Engagement 360
2023 Q2 Report



Contents

This report summarizes the shareholder engagement activities that Morningstar Sustainalytics performed between April to June 2023.

Executive Summary

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On behalf of the Morningstar Sustainalytics Stewardship team, we are excited to share this Engagement 360 report covering the second calendar quarter of 2023. The report will share highlights and insights of the quarter, as well as provide clients with an overview of statistics for the engagement services and vote recommendations conducted so far this year.

Inside this report, you'll find key takeaways and results for Q2, a look ahead with our plans for the next quarter and remainder of an exciting 2023, as well as full statistics of Engagement 360 together with case studies. Additionally, we have included articles from our in-house experts detailing themes and current events that matter to our clients.

Key Takeaways from Q2

During Q2 2023, the Sustainalytics Stewardship team worked on 823 engagements, including 74 new engagements. Throughout the quarter, more than 2,300 emails and phone calls have been exchanged and 149 meetings conducted. The engagement effort has resulted in 98 Milestones achieved and 11 engagements resolved successfully.

In terms of our ESG Voting Policy Overlay, the team has been very busy as usual in the second quarter, where many companies traditionally hold their Annual General Meeting; throughout the quarter our team has delivered 936 vote recommendations on resolutions at 530 shareholder meetings across 27 markets. This represents an increase of 28% compared with the same period in 2022.

Into Q3, we are putting focus on the evolving requirements for scope 3 greenhouse gas (GHG) emissions reporting in North America. New regulation is underway in both Canada and the US, of which many companies are struggling to effectively align. Our engagement dialogues with companies continue to bring focus on the subject, while managing the expectations from investors to disclose and mitigate scope 3 carbon emissions.

In Q2 we have introduced new functionality in the calendar on Global Access; this now allows clients to download a meeting (ICS) that can be added directly into Outlook. This is an easier process for clients to join an engagement meeting, stay up-to-date with the agenda, and be notified of any changes in the meeting details.

Our latest thematic programme the 'Net Zero Transition Stewardship Programme' was launched in Q2. The programme seeks to support investor stewardship ambitions and initiative commitments by engaging with high-emitting portfolio companies proactively addressing associated systemic ESG risk and opportunities. The programme has released its strategy document, selected and initiated engagement with the first group of 50 companies. The second group of companies will be selected at the end of Q3.

Leveraging the Low Carbon Transition Ratings research as a key input and assessment guidepost, this engagement programme helps clients examine investments by looking at performance and real-world impact, aligning interests with Net Zero standards that, if left unaddressed, could represent a material portfolio risk.

The Localized Water Management Thematic Engagement reached its end during this quarter, and the engagements within this theme concluded. The three-year long engagement achieved incremental improvements across the six KPIs defined, with all 18 companies included in the programme having made progress. What's more, our team conducted 103 conference calls, led a collective engagement call with five participating companies, and participated in the UN 2023 Conference on Water throughout this engagement. You can download the full theme report in the "Sustainalytics Reports" section on the Engagement 360 landing page.

Finally, in our Engagement Results you will find a recent case study on our efforts in biodiversity and human rights with Nestlé as well as more case studies and results from Q2 reported by our Material Risk Engagement.

What's Next in 2023

The Net Zero Transition Stewardship Programme will continue to increase the number of companies engaged, and there will be plenty of opportunities in the future the for clients to join engagement meetings on net zero transition.

Q3 is a particularly effective quarter for engagement meetings as many companies following the calendar reporting cycle will have released annual disclosure either in Q2 or the beginning of Q3. The disclosure is providing a good analytical starting point for an engagement dialogue and it is used to verify progress in ESG risk management.

Finally, keep an eye out for product improvements announced in our Quarterly Client Communications, as well as news and engagement opportunities on the Global Access platform and in ongoing communications to clients.

2023 Q2 Stewardship Overview

823
Active Engagements during Q2 2023

11
Engagements have been resolved

SDG 13
Most often (51%) associated with engagement

Food producers is the most engaged industry

Highest number of engagements in a single market is the U.S.

Disclosure and Net Zero/ Decarbonization are the most engaged topics

936
Vote recommendations have been delivered to clients,
of which 21 have been associated with an escalation process, where the engagement dialogue has not been satisfactory

74
New engagements have been initiated,
of which 50 are related to the new Net Zero Engagement theme

Engagement Status

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

Resolved	the company has achieved the engagement objective.
Archived	engagement is concluded but the engagement objective has not been achieved.
Disengage	we deem engagement unlikely to succeed.

749 engagements by 1 April

74 new engagements

11 resolved engagements

39 archived engagements

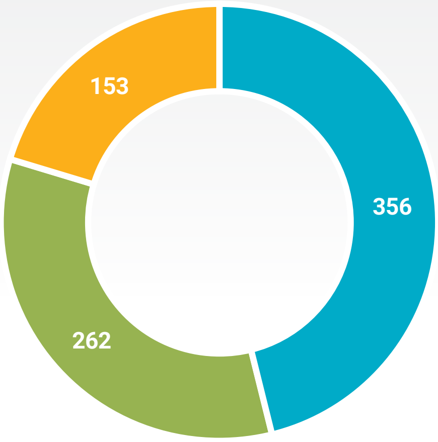
2 disengaged engagements

771 engagements by 30 June

In total 823 engagements during Q2

Engagement Type

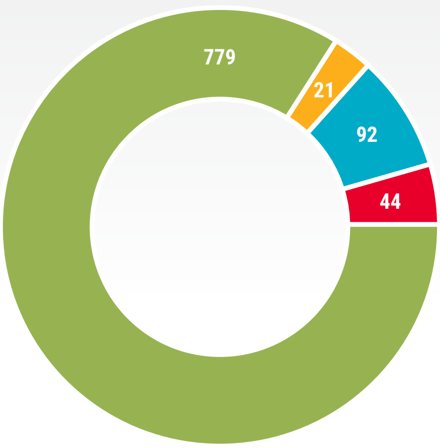
- Strategy and Risk
- Themes
- Incidents



- Strategy and Risk is engaging on unmanaged risk as determined by Sustainalytics ESG Risk Rating.
- Themes are engaging on systemic ESG issues and leverage multiple Sustainalytics research.
- Incidents are engaging on major incidents identified by the Sustainalytics Global Standards Screening.

Vote Recommendations Delivered

- Sustainability
- Engagement Escalation
- Climate Governance
- Research-Triggered



