



北京绿色金融与可持续发展研究院
INSTITUTE OF FINANCE AND SUSTAINABILITY



CATALYSING CLIMATE ACTIONS: INSTITUTIONAL INVESTORS ENGAGING IN CORPORATES' LOW-CARBON TRANSITION

加速气候行动：机构投资者参与支持企业低碳转型

A Report for the UK-China Green Finance Centre

中英绿色金融中心报告

March 2023

2023年3月

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FOREWORD

前言

随着全球气候危机日益紧迫，推动实体经济尽快实现低碳发展与净零转型已经成为了全球趋势。在共同实现全球气候目标的远景下，全球的金融机构与金融领域的从业者应该在支持实体经济低碳转型与可持续发展过程中发挥自身关键影响力。机构投资者也可以充分发挥自身积极作用，比如利用好尽责管理这一有力策略，主动与投资组合内的被投资企业展开对话，参与督促并支持高碳企业低碳转型，从而加速实体经济气候行动。

为探索资产所有者与资产管理者利用自身影响力，督促并支持被投资企业低碳转型的关键作用，尤其是在加速中国实体经济低碳发展、应对气候变化行动中做出的贡献，2022 年中英 ESG 领袖论坛聚焦机构投资者参与支持企业低碳转型这一专题展开深入研究与互动讨论。项目研究课题组通过与多位中外专家的深度访谈，总结了机构投资者参与被投资企业低碳转型的理念、内涵与践行价值，梳理了机构投资者在这一领域的优秀实践经验，供读者学习借鉴。此外，项目研究课题组也通过分析中国在该领域的政策框架、市场情况以及机构投资者所面临的挑战和机遇，尝试提出相关建议与实施路径，协助他们更加高效地与相关企业展开以引导和支持企业实现低碳转型为核心的对话，共同创造更多的可持续效益与长期价值。

展望未来，机构投资者作为可持续投资的实践者与资本市场的中坚力量，其长期坚守的可持续投资信念与主动发起的参与行动必将撬动金融服务业发挥更大势能，支持实体经济加速低碳转型与气候行动。

道阻且长，行则将至。我们将持续为机构投资者领袖提供交流与创新的平台，携手推进全球经济的可持续和永续发展。



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As the global climate crisis aggravates, the low-carbon and net-zero transition has prevailed in the world's real economy. In the common cause toward global climate goals, financial institutions and professionals around the world should play a key role in supporting the real economy's low-carbon transition and sustainable development. Institutional investors can also play a part. They can catalyse climate action in the real economy by leveraging the stewardship strategy, conversing with portfolio investees, and overseeing and supporting high-emitters' low-carbon transition.

In 2022, the ESG Leaders Forum intensively researched and discussed around institutional investors' engagement in corporates' low-carbon transition. The research and discussion aimed to explore asset owners' and asset managers' vital role in supervising and supporting investees' low-carbon transition, especially in promoting low-carbon development for China's real economy and catalysing the country's climate action. The project team conducted in-depth interviews with a number of Chinese and international experts. From their opinions, the team extracted the concept, definition, and real values of institutional investors engaging in investees' low-carbon transition, as well as institutional investors' best practices. In addition, the team examined China's policy framework, market, and the challenges and opportunities that institutional investors face in this area. Based on the analysis results, it provided suggestions and implementation paths to facilitate dialogue between institutional investors and their investees and support their efforts in achieving

low-carbon transition and creating benefits and value for the long term.

Institutional investors are important practitioners of sustainable investment and the backbone of the capital market. With a long-term commitment to sustainable investment with proactive engagements, they will unleash more potential from the financial services sector and catalyse the real economy's low-carbon transition and climate action in the future.

As long and difficult as the journey may be, consistent action will get us there. We will continue to provide institutional investors with the platform for exchanges and financial innovation. Hand in hand, we will help the global economy grow sustainably.

EXECUTIVE SUMMARY

To effectively mitigate the numerous risks posed by the world's growing climate-related challenges, high-emitting companies in the real economy need to adopt more proactive measures to cut emission on top of their existing efforts to ensure the attainment of global climate goals. As the provider of corporate capitals, institutional investors are uniquely positioned to shape and transform corporate behaviours. They possess the strength and will to drive further emissions reduction efforts of high-emitting companies in their portfolios, thereby catalysing the real economy's actions to climate change and contributing to the attainment of global climate goals. This process is defined in this report as institutional investors engaging in corporates' low-carbon transition, which represents the approach for institutional investors to fulfil their fiduciary duty and safeguard the long-term value of clients' assets.

With the strengthening global responses and actions to combat climate change in recent years, institutional investors have grown more concerned than ever about the climate- and environment-related risks of their portfolio companies. They place a higher value on the environmental and social benefits and the long-term value created by their investment preferences and behaviours. In this regard, institutional investors have widely adopted and promoted stewardship and investor engagement strategies that focus on urging and supporting portfolio companies to address climate-related risks and achieve a low-carbon transition. An increasing number of successful case studies have emerged in both the international and Chinese markets. The extensive experience and the momentum of these practitioners are worth exploring and learning from in depth.

This report analyses the global trend of institutional investors engaging in corporates' low-carbon transition and summarises best practices that may give reference to other institutional investors. The analysis is based on interviews with several leading Chinese and international institutional investor representatives in

sustainable investment and climate action, as well as a review of successful examples of engagement practice worldwide. Additionally, the report discusses China's development base and status in this area, as well as the opportunities and challenges that institutional investors face in the Chinese market. The emerging stewardship and related concepts in China have enormous prospects and potential to be tapped and explored by institutional investors. Institutional investors with an eye on the Chinese market should leverage their zeal and stewardship potential and introduce more effective engagement strategies there. The first section of this report provides a thorough analysis and assessment of the content above.

Based on this, the second part of this report offers recommendations and implementation approaches to help those China-focused institutional investors make better use of investor engagement as a powerful tool to promote low-carbon development and net-zero transition for corporates in China, as well as to support China's goals of carbon peaking and carbon neutrality. Specifically, through **intensive external engagement** and **internal foundation enhancement**, institutional investors should play an active role in catalysing China's real economy's low-carbon development and actions to combat climate change. They should focus on developing and enhancing two core strengths: the strength to engage in low-carbon transition and the fundamental strength of stewardship.

In terms of developing and strengthening the capability of engaging in low-carbon transition, this report summarises the process and key tasks of institutional investors involved in engaging to promote low-carbon transition of corporates in China. It highlights the critical aspects of institutional investors engaging in key corporates' low-carbon transitions in related industries and serves as a reference for institutional investors to engage more intensively and efficiently in promoting low-carbon transition in China. **In terms of nurturing and enhancing the**

fundamental strength of stewardship, this report recommends that institutional investors evaluate their maturity in terms of establishing a robust stewardship system, developing proactive stewardship awareness, and strengthening their sustainability influence. They should assess their fundamental stewardship capabilities to engage in low-carbon transition intensively and efficiently. To that end, this report makes the following four recommendations to institutional investors:

Recommendation 1. Develop a stewardship governance structure and clarify related internal policies to ensure internal information sharing and enhance external information disclosure. Regarding the governance structure, institutional investors should develop an effective internal stewardship governance structure, with well-defined stewardship responsibilities and functions from the top to the bottom for conducting stewardship activities. Regarding the internal policies, stewardship policies on investor engagement and voting should be developed to standardise internal stewardship governance and its relevant decision-making processes, while identifying and managing potential conflict of interests. Regarding information disclosure, the precondition is to ensure internal data sharing. The progress of stewardship practices should be disclosed to the public regularly and proactively according to applicable policies issued by domestic regulators, relevant government departments, and associations, with reference to international stewardship reporting and disclosure standards.

Recommendation 2. Enhance the capability of ESG investment research, climate-related risk management, and stewardship, and create a tripartite support and synergy mechanism of 'ESG investment research + fundamental investment research + low-carbon transition stewardship'. The first step is to continually improve ESG investment research capabilities while also improving climate-related risk management capabilities. The second

step is to allocate resources to stewardship, create a professional stewardship workforce, and develop overall professional stewardship capabilities. The third step is to integrate ESG investment research, fundamental investment research, and stewardship while constantly strengthening and improving expertise in these areas.

Recommendation 3. Adopt a stewardship approach that combines engagement and voting. Incorporate into voting guidelines the corporate practices in responding to climate change. Speed up corporates low-carbon transition' by actively exercising voting rights. In addition to engaging in intensive dialogue with portfolio companies on core issues such as climate change and low-carbon transition, institutional investors should take the initiative to improve their voting policy and guidelines to include the consideration of portfolio companies' practices in climate actions and low-carbon transition. Institutional investors should integrate internal and external opinions for key motions on corporate responses to climate change and low-carbon transition at general meetings of shareholders. They should conduct a comprehensive study before finalising a voting decision, and actively participate in and vote at the general meeting of shareholders.

Recommendation 4. Strengthen external exchanges and collaboration and launch collaborative engagements to progress corporate transition and industry changes concertedly. First, Chinese and international institutional investors should leverage their respective strengths, learn from each other, and engage in 'many-on-one' dialogue with selected key corporates to accelerate their decarbonisation efforts. Second, institutional investors can join and support international and local investor initiatives, platforms, or alliances focusing on climate change and low-carbon transition, and participate in more organised and extensive collaborative engagements activities.

01

Part

INSTITUTIONAL INVESTORS ENGAGING IN CORPORATES' LOW-CARBON TRANSITION: CONNOTATION AND SIGNIFICANCE

1.1

Institutional Investors Engaging in Corporates' Low-carbon Transition: Connotation and Significance

1.2

Global Trends and Best Practices

1.3

China's Policy Framework and Market Status



1.1 INSTITUTIONAL INVESTORS ENGAGING IN CORPORATES' LOW-CARBON TRANSITION: CONNOTATION AND SIGNIFICANCE

1.1.1 Role and Duty of Institutional Investors

Institutional investors encompass asset owners (for example, sovereign funds, pension funds, and insurance funds) and asset managers (for example, insurance management corporates, public funds, and private equity funds). They are important players in the global economy. In recent years, institutional investors have made marked progress, with an increasingly large asset base and an ever-growing share in international markets. The global capital market has its structure continuously improved and its functions fully performed. In this process, institutional investors have become the dominant force in the capital market and played a vital role in driving the sustained growth of the global economy.

As the global climate crisis aggravate and pose serious threats to the earth's ecological stability and human sustainability, the extensive economic growth mode is difficult to sustain. With the Paris Agreement signed in 2015, it has become a common goal for mankind to mitigate and respond to climate change, to hold global average temperature increase to well below 2°C above pre-industrial levels, and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels. It has raised the bar for corporates to intensify their responses to major climate- and environment-related risks. It has also explicitly signalled the financial sector to increase their support for the real economy's low-carbon transition and sustainable development.

Institutional investors, as providers of corporate capital, are in a unique position to shape and change corporate behaviour. Their investment preferences and behaviour are highly influential in driving the green and low-carbon development of the real economy. On the other hand, institutional investors have an obligation to protect the long-term value of their trustees' assets, especially to fulfil their fiduciary duties centred on environmental, social and corporate governance (ESG) issues. Against the global trend to respond to climate change, these important roles of institutional investors have been highlighted. As a result of the responsibilities

and obligations they have been given, they have focused on the environmental and social benefits and long-term value created by their investment preferences and behaviour, as well as the climate- and environment-related risks and sustainability performance of their investees.

Many institutional investors are investing and mobilising more social capital in green and low-carbon industries. They are expanding their investment footprint in line with global net-zero goals to meet their commitments to responding to climate change. However, some institutional investors may shift their portfolio only by capital reallocation or adopting a voting-with-their-feet¹ approach while ignoring the low-carbon transition potential and process of corporates from in high-emitting industries. Such a shift will not drive transition among these high-emitting corporates and may even lead to a breakdown in financing for them, causing bigger social problems. For institutional investors ambitious to promote the net-zero transition of the real economy and mitigate climate-related risks, it would be more helpful to urge and promote the low-carbon transition of investees and their stakeholders.

Corporate engagement is an important approach for institutional investors to engage in transition finance from the investment side and influence changes in the real economy. It is at the core of investor engagement and one of the key approaches of stewardship. Compared with minority shareholders, institutional investors are well-informed and professionally experienced. They can use their natural advantages to send strong signals directly to corporates, demanding and expecting them to take action. Corporate engagement strengthens the bond between institutional investors and corporates and allows them to understand each other, grow together, and establish long-term relationships. Successful corporate engagement will lead to a fundamental transition of the business. When a corporate engages in addressing industry-level risks and takes an industry leadership

role, corporate engagement will drive important incremental changes in the economy as a whole². To conclude, corporate engagement plays a critical role

in driving changes at the corporate level, the industry level, or a more macro level.



Concepts of Stewardship, Investor Engagement, and Corporate Engagement and the Relations Between Them

Although the world has not reached an agreement on the definitions of stewardship, investor engagement, and corporate engagement, based on the core principles³ common to the existing definitions of these concepts, they can be defined as follows:

STEWARDSHIP

It is also known as active ownership. It refers to investors using their influence to fulfil their fiduciary duties (especially the duties of loyalty and prudence to protect the long-term value of the fiduciary's assets). They actively maximise the overall long-term value of existing or potential investees, delivering sustainable benefits to the economy, the environment, and society.

Investors approach stewardship primarily by broader dialogue (investor engagement), exercising voting rights, filing shareholder resolutions, joining the board of directors or serving at the board committees of investees, and etc. Among them, investor engagement and voting are the most widely used.

INVESTOR ENGAGEMENT

It refers to proactive communication and interaction between investors and their stakeholders on how to maximise the overall long-term value of existing or potential investees. The practice aims to deliver sustainable benefits to the economy, the environment, and society. Corporate engagement refers to dialogue and communication between investors and existing or potential investees intended to enhance investees' ESG sustainability and relevant capabilities and their disclosure and reporting quality.

Categorised by the objective, in addition to dialogue with a single investee (corporate engagement), investor engagement includes 1) communication and interaction with relevant government departments, policy and standard makers, or regulators on how to improve the market environment or promote engagement in the transition of state-owned enterprises (SOEs) and responding to policy consultations (policy engagement); 2) organising discussions with several corporates on key topics of common interest (thematic engagement); 3) participating in relevant research and public discussions; 4) negotiating and monitoring service providers in the investment chain (for example, communication and interaction between asset owners and asset managers), and etc. Engagement other than corporate engagement, such as policy engagement, plays a significant complementary role in supporting investors' corporate engagement. For example, investors promoting an industry association to introduce industry ESG assessment standards will facilitate investor engagement with corporates in the industry on ESG issues. In terms of SOE engagement, it often requires dialogue with relevant government departments before the transition can be effectively facilitated. The relations between these concepts are further explained in Section 1.2 of this report based on the existing practices of institutional investors.

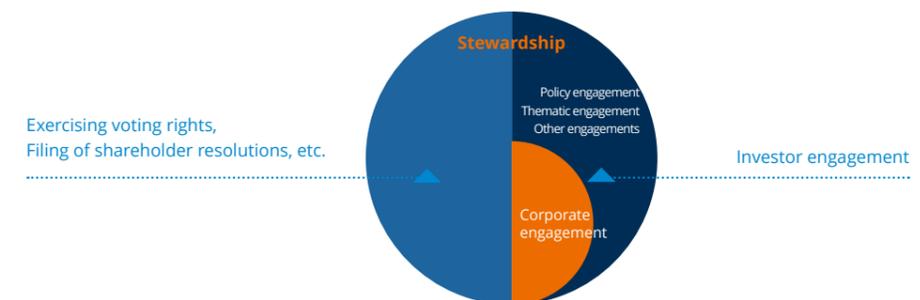


Figure 1-1: Illustration of Stewardship-related Concepts

Source: A work by the project research team

¹ This refers to investors selling their shares or divest directly due to dissatisfaction with the performance of the portfolio company.

² Ceres, Environmental Defense Fund, & KKS Advisors. The Role of Investors in Supporting Better Corporate ESG Performance: Influence Strategies for Sustainable and Long-Term Value Creation [R].2019.

³ Mainly based on the relevant policies introduced by countries, regions and organisations in recent years, as well as relevant research reports published by financial institutions and research institutes.

