MORNINGSTAR | SUSTAINALYTICS

ESG VOTING POLICY OVERLAY PROXY VOTING GUIDELINES

Morningstar Sustainalytics ESG Voting Policy Overlay 2025
Guidelines Applicable to International Companies

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1. About the ESG Voting Policy Overlay

Morningstar Sustainalytics' ESG Voting Policy Overlay offers **ESG-aligned proxy voting guidance**. We undertake **continuous monitoring of ballots to identify strategically significant votes** with **high ESG leverage for investors**. We develop well-researched and **timely voting recommendations** supported by detailed analysis, drawing on Morningstar Sustainalytics data and research. Our voting recommendations supplement in-house **or external voting guidelines** to round-out an intentional ESG investment strategy.

2. Introducing our Voting Strategies and Guidelines

This document constitutes the Morningstar Sustainalytics' ESG Voting Policy Overlay guidance, which is updated annually at the beginning of each calendar year.

The ESG Voting Policy Overlay generates voting recommendations that can be grouped into sustainability themes and escalation vote recommendations.

We offer proxy voting recommendations on all sustainability-themed resolutions. These are proxy items, proposed by either shareholders or the company itself, that directly address environmental, social and governance themes.

We also offer voting recommendations against selected management-proposed ballot items - such as the approval of board nominees, pay practices, or annual reports and accounts - based on signals linked to company-specific sustainability risk considerations. These include:

- Engagement signals based on Morningstar Sustainalytics' ongoing engagements with companies,
- Research signals based on Morningstar Sustainalytics' ESG Risk Rating indicators mapping to priority investor themes,
- Climate governance signals based on an examination of climate targets, climate-linked performance metrics, and incentive pay practices at the largest companies in selected heavy emitting sectors, and
- Controversy signals based on Morningstar Sustainalytics' Controversies research.

A voting recommendation triggered by one of these categories of signals are based on an assessment that the company is failing to adequately manage key ESG risks or themes. Investor votes against key company-sponsored proposals are intended to encourage the company to (re)engage with shareholders and to strengthen corporate accountability.

Overview of the Signals Triggering Voting Recommendations

Signal	What is the objective of the voting recommendation?	What informs our analysis and recommendations?
1. Sustainability Signals	To align corporate conduct to internationally accepted standards and sustainability priorities	**Morningstar Sustainalytics' ESG Principles, aligned to the:** • UN Global Compact • UN Guiding Principles on Business & Human Rights • Sustainable Development Goals, • OECD Guidelines for Multinational Enterprises on Responsible Business Conduct • ICGN Global Governance Principles

2. Investor Driven Research Signals	To address weaknesses in portfolio companies' management of priority sustainability themes where corporate conduct is not aligned to investors' expectations	**Morningstar Sustainalytics' ESG Risk Ratings Indicators, linked to:** • Biodiversity • Circular Economy • Climate Change • Diversity, Equity and Inclusion • Human Rights
3. Engagement Signals	To encourage unresponsive portfolio companies to engage Morningstar Sustainalytics in a constructive dialogue	**Morningstar Sustainalytics' Engagement Pillars** • Thematic Stewardship Programs • Material Risk Engagement • Global Standards Engagement
4. Climate Governance Signal	To encourage the heaviest emitters, globally, to align corporate governance arrangements with corporate climate strategies informed by sound climate scenario analysis and Paris Climate Agreement goals.	**Morningstar Sustainalytics' Research, drawing on** • Emissions Data and Climate Risk Exposure • Corporate Proxy & Governance Disclosures • Corporate Climate Reports & Transition Plans
5. Controversy Signals	To encourage corporate boards to take timely action to address significant lapses in board-level oversight of material environmental, social and business ethics factors that may lead to reputational and litigation risks for the company.	**Morningstar Sustainalytics' Controversies Research, taking account of:** • Controversy Level • Outlook • Recency • Assessment

2.1 National Market, Legal, Regulatory and Company-Specific Considerations

The rules and frameworks that codify norms and expectations under which corporations operate in the global economy have been evolving rapidly, and along two related paths: sustainability reporting and sustainability due diligence. Reporting involves disclosing information about a company's sustainability performance, risks, and impacts to stakeholders. Sustainability due diligence involves systematically assessing, identifying, preventing, mitigating, monitoring and accounting for adverse sustainability risks, opportunities and impacts in a company's operations, investments and value chain.

In January 2023, the Corporate Sustainability Reporting Directive (CSRD) entered into force in the EU. It mandates sustainability disclosures under new European Sustainability Reporting Standards (ESRS), taking effect from the 2024 fiscal year for the first tranche of companies, which are those already subject to the Non-Financial Reporting Directive. On 26 February 2025, the European Commission announced an Omnibus package of proposals, which could see substantial simplification of the EU's sustainability reporting and due diligence frameworks, as discussed below.

