process whereby it periodically scans signed and dated notebooks of every scientist onto diskettes and then engages a notary public office to notarize the records. • Each customer project has dedicated laboratory space equipped with key-card access control systems, alongside fire wall policies that restrict communications between different project teams and prohibit intermingling information of different customers. • It has established documentation procedures, powered by the Laboratory Information Management System, or LIMS, licensed by LabWare, to control information access on a need-to-know basis and to restrict system access in connection with biologics discovery and development. • In response to the COVID-19, WuXi's Information Technology Department strengthened the functionalities of its online office software to ensure its stability, so as to help employees work from home to fight against the pandemic.
ESG thesis	Protecting the proprietary rights of customers has been a top priority for the business, with the company not experiencing any violations that have caused substantial impact on customers, projects or itself. It has carried out several trainings to improve employees' awareness of intellectual property guidelines, alongside strengthening its information technology security and safety operating systems. As such, the data privacy and security risk for the company remains low, with this reflected in our model, by not applying a discount to projected cash flows. The company continues to outperform home market peers in environmental and social practices.

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Intentionality case study

HDFC Bank

HDFC Bank Limited is India's largest private sector bank in terms of loans.

ESG topic	Governance
Materiality and risk	Strong and effective corporate governance helps to cultivate a company culture of integrity, leading to positive performance and a sustainable business overall. Poor corporate governance can lead to interests that are misaligned with those of minority shareholders as well as reputational risk. Banks continue to face challenges related to business ethics and consumer financial protection practices.
Strategies and targets on improving the environmental footprint	• The bank has a very strong internal risk management framework which has helped it avoid any major errors of omission over the past decade. Its consistent industry leading return on risk weighted assets (RoRWA) over the past decade is a testament to its risk management practices. Compared to peers, the bank has some of the best-in-class metrics on capital adequacy and liquidity coverage with fairly diversified loans as well as deposits. • The bank has well-respected board members with a reasonable proportion having experience related to the banking industry. Majority of the board members are independent, but the share of female directors is low, at just 2/11, which is an area that requires improvement at all leading Indian private sector banks. • The bank's overall remuneration is in line with peers and employee stock ownership plans (ESOPs) are granted as variable pay for full-time directors and material risk takers subject to review of the Nomination and Remuneration Committee of the Board. ESOP grants by HDFC Bank are higher than grants by peer banks. • HDFC Bank has a historically strong reputation on overall governance and business practices. However, we note there was a controversy in 2019 with allegations of bribery in its auto loan division. This has been acknowledged by the bank as instances of individual transgressions post completion of its internal investigation.
ESG thesis	HDFC Bank has been and is one of the best governed banks in India. All governance-related risks associated with the bank have been incorporated into our cost of equity calculations. There are no material red flags for the bank and we believe the auto controversy does not pose any systemic risk to the company's operations. While the management has clarified that issues in its auto loan division were instances of individual transgressions, the bank has since further stepped up its culture of compliance within the organization. Incremental governance and control aspects remain a key monitorable.

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Intentionality has been a long-standing process at FTEME. In recent years we have enhanced that with a holistic assessment through alignment and transition.

Basis of alignment

How are the company's products and services aligned to one or more of our six positive outcomes areas linked to the UN SDGs?

The UN SDGs were created as a framework for governments, not investors. Our six positive outcome areas group the UN SDGs into 'investable themes'. Adapted from work by the Institute for Sustainability Leadership at the University of Cambridge, these are the social and environmental outcomes that create alignment in our three-pillar framework.

Defining our Six Positive Outcome Areas		Links to the Following UN SGDs	Examples of Investable Opportunity
Social Outcomes			
Basic needs	Focuses on goods and services known to contribute significantly to development including clothing, communications, education, energy, finance, food, healthcare, housing, sanitation, transport, and water.	1 No Poverty; 2 Zero Hunger; 3 Good Health and Well-Being; 6 Clean Water and Sanitation; 7 Affordable and Clean Energy; 10 Reduced Inequalities	• Communications • Consumer finance • Consumer essentials
Wellbeing	Promotes enhanced health, education, justice and equality of opportunity for all. This may involve critical services including healthcare, education, justice, crime, welfare, culture, security, and environmental protection.	3 Good Health and Well-Being; 4 Quality Education; 5 Gender Equality; 10 Reduced Inequalities; 11 Sustainable Cities and Communities; 16 Peace, Justice and Strong Institutions	• Healthcare • Education • Internet search
Decent work	Creation of secure, socially inclusive jobs and working conditions for all. Facilitates job creation, in particular alleviating people from poverty/rural areas, and the use of formal employment contracts.	5 Gender Equality; 8 Decent Work and Economic Growth; 9 Industry, Innovation and Infrastructure	• E-commerce • Business finance
Environmental Outcomes			
Healthy ecosystems	Looks to maintain ecologically sound landscapes and seas to benefit both people and nature—particularly in terms of the ability to supply or facilitate freshwater, clean air, and abundant food.	14 Life Below Water; 15 Life on Land	• Waste management • Agricultural
Climate stability	Focuses on global efforts to curb the Earth's temperature rise by supporting companies providing climate stability solutions, including green infrastructure, large-scale energy efficiency solutions, and zero-emissions mobility.	9 Industry, Innovation and Infrastructure; 13 Climate Action	• Green infrastructure • Low-emissions mobility • Semiconductors • Cloud computing
Resource security	Refers to the preservation of natural resources through efficient and circular use. Focuses on a company's progress from linear to circular operation and those facilitating this transition.	12 Responsible Consumption and Production	• Sustainable materials • Circular economy enablers

Alignment case study

Rumo

Rumo S.A., the largest independent rail logistics operator in Brazil. The company operates through the provision of logistical services for rail transport, port elevation and product storage.

Positive outcome area

Climate stability—85%

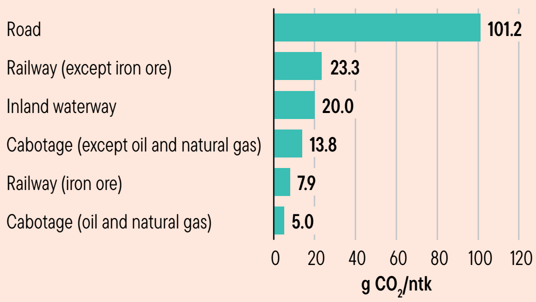
Primary UN SDG

13 CLIMATE ACTION

Basis of alignment

Railways are one of the most energy efficient forms of transport, displacing diesel engine haulage trucks.

The rail model, in itself, is linked to the decarbonization of the economy, emitting less greenhouse gas (GHG) emissions than the road model. According to data from the Climate Observatory (SEEG, 2018), carbon dioxide (CO_2) emissions per ton-kilometer generated by road transportation are between 4.3 and 12.8 times higher than emissions from rail transport, depending on the product being moved, and may be up to 20 times higher than in short-sea (coastal) shipping.[1]



Rumo estimates that rail transport emits 7.2 times less than other less efficient transport modes.[2]

Rumo serves more than 90 clients from various economic sectors, especially agriculture commodities operating across Brazil in the Midwest, South, Southeast and North regions. The investments to increase capacity has allowed Rumo to replace the volume transported by trucks to railways, qualifying the Brazilian transportation grid. As such, over the two-year period ending 2022, they avoided the emission of 11.9 million tons of CO_2 (relative to volume transported by trucks).

The demand for logistics is strong as Brazil is expected to continue increasing grain exports over the next few years. Rumo competes mostly with trucks, which have a higher cost and a greater carbon footprint.

The company continues to expand its operations, taking the model to more regions and structuring yards, railroads and warehouses. This capacity expansion brings the ability to avoid more emissions compared with road transport and along with the company's initiatives of becoming more efficient in its operations (gases CO_2 equivalent, per net ton-kilometer has been decreasing), it is truly well-positioned to helping the economy reduce its GHG emissions output.

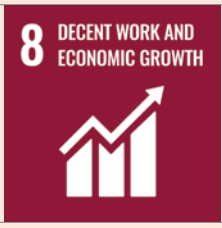
Many of our covered companies neatly fit into these outcome areas, however for others we need a much deeper understanding of the business mix to truly understand what outcomes a business may be generating through its products and services. To demonstrate this, we spotlight some well-owned internet companies. Through our alignment analysis, we have come to learn that many of these companies democratize access to knowledge and services, regardless of whether a user is based in a rural or urban area, is old or young, or a white or blue collar; all that is required is an internet connection. Their positive outcome areas are SDG 8: decent work and SDG 10: wellbeing.

1. Source: Freight in Brazil—An assessment and outlook for improving environmental performance September 2021.
2. Source: Rumo Sustainability Report 2021.

Alignment case study

Tencent

Tencent Holdings Limited, via its subsidiaries, provides social networking, music, web portals, e-commerce, mobile games, internet services and payment systems.

Positive outcome area (% of revenue)	Decent work—27%
Primary UN SDG	
Basis of alignment	As a leading Chinese online platform, Tencent empowers small and medium-sized enterprises (SMEs) by allowing them to do business with its WeChat userbase and receive payments via its digital wallet WeChat Pay. WeChat (and Weixin for mainland Chinese users) has over 1.3 billion active monthly users and penetrates every aspect of Chinese society. The service provides a vast customer base with which SMEs can do business. Over the last decade, Tencent's WeChat has sought to simplify daily life for its users and has become a one-stop shop for the social and transactional needs of Chinese consumers. The service provides numerous functions that interact with people's daily lives. For SMEs looking to enter Chinese markets, WeChat can provide them with a competitive edge. WeChat Pay has also become a vital payment method for businesses wanting to reach Chinese shoppers, both internationally and in China. Tencent's FinTech and Business Services revenue is mostly from WeChat Pay and related financial services. Recently, we have seen Tencent reducing transaction fees for SMEs on WeChat Pay to tide pandemic-hit merchants over and assist with the country's economic recovery.

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Alignment case study | Baidu

Baidu Incorporated operates internet search and software services. The company offers enterprise, online storage, navigation services, and news and image searches.

Positive outcome area (% of revenue)	Wellbeing—65%
Primary UN SDG	
Basis of alignment	Baidu's search engine enables opportunities and access to knowledge, thus reducing inequalities. The service enables SMEs to be discovered by users, hence supporting economic growth in connecting businesses with potential customers. The search engine also enables advertisers to reach a large pool of potential customers and increase brand influence at a relatively low cost. The monthly active users of the Baidu app have grown from 545 million in 2020 to 648 million in 2022. The word "Baidu" literally translates as "100s of times." It is taken from a poem called *The Green Jade Table in the Lantern Festival*, written by Xin Qiji (1140–1207), and refers to a persistent search for the ideal. Now, in its 20th year, Beijing-based Baidu is not just a search engine; the company also provides maps, encyclopaedias, forums and cloud storage services. Baidu is also a developer of the world's largest open-source autonomous driving platform: Apollo. Search enables users to: • Covert information to action. • Understand and educate ourselves on a particular topic. • Fulfil the need to connect and socialize with others. • Experience moments in real-time. • Progress personal growth with long-term rewards. • Self-discover and develop a sense of identity.

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Basis of transition

What is the potential for improvement in intentionality and alignment through targeted engagement?

Ideally, all our investee companies would be doing well on our first two ESG pillars: alignment and intentionality. However, many companies, especially those in emerging markets, are at a relatively early stage of their sustainability journey. Some of the more interesting investment opportunities exist with those companies that are in the transition phase, where we have identified incremental improvements in their intentionality and alignment.

We measure transition by identifying where there is scope for realistic improvement in a company's intentionality or alignment through engagement. Our on-the-ground presence in 13 countries and local relationships give us the resources to identify companies on the transition pathway. Our approach to facilitating this transition is through long-term engagement and feedback on best practice.

We are pragmatic investors who recognize the world is imperfect and the perfect company does not exist. Nevertheless, through targeted engagement with transitioning companies we can identify interesting businesses in the early stages of growth that could be attractive investment opportunities in the future.

Transition case study

FILA Holdings

FILA Holdings Corporation engages in the manufacture, sale and trade of various sporting goods and apparel.

