SUSTAINALYTICS
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Material Risk Engagement

2021 Q2
Quarterly Report

Material Risk Engagement promotes and protects long-term value by engaging with high-risk companies on financially-material ESG issues.

Contents

This report summarizes the shareholder engagement activities that Sustainalytics performed for investor clients between 1 January to 15 May 2021.

Executive Summary

Palle Ellemann
Director and Product Manager for Material Risk Engagement

Sustainalytics' Material Risk Engagement (MRE) continues at a fast pace to expand its engagement program, and by mid-May, there are 277 active engagements. The core MRE team is well-established in all three main regions: Americas, EMEA and APAC, and there has been high engagement activity in the first part of 2021 with 74 meetings and more than 500 emails and phone calls.

This inaugural quarterly report covers engagement activity from 1 January to 15 May, while the following quarterly reports will cover three months. MRE quarterly reports provide regular updates to clients and an update of progress and insight that clients can use to report to their stakeholders. For individual engagements and portfolio screening, clients can use Global Access for real time-updates.

As we started following up with engagements established in 2020, the engagement shows a growing number of positive developments. We are defining positive developments as new initiatives that companies have implemented related to the suggested actions (recommendations), so we can only track these positive developments when we follow up on progress with the companies.

In the first part of 2021, we have tracked 29 positive developments, which is more than the entire year of 2020.

We have also resolved three engagements, where the ESG Risk Rating scores improved significantly. All three of these engagements have been highly constructive and produced clear results from our efforts.

This report includes an article from one of Sustainalytics' Engagement Managers, discussing what the new 14th Five Year Plan in China will mean for engagement with Chinese companies. The 14th Five Year Plan will be an important reference and we anticipate focus on carbon, resource use, and product governance.

Material Risk Engagement clients are encouraged to leverage engagement insights for their applicable portfolio and reporting needs. Instructions on how to generate reports through our Global Access platform are included in this report, and Engagement Managers are available to discuss ongoing engagements. For general program questions, please send an email to mre@sustainalytics.com or your client advisor.

2021 Q2 Statistics

277
Active Engagements by 15 May 2021

507
Emails

74
Meetings

312
companies engaged since the beginning of MRE in March 2020

29
Positive Developments (between 1/1 and 15/5 2021)

COMPANY RESPONSE

Excellent	2%
Good	36%
Standard	33%
Poor	8%
None	20%

COMPANY PROGRESS

Excellent	1%
Good	17%
Standard	70%
Poor	6%
None	7%

3
Engagements Resolved (between 1/1 and 15/5 2021)

Material Risk Engagement 2021 Q2 Statistics

Status of Engagement by Research Universe

Ratings	ENTIRE UNIVERSE	GLOBAL DEVELOPED	GLOBAL EMERGING
Total Engagements	295	174	122
Resolved	3	2	2
Archived	15	12	3
Remaining Active Engagements	277	160	117

Active Engagements by ESG Risk Ratings Categories

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)
		3% (28-30)	55%	41%

Industry Distribution

Industry	Engagements
UTILITIES	34
CHEMICALS	28
FOOD PRODUCTS	27
OIL & GAS PRODUCERS	20
PHARMACEUTICALS	19
MACHINERY	17
PRECIOUS METALS	16
HEALTHCARE	15
BANKS	15
DIVERSIFIED FINANCIALS	12
INDUSTRIAL CONGLOMERATES	10
TRANSPORTATION	8
AUTOMOBILES	7
DIVERSIFIED METALS	7
CONSTRUCTION & ENGINEERING	7
REFINERS & PIPELINES	6
SOFTWARE SERVICES	5
CONSTRUCTION MATERIALS	4
AEROSPACE & DEFENSE	3
SEMICONDUCTORS	3
STEEL	3
TELECOMMUNICATION SERVICES	2
ENERGY SERVICES	2
CONSUMER SERVICES	2
FOOD RETAILERS	1
INSURANCE	1

Regional Distribution

EUROPE, THE MIDDLE EAST AND AFRICA
23%

AMERICAS
37%

APAC
39%

Engagement Topics

Engagement with companies within the MRE program focuses on Material ESG Issues with the largest management gaps as measured by Sustainalytics' ESG Risk Ratings. The engagement is typically related to multiple Material ESG Issues as most companies will have several management gaps in their ESG risk management. The below table gives an overview of the main topics in the engagements, but keep in mind each engagement involves a broader set of ESG issues.