In June 2023, the IFRS Foundation's International Sustainability Standards Board (ISSB) released inaugural standards for sustainability-related disclosures - IFRS S1 and IFRS S2 - which aim to provide a global baseline for reporting on general sustainability and climate-related risks and opportunities,

respectively. The ISSB standards take their form from the widely adopted TCFD framework. IFRS S2 incorporates and extends the TCFD's recommended climate-related disclosures.

Growing Harmonization and Interoperability Among International Sustainability Standards and Frameworks

During 2024, the ISSB undertook several initiatives to harmonize sustainability disclosure standards globally. Most notable are interoperability commitments with Global Reporting Initiative (GRI) and the ESRS. In November 2024, the ISSB released detailed guidance on materiality assessments to help reporting companies identify sustainability-related risks and opportunities. The guidance incorporates insights from the ISSB's assessment of the first year of implementation, also published in November 2024, which found that 30 jurisdictions intend to use or are taking steps to introduce ISSB Standards in their legal or regulatory frameworks.

A Growing List of Countries Adopt Sustainability Reporting Standards

In the UK, final recommendations for mandatory Sustainability Reporting Standards (UK SRS) issued in December 2024 endorse the adoption of the two IFRS Sustainability Disclosure Standards, with minor amendments for the local market, and would likely become effective for the 2026 fiscal year.

Canada and Australia have also opted to closely follow the IFRS standards. The Australian Account Standards Board (AASB) released the inaugural Australian Sustainability Reporting Standards (AASB S1 and AASB S2) in September 2024 and the phase-in of mandatory climate disclosures began on 1 January 2025. Similarly, the Canadian Sustainability Standards Board (CSSB) released the first Canadian Sustainability Disclosure Standards (CSDS 1 and CSDS2) in December 2024, with a 1 January 2025 effective date.

In 2024, China also made significant strides towards establishing mandatory ISSB-aligned sustainability reporting standards. In May, China's Ministry of Finance (MOF) opened a public consultation on an exposure draft for Chinese Sustainability Disclosure Standards for Businesses and, in December 2024, the MOF unveiled the Basic Standards of its Corporate Sustainability Disclosure Standards, which companies can adopt voluntarily ahead of mandatory reporting requirements. This initiative marks a significant step toward establishing a unified national ESG reporting system, with full implementation expected by 2030.

Areas of focus for the ISSB in 2025 will be supporting adoption of the IFRS standards by emerging market jurisdictions, drafting industry-specific disclosure requirements, and beginning new research and standard-setting projects on the risks and opportunities related to biodiversity, ecosystems and ecosystem services and human capital.

While efforts have been made to ensure interoperability between the ISSB standards and CSRD, a key difference has been their perspective on materiality. ISSB standards use a single, or financial, materiality lens (focused on financial impact only), and CSRD uses a double materiality lens (focused on financial and environmental/social impacts). We do not believe this difference makes the two irreconcilable as guiding frameworks for corporate sustainability disclosure. However, extended double-materiality disclosures help investors better align investment decisions with broader sustainability goals, and the

reach of the EU sustainability reporting requirements means that many large global companies are working to apply the CSRD's materiality assessment framework. Furthermore, the ISSB has signaled that its research agenda on biodiversity, ecosystems and human capital will aim to understand how systemic risks and opportunities relate to investor portfolio value.

Besides the ISSB's interoperability initiatives, other initiatives to map the GRI to the ESRS and the Taskforce on Nature-Related Financial Disclosures (TNFD) framework to the ESRS further advance global comparability among sustainability disclosures.

Sustainability Reporting Increasingly Subject to Scrutiny and Shareholder Approval

In 2018, Spain became the first EU state to mandate shareholder approval of companies' report on non-financial – in other words, ESG – information. Starting in 2024, a requirement under the Swiss Code of Obligations (CO) came into force, mandating that Swiss-listed companies of a certain size (with at least 500 full-time positions, total assets of CHF 20 million, or revenues of CHF 40 million) publish a sustainability report and submit it to shareholders for approval. In 2024, around 140 Swiss companies offered shareholders this vote.

While the CSRD does not require shareholder approval of sustainability reports, we believe that reporting will be more closely scrutinized by shareholders when voting on regular ballot measures like external auditor approval and ratifying the annual reports and accounts.

Mandatory Corporate Due Diligence Extends Supply Chain Responsibility

Regarding corporate sustainability due diligence developments, in June 2023, the OECD released revised Guidelines for Multinational Enterprises on Responsible Business Conduct (previously updated in 2011). Revisions strengthen voluntary corporate due diligence recommendations on sustainability matters covered by the guidelines.