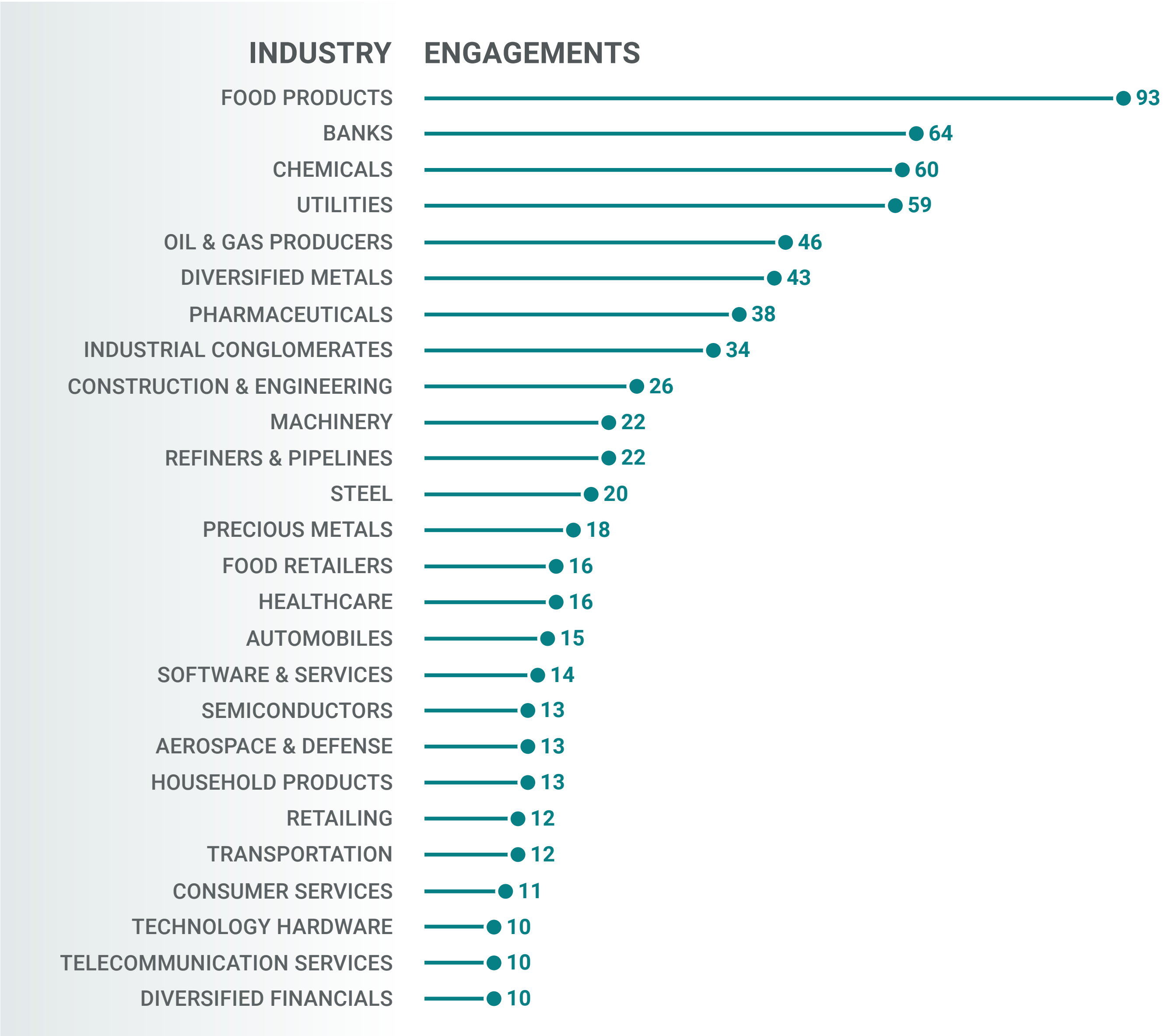
Triggers for Vote Recommendations

Vote recommendations can be triggered by four different reasons:

Sustainability	ESG-related resolutions
Engagement Escalations	poor performance in engagements
Climate Governance	misalignment between executive performance metrics and decarbonization targets
Research	poor performance in climate change risk management and DEI (Diversity, Equity and Inclusion)

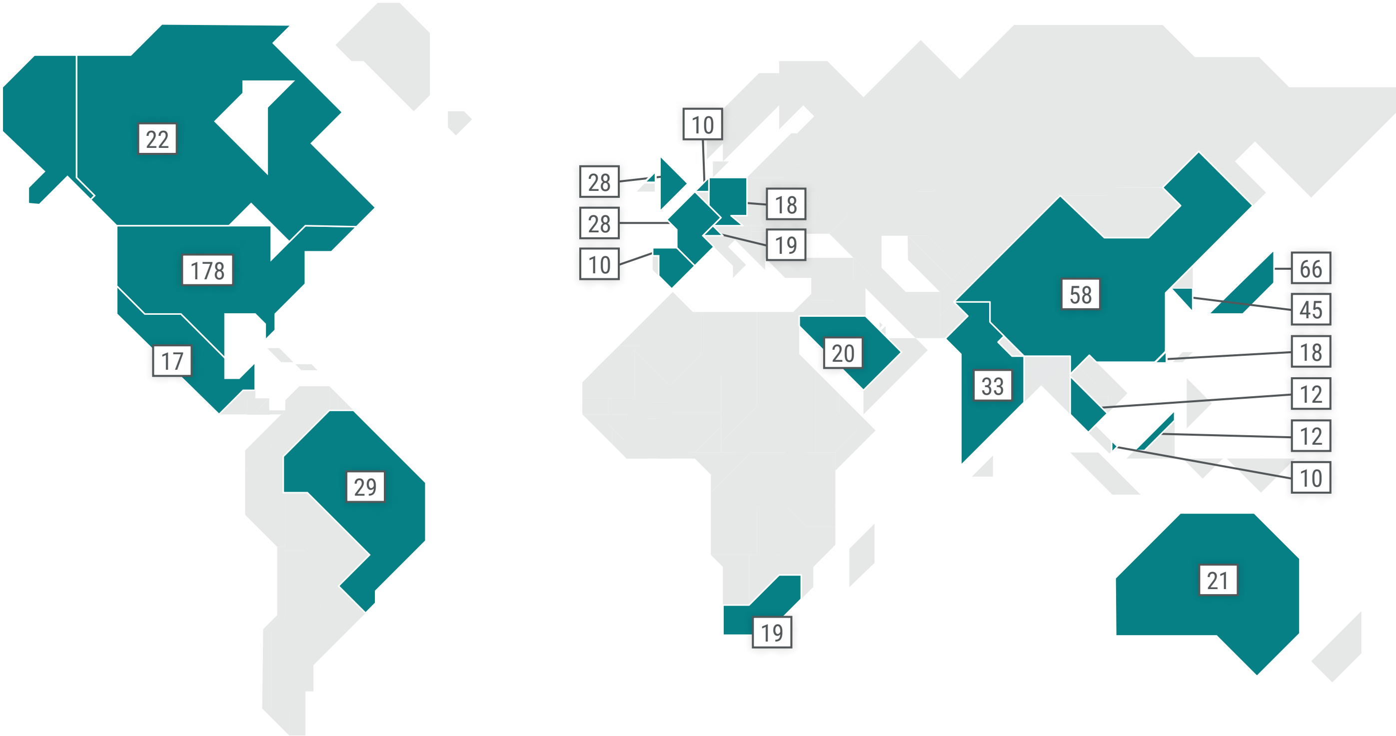
Industry Distribution

(industries included with a minimum of 10 engagements)



Home Country

(countries included with a minimum of 10 engagements)



Engagement Topics

As our most comprehensive stewardship solution, Engagement 360 is designed to help our clients generate positive and meaningful change in a number of topics across the environmental, social, and governance pillars.

ENGAGEMENT TOPICS	ENGAGEMENTS
Disclosure	262
Net Zero Decarbonization	183
ESG Governance	174
Water and Marine Ecosystems	161
Human Rights	120
Community Relations	106
Climate Change	100
Business Ethics, Bribery, and Corruption	96
Labour Rights	95
Biodiversity	94
Product Quality and Safety	92
Land Pollution and Spills	79
Human Capital	79
Board Compensation	71
Occupational Health and Safety	66
Child Labour	48

Engagement Topics cont.