About one-third of the engagements are focused on ESG risk assessment and disclosure practices. A sound and efficient ESG risk assessment process is fundamental for effective ESG risk management. A good risk assessment process is intended to inspire constructive dialogue with internal and external stakeholders — helping companies to establish accountability and focus on material issues. Having clarity of the risks, companies can move on to risk mitigation. As seen in practice, robust ESG disclosure is an important driver for commitment to and consistency in ESG practices. What gets measured gets done.

Beyond ESG disclosure, carbon-related issues are the most common focus. This is even more evident when we also consider the additional issues that the engagements touch upon. Carbon- or climate-related issues are very often highlighted among the suggested actions for the companies to address. Product governance is another prevalent engagement focus, as it often relates to significant liabilities for companies and investors.

TOPICS	NUMBER OF ENGAGEMENTS
Risk Assessment and ESG Disclosure	92
Carbon Risk Management	32
Product Governance	19
Emissions, Effluents, and Waste	11
Corporate Governance	7
ESG Integration in Financials	6
E&S Impact of Products and Services	6
Business Ethics	3
Occupational Health and Safety	3
Human Capital	2
Land Use and Biodiversity	2
Community Relations	1
Resource Use	1
Data Privacy and Security	1

Engagement Results

During the first period of 2021, from January 1 to May 15, we conducted 74 meetings and exchanged 507 emails and phone calls with the engagement companies in the MRE program. Performance is tracked in various ways throughout the engagement process. First, the company is assessed on their awareness of ESG and willingness to engage with Sustainalytics and investors. 38% of the companies achieved a good or excellent response. Engagement Managers will explore alternative strategies to establish a dialogue for companies that did not respond to our initial outreach.

Effective practices include reaching out to senior management or board members, joining investor calls and engaging investor clients with a specific interest in the non-responding companies. Secondly, the progress is assessed, showing the extent that companies adopt recommended actions provided by Sustainalytics. As there are still a high number of new engagements, verification of actions is still in progress. These companies received a neutral rating of "standard progress," accounting for 70 percent of total cases. Additionally, the suggested actions implemented as "positive developments" are also tracked. Finally, company performance is evaluated as part of its ESG Risk Ratings assessment, which is updated annually. Once the company improves its performance to bring its ESG Risk Ratings score below 28 or ranks within the top 40% of its industry, the case will be resolved.

*Up to May 15, 2021, Sustainalytics recorded **29 positive developments** in engagements where the companies implemented the suggested actions.*

COMPANY RESPONSE

Excellent	2%
Good	36%
Standard	33%
Poor	8%
None	20%

COMPANY PROGRESS

Excellent	1%
Good	17%
Standard	70%
Poor	6%
None	7%

3

Engagements Resolved (between 1/1 and 15/5 2021)

Company: Petroleo Brasileiro (Petrobras)
ESG Risk Ratings Score

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

41.3

INDUSTRY
Integrated Oil & Gas

BASE LOCATION
Brazil

ENGAGEMENT FOCUS
Carbon
Bribery and corruption
Emissions, effluents and waste

RATIONALE FOR RESOLVED STATUS
Petrobras moved into the top 40% of its industry category.

Positive Development Highlights:

- The Ombudsman function has improved significantly and operates with much better disclosure with credible numbers of whistleblower reports coming in. There is a good transparency in incoming reports, how they are managed and the outcome.
- In 2016, Petrobras defined climate change as a strategic theme that will influence all investments and strategic decisions going forward.
- Petrobras significantly expanded its strategy and disclosure on climate changes and aligned with the TCFD.
- Petrobras has expanded the disclosure on oil theft so that investors can see the trends in scope and occurrence of these incidents. The scope of oil theft is 30% lower in 2020 compared with 2019. Petrobras has implemented multiple monitoring mechanisms to manage this risk.
- The targets for carbon emission reductions are relatively ambitious and now extended to 2030, so there are targets for 2025 and 2030 for most metrics. This includes a commitment for no routine flaring by 2030.
- In the 2020 Sustainability Report, Petrobras is giving investors a much better insight to water-related risks and mitigation strategies. This includes an ambitious target for reduction of water consumption through an increased reuse of water.
- For the first time, Petrobras is highlighting development of renewable energy among three key issues in its five-year strategic plan.

