SARASIN
& PARTNERS

POLICY OUTREACH AND COMPANY ENGAGEMENT REPORT

Q2 2024

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INTRODUCTION

Investors in companies have an important shared responsibility in holding the board to account for the management of the business.

On behalf of our clients we are active in voting on matters put to shareholders, and we closely monitor investee companies and engage on issues of concern relating to corporate governance, capital structure and strategy. We do this because we believe that poor governance can adversely affect the returns for investors and, equally, good stewardship can lead to better returns over the long term.

As long-term investors, we also take an interest in the broader market environment in which companies operate. Where we perceive problems, and believe we can catalyse positive change, we will reach out to policy-makers and other key market participants to promote reform. Our objective is to shape the regulatory and market environment to support more sustainable economic growth.

Given the emphasis we place on responsible and active ownership, we aim to communicate openly with our clients and other interested parties about our activities. This report offers a window into our recent company engagement, policy outreach and voting activities.

POLICY AND COMPANY ENGAGEMENT

Market Outreach: Pressing for high-quality accounting and audit

Auditors should provide a robust and independent check on companies' accounts, such that investors can trust the numbers, allocate capital efficiently and ensure remuneration is paid to executives for genuine performance. Efficient and stable markets depend on audits working well.

However, these aspirations are not being met in practice. The Audit Reform Lab's latest report find that of the 250 UK companies that went bust between 2010 and 2022, three in four audit reports failed to raise the alarm[1]. The International Forum for Independent Audit Regulators similarly found that across 51 jurisdictions it surveyed in the year to 30 June 2023, nearly a third of listed company audits had at least one 'inspection finding', or audit quality deficiency[2].

Despite the poor performance, shareholders are doing little to hold auditors to account. According to data from Diligent Market Intelligence for 2023, in the UK auditors were reappointed with an average 99% support. In the US, the figure was 98%.

Therefore, we have continued to press for a stronger regulatory environment governing accounting and audit, as well as fulfilling our own role in holding auditors at our clients' companies to account.

This quarter we wanted to share with you four developments.

US Trip to meet standard setters

We travelled to Washington DC and New York where we:

- Met with the head of Corporation Finance and Chief Accountant at the Securities and Exchange Commission (SEC, responsible for oversight of company reporting);
- Met with a board member at the federal audit regulator (PCAOB); and
- Participated in the inaugural meeting of the audit standard setter's (IAASB's) Stakeholder Advisory Council.

While the nature of discussions varied, the overall focus of our contribution was to provide a responsible long-term investor perspective. Our key messages are:

- To seek enhanced disclosures on critical accounting assumptions and estimates;
- To reinforce the materiality of climate-related disclosures in company accounts and support for the SEC's rule on climate disclosures;
- To promote auditor independence and professional scepticism;
- To call for greater auditor disclosure to shareholders on accounting risks; and
- To call for increased focus on inadequate shareholder scrutiny of auditor performance.

Meeting with CEO of the Financial Reporting Council

Following our trip to the US, we met with the head of the UK's Financial Reporting Council (FRC). We expressed our ongoing support for the FRC's efforts to ensure companies include disclosures on climate factors in their financial statements, and for auditors to scrutinise these. The progress made in the UK offers an example for others to follow.

Call with International Accounting Standards Board

We continued our outreach to the International Accounting Standards Board (IASB). We expressed our support for their ongoing project to provide companies with clearer guidance on where climate factors should be incorporated into the determination of forward-looking assumptions (e.g. relating to impairment testing or decommissioning liabilities) and disclosures[3]. A key area of focus was to highlight our ongoing concerns that banks are failing to properly consider or disclose climate risks building in their loan and trading books.

Opinion piece published in Reuters

Finally, we continue to put the spotlight on the failure of the investment community to play their role in holding auditors to account through an article we published in Reuters.