Germany's new Supply Chain Due Diligence Act came into force in January 2023, obliging German companies and companies doing business in Germany to undertake human rights- and environment-related due diligence. In May 2023, Canada enacted the Fighting Against Forced Labour and Child Labour in Supply Chains Act, requiring mandatory due diligence by companies listed on Canadian stock exchanges and by private companies of a specified size doing business in Canada. In June 2023, the EU's Regulation on Deforestation-free Products (EUDR) entered into force, with compliance effective from the end of 2025, requiring extensive due diligence of supply chains containing commodities like cattle, soy, wood, etc.

In June 2024, the European Parliament reached agreement on the final text of the Corporate Sustainability Due Diligence Directive (CSDDD), and it entered into force in July. The Directive requires that companies set up and report on management procedures for governing and mitigating negative impacts of their operations and across their supply chains on human rights, climate change and the environment - both inside and outside of Europe. The CSDDD's mandatory requirements will become effective from 2027 and, like the CSRD, will be progressively extended to a broader range of companies, including non-European companies operating in Europe.

In November 2024, the European Commission announced plans to merge the CSRD, CSDDD and the EU Taxonomy Regulation, the centerpiece of the EU's sustainable finance framework, into a single omnibus regulation – aiming to streamline ESG reporting for businesses in line with a broader push for greater simplification across the EU's regulatory regime. The 'Omnibus' package presented by the EU on 26 February 2025 proposes revisions to sustainability reporting requirements, scope, rules, penalties and due diligence that could mean streamlining the sustainability requirements for companies.

Our Approach

We undertake to deliver our recommendations and supporting analysis at least 12 business days before the company's annual shareholder meeting. We invite each company to respond to our recommendations within a reasonable timeframe and, where provided, we commit to delivering the company's response in a subsequent version of the relevant Meeting Profile. Based on the company's response, we may change our voting recommendation, clearly notifying clients of any changes.

The ESG Voting Policy Overlay takes into consideration widely recognized international norms and standards as well as market-specific due diligence and disclosure requirements in establishing expectations around the governance of sustainability. It does not assess the issuer's compliance with local legislation. Rather, our analysis of voting matters provides insight into how the company compares with global standards and investor expectations in managing sustainability-related risks and opportunities.

For all sustainability-linked shareholder resolutions and management proposals, Morningstar Sustainalytics considers their alignment with Morningstar Sustainalytics' ESG Principles, which are founded on widely accepted international norms and standards for corporate conduct, such as the United Nations' Global Compact and the OECD's Guidelines for Multinationals. All voting recommendations are mapped to the relevant Sustainable Development Goals (SDGs) and to standard sustainability issue categories used by our engagement services.

With regard to traditional corporate governance voting items, Morningstar Sustainalytics supports the International Corporate Governance Network's (ICGN) Global Governance Principles as overarching guidelines for best practice. These principles set internationally recognized and respected standards of good corporate governance. Our view is that good governance serves long-term value creation and balances stakeholder interests in corporate decision making. Market-specific considerations that may influence the exercise of investor voting rights include, among others:

- Timing of meetings and meeting notifications, which may impact our commitment to providing recommendations at least 12 working days in advance of shareholder meetings;
- Prevailing governance arrangements and shareholder voting rights, which may influence the types of ballot items on which we are able to offer voting recommendations; and
- Available disclosures and sources of governance and sustainability information within specific reporting regimes.

2.2 Research and Sources

In researching and formulating our positions, we consult a variety of sources, including:

- The supporting statement issued by the company or the resolution proponent.
- The company's response to a shareholder-proposed resolution and any additional public communications on an upcoming vote published by the company or the resolution proponent (press releases, notices of exempt solicitation filed with the SEC, analyst briefs, etc.).
- The identity of the proponent.
- The governance and sustainability reports available on company websites or in public repositories, such as the SEC's EDGAR platform.
- Morningstar Sustainalytics' company-level research and data.
- The company's track record of engagement with Morningstar Sustainalytics' Stewardship Services.
- Historical voting trends relevant to the company and the ESG theme under consideration.
- Industry reports from reputable investors, investor groups, regulatory agencies, and independent non-governmental organizations with a strong research focus.
- Morningstar Sustainalytics' ESG Principles and global codes and standards, such as relevant SDG targets.

More information on the sources and uses of company-provided information by Morningstar Sustainalytics' Stewardship Services is available here.

3. ESG Principles & Sustainability Signals

Sustainability-focused recommendations apply to the universe of sustainability measures that come to vote across our clients' holdings, whether management- or shareholder-sponsored. These are ballot measures that directly address ESG themes and that may call for additional assessments and reporting, new governance arrangements, or new or enhanced policies for better navigating and managing environmental and social risks and opportunities. Morningstar Sustainalytics will review all ESG-related shareholder resolutions and management proposals on relevant companies' AGM agendas against ongoing engagement activities, Morningstar Sustainalytics' ESG Principles, and the SDG targets.