Institutional investor stewardship by investor engagement, exercising voting rights, and other means promotes sustainable changes at the corporate level, the industry level, or a more macro level. It also benefits institutional investors in many ways, the most central of which is to help them increase their long-term investment returns. Many studies have shown

that it is financially beneficial for institutional investors to communicate with corporates on climate change and other environmental issues and urging them to transition. It further reveals the original motivation and value of institutional investors to urge and engage in the low-carbon transition of corporates and their stakeholders.



Financial Benefits of Climate Change related Corporate Engagement

- 1 **A study by Hoepner et al.**⁴ found that engagement on ESG issues can significantly reduce a corporate's downside risk, thereby benefiting shareholders. The risk reduction is most pronounced in the area of environment and climate change.
- 2 **Sautner et al.**⁵ examined whether shareholder engagement affects the downside risk of target corporates in a case study of pension funds. The results demonstrated that successful investor engagement in ESG issues reduces downside risk for target corporates, with engagement in environmental issues presenting the most significant effect. In engagement in environmental issues, the most significant effect falls in engagement in climate change issues.
- 3 **Dimson et al.**⁶ examined changes in investor engagement to address ESG issues in listed corporates in the US over a decade. They found that with successful investor engagement, corporate accounting performance and governance see significant improvements. In particular, institutional ownership increases on environmental and social issues. Successful investor engagement actions result in a 4.4% increase in average returns, while unsuccessful engagement actions had no impact.
- 4 **A study by Becht et al.**⁷ on the Hermes UK Focus Fund revealed that, the fund, net of fees, outperformed the FTSE All-Share Index by 4.9% per annum and significantly outperformed the benchmark. The excess return is primarily related to shareholder engagement rather than stock selection.
- 5 **A study by Barko et al.**⁸ demonstrated that institutional investor engagement in corporate ESG issues effectively improves a corporate's ESG rating. Additionally, if the corporate adapts to risks as per the improvement requirements raised by stakeholders, it can generate higher stock returns and achieve better corporate performance.

Institutional investors engaging in corporates' low-carbon transition is related to institutional investors fulfilling of their fiduciary duties to holders, obtaining long-term returns, and strengthening their capacity to deal with climate-related risks. It is also closely related to building a capital market that is robust and sustainable in the long term. In the current global drive of climate governance, institutional investors should exert their influence and play an active role in fulfilling

their fiduciary duties of loyalty, prudence, and diligence. They should focus on issues concerning climate change and low-carbon transition and actively engage with their investees. They should assist their investees in their strategies, capital allocation, and technology deployment to enhance their ability to manage and address climate-related risks and jointly catalyse climate action and sustainable changes at the investee and systemic levels.

⁴ Hoepner, A. G., Oikonomou, I., Sautner, Z., Starks, L. T., & Zhou, X. ESG Shareholder Engagement and Downside Risk[A]. European Corporate Governance Institute (ECGI) - Finance Research Paper Series, 2018.

⁵ Sautner, Z., & Starks, L. T. ESG and Downside Risks: Implications for Pension Funds [D]. Wharton Pension Research Council Working Paper, 2021.

⁶ Dimson, E., Karakas, O., & Li, X. Active Ownership[J]. The Review of Financial Studies, 2015.

⁷ Becht, M., Franks, J., Mayer, C. & Rossi, S. Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund[J]. The Review of Financial Studies, 2009.

⁸ Barko, T., Cremers, M., & Renneboog, L. Shareholder Engagement on Environmental, Social, and Governance Performance [J]. Journal of Business Ethics, 2022.

1.1.2 Corporates Low-carbon Transition' in Need of Supervision and Support

Corporates are key players in the global response to climate change and sustainability, both as consumers of natural resources and emitters of pollutants, and as the cornerstone of the real economy. Climate change poses transition and physical risks, both of which can lead to credit risk, market risk, and liquidity risk, among others, seriously threatening corporates and their investors⁹. For example, the transition risk associated with policy-based climate interventions will directly lead to the shelving of corporate brownfield assets, resulting in massive asset impairments for some corporates in high-emitting industries¹⁰. With a negative wealth effect, this would be a drag on business investment, which will turn into a heavy blow to corporate financial and operational performance and a substantial financial risk. Today's world sees the concept of sustainable investment on the rise. High-emitting corporates that fail in low-carbon transition in time will face difficulties in credit rating and financing costs and access. According to Bloomberg Intelligence's forecasts¹¹, if ESG investments continue to grow, global ESG assets are expected to exceed US\$53 trillion by 2025, accounting for more than a third of total global assets under management (AUM). Compared to peers leading in sustainable development, corporates inactive in reducing emissions or unwilling to respond to institutional investors' demands for ESG governance in this regard will find it difficult to access capital. As a result, they will be seriously hindered in long-term growth.

To respond to national and regional policies on climate change and sustainable development and to maximise their economic interests, many corporates have launched self-transition and actions to reduce emissions. However, only with these corporate actions to reduce emissions, the global average temperature will rise by around 2.7°C in 2100, far short of the 1.5°C target set out in the Paris Agreement¹². To hold the global average temperature increase below 2°C or further limit it to 1.5°C, it needs more than all the announced net-zero targets and other long-term climate-related goals. Stronger external forces and support will be necessary to boost the green and low-carbon development of the global economy.

The core of corporate engagement, centred on corporates' low-carbon transition, is a call for high-emitting corporates to take more initiatives to reduce emissions to further support the achievement of global climate goals. For high-emitting corporates, the original economic incentive to take action to reduce emissions lies in short-term financial gains. In such cases, the corporates will take the initiative without additional urging. However, to achieve global climate goals will require the corporates to take further action to reduce their emissions, which means higher marginal costs in reducing emissions and makes them hesitate in a further low-carbon transition. It is necessary for institutional investors to step up to the plate and support these corporates in their transition¹³. They should help the corporates improve their environmental performance, avoid climate-related risks, and expand access to financing. That way, the corporates can improve their operations and boost financial growth, thereby creating long-term value.



⁹ Ma, J. & Sun, T. The Impact of Climate Change on Financial Stability[J]. Modern Finance Guide, 2020.

¹⁰ Ma, J. Roadmap for Financing China's Carbon Neutrality[R]. 2021.

¹¹ Bloomberg Intelligence. ESG Assets May Hit \$53 trillion by 2025, A Third of Global AUM[EB/OL].

<https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/>

¹² Climate Action Tracker. Glasgow's 2030 Credibility Gap: Net Zero's Lip Service to Climate Action[R]. 2021.

¹³ UN-convened Net-Zero Asset Owner Alliance. The Future of Investor Engagement: A Call for Systematic Stewardship to Address Systemic Climate Risk[R]. 2022.



Value Created in Corporate's Transition Enabled by Investor Engagement

IMPROVING CORPORATE ENVIRONMENT-RELATED PERFORMANCE AND PERFORMANCE

Using a comprehensive sample of listed companies in over 40 countries, Dyck et al.¹⁴ demonstrated that institutional investors are very strong in driving environmental and social performance at the corporate level globally. Investor demands are driving corporates to continuously improve their environmental and social performance.

EXPANDING ACCESS TO CORPORATE FINANCING

Srivastava et al.¹⁵ explored the impact of stakeholder ESG engagement in the corporate financing and borrowing ability during the COVID-19 pandemic based on corporate-level data from 51 countries. The results show that corporates with higher levels of stakeholder ESG engagement are able to obtain more debt financing during the pandemic¹⁶, and that this effect is more pronounced for riskier corporates. Moreover, stakeholder engagement facilitates corporates and firms in emerging economies that are less asset-intensive to obtain more debt financing.

OPTIMISING BUSINESS OPERATIONS AND IMPROVING FINANCIAL PERFORMANCE

According to the Kay Review¹⁷ of UK, stewardship for a range of activities and issues, as a core function of the equity market, can drive growth in corporates' operational and financial performance, with benefits that can last for many years. In a broader context, stewardship can enhance the overall stability of the financial market and contribute to economic growth.

According to Odell et al.'s analysis¹⁸, constructive engagement with an investee's board members and management teams to improve its ESG profile can drive progress in its overall business operations and improve its risk management.

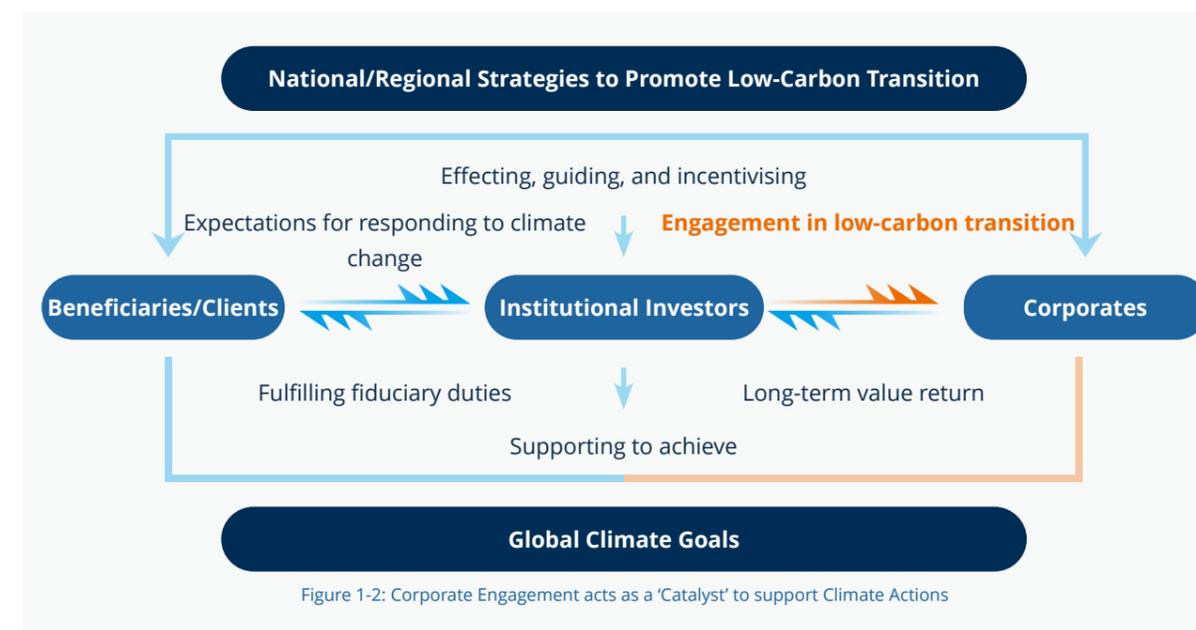
He et al.¹⁹ studied the effects of ESG engagement from the perspective of managerial misconduct using a sample of Chinese listed companies from 2010 to 2020. The study shows that ESG engagement can significantly curb managerial misconduct. The effect is more pronounced in corporates with lower information transparency, lower institutional ownership, and that voluntarily disclose ESG information.

Recent years has seen a rapid growth in green finance worldwide. The expanding market size has enabled thriving green industries with environmental and ecological benefits, which play an important role in supporting the global response to climate change. However, a successful global response to climate change also needs adequate financial support for the low-carbon transition of high-emitting industries. To this end, transition finance, a more flexible, targeted, and adaptable financial support instrument, is mainstreaming in the international capital market.

Transition finance aims to meet the financial needs of high-emitting industries in low-carbon transition in a more extensive and larger manner. To achieve this, it provides financial services for traditional carbon-intensive and environmentally-risky market entities, economic activities, and asset projects in their transition to low-carbon and net-zero. This practice bridges and complements areas that are beyond the reach of green finance, thus contributing to the achievement of global climate goals more efficiently.

Governments around the world have launched actions for transition finance. They support the investment and financing of green and low-carbon technologies and the development of green industries. Additionally, they focus on financing and supporting high-emitting corporates in the low-carbon transition and introduce policies to support decarbonisation and the sustainable development of the real economy in their jurisdictions. The public sector in some countries is developing financial standards and introducing disclosure requirements and policy incentives for transition activities²⁰. They also promote financial institutions to develop innovative transition finance products. Among the existing financial products, bonds and loans are two active areas of global practice in transition finance, which are of the largest scale²¹. Driven by national and

regional policies and strategies, institutional investors are responding to climate change for the goal of carbon neutrality. They are developing their own carbon reduction strategies and reducing direct and indirect carbon emissions from their operations to meet their commitments to climate change. For investors, however, it is even more critical to achieve a net-zero portfolio, in which stewardship practice is crucial. Furthermore, in unleashing the investment sector's potential in transition finance, institutional investors need to proactively measure the impact of their portfolio's carbon emissions on global warming. Moreover, they should leverage their unique position and influence to further support high-emitting corporates in their low-carbon transition and sustainable development.



Source: A work by the project research team

In summary, existing national and regional policies to promote low-carbon transition effect, guide, and incentivise beneficiaries and clients, institutional investors, and corporates to take actions in support of global climate change goals in many aspects. In this transmission chain, corporate engagement by institutional investors acts as a catalyst. Specifically, institutional investors are driven by both national and regional strategic guidance to promote low-carbon transition and beneficiaries' and clients' expectations to respond to climate change. They are actively engaged in dialogue with investees to address climate-related risks, position themselves for low-carbon transition, and seize new development opportunities, and urge them

to move towards net-zero emissions. These initiatives will support the green and low-carbon development of the real economy, which in turn will accelerate the achievement of global climate goals. Moreover, this process will further enhance the long-term value of investees, which will reward institutional investors with long-term financial and operational performance. It demonstrates that institutional investors will create values for themselves, investees, and society by actively carrying out corporate engagement, urging and supporting their low-carbon transition. The most valuable is the catalysing role, which is important for the world to successfully respond to climate change and achieve climate goals.

¹⁴ Dyck, A., Lins, K. V., Roth, L., & Wagner, H. F. Do Institutional Investors Drive Corporate Social Responsibility? International Evidence[J]. Journal of Financial Economics, 2019.

¹⁵ Srivastava, J., Sampath, A., & Gopalakrishnan, B. Is ESG the Key to Unlock Debt Financing During the COVID-19 Pandemic? International Evidence[J]. Finance Research Letters, 2022.

¹⁶ For every unit increase in ESG score, debt financing increases by 0.02%.

¹⁷ Kay, J. The Kay Review of UK Equity Markets and Long-term Decision Making Final Report[R]. 2012.

¹⁸ Odell, J., & Ali, U. ESG Investing in Emerging and Frontier Markets[J]. Journal of Applied Corporate Finance, 2016.

¹⁹ He, F., Du, H., & Yu, B. Corporate ESG Performance and Manager Misconduct: Evidence from China[J]. International Review of Financial Analysis, 2022.

²⁰ For example, in November 2021, the People's Bank of China launched the Carbon Emission Reduction Support Tool, which adopts a "lending first, then borrowing" mechanism to provide funding at 60% of the principal amount of eligible carbon emission reduction loans issued by national banks to corporates in key areas of carbon emission reduction, such as clean energy, energy conservation and environmental protection, and carbon emission reduction technologies. At the same time, the Bank of England incorporated climate governance and disclosure requirements for bond issuers into its corporate bond purchase program, and announced its own medium- and long-term carbon intensity and net-zero emissions targets for the program's investment portfolio.

²¹ The Macro and Green Finance Lab of the National School of Development, Peking University. A Study on the Mechanism of Transition Finance to Support Low-carbon Transformation of Coal Power Enterprises[R]. 2022.

1.2

GLOBAL TRENDS AND BEST PRACTICES



With the strengthening global responses and actions to combat climate change in recent years, institutional investors have grown more concerned than ever about the climate- and environment-related risks of their investees. They place a higher value on the environmental and social benefits and the long-term value created by their investment preferences and behaviours. In this regard, institutional investors have widely adopted and promoted stewardship and investor engagement strategies that focus on urging and supporting portfolio companies to address climate-related risks and achieve a low-carbon transition. An increasing number of successful case studies have emerged in both the international and Chinese markets. The extensive experience and the momentum of these

practitioners are worth exploring and learning from in depth.