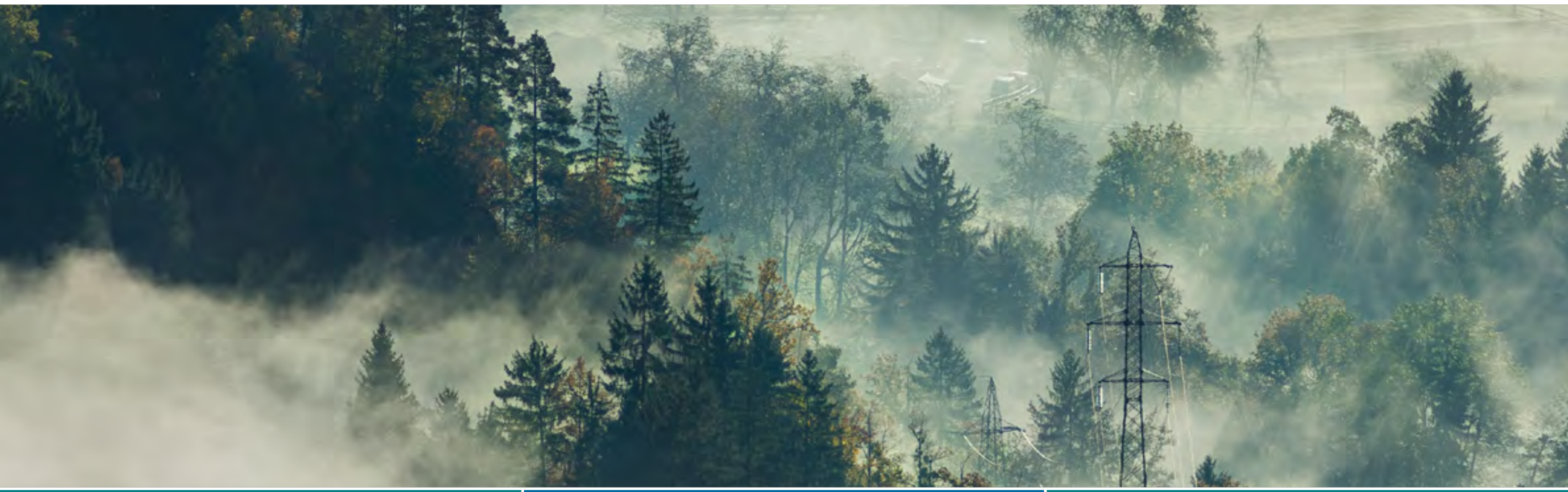
ENGAGEMENT TOPICS	ENGAGEMENTS
Diversity, Equity, and Inclusion (DEI)	47
Shareholder Rights	41
Indigenous People	39
Forced Labour	35
Waste Management	32
Accounting and Taxation	30
Natural Resource Use	30
Data Privacy and Security	20
Circular Economy	20
Just Transition	19
Market Practice	12
Weapons	5
High-Risk Territories	4
Sanctions	3
Air Pollutant Emissions	1
Competitions	1

Sustainable Development Goals – Mapping Engagements

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

SDG	Goal	Share of engagements
1	No Poverty	6%
2	Zero Hunger	11%
3	Good Health & Well-Being	21%
4	Quality Education	5%
5	Gender Equality	9%
6	Clean Water & Sanitation	14%
7	Affordable & Clean Energy	18%
8	Decent Work & Economic Growth	29%
9	Industry, Innovation & Infrastructure	18%
10	Reduced Inequalities	12%
11	Sustainable Cities & Communities	12%
12	Responsible Consumption & Production	48%
13	Climate Action	51%
14	Life Below Water	12%
15	Life on Land	17%
16	Peace, Justice & Strong Institutions	42%
17	Partnerships for the Goals	9%

Engagement Results



149
Meetings conducted in Q2, 3 in person

2,347
Emails and phone calls exchanged

11
engagements have been resolved

8%
Companies not responding to the engagement dialogue has been reduced to 8% of all engagements

98
Milestones achieved in Q2.
More than half of the engagements (54%) are not further than Milestone 2 (out of 5)

51%
About half of the engagements show standard progress

31%
of the engagements show good or excellent progress

Company Response

We rate the company response to the engagement dialogue and willingness to engage with investors on five-point scale:

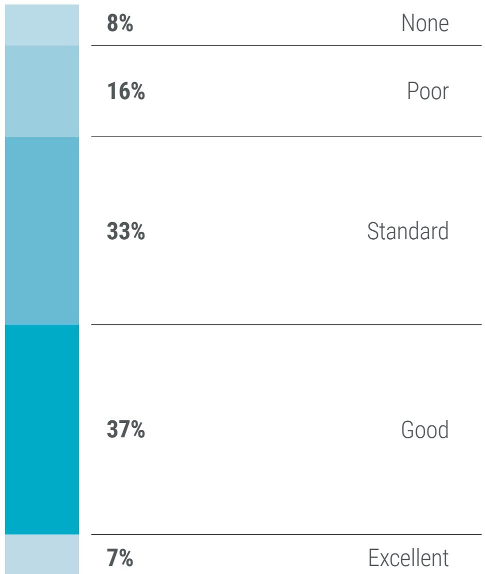
None the company has not responded to the inquiries.

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

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

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

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



Engagements Resolved

COMPANY	COUNTRY	INDUSTRY	ISSUE
RUMO SA	Brazil	Transportation	Focus on Carbon and Community Relations
Companhia Siderurgica Nacional	Brazil	Steel	Focus on Risk Assessment and Corporate Governance
Dr. Reddy's Laboratories Ltd.	India	Pharmaceuticals	Focus on Product Governance
BAE Systems Plc	United Kingdom	Aerospace & Defense	Focus on Product Governance
Melrose Industries Plc	United Kingdom	Industrial Conglomerates	Focus on Carbon and Resource Use
Hexagon Composites ASA	Norway	Machinery	Focus on Risk Assessment and ESG Disclosure
Hankyu Hanshin Holdings, Inc.	Japan	Transportation	Focus on Carbon Own Operations
Sime Darby Plantation Bhd.	Malaysia	Food Products	Focus on Occupational Health and Safety and Human Capital
FirstEnergy Corp.	United States	Utilities	Focus on Carbon Own Operations
Albemarle Corp.	United States	Chemicals	Focus on Emissions, Effluents and Waste
Nissin Foods Holdings Co., Ltd.	Japan	Food Products	Focus on Corporate Governance

Engagement Success

Company: Albemarle Corp.

ESG Risk Ratings Score

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

26.6

INDUSTRY
Chemicals

BASE LOCATION
United States of America

ENGAGEMENT FOCUS
Emissions, Effluents and Waste
E&S Impact of Products and Services
Carbon – Own Operations

RATIONALE FOR RESOLVED STATUS
Albemarle Corp. has improved their ESG Risk Rating score to below 28.

Positive Development Highlights:

- Albemarle established a target to reduce the intensity of its freshwater usage by 25% by 2030 in areas of high and extremely high water-stress as defined by the World Resources Institute, with initiatives to support this reduction including the 2021 completion of construction of the company's $100M thermal evaporator at La Negra as well as completion of the HBr Clean-up project at Jordan Bromine Company (JBC).
- Albemarle continued to report on progress and initiatives related to its carbon emissions reduction targets, disclosing a 3.8% year-over-year reduction in its scope 1 and 2 GHG emissions. Reduction initiatives reported include the company's purchase of certificates for 100% renewable hydroelectricity from Norway for its Amsterdam site and the purchase of 12,000 MWh of solar power for the company's Xinyu plant.
- Albemarle's goal to grow its lithium business in a carbon-intensity neutral manner through 2030 included 2022 objectives to increase renewable energy consumption, including 50% renewable energy for its Chile operations.

In the latest update of the ESG Risk Rating, Albemarle's management score improved by 5.1 points, bringing the company into the medium risk category and below the 28-point threshold for engagement.