Transparency is a prerequisite for building trust as investors expect companies to communicate challenges and goals to shareholders and other stakeholders in a transparent manner. Morningstar Sustainalytics will support measures that seek to improve board level transparency on the management of material ESG issues and that encourage corporate accountability for human rights and environmental impacts, even where particular markets or jurisdictions may lack legal safeguards for workers, nature, and communities. We may recommend voting against items when there is a misalignment between

shareholder resolutions or management proposals and our ongoing engagement objectives. Further, Morningstar Sustainalytics applies issue- and company-level considerations as indicated below.

Specific considerations guiding our research and recommendations include:

- Is the issue of broad relevance to facilitating well-functioning markets?
- Is the issue of broad societal relevance?
- Is the issue relevant to the company, using the double materiality test?
- Has the company already implemented the measure requested?
- Do existing governance arrangements sufficiently address concerns raised by the proposal?
- Is there good evidence that the company is engaging constructively with shareholders?
- Are there potential unintended consequences of implementing the proposal?
- Does it appear that the proposal is intended to derail progress on an important issue?
- Does the proponent's supporting statement – and its broader public positions and actions - demonstrate a good-faith effort to address a material issue and provide sufficient grounds for the proposed measure?
- Does the proposal allow for board discretion in implementation?
- Does the proposal supplant the role and judgement of management and the board on company-specific matters?

In situations where a shareholder proposal directs a company to discontinue a particular type of business practice or take a specific strategic or operational action, Morningstar Sustainalytics will assess these requests on a case-by-case basis, including assessing whether relevant jurisdictions have in fact committed to reaching carbon neutrality or 'net zero' emissions by 2050 or sooner. Where this is the case, we will usually recommend a vote FOR when shareholder proposals request the following:

- New policies (or a review of the effectiveness of existing policies) to ensure that a company's financing or underwriting activities are consistent with the goals of the Paris Climate Agreement,
- New policies (or a review of the effectiveness of existing policies) to ensure that the company's strategic direction is consistent with the goals of the Paris Climate Agreement,
- New policies (or a review of the effectiveness of existing policies) to ensure that the company conforms with internationally accepted human rights standards in its operations and throughout its supply chain.

We will usually recommend a vote AGAINST shareholder proposals that appear politically motivated against a particular state or government or that seek to limit or restrict sustainability-related practices and reporting. We may ABSTAIN on shareholder proposals where the aim of the proposal is not clear.

Below we explain our voting approach on broad ESG themes that have regularly appeared on corporate proxy ballots in recent years.

3.1 Climate Change

The climate crisis entails physical, transition, and litigation risks that will impact all businesses. Some investors expect companies to show commitment and action beyond the minimum legal compliance, in line with globally aligned investor expectations. The Paris Agreement reached in December 2015 commits countries collectively to limit global warming to well below 2°C above pre-industrial levels, and to aim for a 1.5°C limit through to 2100. The Glasgow Climate Pact reached at COP 26 in 2021 affirms the necessity of pursuing the global warming limit of 1.5°C and commits parties to revisit and strengthen emissions targets to 2030, recognizing the global goal of achieving net zero emissions by 2050. For carbon-exposed companies, decarbonization in line with the global goal of reaching net zero emissions by 2050 requires a transformation of business strategy and therefore companies should articulate their goals in terms of time-bound, science-based targets covering scope 1, 2, and 3 greenhouse gas (GHG) emissions.

The Taskforce on Climate-Related Financial Disclosures (TCFD) framework, now incorporated into the ISSB's IFRS S2 disclosure standard, requires that companies report on their climate strategy, climate-related risks, metrics, and targets for tracking climate action and emissions reductions, and that they explain their climate governance arrangements. The ISSB's IFRS S2 climate disclosure standard builds on the TCFD framework by requiring additional and more detailed disclosures in each of the four reporting areas (governance, strategy, risk management, and metrics and targets).

In March 2024, the US SEC adopted final rules intended to enhance and standardize climate-related disclosures for publicly listed companies. The final rules were set to become effective for the fiscal year 2025. However, in response to multiple legal challenges, the SEC voluntarily decided to pause the adoption of final rules pending judicial review. The final rules had already been scaled back from the originally proposed rules, notably removing the requirement to disclose Scope 3 GHG emissions for filers, as well as removing the requirement for filers to disclose climate-related board level expertise. However, the final rules would significantly increase the required climate disclosures of publicly listed companies and would provide investors with a level of standardization and comparability when assessing their investee companies' climate-related risks and opportunities.

