RESPONSIBLE INVESTMENT

VOTING AND ENGAGEMENT
QUARTER 1, 2022

QUILTER CHEVIOT
INVESTMENT MANAGEMENT

INTRODUCTION

Welcome to our report of voting and engagement activity for the first quarter of 2022.

Overview of our activity across our discretionary holdings at Quilter Cheviot:

Activity	Universe
Voting	Discretionary holdings within the UK, US and European equity monitored lists where we have voting rights including: • MPS (Managed Portfolio Service) Building Blocks • Climate Assets Fund • Quilter Cheviot Global Income and Growth Fund for Charities • Quilter Investors Ethical Fund • AIM Portfolio Service This includes our UK, US and European equity and investment trust monitored lists; as well as holdings in the AIM Portfolio Service and UK holdings where we own more than 0.2% or £2 million of the market cap. *Additionally, clients are able to instruct voting on their behalf.*
Engagement	• UK, US and European equities within the monitored list • Funds held on the centrally monitored list • AIM Portfolio Service holdings • UK holdings where we own more than 0.2% or £2 million of the market cap.
ESG integration	All holdings within the centrally monitored universe of equities, funds and fixed income.

We use the ISS proxy voting service in order to inform our decision making, however we do not automatically implement its recommendations. When we meet a company to discuss governance issues, the research analyst does so alongside the responsible investment team as we are committed to ensuring that responsible investment is integrated within our investment process rather than apart from it. As part of Quilter, we became one of the first wave of signatories to the 2020 Stewardship Code.

Signatory of: UK STEWARDSHIP CODE | 2021

Where clients wish to vote their holdings in a specific way, we will do so on a reasonable endeavours basis; this applies whether the investment is in the core universe or not, and also to overseas holdings. We have ensured that two clients were able to instruct their votes over the last quarter.

For information regarding our approach to responsible investment, including our response to the UK Stewardship Code and our voting principles, as well as more granular detail on how we voted at each meeting please visit our website **Responsible Investment | Quilter Cheviot**.

This quarter we have looked at the engagement process whilst from a climate perspective we reflect on the outcomes from COP26, as well as the findings of our first climate thematic engagement.

RESPONSIBLE INVESTMENT AT QUILTER CHEVIOT

Responsible investment and ESG integration – for discretionary clients
We vote and engage with companies and fund managers on environmental, social and governance (ESG) matters. Integrating ESG considerations into our investment process can have direct and indirect positive outcomes on the investments we make on behalf of our clients.

We take a more targeted approach for clients who want their portfolios to reflect their specific interests or preferences:

Sustainable investment – the Climate Assets Fund and strategy
Investing in the growth markets of sustainability and environmental technologies, with a strong underpinning of ethical values. The strategy is fossil fuel-free and invests in global equities, fixed interest and alternative investments. Five positive investment themes are at the heart of the stock selection: low carbon energy, food, health, resource management and water.

A funds based approach - Positive Change
A pragmatic approach that combines funds that invest with a sustainability focus or for impact, with funds managed by leading ESG practitioners. Meaningful engagement by fund houses with company management prioritised over formal exclusions on the basis that engagement can encourage change where it is needed most.

Ethical and values-oriented investment (ESG screening) - client specific
This is incorporated on an individual client basis, informed by their specific ethical preferences. These will vary from client to client and will focus on sectors, industries or individual companies.

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ENGAGEMENT

Below we have outlined some examples of our engagement during the three months to the end of March 2022. In line with the Shareholder Rights Directive II (SRD II) disclosure regulations we have, in the majority of cases, included the name of the company or fund. In some cases we will not, as this would be unhelpful in the long-term to the ongoing engagement process.

We use ISS as our proxy voting service provider and based on our responsible investment principles, ISS provides recommendations on each resolution companies put forward to shareholders. We do not always follow the ISS recommendations, as we believe it is important that responsible investment is integrated into our investment process, and that Quilter Cheviot makes up its own mind. In all cases where we have a concern regarding a company we make contact to discuss the issues ahead of the Annual General Meeting (AGM).

Apple Inc.

Objective: To raise concerns related to transparency issues highlighted by several shareholder resolutions put forward at the 2022 AGM.

After receiving no response from the company, we voted in favour (against management) of four shareholder resolutions related to approving transparency reporting, reporting on forced labour, reporting on median/racial pay gap, reporting a civil rights audit and reporting on concealment clauses. We are comfortable with the rationale on all these items which cover a range of material ESG issues and will improve company reporting and transparency. Despite concerns raised by our proxy advisor over CEO compensation, we supported management on this item. We are comfortable with the quantum awarded and have reached out to the company expressing a desire to see a timeline line stated on future equity grants. We would also have an opportunity to vote on future awards.

Outcome: We voted against management on four shareholder resolutions to improve transparency and voted to support management on CEO compensation.

Aptiv

Objective: To discuss concerns around executive pay and to engage for more information on supply chain management processes.

This was a high-level engagement on supply chains and remuneration, further detailed conversation will be needed – and we look forward to receiving more specific information on supply chain management auditing. Detail on supply chain management was light, although the company does audit any new supplier. This process includes an auditing of ESG risks and use of third-party data providers to assess suppliers. We also raised concerns around the fact that the CEO pay ratio to the median employee is one of the highest in the S&P 500. The company reflects that since 2018, CEO pay has increased by 4% relative to a 37% increase for the wider workforce. A significant amount of the company's workforce is based in Mexico where median salaries are lower. Given the material shareholder opposition to the CEO salary at the previous AGM, we encouraged the company to provide more information on how they are addressing this disparity and considerations around the living wage levels in Mexico.

Outcome: This was a high-level preliminary conversation on supply chains and remuneration, further detailed conversation will be needed – and we look forward to receiving more specific information on supply chain management auditing.

Britvic

Objective: To raise concerns over the amendment to in-flight performance targets within executive remuneration.

In the run up to the 2022 AGM, the remuneration committee exercised discretion to amend the performance targets applicable to a portion of the in-flight awards made under the 2018 LTIP, which were not scheduled to vest. Any amendment to in-flight performance targets is not considered best practice. We engaged with the company and were comfortable with the board's rationale and use of discretion. In 2020 no short-term bonus was paid and there was no vesting of share options. Given the impact of Covid-19, instead of resetting targets, the RemCo agreed 'gateway' measures must be met before deciding if any discretion could be applied. The company made no use of UK government support during the pandemic.

Outcome: Based on our conversation, we voted to support management.

Compass Group

Objective: To raise concerns related to the proposed increase in LTIP opportunity maximum, prior to the 2022 AGM.

The new remuneration policy looked to increase LTIP from 300% to 400% of salary for the CEO, and from 250% to 350% of salary for the other executive directors. We engaged with the company who justified the proposed increase based on talent retention, peer benchmarking and introduction of increasingly stretching targets relative to the 2019 policy. Total compensation will remain below market peer median following the increase.