[1] Reward for failure: The paradox of audit partners' record payouts amidst poor audit quality, May 2024

[2] Survey of Inspection Findings, March 2024

[3] Climate-related and Other Uncertainties in the Financial Statements, April 2024

POLICY AND COMPANY ENGAGEMENT– CONTINUED

Market outreach: Why Exxon's legal action threatens shareholder rights

Sarasin signed a public statement alongside 38 other institutional investors representing $5.2 trillion, after Exxon Mobil decided to take legal action against two shareholders. The shareholders, Arjuna and Follow This, had filed a resolution at Exxon's AGM asking it to accelerate efforts to align with global efforts to combat climate change[4].

We believe Exxon's action has the potential to weaken shareholder rights in the US as set out in our blog post.

Since publishing our statement, Exxon's case was dismissed by the court on the grounds that the resolution had been withdrawn and the filer committed not to file future climate-related resolutions, and thus there was no case to answer[5].

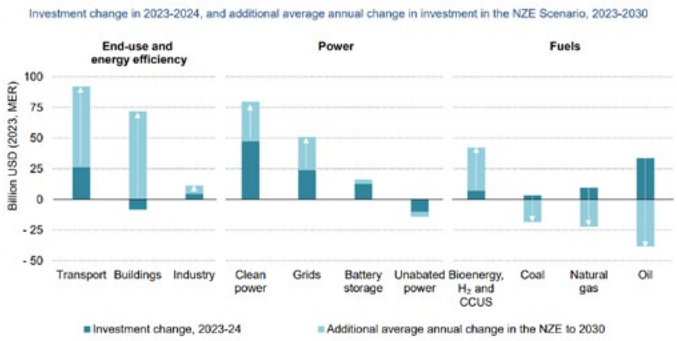
Market news: IEA warns (again) over fossil fuel tipping point

The International Energy Agency's (IEA's) latest World Energy Investment report[6] underlines the ongoing energy transition away from fossil fuels and accelerating rollout of renewables, despite numerous challenges in the past year:

> "Despite pressures on financing, global investment in clean energy is set to reach almost double the amount going to fossil fuels in 2024, helped by improving supply chains and lower costs for clean technologies… Total energy investment worldwide is expected to exceed $3 trillion in 2024 for the first time, with some $2 trillion set to go toward clean technologies."

This incredible transformation of global economies continues apace, even as oil and gas companies double down on investment in fossil fuels. As highlighted in the chart below, if governments continue to tighten climate regulations and clean tech continues to get cheaper and more accessible, the capital at risk in higher-carbon activities is likely to grow.

A secure and affordable transitioning away from fossil fuels requires a major rebalancing of investments



Note: CCUS = carbon capture, utilisation and storage. Low-emissions generation includes modern bioenergy, low-emissions hydrogen, hydrogen-based fuels and CCUS associated with fossil fuels.
NZE = Net Zero Emissions by 2050 Scenario.

Source: IEA, World Energy Investment, June 2024

What the IEA is highlighting at a global level is playing out in the UK. Renewables use broke records this Spring, reaching 88% of total power consumption on 15 April, with fossil fuels falling to a record low of 2.4%. This is an incredible milestone, which demonstrates the opportunity for a clean and prosperous transition.

For an inspirational account of these opportunities, this interview with Greg Jackson, CEO of Octopus Energy, is worth listening to.

[4] Investor statement on shareholder rights, May 2024
[5] US judge dismisses Exxon case against activist investor over proxy filing, June 2024
[6] World Energy Investment Report, IEA, June 2024

POLICY AND COMPANY ENGAGEMENT– CONTINUED

Company engagement: HSBC

Building on our outreach to banking regulators outlined last quarter, we continued our engagement with HSBC's chief accountant this quarter. This discussion followed a call with HSBC's audit committee chair in March seeking greater disclosure on HSBC's exposures to material climate risks and how these are being managed.

We remain concerned that HSBC believes the climate risks are not material to its financial position in the short to medium term, at a time when the physical risks from climate change are becoming more evident, and the economic disruption from decarbonisation accelerates (see above on the IEA's latest assessment).

The Prudential Regulation Authority's guidance for banks in October 2022 is clear they are concerned[7]:

> "[t]he PRA considers that timely incorporation of climate risk in accounting valuations is important in ensuring the safety and soundness of PRA-authorised firms."