Two climate disclosure laws passed by the state of California in October 2023 go further. They require companies to report their climate emissions, including Scope 3 emissions, as well as their climate-related financial risks. The requirements apply to both public and private companies that do business in the state and that meet certain revenue thresholds (USD 1bn) and become effective in 2026. Like the SEC rules, California's rules also face legal challenges.

Despite opposition to climate disclosure rules in the US, global momentum for mandatory climate disclosure accelerated in 2024, with progress towards the adoption of sustainability reporting frameworks that incorporate climate disclosure in markets such as Australia, Canada, China and the UK (see Section 2.1 above). KPMG's recently published Survey of Sustainability Reporting 2024 finds that there has been a significant increase in the proportion of large global companies publishing carbon reduction targets over the past two years., Likewise, despite high profile departures from financial net

zero alliances, investor demand for more transparency around GHG emissions, improved climate targets, improved climate governance and disclosure of climate risks continue to grow.

3.1.2 GHG emissions targets and climate transition plans

Morningstar Sustainalytics will usually recommend a vote FOR resolutions requesting:

- that companies disclose their GHG emissions;
- that companies set and disclose emissions reduction targets covering Scope 1, 2 and, where relevant, Scope 3 GHG emissions (we consider SBTi's C4 requirement setting a 40% Scope 3 emissions threshold and fossil fuel involvement criterion in assessing the relevance of Scope 3 for near-term emissions target setting);
- that companies disclose a climate transition strategy in line with the 1.5°C global warming limit;
- that financial institutions report on plans to measure, disclose, and reduce GHG emissions associated with underwriting, insuring, and investment activities;
- that fossil fuel companies set methane emissions reduction targets and be prepared to comment on the quality of their reported methane emissions; and
- that fossil fuel companies provide more detail of assumptions guiding estimates of asset retirement costs and long-term asset valuations under a net zero GHG emissions by 2050 scenario.

Morningstar Sustainalytics will make recommendations on management climate transition plans, or 'say-on-climate' resolutions, on a case-by-case basis, taking into account:

- whether the plan takes into account widely recognized decarbonization pathways, such as the IEA Net Zero by 2050 Roadmap;
- whether the company has set independently verified science-based emissions reduction targets, including short-, medium- and long-term targets;
- whether the company has set a target for Scope 3 GHG emissions reduction, where material;
- whether the company's transition plan includes appropriate governance measures to support the transition, with particular focus on the alignment of executive remuneration with the company's decarbonization efforts;
- whether the company performs scenario analysis for physical, financial and transition risks, and what temperature rise assumptions underlie analysis of risks and opportunities;
- Whether the company completes materiality assessments regarding the company's climate exposure to better understand its climate risks;
- whether the company discloses efforts to align capital allocation with its decarbonization efforts;

- whether the company's transition plan incorporates considerations of the social dimensions of climate change, and is informed by engagements with affected stakeholders, in line with the broadly understood concept of "just transition"; and
- whether the company reports in line with an internationally recognized sustainability framework.

3.1.3 Climate policy influence

Beyond regulatory, reputational, and legal risks to investors, corporate lobbying activities that are inconsistent with meeting the goals of the Paris Agreement pose systemic risks to economies and can introduce uncertainty and volatility into investors' portfolios. Trade associations and other politically active organizations that represent business interests frequently present obstacles to initiatives that address the climate crisis. Boards and management are increasingly asked to assess their climate-related lobbying and report to shareholders on alignment of lobbying activities - including those of organizations to which it pays membership dues - to global decarbonization goals.

Morningstar Sustainalytics will usually recommend a vote FOR resolutions requesting:

- that companies disclose lobbying alignment with climate targets, and
- that companies review and disclose membership and fees paid to trade associations and lobby groups active on climate policy.

3.1.4 Climate governance

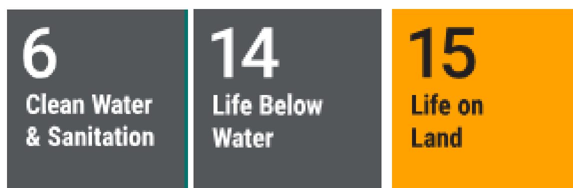
Climate governance is one of the four pillars of the Taskforce on Climate Related Financial Disclosures (TCFD) framework. IFRS S2 requires companies to go further into details of the board's oversight of climate-related risks and opportunities. Climate governance is one of the 10 assessment areas of the Climate Action 100+ Net Zero Company Benchmark. It is also assessed within the Transition Pathway Initiative's assessment of companies' low carbon transition progress. Climate governance encompasses the quality of board and senior management oversight and the alignment of executive performance metrics and incentives with key climate targets. As businesses transform in the global shift to net zero GHG emissions by 2050, corporate boards require new competencies. Furthermore, pursuing climate targets in corporate strategy should, of necessity, translate into compelling performance targets for senior executives.