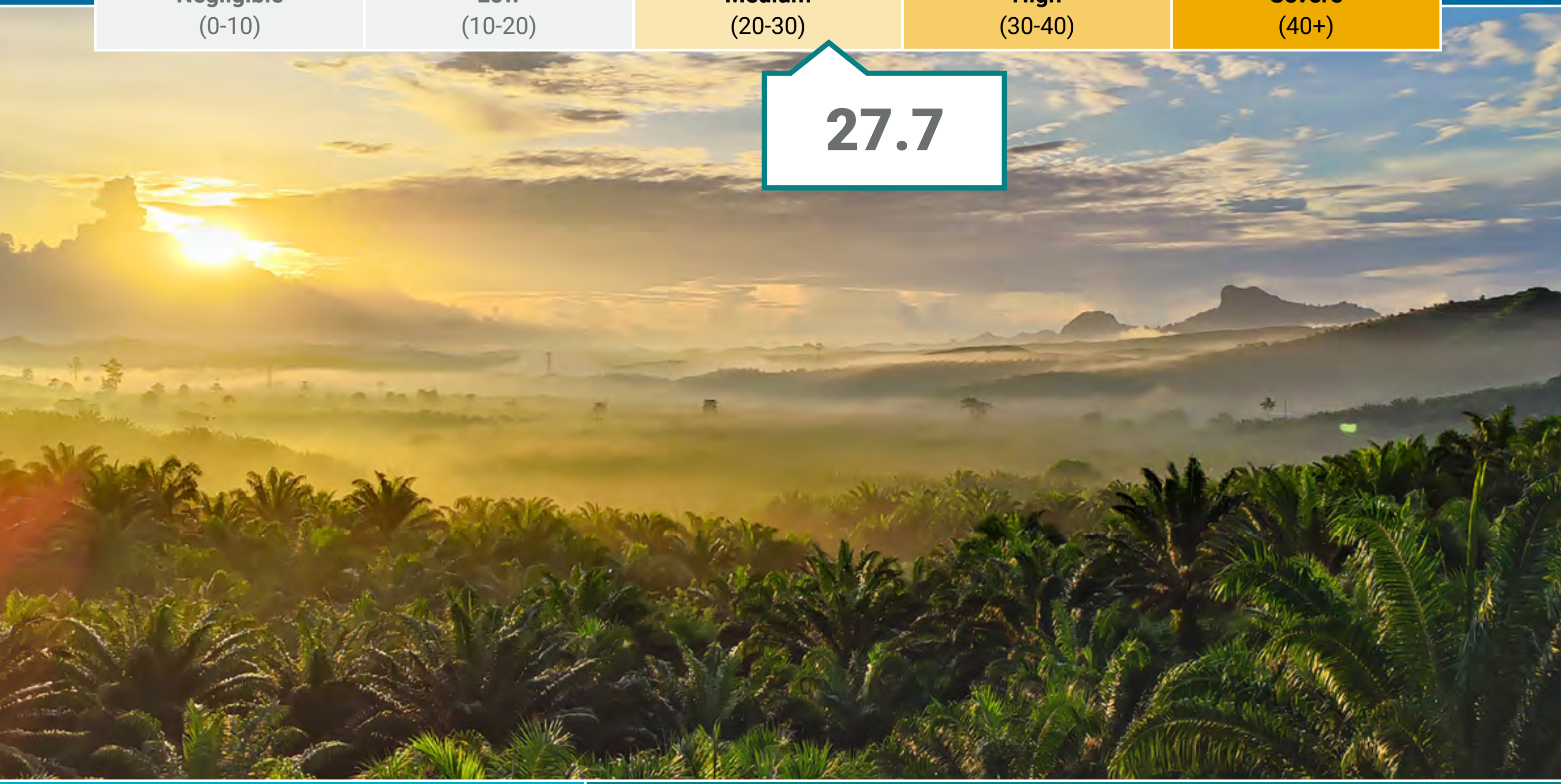
Engagement Success

Company: Sime Darby Plantation Bhd.

ESG Risk Ratings Score

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

27.7



INDUSTRY
Agriculture

BASE LOCATION
Malaysia

ENGAGEMENT FOCUS
Occupational Health and Safety
Carbon – Own Operations
Human Capital
Human Rights

RATIONALE FOR RESOLVED STATUS
Sime Darby Plantation has improved their ESG Risk Rating score to below 28.

Positive Development Highlights:

- Sime Darby Plantation has adopted a much more structured approach to using recruitment agencies for immigrant workers, including developing policy, banning fees for applicants and systematic monitoring of compliance.
- There is increased focus on safety and safety metrics are now included in the performance evaluation of operational managers and sites.
- Sime Darby Plantation has developed a Responsible Agriculture Charter to guide minimum standards and best practices for palm oil production.
- Most of the palm oil production is certified with the Roundtable on Sustainable Palm Oil (RSPO) standards and Sime Darby Plantation is systematically engaging with suppliers to live up to these standards.

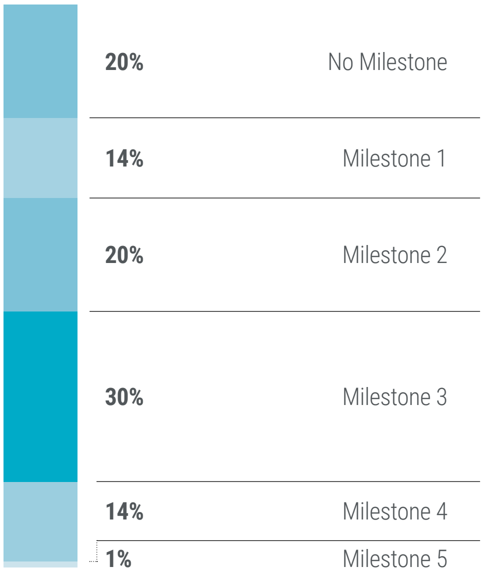
In the latest update of the ESG Risk Rating, Sime Darby Plantation's management score improved by close to 8 points, bringing the company into the medium risk category and below the 28-point threshold for engagement.

Engagement Milestones

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

98 milestones achieved in Q2 2023

Engagements by Highest Milestone Achieved



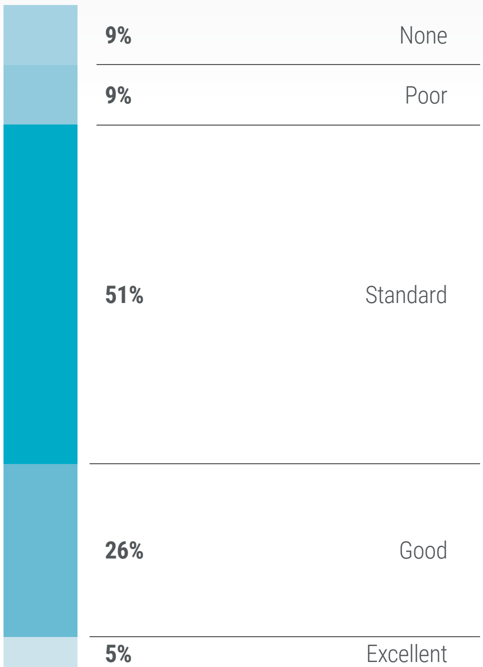
Milestone Framework Structure

1. Acknowledgement of issue(s) and commitment to mitigation.
2. ESG risk management and strategy established.
3. Strategy is well formed and has moved into early stages of implementation.
4. Implementation of strategy has advanced meaningfully, and related issuer disclosure maturing.
5. Change objective is considered fulfilled.

Progress

The rating of Progress reflects the pace and scope of changes towards the engagement objective that the company is making. We rate progress according to a five-point scale:

None	the company has not made any progress against the engagement objective.
Poor	the company has indicated willingness to addressing the issues related to the change objective, but no measures have been taken yet.
Standard	the company has undertaken a number of measures to address the issues related to the change objective.
Good	the company has taken sufficient measures to address the issues related to the change objective.
Excellent	the company has adopted a proactive approach and addressed the issues related to the change objective.



Spotlight on Biodiversity and Human Rights Efforts with Nestlé

Background
In Sustainalytics' Biodiversity and Natural Capital Stewardship programme, we engage with issuers most exposed to nature-related risks and opportunities. The human right to a clean, healthy and sustainable environment is central to the Kunming-Montreal Global Biodiversity Framework; adopted in late 2022, the framework supports the achievements of the Sustainable Development Goals and builds on the ambitious roadmap to reach the global vision of a world living in harmony with nature by 2050.