Basis of transition	FILA is a company we have identified that can improve its shareholder return policy and be greater aligned with minority shareholders. This is a theme for a number of Korean companies in our universe and although the country's governance has improved over recent years, this still remains a topic of conversation and an objective of ours. Moreover, the company would be better positioned with a majority independent board; although not a legal requirement, it would help improve the company's governance standards.
Engagement	FILA has started to pay greater attention to governance-related topics and there were some achievements including more frequent communication with the market, and access to more detailed ESG information. However, as the company remains a family-run business, decision-making through the board needs to have more independence going forward. In 2022, FILA announced its 5-year strategic plan, which includes investing 1 trillion South Korean won or more in brand rebuilding and significantly improving shareholder returns. This will be funded internally and, with this, the company also announced a long-term capital allocation plan including the enhancement of shareholder returns by significantly improving its dividend payout ratio and scope for share buybacks. This led the company to announce a special dividend for the first time in its history in 2022. We remain active owners and seek to partner with our investee companies on a journey to greater sustainability.

How our analysts bring the three-pillar ESG framework together

Our analysts are required to document evidence of how they have evaluated a company using our three-pillar ESG framework. This is saved in our database and updated following material company disclosures as well as engagements with the company. We note that not all companies will require active engagement to target areas for improvement, and in these cases, we continue to monitor and engage with management.

The case studies on the following pages illustrate how our analysts bring together each of the three pillars to develop a holistic view.

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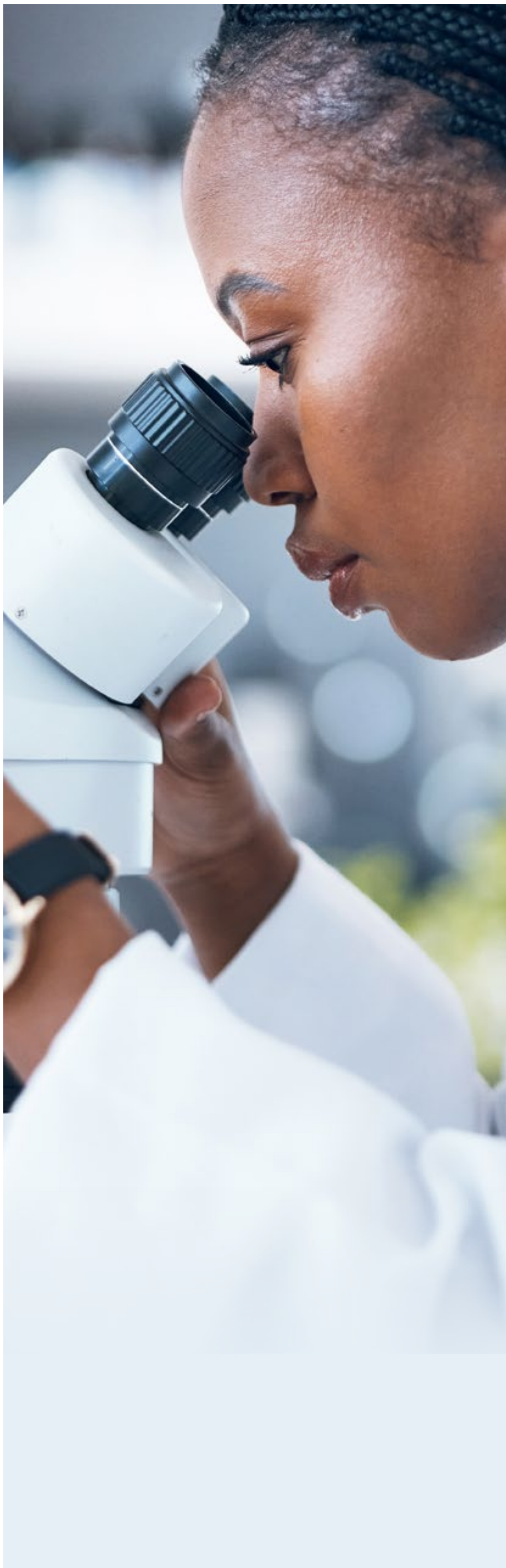
Three-pillar case study

Netcare

Netcare Limited is a private hospital group covering a range of medical and healthcare services in South Africa.

Positive outcome area (% of revenue)	Wellbeing—100%	3 GOOD HEALTH AND WELL-BEING



Intentionality

Netcare exhibits a positive patient experience, which is a strong reflection of its product quality. The company has seen consistent improvement in patient experience as well as clinical outcomes in the hospital and mental health clinics over the past three years. Netcare has not had any complaints or regulatory warnings from the government health department or other regulatory bodies in South Africa.

The company has good workforce diversity across gender and race, with turnover in line with industry standards. Netcare also ensures a favorable working environment for all staff.

Netcare has recorded a consistent reduction in energy and waste and continues to meet internal targets. The company targeted a 30% reduction in energy consumption per bed (kWh/bed) by FY2023. However, in FY2022, it already exceeded that target with energy consumption declining 35%. We continue to monitor the company's performance across key environmental indicators.

The company's governance practices are sound with 70% board independence including diversity across skills and strong incentives for sound capital allocation.

Netcare has good management of key ESG risks. The above analysis has been factored into our research model with energy reduction efforts reflected in the company's operational expenditure profile and better patient outcomes helping to maintain market share. Finally, as its governance is strong, we have not applied a discount to management on the weighted average cost of capital (WACC).

Alignment

Approximately 90% of Netcare's revenue comes from hospitals and pharmacies, with the remaining 10% from other medical services including mental health care. The company offers high volume and low-cost services to private patients who would previously have been unable to pay for conventional private hospital services. In addition, Netcare has also launched several out-of-pocket products at a reduced cost to serve low-income and uninsured patients. As a result, its services are attributed to wellbeing as it contributes to critical healthcare and enhanced health in the country.

Transition

Given Netcare manages its operational ESG footprint well, we have not identified targeted areas for engagement. However, we continue to monitor and engage with management on ESG issues as needed particularly around its data management and pricing policies.

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Three-pillar case study

Tinci

Guangzhou Tinci Materials Technology Company Limited (Tinci) develops, manufactures and sells fine chemicals and new materials. The company's main products include personal care materials, lithium-ion battery materials, and organic silicon rubber materials.

Positive outcome area (% of revenue)	**Climate stability—65%**	13 CLIMATE ACTION

Intentionality

Tinci conducts pollution assessments for new projects in terms of emissions and waste. It has also built its own devices and systems for pollution control.

The company has taken practical actions to achieve its carbon reduction target, but we do recognize that the target should be better-defined and the use of cleaner energy resources should be expanded. With regards to water management, Tinci's water pollution risk is regularly monitored for both surface and groundwater.

The company also has products that are subject to stringent chemical regulations, raising chemical pollution and reformulation costs concerns. However, Tinci has started taking actions to minimize this, and as such we believe that the risk of losing market revenue or increasing reformulation costs has decreased. Most of company's board executives are financial or industrial experts, but the board is not fully independent. We also note that Tinci has had no major controversies.

The company has good management of its environmental and social practices and performs in line with its peers in most governance aspects. We do, however, note that areas of improvement remain. Thus, to factor in the risks associated with the chemicals business, we have adjusted our estimates of revenue growth and operating costs accordingly to satisfy higher standard regulations.

Alignment

The company is the top global electrolyte supplier with a market share of about 30% and over 40% in 2021 and 2022, respectively. A key component for batteries, Tinci's electrolyte business is an essential part of the battery supply chain and can help play a role in tackling the carbon emission issue. Electric vehicle (EV) shipment growth and product expansion will allow the company to add greater contribution to emissions reduction in the real world.

Transition

Although the company is managing its ESG footprint well, it could be further enhanced in a couple of areas, and we believe our targeted engagement in this regard can help. For example, although Tinci has set targets around its carbon emissions output, we believe that it could improve its disclosure by detailing its long-term environmental development plans.

In addition, we recognize the company has been increasing its research and development (R&D) spending on an absolute basis, but its R&D/sales ratio has been decreasing. For the company to remain competitive, we believe this should increase and thus further R&D investment is needed.

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Modular aspect of the three-pillar cases

Our three-pillar framework allows it to be used in a modular fashion.

Allows us to filter those companies highly exposed to a particular E or S outcome area.	**Allows us to filter for best-in-class operators or ensure there is appropriate management of ESG issues.**	**Allows us to understand where realistic improvement is expected and a driver for engagement.**

Advantages of our proprietary three-pillar ESG framework

Our three-pillar ESG framework has the following objectives:

1. ESG outcomes and risks	• Measure positive and negative contributions to ESG outcomes and SDGs. • Analyze ESG risks and improve our search for sustainable earnings power.
2. A rigorous and holistic view	• Using granular analysis, we link material ESG factors to our investment thesis to develop our proprietary view.
3. Scalability	• A rigorous scoring system ensuring consistency and scalability.
4. ESG solutions for clients	• The genesis of the three-pillar framework was the launch of our first dedicated ESG solution, a sustainability-themed strategy we launched in September 2020. • The three-pillar ESG framework and scoring system help us meet specific client demands for evidence of ESG integration into our investment approach across all strategies.

Valuation impact

Introducing a dedicated assessment to link material governance and sustainability factors to company valuations was an enhancement to our existing intentionality analysis. Analysts assess governance and sustainability factors through the following channels and ask the following questions:

- Fundamentals/cash-flow channel: Is there a direct impact of material factors on revenues, costs, margins, and capital expenditure? If yes, how do we quantify the impact and build sensitivity analysis?
- Risk channel: Do material risks threaten the sustainability of the business? Has the company identified these risks through appropriate risk control and compliance standards? If yes, does this lower tail risks and can we factor this into our scenario analysis?
- Valuation channel: Is the company managing its material risks effectively? What kind of scenarios are we building into our assessment of the impact on the cost of capital, risks to margins and impact on valuation multiples?

Examples of where material governance and sustainability factors have impacted valuations

Industrial conglomerate
The company has appropriate measures in place to manage its environmental and social risks. However, due to potential disruptions from the proliferation of EVs in Indonesia, we adjusted our valuations to account for lower automobile demand, reaching pre-COVID sales by 2025, while the company starts to produce/distribute EVs in the country. Also, we have lower for longer heavy machinery sales and coal contracting overburden removal due to expectations of lower thermal coal demand due to environmental concerns. Corporate governance risks have been factored in via a higher cost of equity (1.1x beta) and terminal growth rate lower than gross domestic product (GDP) growth potential.

Household products
Given the company's strong positioning with respect to E&S risk factors, we have assumed stable market share trends (i.e., ability to compete effectively in the market) and low discount rate in our DCF valuation. Its corporate governance standards are among the best within the sector as well as the broader listed universe. This element is also reflected in the low discount rate used for DCF.

Online food delivery
The company has committed to 100% EV for its delivery fleet by 2030. We expect the goal to be reached earlier due to the commercial benefits of a shift to EVs and have accordingly assumed some benefit of this shift in delivery costs. We also rate the company highly on corporate governance. The board composition, including the presence of a key individual, and track record gives us confidence. This high corporate governance score is reflected in a lower cost of equity.

Cement manufacturer
Against the backdrop of operating in a high carbon intensive industry, the company is in full compliance with all national standards on emissions and manages its operational footprint from a forward-looking perspective well. As such, we believe it should face a low risk of fines/penalties/compensation. Having said that, given potential emissions costs in the future to Chinese cement manufacturers, we have factored this into the company valuation by assuming lower margins in our cash flow forecasts.

Technology

As much as we use our access to management to our advantage, we recognize there is a vast amount of available ESG information that can be valuable to our corporate assessments. It can be resource-intensive in nature to mine for material information while ensuring we avoid noise. As such, over the past year, we have built in-house tools to help our investment team focus on key areas that will help not only our analysts to research their coverage effectively but also our portfolio managers to have greater portfolio oversight of their exposures.

Natural language processing (NLP)

NLP is a subfield of linguistics, computer science and artificial intelligence concerned with the interactions between computers and human language, particularly how to program computers to process and analyze large amounts of natural language data. The goal is a computer capable of "understanding" the contents of documents, including the contextual nuances of the language within them.

The NLP model can be used for a host of down-stream tasks. Contextual search, language translation, sentiment analysis, document summarization, question-answering (chatbots), text classification and text generation are some of the most promising uses.

How is FTEME leveraging NLP?

EnSiGnia FTEME – a true distinguisher

We identified a gap when it comes to structured data in the ESG domain. While many vendors are venturing in this space to provide structured, standardized ESG data, emerging markets remain lower in priority and hence has resulted in some coverage gaps.

Also, much of the ESG information is disclosed through company filings and the reporting format across companies and markets is very diverse. So, our analysts are sifting through large documents to find relevant ESG information.

We believe that NLP can help us fill these gaps and create an efficient way to generate ESG insights. We customized Google's Bidirectional Encoder Representations from Transformers (BERT) with ESG specific data and created ESG-BERT which can categorize information in line with the SASB framework.