Outcome: Based on our conversation, we agreed with the proposed rationale and voted to support management.

EDPR

Objective: To raise concerns over the level of equity issuance and level of issuance excluding pre-emptive rights, prior to the 2022 AGM.

We followed up with the company for more detail on the rationale and reaction to the ISS (our proxy adviser) recommendation. In summary, EDPR considers its approach to share issuance to be reasonable and in accordance with market practice in Spain, according to the Spanish Companies Act. We understand the issuance request is common practice among listed companies in Spain, however, we have determined to follow our internal view on share issuance.

Outcome: We voted against management on the item related to equity issuance.

GCP Infrastructure Investments

Objective: Open engagement to discuss concerns related to the independence of a board member prior to the 2022 AGM.

This concern was raised by our proxy advisor owing to the non-executive director (NED) in question being paid to shadow the board prior to taking up the board position. We engaged with the board and were comfortable with the management rationale for the situation. The board member provided no other services (other than to observe board functioning) and as such we do not see the independence compromised.

Outcome: We voted in favour of election at the AGM.

Haydale Graphene

Objective: To raise concerns over a proposed equity issuance.

We held dialogue with the company regarding the proposed equity issuance prior to 2022 AGM. This issue was raised by our proxy advisor. After speaking with the company, we were comfortable with the issuance authority and were given assurance that we would be brought into discussion if the full extent of issuance was needed, an event the company saw as unlikely.

Outcome: We raised concerns with the company and based on our conversation were comfortable supporting management in this instance.

Henkel AG

Objective: To discuss the re-election of two members of the shareholder board over concerns related to independence and board gender diversity.

The board is only 28% independent (across both boards), and collectively has gender diversity of only 28% overall with the shareholder-elected directors only accounting for 18% percent of the under-represented gender. We engaged with the company who highlighted that one component of the board (the supervisory committee) has 33% women representation. The shareholder board also consists of five members of the same family, not considered independent.

Outcome: We voted against management on the re-election of both directors and encouraged improvement in gender and independent representation.

JPMorgan Global Emerging Markets Income Trust

Objective: This was a catch-up conversation with the board chair

Topics of discussion included board transition planning with the chair retiring in 2022. The board is actively seeking a diverse candidate. The trust has been successful in hiring women candidates and we discussed further details on recruitment practices and the 'Nurole' platform in particular (a hiring platform that does not rely on head-hunters but candidates putting themselves forward).

Outcome: This was a catch-up conversation, but we also requested more information to be published on voting and engagement activity. This seems to be taking place but is not disclosed particularly well at the trust level.

Investment Trust (anonymised)

Objective: Escalation of engagement regarding PRI signatory status.

As a first step, we communicated our view that the manager should be a signatory to the UN backed PRI to the board and the broker. We followed this up with a discussion with the manager to talk about why they have not yet signed up to the PRI and to make clear the growing importance of ESG integration and engagement in our fund selection process. We reviewed their revised policies on this and as a next step met with the chair and one of the NEDs (non-executive directors). The chair and NED provided more detail on the actions taken including the use of an external consultant to validate the processes, however there is very little external disclosure of ESG integration examples, let alone stewardship metrics or examples. There is some concern voiced by the manager that signing up to the PRI could be at odds with regulatory developments specifically in the US - we do not believe this to be valid. We noted that we have passed on investing in a new fund that the manager is launching because of the lack of PRI signatory status.

Outcome: The board will reassess the position and we will explore other avenues to escalate this further.

Investment Trust (anonymised ~2)

Objective: Follow up on discussions with the chair regarding greater disclosure on how the investment trust manager integrates ESG factors within the investment process.

We were asked to review the proposed reporting on the investment trust's approach to responsible investment and the integration of ESG metrics. The proposed reporting was a good first step in the right direction, however we felt it would benefit from more examples of the manager's consideration of ESG factors, and less focus on the areas which they do not invest in which are less pertinent as the investment trust focuses on a specific sector.

Outcome: Continue to monitor progress on reporting.

Persimmon
Objective: To participate in consultation on the incoming CFO's remuneration arrangements.
We met with the chair of the Remuneration Committee (RemCo), to discuss the appointment and remuneration of the new CFO. The RemCo chair provided an overview of the recruitment process and explained in further detail the incoming CFO's profile, who is seen to have a flexible set of capabilities and broader strategic value. We also discussed the cultural changes within the business with the steps it has taken to refocus on customer satisfaction and improving customer service.
Outcome: A useful catch-up meeting, we highlighted that gender diversity could have been more balanced throughout the hiring process, and we will continue to monitor other areas of diversity.

Walgreens Boots Alliance
Objective: We sought dialogue with the company to raise concerns related to failure to respond to 2021's 'say on pay' vote result.
In response to last year's failed say-on-pay vote, the proxy included disclosure regarding feedback received from shareholders. However, disclosure of engagement efforts was incomplete and, more concerning, the pay program changes did not fully address the most prominent shareholder concern regarding the use of positive discretion to increase 2020 LTIP.
Outcome: Despite multiple efforts to initiate dialogue, the company failed to respond. We voted against the remuneration report and election of directors. We also voted to support a shareholder resolution (against management) to reduce the ownership threshold for shareholders to call a special meeting.

Walt Disney Co.
Objective: To raise concerns related to transparency issues highlighted by several shareholder resolutions put forward at the 2022 AGM.
After receiving no response from the company, we voted in favour (against management) of four shareholder resolutions related to approving calls to report on lobbying payments &policy, human rights due diligence efforts, gender/racial pay gap. In addition to this a resolution was also tabled to reduce the ownership threshold for shareholders to call a special meeting. This is a measure that could improve shareholder voice.
Outcome: We voted against management on four shareholder resolutions to improve transparency on material ESG issues and voted to reduce the ownership threshold for shareholders to call a special meeting.

Xylem
Objective: This was a catch-up conversation to receive a general update on the company's sustainability strategy.
We ran through the company's sustainability performance. Over the past few years, the strategy has pivoted from just foot printing operational emissions and now look to incorporate a new set of goals that focuses on the impact of their suppliers as well as the company's impact upon the local communities in which they operate. Xylem has a 2050 net zero plan in place and is currently working with the Science Based Targets initiative (SBTi) to get this externally verified.
Outcome: Positive update from a company who inherently has a sustainable focus given the nature of its products/services but encouraging to see that various sustainability criteria are being progressed internally – including a net zero plan.

2021/2022 THEMATIC ENGAGEMENT – TRANSITION PLANS & CLIMATE DISCLOSURE

Objective: We continued our thematic engagement on climate transition plans and disclosures with the largest emitters in the voting universe (scope 1 and scope 2 emissions). The first phase is very much engagement for information to get a better understanding of the quality of transitions plans and whether companies are taking (or not taking) appropriate measures to align with a future lower carbon economy.