None of HSBC's four macro-economic scenarios underpinning their expected credit loss assumptions in their accounting considers climate. None of their industry level modelling of default risks appear to consider climate. The fear is continued reliance on backward-looking models, will leave HSBC (like other banks) exposed to the climate transition. We will be seeking a discussion with HSBC's new audit committee chair, Brendan Nelson, in coming weeks.

Company engagement: Equinor

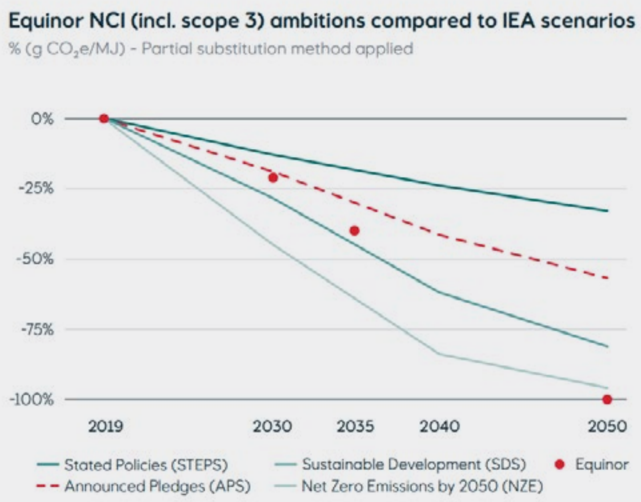
As the dust settles following Equinor's AGM in May, we are pleased to report that our shareholder resolution received over 30% of the non-state affiliated shareholder support.

As explained last quarter, our resolution, co-filed alongside three other investors, asked Equinor to align its strategy and capital expenditure with its commitment to support the Paris Climate Agreement. Not only did Equinor's board recommend a vote against our resolution but the Norwegian state also voted against it.

We published a response following the AGM, underlining the apparent disconnect between Norway's commitment to the Paris Agreement and its support for Equinor to pursue a strategy that is hard to reconcile with a 1.5°C, or even well below 2°C, temperature goal (see chart below). We were pleased to see this question put to the Minister responsible in Norway's Parliament in the days following the AGM. However, the response failed to clear up the inconsistency.

Equinor's Transition Plan lies above 1.5°C pathway

Equinor's latest production plans will shift its pathway further away from 1.5°C



> **Equinor is commited to long-term value creation in support of the goals of the Paris Agreement.**
>
> Equinor, Integrated Annual Report 2022

> **Equinor's energy transition plan demonstrates a business model and strategy that are compatible with … limiting of global warming to 1.5°C, in line with the Paris Agreement**
>
> Equinor response to Sarasin's shareholder resolution

POLICY AND COMPANY ENGAGEMENT– CONTINUED

Looking forward, we would like to see Norway's Financial Service Authority look into the validity of Equinor's claim of Paris alignment.

Equinor is committed to reviewing its Transition Plan in 2024, to put to a shareholder vote in 2025. We will continue to press them to take this opportunity to increase their ambition. As we have said many times before, if Norway can't deliver Paris alignment, who will?

Company engagement: ING Group

In parallel with our outreach to banking regulators outlined last quarter, we continued our engagement with Dutch financial services group ING in April. We held two calls with the executive team seeking greater disclosure on ING's exposures to material climate risks and how these are being managed. This engagement is being undertaken in collaboration with other investor members of the Net Zero Banking initiative.

A key focus of discussion was on the anticipated Friends of the Earth lawsuit, which alleges that ING is failing in its duty of care to society by continuing to finance fossil fuel activities that are not consistent with the Paris Agreement goals. This case follows a similar logic to that brought against Shell in the Netherlands, which Friends of the Earth won in 2021 but is being appealed.

ING views the Friends of the Earth demands as overly rigid, particularly the delivery of an absolute reduction in financed emissions by just under 50% by 2030. ING believes their transition plan and commitments are aligned with the Paris goals and argue that to stop financing fossil fuels will have perverse impacts.