NLP customization process

Basic NLP transformers

- Most basic NLP components
- This is then trained with Wikipedia Text & Books

BERT

- Generic BERT
- Available as open-source from Google
- This is then fine-tuned using sustainability reports

ESG-BERT

- Domain-specific BERT
- This is then trained using supervised dataset in SASB standards

Final model

- Ready to classify/tag any text statement(s) into an ESG topic as per SASB standard

EnSiGnia is an NLP-based tool developed to assist our investment team members in:

- Studying large annual reports and sustainability reports in a time saving manner
- Viewing multiple reports in a single standardized format
- Improving their ESG engagement with companies
- Documenting proprietary three-pillar ESG framework for the companies
- Evaluating companies for investment eligibility/ opportunity with reference to sustainability outcomes
- Discovering net-zero pathway of emerging market companies

- Generating summarized ESG reports on specific topics (v2.0)
- Screening ESG events which can have a positive or negative impact on the companies (v2.0)
- Highlighting any ESG topic which is getting increased media coverage (v2.0)

EnSiGnia can, for example, help the research team analyze ESG issues in the semiconductor industry by answering all these questions:

- Has MediaTek become more focused on highlighting their environmental initiatives?
- What water management practices are adopted by Taiwan Semiconductor Manufacturing Company (TSMC)?
- Who gives more importance to environmental issues—MediaTek or SK Hynix?
- What employee well-being initiatives were taken by Novatek two years ago?
- What is the net-zero commitment of semiconductor companies?
- How can we get relevant information to assist the three-pillar analysis for Hon Hai Precision?

Similarly, EnSiGnia can also address questions such as these in more focused subjects such as Indian banks:

- Has ICICI Bank become more focused on highlighting their governance initiatives?
- What data security policies are deployed by HDFC Bank?
- Who gives more importance to governance—Middle Eastern banks or Indian banks?
- What environmental initiatives were undertaken by Kotak Mahindra Bank two years ago?
- What is the net-zero commitment of Indian banks?
- What are Indian banks reporting about rural banking?
- How can we get relevant information to assist the three-pillar analysis for Federal Bank?

Our vision for EnSiGnia

Current coverage	**Coverage goal**
123 Companies	**700+ Companies**
$5.52 Trillion of market-cap	**$10+ Trillion of market-cap**
527 Annual reports	**4K+ Annual reports**
788K+ Paragraphs	**5M Paragraphs**
9.35 GB of PDFs	**60 GB of PDFs**
144K+ Pages	**1M+ Pages**
70%+ of FTEME holdings	**95%+ of FTEME holdings**
420 Sustainability reports	**3K+ Sustainability reports**

Principal adverse impacts (PAIs)

The Sustainable Finance Disclosure Regulation 2019/2088 (SFDR) was adopted on 27 November 2019 and was implemented on 10 March 2021 for European domiciled products. The introduction of SFDR brought with it the concept of Principal Adverse Impacts (PAIs). These consist of a list of sustainability factors (14 mandatory for corporates) that firms need to consider in their investment policies and decisions, where they qualify to do so. Although these PAI indicators may have issues in data coverage as well as quality, the SFDR nevertheless provides, for the first time, a uniform disclosure practice. To aid the monitoring and incorporation of PAIs into our investment process, where required, we have built two in-house tools for consumption by our portfolio managers and analysts.

Issuer dashboard

The issuer dashboard is integrated into our proprietary research database (EMDB). This dashboard allows us to systematically view the 14 mandatory corporate PAI indicators, along with other third-party vendor-fed metrics, directly into our research portal, and accessible to the entire investment team. Here we can assess the indicators on absolute and relative levels to determine a sense of adverse impact from a sustainability lens.

Portfolio analysis

The portfolio analysis tool allows portfolio managers to assess adverse impacts from a portfolio perspective. PAI values from underlying issuer investments are aggregated to portfolio values, with the ability to drill down to understand contributions and historical trends. This is an important tool not only to understand and manage potential adverse risk exposures, but also inform and target necessary engagement activity.

Supply chains

Corporate supply chains are increasingly becoming more complex. As businesses grow and value chains reshape to new demand and technologies, the ESG issues carried within supply chains can bring greater reputational and operational risks. This means that we often need to look at sectors and their supply chain exposures with greater depth, with enhanced scrutiny.

Case study: Brazilian food

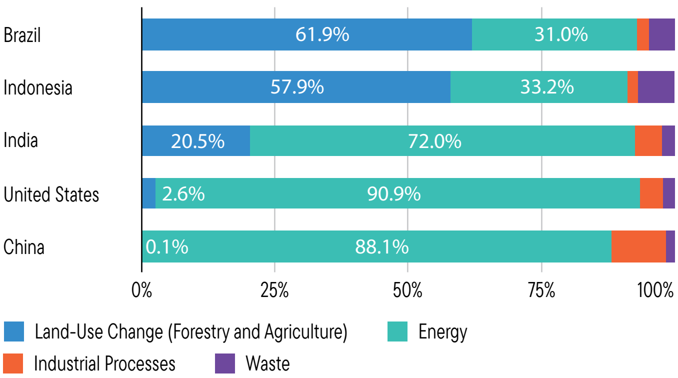
Sustainable beef is key to slowing Amazon deforestation (franklintempletonglobal.com)

For over a decade, Brazil's beef industry has faced pressures over deforestation as ranchers clear Amazon forests to make room for grazing livestock. Pressure on Brazil's publicly listed meatpackers is also mounting as more retailers and consumers steer clear of beef linked to the Amazon's demise.

Clearing the Amazon to make room for cattle is Brazil's biggest source of GHG emission.

Deforestation Driving Brazil Emissions[3]

Greenhouse Gas Emissions by Sector as % of Total
2019



For our research analysts, direct engagement has been indispensable to gauging the sustainability of corporate business models and near-term strategies for navigating Brazil's sprawling system of 2.5 million cattle ranchers and 446 meatpackers.[4] Some key discussion points include ways to verify cuts of beef are free from deforestation and future impacts from export bans.

We are of the opinion that there are three areas critical to gauging future market risks for Brazil's meatpackers and sustainable beef production at the farm level.

- **Digital tracking solutions.** The ability to trace cuts of beef to a single animal and ranch already exists in countries like Uruguay. With a focus on food safety, many of the world's largest beef exporting countries use national livestock tracking systems. This could be a silver bullet for Brazil's meatpackers.
- **Carbon-neutral beef.** Sustainable beef production starts on the ground with farmers—long before cattle reach meatpacker auctions. The use of new regenerative grazing techniques that farmers in Brazil, and across the globe, could boost soil quality and carbon sequestration.
- **Carbon market incentives.** The ability to monetize the Amazon's carbon sequestration capacity through global carbon markets could accelerate sustainable grazing practices among farmers and ranchers.

In the face of escalating climate risks, it is critical that equity analysts uncover future ESG risks and opportunities that can be easy to miss by just scrutinizing a balance sheet. In our discussions with Brazil's meatpackers about deforestation bans, it became clear that national traceability infrastructure is a better solution than one-off systems that only a handful of meatpackers can afford to deploy. Without more support from Brazil's government agencies, Amazon deforestation caused by cattle farming is unlikely to decline.

Looking ahead, a global carbon market that confers monetary value to forests and farmland soils could be a victory not just for Brazil and the Amazon, but also for other rainforest countries like Indonesia and the global agriculture sector. That said, we think it's unlikely that entities will buy carbon offsets from Brazil if large-scale Amazon deforestation from ranchers and farmers continues unabated. If big export markets like China move toward an EU-style deforestation ban, we expect Brazil's government will move quickly to enforce sustainable Amazon policies. More broadly, systemic problems like climate change means sustainable practices by private farmers, ranchers and pastoralists in Brazil play an equally important role in delivering potentially carbon-free beef to consumers.

3. Source: CAIT, World Resource Institute
4. Source: Brice, J. and T. Freitas. "Why It's So Hard to Stop Amazon Deforestation, Starting With the Beef Industry" Bloomberg, December 17, 2020.

Case study: Semiconductors

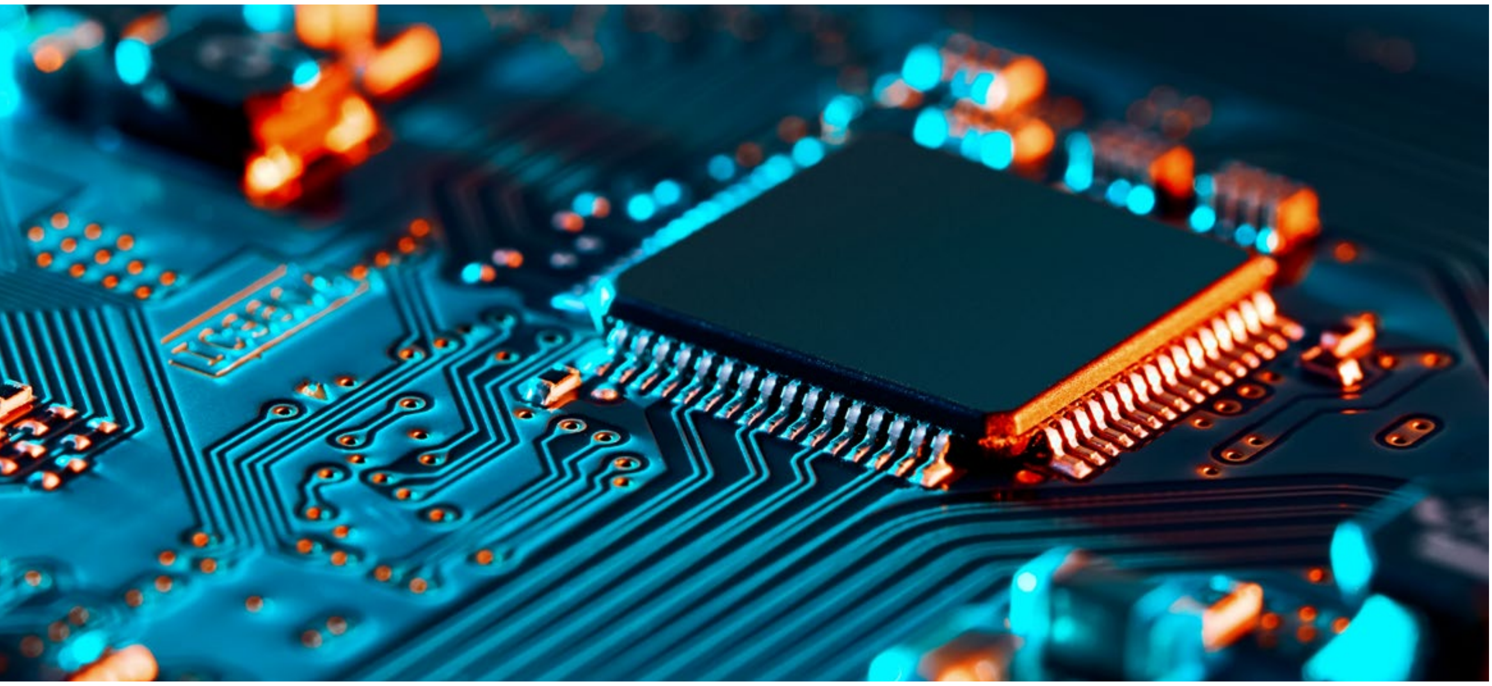
In 2022, FTEME took part in supporting a collaborative initiative to encourage greater accountability in semiconductor company supply chains, around conflict-free sourcing of minerals. The group of long-term investors believe that sound labor practices and good environmental management go hand in glove with shareholder returns. As regulators and consumers pay increasing attention to the challenges of mineral sourcing within the semiconductor supply chain, there is an opportunity for companies to take a lead in the development of conflict mineral free supply chains.

Tantalum, tin, tungsten, gold and cobalt (referred to collectively as conflict minerals) are vital materials and building blocks of the semiconductor industry. The poor traceability of these minerals along complex supply chains, including smelting and refining, can obscure the provenance of these minerals. This can lead to the inadvertent financing of armed conflict and the abuse of human rights.

The investor group wrote to more than 25 companies, highlighting best practices, including the following:

- Develop and invest in technological solutions to improve traceability, possibly blockchain.
- Increase transparency and reporting on minerals from mine to product.
- Encourage and participate in industry wide collaboration to improve industry practices.

We contacted our investee companies in this list to let them know that we are aware of the investor letter and are supportive of its direction. We continue to monitor the progress made by this initiative.