BHP

BHP's exposure to metallurgical coal and legacy oil/thermal coal assets makes the decarbonisation trajectory more complicated that peers like Rio Tinto – that said – in terms of target setting BHP has not been as ambitious and does not appear to have committed as much capital expenditure to the decarbonisation strategy. Plans/expenditure on coal mine extension and expansion do not appear consistent with a net zero trajectory (despite stating this as a goal). Similarly, to peers, scope 3 emissions from Chinese steelmakers presents a challenge and there are individual projects ongoing to reduce carbon intensity of clients. Further engagement may be needed to fully establish the scope and impact of these projects. The specific commitments to reduce emissions in shipping is a welcome level of detail in an area where BHP can exercise more agency. This is a solid framework but overall, the ambition seems to fall behind peers.

Outcome: This was an initial engagement to establish an opinion on transition plans. We would like to see further progress on scope 3 emissions target setting and alignment of capital expenditure with a net zero trajectory. Ongoing dialogue will be required.

BP

BP has outlined a transformative strategy to become an integrated energy company, punctuated by significant capital expenditure commitments to low-carbon solutions. This is a welcome move towards significant absolute emissions reduction in the short and medium term and a move away from carbon intensity targets (used in less credible plans). With this, BP is effectively the first major to acknowledge that oil and gas production will most likely need to be reduced in the short to medium-term for the world to reach the goals of the Paris Agreement. One concern is the continuing sanctioning of high-cost projects that do not fit within a lower-demand pathway and hence run a heightened risk of destroying value in a decarbonising world. Net zero considerations (and ten pay-back) periods are being built into new project plans.

Outcome: This was an engagement for information – we used this preliminary conversation to establish an opinion on the quality of their transition planning. We will continue to monitor progress towards aims and encourage more detail to be disclosed on how scope 3 emissions will be addressed.

Linde

Linde is a carbon intense company that is aware of the pressing need to reduce carbon emissions. Scope 2 emission reductions should carry through with a decarbonisation of national energy systems but, based on our conversations, significant reductions in scope 1 emissions are contingent on technological advances in scalable green hydrogen production. The latter seems to be the motivation behind a carbon neutral target rather than a more ambitious net zero one. This is understandable, however, more information on the potential path to longer-term absolute carbon emission reductions would be welcome. The granularity of wider ESG metrics reported should also be commended – particularly in water emissions. In conclusion, relative to their sector, progress is encouraging and a shift to absolute medium-term reductions is welcome. More information on research and development efforts as well as capital committed to scaling green hydrogen would give a clear picture on the longer-term preliminary pathway to net zero.

Outcome: This was an engagement for information – we used this preliminary conversation to establish an opinion on the quality of their transition planning. We will continue to monitor progress towards aims and encourage more detail to be disclosed on how scope 3 emissions will be addressed.

National Grid
National Grid has set out an ambitious plan to reduce scope 1 and scope 2 emissions, most of which will take place by 2030. The company has made quantitative absolute reduction targets for scope 3, but these are less ambitious and more reliant on general decarbonisation of the UK/US energy system. National Grid has been an early participant in the Science Based Targets initiative (SBTi) process – having received validation of its carbon reduction plan and committing to net zero validation. This is an encouraging certification and is increasingly seen as a measure of a credible transition plan. One inconsistency, and presumably a barrier to net zero planning is the company's US power generation capacity and specifically an oil-fired power plant on Long Island. This represents 45% of scope 1 and scope 2 emissions. This is a legacy operated from the purchase of Geronimo Energy. National Grid has limited agency in the fuel used by the power plant and has contractual obligations in place until the contract with the New York authority expires in 2027. Overall, National Grid has been proactive in building a detailed, absolute reduction strategy and one that has been externally verified by the SBTi.
Outcome: This was an initial engagement to establish an opinion on transition plans. We will continue to monitor how US operations and legacy fossil-fuel generation affects the net zero strategy execution.

NextEra
NextEra is one of the most carbon intense companies in our holding's universe (on a scope 1 and scope 2 emissions basis). This is owing to legacy coal/oil-fired generation capacity and the remaining generation fleet which is majority natural gas fired. This does not account for the company's direction of travel. NextEra is one of the early movers into renewables in the utilities sector in North America. No company outside of China produces as much power through solar and wind. The company has set a clear objective to be fossil-fuel free by 2035 and has pin-pointed green hydrogen as the route to doing this by adapting current gas-fired plants and retiring oil/gas ones. From a strategic perspective this is welcomed. More specifically, science-based carbon reduction targets or a quantitative pathway to net zero are lacking. NextEra argues that any net zero target would be disingenuous as key technologies on which their strategy depends on (green hydrogen, battery storage) are not yet scalable. We have encouraged more quantitative targets, aligned with science-based methodologies to be put in place. High level strategic ambitions are welcome (and the company has a track-record of making progress on these) – but externally verifiable commitments improve accountability and transparency.
Outcome: This was an engagement for information – we used this preliminary conversation to establish an opinion on the quality of their transition planning. We will continue to monitor progress towards aims and encourage the company to produce a net zero strategy.

Total Energies
Total's shift towards renewables generation and gas production is clear. Total has a detailed plan for reducing scope 1 and scope 2 emissions (on an absolute and interim basis) and was one of the first companies to set net zero targets for scope 3 emissions. These targets are as comprehensive as most of the top climate performing oil and gas majors, but there are still gaps. There is a focus on scope 3 emissions from European customers, it is not clear how and when this will be measured on a worldwide basis. There is a lack of clarity over the use of carbon offsets. It is unclear how the company will significantly increase fossil fuel production, particularly oil (unlike peers such as BP) and then get to net zero emissions. The company has signalled how it aims to become a lower carbon company, but despite the announcements the route to becoming a net zero company is relatively opaque.
Outcome: This was an engagement for information – we used this preliminary conversation to establish an opinion on the quality of their transition planning. We will continue to monitor progress towards aims and encourage the company to produce more tangible detail on how all scope 3 emissions will be addressed.