Morningstar Sustainalytics will usually recommend a vote FOR resolutions requesting:

- Climate reporting aligned to an internationally recognized framework;
- Measures that strengthen board-level oversight of climate risks and climate transition planning, including climate adaption and Just Transition planning; and
- Measures that meaningfully align senior management performance goals and incentives with climate targets, such as the inclusion of climate change indicators in the executive remuneration setting.

See also Section 4.3, which describes our voting policy on management resolutions to approve remuneration practices and policies at large companies with significant exposure to climate transition risk.

3.2 Biodiversity, Natural Capital and Environmental Stewardship



Investor focus on nature and biodiversity has increased sharply, along with a growing awareness of the intersections with climate risk and human rights. The COP26 Deforestation Pledge recognizes natural solutions as the most effective climate mitigation strategy and signatories affirm support for Indigenous Peoples and local communities. Like climate change, nature loss represents a significant risk to financial stability and human well-being.

The COP 15 UN Biodiversity Conference in December 2022 culminated in the adoption of the Kunming-Montreal Global Biodiversity Framework (GBF) by 195 nations. The Framework commits member states to the high profile 30-by-30 goal, which aims to protect 30% of land and 30% of coastal and marine areas by 2030 and undertake restoration of 30% of degraded lands and waters by 2030. Importantly, the agreement also commits nations to cutting subsidies for activities that harm nature by USD 500 billion by 2030 and to mobilizing financing for national biodiversity strategies and action plans by up to USD 200 billion per year by 2030.

COP 16, which was held in Colombia in late 2024, advanced the implementation of the GBF with the finalization of mechanisms for Indigenous Peoples' representation and sharing digital genetic resources. However, COP 16 talks failed to resolve approaches to financing for developing nations and monitoring progress towards biodiversity targets. Globally agreed biodiversity targets have significant implications for businesses and their supply chains, as well as for investors.

Target 15 of the GBF urges businesses to monitor, assess and disclose biodiversity-related risks and dependencies. The Taskforce on Nature-Related Financial Disclosures, or TNFD, which was published in September 2023, is likely to become the global baseline for natural capital disclosure and risk management. The framework builds on the recommendations of the TCFD, integrating all 11 TCFD-recommended disclosures - thereby making it compatible with the ISSB and ESRS disclosure standards. However, as a double-materiality framework, it goes further than the TCFD in several respects. It recommends reporting on dependencies and impacts in addition to risks and opportunities. It provides guidance to companies on incorporating engagement with Indigenous Peoples, local communities and affected and other stakeholders into their assessments. It also recommends that nature-related disclosures cover both the upstream and downstream value chain. As with the TCFD, the TNFD is voluntary, yet may be incorporated into, or adapted for, local mandatory reporting regimes.

Following the CA100+ model for channeling global investor influence, the Nature Action 100+ initiative was launched at COP15, and in September 2023 announced a list of 100 companies that its 190 institutional investor participants will engage with collaboratively on biodiversity risks. Another parallel with the CA100+ is the publication, in October 2024, of the first Nature Action 100 Company Benchmark

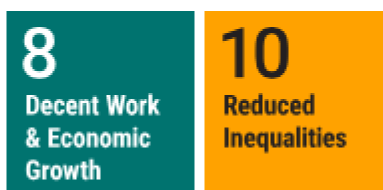
Assessment, based on public disclosures. The assessment measures company progress toward the six expectations pursued by investor members.

In June 2024, the Principles for Responsible Investment (PRI) launched the PRI Spring initiative, which is a PRI stewardship initiative for nature, addressing the systemic risks of biodiversity loss to protect the long-term interests of investors. While Nature Action 100+ takes a targeted, company-level approach, PRI Spring helps guide investors in integrating nature-related issues into broader stewardship activities.

Morningstar Sustainalytics will usually recommend a vote **FOR** resolutions requesting:

- that companies conduct and report on environmental due diligence across their operations and supply chains;
- that companies disclose water use and water stewardship measures where water management is a material issue for the company or its supply chain;
- that companies disclose metrics describing pesticide use, impact on pollinator populations and strategies for more sustainable agriculture across their operations and supply chains;
- that companies disclose efforts to identify, monitor, manage and eliminate deforestation, forest degradation and conversion of natural ecosystems in commodity supply chains, for both direct and indirect suppliers;
- that companies disclose metrics for tracking, and measures to reduce plastic packaging and/or plastic waste, including industry-level lobbying and advocacy;
- that companies disclose electronic waste and e-waste recycling and reduction strategies, including 'right to repair' policies, where relevant;
- that companies disclose industry-level lobbying and advocacy on policies impacting biodiversity and ecosystems, including via trade associations to which they pay membership fees.
- that companies explain Board oversight of assessing and managing nature-related dependencies, impacts, risks and opportunities.