Climate change

According to Climate Action Tracker, policies presently in place around the world are projected to result in about 2.7°C warming above pre-industrial levels. Nationally determined contributions (NDCs) alone will limit warming to 2.4°C. When binding long-term or net-zero targets are included, warming would be limited to about 2.0°C above pre-industrial levels.

As part of our commitment to the analysis of governance and sustainability factors, we include climate considerations. Factoring material climate issues into our company forecasts can lead to adjustments in growth projections, margin expectations, or discount rates. In addition, as active stewards of our clients' assets, engagement is a key tool that enables us to understand and share best practice on a company's governance and sustainability journey.

Within emerging markets, the landscape varies considerably, ranging from countries that have announced meaningful carbon targets to those that have yet to declare any significant policies. Our objective is to understand the climate commitments of our investee companies incorporating both local and global perspectives, recognizing that the pace of decarbonization and the associated strategies will differ across countries and cultures. We also recognize that some industries will need to decarbonize at a much faster pace than others, hence our approach is sector specific.

Companies in emerging markets are fighting climate change in multiple ways. Some are seeking to decarbonize in high-emitting sectors, while others are providing environmental solutions through their products and services. Elsewhere, there are companies employing technology to reduce carbon emissions, cutting high-pollution industrial activities, and pivoting their corporate strategy toward green businesses such as renewables and EVs. We also invest in companies in carbon-intensive sectors such as steel, cement, and extractive industries where there are real decarbonization commitments. These companies have a critical role to play in reducing global emissions. We believe in engaging such companies as opposed to divesting; divestment does not resolve the environmental challenge.

Just transition

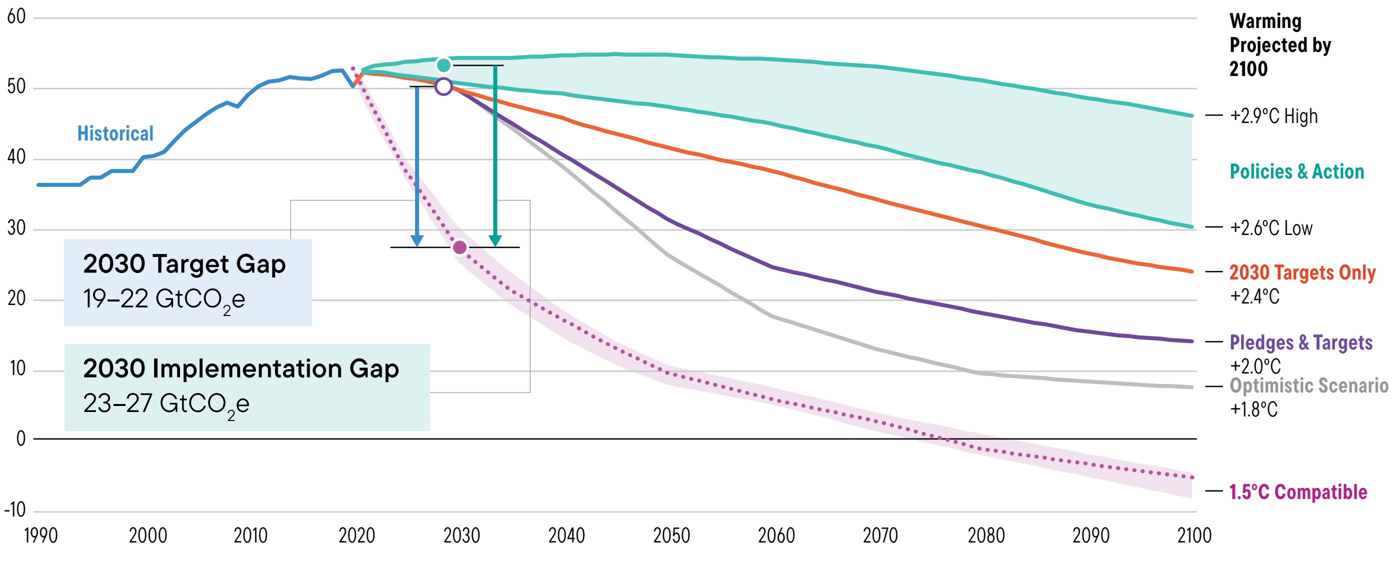
As we look to focus on climate transition, we also need to be aware of the 'Just Transition.'

A just transition seeks to ensure that the substantial benefits of a green economy transition are shared widely, while also supporting those who stand to lose economically—be they countries, regions, industries, communities, workers or consumers.

A just transition is an integral part of many of the global commitments adopted by countries. The Paris Agreement acknowledges "the imperatives of a just transition of the workforce and the creation of decent work and quality jobs in accordance with nationally defined development priorities" and highlights the importance of workers in responding to climate change.

2100 Warming Projections

Emissions and expected warming based on pledges and current policies



> **“Ambitions of net-zero cannot ignore a ‘just transition’ and this in emerging markets is particularly important.”**
>
> **Preyesh Patel**
> Senior ESG Analyst

We as an investor base need to recognize that the structures of the economies we invest in are different and this means that the transition to a net-zero or low-carbon economy will not be felt equally across countries and regions. Having social awareness alongside our climate research becomes key in assessing how we approach our engagement and its impact on all stakeholders, including the communities these companies may support.

Net Zero Asset Managers initiative (NZAM)

The NZAM is an international group of asset managers committed to supporting the goal of net-zero GHG emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5°C; and to support investing aligned with net-zero emissions by 2050 or sooner.

The Paris Aligned Investment Initiative Net Zero Investment Framework (PAII NZIF) alignment maturity scale for portfolio companies

The PAII NZIF alignment maturity scale for portfolio companies is a 5 category climate scale ranging from companies that are achieving or aligned to net-zero, to those that show no evidence of transition potential.

Goal: for our committed portfolios to move up the climate alignment scale over time, to 100% aligned to net-zero by 2040 and achieving net-zero by 2050.

Achieving net-zero	Aligned to a net-zero pathway	Aligning towards a net-zero pathway	Committed to aligning	Not aligned
• Current emissions at/close to 2050 net-zero level + investment plan/ business model in line with net-zero	• Higher impact companies: criteria 1–6 • Lower impact companies: criteria 2, 3, 4	• Criteria 2, 4, + partial fulfilment of criteria 5	• Criteria 1	• All other companies

Higher impact companies: criteria 1-6

Lower impact companies: criteria 2-4

1. **Ambition:** A long-term 2050 goal consistent with achieving global net-zero
2. **Targets:** Short- and medium-term emissions reduction target (scope 1, 2 and material scope 3)
3. **Emissions performance:** Current emissions intensity performance (scope 1, 2 and material scope 3) relative to targets
4. **Disclosure:** Disclosure of scope 1, 2 and material scope 3 emissions
5. **Decarbonization strategy:** A quantified plan setting out the measures that will be deployed to deliver GHG targets, proportion of revenues that are green and where relevant increases in green revenues
6. **Capital allocation alignment:** A clear demonstration that the capital expenditures of the company are consistent with achieving net-zero emissions by 2050

At FTEME, we integrate ESG analysis with traditional financial analysis so we can gain valuable insights into the quality and risks of businesses we invest in. This includes climate factors, where material for a company. As firm signatories to NZAM, FTEME supports the initiative and as such will take greater accountability of climate issues in our process that goes beyond the materiality aspect of climate considerations within our research. In addition, and in partnership with our clients, we will seek to officially commit some of our portfolios to net-zero with the ambition to increase those commitments over time.

To manage a portfolio to net-zero and include it as a committed portfolio to NZAM, FTEME plans to follow the PAII NZIF. The framework provides a robust, transparent route to categorizing the status of net-zero ambitions of companies (see scale on p.36), while having an engagement agenda focused on decarbonization outcomes. It is the preferred methodology for FTEME as it is flexible, adopts a transparent approach and goes beyond target verification, while using engagement as a key tool.

Engagement will be our primary tool for a portfolio transition to net-zero and the goal for a committed portfolio will be for owned companies to move up the climate alignment scale over time towards achieving net-zero by 2050. As such, we do not expect portfolio turnover as of today, but do expect potential action points coming towards the latter end of this timeline based on engagement effectiveness and climate-related financial risk.

We will set an interim 2030 target, to ensure progress and an engagement agenda prioritizing material sectors (as defined in the PAII NZIF framework). A portfolio reference target will also act as a mechanism to ensure that we do not just achieve a net-zero portfolio, but our work contributes to real-world emissions reductions.

Summary

We believe that as companies make commitments to net-zero and subsequently take greater accountability of carbon emissions in their businesses, this will lead to real-world decarbonization outcomes. The PAII NZIF framework will allow assessment and alignment to a 1.5°C scenario. In addition, our targeted engagements will further help that journey, particularly with the focus on material sectors (as defined in the PAII NZIF framework) and largest portfolio financed emissions contributions. **In addition to explicit portfolio commitments where introduced, FTEME will seek to take greater accountability and action across our coverage through execution of our climate workflow.**

Climate workflow

Encourage all our investee companies to disclose GHG emissions

- Scope 1+2 at minimum and Scope 3 where material
- Reporting against TCFD framework and to CDP

Encourage companies to set climate reduction strategies and targets

- Meaningful medium/long-term carbon strategies to be introduced e.g., SBTi
- Accountability of senior management

Monitor companies that aren't de-carbonising and engage

- Run regular carbon screens on our holdings to monitor the rate of decarbonization and flag companies of concern; monitor company net-zero carbon targets
- Escalation if there is no progress, post engagement

Assess companies providing real-world climate/ carbon reduction solutions

- Consider the opportunity set that the transition to a low-carbon economy provides

Partnering on climate change

In 2022, we partnered with Dr. Mathew Hampshire-Waugh, founder of Net Zero Consulting Services Limited, to deepen our understanding of climate change and the transition to a net-zero economy. Working with a thought leader in the field allows us to broaden the team's knowledge of acute physical risks (e.g., extreme weather), chronic physical risks (e.g., rising seas), and transition risks & opportunities (e.g., market changes) through all sectors of the economy. In turn, this supports our capacity to identify, quantify, and manage climate-related risks and opportunities across multiple future pathways. Helping to better integrate climate-risk through our reporting processes, business strategy, investment decision-making, and stewardship process.

Net-Zero Consulting Services Limited

Working with the scientific community, corporates and the financial services industry to support knowledge building, foster collaboration and accelerate action on climate change and the net-zero transition. Impact-led, value-add services including workshops, presentations & writing; techno-economic due-diligence; net-zero & decarbonization strategy, risk analysis & reporting.

Dr. Mathew Hampshire-Waugh

Dr. Mathew Hampshire-Waugh is the founder of Net-Zero Consulting Services Limited and author of bestselling book *CLIMATE CHANGE and the road to NET-ZERO*. A former director at a global investment bank where his work focused on new-energy technologies. Hampshire-Waugh holds a doctorate in materials chemistry on the use of nanomaterials for energy-saving windows and solar panels.

> **"Net-zero offers not only a solution to climate change, but also an opportunity to build a more resilient energy system, a more productive economy, and a better quality of life for all."**

Dr. Mathew Hampshire-Waugh
Founder of Net Zero Consulting Services Limited

Climate core competencies

We predict that the decarbonization of the global economy will fundamentally transform all markets and all regions over the coming decades, creating unprecedented risk and opportunity. We believe that a deep understanding of the rapid changes taking place in Earth's physical systems, and the impact these changes will have on the economy, will prove vital to the successful allocation of capital today and into the future. We endeavor to maintain a high level of climate-competency across our analysts, portfolio managers, ESG specialists, and senior management to help navigate the transition.

Partnering with Dr. Mathew Hampshire-Waugh on a series of workshops and interactive discussions, our team has explored the science, economics, and politics of climate change and the road to net-zero. Providing both a top-down overview of the climate problem in relation to the global economy, and a bottom-up assessment of likely changes to technology, markets, and regulation. The workshops have offered a dynamic forum to explore the many dimensions of climate change in the context of our business and portfolio allocation.