QUARTER VOTING STATISTICS

Over the first quarter we voted at:

49 COMPANY MEETINGS

VOTE 1 X — **vote against remuneration report**

VOTE 1 X — **vote against to ratify executive compensation**

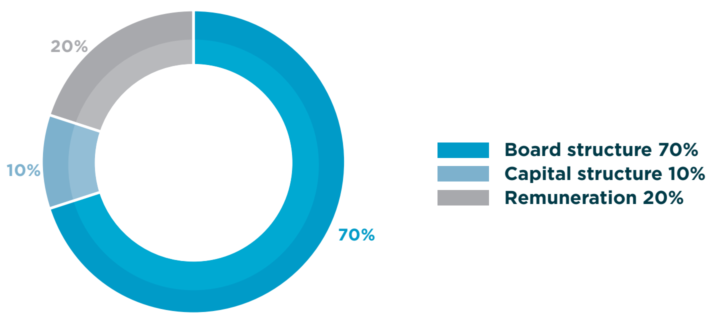
VOTE 7 X — **vote against on the election of director**

VOTE 2 X — **client instructed votes**

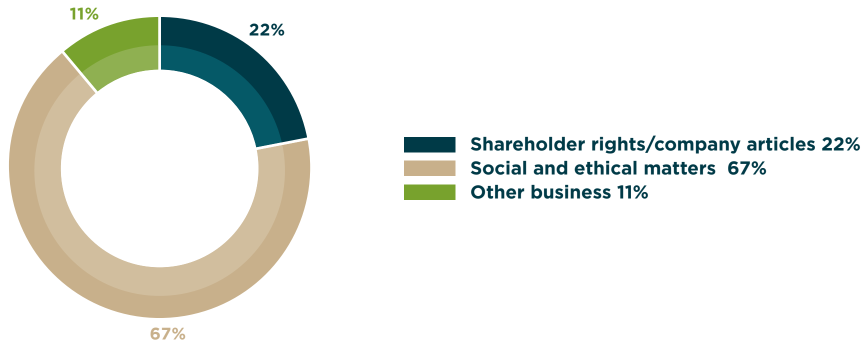
It is important to note that on a number of occasions having engaged with the relevant company we did not follow ISS' recommendations.

MANAGEMENT RESOLUTIONS VOTED IN Q1 2022

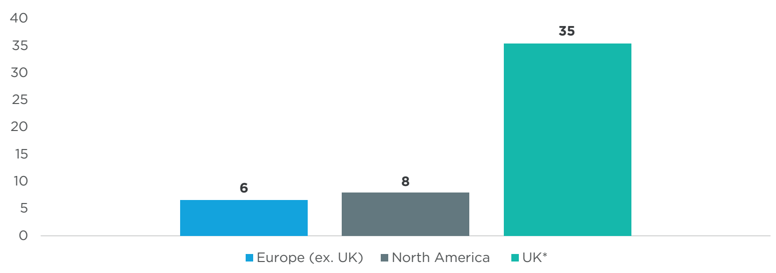
TOPICS WHERE WE HAVE VOTED AGAINST MANAGEMENT IN Q1 2022



SHAREHOLDER PROPOSALS SUPPORTED IN Q1 2022



MEETINGS VOTED IN EACH GEOGRAPHY IN Q1 2022



* Includes the Crown Dependencies of Jersey and Guernsey.

QUILTER CHEVIOT
INVESTMENT MANAGEMENT

ENGAGEMENT PROCESS EXPLAINED

Greg Kearney, Senior Responsible Investment Analyst

As a responsible investor Quilter Cheviot is committed to its role as a steward of clients' assets to protect and enhance long-term returns. Engagement is a cornerstone of this approach and integral to our investment process.

Engagement results are not always obvious. It can be difficult to accurately measure progress. Changes in practices can stem from multiple conversations often spanning several years or, with multiple investors engaging the company on the same subject, it can be difficult to pinpoint which conversation nudged the company to a tipping point. Attributable outcomes can be more obvious, particularly in companies, investment trusts and funds where holdings are sizeable, or if the company highlights the role your engagement played. Despite the difficulties in claiming bragging rights, engagement outcomes are tangible and when investors undertake dialogue with investee holdings, whether individually or collaboratively, we can see investor-led change happening – as can be seen in the 40% of FTSE 100 board positions now held by women (10 years ago it was 12.5%) or the proliferation of company net-zero commitments. For us, it is a constant and ongoing process which lies at the core of our approach to investing responsibly.

The role of engagement can be overlooked as it is not factored in within the proliferation of ESG (environmental, social and governance) ratings published by third party providers. However, it is integral to a thoughtful and authentic responsible investment process.

How we do it

Engagement means speaking directly to companies and investment trusts regarding issues that concern us, as well as providing an avenue to develop a deeper understanding of their general approach to material ESG issues. The process can be reactive or proactive and runs alongside our ongoing monitoring activities. For the funds we hold, we engage with managers on the quality of ESG analysis processes, their active ownership work (voting and engagement), signatory status to the UN backed Principles for Responsible Investment as well as attestations for active managers in regards exposure to controversial weapons (cluster munitions and anti-personnel landmines).

In 2021, we voted at over 300 company meetings, voting against management on a range of topics from executive remuneration to re-election of directors, and supporting numerous shareholder resolutions on improving reporting on social and environmental issues. We usually engage with the company ahead of taking the decision to vote against management.

Reactive - Reactive engagement occurs in response to a company-specific event, such as an AGM/SGM resolution of announcements relating to remuneration or other policy consultations. These are essentially red flags raised by developments within a company or industry and a response to events that have already occurred.

Proactive - Proactive engagement is more forward looking and involves looking for issues before they have patently manifested. For instance, this could involve conducting analysis on a specific topic, such as climate change, then looking to engage with the worst performers. This process plays a larger role in our thematic engagement.

On an ongoing basis we monitor developments through regular conversations.

Priorities

As well as taking an incident and risk-based approach to engagement prioritisation, we have also declared a list of three thematic priorities that play a significant role in where we focus our attention: climate change, people and human rights and water. We adopt a long-term approach, and our key themes are a work in progress - we expect the areas of focus within these themes to evolve over the coming months and years.

Our responsible investment team identifies areas of specific focus within the three broad groups mentioned above. These are then put before our engagement panel, which includes representatives of the research and executive teams, to verify for agreement. In 2021/22 preliminary areas of focus include carbon emissions and board diversity. Outcomes, as well as further engagement details, are disclosed quarterly on our website.

In addition to proprietary research, we use multiple external data sources to identify engagement targets and inform our dialogue. At the time of writing, these are ISS, Sustainalytics, CDP and Ethical Screening. In addition, a multitude of publicly available data sources and reports are essential to informing the engagement process.

Examples

Our interaction with **Tesla** provides an example of reactive engagement, which also reflected one of our themes: climate change. We spoke to the company surrounding the 2021 AGM. There was a long list of items to cover including four shareholder resolutions. Our discussion focused on shareholder efforts to declassify the board, significant discretionary remuneration for board members, emissions reporting and conflict mineral sourcing audit and verification. Tesla also does not currently report company level scope 1, 2 and 3 emissions – something we raised. The company reports several product-based carbon emissions statistics; however, a commitment has been given to disclosure company level emissions in the next 12 months. This was a constructive conversation with further detail provided on cobalt sourcing audits and initiatives to improve diversity and inclusion. The company is relatively unusual in that directors are paid solely in equity grants – given share price performance over the past few years, remuneration has been significant. We registered this concern and encouraged the implementation of a structured performance-based policy to add transparency to the equity grant process.