3.3 Human Capital Management



The COVID pandemic raised awareness of the business and societal value of employee protections such as paid sick leave and workplace cultures that advance diversity, equity, and inclusion (DEI). Measures to empower employees and create more supportive workplaces build employee morale and help companies attract and retain valuable talent.

According to the International Labour Organization, "There has been an increased urgency among international policy-makers, particularly in the wake of the global financial and economic crisis of 2008, to deliver quality jobs along with social protection and respect for rights at work to achieve sustainable, inclusive economic growth, and eliminate poverty."

Decent work encompasses fair income, security at work, and basic social protections. Morningstar Sustainalytics will generally recommend voting FOR resolutions requesting companies to report to shareholders on:

- the provision of paid sick leave among employees, including full- and part-time employees and franchise employees;
- wage gap analysis, such as details of the number of company workers, both direct and contract workers, paid below a living wage as well as details of progress the company is making toward paying living wages;
- reviews of, and reporting on, workplace safety standards and the implementation of grievance mechanisms;
- requesting that a company adopt a policy upholding the rights to freedom of association and collective bargaining in its operations as reflected in the International Labour Organization's Declaration on Fundamental Principles and Rights at Work;
- assessment of a company's adherence to workers' freedom of association and collective bargaining rights, as reflected in the International Labour Organization's Declaration on Fundamental Principles and Rights at Work;

Morningstar Sustainalytics will evaluate on a case-by-case basis resolutions requesting the adoption of specific measures to advance workplace safety, paid sick leave or to seek living wage accreditations.

A growing body of research shows that companies and economies benefit from stronger workplace participation by women and underrepresented groups.

Investors have increasingly asked companies to provide workforce gender and racial diversity breakdowns, report on diversity and inclusion efforts within the workplace and to evaluate and report on broader societal impacts.

Morningstar Sustainalytics will usually recommend a vote FOR resolutions requesting:

- workplace diversity reporting and disclosure of workplace diversity policies;
- workforce gender and racial pay gap reporting;
- reviews and reporting about the governance of workplace discrimination and sexual harassment claims, including the impact of specific arrangements like mandatory arbitration and concealment clauses.

Morningstar Sustainalytics will evaluate, on a case-by-case basis, resolutions requesting adoption of specific diversity targets and timelines and board-level worker representation.

3.4 Public Health and Product Safety

3 Good Health & Well-being

12 Responsible Consumption & Production

Corporate industrial operations, supply chains, products, and marketing activities can have significant impacts on public health. Food labelling, access to healthcare and medications, gun safety background checks, environmental pollution and contamination, and antibiotic use are some of the ways in which business practices can impact human health and public safety. Digital platforms and computational advances will continue to expand public health awareness and expose the connections between business activities and population health outcomes.

Business-level investment risks follow from reputational and litigation risks where companies fail to adequately account for human health impacts. Population-wide health outcomes impact retirement, insurance and other long-term investments and are therefore an important consideration for institutional investors having fiduciary responsibility to protect beneficiaries' interests.

Morningstar Sustainalytics will usually recommend a vote FOR resolutions requesting:

- reviews of, and reporting on, the sale and marketing of products with known public health risks, such as tobacco products, firearms and munitions, opioid pharmaceutical products and sugary beverages;
- reviews of, and reporting on, industrial processes resulting in air, water, soil or noise pollution with potential community health impacts;
- reviews of, and reporting on, agricultural practices, whether in own or supply chain operations, that lead to environmental pollution and contamination with known health outcomes, or that create or exacerbate public health risks, such as antimicrobial resistance; and
- reviews of, and reporting on, equitable access to lifesaving healthcare and pharmaceutical products.

Morningstar Sustainalytics will make recommendations on a case-by-case basis where resolutions propose specific measures, such as bans on the sale or advertising of certain products, or where the request does not appear to address a material risk or further investors' understanding of the risk.

3.5 Human Rights, Civil Rights and Social Justice

5 Gender Equality

8 Decent Work & Economic Growth

10 Reduced Inequalities

Under the UN Guiding Principles on Business and Human Rights (UNGPs), all businesses have a responsibility to respect internationally recognized human rights. This entails, among other obligations, having appropriate policies and processes in place and conducting regular human rights due diligence to identify, prevent, mitigate, and account for actual and potential human rights impacts. Businesses should also report on human rights risks and on strategies to address risks. Where relevant, businesses are obligated to remediate adverse impacts. Ahead of the CSDDD effectiveness

date, companies are encouraged to proactively prepare to comply with the EU's due diligence law, recognizing global human rights standards. This is likely to increase scrutiny on supply chains.