To this end, the project research team analyses the global trend of institutional investors engaging in corporates' low-carbon transition and summarises best practices that may give reference to other institutional investors. The analysis is based on interviews with several leading Chinese and international institutional investor representatives in sustainable investment and climate action, as well as a review of successful engagement practices worldwide. This section presents the project research team's key findings from interviews and desktop research.



1 A major trend: Engaging in corporate's material climate change issues

In recent years, climate change has become a major area of concern for institutional investors around the world. As time goes on, the impact of climate change on corporate value will be more prominent. For institutional investors, it has become a decisive ability for their portfolios to withstand risks and adapt to the long-term impacts of climate change. This has led to an increase in institutional investors' engagement with investees on climate change-related topics. More institutional investors are helping corporates to address climate risks and transitional opportunities through constructive, goal-oriented, and ongoing dialogue with their investees' boards and executives. In today's wave of global ESG investments, in addition to general corporate strategic issues, institutional investors are focusing on environmental topics (particularly,

climate change and emission reduction) and frequently engaging with corporates in them²². For example, the UN Principles for Responsible Investment (UN PRI), which provides examples of ESG-related engagement practices, has the largest number of engagements with investees on the topic of climate change, far exceeding the number of general ESG topics and other ESG topics²³. ISS ESG, the investment research branch of Institutional Shareholder Services (ISS), found that climate change is the engagement topic most concerning investment companies in a survey of 133 investment companies worldwide²⁴. These figures illustrate the emphasis and attention that institutional investors have placed on corporate climate governance and investor engagement to urge corporate response to climate change in recent years.

Impax Asset Management

'We believe that proactive engagement and interaction with investees demonstrate investors' commitment to active ownership and they are also part of our fiduciary duties to our clients. We put high priority on investee engagement. On the one hand, we help investees (especially those facing significant climate-related risks and opportunities) enhance their strategies, practices, and disclosure in the context of low-carbon transition to highlight their intrinsic long-term value. On the other hand, from our perspective as an asset manager, we can obtain a deeper understanding of their business sustainability and be better positioned to make accurate judgements on industry risks and opportunities and to generate relatively stable excess returns for our clients over the long term. Furthermore, in-depth and frequent dialogues with corporates on climate-related issues enrich our understanding of climate-related risks in each market. Additionally, we embed climate-related issues into our fundamental investment research and deepen our research and analysis of the low-carbon transition of key industries based on the latest internal and external climate-related data.'

Allianz Global Investor

'Climate change is one of the three major themes in our engagement with investees, alongside planetary boundaries and inclusive capitalism. In recent years, the significance of environmental issues in our interactions with corporates has been steadily increasing, with numerous discussions centred on corporate climate-related risk assessments and exploring ways for corporates to include climate-related risks and low-carbon transition into their strategies, operations, and product planning. To address this, we have established an approach called Climate Engagement with Outcomes (CEWO) for high-emissions industries and companies. Under this strategy, we initiate dialogues with high-emissions corporates through questionnaires, systematically evaluate their climate profiles, including relevant social and governance indicators, identify climate-related issues that significantly impact corporates in high-emissions industries, and engage in dialogues with them on those issues. This ensures that they can anticipate and mitigate climate-related risks and steadily transition towards a net-zero vision.'

²² The UK-China Green Finance Center. The Value Creation of Active Engagement[R]. 2021.

²³ UN Principles for Responsible Investment (UN PRI). Listed Equity Snapshot 2017-2020[R]. 2020.

²⁴ Institutional Shareholder Services (ISS) ESG. Stewardship Excellence: Engagement in 2021[R]. 2021.

More importantly, leading institutional investors do not stop at engaging in dialogue with corporates on general climate topics. They capitalise their insight into climate-related risks and opportunities, trends and priorities for low-carbon transition across sectors and market practices. With those, they work with corporates to identify material issues²⁵ significantly impactful on the corporate's economic, environmental, and social aspects and on the assessment and corporate stakeholders' decision-making. They prioritise dialogue with corporates on these material issues and monitor and support their transition in these areas. Through interviews and research, the project research team found that institutional investors first identify the key topics for corporates' low-carbon transition. After that, the leading ones carefully select the most critical material issues that directly concern corporate's economic, environmental and social aspects and affect corporate stakeholders' assessment and decision-making. They prioritise in-depth dialogue and exchange with corporates on these material issues rather than just 'box-ticking'. They believe that meaningful and effective engagement on the theme of climate change should go beyond discussing general key topics, such as asking corporates to improve their ESG ratings and climate governance. It is important to look deeper to discover which key factors contribute to low ESG ratings or weak climate governance, or key topics in which sub-sectors have a material impact on corporates and their stakeholders. By prioritising dialogue with corporates on these material issues, institutional investors can act more effectively in urging the corporates' low-carbon transition. To do so, institutional investors must first have extensive industry research and experience. They should include climate change into macro analysis and case studies to understand current sectoral carbon emissions, especially high-carbon sectors, and relevant state and local emission reduction goals and low-carbon development policies. They must be able to identify the pathways and key areas of emission reduction in various sectors. In addition, institutional investors need to be able to assess their investees' climate resilience and to identify and quantify the multiple climate-related risks faced by their investees. They should actively engage in scenario analysis to assess their investees' resistance to climate-related uncertainties at the strategic and operational levels.

Only by meeting these requirements and focusing on identifying the corporate's material issues can institutional investors set clearer, more realistic, and measurable objectives and milestones for the corporates they engage with. That way, they can help the corporates chart a logical transition pathway based on these objectives. It will provide more targeted guidance and assistance in the corporate's subsequent transition, thus making the dialogue with the investees more efficient and the results of the transition achieved by the engagement more visible. In addition, identifying material issues helps institutional investors understand the material issues of the corporate and the industry as a whole, research from a more comprehensive perspective, and accumulate relevant data. It also helps institutional investors engage in deeper and more effective dialogue with more corporates and drive more systematic transition.



²⁵ The sustainability reporting standards issued by the Global Reporting Initiative (GRI) require organisations to identify, analyze and report on issues that reflect significant economic, environmental and social impacts of the organisation and substantively influence the assessments and decisions of stakeholders, based on the "Materiality Principle".

1 CASE

Bosera Fund's Engagement in a Chinese Chemical Company: —Improving climate and environmental information disclosure

Bosera Asset Management Co., Limited (hereinafter referred to as "Bosera Fund") has researched and invested in this chemical company for over eight years and has a good understanding of its overall operations. Under the international assessment framework, the company lagged behind international best practices in carbon emissions, chemical safety, and water resources. After thorough research and surveys, Bosera Fund recognised that the company has taken some sustainable actions in its past operations. However, international rating agencies' rating results failed to fully reflect the company's actual status due to long-term lags in information disclosure. Bosera Funds is assisting the company in improving its performance through targeted communication on topics that are important to the industry and have significant room for corporate performance improvement. It hopes that this practice will increase the market's recognition of the company's sustainable performance, thereby further enhancing the company's value.

Instead of intervening in the listed company's specific operations, Bosera Fund interacts with it by the means of enquiry emails, telephone communications, and field research and expresses to it Bosera Fund's concern about its sustainable business performance. Bosera Fund has been active in providing sustainable advice to the company in the enduring communication. The company has also launched the transition to a green company and improved its ESG performance.



First, in terms of carbon targets and management, the company has followed the United Nations Sustainable Development Goals (SDGs) and prepared and published system documents regarding carbon emissions.



Second, in terms of environmental information disclosure, the company has improved the transparency on sustainable investment and undertaken CDP climate change and water safety information disclosure.



Third, in terms of emission reduction and resource utilisation, the company has taken measures to reduce the intensity of greenhouse gas emissions and increase the water recycling rate. Additionally, the company has been actively and steadily promoting environmentally friendly products, such as biodegradable plastics, in its business.

Active shareholder action, including voting and interaction, is an important part of Bosera Fund's responsible investment. Bosera Fund believes that it is valuable for ESG investors to be directly engaged in investees' corporate governance, especially in emerging markets. In situations where there is inadequate ESG-related data disclosure, regulation is not in place, and corporate disclosure is not mandatory, engagement in corporate governance can help corporates improve their sustainable performance and assist and supervise investees in practising ESG concepts.

2 Equipped with fundamentals of stewardship is a prerequisite to engage effectively

Successful and effective institutional investor engagement in corporates' low-carbon transition is ensured by a well-developed internal governance structure, a clear stewardship policy, active ESG research investment and in-depth integration with investment decisions, and continuous improvement of relevant information disclosure. Through interviews and research, the project research team found that leading institutional investors often view their work in these areas as fundamental to a more segmented or focused engagement. They are constantly reviewing

their readiness and execution in these areas and increasing their maturity in these areas. Both leading and growing institutional investors agree that they need to be equipped with these fundamental elements and a proactive approach to stewardship. Only by that can they invest more in intensive dialogue with corporates on core topics such as climate change and low-carbon transition and help investees address climate-related risks. That way, they can exert their sustainability influence to guide and support corporates in their low-carbon transition.

Bosera Fund

'At the board level, we implement an ESG investment reporting mechanism for the board's Strategy Committee. At the corporate level, we have an ESG Investment Committee responsible for developing climate strategies and related policies and overseeing their execution. At the departmental level, we have ESG groups that conduct ESG research, share findings with investment research teams, and collaborate with them to optimise the ESG evaluation system and carry out ESG due diligence. We have comprehensive ESG investment policies, including responsible investing policy, active ownership policy, and policy for voting at general meetings of investees, embedding ESG considerations into our investment process. To effectively integrate the ESG investment philosophy with our everyday investment activities and help investees generate long-term ESG value, we adopt a "fundamentals + ESG" investment research framework that requires our analysts to consider ESG factors in fundamental research, engage investees on sustainability issues and include feedback in investment recommendations. We practise sustainable proxy voting on investees' motions by way of active ownership and seamlessly combine ESG research, responsible management, and investment decision-making on our internal integrated investment platform.'

China AMC

'China AMC has comprehensive ESG policies, including Responsible Investing Policy, Listed Company Communication Policy, and Proxy Voting Policy, that takes major ESG risks into consideration. We not only incorporate ESG considerations into our investment philosophy and overall company strategy in a way that reflects China's reality and draws upon advanced overseas experience, but also put ESG investing into action throughout our active equity investment management. We pioneered in the industry in directly installing an ESG investment team in the investment department and apply a six-step ESG investment process (strategy formation, fundamental analysis, portfolio management, risk management, listed company communication, and regular tracking), working to appropriately manage ESG risks and deliver sustained superior returns to investors in the long run.'

● Governance structures and internal policies



It is essential for institutional investor stewardship to establish a sound stewardship governance structure, develop internal stewardship policies, and define implementation and decision-making processes and all parties' responsibilities.

Through interviews and research, the project research team found that leading institutional investors are constantly improving their internal governance to better support and ensure the implementation of stewardship.



For example, they establish a clear stewardship governance structure and accountability mechanism, define the responsibilities of all positions involved in stewardship, and standardise the decision-making process.



They have dedicated positions in the board of directors and the management to co-ordinate internal stewardship, deploy relevant strategies, and coordinate their implementation.



They establish a separate stewardship department or a stewardship function within the investment research department. The department or function undertakes specific stewardship tasks and ensure smooth collaboration and cooperation between departments, especially with fund managers/portfolio managers.



They develop and issue separate internal stewardship policies, including engagement and voting policies, or incorporate stewardship-related policies and regulations into their investment policy.



In the internal stewardship policies, they define the overall motivation and objectives for stewardship, integration with the investment process and investment decisions, internal governance and resource input, policies, regulations, and standards to be observed, asset classes to be covered, engagement and voting processes, themes and sectors to be focused on, and etc.

- **ESG investment research capabilities and integration with investment decisions**



To perform stewardship, especially to promote corporates' sustainability and low-carbon transition, it is crucial for institutional investors to continuously improve their investment research capabilities in ESG, conduct ESG investment research, and deeply integrate such research with investment decisions.



Through interviews and research, the project research team found that most institutional investors experienced in climate-related engagement practices have strong ESG investment research teams and well-developed ESG investment frameworks and databases. These elements provide comprehensive and professional ESG data, assessments, and research support for institutional investors in specific stewardship practices, including voting and engagement.



As they continue to explore stewardship practices, they will allocate more resources to strengthen their ESG investment research capabilities and improve their internal ESG research systems. That way, they can better support higher quality dialogue with their investees on a broader range of ESG issues.



Institutional investors also focus on the integration of ESG investment research with fundamental investment research, fully integrating the consideration of key ESG factors into their investment decisions and process. It injects more impetus into themselves and their investees to jointly explore sustainable development practices such as low-carbon transition.



These institutional investors also indicated that ESG stewardship practices allow institutional investors to better understand their investees' ESG performance and collect higher quality ESG data. It helps them further enhance their ESG investment research capabilities to support investment decisions, forming a virtuous cycle internally and externally.

- **Information disclosure**

The quality of stewardship-related information disclosure is generally indicative of institutional investors' stewardship capacity. Through interviews and research, the project research team found that institutional investors generally improve their information disclosure in stewardship in three ways.



First, institutional investors make their internal stewardship policies available to relevant beneficiaries and customers, collect feedback, and review and revise them on a regular basis. Some leading institutional investors seek greater transparency by making their internal stewardship policies available to the public.



Second, institutional investors record and update the process and outcomes of each stewardship item in detail in their internal systems. Stewardship, especially engagement in investees' governance, usually spans a long period, and the results typically take a long time to show. During the process, changes in participants and internal policies are almost unavoidable. It is therefore essential to keep detailed records of the engagement process and milestones and to share the information on internal platforms. It allows institutional investors to consider the continuity of stewardship and engagement when making internal policy or personnel changes and hires, and helps stewardship teams work in a more efficient and integrated manner.



Third, the quality of information disclosure by institutional investors is also reflected in proactive disclosure of the actual progress of stewardship. Such disclosure includes specific investor engagements, exercise of voting rights, and submission of shareholder resolutions or motions. In terms of disclosing the execution of corporate engagements, leading institutional investors will disclose the number of engagements during the reporting period and the overall implementation of engagement programmes. They will also disclose examples of engagements with key corporates while avoiding sensitive information, as well as the escalation measures taken for engagements. Leading institutional investors engaging in vote will disclose their voting record on a case-by-case basis and clarify the reason behind each vote.

Allianz Global Investors

'We have comprehensive internal policies on stewardship and a rigorous methodology and attach high importance to internal information sharing and corresponding disclosure. All engagement and voting records of Allianz Global Investor, along with their respective outcomes, are shared on our Collaborative Research and Investment Platform, so that all portfolio managers and analysts can incorporate this information into their investment decision-making. We have also developed a series of detailed climate and sustainability-related policy documents, such as the Stewardship Statement, Climate Policy Statement, Sustainability Risk Management Policy Statement, and Global Corporate Governance Guidelines, which are made public. In addition, we publicly disclose our annual sustainability and stewardship reports as well as detailed voting records, to ensure our transparency and disclosure quality in stewardship and sustainability.'

3 Define effective engagement in corporates' low-carbon transition—helping corporates set transition goals on engagement issues, map the transition pathways, and track the transition progress on an ongoing basis

As mentioned above, institutional investors tend to concern corporate response to climate change and progress on the low-carbon transition, to identify topics with a substantial impact on corporates, and to drive changes on these material issues. However, the institutional investors interviewed noted that effective corporate engagement in low-carbon transition needs more than setting and achieving transition goals and milestones on the engaged material issue. It is necessary to pay additional attention to whether the corporate's specific pathway to these goals and milestones are sufficiently clear, feasible, and consistent with the net-zero commitments and milestones set by the corporate.

The core step in institutional investors' engagement practice is setting goals with corporates on the topics to be engaged in. Only with clear engagement goals set can institutional investors judge the effectiveness of their engagement efforts and make public the results achieved under their influence and impact. Therefore, typically in engagement in climate-related topics, institutional investors will first identifying key climate change topics that have a material impact on the corporate. After that, they will help the corporate set more specific and measurable transition goals for these material issues to be engaged in. They will then work with the corporate to identify timelines and milestones at each stage to reach the goals, drive its practices

HSBC Asset Management

'With the philosophy that stewardship and engagement contribute to value creation of our portfolio companies, we adopt both a top-down stewardship strategy covering key themes such as climate change and biodiversity, and a bottom-up approach to identify priority companies for objectives-led engagement. On climate change, we typically encourage portfolio companies to commit to net-zero emissions, include just transition considerations, assist them in setting interim targets, and improve the quality of their climate related disclosure (for example Scope 1,2 and 3 emissions). In addition to this, we recommend that companies provide climate related KPIs which is aligned with international disclosure practices, this includes management processes for monitoring and disclosing climate-related risks, time periods for monitoring those risks, and the role of the board or management team (sustainability committee or similar body).'