In terms of ESG risks associated with food production, a human rights-based approach is especially relevant as the degradation of biodiversity can significantly impact local livelihoods. Still, companies often miss the connection between human rights and biodiversity.

Nestlé is exposed to different ESG risks. Environmental risks and impacts can include issues associated with climate change, biodiversity loss, waste practices and water stress. Social risks and impacts include labour rights, land rights, diversity, equity and inclusion. For this case study, we will be looking at our work with the company on their biodiversity and human rights improvements.

Activities
Since May 2018, Sustainalytics has engaged with Nestlé to promote best management practices related to child labour in cocoa, living income, sustainable food production and biodiversity. The objectives are to support the company in setting robust and effective human rights due diligence (HRDD) systems, encourage a transition towards more sustainable practices related to food production and promote leading management practices on biodiversity-related risks and opportunities.

During this period, Nestlé has significantly improved on many of these issues; even so far as the company scoring highly on all the engagement's objectives of the thematic engagement Child Labour in Cocoa, and actively supporting local farmers transitioning to regenerative agriculture.

Given Nestlé's advancement, Sustainalytics hosted a conference call on the interconnected issues of biodiversity and human rights in March 2023.

Outcome
During our conference call, Sustainalytics highlighted that it is critical to investors that companies holistically address human rights and biodiversity. Nestlé shared how the company engages with rights-holder representatives and local communities to assess material ESG risks, develop biodiversity-focused initiatives, and conduct supply chain due diligence. The company is developing a single due diligence process that includes environmental and human rights considerations holistically. Sustainalytics recommended that Nestlé increases accountability by using KPIs for biodiversity initiatives covering human rights. Sustainalytics also suggested the company look to the ALivE Framework for guiding principles on involving indigenous people in biodiversity initiatives and encouraged further disclosure on Nestlé's due diligence processes.

Overall, Nestlé has a achieved a relatively strong ESG risk management with comprehensive ESG disclosure and clear ESG governance oversight.

Engagement Status

ONGOING

Performance

LOW | **MEDIUM** | HIGH

Dialogue Statistics

422 Number of Contacts	**37** Conference Calls	**136** Correspondence
10 Meetings in Person	**0** Vote Recommendations	**0** Other Activity

Next Steps
Sustainalytics will continue the dialogue with Nestlé to understand its management of nature-related risks and share investor perspectives on emerging best practices. In the future, the Biodiversity and Natural Capital Stewardship programme and the Human Rights Accelerator will collaboratively engage on biodiversity and human rights.

Localized Water Management Thematic Engagement

The Issue at Hand

The water crisis is a global challenge, that needs local solutions. The growing scarcity of freshwater resources is a risk to the economic, social and environmental well-being of communities around the world, in addition to being a material issue for companies. Company-wide water strategies are therefore essential, but because water security challenges are experienced at the local level, and water basin conditions are unique, there is no one-size-fits-all solution for companies to implement. Ensuring a sustainable freshwater supply for all basin users for the long-term is an extremely complex challenge that requires collaboration between various stakeholders including communities, authorities, and companies. The purpose of Sustainalytics' Localized Water Management engagement is to have positive impacts on water management and stewardship on a company and basin level, and more broadly where possible.

Engagement Results (February 2020-March 2023)

This thematic engagement focuses on 18 companies with operations in the Tiete basin in Brazil and/or the Vaal basin in South Africa. We discussed our gap analysis of these KPIs and encouraged company- appropriate strategies and solutions. Supply chain water risk assessment was the most common focus area along with wastewater quality although crisis management increased in relevance over the course of the three years.

This engagement resulted in incremental improvements across the KPIs (see Chart 1), linked to changes at all 18 companies. Most companies continued to display strong performance on KPI 1 Water Governance over time. Improvements were observed based on plans to link executive compensation to water metrics, expansion of environmental management system certification, and completion of a value chain pilot program for ESG among other improvements. Although, a clear strategy for water management in the value chain has been the most common deficiency.

Performance on KPI 2 Water Risk & Opportunity Management improved significantly over the course of the engagement related to completing physical climate risk scenario analysis, completing site-specific water risk analysis, and leveraging water opportunities. Again, deficiencies related to the supply chain are frequent, although the companies that excel in this area tend to leverage external certifications and/or third-party services for understanding and mitigating supply chain risk.

KPI 3 Water Quantity has demonstrated the most consistent scoring or the fewest improvements since the baseline, which is likely related to global reporting standards enabling more stable and frequent disclosure on this topic. Moreover, companies understand the operational and financial benefits of improving water efficiency at their own facilities and tend to measure and disclose what they are managing. Improvements on KPI 3 were related to water quantity management programs and increased localized reporting. However, some companies still lack detailed context-based management plans and/or water targets for all high-risk sites.

Consistent with Morningstar Sustainalytics' previous water engagement program that concluded in 2019, performance on KPI 4 Water Quality lags KPI 3 Water Quantity. A trend that appears both in the disclosure and in our dialogues is the prioritization of water efficiency and decreasing water withdrawal. As a result, there is less direct focus on decreasing water discharges and improving the quality of the effluent because effluent quantities naturally decrease as recycling, and efficiency water metrics increase. Although most companies do not disclose wastewater quality goals, several have implemented or are planning to implement municipal wastewater recycling. The current ineffective state of wastewater treatment is well documented in both basins. By increasing the capacity and efficiency of municipal wastewater treatment and reusing the water in their industrial operations, companies are able to improve local water quality and water security for all basin users. Wastewater reuse agreements tend to make financial sense while also decreasing reputational risk related to localized competition for water. Disclosure related to KPI 4 is strongly driven by regulatory compliance and very few companies actively plan to go above and beyond this. However, with the growing trend towards natural capital valuations, science-based biological limits will become more relevant in risk- based evaluations and compliance and legal limits will continue to be seen as a minimum standard.

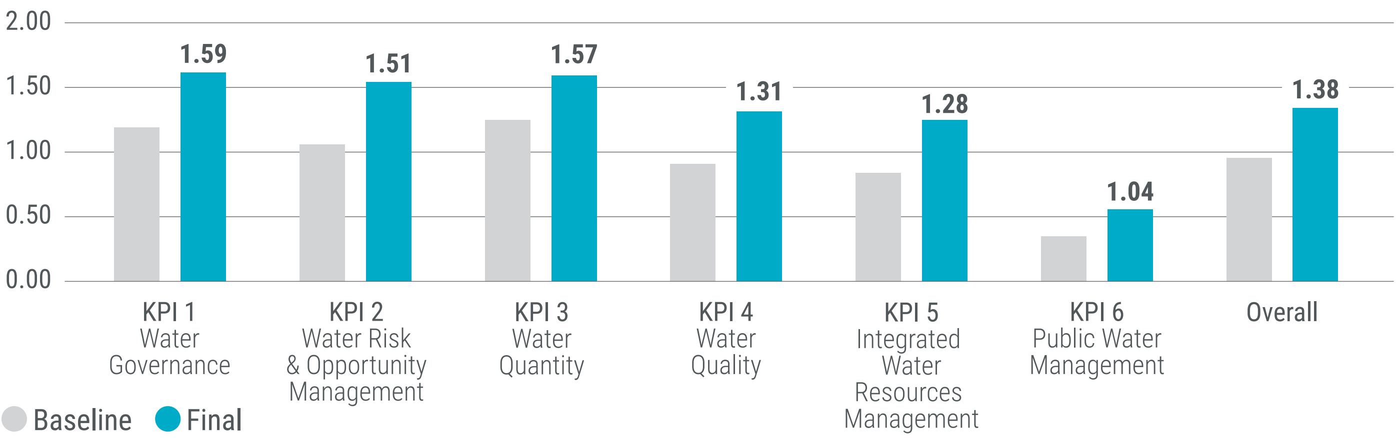
KPI 5 Integrated Water Resource Management is the second to last performing KPI in the framework. At the inception of the Localized Water Management engagement program, companies scored low on average on KPI 5 and 6, the most ambitious KPIs. It was challenging to determine what company programs were in place based on the available public disclosure. Despite this, several companies excelled in this area as they had clearly committed to Integrated Water Resources Management and proactively discussed it in their disclosure. Shifting a company's management perspective to a basin level from a facility level (or corporate-wide) approach can be difficult as it requires considerations that are outside the company's control. Companies are willing to work hard to secure business continuity, but stewardship also requires more serious consideration of other stakeholders' interests which can be difficult to model and quantify internally. The most common missing element in our evaluation of KPI 5 is a clear and systemic approach to community WASH (Water, Sanitation, and Hygiene). Many companies list ad hoc community water programs they have led or supported; however, systematic support is lacking.