In the latest update of the ESG Risk Rating, the management score of Petrobras has significantly improved, bringing the company into the top 40% of its industry.

Company: Bayer
ESG Risk Ratings Score

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

28.6

INDUSTRY
Pharmaceuticals

BASE LOCATION
Germany

ENGAGEMENT FOCUS
Product governance
Environmental and social impact of products and services
Business ethics

RATIONALE FOR RESOLVED STATUS
Bayer moved into the top 40% of its industry category.

Positive Development Highlights:

- Bayer announced its 2030 Sustainability Goals including a carbon neutral target by 2030.
- Bayer has been settling several outstanding lawsuits:
  - It was announced that Bayer has agreed to settle 651 individual lawsuits on its Yaz/Yasmin contraceptive pill for USD 142 million.
  - It was announced that Bayer and Johnson and Johnson had agreed to settle more than 25,000 lawsuits for USD 775 million.
  - It was announced that Bayer has agreed to settle 90 per cent of Essure injury claims.
- Bayer explained that it had set-up a new independent Sustainability Advisory Council that was to report to the CEO and had a remit to advise on improvements regarding sustainability throughout the organization.
- Bayer re-assessed executive long-term incentives and now ties 20 per cent of executive long-term incentives to environmental and social goals.
- Bayer expands transparency for investors and enables access to its pharmaceutical, clinical trials data through a clinical data request portal.

In the latest update of the ESG Risk Rating, the management score of Bayer has significantly improved, bringing the company into the top 20% of its industry.

Company: Vale
ESG Risk Ratings Score

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

40.5

INDUSTRY
Diversified Metals Mining

BASE LOCATION
Brazil

ENGAGEMENT FOCUS
Community relations
Carbon
Emissions, effluents and waste

RATIONALE FOR RESOLVED STATUS
Vale moved into the top 40% of its industry category.

Positive Development Highlights:

- In the early stages of our engagement, in 2015, Vale established Memory of Understanding (MoU) with Mozambique government to address issues with resettlements.
- Vale has improved water risk disclosure in the 2015 Sustainability Report and the disclosure shows 80+ per cent reuse/ recycling rates.
- Vale has migrated stocks to live up to the high corporate governance guidelines in Novo Mercado.
- Vale files annually a country-by-country tax report, which is improving tax transparency.
- Vale published a more ambitious target for carbon emission reductions. The company is now aiming for carbon neutrality in 2050.It also announced a commitment of at least USD 2 billion to make good on its pledge to become carbon neutral by 2050. This includes an interim commitment to reduce carbon emissions by 33 per cent by 2030.
- In August 2020, a new Global Industry Standard on Tailings Management was published. Although the standard is voluntary, the ICMM members have committed to implement it. Vale is an ICMM member.

In the latest update of the ESG Risk Rating, the management score of Vale has significantly improved, bringing the company into the top 40% of its industry.

Thought Leadership: Engaging with Chinese Companies Under the 14th Five Year Plan

Author: Keiyau Sin
Manager
Engagement Services

Each spring, all eyes are on the so-called “two sessions” in China, i.e., the annual gatherings of the People’s Political Consultative Conference and the National People’s Congress (NPC). This past March was no different, except that the two sessions have probably garnered even more attention as the 14th Five Year Plan (14FYP) was officially passed at the NPC. The 14FYP offers a strategic framework for China’s economic and societal development for the next five years and envisions the nation to be “moderately prosperous” by 2035. This article will explore key ESG risks likely to be impacted by the 14FYP during Material Risk Engagement.

Setting the scene: dual circulation strategy

The 14FYP is built on the backbone of the “dual circulation strategy”, which calls for boosting domestic economic activity while supplementing growth by external economic exchange. Such internal demand will be driven by a growing urban population that will reach 65% of the total population by 2025. And then by 2035, China’s five key metropolitan areas will be home to 600 million people. To put that figure into perspective, European Union’s total population was estimated to be 448 million in 2020.