Schroders

'There are multiple ways to make progress on net-zero emission targets for investment portfolios. One way is to shift investments from higher carbon companies to lower carbon ones. The other is to engage with companies to encourage them to set targets and share knowledge to support their decarbonisation efforts. The first can be done immediately, but could lead to heavily concentrated portfolios and may not lead to decarbonisation of the divested assets. The other, which we are focusing on, can drive system-wide decarbonisation but requires a plan if engagement is not successful. Based on this, we have developed a climate engagement and escalation framework (Climate Engagement and Escalation Framework), which clearly lays out our expectations of companies, how we plan to monitor them and what we plan to do if they do not take action. We expect to focus our climate engagement efforts on around 1,000 priority companies through to 2030.'

and progress on these topics. That way, they will help it achieve its decarbonisation goals at each stage and net-zero commitment. However, leading institutional investors see this as only the first step towards successful engagement in low-carbon transition.

Through interviews and research, the project research team found that while helping corporates set clear, practical, and measurable goals and milestones for material issues, leading institutional investors think further about the pathways to these goals and milestones. Moreover, they continuously monitor the transition progress until the goals are achieved.

to set its decarbonisation goals by phase, institutional investors need to consider two things. The first is whether the corporate's capital expenditure plans by phase are aligned with its decarbonisation goals and the second is whether the chosen technology pathways have the greatest potential to reduce emissions. In this way, institutional investors can ensure that the corporate's pathway to the transition goal is aligned with its long-term net-zero commitment and is the most cost-effective for the corporate.

Additionally, leading institutional investors continuously track and measure the progress of corporate transition and the outcomes of their engagement until the ultimate transition goal is achieved. By continuously tracking and measuring the outcomes of their engagement, they make a successful engagement in low-carbon transition. Institutional investors interviewed indicated that they typically track and assess the progress of low-carbon transition by referring to international indicators and standards for assessing corporate emissions reductions (for example, the Climate Action 100+ Net Zero Company Benchmark), as well as domestic and international corporates' climate transition practices and disclosures.



They focus not only on engagement outcomes but also whether the pathways to the outcomes are clear enough for implementation and consistent with the corporate's net-zero commitment and phased decarbonisation goals. For a corporate, the achievement of a transition goal may prove that it has successfully transitioned itself on a key topic. However, a greater concern of the beneficiaries and the public is whether the transition on this key topic actually supports the corporate's efforts to address climate change and achieve long-term sustainability and net-zero. To support this, institutional investors need to consider the specific arrangements for and transition pathways to this goal. For example, when requesting a corporate

- They also take into account applicable policies and standards and the situation in their region.
- Institutional investors are also open to the possibility that a corporate may face difficulties in the transition or that the transition pathway is no longer relevant to the current scenario.
- In that case, institutional investors will discuss with the corporate on developing a more appropriate pathway or milestones, and continue to support the transition until its long-term goals and net-zero commitment are achieved.



Schroders' Engagement in a Hong Kong Industry Machinery and Equipment Company:

—Improving carbon emission targets

Climate change is a priority theme set out in our Engagement blueprint, which establishes and articulates Schroders PLC (hereinafter referred to as "Schroders")' guiding principles for our active ownership efforts. The blueprint is forward-looking and acts as a compass to guide our desire to generate investment returns for our clients by supporting the transition to a low-carbon economy.

One of the desired long-term outcomes under the Climate Change theme expressed in the blueprint is for companies to have robust governance and oversight of climate-related risks, as this is critical for dealing with the strategic and financial risks that can be triggered by climate change. One of our priority asks is for the disclosure of key information on material climate factors that could impact the company. Another area of focus is climate alignment, where we aim to engage with companies to encourage them to develop a robust and inclusive path to net-zero, through setting long, medium and short-term science based emission targets, covering Scope 1, 2 and relevant Scope 3 emissions, and publishing a detailed transition plan to explain how they plan to meet those targets.

Our decision to engage reflects in part our view that climate change is a material ESG risk for the company, as is the case for many companies involved in the manufacturing industry. Prior to the engagement the company had already significantly increased their disclosure on ESG issues in the past 2 years, and achieved material reduction in Scope 1 and 2 emission intensity. Looking ahead, the company had also made new commitments to reduce Scope 1 and 2 emissions by 60% by 2030, alongside expressing an ambition to become a net zero organisation and map Scope 3 emissions.

We wanted to follow up to understand where the company saw the greatest scope for emissions reduction and encourage the company to gain formal accreditation of their emission targets the Science-Based Targets Initiative (SBTi).

The company was collaborative in the discussion and receptive to our suggestion of SBTi validation. They noted that they are working on mapping Scope 3 emissions to be consistent with the SBTi methodology, and the timing of any related-targets and validation process could be contingent on the timing of this work. The company agreed to follow up with more details. We also discussed the need for greater scrutiny in monitoring Scope 3 emissions and the importance of supply chain monitoring more broadly.

The company also outlined the steps they are taking to shift their product mix from fuel-powered products to battery-powered, which could potentially reduce Scope 3 emissions as well as benefiting the environment more broadly.

The engagement, together with improvements in disclosure and target setting, provides us confidence that management is focused on managing emissions well. We will continue to monitor the company's progress on climate and other ESG issues, and follow-up on the improvements discussed.

4 Further shaping the ecosystem for engagement in corporates' low-carbon transition through policy and thematic engagement efforts

In addition to the conventional engagement with a single investee, institutional investors are launching policy and thematic engagement, among other engagement practices, with different players to fulfil their fiduciary duties. That way, they play their role as shareholders and exercise their influence to support the green and low-carbon development of the real economy. Through interviews and research, the project research team found that in recent years, institutional investors have actively engaged in dialogue and communication with investees. They aim to improve the environmental performance of investees and enhance their ability to address climate-related risks through corporate engagement activities. This has led to numerous engagement outcomes, but also to challenges that have led to deeper thinking among institutional investors. In many cases, institutional investors have engaged in dialogue with investees on key low-carbon transition issues, suggesting possible transition pathways and initiatives, and the corporates have responded positively and cooperated fully. However, the carbon reductions have been less than significant and the transition has not been as effective as it could have been. Leading institutional investors have come to realise that these key low-carbon transition issues are the result of a combination of factors. Promoting corporate action on these key low-carbon transition issues requires more than just urging corporates to transform themselves. It is more important to seek policy support and unified action among multiple corporates to promote a systematic shift in these issues from multiple perspectives and penetrate the corporates. That way, the corporates will be assisted more effectively in their low-carbon transition.

To address these challenges and drive more fruitful corporate transition, leading institutional investors go beyond dialogue with a single investee (corporate engagement). Some key topics involve multiple corporates or require discussion with multiple corporates (for example, research and development of advanced low-carbon technologies and investment in shared infrastructure). For such topics, leading

institutional investors discuss with relevant industry association, experts in the area, and multiple key corporates to promote unified action of these corporates on key topics of common interest (thematic engagement). Sometimes, policy support is required (for example, the engaging corporate is a SOE or there is a lack of universal corporate environmental and climate disclosure standards). In those cases, leading institutional investors will engage in dialogue with competent government departments, policy and standard makers, or regulators, or respond to policy consultation to seek policy support (policy engagement). For institutional investors, policy engagement and other engagements play a significant role in complementing corporate engagement. As climate change action is increasingly urgent, institutional investors are exploring different engagement approaches to effectively address systemic issues, such as thematic and policy engagements, to catalyse a more scalable transition.

Schroders

'We support climate-related initiatives initiated by relevant industry associations and actively contribute our views and experience to public policy consultations related to climate change, including regulations in the UK, EU, Hong Kong and Singapore.'



3

CASE

Impax Asset Management's Engagement in a Chinese Energy and Utilities

Company:

—Improving greenhouse gas emissions reporting and physical climate risk management

Engagement is a strategically important part of Impax Asset Management's investment procedure because it helps us determine how companies understand their own risk and opportunity landscapes. Engagements also help us improve our pricing of risks — particularly emerging ones such as physical climate risks and water availability.

In 2021

our policy advocacy work continued to focus on financing net zero, greening the financial system, and nature and addressing biodiversity loss. In the run-up to the COP26 climate summit, Impax Asset Management actively contributed to commitments and calls to action that were announced in Glasgow, including the emergence of coalitions committing to ambitious action in key areas such as power, transport, nature and finance.

In this context, we engaged with this company which is one of the largest gas distributors in China as a long-term investor on greenhouse gas (GHG) emissions disclosure, sustainability-related target-setting and physical climate risk management.

The objectives we set for engaging with this company were:

- Start publicly reporting greenhouse gas (GHG) emissions
- Disclose GHG emissions data to CDP, a charity that runs a global disclosure system for investors, companies and governments to manage their environmental impacts
- Set GHG emission reduction targets and report on progress
- Link performance-based executive remuneration to climate targets
- Disclose localised, plant-level physical location data
- Raise awareness about physical climate risks
- Commit to mitigating processes for physical climate risks

Since early 2018

we have had several one-on-one engagements with this company both in-person and virtually to discuss progress on a range of issues, including sustainability reporting and disclosures, climate risks and corporate governance.

Early on, we provided the company with a physical climate risk assessment that the company later used as a starting point for conducting a survey of site managers on their perceived physical climate risks and for carrying out a forward-looking pilot financial impact analysis of extreme weather risks.

During two engagements in 2021

we found that the company had made significant improvements. For example, the company has improved its ESG disclosures; its GHG emissions reporting is now verified against internationally agreed ISO standards; and the company has also set mid-term emissions reduction targets.

As of 31 May 2022

we measured objectives 1, 2, 3, 5 and 6 had been achieved and objectives 4 and 7 remained ongoing. We will continue engaging with this company through voting and dialogues regularly to closely watch the progress of its ESG and sustainability developments on the proposed changes we have recommended.

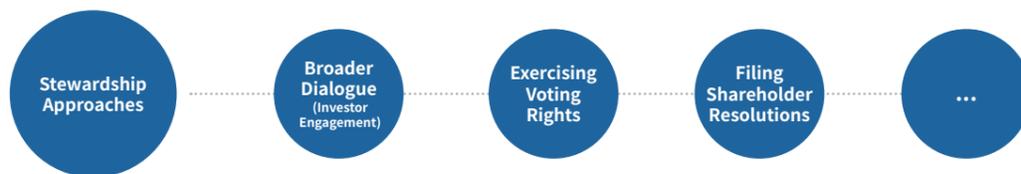
From the engagement with this company (and many others we have done in Asia-Pacific), we have learnt two things. Firstly, it is a long process to promote changes for companies in Asia. The mindset of players in many Asian markets is still top-down driven, so it is hard to promote changes at the company-level using a bottom-up approach. For this reason, it is critical for investors to engage with companies on some specific issues but also with regulators from the policy advocacy angle. Both processes require a good understanding of market attributes and persistence to bring changes.

Secondly, we learnt it is valuable for foreign institutional investors like us to ask questions. The concentrated ownership structure of many Asian companies undermined the voices of minority shareholders in many cases, and it is often quite challenging for foreign institutional investors to get access to Asian companies. That said, when we asked ESG-related questions to some companies, they would genuinely admit they were still in a steep learning curve for many issues, so each engagement turned out to be an effective communication to help both investors and companies close the gap of misunderstanding and expectations from different perspectives.



5 Leveraging diverse stewardship tools and actively collaborating with peers to drive engagement progress: Exercising Voting Right and Collaborative Engaging

In addition to investor engagements such as corporate, thematic, and policy engagements, institutional investors interviewed suggested more institutional investors be encouraged to use more diverse stewardship approaches (for example, exercising voting rights and submitting shareholder resolutions or motions). They also recommended collaboration with peers and collaborative engagement to further accelerate progress in investor engagement practices centred on low-carbon transition. Leading institutional investors have a wealth of experience and insight in both areas.



Engagement and voting go hand in hand

- For institutional investors with voting rights, exercising them, either in person or by proxy, is complementary and mutually reinforcing with investor engagement. Institutional investors usually communicate with the investee and vote during the general meeting of shareholders.
- In a survey of 150 asset owners practicing stewardship by ISS²⁶, 57% of the asset owners said they supported proxy voting or offering voting guidelines to external asset managers. Moreover, 32% said they delegates voting responsibilities to external asset managers.
- The institutional investors interviewed noted that if institutional investors with voting rights only practice engagement but do not vote, it will have no material effect whether the corporate's commitment in the engagement practice is delivered or not. On the contrary, if institutional investors only vote but do not explicitly communicate their expectations and reasons for voting with the corporate, it will not be fair to the corporate. Worse, it indicates that institutional investors are failing to take a dynamic view of the corporate's transition potential. Exercising voting rights is one way to get the attention of the investee and help institutional investors open up dialogue with the investee more quickly.
- Interviews by the project research team revealed that when institutional investors identify motions that are inconsistent with to their sustainable investment principles and philosophy, they do not usually vote against them directly. Instead, they communicate with the corporate about these motions and clarify their concerns, with a view to facilitating the corporate's transition. The institutional investors interviewed said that they do not vote 'for the sake of voting' or 'for the sake of opposing'. They are more interested in opening up dialogue with the corporate and pushing it to move in a more positive direction.

E Fund

'We believe that actively exercising our voting rights is essential to effectively leverage our influence on investee companies. To this end, our ESG and sector analysts collaborate to provide comprehensive and professional voting recommendations for proposals related to our investee companies. Ultimately, our portfolio managers and investment committee make the voting decisions collectively. We understand the importance of communicating our stance to investee companies before voting on proposals that concern us. By doing this, we can provide constructive suggestions and help them make positive changes. By exercising our voting rights, we can promote the sustainability of investee companies and foster a long-term, harmonious relationship with them. For us, active ownership is not just about maximizing shareholder value but also contributing to the greater good of society.'

Fidelity International

'Fidelity International is committed to both engagement and proxy voting. Both engagement and proxy voting work hand-in-hand and one is needed for the other to be effective. Without voting, investors lack influence over the investees and there is no incentive for companies to deliver their promises made during engagement. Without engagement, there lacks a platform prior voting for investors' expectations to be put across to investees. On the other hand, engagement provides an opportunity for two-way understanding and communication between investors and investee companies. Engagement provides an opportunity for investors to communicate their policies and requirements, while providing a space for investors to take a dynamic view of investees' transition and ESG development potentials as well. Collectively, these engagements help relationship building between both parties.'

²⁶ ISS. 2020 Asset Owner Stewardship Survey: Summary of Results[R]. 2020.

● Collaborative engagement is one of the most effective approaches

In climate-related engagement practice, institutional investors often see collaborative engagement as one of the most effective means to drive progress of corporates' low-carbon transition. This is because the shareholding structure of the world's top carbon emitters often comprises institutional investors on a global scale, resulting in fragmented ownership. In this context, the most effective means of driving changes in these high-emitting corporates is collaborative engagement with other institutional investors. In recent years, leading institutional investors have joined relevant investor initiatives, platforms, or alliances, and worked with other institutional investors for engagement in high-emitting corporates to advance their decarbonisation process. These initiatives, platforms, or alliances have gathered institutional investors from around the world to create successful examples of engagement practice in corporates' low-carbon transition that have driven milestone progress. The Climate Action 100+, the world's largest initiative of collaborative engagement by institutional investors in response to climate change, has more than 700 global institutional investor signatories, with over US\$68 trillion in AUM. Institutional investor signatories to the initiative push the world's 166 largest greenhouse gas (GHG) emitters, which account for 80% of global industrial GHG emissions, to accelerate their climate action in line with the global goal of net-zero emissions by 2050 or sooner by communicating with and engaging in these corporates²⁷. By the end of 2022, 75% of the Climate Action 100+ engaged corporates, driven by institutional investors, had made a net-zero emission commitment²⁸. There are many other initiatives, platforms, or alliances working to bring together global and local institutional investors to facilitate the transition of high-emitting corporates to net-zero emissions and low-carbon. For example, the Climate Engagement Canada (CEC) was launched in 2019. It is led by an investor network comprised of the Responsible Investment Association (RIA) of Canada, the Shareholder Association for Research and Education (SHARE) of Canada, and the Coalition for Environmentally Responsible Economics (Ceres). It provides a platform for dialogue between the Canadian financial community and real corporates, bringing together forces to promote Canada's just transition to a net-zero economy. The establishment of the CEC is a good example for other countries to establish platforms to promote local climate-related engagement. Institutional investors that have joined or expect to join more such initiatives, platforms, or

alliances share a common purpose: to leverage their respective strengths and influence and promote local and global high-emitting corporates to take key low-carbon transition actions in line with the Paris Agreement goals by working with more of their peers.