We voted to support all shareholder resolutions on diversity and inclusion efforts, employee arbitration and creating an independent board level committee to oversee human capital management. We also voted against two directors on the board mainly in relation to remuneration concerns.

Rio Tinto is an example of proactive engagement linked to the climate change theme. Rio Tinto has set ambitious, detailed plans for reducing scope 1 and 2 emissions. The company reports scope 3 emissions and the transparency on disclosures and difficulties faced on setting meaningful reductions targets in this area is noted. Much of the scope 3 emissions comes from steelmaking practices, particularly in China. The company has relatively little control over the practices of these clients or the energy mix in the grid providing power to these sites. Even with these limitations, it is encouraging to see the efforts the company is putting into working with clients to optimise processes and introducing new technology to bring scope 3 emissions down. It is difficult to assess the impact of such projects at this stage, but relative to other high emitting companies it shows action can be taken on scope 3 if there is willingness. That said, we encouraged formal target setting to be put in place for scope 3 emission.

This was an initial engagement to establish an opinion on transition plans. We would like to see further information on how these targets will be integrated in executive remuneration and believe there could be a case to further integrate metrics into the longer-term incentive, not just the annual bonus. Ongoing dialogue will be required.

Collaboration

Collaboration can enhance the effectiveness of engagement, and as such Quilter Cheviot is a member of various initiatives and trade bodies. The most relevant collaborations and memberships are with the 30% Club, which looks to promote gender diversity within companies, the UK Investment Association, UN Backed Principles for Responsible Investment (PRI) and Institutional Investors Group on Climate Change (IIGCC).

An example of this is the work we have undertaken as a lead engager, as part of the 30% Club investor group, we launched a collaboration to open discussions with leading executive search firms to assess their hiring practices when making women appointments to executive and board positions. This is still ongoing, but learnings will be aggregated and used in future company engagements.

A further example of our collaborative engagement came in 2021 when we joined the UK Modern Slavery Collaboration using the UN-backed PRI collaboration platform.

We were also among the first group of investors to become signatories to the revised 2020 UK Stewardship Code.

Escalation

The desired outcome of engagement activity is to reduce risk and enhance prospects for the company and therefore our clients. Regular engagement arises from one-to-one and group meetings with company executives. Depending on the topics of discussion, meetings are also held with company chair and chair of remuneration committees while in specific instances we will request a meeting with the senior independent director, if we believe this will be helpful.

Where we perceive a threat to the value of the company, we will take the necessary steps to protect our clients' investments. Beyond individual dialogue measures of escalation include collaborative engagement, voting contrary to management at general meeting and selling the holding where we evaluate it is in the best interest of our clients. In extreme circumstances, we could request a general meeting.

Active ownership is not a simple approach, multiple engagements are often required, and patience and perseverance are essential.

Any reference to any securities or instruments is not a personal recommendation and it should not be regarded as a solicitation or an offer to buy or sell any securities or instruments mentioned.

CLIMATE ACTION: WHAT NEXT AFTER COP26?

Yusuf Durmaz, ESG Fund Research Analyst; Greg Kearney, Senior Responsible Investment Analyst; Jamie Maddock, Equity Research Analyst; Mamta Valechha, Equity Research Analyst; Gemma Woodward, Head of Responsible Investment

The United Nations Climate Change Conference (COP26) attracted plentiful interest and media coverage during the final quarter of 2021, as prominent world leaders convened in Glasgow, Scotland, to accelerate action towards the goals of the Paris Agreement and the UN Framework Convention on Climate Change. Given that several months have now passed, it is a good opportunity to reflect on what was promised and what is being achieved. How is this influencing the companies and funds we invest in? And, particularly around net zero ambitions, what more should we expect?

Glass half full?

There is a sizable degree of subjectivity when analysing the success of COP26, as is often the case when reviewing events of this ilk. Those who took a glass-half-full approach will point to the reaffirmation of the Paris Agreement goal of holding the increase in global average temperature to well below 2 degrees above pre-industrial levels and pursuing efforts to limit the rise to 1.5 degrees. A clear highlight was the fact signatories recognised that limiting global warming to 1.5 degrees requires rapid, deep and sustained reductions in global greenhouse emissions, including reducing global carbon dioxide emissions by 45% by 2030, compared to 2010 levels.

What is more, two of the most damaging fossil fuels in use, coal and methane gas, were specifically targeted by pledges under the new deal, the Glasgow Climate Pact. Over 190 countries agreed to reduce their use of coal for power generation and around 100 countries committed to reduce methane emissions by approximately 30%. Also, more than 130 countries, accounting for over 90% of the world's forests, made pledges against deforestation, agreeing to halt and reverse the process by 2030. The private sector also made significant commitments, with over 450 financial institutions, overseeing more than US$130 trillion of assets, pledging to align their portfolios with the goal of achieving net zero emissions by 2050[1].

That said, those who were less enthused with the outcomes of the conference would argue that while progress was made, the agreed upon measures lack the requisite size and scope to achieve the stated goals. Although the 1.5 degrees target was kept alive, the commitment to deeper emissions cuts has been kicked down the road to the next COP. Simply put, the longer the delay in implementing these cuts, the deeper they will need to be. Notably the IPCC report published on 4 April 2022 has stated that emissions must peak in 2025[2].

Despite conference president Alok Sharma urging countries to consign coal to history, late interventions from China and India saw a commitment to "phase-out" its use reduced to "phase-down". Furthermore, the largest users and extractors of coal, including China, India, Australia and Russia, didn't explicitly pledge to reduce its use significantly. Progress on climate financing was also underwhelming. An estimated US$140bn will be needed to make the transition and put in place adaptation measures, and pledges in the region of US$100bn were shy of the total amount.

No show from China

The absence of high-level representation from China attracted several negative headlines and was perceived by some as suggestive of a lack of ambition and commitment, but there were

1 Figures source: COP26-Presidency-Outcomes-The-Climate-Pact.pdf (ukcop26.org)

2 Climate Change 2022: Mitigation of Climate Change (ipcc.ch)

mitigating circumstances, with Xi Jinping dealing with an energy crisis not too dissimilar to that currently facing Europe. Though the lack of centre stage participation will be noted, China is making significant progress in renewables with ambitious plans to completely change its energy mix and reduce carbon emissions. Global investments into renewable energy increased 30% in 2021 to circa US$750bn, with China accounting for around a third of the total spend and double the expenditure of the United States.

The investment perspective

Overall, the response from asset managers has been mixed but positive. Most highlighted disappointment around topics such as coal, but generally there was a more optimistic feel than usual. They have aligned themselves with the glass-half-full crowd and perhaps, due to a desire to be seen as part of the solution, those harbouring negative views have largely kept quiet. A lot of the larger managers were active in promoting and participating in the event as well as deciding to join initiatives, such as net zero, in the run up to the conference. One shortcoming with the approach of most managers, as well as many large companies, is the targeting of carbon intensity, rather than an absolute figure. As carbon intensity is measured per unit of revenue, it is quite feasible that a company could claim a reduction in intensity even though its overall carbon footprint has increased, providing revenue growth outstrips the rise in carbon emissions. At Quilter Cheviot we favour looking past carbon intensity targets for these reasons.