While we have concerns with overly rigid demands for absolute reductions crowding out efforts by responsible banks to drive decarbonisation, we have made clear to ING that we need greater clarity over how their financing of high-carbon activities is conditional on a credible 1.5°C transition plan. We will also continue to press for more detail on how they are reflecting rising risks of lending to carbon-intensive sectors in their credit risk modelling and accounting frameworks, and thus reinforcing capital adequacy.

Climate active panel news

In Q1, Claire Perry O'Neill stood down from Sarasin's Climate Active Panel. Claire is a non-executive director on Occidental's board, which is a large US oil and gas company that Sarasin has recently taken a position in. We very much valued Claire's contributions over the past year, and look forward to future interactions.

We are in discussions with a new potential member of our Panel, which we hope to finalise shortly. Current members of our panel can be viewed here.

Company engagement: Amazon.com Inc.

As a follow-up to our previous engagement with Amazon's ESG investor relations team, we visited their fulfilment centre servicing the London area, their largest site in Europe.

Our purpose was to check on what Amazon's team had told us about working conditions, safety performance and employee engagement. The reality has supported what we have heard.

Working conditions

1. Employees work in 10-hour shifts (day or night), 3 times a week, with two 30-minutes breaks during the shift, and a mandatory 30-seconds stretch exercise every hour.
2. The working floors and public spaces are clean and relatively quiet. We did not see any signs of pressure put on the employees, but performance is clearly measured.
3. The level of robotisation is remarkable: moving storages and labelling arms, agile computerised controls suggest that manual labour is minimised and optimised in every possible way.
4. Safety instructions are everywhere, and you can see various precautionary measures and tools.
5. Any job with one-sidedness would assume rotation to another side at the middle of the shift. People also rotate from one line to another.
6. There are various professional trainings, and cross-trainings are now mandatory for everyone. Career progression includes various roles such as quality controls, puzzle solving and even drone operation. For example, all the people on the touring team were ex-floor workers of the recent 10 years.

POLICY AND COMPANY ENGAGEMENT– CONTINUED

Employee communication

7. There are various means of communication with workers. Especially impressive is the Voice of Associate (VoA) – an electronic board in the entrance hall, where every worker can post a message – praising, criticising or asking a question. The manager has to acknowledge receipt within 24 hours and respond within 48 hours.
8. Every morning, each worker receives a question on their monitor asking about their opinion on various aspects of the work environment.
9. The HR department is located on the way to the floor in a glass cubicle, to encourage easy communication.
10. 10. We spoke with the general manager of this fulfilment centre. His incentives include results of employee surveys; he was proud that his centre is one of the top five in the UK by the level of employee satisfaction.

This largely contradicts the negative sentiment about poor working conditions and obstacles set to freedom of association at Amazon. It seems like this sentiment is largely instigated by the media and unions. The company tells us that they do not prevent unionisation, but the levels of support shown at voting for unions at specific sites has traditionally been not very high.

In the UK, Amazon keeps raising its minimum hour rates above the National Living Wage. We also heard that they design flexible working hours offered for people with specific needs, for example, working mothers.

In addition to labour relations, we also had a chance to see signs of good environmental footprint management: the packaging is paper and carboard only, and measurements of materials are automated; computerised logistics minimises shipping times and lengths.

We marked this engagement as a Milestone on our work practices goal.

Company engagement: Alphabet

We initiated collaborative engagement with Alphabet as part of the Collective Impact Coalition on on Ethical AI of the World Benchmarking Alliance.

Alphabet is one of the leaders in fostering responsible AI. In our letter we praised them for this highlighting the following aspects:

POLICY AND COMPANY ENGAGEMENT– CONTINUED

- Google was among the first companies to publish AI Principles and a white paper on AI governance in January 2019 to outline a plan of work.
- Google has an explicit public commitment to human rights linked to UN Guiding Principles on Business and Human Rights and other international frameworks
- In June 2023, Google released its Secure AI Framework (SAIF), a conceptual framework to help collaboratively secure AI technology.
- Google became a signatory to the Commitment that seven leading generative AI developing companies made in the White House in July 2023 to eight courses of action aimed at increasing safety and security of AI systems.