Fidelity International

'Collaborative engagement is one of the engagement approaches used often by Fidelity International. Compared to one-on-one engagement, this approach can amplify investors' impact to promote companies' understanding of investors' ESG expectation and requirements, while advancing the way they are managed. In addition, collaborative engagement that involves both Chinese and foreign investors can provide full scope to their respective strengths, i.e., a combination of local expertise and overseas experience to enhance the effectiveness of engagement.'



²⁷ The latest data is from the official Climate Action 100+ website. <https://www.climateaction100.org>

²⁸ Climate Action 100+. 2022 Year in Review: A Progress Update[R]. 2023.

4 CASE

China AMC's Engagement in a Chinese Automotive Manufacturing Company:

— Improving climate
information disclosure and
practices

China Asset Management Co., Ltd. (hereinafter referred to as "China AMC") actively responds to sustainability initiatives launched by international organisations and improves corporate climate disclosure and practices through its engagement in investor communication groups. It became the first Chinese asset manager to sign up to the Climate Action 100+ in 2018 and joined its Asian Advisory Group. As a member of the Corporate Communication Working Group the initiative belongs to, China AMC advised large local corporates, including a Chinese auto manufacturer, on climate disclosure to drive the climate goals set in the Paris Agreement.

Since China announced the goals of carbon peaking and carbon neutrality, the corporate has responded positively and accelerated its carbon reduction by optimising its production processes and focusing on the development of new energy vehicles. However, its environmental and climate information disclosure mostly follows national disclosure requirements while lacks understanding of major international frameworks for climate information disclosure. By engaging in the corporate on topics related to climate and low-carbon transition, China AMC hopes to address the corporate's concerns on how to further improve its environmental information disclosure and assist it in improving its carbon reduction action mechanisms and practices.

As a member of the Corporate Communication Working Group the initiative belongs to, China AMC collaborated with members of other working groups to undertake corporate engagement in the corporate, mainly in the form of meetings with the corporate's management. After research and discussion, China AMC presented and explained the Climate Action 100+ Net Zero Company Benchmark and Disclosure Framework Indicators to the corporate's management. It suggested that the corporate provide detailed materials and information on its carbon neutrality strategy in its company report and try to assess the lifecycle emissions of its vehicles, starting with its flagship model, so as to reflect its products' clean technology advantages and demonstrate to overseas and domestic investors the efforts made by local Chinese automakers in net-zero transition. The proposal was accepted

and adopted by the corporate's management and is expected to be rolled out step by step. In response to the corporate's feedback, China AMC and members of other corporate communication working groups have developed a long-term corporate engagement plan. They are also about to confirm the progress and results of the corporate engagement through regular follow-up communications.

Through communication with the corporate, China AMC has recognised the necessity and importance of investors' engagement in listed companies' sustainable development. Today, in the context of China's goals of carbon peaking and carbon neutrality, SOEs represented by the corporate, tend to respond positively to policy trends. They are accelerating their low-carbon transition in both automotive product development and manufacturing technology, with a rapidly increasing awareness of sustainability. However, there is a significant gap between the international sustainability performance assessment system and China's regulatory requirements and general industry practices. Therefore, there is an urgent need for Chinese government departments, regulators, industry organisations, and investors to work together to guide listed companies in information disclosure and best practices, so as to accelerate low-carbon transition step by step.

• To this end, China AMC will continue to exert its external influence and sign up to sustainability initiatives launched by international organisations to enhance interaction and raise awareness with Chinese listed companies on ESG-related topics such as climate change and long-term sustainable development.

• It will also sign up to green finance initiatives of the Chinese government, regulators, and industry associations, aiming to communicate international and domestic sustainable policy trends to Chinese listed companies and provide more professional solutions and advice on low-carbon transition.

• Additionally, regarding the communication's impact on China AMC's sustainable investment, the engagement practice has deepened China AMC's understanding of the climate-related risks and opportunities facing the automotive manufacturing industry and the listed companies in it. It will allow China AMC's investment research team to more comprehensively and accurately measure listed companies' sustainability-related performance when making investment decisions.

1.3

CHINA'S POLICY FRAMEWORK AND MARKET STATUS



As one of the world's largest economies and largest GHG emitters, China plays a critical part to successful global response to climate change with its decarbonisation action. Chinese corporates' low-carbon transition is also crucial to global green changes and the development of a new green economy. In recent years, with China's fast-growing economy and improving capital market, institutional investors have become an important driver behind China's economic and social transition. There has been an increased focus on how they can influence Chinese corporates' low-carbon transition through effective stewardship. This section presents the policy framework and market status for institutional investors to practice stewardship in China, especially investor engagement with a focus on promoting corporates' low-carbon transition. It is accompanied by the project research team's analysis of and reflections on the current challenges and opportunities faced by institutional investors.

1 An improved policy system and financial ecosystem to support the goals of carbon peaking and carbon neutrality provides strong support for institutional investors to engage in corporates' low-carbon transition.

In September 2020, Chinese President Xi Jinping announced in his speech at the 75th General Debate of the United Nations General Assembly that China will scale up its nationally determined contributions and adopt stronger policies and measures. China aims to peak carbon dioxide emissions before 2030 and achieve carbon neutrality before 2060.

China aims to Peak Carbon Dioxide Emissions before **2030**

China aims to Achieve Carbon Neutrality before **2060**

The goals of carbon peaking and carbon neutrality target are a landmark climate ambition and a core initiative to move China from an industrial to an ecological civilisation. They not only reflect China's full recognition of the importance and urgency of climate change but also demonstrate that China takes up its responsibilities as a major global player for addressing global climate change. Regarding the capital market, the goals will promote the second transformation of China's economic supply structure. They will also prompt a comprehensive transition of China's industry from a high-carbon consuming structure to a low-carbon and environmentally-friendly one.

Toward the goals of carbon peaking and carbon neutrality, the establishment of a sound system of supporting policies lays the essential groundwork for China to advance comprehensive transition, economic growth, reform, and innovation. In recent years, China has made efforts in policies. Competent departments have introduced supporting implementation plans for key sectors and industries to achieve the goals of carbon peaking and carbon neutrality. A '1+N' policy system²⁹ for China's carbon peaking and carbon neutrality has been basically established, which provides corporates, financial institutions, and other market players with continuous policy support and work momentum to achieve the goals. So far, there have been two major paths to build the financial ecosystem for carbon peaking and carbon neutrality. The first is to improve the green finance system to guide funds into green and low-carbon areas. The second is to explore the transition finance framework to promote high-emitting industries' low-carbon transition.



In 2015, the Central Committee of the Communist Party of China (CPC) and the State Council of the People's Republic of China issued the *Opinions on Accelerating the Construction of Ecological Civilisation and the Integrated Reform Plan for Promoting Ecological Progress*, among other documents. In 2016, the People's Bank of China (PBOC), the Ministry of Finance, and the Development and Reform Commission, and four other ministries and commissions jointly issued the *Guidelines for Establishing the Green Finance System*. Since then, China has formed a green finance framework with five pillars: policy and standard systems, information disclosure requirements, incentive and restraint mechanisms, product and market systems, and international collaboration.



²⁹ In China's 1+N policy framework for carbon peaking, carbon neutrality, '1' means the *Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy* issued by the CPC Central Committee and the State Council, which serves as the programmatic document that sets forth the overall objective and long-term goals, and 'N' means a set of policy documents represented by the *Action Plan for Carbon Dioxide Peaking Before 2030* issued by the State Council, which provide detailed implementation plans for carbon peaking in different fields and sectors, such as energy, industry, transportation, and urban-rural construction. This policy framework has basically been established.

Based on that, China has established one of the world's largest green finance markets. By the end of the third quarter of 2022, the balance of China's green loans in domestic and foreign currencies totalled CN¥20.9 trillion, an increase of 41.4% year-on-year³⁰, and the stock size of its green bonds was CN¥1.2 trillion in mid-year, ranking second in the world³¹.

20.9 trillion
the balance of China's
green loans in domestic
and foreign currencies
totalled

an increase of
year-on-year
41.4 %

1.2 trillion
the stock size of its green
bonds

in the world
2nd

The setting of the goals of carbon peaking and carbon neutrality has ushered in a new era of historical significance for green finance. To achieve the goals, it requires a large amount of capital into green and low-carbon sectors. It is estimated that the amount of green and low-carbon investment needed could reach hundreds of billions of RMB in the next 30 years or so³². As China's green financial system improves, the scale of green and low-carbon investment will show a rapid growth. It will provide ambitious and prepared financial institutions with a broader market and more opportunities to invest in green and low-carbon sectors. That way, such institutions can rapidly build up their green and low-carbon investment capabilities and expand their investment footprint in green and low-carbon industries.

To achieve the long-term goal of carbon neutrality, it requires not only green and low-carbon industries but also the cooperation and transition of high-emitting industries. High-emitting industries such as power generation, petrochemicals, chemicals, and building materials are important sectors in China's economy. Their progress in reducing carbon emissions has a profound impact on China's progress in industrial restructuring and upgrading and pace toward the

goals of carbon peaking and carbon neutrality. Thus, based on the sound green finance system, China is exploring a transition finance framework for in line with international practices and filling the financial gap that green finance fails to fill. That way, it supports high-emitting industries' low-carbon transition and builds a more comprehensive and solid financial ecosystem for the goals of carbon peaking and carbon neutrality.

For example



in late 2021

the PBoC launched a new monetary policy tool in late 2021 to support carbon emission reduction projects through cheap lending to financial institutions.

To date, over **CN¥300 billion** has been issued in relending,

supporting carbon emission reduction loans of over **CN¥510 billion**

and facilitating **100 million** metric tonnes of carbon dioxide equivalent to be reduced in 2022³³.

In the next phase, the policy will expand its coverage to include more financial institutions.



In June 2022

the International Platform on Sustainable Finance (IPSF), a joint initiative of China, the EU, and other economies, released an updated version of *the Common Ground Taxonomy - Climate Change Mitigation*. It identifies 72 economic activities that significantly contribute to climate change mitigation, laying the foundation for the interconnection between the Chinese and foreign green debt markets and facilitating cross-border investment and financing for green and low-carbon transition.



In November 2022

G20 leaders endorsed the China-led *G20 Transition Finance Framework*. It was the first time for the world to agree on financial support for low-carbon transition and for China to gain an international voice in promoting global standardisation of transition finance.



In 2021

the PBoC launched its research program on transition finance. It has initially defined the basic principles of transition finance and organised research on transition finance standards for steel, coal power, and construction and building materials, among other sectors.

These developments and arrangements reflect the great importance China attaches to the efforts in developing transition finance and mobilising the capital market to engage in economic and social transition in the next step. They set priorities for financial institutions to simultaneously promote investment and financing in green and low-carbon industries and financial support for the transition of high-emitting industries. The supportive policy system and financial ecosystem for the goals of carbon peaking and carbon neutrality are seeing continuous improvements. With their strong guidance and support, it will become a mainstream for institutional investors to practice stewardship and play an active role in supporting Chinese corporates' low-carbon transition.

³⁰ The People's Bank of China, Statistical Report on Loan Direction of Financial Institutions in the Third Quarter of 2022[R]. 2022.

³¹ Research Bureau of The People's Bank of China, Improve the Green Finance System in Support of Green, Low-Carbon, and High-Quality Development[J]. 2022.

³² Ma, J. Improving the Green Finance System with the Aim of Carbon Neutrality[J]. Financial Times. 2021.

³³ Excerpt from the speech by Yi Gang, Governor of PBoC, at the launch ceremony of China Beijing Green Exchange in Beijing, on 4 February 2023.

2 Driven by multiple forces, institutional investors actively practice local stewardship and increase their awareness to engage in promoting Chinese corporates' low-carbon transition

Leading institutional investors in the global market have a wealth of practical experience in stewardship. As discussed in Section 1.2 of this report, there have been a growing number of successful examples of engagement practice in low-carbon transition in the Chinese and other capital markets. Stewardship is new to the Chinese market. Nonetheless, institutional investors have been more active in practicing stewardship in China in recent years, as the country's financial market opens up, sustainable investment grows rapidly, and the policy system improves. Overseas and local institutional investors have increased awareness of and interest in helping Chinese corporates initiate and implement low-carbon transition plans. There is a growing trend towards localised implementation and development of relevant practices. These China-focused institutional investors have set engagement in facilitating Chinese corporates' low-carbon transition one of the priorities in their sustainable investment process. They have been more active in dialogue on low-carbon transition with Chinese corporates and taken up the powerful voting rights to communicate their expectations for such transition at general meetings of shareholders.

The progress of stewardship in China is first and foremost a result of China's opener financial market. In recent years, China has continued to deepen its financial reforms and opening up. As a result, the ownership of China's A-share listed companies has been less concentrated, with the average shares held by controlling shareholders steadily declining. As controlling shareholders' absolute dominance in Chinese corporates reduce, institutional investors have gained a bigger voice. Their engagement in China's A-share market is on the rise, with their shareholding increasing³⁴. Thus, institutional investors have more room and opportunities to deepen their stewardship practices in China. Take the number of Chinese signatories to UN PRI as an example, which reached 123 by the end of 2022³⁵. These signatories commit to follow the second principle of the UN PRI, 'We will be active owners and incorporate ESG issues into our ownership policies and practices.' Notably in 2017 and before, the number of Chinese signatories was only in single digits. The increase reflects that the Chinese capital market has been embracing and supporting stewardship-related concepts in recent years. Additionally, more Chinese and foreign institutional investors have cast their eyes to climate-related engagement in Chinese investees.

For example, as of the end of 2022, the Climate Actions 100+ had organised global institutional investors to engage in ten key Chinese corporates to facilitate their transition to a net-zero economy in all aspects. The corporates have seen breakthroughs in their net-zero commitments, strategies and objectives, governance and information disclosure areas. So far, Climate Actions 100+ has eight local Chinese institutional investors as signatories, who practice engagement collaboratively with global institutional investors. It demonstrates how local institutional investors value and practice cross-regional exchange and collaboration on climate change and stewardship.

At the same time, the wave of sustainable investment continues to fuel stewardship in China. As China's supporting policy system and financial ecosystem for the goals of carbon peaking and carbon neutrality improves, sustainable investment in China is scaling up rapidly. The capital market has been fully mobilised. Institutional investors are developing innovative sustainable financial investment tools to channel resources to the backbone of green and low-carbon transition.

By 31 October 2022, 198 carbon neutrality-theme/concept funds and 73 ESG funds had been issued across the domestic market.

198 carbon neutrality-theme/
concept funds

73 ESG funds

By 30 September 2022, domestic carbon neutrality public funds totalled CN¥197.6 billion, up 561% from CN¥30 billion in 2017.

CN ¥ **197.6** billion
domestic carbon neutrality
public funds totalled

561 %
from CN¥30 billion in
2017.

ESG-themed public funds totalled CN¥22.51 billion, up 37% from CN¥16.42 billion in 2017³⁶.

CN ¥ **225.1** billion
ESG-themed public funds
totalled

37 %
from CN¥16.42 billion in
2017

The fast-growing sustainable investment landscape has led to increasing attention to sustainable investment strategies, such as stewardship, in the Chinese market. In particular, the long-term sustainable value created by promoting investees' sustainable development through investor engagement and the exercise of voting rights has been more widely recognised in recent years. More sustainable institutional investors focusing on the Chinese market have realised that rather than avoiding investing in a certain category of corporates, it is more effective to engage in the low-carbon transition process and improve corporate behaviour. It will benefit both the investors themselves and society.