Our recent engagements with companies have focused on the number and quality of carbon reduction ambitions, or even better net zero strategies. We've been speaking to the largest emitters that we invest in, with conversations naturally centring around certain industries such as energy and mining companies. Specifically, we are looking for a thorough and robust climate transition plan.

We want to see alignment with a 1.5 degree pathway and in our view that is the crux of the net zero commitment - still some companies are only aligning their plans with a 2 degrees pathway. It is industry specific, but we are looking for a focus on the next decade. 2050 targets are admirable but, given the time to delivery, their effectiveness can be hard to measure until a significant amount of time has elapsed. Therefore, we prefer to focus on the short and medium-term targets that are in place.

We want to see a reduction in absolute emissions, on a scope 1, 2 and 3 bases as well as companies taking ownership of scope 3 emissions, which can be notoriously difficult to calculate. The recognition and acceptance of their presence demonstrates desirable transparency characteristics. Linking executive remuneration to carbon reduction targets is an example of good governance and the alignment of capital expenditure with climate change transition displays action to support rhetoric.

Can't be too simplistic

Due to the complexity of the challenges involved, it can be misleading to label companies as simply "good" or "bad" from a responsible investment perspective. For instance, there is a paradox regarding large energy companies, simultaneously among the worst emitters but also arguably best placed to provide solutions. Their geographical reach and expertise could provide significant value to the transition and while they may only be spending 10%-15% of capital expenditure on renewable solutions, the figures involved are just as large, if not larger, than some pure-play renewable firms. They are also already fully operational and largely profitable businesses, meaning investments can be self-funded, thereby negating the aforementioned financing issues. Mining companies are among the largest emitters but provide in-demand goods, some of which, like cobalt, are essential for other lower carbon businesses.

Tesla is a prime example of conflicting pressures when analysing a company under ESG criteria. As it purely makes electric cars it scores among the highest ranks for E, the environmental aspect, but its S, social, and G, governance, ratings are less favourable. Cobalt mining has become increasingly controversial from a social standpoint, with Tesla sourcing the element from the Democratic Republic of Congo which accounts for around 70% of the world's cobalt. Tesla is committed to a number of cobalt mining initiatives as well as conducting third-party auditing and verification of sourced cobalt. It is also working on reducing cobalt use in batteries and has an ultimate goal to eliminate the need for cobalt, but for now it represents risks from an ESG integration perspective.

Energy transition and energy security

Since COP26, there has been a seismic shock to energy markets due to the Russian invasion of Ukraine. Its impact on the energy transition is yet to be known, but there's a sense that while it is negative in the short run, longer-term it could be beneficial. In the near-term, power prices have surged due to higher gas prices, which in turn have caused a switching from gas to coal. This means meeting energy needs in the short-term will see higher carbon emissions, but this could be merely an interim solution. Ultimately, there is growing hope that it accelerates the energy transition. Energy security and the energy transition should not be seen as mutually exclusive, rather they can be viewed as two sides of the same coin. A coordinated effort on a policy standpoint is required along with significant funding but it is entirely possible that recent tragic events will provide a catalyst for this process.

Along with energy security, an additional method for incentivising the transition to a low carbon economy is the effective pricing of carbon. This would essentially see a bill for the environmental and social damage levied on those responsible for production, a bill which would be made smaller by producing less. Pricing carbon at a sufficiently high level would stimulate carbon innovation and new technologies. The implementation of this would create the possibility of carbon leakage, where high prices in areas leading the approach, such as the European Union, would see companies shift production to countries without the same constraints. The proposed solution to this is called the Carbon Border Adjustment Mechanism (CBAM), which would place the same carbon price on imports as those on goods produced in the EU. At COP26, the EU and US announced a deal to remove tariffs on steel and aluminium for two years but retained them on other countries that have failed to hit the standards for lower carbon production. Details on this are still scarce, but there is clearly a strong signalling effect, especially to China.

COP27

The next United Nations Climate Change Conference (COP27) is scheduled to take place in Egypt this coming November. More detailed and ambitious commitments are required to keep the 1.5 degree target alive and additional pressure on countries such as China, Brazil and India to step away from coal could go some way to achieving this.

To view our recent on-demand webinar on this topic click here.

WHAT DOES A GOOD CLIMATE TRANSITION PLAN LOOK LIKE?

Greg Kearney, Senior Responsible Investment Analyst

One of the notable achievements of the COP26 gathering in Glasgow last year was the agreement to strengthen the national emissions reductions targets for 2030, agreeing they would have to fall by 45%. A large part of the responsibility for these national commitments to limiting global temperature increases to 1.5 degrees by 2050 (also known as net zero[1]) falls on the shoulders of companies, and by extension active owners of these entities.

Climate change is one of Quilter Cheviot's stewardship priorities. We have engaged with some of the largest carbon emitters within portfolio holdings with the aim of better understanding corporate climate strategies, and where lacking, encouraging alignment with best practice. This is an ongoing dialogue that will require systematic monitoring to ensure companies walk the talk – but it is worth sharing some of our learnings so far and what, in our opinion, constitutes a good transition plan.

The good

Our engagements have spanned varied industry groups including industrial gases, cement manufacture and utilities, but unsurprisingly most conversations were held with oil & gas majors and diversified miners. Despite the breadth of business processes there is cross-industry progress and every company we engaged had a carbon reduction strategy, with the majority having some form of net zero aligned targets.

Oil & gas companies have been under intense pressure to reduce carbon emissions and change is taking place, particularly amongst European majors. Companies like BP, Total Energies and Shell have committed to ambitious scope 1 (emissions from direct activities) and scope 2 (emissions from electricity purchased and used) targets; with BP and Total committing material amounts of future capital expenditure to renewable revenue streams, proposing to transform into low carbon integrated energy companies in the long-term.

Diversified miners see greater opportunities in minerals that will contribute to the electrification of the economy and are moving away from thermal coal. Ambitious plans to electrify mining fleets are under way and for those involved in aluminium manufacture (a high emissions activity), like Rio Tinto, capital is being committed to early-stage electrified or hydrogen-power smelting processes. Green hydrogen manufacture and use is an increasing focus for industrial gas producers like Linde, but also US utilities companies such as NextEra Energy which is launching early-stage projects with the aim to replace natural gas power generation with green hydrogen as part of the goal to decarbonise the US grid by 2035.

Climate transition plans are company and sector specific, but it is encouraging to see carbon reduction timelines built into strategic planning and that preparations for a lower carbon economy are underway. External validation of these targets and strategies are very much on the agenda. Most companies are either participating or closely monitoring frameworks like the Science Based Targets initiative[2] as high emitting sectors move towards more comparable and verifiable disclosures and target setting.