Workshop sessions

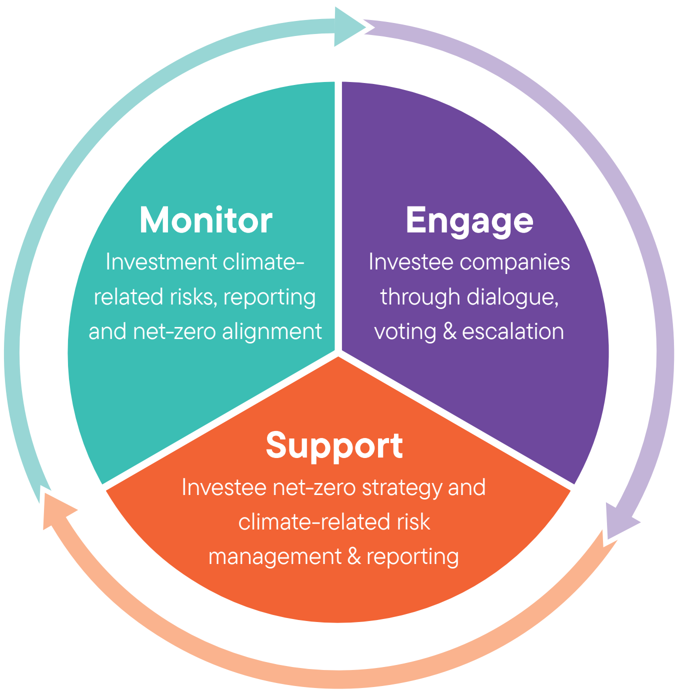
1. **Climate science and physical change:** The greenhouse effect, evidence for human influence on climate, and the physical changes already taking place.
2. **Projecting future climate damage:** Scenario analysis, global climate frameworks, and projecting physical and socio-economic damage under different pathways.
3. **Net-zero energy supply:** The role of adaptation, climate engineering, and mitigation. Re-wiring the global energy supply based on techno-economic assessment.
4. **Net-zero energy demand:** Re-engineering transport, buildings, industry, and agriculture to run net-zero. Techno-economics, cultural change, and regulation.
5. **Systems thinking, economics, and investment implications:** Impact of technological change on the economy. Consolidating key risks and opportunities in the context of portfolio allocation.

Net-zero engagement

We consider engagement on climate a purposeful dialogue to drive positive change with the defined objectives of supporting a swift and orderly net-zero transition.

We partnered with Dr. Mathew Hampshire-Waugh to create a framework for our investee companies to help communicate our net-zero ambitions, our expectations of investee partners, and to share best practice in carbon accounting using the Green House Gas protocol, setting science-based decarbonization targets via SBTi, and climate-related reporting through the TCFD framework for corporates.

We plan to begin our net-zero engagement process with the first wave of identified companies through the course of 2023.



Climate opportunities

District Cooling (DC)

DC is one of the most effective sustainable solutions in space cooling; it applies industrial scale to the cooling process, chilling water at a central plant and distributing it to buildings through a network of underground insulated pipes. Globally, DC has been providing more cost-effective low carbon pathways for cities to meet their energy needs, also accelerating the transition of green buildings to carbon net-zero buildings.

The transition to clean energy in emerging markets should boost demand for DC systems. Currently, it is estimated that almost 20% of the total global electricity demand is used for cooling purposes, via air conditioners and electric fans in buildings.[5] Over the next decades, urbanization, climate change, economic development and continued industrialization will only intensify the electricity demand for cooling.

As well as contributing to a low carbon economy by increasing energy efficiency (a 50% reduction in power consumption) and reducing GHG emissions, DC has lower life-cycle costs and enhanced efficiency and reliability compared to traditional air conditioning.

Studies show that district energy systems allow for a low cost and energy-efficient transition towards renewable energy-based energy systems, enabling, for example, increased flexibility in the operation of energy conversion technologies, low-costs storage solutions, and the utilization of otherwise non-utilized energy sources such as excess heat from industries and natural cooling from natural cold sources.[6]

District cooling case study | Empower, UAE

Increased urbanization in the Middle East has led to an inevitable increase in the consumption of energy. In fact, energy consumption in this region has grown faster than GDP since 1980, with some of the highest consumption rates in the world. Given the region's hot climate, air conditioning systems in the region tend to operate all year round, so there is a pressing need to generate sustainable cooling at speed and on a large scale.

Emirates Central Cooling Systems Corporation PJSC (Empower) is the largest DC services provider in the world, primarily operating in Dubai with an 80% market share. The company will be a beneficiary of the region's increased DC penetration as DC is a key pillar of the Dubai Transition Plan where the Dubai Government has targeted 40% DC penetration by 2030 versus 26% in 2021 (18% in 2016).

As Empower is looking to operate carbon neutral DC plants by 2050 by targeting the utilization of 100% renewable energy and recycled water in its plants, it will have an important role to play in the UAE Net-Zero by 2050 initiative as cooling remains integral to the region given the hot desert climate, especially for any new large-scale residential or commercial establishments.

The UAE is one of the leading countries in developing renewable energy solutions and resources, with the country's clean energy capacity set to reach 14 gigawatts by 2030, compared to 100 megawatts in 2015.

5. The four generations of district cooling - A categorization of the development in district cooling from origin to future prospect, 28 April 2022, ScienceDirect
6. Ibid

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Solar

Despite supply-chain bottlenecks and higher commodity prices, clean energy is today more cost competitive in more nations than ever. China has played a crucial and unique role in the global energy transition to date and in 2021 attracted $266 billion for these technologies representing roughly one-third of all such investment worldwide.[7]

The falling cost of key clean energy technologies offers a tremendous opportunity to follow a new, lower-emissions pathway for growth in emerging markets, but if this opportunity is not taken, and clean energy transitions falter in these countries, this will become the major fault line in global efforts to address climate change and to reach the sustainable development goals.

China is forecast to install almost half of new global renewable power capacity between 2022 and 2027, as growth accelerates in the next five years despite the phaseout of wind and solar photovoltaic (PV) subsidies.[8] In India, new installations are set to double over our forecast period, led by solar PV and driven by competitive auctions implemented to achieve the government's ambitious target of 500 gigawatt (GW) of non-fossil capacity by 2030.[9]

The global solar PV supply chain is diversifying, but China will continue to dominate manufacturing. The International Energy Agency has forecast that solar PV on its own will account for over 60% of all global renewable capacity expansion through 2027, and although module prices have increased, utility-scale solar PV is the least costly option for new electricity generation in a significant majority of countries worldwide.

Solar case study

LONGi, China

LONGi Green Energy Technology Company Limited is a world leader in the clean energy transition. As a vertically integrated player focusing on mono-silicon rod, wafer, module, and cell production, the company should benefit from a growing global demand for clean energy technology.

Our research into the PV supply chain highlighted LONGi as the largest mono-silicon wafer producer in the world and a technological leader in the industry; over the past 20 years LONGi has continued to improve cell efficiency and lower costs, as well as developing innovation-focused solutions for large-scale power plants, for different industries and households. Its building integrated PV products entered mass production in 2020, which could help to serve the growing green building market.

As a growing coalition of countries, cities, and businesses are setting climate targets, LONGi has opportunities to tap the increasing demand for clean technology. The group has been active in promoting and realizing its "Solar for Solar" ideal, where the company uses clean energy and green manufacturing practices in its operations whenever possible. The company have committed to powering their global operations with 100% renewable electricity by 2028. Yunnan province may be the first production center where LONGi achieves this, as five of its factories already consume 100% renewable energy.

The company continues to focus on innovation-led development and plan to eventually supply "Green Power and Green Hydrogen" solutions for global zero-carbon development.

7. Mobilizing Capital Into Emerging Markets and Developing Economies Commissioned by Glasgow Financial Alliance for Net Zero, November 1, 2022
8. Renewables 2022, Analysis and forecast to 2027, International Energy Agency
9. Ibid.

Investing in carbon-intensive industries

We are willing to invest in companies in carbon-intensive sectors, such as cement, steel and extractive industries. This is because we are pragmatic investors who understand that not every company can have a perfect sustainability profile today. The right thing to do is not always black and white; rather, we believe it is about managing shades of grey.

Our engagement with these companies focuses on their intention to decarbonize and any incremental improvements they are making to reach these goals. We have found that divestment does not resolve the challenges facing carbon-intensive industries. On the contrary, it may even make the challenge harder as future shareholders may not engage with management to develop a decarbonization plan.

Analyzing the carbon intensity of our investments highlights the cement and steel industries as significant contributors to the carbon footprint of our portfolios. Therefore, we tend to have deeper discussions around climate change in these industries and others where the emissions profile is high. Carbon-emissions management is a material ESG issue for both sectors and can impact a company's business model in a number of ways; current and future carbon taxes, and technological upgrading and compliance costs.

Focus on the steel sector

The transition to a low-carbon economy will require a change in the way we manufacture steel. Accounting for nearly 8% of global emissions from the energy sector[10], the steel industry will play an important role in mitigating climate change by reducing the CO_2 emissions in the production process. Contributing to innovative infrastructure technology where electricity, hydrogen and carbon capture, utilization and storage (CCUS) are seen as the three main pillars to achieving substantial emission reductions.

Steel recycling has significantly lower emissions than other available options for steel production

CO_2 intensity of steel production (t CO_2/t steel)

Basic oxygen furnace (BOF)
The large majority of current steel production uses coal to reduce iron ore and produce steel in integrated steelworks.

BOF, with best available technology; Increased process efficiency
An estimated 15% process efficiency improvement is possible within the current BOF process.

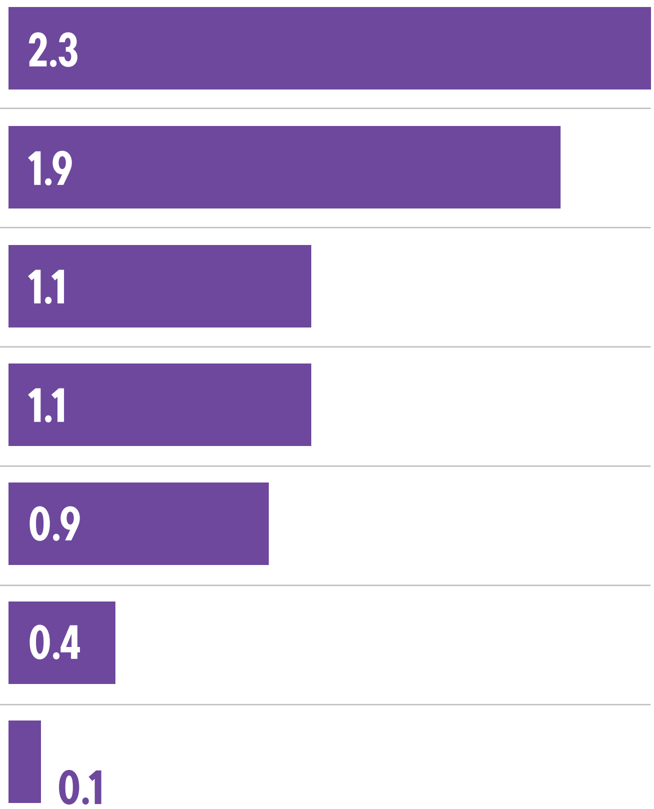
BOF, with bio fuels; bio-based Inputs
Bio-based fuels can substitute for some of the coal input, with emissions reductions of around 50%.

Direct reduced iron (DRI)
This route uses natural gas to reduce iron ore, which almost halves emissions. DRI accounts for 5% of current world production.

BOF + Carbon capture and storage (CCS)
Capturing the CO_2 from the blast furnace of an integrated steel plant can reduce overall emissions by 60%.

Electric arc furnace (EAF)
The main route for secondary steel uses electricity to melt steel scrap and/or direct reduced iron, with only small onsite emissions.

EAF + zero carbon electricity
By using zero-carbon electricity, nearly all the emissions from steelmaking can be eliminated.

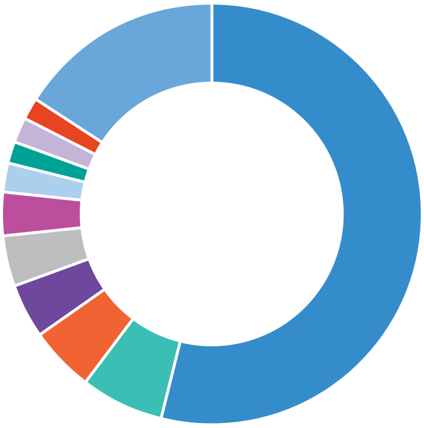


Source: Material Economics

10. Assessing Steel Decarbonisation Progress - Ready For The Decade Of Delivery? OECD, November 2022

In 2021, more than half of the world's crude steel was produced and consumed in China, with India taking second place.[11] In addition to the fact that China is a big steel producer, the amount of CO_2 per ton of steel is higher due to the way the steel is produced there (majority basic oxygen furnace). Addressing the large carbon footprint of companies in the steel industry is crucial if both China and India are to meet their commitments as signatories to the Paris Agreement.