For local sustainable institutional investors

proactive engagement in corporates' low-carbon transition helps them fast-track their sustainable investment process at the current stage. Specifically, they can access more long-term capital, practice their sustainable investment philosophy, and strengthen their ability to manage climate-related risks in the engagement.

For overseas institutional investors

proactive engagement in Chinese corporates' low-carbon transition helps them broaden their communication channels with Chinese investees. That way, they can have a better understanding of the Chinese market, regulation, and trends. Moreover, it provides these overseas institutional investors with more opportunities to work with outstanding local industry partners to support Chinese corporates' sustainable development.

In addition, as mentioned above, active engagement in Chinese corporates' low-carbon transition helps institutional investors gain long-term returns in the Chinese market and fulfil their fiduciary duties to holders. In that course, they can work together to drive sustainable changes at the systemic level. These benefits are key motivations for institutional investors to pay more attention to and expand their engagement practices in the low-carbon transition in the Chinese market.

Furthermore, the progress of stewardship in China is closely related to continuous improvements to the relevant policy system. In addition to the bottom-up actions of institutional investors, another core condition for the implementation and progress of stewardship practices in China is top-down policy guidance. In September 2018, the China Securities Regulatory Commission (CSRC) issued the revised *Code of Corporate Governance of Listed Companies*. In the new edition, it explicitly encourages institutional investors to exercise their shareholder rights to engage in the governance of listed companies in China, with an emphasis on listed companies' green development and ESG-related disclosure. Since then, as more applicable policies and guidelines have been issued, institutional investors' corporate engagement around ESG-related topics in China has been clarified and highlighted.

2022

April the CSRC issued *the Guidelines on Investor Relations Management of Listed Companies*. In this paper, ESG information is set as part of the communication between listed companies and investors in investor relations management.

June the China Banking and Insurance Regulatory Commission (CBIRC) issued *the Green Finance Guidelines for the Banking and Insurance Sectors*. It guides Chinese banking and insurance institutions to serve economic activities with both environmental and social benefits and to enhance post-lending and post-investment ESG management.

September the Insurance Asset Management Association of China (IAMAC) issued *the ESG Stewardship Proposal for the Chinese Insurance Asset Management Sector*. It is designed to encourage domestic insurance asset management institutions to adopt the stewardship approach in progressing corporates' green transition.

These policies and guidelines have created a favourable policy environment for institutional investors to practice stewardship in China. They guide institutional investors to engage in progressing Chinese corporates' sustainable development and low-carbon transition. In the future, relevant regulators and industry associations may introduce more applicable policies, guidelines, or codes in due course to encourage institutional investors to continue to intensify their practices and promote the development of stewardship on a larger scale in China.

³⁴ Fidelity International, Fidelity International China Stewardship Report 2022[R]. 2022.

³⁵ The latest data is from the official UN PRI website. <https://www.unpri.org/>

³⁶ Fidelity International, Zhong Ou AMC, Ant Wealth Management Think Tank, and CITIC Securities. 2022 China Sustainable Investing White Paper [R]. 2022.

3 In the face of both challenges and opportunities, there is an urgent need for institutional investors to take the lead in progressing engagement in corporates' low-carbon transition and stewardship.

The support and assistance from multiple sources have create sufficient space for institutional investors to practice stewardship in the Chinese market, especially through investor engagement to promote corporates' low-carbon transition. However, there are still challenges for institutional investors in fast-tracking engagement in corporates' low-carbon transition and stewardship in China in the following areas:



In terms of the policy environment for institutional investors

China's supporting policy system for the goals of carbon peaking and carbon neutrality has taken shape and been improved. However, there is still a lack of universal and clear policies, guidelines, or standards in certain key areas, which impedes institutional investors to break new ground in their existing engagement practices. For example, there is still a lack of universal and mandatory corporate ESG disclosure standards. As a result, institutional investors have no access to consistent and comparable high-quality ESG data to measure the effectiveness of their engagement practices.



In terms of institutional investors' internal governance

there is a shortage of professionals in sustainable investment, ESG, and stewardship. Under such circumstances, it is challenging for institutional investors to allocate resources, strengthen internal collaboration, and combine fundamental investment research, ESG investment research, and stewardship to give full play to the positive role of internal functions that complement and support each other and efficiently produce outcomes.



In terms of institutional investors' engagement practices

to identify effective engagement processes, approaches, and priorities, institutional investors must have knowledge and capacity in many areas. They include 1) an extensive understanding of the Chinese culture, policies, and market environment; 2) the ability to use the appropriate language when communicating with corporates and to identify key communication channels; 3) and insight into low-carbon transition in high-emitting sectors. The knowledge and capacity will take time and repeated practical exploration by institutional investors.

In the midst of challenges, there are often opportunities. The stewardship market in China is a largely unexplored realm. In this regard, the key to breakthroughs in stewardship in China lies in institutional investors focusing on the Chinese market. They can act as practitioners of stewardship and initiators of corporate engagement dialogue to mobilise stewardship initiatives and potential from the inside and launch more good investor engagement practices in China. It takes long for good engagement practices for low-carbon transition to take effect. Continuous trial and error and matching are often prerequisites for rapid progress. Even in the face of multiple challenges in the exploration, institutional investors can break through and create more long-term value, as long as they consistently believe in helping China's real economy achieve a net-zero transition.



02

Part

DEVELOPING NEW ECOSYSTEM FOR INSTITUTIONAL INVESTORS ENGAGING TO CATALYSE CLIMATE ACTIONS OF CHINA'S REAL ECONOMY

—How do institutional investors engage to promote low-carbon transition of corporates in China?

2.1

Developing the Strength to Engage in Low-carbon Transition: Institutional Investors Engaging to Promote Low-carbon Transition of Corporates in China

2.2

Enhancing the Fundamental Strength of Stewardship: Laying the Foundation for Stewardship and Tapping Low-carbon Engagement Potential



Based on this, the second part of this report offers recommendations and implementation approaches to help those China-focused institutional investors make better use of investor engagement. It is a powerful tool to promote low-carbon development and net-zero transition for corporates in China, as well as to support China's goals of carbon peaking and carbon neutrality. Specifically, through intensive external engagement and internal foundation enhancement, institutional investors should catalyse China's real economy's low-carbon development and actions to combat climate change. They should focus on developing and enhancing two core strengths: the strength to engage in low-carbon transition and the fundamental strength of stewardship.

'The strength to engage in low-carbon transition' of institutional investors is embodied in their deep involvement in the low-carbon transition of Chinese corporates. That way, they contribute to the achievement of China's carbon peaking and carbon neutrality goals. To strengthen the capability of

engaging in low-carbon transition, institutional investors must think about how to better utilise their resources and leverage their strengths to promote their portfolio companies' low-carbon transition. 'The fundamental strength of stewardship' of institutional investors is embodied in the readiness and maturity of institutional investors' engagement. It reflects whether a solid stewardship foundation is in place to carry out in-depth the engagement work for low-carbon transition. To nurture and enhance the fundamental strength of stewardship, institutional investors must continuously improve their internal systems for stewardship, including investor engagement and exercising voting rights. They should also form a proactive awareness of stewardship and strengthen the influence of sustainable development, so as to prepare themselves for in-depth engagement in low-carbon transition. In this part, the project research team puts forward specific suggestions and implementation approaches for how to develop, train, and continuously improve the two 'strengths' of institutional investors.



2.1

DEVELOPING THE STRENGTH TO ENGAGE IN LOW-CARBON TRANSITION: INSTITUTIONAL INVESTORS ENGAGING TO PROMOTE LOW-CARBON TRANSITION OF CORPORATES IN CHINA



As China pursues high-quality economic development, the carbon peaking and carbon neutrality goals have been introduced and corresponding policies have been deployed. They have brought huge transformation challenges to high-carbon industries such as power generation, petrochemicals, chemicals and building materials. Therefore, it is of utmost importance for China's economic restructuring to study and promote the steady and orderly progress of corporates in these key industries towards low-carbon development.

Into their own investment, research and engagement practices, institutional investors should also fully incorporate catalysing corporates in key high-carbon industries in low-carbon transition. They should actively develop and train the 'the strength to engage in low-carbon transition' and launch policy engagement and engagements in other forms. That way, they can support and urge Chinese corporates to carry out emission reduction actions and jointly accelerate China's real economy to cope with climate change.

To this end, the project research team summarises the process and key tasks of institutional investors involved in engaging to promote low-carbon transition of corporates in China.

It highlights the critical aspects of institutional investors engaging in key corporates' low-carbon transitions in related industries.

It also serves as a reference for institutional investors to engage more intensively and efficiently in promoting low-carbon transition in China.

Institutional Investors Engaging to Promote Low-carbon Transition of Corporates in China: Process and Key Tasks



Figure 2-1: Institutional Investors Engaging to Promote Low-carbon Transition of Corporates in China: Process and Key Tasks

Source: A work by the project research team

Investment Research Knowledge Building

Institutional investors may expect to accelerate the low-carbon transition of corporates in China through in-depth engagement to promote the achievement of China's carbon peaking and carbon neutrality goals. For that purpose, they should continue to conduct relevant research on the current situation, trends and future development direction of the low-carbon transition of high-carbon industries in China in their daily investment research work. Such industries include power generation, petrochemicals, chemicals and building materials. They should also include climate change in macro analysis and case studies. Specifically, they should fully understand the current status of carbon emissions in key industries in China, especially the high-carbon industries, the carbon emission

reduction goals and related low-carbon development policies set by the state and local governments for these industries. Moreover, they should analyse and identify the opportunities and challenges faced by the corporates during the process of low-carbon transition and explore low-carbon transition pathways and crux of emission reduction. The outcomes of their daily investment research can help institutional investors establish a more systematic knowledge frame, form a more comprehensive knowledge pool, and accumulate multiple elements of corporates' low-carbon transition. With all these, institutional investors can efficiently analyse the crux to emission reduction, laying a solid foundation for institutional investors to carry out specific engagement work.

Conducting Engagement Actions

Based on the adequate understanding and analysis of the low-carbon transition of corporates in daily investment research, institutional investors should engage in specific low-carbon transition effort from two aspects respectively.



On the one hand

institutional investors should take the initiative to identify key issues of low-carbon transition that need to be jointly promoted by multiple relevant corporates and/or lobby for policy action and support. They may assemble discussions on the key issues of common interest or concern (i.e., thematic engagement). Another approach is to conduct dialogues with relevant government departments, policy and standard makers or regulators, and respond to policy consultation (i.e., policy engagement). As mentioned above, the thematic and policy engagement of institutional investors will also play a critical role in supporting corporate engagement. Thus, it is also important to focus on the engagement of different participants and adopt a diversified approach to promote the systematic transformation of each low-carbon transition priority. That way, corporates will be facilitated to realise low-carbon transition. In addition, to avoid ineffective engagement as much as possible, institutional investors need to identify the key issues that are related to or need to be discussed with multiple corporates. In that process, the investors should promote unified actions and solutions among them. Institutional investors may also need to make judgements according to the extent that corporates are influenced by national strategies and policies or the market. They should determine whether the corporates need to further enlist the help of relevant government departments, policy and standard makers or regulators. At this stage, specific thematic and policy engagement practices in China that institutional investors could consider include:

Thematic engagement: Institutional investors should first identify the key issues that need to be jointly promoted by multiple related corporates. After that, they should collaborate with relevant associations, key corporates, research institutions and experts in related fields. Together, they should conduct thematic industry research and capacity building on low-carbon transition, collectively publish research findings on low-carbon transition, and develop group/industry low-carbon transition and sustainable development standards. That way, they can raise the awareness and attention towards low-carbon transition with real actions and advocate a more unified net-zero transition action among Chinese corporates.

Policy engagement: Institutional investors should actively respond to and provide feedback on the proposed policies related to climate change and low-carbon transition to be introduced by competent government departments, policy and standard makers and regulators. The investors may even cooperate with them on the basis of the general establishment of the support policy system for China's carbon peaking and carbon neutrality goals to jointly issue more detailed and thorough policies. Institutional investors should provide support information to relevant government departments, policy and standard makers and regulators. Such information includes the best practices and experience accumulated through corporate engagement and thematic engagement. It will be a way to contribute to a healthy policy environment to support the green and low-carbon development of the real economy.



On the other hand

institutional investors should engage in a dialogue with a single priority corporate by identifying and prioritising target engaged portfolio companies. This is known as 'corporate engagement' in the traditional sense. For a one-on-one dialogue with a single corporate, the institutional investor should first select the key portfolio companies that have the most potential for low-carbon transition and determine the priority thereof. Normally speaking, institutional investors hold the equity of thousands of corporates in their portfolios. Yet, considering the limitation of resources, institutional investors can only conduct communication and dialogue in-depth with a few key corporates first or in batches. This means that institutional investors need to identify the climate-related risks and opportunities faced by portfolio companies and assess their climate resilience based on their carbon emissions and environmental benefits. That way, they can screen out the key portfolio companies that have the most potential for low-carbon transition, prioritise them and compile a list. In the process of prioritising, institutional investors should also consider their own shareholdings and ownership coverage of these key corporates, as well as the degree of engagement and willingness of other institutional investors. They should strike a balance between improving the financial performance of the portfolio and promoting its low-carbon transition. Prioritising portfolio companies for engagement can also help institutional investors understand the readiness of corporates to make a low-carbon transition. Being informed, institutional investors can be well prepared to provide pertinent advice to corporates in favour of their transition needs.

After prioritising the engaged portfolio companies and compiling a list, institutional investors can engage in the key corporates. In on-going dialogue, they can urge the corporates to make a low-carbon transition. In the process of on-going dialogue, institutional investors should attach great importance to the five key tasks:

- **1) Identify and prepare a list of key issues/topics on corporates' low-carbon transition for target corporates.**

Firstly, institutional investors should accumulate research findings and knowledge from daily investment research, including a deep understanding of climate-related risks and opportunities, as well as the trends and priorities of low-carbon transition in China's high-emitting industries and market practices. Based on those, institutional investors can identify the key issues/topics of low-carbon transition faced by the corporates they engage in and prepare a list. During this process, institutional investors should actively draw on international best practices and high-level standards and consider the consistency of the key issues/topics with global net-zero goals and sustainable development strategies. They should promote the alignment of Chinese corporates with international development trends and the formation of international basic consensus.

On the other hand, they should explore the key issues/topics faced by corporates during low-carbon transition suitable for China's reality according to China's development stage and characteristics. They should fully consider China's sustainable development and strategies related to low-carbon transition including China's carbon peaking and carbon neutrality goals. Based on the above considerations, they should form a list of the key issues/topics of Chinese corporates' engagement in low-carbon transition that takes both the international trends and Chinese practices into account. Table 1 illustrates an example of the key issues/topics of institutional investors' engagement in low-carbon transition of Chinese corporates. It provides a reference for institutional investors to compile a list of the key issues/topics of engaged corporates' engagement in low-carbon transition according to the practical situation.