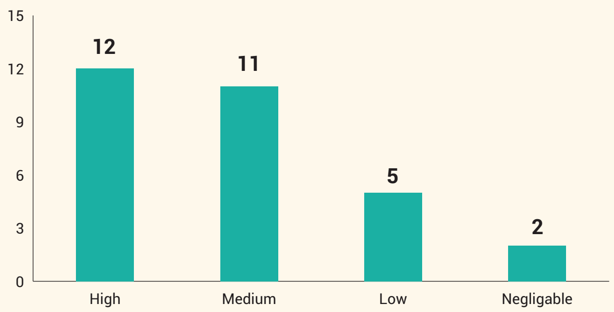
Carbon emissions management

China has already pledged to peak its carbon emissions by 2030 and attain carbon neutrality by 2060. The 14FYP now sets an 18% reduction target for carbon emissions per unit of GDP and a 13.5% reduction target for energy consumption per unit of GDP . The Plan also outlines the idea of capping total carbon emissions though details are not yet available. More granular sectoral targets are expected to be released later in 2021. How energy-intensive sectors such as oil & gas, utilities and cement will respond to these ambitions and maintain a resilient business model against the backdrop of rapid urbanization should be the continual focus of investor engagement dialogue.

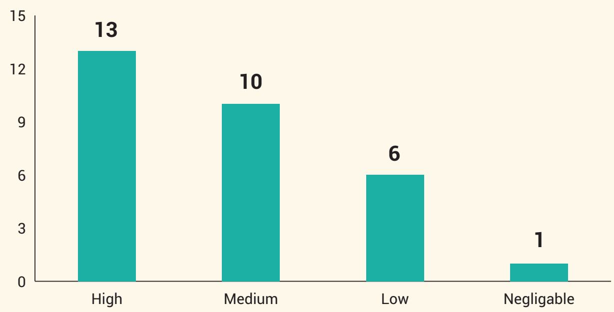
Improving resource use

Basing economic growth on the internal cycle of innovation, manufacturing, and consumption will undoubtedly put pressure on companies to ensure the responsible and efficient use of natural resources. However, among the 30 Chinese companies covered in MRE that have material exposure to Resource Use, close to half of them are rated High risk. Over 75% either have a weak water management program or do not have a program at all. It raises the question of whether these companies are ready for the challenge of expanding production and improving resource use efficiency.

Unmanaged risk related to Resource Use - Chinese companies in MRE



Assessment of Water Management Program - Chinese companies in MRE



Governing product quality and safety in domestic market

We also expect that rising domestic consumption will inevitably bring the issue of product governance to the fore at China's home market, as urban population – who on average have higher purchasing power, are more educated and more sensitive to product quality issues – continues to grow.

Further, a recent study by Harvard researcher has shown that investors tend to react – both positively and negatively – the most to company news relating to product impact among different themes of ESG news. Companies that can generate positive impacts through their product offering and prevent product safety and quality scandals through robust risk management will be better positioned overall.

As the 14FYP continues to unfold, we will have more clarity on China's roadmap to its "Vision 2035". We can already anticipate that cutting carbon emissions, properly managing resource use, and ensuring sound product governance would remain the focal points of MRE's dialogue with Chinese companies on their ESG risk management.

Plans for 2021

In the next quarter, there will be follow-up engagement meetings with, many of the new engagements started by the end of 2020. This should generate an even higher number of positive developments, where the companies have implemented new initiatives related to the suggested actions made.

We will continue opening new engagements, particularly in Asia, but with a slower pace than so far as we are moving closer to full coverage of the universe and already have a large number of engagements to maintain.

Depending on the roll-out of the vaccine programs around the world, there might be possibilities to schedule in-person meetings in Q3.