KPI 6 Public Water Management, asks companies to understand and manage risks inherent in local infrastructure and regulatory conditions and demonstrate local water crisis management capacity. KPI 6 demonstrates the largest score increase since the baseline report, by a significant margin. At the same time KPI 6 remains the lowest-performing KPI. Many companies were triggered to evaluate the risk to public infrastructure by recent extreme water stress or utility interruption events.

Tangible outcomes over the course of the engagement include individual companies:

- linking executive compensation to water metrics in FY2022;
- publishing a corporate water policy;
- releasing Taskforce on Climate-Related Financial Disclosure (TCFD) aligned reports including physical climate risk assessments;
- creating a water opportunity by generating revenue from wastewater streams;
- reusing treated municipal wastewater;
- implementing a corporate-level effluent standard with more stringent criteria than local regulations;
- evaluating a majority of its critical suppliers for water risk, including audits and mitigation assistance plans;
- publishing the Water Security Index, a single company-level value that expresses the company's exposure to the risk of water stress;
- using sustainability-linked financing instruments to fund water efficiency projects;
- completing site-level assessments for water stress and implementing mitigations;
- regional level disclosure on material water issues;
- committing to their first water replenishment project; and
- implementing various infrastructure changes to increase water security triggered by the outcomes of water reduction scenarios.

Chart 1: Overall Average KPI Scores Baseline vs Final



Next Steps

Unlike carbon, water is localized, and must be managed at a basin level, which is why this theme was geographically focused. At the conclusion of these three years, we are seeing more than just the leading companies committing to larger scale basin-level projects that consider all stakeholders. The localized water management theme has been a proactive thematic engagement, and although that made it difficult to be scalable and impactful initially, we did our part to raise awareness within companies. We continue to challenge companies to take an investor lens and consider whether their reporting meaningfully discloses localized water risk and mitigation measures. To further scale impact, all water actors need to get involved, urgently. It is up to whole governments, economic actors, and societies to act together and not just as siloed groups of water-focused individuals. Results will come as we make the links between climate, nature, and water and address them through a holistic approach to nature- risk (or natural capital). Continued dialogues on water in the context of natural capital will promote a holistic approach to addressing nature risks including water risks.

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Mandatory Scope 3 Emissions Reporting in the U.S. and Canada: Most Companies Unprepared

As mandatory climate-related reporting continues to advance around the world, companies headquartered in the United States and Canada are subject to pending disclosure rules with securities regulators. This article focuses on the proposed scope 3 emissions disclosure rules in North America, providing insights into companies' levels of preparedness to respond, and the challenges and solutions being discussed through engagement strategies with high or severe risk companies in the Morningstar Sustainalytics Ratings universe.

Examining the SEC and CSA Proposals for Scope 3 Emissions Disclosure

In recent years, both the Securities and Exchange Commission (SEC) in the United States and the Canadian Securities Administrators (CSA) have proposed rules to enhance corporate climate disclosures. Of particular interest are the provisions related to scope 3 emissions.

Compared to scope 1 and 2 emissions, which refer to the direct emissions from owned or controlled sources and indirect emissions from the generation of purchased energy respectively, scope 3 emissions are all other indirect emissions that derive from an organization's value chain. It is critically important for companies to account for their scope 3 emissions as they are estimated to take up more than 70% of a business' total carbon emissions on average.[1] The share of scope 3 emissions can be as high as 99.84% in financial services and 80.85% for oil and gas.[2]

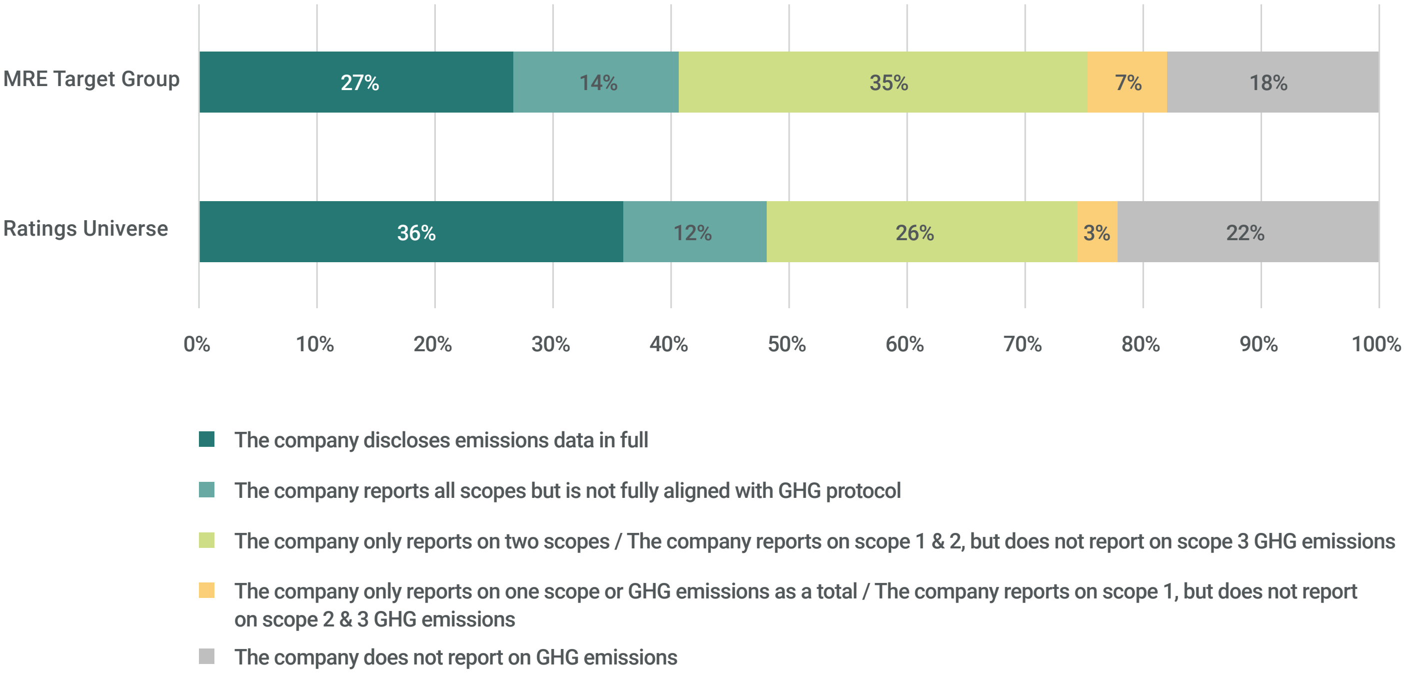
Under the SEC proposal, issuers would be required to disclose their scope 3 emissions if they are material or if they have set targets for them.[3] In Canada, the CSA is considering mandating a "comply or explain" approach to all three emission scopes or to scope 2 and 3 emissions only.[4]

While the comment period for both proposals has ended, the regulatory agencies have yet to finalize the rules. The CSA announced in October 2022 that it was considering the international consensus on the topic.[5] Meanwhile in the U.S., there are indications that the SEC may delay launching the rules until fall 2023.[6] Legal challenges against the rules are also expected once they are finalized, which could complicate adoption.