Table 1: Example of the key issues/topics of institutional investors engaging to promote low-carbon transition of corporates in China

Commitment to carbon peaking and carbon neutrality	<ul style="list-style-type: none"> • Make carbon peaking and carbon neutrality commitments consistent with China's carbon peaking and carbon neutrality goals proposed by the competent department/association (if any). • Encourage corporates to develop a carbon peaking and carbon neutrality commitment ahead of the '30/60' goals.
Emission Reduction Targets	<ul style="list-style-type: none"> • Sets detailed and phased reduction targets based on corporates' carbon peaking and carbon neutrality commitments, including quantified short-, medium- and long-term emission reduction targets. • Clarify the scope and boundary of GHG accounting, and the emission reduction targets should cover scope one and scope two emissions, as well as scope three emissions that are significant (based on the factual situation of corporates).
Transition Plan	<ul style="list-style-type: none"> • Develop specific transition approaches/initiatives to achieve short-, medium- and long-term emission reduction targets, plan the technical approaches for each phase as well as the capital expenditure plans. • Identify the sources of GHG emissions involved in the transition approaches/initiatives (corresponding to the range of GHG emissions covered by the reduction target). • Incorporate 'Just Transition' to assess the impact of transition approaches/initiatives on other sustainability goals (e.g., UN SDGs), and identify countermeasures.
Internal Governance	<ul style="list-style-type: none"> • At the board level, designate relevant personnel or establish a carbon neutral/climate change/sustainable development committee to coordinate and oversee related work on climate change and low-carbon transition. • At the management level, designate executives and set up special teams/departments to coordinate the implementation of low-carbon transition actions across internal departments. • Ensure that the board and management are equipped to manage climate risks and opportunities, building capacity where necessary. • Link phased emission reduction targets to emission reduction and transformation pathways/implementation of measures, and performance assessment indicators.
Information Disclosure	<ul style="list-style-type: none"> • Refer to the climate-related information disclosure requirements and guidelines issued by international authorities (e.g., TCFD, ISSB, etc.) or widely used at home and abroad, and carry out information disclosure related to climate change and low-carbon transition in conjunction with the requirements of domestic authorities/associations (if any). • Publish independent reports on a regular basis, or disclose milestone reduction targets, implementation status of reduction and transformation actions, and arrangements for next steps in annual/ESG reports.

2) Identify and prioritise the material issues of priority engagement among the key issues/topics.

Substantive low-carbon transition key issue/topics are important enough among numerous issues/topics in this field. As mentioned above, material issues usually have critical impacts on the economic, environmental and social aspects of corporates and the assessment and decision-making of corporates' stakeholders.

Therefore, institutional investors should discuss with engaged corporates to select these material issues after compiling the list of focus topics for low-carbon transition. They should prioritise the dialogue with corporates on these material issues and invest resources in the engagement practices on them.

Moreover, they should help the engaged corporates solve the difficulties they face on these topics and promote the low-carbon transition of corporates on them. It is worth noting that, in addition to selecting material issues with the engaged corporates, institutional investors should also have a deep understanding of their overall business, operation management, cultural values and local policies through due diligence and dialogue. They should be keenly aware of the differences between engaged corporates and their peers in addressing climate change issues. In-depth study of the relevant risks and opportunities faced by corporates can help corporates identify the material issues requiring external assistance and support more accurately.

3) Set clear, realistic and measurable transition goals and milestones for the material issues and ensure that the final goals are 'inclusive'.

Setting transition goals and milestones for corporates on the engagement issues is a fundamental element of corporate engagement for institutional investors. Before or during the dialogue with corporates, institutional investors should ensure that the transition goals and milestones set for corporates on the selected engagement issues are clear, realistic and measurable. This is the key to ensure the continuity and effectiveness of the dialogue.

While ensuring that the outcomes of the engagement are truly supportive of China's carbon peaking and carbon neutrality goals, institutional investors should pay special attention to the 'inclusiveness' of the transition goals set for corporates. The final goals set for the engagement issue should allow institutional investors to adjust the milestones and the pathway according to the internal development and transformation of corporates, external policy and market shifts. Such adjustments should ensure the achievement of the final goals.

The 'inclusiveness' of the final targets is also reflected that goals that are too harsh will not be set in the communication with some engaged corporates facing major transformation difficulties or in the early stage of transition. This practice will ensure that the goals set are realistic and achievable for the engaged corporates. For these corporates, institutional investors should also adopt a 'progressive' approach to communication. They should upgrade the goals over time, depending on the actions of and dialogues with the engaged corporates. This approach can give these corporates the confidence to take the "first step" of transition and help them overcoming the challenges.

4) Based on the transition goals and milestones, assist corporates develop transition plans with clear pathways.

After defining the goals and milestones, institutional investors should launch their work accordingly. Specifically, they should base themselves on these transition goals and milestones set for the corporates on the engagement issue, combined with the accumulation of daily investment research and the actual situation and needs of the engaged corporates. They should work with the engaged corporates to analyse and derive a detailed, clear and most cost-effective transition pathway. They should help the engaged corporates plan practical, concrete and implementable transition solutions from various aspects to achieve the goals and milestones and realise long-term sustainable development and net-zero commitment.

Institutional investors should also sort out and summarise excellent practices at home and abroad, and share with corporates and give them more direct guidance in the follow-up communication and dialogues.

5) Continuously track progress and review milestones in a timely manner, cooperate with corporates with a long-term, open attitude until the final goal is reached.

Institutional investors should first define the transition goals, milestones and corresponding transition pathways with the engaged corporates. After that, they should continuously track the transition performance of the corporates on the engagement issues. They should evaluate the corporates' transition progress with relevant domestic and international evaluation indicators and standards (e.g., the Climate Action 100+ Net Zero Company Benchmark), as well as the practical experience and disclosure of domestic and international corporates on climate transition.

Institutional investors should, as they gain a deeper understanding of the engaged corporates, promptly identify the difficulties faced by the engaged corporates in the low-carbon transition. In that case, they should proactively help the corporates find better solutions and communicate with them with a long-term and open attitude. They should work together to achieve a more macro and long-term sustainable development vision and net-zero commitment.

Fidelity International's Engagement Case Study with a Chinese Cement Manufacturing Company and Reflections for Chinese Cement Companies

Fidelity International's Engagement Case Study with a Chinese Cement Manufacturer:

Fidelity International (hereinafter referred to as "Fidelity") adopts an active sustainable investing approach in guiding its decisions to have a positive impact on society. In a long run, engagement with companies and industry groups is the key to improving company behavior and performance, and therefore is at the core of Fidelity's sustainable investing approach. Fidelity requires companies to disclose positive progress on ESG topics such as gender diversity, climate change risks, shareholder rights, and supply chain management. Currently, climate change, greenhouse gas emissions, and other related topics have become the focus and hot topics of Fidelity's company engagement.

Cutting emissions in the cement industry is crucial to China's national drive towards net zero by 2060. In facilitating decarbonization within the cement industry, Fidelity's equity research and sustainable investing teams have started speaking to the management of China's second-largest producer about emissions targets in late 2020. This company is a leader in the domestic cement production industry, headquartered in Anhui Province, and listed in both A-share and H-share markets. Since then, Fidelity has maintained in-depth communication with the company and actively explored decarbonization pathways in order to improve the company's overall ESG competitiveness.

Prior our first engagement with the company, the company's management had begun to actively advance its ESG and sustainable development. Therefore, reflecting some of the improvements the company has made in response to Fidelity's advice, the company's

received an increase in its sustainability score in 2021 and 2022 by an external third-party ratings provider, demonstrating its efforts in continuous improvement. Advice from Fidelity, an external third-party ratings provider raised the company's sustainability score in 2021, and upgraded it again in 2022, demonstrating a continuous improvement.

Further analysis into the company's operations revealed that the company was selling its efforts short based on how it was disclosing and benchmarking its emissions data. For example, some global sustainability rating agencies have been rating the company based on emissions per million dollars of revenue, but this overlooks one of the basic dynamics of the global cement industry: prices, production and consumption are highly localized due to high shipping costs. Consequently, the prices of cement in China tends to be 40 to 50 per cent cheaper than in the West. We realized that applying revenue-based emissions metrics would by nature place the Chinese company in a disadvantaged position in comparison to its global peers. Instead, utilizing volume-based metrics that reflect emissions per unit of actual cement production would provide a more accurate cross-border comparison and a better picture of the company's carbon reduction efforts. We suggested the company to communicate this clearly to external sustainability ratings agencies, such that the company's efforts can be re-evaluated. Subsequently, the company received an upgrade in their ESG ratings.

While Fidelity has provided advice and encouragement, the company has also been

proactive in limiting its energy consumption per tonne of cement as well as boosting its overall operating efficiency. While the company currently has the lowest emission density among large cement producers when measured by unit of output, they continued following our suggestions of establishing mid-term carbon reduction goals as well as setting a more stringent target to achieve 6 per cent total reduction in emission intensity by 2025.

Moreover, the company has taken it upon itself to explore new ways to reduce its emissions of carbon and other harmful greenhouse gases. For example, it has developed an efficient system to curb nitrogen oxide emissions, which in many cases have greater global warming potential than carbon dioxide emissions. could cause more global warming than carbon emissions.

There are other indicators that other large cement makers in China are starting to follow the company's lead in ESG commitments, as the government pushes ahead with nationwide decarbonization targets. We believe that the drive toward net zero, on top of serious engagement by investors, will eventually help eventually firm up a greener path for China's cement industry.

Reflections for Chinese Cement Companies:

The chemical reactions inherent in the cement production account for up to 60% of cement's carbon emissions, which is one of the key challenges faced in low-carbon transition of cement companies. In order to power their transition, Fidelity believes that investors need to take a dynamic view of a company's transition and ESG development potentials, and be prepared to engage and partner with them over the long term. As mentioned in the above case, Fidelity's years of engagement with the leading company has effectively helped its transition and development. Being the industry's leader, their progress has drove other companies in the industry to keep pace and accelerate transition. As seen, long-term and practical engagement between investors and companies can efficaciously promote positive impact in companies, thereby enabling reforms within the industry.

- In addition, one of the challenges faced by sustainable investors is the lack of effective information disclosure on companies' low-carbon transition strategies and their implementation progress. Without relevant information to support analysis and form opinions, effective communication can be impeded.
- To this end, Fidelity has also improved its own ESG rating framework to ensure effective transformation of ESG data to guide investment decisions. At the same time, we also encourage all cement companies, regardless of their stage of transition, to systematically sort out and disclose their ESG practices to improve communication efficiency with investors.

Allianz Global Investor's Engagement Case Study with a European Oil & Gas Company and Reflections for Chinese Petrochemical Companies

Allianz Global Investor's Engagement Case Study with a European Oil & Gas Company:

As an active asset manager, Allianz Global Investor (hereinafter referred to as "AllianzGI") is committed to driving positive change and believes that constructive engagement dialogue with investee companies is essential. Within the many sustainability topics, we consider climate change among humanity's most pressing challenges and has significant implications for all three ESG elements. A lot of our discussions with investee companies focus on climate risk assessments, exploring how companies reflect climate risk and the low-carbon transition in their strategy, operations, and product pipelines. Climate change, planetary boundaries, and inclusive capitalism altogether form AllianzGI's three-pillar strategic sustainability themes.

Given the above focus, we identified this European multi-national energy and petroleum company as one of the few significant listed players in the industry globally. It operates in more than 130 countries and deals with the business along the entire oil and gas value chain. It accounts for 2% of the Oil & Gas production and 0.4% of the global O&G reserves. Considering that the net-zero transition pathway of this company has implications for itself, its peers as well as the supply chain, we initiated this engagement activity since more than three years ago and have witnessed trackable progress along with our recurring conversations. It is one of the most advanced and transparent in its decarbonisation strategy with a clear consideration for a just transition not only towards employees but also local communities.



Feb 2019

The first engagement meeting with the company was held back in Feb 2019 when it announced an updated version of climate change strategy a week earlier, and our purpose was to kickstart the conversation and understand more details. The strategy's primary goals included a 15% reduction target by 2025 on its absolute GHG emissions (Scope 1+ Scope 2) based on a bottom-up calculation approach, majorly through reduced flaring, electrification of industrials processes, and reduction in methane emission among other actions. Although the company has completed a relatively comprehensive lifecycle analysis of its products to better assess its Scope 3 emissions, it stressed that Scope 3 emissions are partly under the control of clients, so that's left out of their decarbonisation targets.

For an O&G company, Scope 3 emissions can account for as much as 85% of its total GHG emissions. As such, it's important to have a good understanding of how the Company is addressing them while we also appreciate that scope 3 GHG reductions will be driven by policymakers and the enforcement of regulation, changes in consumer behaviors in particular. Therefore, with a joint effort of our global stewardship team and portfolio managers, we kept our discussions on-going with the company during a range of occasions, including pre-AGM/EGM engagements, regular conversations on business strategies, dialogues to address alleged controversies in new projects, and thematic engagement specifically on climate ambitions. We communicated our expectations and demonstrated the materiality that the company should amend its climate strategy – include Scope 3 GHG reduction targets, rebalance the portfolio mix towards low-carbon technologies (i.e. renewable energies, biofuels, CCS) and set quantitative sustainability-related KPIs to executive compensation. In the meantime, we also reinstate that maintaining the O&G business is the condition to develop a profitable and reliable renewable business, which is the key to a sustainable transition in the long run.

2020

In the year 2020, through the collaborative efforts of different investors and stakeholders, the company finally announced a strengthened version of climate ambitions with more tangible evidence. The key measures include diminishing oil product sales by 30% and growing energy production by half from LNG and half from electricity, mainly from renewables. Besides, it also confirms the ambition of achieving Net Zero by 2050 in Scope 1+2+3 and reducing the Scope 3 emissions of its European customers by 30% in absolute value. Although the contents sound material, the 'Net Zero by 2050 Together with Society' commitment was later challenged on its honesty by a few investor activists. We also consider it essential to engage with the company once more to understand how it will ensure achieving the goals.

In the later occasion, we engaged with the company's executives on their say-on-climate to inform our votes at the AGM and make sure that their climate plans were ambitious enough. We have also informed the company that AllianzGI believes on-going tracking and monitoring is a key element to successful engagement outcomes. In the future, we will continue tracking the company's climate action and net-zero alignments with a focus on where the company can make a difference. As an example, which was also mentioned in the engagement meeting, we will encourage the firm to work with any relevant think-tank on the establishment of and contribution to an industry-wide decarbonisation framework aligned to the Paris Agreement of limiting global warming to 1.5°C.

Through the discussions, we evaluated and found that the company's climate approach is supported by a net-zero ambition by 2050 including all emissions (scopes 1-3) as well as concrete short- and medium-term targets. The latter is essential given the current decade is critical to decarbonising the firm's energy mix. Through this engagement, AllianzGI got a good

sense of the level of accountability, transparency on lobbying as well as the executive incentive structure and respective alignment with the firm's decarbonisation journey. As a consequence of the dialogue and evidence of such items, AllianzGI supported the firm's resolution around its climate strategy.

Reflections for Chinese Petrochemical Companies:

To support Chinese petrochemical companies' low-carbon transition, we believe in the necessity to develop customized active stewardship strategies according to different listed companies' organisational types, shareholder structures and unique competitive advantages. Engagements need to be driven by ambitious outcomes, whereas a sustainable transition in the long run would always require a profitable pathway with concrete short and mid-term targets.

Additionally, we also consider more 'active' measures can make a difference when private and independent engagements continuously meet obstacles. Collaborative engagements by a joint effort of investors and escalation strategies such as sending open letters can always be powerful tools for shareholders, as long as they're with good intentions.

With the increasing number of guidelines and regulations prompting petrochemical companies' low-carbon transition in China, we expect to see their portfolio mix's acceleration towards low-carbon technologies with greater efficiency. AllianzGI would continue to support our investee companies by sharing knowledge on industry best practices.

2.2 ENHANCING THE FUNDAMENTAL STRENGTH OF STEWARDSHIP: LAYING THE FOUNDATION FOR STEWARDSHIP AND TAPPING LOW-CARBON ENGAGEMENT POTENTIAL

Institutional investors pay close attention to and invest in nurturing their own 'strength to engage in low-carbon transition' and actively carrying out investor engagement work with the theme of low-carbon transition. Meanwhile, they should also attach equal importance to nurturing and improving their own 'fundamental strength of stewardship'. Institutional investors should actively consider and examine their maturity in establishing and improving a stewardship system, forming a proactive awareness thereof, and strengthening the impact of sustainable development. They should measure whether they have a solid foundation for stewardship to carry out in-depth engagement in low-carbon transition. As mentioned earlier, 'fundamental strength of stewardship' is the foundation for institutional investors to thoroughly engage in low-carbon transition work. It is a prerequisite for in-depth communication with corporates on these core issues related to China's sustainable development and even global successful response to climate change. Some institutional investors are willing or initially engaged in the low-carbon transition of corporates but have not yet formed a complete internal system or established corresponding stewardship capabilities. For them, the nurturing of 'fundamental strength of stewardship' is particularly crucial. Possessing the 'fundamental strength of stewardship' is a source of confidence to further enhance the 'strength to engage in low-carbon transition'.