The not so good

The pathway to net zero emissions requires a rapid and radical transformation of the economy. As

1 Net zero emissions are achieved when human-caused emissions of greenhouse gases to the atmosphere are balanced by removals over a specified period. Scenarios that limit global warming to 1.5°C with no or limited overshoot reach global net zero CO2 emissions around 2050 accompanied by rapid reductions in non-CO2 GHG emissions. (Source: IPCC)

2 [Ambitious corporate climate action - Science Based Targets]

defined by the 2015 Paris Climate Agreement, a net zero trajectory is also largely absent of the use of carbon offsets (such as tree-planting) and focuses on absolute emissions reductions (unlike carbon neutral strategies). A lot of companies have made high level commitments to achieving net zero by 2050, however, in many cases it is not obvious how this will be achieved, with strategies either relying on significant use of carbon offsets or technologies that are not yet scalable.

Action over the next ten years is critical to maintaining an emissions reduction trajectory to limit global temperature rises to 1.5 degrees. In some cases, we found targets were piecemeal or didn't align with a net zero trajectory. Linde proposes to be carbon neutral by 2050 and NextEra Energy has promised to cut absolute emissions by 40% by 2025 and become 'fossil fuel free' by 2035, but nothing beyond this. These carve outs can make comparisons difficult. Instead of an absolute emissions reductions target, some companies rely on carbon 'intensity' measures (i.e., carbon emissions per $ revenue). This is not best practice and can allow for energy companies to increase fossil fuel production as low carbon activities are introduced into activities, while claiming alignment with reduction targets.

Another complexity is scope 3 emissions (indirect emissions from supply chains and products sold). Among miners and energy companies, scope 3 emissions tend to make up over 90% of the overall emissions, but many of the more detailed net zero strategies only account for scope 1 or scope 2 emissions. Others, such as Rio Tinto, do not have net zero targets that include scope 3 emissions. While there are legitimate challenges in allocating responsibility for these emissions, the question of who owns them looms large; accountability of ownership and accurate measurement are essential prerequisites for the targeted reductions needed to achieve the goals set out in the Paris Climate Agreement.

Finally, there is an overreliance on carbon offsetting through nature-based solutions and carbon capture & storage (CCS) technology. Many of the companies we speak to laud CCS projects as one of the ways they are tackling climate change but, in most areas, the technology is not yet commercially viable and corporate strategies should not be reliant upon this making up a structural component of medium or later stage reduction efforts. Shell is an example of a company which has made a significant commitment to nature-based carbon offsetting solutions (such as afforestation), but again, a viable Paris-aligned transition plan should focus on absolute emissions reductions with minimal use of offsets to 'mop-up' harder to reduce residual emissions.

The US

During this initial stage of engagement, company responsiveness was high, and we were encouraged by the commitment to speak to shareholders. The notable exception was Chevron, who did not respond to requests for dialogue. US oil majors have not echoed the ever more ambitious commitments made by European peers. Exxon and Chevron both made high-level ambition statements to be net zero - by 2050, but how this will be achieved is unclear. Chevron has gone further in announcing a 2028 emissions intensity target, which is welcome progress, but is not comparable to the detail being provided by peers and not aligned with the Paris Climate Agreement.

Despite company specific progress in areas like utilities, conversations with US companies had less of a focus on net zero, clearly differing from European peers which currently face a higher level of government, investor and public scrutiny. With the US government recommitting to the Paris Agreement, we expect this to change and the level of US company engagement with external validation providers such as the Science Based Targets initiative to become a positive trend.

What does a good climate transition strategy look like?

Understanding the credibility of a climate strategy and measuring progress towards stated aims (as well as the Paris-aligned targets) will be an ongoing process. Moving forward we are looking for:

1. A focus on the next ten years with specific short and medium-term targets (2050 goals are welcome, but action over the next decade is critical).
2. A reduction in absolute emissions. This includes scope 3 metrics and is largely absent of carbon offsets. Carbon intensity measures can be supplemental but should not be the main target.
3. A target reduction aligned with 1.5 degrees warming limit pathway. This is the crux of a net zero commitment. Some companies have declared 2 degrees alignment or carbon neutrality, this is not the same thing.
4. Actions that demonstrate alignment of capital expenditure with transition targets – and consideration of Paris Climate goals into significant capital expenditure projects.
5. Limited use of carbon offsets. Residual emissions may be abated with offsets and carbon capture and storage, but use should be specific with clear end dates. This should not be a structural element of reduction targets. There isn't enough land to plant our way to net zero and a lot of the existing carbon capture technologies exist at a level that is not scalable.
6. The linking of executive remuneration to internal carbon reduction targets to help integrate transition planning into company strategy.
7. A reassessment of participation in industry associations that lobby governments to soften GHG (greenhouse gas) reduction legislation.
8. A willingness to take ownership of scope 3 emissions and building these into carbon reduction targets.

As an investor our role is to engage with these companies in order to encourage actions. A summary of the positions can be found below:

Company	Main metric	Absolute 2030 goal	2050 goal	Scope 3 included in targets
ENERGY				
Total Energies	Absolute emissions of products sold in Europe	Yes	Net zero (all emissions)	Yes (2030 target)
BP	Absolute emissions from oil & gas products	Yes	Net zero (all emissions)	Yes (2050 target)
Shell	Emissions intensity of all products	Yes	Net zero (all emissions)	Yes (2050 target)
Chevron	Oil & gas operational* emissions intensity	No	Net zero (scope 1 and scope 2)	No
DIVERSIFIED MINERS				
BHP	Absolute - operational* emissions (plus shipping)	Yes	Net zero (scope 1 and scope 2)	No
Rio Tinto	Absolute - operational* emissions	Yes	Net zero (scope 1 and scope 2)	No
UTILITIES				
National Grid	Absolute emissions (all activity)	Yes	Net zero (all emissions)	Yes (2030 target)
NextEra	Operational emissions intensity	Yes	Aim to be fossil fuel free by 2035	No – but not as relevant to sector
OTHER				
Linde	Absolute – operational emissions	Yes (2035 target)	Carbon neutral	No
CRH	Operational emissions from cementitious products	Yes	Net zero (scope 1 and scope 2 for cementitious products)	No

*Operational - scope 1 and scope 2 emissions.
Source: Quilter Cheviot

GLOSSARY

Active Ownership: Where shareholders use voting and engagement to influence the management of companies with respect to environmental, social or governance factors. Similar principles are also used by investors in other assets classes such as fixed income, private equity, or real estate.