Challenges With Scope 3 Emissions Reporting

In anticipation of the finalized rules, North American companies are struggling to understand, calculate and disclose their scope 3 emissions. Only 36% of the companies included in Sustainalytics' Ratings universe, which covers about 5000 large- and mid-cap companies in developed and emerging markets, are disclosing all three types of emissions in line with the Greenhouse Gas (GHG) Protocol (See Figure 1 below). Of the companies targeted by Sustainalytics Material Risk Engagement — those companies assessed as having high or severe risk based on Sustainalytics ESG Risk Ratings — only 27% are disclosing all three emission scopes. Overall, more than half of the companies in both groups are either not disclosing GHG emissions at all or have only reported on one or two scopes.

Figure 1: Sustainalytics Ratings Universe - Scope of GHG Reporting for Issuers Headquartered in the U.S. and Canada



Source: Morningstar Sustainalytics. The data for this analysis was retrieved on June 1, 2023, from Sustainalytics Ratings Universe. For informational purposes only.

The GHG Protocol Corporate Standard divides scope 3 emissions into upstream and downstream emissions and then categorizes them into 15 distinct categories.[7] So, to achieve full disclosure of emissions data, a company's scope 3 emissions inventory should be disclosed by category. But for many companies, this is no easy task.

Common challenges with scope 3 reporting are often discussed during conversations with companies through Sustainalytics' Material Risk Engagement programme. These companies often reference issues with data quality and calculations, lack of accounting or estimation methodologies, and conglomerate, decentralized or geographically diverse organizational structures that hinder data collection and assimilation. However, even without mandatory reporting rules from the SEC and CSA, the need for consistent, comparable scope 3 emissions data will continue to increase, irrespective of the challenges companies are facing.

Why Companies Should Act Now to Improve Their Scope 3 Disclosures

Although it may take some time before the scope 3 emissions disclosure rules take effect in North America, companies can benefit from understanding and gradually working towards reporting their scope 3 emissions now. Such an exercise can offer deeper insight into a business' carbon footprint across its value chain and identify decarbonization opportunities.

Other developments within different jurisdictions and standard setting organizations are also driving companies towards enhanced transparency. For example: the U.S. federal government proposed in 2022 that major federal contractors (US$ 50 million in annual contract obligation) must report on their scope 3 emissions; California and New York introduced bills similar to the SEC's proposal; scope 3 disclosures will be required under the EU's Corporate Sustainability Reporting Directive, which comes into effect January 2024 and will likely impact more than 3,000 U.S. and 1,300 Canadian companies.[8] The International Sustainability Standards Board has also issued its inaugural climate-related disclosure standard that includes scope 3 emissions in June 2023.[9] Companies need to be prepared for the ever-growing demand for emissions data.

Investor Engagement Strategies to Improve Corporate Scope 3 Disclosure
Engagement can help investors assess a company's preparedness for the proposed disclosure rules, understand challenges they are facing, and help to implement solutions. By first discussing the potential benefits of enhanced transparency around scope 3 emissions, investors can then inspire companies to take steps to improve disclosure.

Companies wrestling with data quality and calculation uncertainty can be directed to the **GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard** and its supplemental document, **Technical Guidance for Calculating Scope 3 Emissions**. These documents provide guidance on calculation methods, data sources, and examples of calculating scope 3 emissions as well as several cross-sector and sector-specific calculation tools.

But understanding scope 3 emissions standards isn't necessarily enough. A company often needs to invest in resources dedicated to performing the calculations and managing the emissions inventory once it is established. Carbon accounting software can help with automated data processes, measurement conversions, calculations, and forecasts. These systems will also come in handy for internal audit and external verification.

In the absence of data, estimation is an accepted first step in the development of a scope 3 emissions inventory. According to the GHG Protocol, a company needing to collect a large quantity of data for a particular scope 3 category may find it impractical or impossible to collect the data from each activity in the category. In such cases, companies may use appropriate sampling techniques to extrapolate data from a representative sample of activities within the category[10].

In addition, some sectors are developing their own scope 3 estimation methodologies based on guidance from the GHG Protocol. As an example, oil and gas companies can look to the International Petroleum Industry Environmental Conservation Association for methodologies to inform scope 3 GHG emissions estimation and approaches[11]. Financial institutions endeavoring to disclose against their financed emissions (scope 3, category 15) can refer to the Global GHG Accounting and Reporting Standard by the Partnership for Carbon Accounting Financials[12]. Whichever way an estimate is calculated, the company should disclose the methodology used.

Performing and disclosing these calculations can also be done in phases. A company can be encouraged to focus efforts on its most material scope 3 category first and disclose the reasons why it is not reporting against the remaining categories. Finally, market leaders should be expected to demonstrate support and guidance with their suppliers' capacity to calculate carbon emissions, which in turn could enable multiple companies to move from estimated to actual scope 3 data.

Developing a scope 3 emissions inventory is complex and built on cumbersome processes that many North American companies are struggling with. Even though the task can be daunting, solutions are available and flexibility in disclosure remains on the table, for now. There are obvious environmental and financial benefits to understanding and reporting value chain emissions. Investors and market leading companies should continue to encourage voluntary corporate transparency with a solutions mindset, so that companies are prepared to respond to evolving global market requirements and more importantly, truly understand and address the impact of their carbon footprint.

Engagement Events

2023 OECD Global Anti-Corruption & Integrity Forum

The Organisation for Economic Co-operation and Development (OECD) held its 11th Global Anti-Corruption & Integrity Forum in Paris from 24-25 May 2023. Morningstar Sustainalytics' Nigel Rossouw, Associate Director of Stewardship Services, attended the forum with an aim to purposefully incorporate the multilateralism provided by the OECD into the work the Global Standards Engagement (GSE) team does on business ethics controversies. The OECD Guidelines for Multinational Enterprises on Responsible Business Conduct is a key document that the GSE team uses during engagement to hold companies accountable and drive improved performance towards international best practice. The OECD has updated those guidelines and launched its 2023 version.

The theme of the OECD Forum was "Action to Impact: Working together to strengthen integrity and fight corruption." The focus was on the public sector and business ethics and responsible business conduct, and there was a special spotlight on corruption and its impact on human rights.

Sessions in which Morningstar Sustainalytics actively participated included:

- Strengthening the partnership between the public and private sectors to combat corruption;
- Data analytics for assessing fraud and corruption; o Corruption in critical mineral supply chains;
- Incentivising integrity in infrastructure;
- Due diligence in anticorruption and human rights;
- Developing effective whistleblowing systems.

Speakers at the forum, such as the OECD Secretary-General, the President of Costa Rica, and the US Department of State's Global Coordinator for Anti-Corruption, emphasized that governments have a responsibility to protect internationally recognized fundamental rights and to improve the functioning of markets through good governance and fair regulations. Other speakers, such as the Chair of Transparency International, and the President of Microsoft, spoke about the need for companies to adopt responsible business practices and emphasized that transparency is a precondition for monitoring and scrutiny.

Morningstar Sustainalytics' participation at the OECD Forum provided the GSE team an opportunity to verify that its internal engagement framework effectively covers all the measures for business integrity to combat corruption, which includes:

- Policies prohibiting corruption;
- Code of conduct;
- Ethics and compliance programmes;
- Oversight and leadership by the board of directors;
- Clear lines of responsibility at the executive team level;
- Business principles for ethics and integrity;
- Financial, accounting and procurement controls;
- Compliance officers with direct reporting lines to the board of directors;
- Information-technology safeguards;
- Monitoring and auditing.