To this end, the project research team proposes four specific suggestions to assist institutional investors nurture and enhance the 'fundamental strength of stewardship'. It is recommended that institutional investors who are currently in the initial stage of investor engagement give priority to nurturing the following fundamental capabilities to carry out stewardship practices. It will be advisable for them

to tap their potential for engaging in low-carbon transition and follow the pace of leading institutional investors in this field. For institutional investors who have seasoned experience in conducting investor engagement practices, they should examine their preparation and implementation based on the following recommendations and further improve their 'fundamental strength of stewardship'. They should build themselves into industry leaders in low-carbon transition, and mobilise their peers to jointly build a new ecological landscape. In such a landscape, institutional investors will expedite with concerted effort China's real economy in responding to climate change.

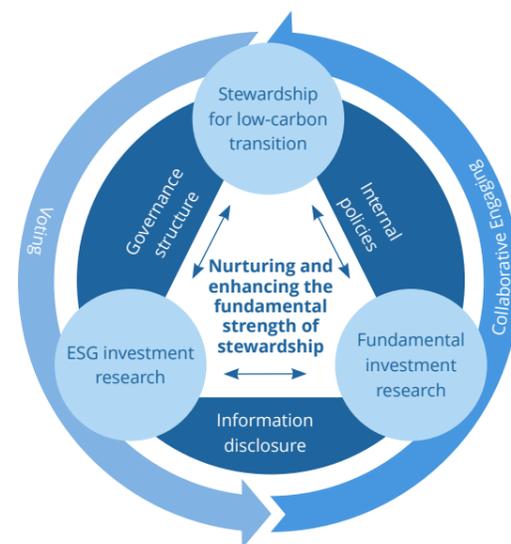


Figure 2-2: Nurturing and Enhancing the Fundamental Strength of Stewardship

Source: A work by the project research team

- **Recommendation 1. Develop a stewardship governance structure and clarify related internal policies to ensure internal information sharing and enhance external information disclosure.**

Regarding the governance structure



institutional investors should develop an effective internal stewardship governance structure, with well-defined stewardship responsibilities and functions from the top to the bottom for conducting stewardship activities. At least one person should be proposed in the board of directors and management to coordinate internal stewardship, supervise daily implementation, and approve pivotal stewardship decisions. At the departmental level, an independent department or positions within the existing investment research department should be established to carry out related work in stewardship. Its responsibilities should include formulating and disclosing internal stewardship policies, evaluating and integrating voting suggestions, and conducting dialogues with portfolio companies. If an independent department is set up, it is necessary to strengthen the collaboration and information exchange between the department and the investment research department, fund managers/portfolio managers. That way, the three parties can be ensured to engage in specific dialogues and voting decisions under the premise of clear rights and responsibilities and avoiding potential conflicts of interest. All parties shall actively engage in and contribute while ensuring the independence of decisions related to stewardship.

Regarding the internal policies



stewardship policies on investor engagement and voting should be developed. The purpose is to standardise internal stewardship governance and its relevant decision-making processes and identify and manage potential conflict of interests. Institutional investors should specify in their policies the following aspects of their stewardship. 1) The overall motivation and objectives. They include the requirements and expectations for the portfolio companies, and the consistency with their overall investment goals and strategies. 2) Internal governance and resource investment. They include the positions involved in stewardship, power and responsibility allocation and decision-making processes, integration of investment processes and investment decisions, the professionalism and contributions of relevant personnel, as well as the resources invested and measures taken to improve the quality and efficiency of stewardship. 3) Relevant international and domestic policies, regulations, and standards. The consistency of their own stewardship with the specific rules in these policies, regulations and standards should be explained. 4) The scope of coverage. It includes the asset categories covered (such as all assets, specific asset categories, or entrusted management assets) and the focus of stewardship (such as topics and industries of concern, focus topics of priority engagement, key voting issues, etc.). 5) The methods and processes adopted. They include the methods and processes for dialogue and expansion with the portfolio companies, the processes and standards for exercising voting rights, tools for measuring and tracking the transition of the corporates. The investor should clarify how it identifies and manages potential internal and external conflicts of interest in different work processes. 6) Other relevant content that needs to be clarified.

Regarding information disclosure



it is recommended that institutional investors record and share feedback on stewardship work item by item in their internal systems. This practice can ensure that feedback can be shared internally and facilitate real-time tracking and follow-up. On the premise of internal information exchange and sharing, institutional investors should disclose the progress of stewardship practices to the public regularly and proactively. Such disclosure should comply with applicable policies issued by domestic regulators, relevant government departments, and associations, with reference to international stewardship reporting and disclosure standards. Institutional investors should provide feedback through public disclosure on how the public has implemented relevant stewardship in accordance with internal policies and relevant standards. Moreover, they should integrate stewardship into daily investment research work and investment decision-making processes. When disclosing to the public, institutional investors should also focus on integrating, disclosing, and communicating with peers the most representative and successful engagement practices. With such information, their peers, especially those at an early stage of this field, can learn lessons and grow together.

Recommendation 2. Enhance the capability of ESG investment research, climate-related risk management, and stewardship, and create a tripartite support and synergy mechanism of 'ESG investment research + fundamental investment research + low-carbon transition stewardship'.

step 1

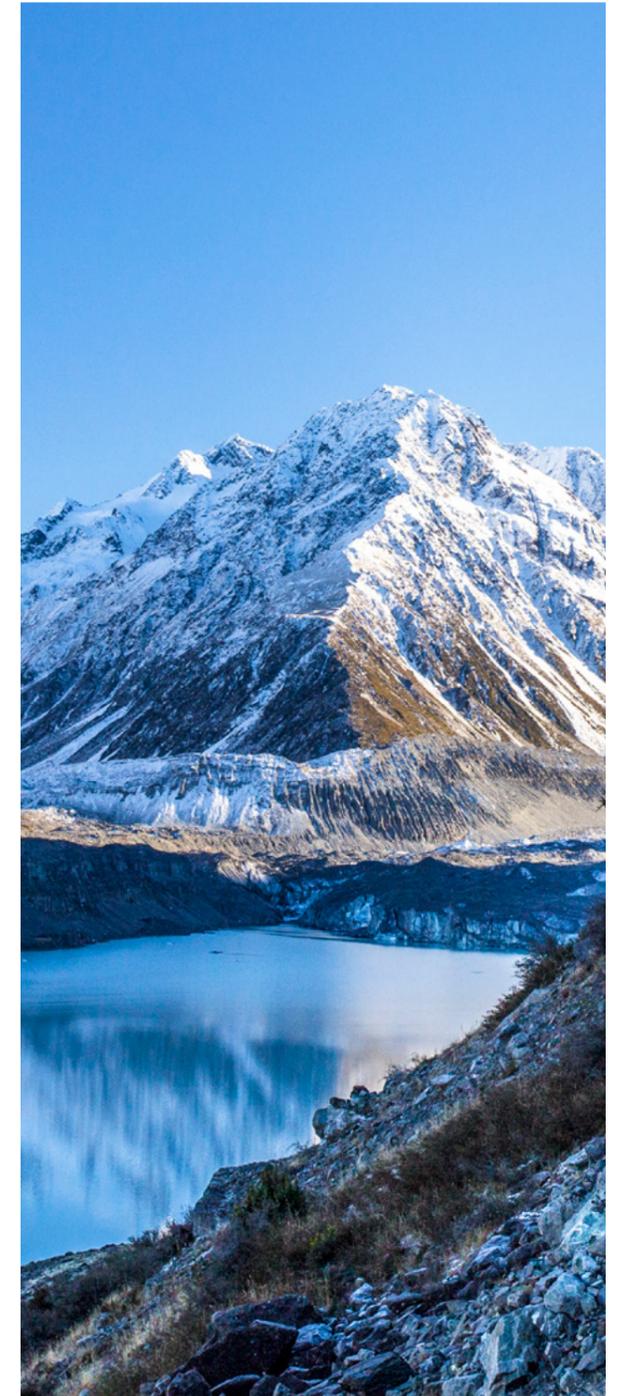
The first step is to continually improve ESG investment research capabilities while also improving climate-related risk management capabilities. In terms of ESG investment and research, a more specialised ESG team should be established. Multiple external professional databases should be flexibly leveraged to build high-quality and wide-ranging ESG databases. Self-owned ESG evaluation models and analytical frameworks should be developed and established. These practices provide comprehensive and professional ESG evaluation and research support for more focused and responsible management work. In terms of climate risk management, institutional investors should continuously improve their ability to identify, quantify, and manage climate risks. They should ensure that the investment strategies are consistent with their understanding of climate related risks and the impact on the real economy. Specifically, 1) they should fully understand the climate related risks faced by corporates in key industries and make forward-looking judgments and identification of the various climate risks faced by portfolio companies. For significant risks, they should quantify the impacts. 2) They should develop environmental benefit and carbon emission assessment tools, establish a tracking database to continuously assess and monitor the carbon footprint of investment portfolios, and measure the carbon intensity thereof. 3) They should conduct climate risk scenario analysis to dissect the impact of climate related risks on the investment portfolio. They should also assess the robustness and sensitivity of the investment portfolio under various scenarios, and evaluate the resilience and competitiveness of the portfolio companies under these scenarios.

step 2

The second step is to allocate resources to stewardship, create a professional stewardship workforce, and develop overall professional stewardship capabilities. First, institutional investors should enhance the training of their staff. They should organise regular or irregular theoretical and practical seminars and discussions on stewardship, sustainable investment, and transition finance. These sessions should be designed to develop a forward-looking mindset in terms of stewardship among the staff. This quality is a guarantee of unhindered collaboration between all parties in the implementation of stewardship. Second, institutional investors should recruit stewardship professionals with a long-term focus on carbon neutrality, climate change, and sustainable development, who have an international perspective and are familiar with the local culture, policies and market environment. With such hires, institutional investors can strengthen their pool of stewardship professionals and prepare for long-term and sustainable professional stewardship.

step 3

The third step is to integrate ESG investment research, fundamental investment research, and stewardship while constantly strengthening and improving expertise in these areas. On the one hand, institutional investors should integrate ESG investment research and fundamental investment research. They should fully incorporate considerations of key ESG factors (such as addressing climate change) into investment decision-making and investment processes to provide support research and motivate stewardship. On the other hand, through in-depth stewardship centering on low-carbon transition, institutional investors should obtain an all-around understanding of the portfolio companies and accumulate climate-related data and feedback thereof. With such information, they can continuously improve ESG investment research and fundamental investment research system and database, so as to more comprehensively evaluate the portfolio companies. In this way, a tripartite support and coordination mechanism of 'stewardship for ESG investment research + fundamental investment research + low-carbon transition' can be forged. Institutional investors can join forces to implement stewardship tasks with low-carbon transition as the core and strengthen investment research capabilities to improve investment decision-making.



Recommendation 3. Adopt a stewardship approach that combines engagement and voting.

- Incorporate into voting guidelines the corporate practices in responding to climate change. Speed up corporates' low-carbon transition by actively exercising voting rights.

It is recommended that institutional investors with voting rights adopt a stewardship approach that combines engagement and voting to accelerate the low-carbon transition of portfolio companies. In addition to engaging in intensive dialogue with portfolio companies on core issues such as climate change and low-carbon transition, institutional investors should improve their voting policy and guidelines. In these documents, they should include the consideration of portfolio companies' practices in climate actions and low-carbon transition. Specifically, they should define their voting actions and principles for shareholders' meetings involving relevant content, and the internal voting process and resources invested to make more comprehensive and professional voting decisions.

At the same time, institutional investors should actively seek relevant voting suggestions from professional third-party service providers, proxy voting consultants, experts, and research institutions for key general meetings of shareholders related to corporates' response to climate change and low-carbon transition. Meanwhile, they should conduct a comprehensive study before finalising a voting decision, and actively engage

in and vote at the general meeting of shareholders. Notably, institutional investors should consider casting a negative vote on two occasions. One is that they believe that the proposal suggested by the corporate is inconsistent with the principles and concepts in their own voting policy guidelines. The other is that the implementation of the proposal would have a negative impact on the corporate itself and society in addressing climate change and other aspects. However, before casting a negative vote, institutional investors should conduct in-depth internal discussions and research on the proposals in question and compose a position paper with sufficient reasons and arguments. With this paper, they should communicate with the corporate and help it find better solutions. They should lead the corporate towards a more long-term and sustainable direction and to assist the global response to climate change. In stewardship, institutional investors should always promote low-carbon transition of corporates, address climate change, and tap long-term value. They should fully convey this concept to corporates when exercising voting rights and engaging in dialogue with them.

**Recommendation 4. Strengthen external exchanges and collaboration and launch**

- collaborative engagements to progress corporate transition and industry changes concertedly.

It is recommended that institutional investors strengthen external exchanges and cooperation and launch collaborative engagement. They should adopt a collaborative approach and integrate forces to collectively promote Chinese corporates to fulfill their low-carbon transition as soon as possible. By pooling greater influence and effectively promoting systematic transition in various industries in China, especially high-carbon industries, and carrying out unified net-zero action, they can advance the realisation of China's carbon peaking and carbon neutrality goals.



First, Chinese and international institutional investors should leverage their respective strengths, learn from each other, and engage in 'many-on-one' dialogue with selected key corporates to accelerate their decarbonisation efforts.

Compared to international institutional investors, local institutional investors have a better understanding of China's culture, policies, and market environment, and have accumulated more local resources. They should actively help international institutional investors understand China's national conditions and culture, connect with key Chinese corporates, coordinate local resources, and broaden local communication channels. They should support international institutional investors in conducting smoother dialogues with key Chinese corporates, cultivate and establish successive and close relationships with them. Compared to local institutional investors, international institutional investors have a long history of stewardship with rich and excellent experience in tools, processes, policies, and standards that are valuable reference. They should actively discuss and exchange with local institutional investors on how to conduct more efficient dialogues with corporates, strengthen mutual understanding and trust, and establish a healthy cooperative relationship. In collaborative engagement, international institutional investors should also energetically contribute their own practical experience and excellent practices. At the same time, they should maintain an open attitude to guide key Chinese corporates to align with high-level international standards for addressing climate change and international development trends. They should also promote Chinese corporates that actively engage in low-carbon transition and support climate change to speak out on the international platform.



Second, institutional investors can join and support international and local investor initiatives, platforms, or alliances focusing on climate change and low-carbon transition, and launch more organised and extensive collaborative engagements activities.

Institutional investors should forwardly join internationally representative investor initiatives, platforms, or alliances such as the Climate Action 100+, the Asia Investor Group on Climate Change (AIGCC), UN PRI, Glasgow Financial Alliance for Net Zero (GFANZ), Net-Zero Asset Managers Initiative (NZAMI), UN-convened Net-Zero Asset Owner Alliance (NZAOA). They should fervidly participate in collaborative engagement or research organised by these investor initiatives, platforms or alliances. Leading institutional investors should work together with industry associations and research institutions to build local collaborative engagement platform to support the low-carbon transition of key Chinese corporates and implement China's carbon peaking and carbon neutrality goals. Such platforms can broadly gather multiple forces, mainly institutional investors. Leading institutional investors should jointly select China's key corporates to carry out collaborative engagement focused on promoting the low-carbon transition of corporates and summarise best practices. They should research and develop indicators and standards to evaluate the progress of low-carbon transition of Chinese corporates. Based on the findings, they should develop a methodology and guide for institutional investor engaging to catalyse low-carbon transition of key Chinese corporates. Last but not least, they should organise corporates and relevant parties to carry out thematic capacity-building activities on the key issues/topics related to low-carbon transition of Chinese corporates.

Acknowledgement

We are grateful to the following organisations for their involvement and contribution to this work:

- Allianz Global Investor
- Boser Fund
- Fidelity International
- Fidelity Fund Management (China)
- Hwabao WP Fund
- China AMC
- HSBC Asset Management
- Ninety One
- Schroders
- E Fund
- Prudential
- Ping An Insurance
- China Life Franklin Asset Management
- China Life Investment Management
- China Re
- China Nuclear Insurance Pool
- Impax Asset Management

We are grateful to the following individuals for their involvement and contribution to this work:

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Rongrong Huo	Executive Director, Ninety One
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