2021 Global Steel Production Breakdown by Country[12]



China	53.9%
India	6.6%
Japan	4.8%
United States	4.3%
Russia	3.8%
South Korea	3.5%
Germany	2.0%
Turkey	1.9%
Brazil	1.8%
Iran	1.6%
Rest of the World	15.8%

As shareholders of companies in this industry, meeting with management provides our portfolio managers and analysts with a deeper understanding of the management's forward planning as well as facilitating an assessment of progress towards that plan, particularly while operating under increased regulatory scrutiny. Some emerging market countries have introduced specific policies for the steel industry including the announcement of pricing on steel emissions in China, and a steel scrap recycling policy in India.

Focus on the cement sector

We profiled the cement industry in our previous stewardship report and it remains among the most pollutant and highest carbon emitters. The leading companies need to proactively invest in reducing their air emissions to stay ahead of the regulatory curve, while proactively managing hazardous waste. As global carbon legislation for GHG emissions tightens and global pressures from climate change increase, decarbonization will be crucial for companies to mitigate carbon costs.

11. Apparent steel use (finished steel products) 2021, World Steel Association
12. Source: World Steel Association

Environmental case study

POSCO is one of the largest steel producers in the world, headquartered in South Korea

ESG observations and analysis

- POSCO Holdings Incorporated is one of the most efficient and cost competitive steel makers globally, but it has recognized that 'the "survival" of steel companies depends on net-zero carbon.'[13]
- In order to achieve their net-zero by 2050 target, the company plans to optimize low-carbon solutions that are already in use such as hydrogen reduction steelmaking, expansion of renewable energy and carbon capture and storage. Hydrogen reduction steelmaking is an innovative technology that produces iron using hydrogen (H_2) instead of fossil fuels; when fossil fuels such as coal and natural gas react chemically with iron ore they generate CO_2, while hydrogen only generates water (H_2O), dramatically reducing the carbon emissions in the steelmaking process.
- POSCO has a clear timeline in place for the commercialization of their hydrogen reduction steelmaking technology, which includes the conversion of some existing blast furnaces in a phased manner by 2050. Clear progress has been made over recent years, but the technology in its current state is not sufficient to enable fast enough progress for low-carbon steelmaking.

Our thesis

POSCO is a market leader in terms of ESG disclosures and efforts to move towards net-zero steel production. We acknowledge the significant steps that POSCO's management has undertaken to improve the company's environmental initiatives with the implementation of clear disclosures, documentation, and establishment of timelines. POSCO has demonstrated its commitment to accelerating the global steel industry's progress towards net-zero by cooperating with other steel makers, for which their technological development will play a key role.

There are several steps the company will have to take to fully utilize its hydrogen-reduction technology. POSCO is supported by a strong financial position and has committed a substantial capital investment, which has been factored into our valuation.

13. Source: POSCO, 2 June 2022

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Environmental case study

Dalmia Bharat is an Indian cement producer

ESG observations and analysis

- Dalmia Bharat Limited has high accountability of its climate-related risk and is one of the best in the industry globally at managing its carbon footprint.
- The company is involved in providing alternative 'low CO_2' cementitious materials production. 80% of the portfolio is blended cements and the low carbon portfolio is expected to create an additional revenue of 2% (conservative estimate). Dalmia also applied for four patents for products that will contribute to the company's positive climate outcomes.
- It has a target to become carbon negative by 2040 with a clear strategy in place to improve clinker factor (already relatively low at 65%), increase use of alternative fuels (switching to become 100% alternative fuels and sustainable biomass by 2035), add renewable power (solar power + waste heat recovery systems) capacity, invest in low carbon tech and increase R&D of low carbon value-add building solutions.
- Dalmia also has board-level oversight of climate-related issues, with the Group CEO responsible for driving sustainability throughout the organization with the help of board committees.

Our thesis

Dalmia is one of the best-managed cement companies from an ESG perspective and a leading player in low-carbon cement production in India. With one of the highest cement-to-clinker ratios, we are confident in the ability of the company to operate under a backdrop of increased regulatory scrutiny and global pressure to reduce emissions.

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Portfolio managers' views

Sukumar Rajah
Portfolio Manager

ESG view
We take a holistic view when it comes to ESG issues and ensure that we consider both positives and negatives across our portfolio construction. Carbon-intensive industries is an example of that and here we are aware of our carbon footprint, ensuring we manage that appropriately from a forward-looking perspective, both at the stock level and portfolio through position sizing. Take the cement industry, for example. From a demand perspective, cement consumption per capita in Indonesia remains very low relative to the rest of Asia ex-Japan. Cement is essential for the continued Indonesian economic development with no readily available substitutes. We recognize the industry is carbon-intensive with the possibilities of future carbon costs impacting on the industry, but our focus is on those that are well managed and take accountability of their emissions profiles.

Indonesian cement producer
Although the company may have higher GHG intensity relative to some of its domestic peers, we found it to be proactively tackling the issue. In addition to setting realistic targets to reduce GHG by increasing alternative fuels usage, the company has been increasing its use of alternative raw materials and renewable energy sources for electricity generation. We continue to interact with the company's management regularly as it sets its long-term carbon roadmap as well as make further efforts to improve its reduction of carbon emissions.

Chetan Sehgal
Portfolio Manager

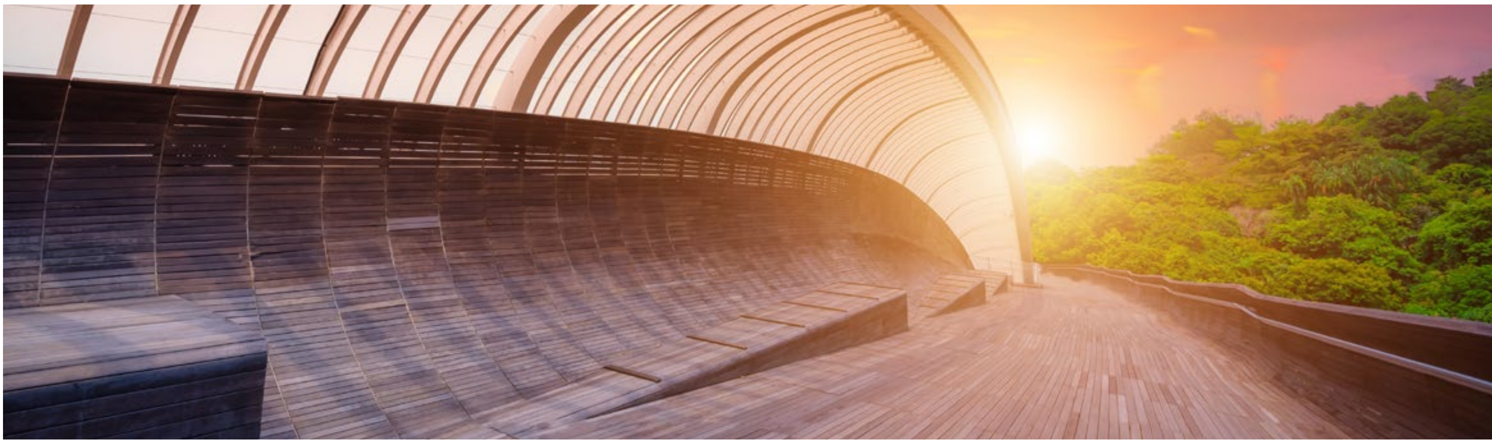
ESG view
Corporate governance is a factor that we closely monitor when constructing our portfolio. This is a consideration in our analysts' fundamental research, but we will manage position sizes accordingly where needed and engage for change where possible. Markets such as South Korea have improved their corporate governance practices, but we believe there is still room for further improvement and have actively been engaging for change.

South Korean conglomerate
The company has seen positive developments on capital allocation in recent years. We were pleased to see the company formally announce a capital allocation plan, which included a 500 billion Korean won stock buyback program to be completed by 2024, and an improved dividend policy with increased flexibility and predictability of dividends, to enhance shareholder value and narrow its discount to NAV. The company also published its inaugural ESG report in September 2022 to ensure greater transparency and facilitate ESG management, created an ESG Committee and Internal Transaction Committee to strengthen its ESG practices, took initiatives to strengthen the authority and independence of the Audit Committee and formed an advisory group including experts to focus on ESG improvements across the group.

Anand Radhakrishnan
Portfolio Manager

ESG view
There are several large conglomerates in India giving us access to fast-growing parts of the economy, however the governance structures of these companies can be complicated and are particularly important to understand for shareholders to realize value. In addition to the exposures we are getting, the governance of such entities, along with its ESG footprint is something we pay particular attention to when selecting investments for our portfolio.

Indian energy conglomerate
Encouraged by the company's improving corporate governance standards and deleveraging efforts, we initiated a position in the company. Management's realization of its goal to make the company debt-free ahead of schedule, via a successful rights issue and strategic stake sales to leading global investors, which also included board representation, gave us increased confidence. We subsequently increased our holdings on optimism surrounding the company's new green initiatives aimed at reducing its environmental footprint. The company plans to establish and enable 100 GW of solar energy by 2030, build giga factories to create and offer a fully-integrated, end-to-end renewable energy ecosystem, and invest in value chain, partnerships and future technologies, as it moves towards its goal of net carbon zero emission by 2035. In addition to the green energy sector, the company has also been expanding its more ecologically-friendly telecommunications and e-commerce businesses. We believe that these endeavors could also create longer-term growth opportunities for the company. The company's commitment to achieving best-in-class ESG standards further strengthened our belief that the company is well positioned to excel in this space.



Vikas Chiranewal
Portfolio Manager

ESG view
More and more companies have been taking action to tackle climate change. Green business models in areas such as solar energy and EV supply chains feature as investment opportunities for us. Moreover, carbon-intensive companies that show real commitment and innovation to decarbonize are also of interest to us.

China polysilicon supplier
Polysilicon is used to produce solar modules. As such, the company's business helps to push forward decarbonization and plays an important role in China's 2030 carbon peak and 2060 carbon neutrality goal by allowing affordable clean energy. Polysilicon production is a technologically advanced process and a key input into solar cells and panels. Its extensive experience gives it a competitive advantage, leading us to initiate a position in the stock. As an industrial manufacturer, however, the company is also exposed to potential negative environmental externalities and as such, subject to stringent regulations. Here we ensure there is active management of ESG issues into company operations.

In 2021, the company produced over 86,000 tons of polysilicon products for PV module manufacturing, which could be used to generate about 43 billion kilowatt-hour of clean electricity annually, equivalent to a reduction of over 25 million tons of CO_2 equivalent in GHG emissions. The company has also been reducing its comprehensive energy consumption density, GHG emissions density, wastewater discharge density and solid waste production as it continues efforts to reduce its carbon footprint.

Gustavo Stenzel
Portfolio Manager

ESG view
The mining sector is important for the Latin American region and contributes significantly to GDP as well as exports, so this is a sector that cannot be ignored. It, however, is one that is highly exposed to environmental and social issues. Against this backdrop, we actively engage with management and closely monitor developments. This is to ensure we do not unduly position ourselves for heightened risk across our portfolio and particularly within this sector.

Brazilian mining company
In addition to mining, the company operates in logistics—with railways, ports, terminals and state-of-the-art infrastructure.

We believe that the company continues to proactively manage material ESG issues. Given two major tail dam ruptures in the past, the company accelerated de-characterization of specific sites and targets to eliminate 30 upstream dams by 2035.

Moreover, most of the company's production expansion will be concentrated in the northern region of Brazil, which provides high-grade ore that results in lower GHG emissions and energy inefficiencies and is also more isolated from densely populated areas.

Following our engagement to support the election of board directors, the company increased the number of board members with sustainability and mining experience, which should further improve their ability to provide oversight of ESG risks. Additionally, the company now has an independent board majority. We were also pleased to see that improvements in the company's corporate governance standards led MSCI to raise its rating by one level in 2022.

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Active ownership

Outcome-oriented: Long term and collaborative

As a signatory to the Principles for Responsible Investment, we are called on to be active owners and incorporate ESG issues into our stewardship policies and practices (PRI 2). It is also expected that we will seek appropriate disclosures on ESG issues by entities in which we invest (PRI 3). In this section, we describe how we have fulfilled our responsibilities as active owners and sought appropriate disclosures by the companies we invest in.