Some key take-aways for Morningstar Sustainalytics to incorporate in its engagement include:

- Recognizing that corruption is a global issue and not something that can be effectively addressed by companies alone; there is a need for business to participate in collective action and multi-stakeholder anti-bribery and corruption initiatives.
- All companies require anti-bribery and corruption intervention, a cultural transformation and a network approach, because corruption exists in social networks and the entire network needs to be the recipient of anti-bribery and corruption measures.
- The "tone from the top" is critical for companies in order to effectively mitigate risks related to fraud, corruption and unethical behaviour.

We note that the approach that the GSE team has adopted to engagement not only conforms to the expectations set by the OECD in developing mitigation strategies to address corruption, but it actually goes one step further by recommending that companies implement preventative measures to effect systemic cultural change.

Webinar on the Vale Brumadhino Reparations

As part of Sustainalytics' ongoing Global Standards Engagement (GSE) process with Vale, an interactive webinar was held on 29 March 2023, attended by 21 investor clients. Interactive webinars provide a different format of company dialogue than standard engagement meetings. The webinar format allows companies dedicated time in the meeting agenda to formally present comprehensive information, which is then followed by an interactive question and answer slot for investor clients. The webinar focused on the status and progress with the 2019 Brumadinho tailings dam collapse reparations process.

Clients expressed their expectations that substantial work still needs to be undertaken to mitigate the environmental damage, support livelihoods restoration and re-build community trust. Vale's Directors of Reparation and Territorial Development gave a comprehensive overview of how 58% of the 10-year Reparation Agreement (covering social, environmental, economic and infrastructure development) has been implemented and that dam safety initiatives are on track to achieve 100% compliance with the "Global Industry Standard for Tailings Management" by the end of 2023. In addition, water and sediment quality of the affected rivers have returned to pre-incident levels.

This Sustainalytics webinar enabled significant progress towards the engagement objectives, by ensuring sharing of a broad scope of comprehensive data in a single engagement event. We aim to provide investor clients with more opportunities to join sessions such as these.

Plans for Q3 2023

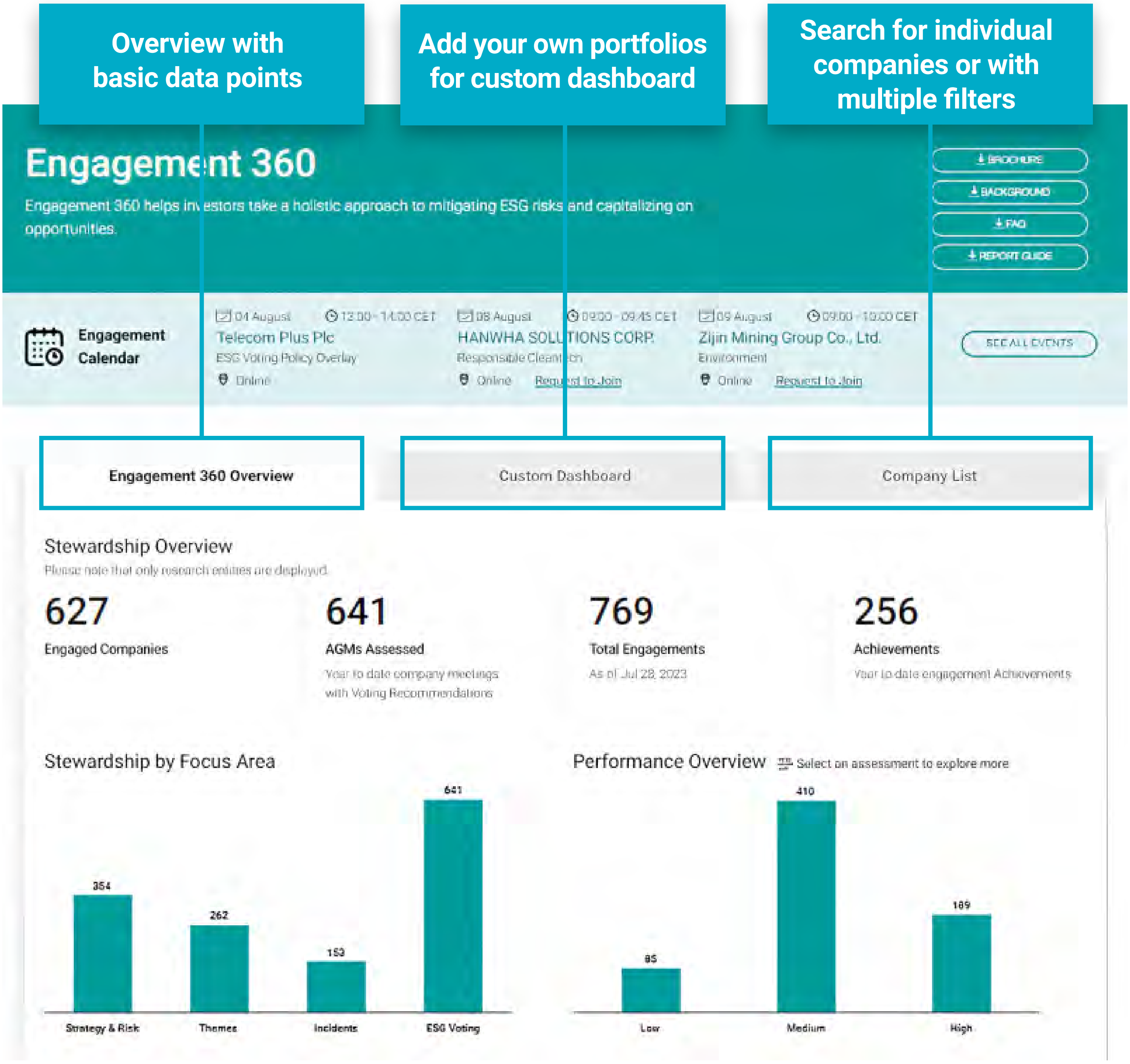
In Q3, the number of vote recommendations will slow down compared with Q2 as there will be fewer AGMs to address. The beginning of Q3 is also dominated by the holiday season in Europe and elsewhere, but Sustainalytics will continue engaging globally and there will be a constant flow of opportunities for investor clients to join the engagement meetings.

The Net Zero Transition engagement is initiating engagement with the first group of 50 companies. In the coming period the number of engagements in this programme will continue to increase.

Despite the holiday season in Europe, there will be intense activity of engagement meetings, where the engagement managers are following up with the issuers on the annual disclosure that is typically released end of Q2.

How to Generate Reports from Global Access

Clients have the opportunity to generate reports on their own through the online platform Global Access. Engagement 360 clients have access to all services and all engagements and vote recommendations on the platform. The starting point is the Engagement 360 landing page.



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About Morningstar Sustainalytics

Morningstar Sustainalytics is a leading ESG research, ratings, and data firm that supports investors around the world with the development and implementation of responsible investment strategies. For 30 years, the firm has been at the forefront of developing high-quality, innovative solutions to meet the evolving needs of global investors. Today, Morningstar Sustainalytics works with hundreds of the world's leading asset managers and pension funds who incorporate ESG and corporate governance information and assessments into their investment processes. The firm also works with hundreds of companies and their financial intermediaries to help them consider sustainability in policies, practices, and capital projects. With 17 offices globally, Morningstar Sustainalytics has more than 1,800 staff members, including more than 800 analysts with varied multidisciplinary expertise across more than 40 industry groups. For more information, visit **www.sustainalytics.com**.

Do you have any questions regarding our Stewardship Services? Contact us today to connect with our team of experts.

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