Clawback (and malus): Incentive plans should include provisions that allow the company, in specified circumstances, to ensure that a recipient:

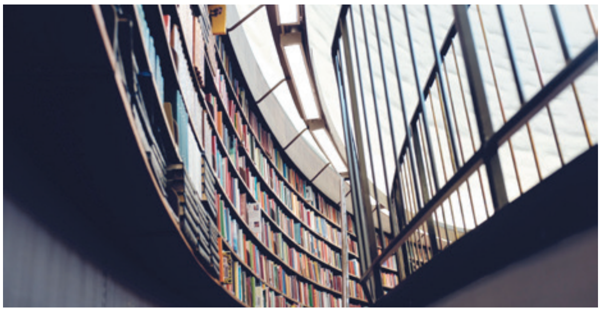
- forfeits all or part of a bonus or long-term incentive award before it has vested and been paid – this is called 'malus' and/or
- pays back sums already paid – this is called 'clawback'.

Disapplication of pre-emption rights: Existing shareholders do not have first refusal on new shares and therefore their holdings will be diluted.

Engagement: Shareholders enter into purposeful dialog with the management or Board of a company with the intention of influencing corporate behaviour. The issues covered can be wide ranging, from corporate strategy, capital discipline, but also environmental, social, or corporate governance matters. Engagement is tool used in active ownership and can be conducted by one investor or a group of investors.

Environmental Factors: Issues related to the environment such as resource, water and land use, biodiversity, pollution, atmospheric emissions, climate change, waste. This is the 'E' in ESG.

Governance Factors: Issues relating to the governance of an organisation, also referred to as corporate governance, examples include board composition, executive remuneration, internal controls, balancing the interests of all stakeholders. This is the G in ESG.



Long-term incentive plan (LTIP): A type of executive compensation that pays out usually in the form of shares company. The reward is linked to performance metrics and the pay-out will be calibrated in line with the achievement of these. The quantum of the pay-out is linked to multiples of salary.

Net Zero: A term that describes an activity, process or organisation which creates no net emissions of carbon dioxide. This can be achieved through use of renewable energy, process changes or offsetting carbon – or a combination of all these. Also referred to as carbon neutral.

NEDs (Non-Executive Directors): These are directors who act in advisory capacity only, however they should hold the executive directors to account. They are not employees of the company, however they are paid a fee for their services.

Over-boarded: Where non-executive directors are deemed to have a potentially excessive number of non-executive positions and the concern is whether they have sufficient time to contribute to the board of the company.

Pre-emption right: These give shareholders first refusal when a company is issuing shares. Premium listing: This was previously known as a primary listing for the London Stock Exchange. A company with a premium listing is expected to meet the UK's highest standards of regulation and corporate governance.

Principles of Responsible Investment (PRI): The world's leading voluntary initiative on responsible investment. Launched in 2006 it now has thousands of investor signatories globally who commit to adopt six principles for responsible investment and report against these annually. Although voluntary and investor-led the PRI is supported by the United Nations.

Proxy Voting: Where a shareholder delegates their voting rights to be exercised on their behalf. Often voting rights are delegated to investment managers who exercise votes on investors' behalf. Votes are used to express shareholder opinions to company management.

Responsible Investment: Responsible investment is a strategy or practice that incorporates environmental, social and governance (ESG) factors into investment decisions and ownership activity.

Restricted share plan: Some companies (and indeed investors) prefer the use of these plans as opposed to LTIPs (see above). The idea is that this type of plan encourages long-term behaviours and does not have the same use of targets that you would see within an LTIP. Therefore, it is expected that companies which adopt such an approach award a lower amount than would be seen under an LTIP which has a variable structure dependent on performance outcomes.

SID (Senior Independent Director): The SID position is taken by an independent NED. The SID often plays a critical role in ensuring communication channels are open between the board and shareholders.

Social Factors: Issues relating to the relationship between companies and people, such as their employees, suppliers, customers or communities. Examples of social issues of interest to investors include health and safety, labour standards, supply chain management and consumer protection. This is the S in ESG.

Stewardship: Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society. When investing in equities it involves proxy voting and active shareholder engagement with company management.

TCFD: Acronym that stands for the Task Force on Climate-related Financial Disclosures. The Financial Stability Board created the TCFD to improve and increase reporting of climate-related financial information. Regulators are adopting TCFD and, in particular, the UK regulator (FCA) is requiring firms to apply these disclosure rules.

Tender – bid waiver: This is the right to waive the requirement to make a general offer under Rule 9 of the Takeover Code.

Total shareholder return (TSR): Is a measure of the performance of a company's shares; it combines share price appreciation and dividends paid to show the total return to the shareholder expressed as an annualised percentage.

UN Sustainable Development Goals: The SDGs, or the Global Goals, were adopted by all United Nations Member States in 2015 as a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030. There are 17 goals reflecting the most significant challenges facing the world.

Voting Rights: When an investor buys a share in a listed company, that typically comes with specific voting rights which can be exercised at the company's annual general meeting or extraordinary meetings as a means of expressing the opinion of the shareholder about how the company is being managed. Typical issues upon which votes are cast include executive pay, board appointments, mergers or acquisitions, or sale of parts of the business and company annual report and accounts. Also referred to a proxy voting when voting rights are delegated.

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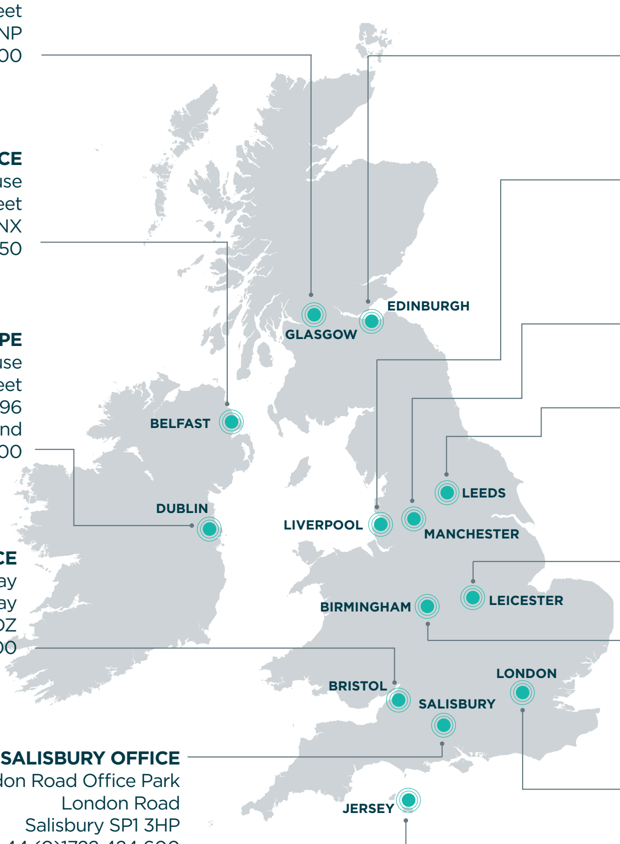

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