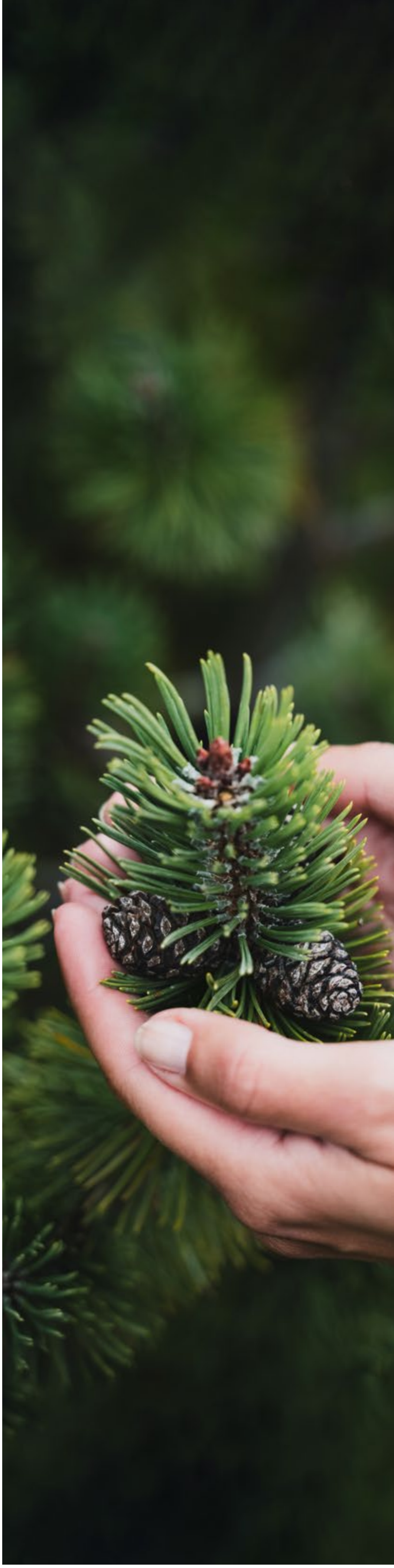
As investors with a significant presence in emerging markets, our active ownership efforts are a key part of our overall approach to stewardship. Our analysts conduct almost 2,000 company meetings a year using our industry-leading research footprint across emerging markets, where we seek to gain a number of fundamental and sustainability insights.

Given our over 30-year history and local presence in emerging markets, we have management and industry relationships cultivated over the long-term. Impactful engagement requires transparent communication and trusting relationships, and our broad and deep on-the-ground presence means we are well-placed to forge close relationships that create value through constructive engagement.

We believe our engagement efforts are key to developing a detailed understanding of companies and improving outcomes for shareholders as well as stakeholders more broadly.

Our approach to engagement and active ownership focuses on material issues that affect the sustainability of earnings, including strategy and material sustainability, and governance factors. Given our long-term outlook, we build strong relationships with our investee companies as co-owners on our clients' behalf.

As active owners, we seek to engage with companies on material issues via several approaches including management and board meetings, letter writing, proxy voting and shareholder-resolution filing. All our voting decisions are made in-house by our analysts/portfolio managers and are undertaken in accordance with our FTEME Corporate Governance Principles and in line with our clients' best interests.



2022 engagement statistics

Our analysts are in a continual dialogue with companies on a range of topics including governance and sustainability. There are also companies we identify where dedicated discussion on ESG topics are necessary and we report the nature and outcome of these meetings.

ESG issue
Identify material ESG issues and rationale for engagement

Objectives and process
Set goal and/or rationale for the engagement and approach

Outcome
Review outcomes, next steps and investment thesis

ESG Discussion by Engagement Type

	Number of Interactions	Percentage of Interactions
Environmental	**38**	**33.9%**
Carbon Risk and Climate Change	29	25.9%
Environmental Consideration	9	8.0%
Social	**20**	**17.9%**
Human and Social Capital	20	17.9%
Governance	**54**	**48.2%**
Corporate Governance	44	39.3%
Strategic Risk and Communication	10	8.9%
Total	**112**	**100%**

ESG Discussion Outcome

	Number of Interactions	Percentage of Interactions
No Progress	3	2.7%
Feedback Noted by Company	45	40.2%
Company Plans to Make Changes	35	31.2%
Company Has Implemented Plans	29	25.9%
Total	**112**	**100%**

Escalating issues

Escalation can include further meetings with the company, voting against management proposals, or divesting from the stock. Reasons for escalation can include management not producing the information we request or an engagement for change that does not result in an outcome we believe is satisfactory for minority investors.

Our decision is based on the specifics of each individual engagement. The need to escalate is ultimately determined by how responsive management is to our questions and the materiality of the issue. As a result, we don't believe in establishing rigid escalation procedures, as this is not conducive to an effective stewardship approach. Instead, we believe in setting clear objectives in advance. We also use our engagement tracker tool to ensure continued visibility on topics requiring attention.

Next steps
If our initial engagement is unsuccessful, next steps may include:

- Engaging other members of the board where management is not responsive
- Voting against proposals
- Collaborating with other investors or industry bodies to raise the topic under review

As a last resort, we will divest where we believe the investment is no longer in our clients' best interests. Divestment does not make the issue disappear, particularly for engagement topics related to sustainability.

Examples of our engagement with companies during 2022

Company

Weichai Power (China)
The company engages in the research and development, manufacture, and sale of diesel engines.

Objectives

- Engaged the company to analyze and share how their environmental efforts (advantages in emission or investment in Ballard) can positively impact their financials, along with plans and targets for the climate transition.
- Engaged the company to leverage KION's experience in ESG disclosure and management, while encouraging the introduction of more performance-based compensation to incentivize upper management.

ESG engagement topic

Environmental & social
Industrials are particularly exposed to both emissions and human capital risk through their operations.

Outcome: Company plans to make changes (environmental) and feedback noted by company (social)

- We requested management to introduce group level carbon peak or reduction targets, similar to what KION disclosed. KION is Weichai's 45% controlled subsidiary, and a listed company. We also enquired and encouraged renewable energy usage. Management indicated that efforts were being made but that it was still difficult to determine a specific target at group level. Solar roof installation is being implemented across all factories and Weichai will start to disclose relevant data once ready. We remain engaged with the company in this regard.
- R&D is particularly important in this industry and the company had experienced some negative news flows regarding R&D personnel's complaints about working overtime. We sought clarification on the issue to understand whether there was a structural concern on incentive models that could affect employee relations in a key department. This can be a common issue with many Chinese companies, but it is not discussed often enough by shareholders. Management clarified that R&D employees are on performance-based compensation and are offered very high base level salaries. Nevertheless, the company recognized that that younger generation employees (born in 1990s and 2000s) indeed have different working mentalities and are considering improving incentive management. High-level managers do not have remuneration ceilings, and their salary is 100% performance based and a stock incentive plan is already under consideration. We see this as an important step in the company's management of its human capital.

Company

Hon Hai Precision (Taiwan)
The company is the world's largest electronics manufacturing service (EMS) company in terms of design, manufacturing, global logistics and after-market services.

Objectives

- The company has production facilities in the Xinjiang region of China which has come under scrutiny given the wider issue of forced labor being raised in that region in China across industries.
- In 2022, the company was downgraded to a 'FAIL' on MSCI's UN Global Compact Screen for violating Principle 4—Businesses should uphold the elimination of all forms of forced and compulsory labor. The accusations were linked to the company's direct role in allegedly employing Uyghurs and other ethnic minorities from Chinese government-sponsored 'Vocational Education and Training Centres.'
- Our engagement with Hon Hai is to encourage best practice supply chain management and understand forced labor risk in its operations.

ESG engagement topic

Social
With a large labor force with operations in an area alleged for human rights exploitation, the management of human capital is paramount.

Outcome: Company has implemented plans

- We engaged with the management of the company to address the allegations, who deny any such activity. Hon Hai denied any such activities and verified this through audits by global customers and independent parties, where no evidence of human rights violations was found. MSCI further elaborated their methodology and stated that Hon Hai's case is now under re-assessment.
- Going back to 2020, the company publicly stated that at no time did Hon Hai ever have employees in its workforce in any market who did not voluntarily join the firm. It also stated that any allegations to the contrary were categorically false and that all workers at Hon Hai were recruited openly and compensated fairly and in compliance with all relevant laws and regulations.
- In a public letter from the Chairman, the group reiterated that Hon Hai is in full compliance with their group's Code of Conduct and that the Responsible Business Alliance (RBA) audit was conducted independently by credible third parties—Elevate Limited, not RBA itself.
- We believe that Hon Hai has adequately addressed future risks regarding forced and compulsory labor. We continue to monitor the situation closely and stay engaged with management and monitor industry developments in this regard.

Company

Fomento Económico Mexicano SAB de CV (FEMSA) (Mexico)
FEMSA operates as a holding company, which engages in the production, distribution, and marketing of beverages.

ESG engagement topic

Governance
As a holding company, corporate governance and structure is particularly important to ensure alignment to minority shareholders.

Objectives

- During the past couple of years, we have been advocating for the company to increase transparency including their decision-making process on capital allocation.
- We have been requesting management to address and act in lowering the holding company discount. This would ensure that the market capitalization accurately reflects the sum of the investments it holds.

Outcome: Company plans to make changes

- We believe that FEMSA can achieve better alignment with minorities by addressing its holding company discount. We have encouraged management to act by increasing its disclosure, consider spin-offs or take other actions to ensure there is appropriate reflection of the company's underlying investments.
- The company has since announced that it is working on a plan to lower the discount and is expected to make an announcement in 2023. With that, we expect positive momentum in this regard.

Company

Asia Cement (China)
An integrated cement company that is mainly engaged in the production and sale of high-quality cement and related products.

ESG engagement topic

Governance
Good corporate governance is particularly important to ensure alignment to minority shareholders.

Objectives

- We were concerned that the company continued to accumulate cash over the year, but with no clear commitment on its intended use.
- We engaged with the board to address this issue as we were concerned that no action could result in further value reduction for shareholders.

Outcome: No progress

- We wrote to the board, questioning the company's substantial cash level, particularly when no mergers or acquisitions were planned.
- We strongly believe that surplus proceeds, for which there was no immediate and viable value-enhancing business development opportunities, ought to be returned to shareholders through dividend payments. Therefore, we urged the board to consider the release of the excess cash via a special dividend or share buybacks.
- While we have requested a meeting with the board to discuss this matter further, no progress has been made on this engagement objective. We will continue to follow up with the board and company.

Proxy voting process

Administration and oversight of proxy voting is managed by the Franklin Templeton Proxy Group. The team reviews each proxy, as well as agendas, materials, and recommendations that the team receives from a proxy service provider.

We believe our analysts and fund managers are best placed to make investment decisions for our clients' assets and, as such, our investment teams are ultimately responsible for determining how proxies are voted. In determining how to vote, investment teams review the issues based on a combination of:

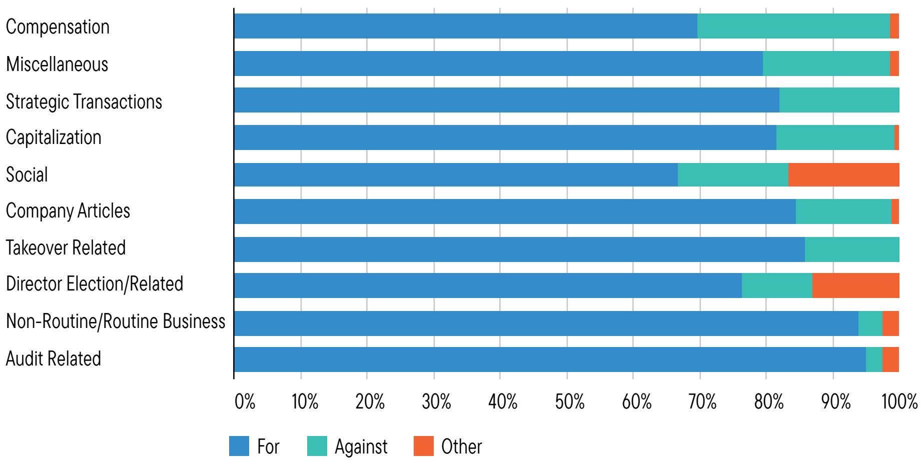
- Proxy voting policies
- Their own in-depth research knowledge of the company
- The recommendations of our proxy service providers

In 2022, FTEME voted on proposals from over 600 companies across 40+ countries. There were >8,600 voteable management proposals, of which we voted FOR management proposals 82% of the time.