Material Risk Engagement Approach

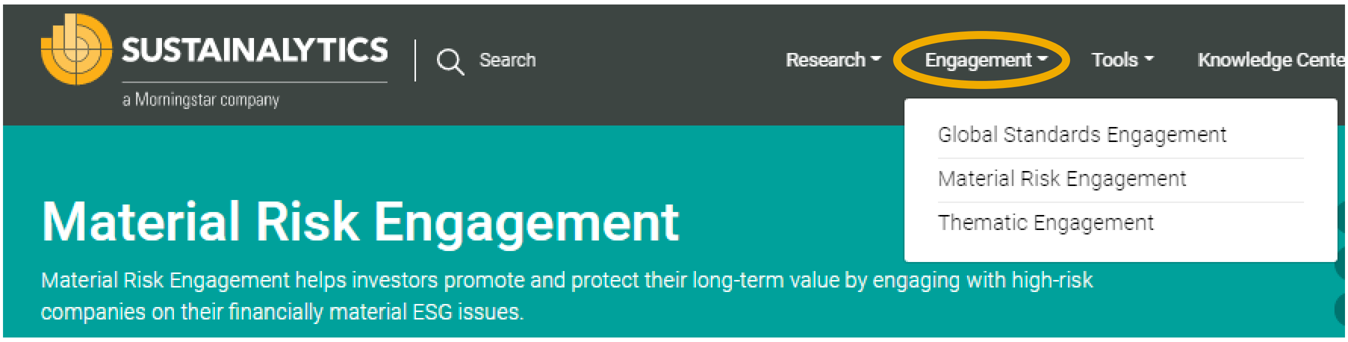
Sustainalytics' Material Risk Engagement (MRE) engages with high-risk companies on the material ESG issues with the greatest levels of unmanaged risks. The purpose is to protect and develop long-value in our clients' portfolio companies. MRE is an engagement overlay of Sustainalytics' flagship product, ESG Risk Ratings.

The Active Owners hip team will engage with companies in Sustainalytics' Ratings universe, consisting of more than 4,500 companies, that have an ESG Risk Ratings Score of 32 or more and are among the lowest-performing half of companies within their industry. The ESG Risk Ratings score reflects the unmanaged ESG risk, so the higher the score, the more risk the company is exposed to.

The engagement is driven by constructive dialogue. The research from ESG Risks and the Controversies research are leveraged to encourage companies to cover gaps in Material ESG Issues risk management. Engagement response, progress and positive developments are consistently tracked to measure commitment and capability to change in addition to the engagement outcome. When a company improves either by bringing the ESG Risk Ratings score below 28 or placing within its industry's top 40th percentile, the MRE will be considered resolved.

How to Generate Reports from Global Access

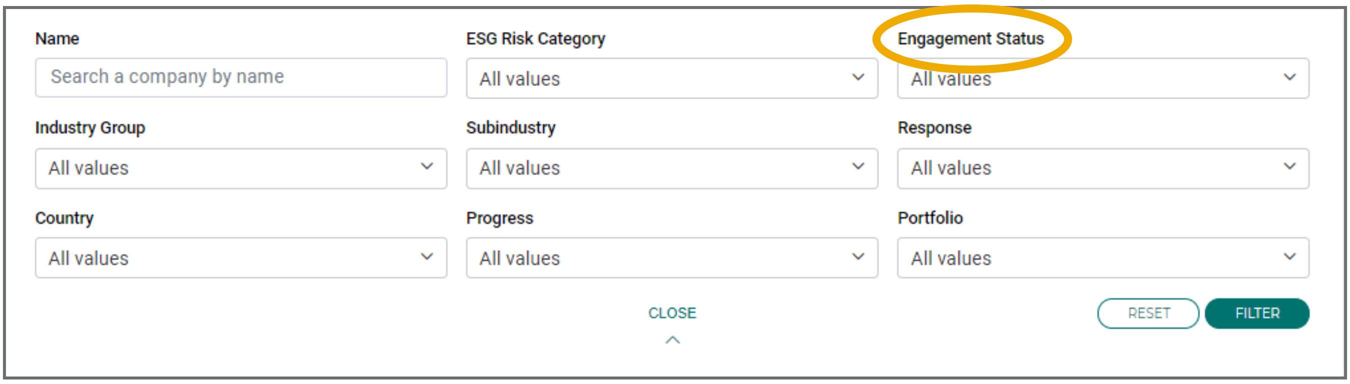
MRE clients can generate individual reports from Global Access, allowing visibility to the status of engagement activities and progress. From the landing page of **Global Access**, find **Material Risk Engagement** under the **Engagement** tab.



On the **Material Risk Engagement** landing page, scroll down to the search section, to search for a specific company or filter by various criteria including industry group, country, response, and progress.

Reports can be generated for an individual portfolio if a portfolio has been uploaded to the user's account in the **Portfolios** section under the **Tools** tab. Once a portfolio is uploaded, it is available under the **Portfolio** filter in the search section, in addition to other standard research universes.

To see the number of engagements in a portfolio, select **Engage** under the **Engagement Status** and the portfolio under **Portfolio**. This will produce a report that includes multiple data points for the companies selected.



Do you have any questions regarding our Stewardship Services?

Contact us today to connect with our team of experts.

Learn More About Sustainalytics

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