Google published an update on their approach to safety and responsibility in October 2023, before the AI Safety Summit in the UK, which was the basis of the CFI assessment of six leading AI companies on a rigorous set of AI safety criteria.

We are also pleased with Alphabet's various efforts to implement its responsible AI policies, including the publication of governance and operational reviews and regular reports on AI risk management. Importantly, Google has been the only one of the big tech companies to offer the UK's AI Safety Institute early access to their frontier models.

In our letter, we asked about the company's evolving approaches to responsible AI policies and Implementation tools, particularly how their responsible AI policies and practices are going to evolve given the expanding range of products and services, as well as the challenges these face.

We also asked for clarification following media reports of reduced resourcing for their ethical, responsible and/or safety teams. Most importantly, we want to know about the involvement of Alphabet's board in the oversight of ethical AI.

We asked to speak with the board or a senior person with internal responsibility for AI Safety / Ethics, but this has been declined. Instead they have shared updated public resources with new details, for example, on specific tools used such as red-teaming, harm assessment frameworks, efforts to reduce bias. We still have some questions on how they are actually enforcing these principles, which we will be following up with.

Company engagement: Service Corp International

We engaged with the CFO and IR of Service Corp before their AGM to raise concerns related to their governance. This included:

- The combined chair-CEO roles, though with a lead independent director;
- Long-tenured and therefore non-independent directors serving on key committees, collectively making up the majority of the board;
- The auditor's tenure being too long (PwC has been their auditor since 1992); and
- The long-term incentive plan (LTIP) allowing performance shares (which represent a low proportion at 28%) to vest at the level when the relative total shareholder returns at as low as the 25th percentile of the S&P MidCap 400 Index.

They expressed understanding on the need for board refreshment, and the nomination committee is already searching for replacements. We have marked this as a Milestone. They also took on board our views about reviewing the remuneration structure.

However, we received pushback regarding auditors, with the CFO suggesting different auditors may not share their accounting approaches. If part of the cash flow is reclassified from operating to investing, it would have a significant impact on the company valuation.

In a follow-up call the CFO explained the challenge further. The issue is raised every five years as PwC rotates its audit partners and has been challenged by the SEC as well, though, following explanations of their business model and industry size, their current practice has been settled upon.

We decided that such risk could mean potential financial damage. We subsequently decided to downgrade the reporting and controls score in our Sustainability Investment Matrix from amber to red, and change the investment rating to 3 (Hold). We reduced some of our portfolio positions in Service Corp.

POLICY AND COMPANY ENGAGEMENT– CONTINUED

Company engagement: US Solar Fund

This quarter, we had particularly intensive engagements with the US Solar Fund (USF). This followed the previous period of engagement with the USF board, where our main aim was to ensure that the board acts in the interests of shareholders.

The board's strategic review in late 2022 aimed to sell the assets and return the money to shareholders, but was unsuccessful, resulting in the appointment of a new investment manager. We highlighted this backdrop in our 2024 vote declaration.

Over the past year we have had little interaction with the board, and we were frustrated by the lack of attention to investor feedback – something that we had articulated to them before. To escalate this, we decided to vote against chair Gill Nott and for discontinuation of the company.

Like last year, the board communicated (orally) to us that they would step down if shareholders vote down the chair. We believe this to be an inappropriate act of pressure on shareholders to prevent them from exercising their rights.

We attended the 2024 AGM to express our concerns, supported by other USF shareholders. The votes against the chair and for the discontinuation still failed to achieve a majority.

As one of the directors has stepped down at this AGM, the board initiated an investor consultation on replacement. We see a need for extended expertise in solar assets, particularly relating to their value realisation. We drafted and sent a collective letter to the board from a group of five investors holding 34.5% of USF stock. We suggested a specific consensus investor candidate for this role who would be independent from any of the shareholders.

We met with two of the directors, who seemed to agree on the relevance of this candidate's skills. We also received their consent to proper investor communication on the tasks and milestones. We have decided on the regime of quarterly meetings going forward.

Further details are available upon request.

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