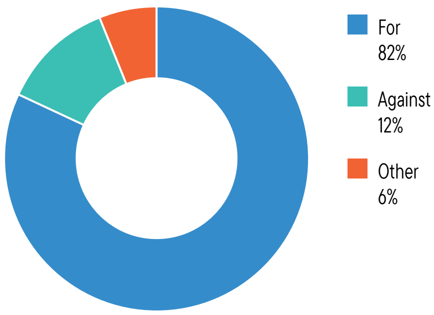
By proposal category, as a percentage of votes within each category, our votes against management were largely concentrated on compensation, miscellaneous, strategic transactions and capitalization related management proposals. We view votes against management proposals as a formal way to communicate our views to management, and we undertake them based on our investment team's assessment of each motion in line with our clients' best interests.

The number of resolutions proposed by shareholders is increasing around the world, particularly on environmental and social issues, although they remain relatively uncommon in emerging markets. We will continue closely to examine the merits of views raised by fellow shareholders.

Votes Cast per Category



FTEME Voting Actions



Other votes can include items where we abstained form voting. These could be related to management proposals which were bundled together, preventing us from voting on individual items.

Proxy voting case studies

Company	Chinese Internet and mobile platform
Vote proposal	Approve the amendments of company articles/bylaws/ charter
Vote instruction	AGAINST
Considerations	For the shareholder vote, we noted a controversial vote related to increasing the founder's voting rights by 5 times at no cost. It promoted the dual class voting rights which is not in best interests of minority shareholders. While we acknowledged the business/regulatory reasons for the proposed changes, we expressed our concerns because the proposed change is a permanent increase in the founder's voting power with no additional cost to the founder, at the expense of minority shareholders who would have to accept fewer voting rights than before. We offered suggestions on how to improve the proposal, which were shared with senior management. The various reasons offered by the company did not persuade us, and we decided to vote against the agenda. We would prefer to have some form of compensation in exchange for giving up some voting rights to the founder.

Company	Chinese bank
Vote proposal	Approve the amendments of articles of association
Vote instruction	AGAINST
Considerations	We voted against the amendment of articles because the proposed amendments were not considered to have adequately addressed accountability and transparency to shareholders, clear delineation of the roles, responsibilities and authorities between the Party Committee and the board or its key committees. The Party Committee may be granted legitimate authority to assert undue influence over the board and/or its key committees, compromising their independence and objectivity in decision-making and exposing shareholders to governance risks. Hence, our vote was AGAINST due to concerns on board independence and decision-making independence.

Company	Brazilian mall operator
Vote proposal	Approve director election
Vote instruction	AGAINST
Considerations	We voted against a number of non-independent director nominees as we wanted to signal that the overall board would lack independence. In 2002, the Sao Paulo Stock Exchange (BM&FBovespa) created differentiated listing segments with higher corporate governance standards to improve the Brazilian capital market. The voluntary listing segments are named Nivel 1, Nivel 2, and Novo Mercado. Typically, we would strive to follow these policy guidelines where appropriate.

At times, we may vote in favor of management's proposal and against the recommendation of our proxy advisory service.

Company	Hungarian pharmaceutical development and manufacturer
Vote proposal	Approve remuneration policy
Vote instruction	FOR
Considerations	Ahead of the annual general meeting, we were in touch with investor relations regarding the company's proposed renumeration policy due to lack of disclosure on variable compensation criteria and asked for more details about management renumeration criteria. This was a proposal that was recommended to vote AGAINST by our third-party vote recommendation provider. Management provided us a detailed explanation on why they could not disclose renumeration criteria on an individual basis (i.e., CEO) and clarified that there was no variable compensation for the board of directors. CEO compensation criteria would be adjusted depending on operation and challenges and mostly tied to long-term projects (2–3 years). These projects involve commercial sensitive information and hence could not be made public. The CEO would need to fulfill 2/3 of the longer-term project criteria, or his compensation is reduced/cancelled. The company has improved disclosure on renumeration of the executive team by providing individual fixed and variable salaries rather than an aggregate number. We did not identify any irregularity regarding variable compensation of the CEO and hence we voted accordingly, FOR.

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Policy advocacy

The Principles for Responsible Investment call on signatories to promote the acceptance and implementation of the principles within the investment industry (PRI 4). Our 2023 FTEME Stewardship Report continues to reflect our commitment to promoting the principles and working toward their acceptance in the industry.

Policy advocacy is one of the three parts of our approach to stewardship

Our engagement efforts are not just limited to companies. We also use our footprint across 13 countries and relationships with policymakers, regulators and stock exchanges to improve corporate governance and foster positive outcomes.

Our policy advocacy capabilities are critical to our holistic approach to stewardship. As emerging markets grow and evolve, we believe engaged active owners partnering with policymakers, regulators and stock exchanges can improve corporate governance and help raise awareness of sustainability factors.

Given our long-standing heritage and local presence, in addition to our long-term management and industry relationships, we benefit from timely and ongoing access to insights from business leaders, government officials and central banks.

While policy advocacy is not linked to every company we invest in, the overarching effort of our team can improve outcomes for investors across emerging markets more broadly. We adopt the same collaborative approach and long-term outlook in our dialogue with countries as we do with individual companies.

As pragmatic real-world investors and active owners, we seek to effect positive change where possible, rather than resort to negative screening or divestment alone.

Looking ahead

ESG Sovereign Model concept*

Our investment process is built on rigorous, bottom-up research, with an awareness of top-down macro and sovereign risks. As we do for our investee companies, understanding relevant material ESG indicators relating to a country's usage of natural resources and climate change vulnerability, human development, the quality of institutions, and rule of law, can help us add to our sovereign risk oversight through a systematic ESG model leveraged by the entire team.

The incorporation of both forward and backward-looking data is important to be able to take into account the rate of improvement/deterioration of sovereign risks over time, and as ESG factors can be slow moving and data may be quickly out of date, it is key to be able to assess the overall trend to get a directional sense of a sovereign's progress. An improving sustainability trajectory is a positive development that creates a strong commonality of interest between sovereigns, their populations, and investors.

1. Our ESG Sovereign Model concept is built on a framework of ESG related indicators that have been produced by international institutions and data providers.

2. There are forward- and backward-looking absolute and relative indicators, which indicate a country's risk using a traffic light system.

Our model enables comparisons across a broad investment universe of developed and emerging markets. It does not just measure E, S and G data as it stands today, but instead focuses on changes in macro indicators over time, both past and projected, that may reveal emerging country risks to further investigate. It is a mechanism to integrate into investment thinking, namely, proactive cost of capital adjustments for companies without double counting. It is a tool (currently under development) for awareness, to keep sovereign risks front of mind. We will continue to develop, improve and update the model based on internal feedback and observations.

1

Environmental	Vendor	Indicator
Raw Data Point	MSCI	Energy Consumption per Capita
Relative Score	Sustainalytics	Water Stress
Social	**Vendor**	**Indicator**
Relative Score	Sustainalytics	Physicians per 1,000 People
Score	EIU	Labor Market Rating
Governance	**Vendor**	**Indicator**
Score	EIU	Institutional Effectiveness
Assessment Flag	MSCI	Civil Liberties Flag

2

Country	Country ABC

Indicator	2019	Q1 22	Q3 22	2023E	2025E
Energy Consumption per Capita	–	–	5413.35	–	–
Water Stress	–	49.34	20.55	–	–
Indicator	**2019**	**Q1 22**	**Q3 22**	**2023E**	**2025E**
Physicians per 1,000 People	–	53.92	53.38	–	–
Labor Market Rating	6.00	–	6.20	6.30	**6.40**
Indicator	**2019**	**Q1 22**	**Q3 22**	**2023E**	**2025E**
Institutional Effectiveness	7.10	–	7.50	7.90	**8.10**
Civil Liberties Flag	–	–	Strong mgmt	–	–

Images used for illustrative purposes only.

*This concept is currently not being implemented at FTEME and is being used for discussion purposes only.

Biodiversity

“Biodiversity loss and ecosystem collapse” is viewed as one of the fastest deteriorating global risks over the next decade, and is one of the six environmental risks to feature in the World Economic Forum's (WEF) top 10 risks over the next 10 years.

Biodiversity, within and between ecosystems, is already declining faster than at any other point during human history.[14] As shown in the WEF's Global Risks Report 2023, unlike other environmental risks, biodiversity loss and ecosystem collapse is not seen as a pressing top 10 concern over the short-term. Yet it accelerates in perceived severity, rising to 4th place over the 10-year time frame.

There are therefore numerous catalysts for the integration of biodiversity risks into investment decision-making as biodiversity loss presents a material risk to corporate and financial stability. For example, extreme weather events or invasive species can have an impact on the sourcing of key raw materials in the agriculture and food retail sector. There is also no solution to reaching net-zero and reducing climate change that does not include a solution to tackle ecological loss to build resilience into the ecosystems that underpin our global systems.

As part of our commitment to the analysis of governance and sustainability factors, we are developing a Biodiversity Framework to include biodiversity considerations in our investment process. As responsible stewards of our clients' capital and as an asset manager with a broad range of clients who all depend upon a stable biosphere, we are seeking to better understand how our investments impact nature, and how nature loss may translate into financial risks.

As part of FTEME’s Biodiversity Framework, we will use the Taskforce for Nature Related Disclosures (TNFD) framework to help identify high priority companies where closer analysis is warranted; these will fall into the eight thematic sectors identified by the TNFD where there is higher potential for financial impact due to dependencies and impacts on nature.

The utilization of data will be key, but there are problems that need addressing. Biodiversity impacts cannot be captured by a single metric, in the same way carbon emissions reflect climate impacts, and the lack of a broadly agreed-upon biodiversity impact measurement approach makes corporate reporting difficult. Because assessing biodiversity data could quickly become a vast and daunting exercise, we have begun to assess the data offerings with the aim of understanding which methodology and data provision will help us best asses the biodiversity footprint of our investee companies (and funds/corporate assets under management).

Top 10 Long-Term Global Risks Ranked by Severity (Over a 10-Year Period)[15]

1	Failure to mitigate climate change
2	Failure of climate-change adaptation
3	Natural disasters and extreme weather events
4	Biodiversity loss and ecosystem collapse
5	Large-scale involuntary migration
6	Natural resource crises
7	Erosion of social cohesion and societal polarization
8	Widespread cybercrime and cyber insecurity
9	Geoeconomic confrontation
10	Large-scale environmental damage incidents

Economic Environmental Geopolitical Societal Technological

14. Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES), The global assessment report on biodiversity and ecosystem services, 2019
15. Source: World Economic Forum, Global Risks Report 2023.

Our contribution to transitioning companies to nature-positive begins with partnering with companies to recognize and analyze their biodiversity-related risks and opportunities in a meaningful way. Different companies will be at varying stages regarding their understanding and reporting of risks, so engaging with corporates using certain questions will be key to establishing where they are in the process. Some examples of this are provided below:

1 | Has the company started to think about its impact on biodiversity and, if so, how far has it progressed?

2 | Is biodiversity a topic being considered at the board level?

3 | Have you identified and understood the relationship between your operations and biodiversity?

4 | Do you or your value chain operate in biodiversity sensitive areas?

Our developing FTEME Biodiversity Framework will help us to establish a baseline against which we can monitor our future performance, provide a high-level compass to identify where closer analysis of individual companies is warranted, and identify key targets for direct engagement by our analysts and portfolio managers.

Non-financial TNFD priority sectors and industries for development of sector specific guidance.

Thematic Sectors	Industries
Food and Beverage	• Meat, poultry and dairy • Agricultural products • Alcoholic beverages • Non-alcoholic beverages • Processed foods
Renewable Resources and Alternative Energy	• Forestry management • Pulp and paper products • Biofuels
Infrastructure	• Engineering and construction services • Water utilities and distributors • Electric utilities and power generators
Extractive and Minerals Processing	• Construction materials • Metals and mining • Oil & gas exploration and production
Health Care	• Biotechnology and pharmaceuticals
Resource Transformation	• Chemicals
Consumer Goods	• Apparel, accessories and footwear
Transportation	• Cruise lines • Marine transportation

"There is no solution to reaching net-zero and reducing climate change that does not include a solution to address biodiversity loss."

Emily Bedford
ESG Associate

We value the time you have taken to read this report and getting to know our approach to stewardship better. We look forward to reporting on the improvements we are making in our next annual report.

For us, at FTEME, stewardship is about how we monitor and manage client assets and returning them in a better condition than when we received them. This is achieved via a holistic approach centered on:

- Integration of governance and sustainability factors
- Active ownership including our engagement and voting actions
- Policy advocacy with regulators, policymakers, and industry bodies

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