Taking their lead from the ILO's International Labour Standards on Forced Labour, a growing number of jurisdictions around the world have adopted or are tightening anti-slavery legislation prohibiting the use of forced labor - including forced prison labor and child labor - in companies' operations and supply chains, potentially leading to import bans. In March 2024, the EU reached agreement on Forced Labor Regulation (FLR) which will ban the import, sale, and export of products made with forced labor from the EU market, further advancing supply chain visibility. Once formally approved by the EU Council, the regulation will replace existing EU rules on human trafficking and will likely become effective across EU-member states from mid-2027.

As part of our commitment to evaluating human rights, civil rights, and social justice risks, Morningstar Sustainalytics uses the United Nations Global Compact and the United Nations Guiding Principles on Business and Human Rights as primary reference points.

Morningstar Sustainalytics will usually recommend a vote FOR resolutions requesting:

- that companies perform human rights due diligence assessments where there is the potential for adverse human rights impacts from operations, products or from companies' supply chains; and
- that companies adopt and/or report on the implementation of policies that commit to respect human rights where there is the potential for adverse human rights impacts from the company's operations, products or from companies' supply chains.

With growing legal and regulatory scrutiny, global digital platforms are being challenged to adopt specialist governance approaches to manage digital human rights risks linked to content and online abuse, data privacy, access to information and political censorship, political misinformation, and the development and licensing of biometric surveillance technologies. With the widespread adoption and usage of artificial intelligence (AI) in digital platforms and applications, shareholders are turning to the amplified risks associated with machine-generated misinformation and disinformation, asking companies to assess the financial and public welfare risks.

More broadly, AI governance is an area of growing investor concern, with governments and regulatory bodies around the world considering regulatory responses to the risks and opportunities linked to the rapid rise of AI. The EU's Artificial Intelligence Act (AI Act) entered into force in August 2024, becoming the first AI-specific regulatory framework. It will be effective from August 2026. It applies to companies located in the EU or that develop and operate AI systems in the EU. Obligations under the AI Act are based on four defined levels of risk presented by AI systems: minimal, requiring specific transparency, high risk and unacceptable risk, with substantial fines for violation. At the same time, the EU also launched a consultation on a Code of Practice for providers of general-purpose Artificial Intelligence (GPAI) models, with the aim of having a draft set of rules for AI developers around topics like transparency, copyright, risk assessment and risk mitigation measures by mid-2025. The model set by

the EU is likely to shape regulatory frameworks by other jurisdictions, with far-reaching implications for the governance of AI.

Morningstar Sustainalytics will usually recommend a vote **FOR** resolutions requesting:

- that social media platforms conduct and report on assessments of their online content governance with respect to hate speech, sexual abuse and child pornography, violent content, political misinformation, political censorship and access to information;
- that social media platforms take the necessary steps to identify and prevent organized social media misinformation campaigns and prevent the spread of abusive content;
- that companies review and report on privacy, data protection and potential civil rights violations related to the collection, storage, use and sharing of personal, including biometric, data and the development of facial recognition technologies; and
- that companies report on their use of artificial intelligence in business operations, including recruitment, board's role in overseeing AI usage, and any ethical guidelines that the company has adopted regarding its use of AI.

3.6 Political Influence

Investors are increasingly concerned about corporations' political influence, also referred to as corporate political activity, via contributions to political campaigns, as well as lobbying and grassroots political action aimed at shaping public opinion. At the company level, investors are concerned about potential abuse of the discretionary use of funds and the significant reputational risks that can arise out of the misalignment between expenditures and stated corporate values. Furthermore, corporate political influence may skew public policy in ways that could erode economic resilience and undermine the competitiveness of markets.

In markets where corporations have the power to influence the political process through financial support for political campaigns, transparency around political spending and lobbying, as well as board oversight of political influence are governance priorities for investors. Corporate public policy influence can take the form of direct funding and contributions as well as via indirect channels, such as trade associations membership dues or funding for groups that undertake policy advocacy.

Morningstar Sustainalytics will usually recommend a vote **FOR** resolutions requesting:

- disclosure of lobbying expenditures and of the policies and procedures governing spending on lobbying and grassroots political action;
- disclosure of contributions towards political campaigns and of the policies and procedures governing electoral contributions; and
- alignment of lobbying and electoral spending and activities as well as trade association membership fees with stated public policy positions and commitments to societal values, such as racial justice and worker protections.

Morningstar Sustainalytics will make recommendations on a case-by-case basis when:

- resolutions are prescriptive as to the actions that corporations should take or not take to limit political influence;
- evaluating the standard UK company ballot item tabled annually by management in accordance with the UK Companies Act 2006 and the Political Parties, Elections and Referendums Act 2000 to approve political donations and expenditure, taking into consideration shareholder concerns over past political donations in markets in which the company operates, the maximum aggregate expenditure for which authorization is being sought, and the general level of transparency into political spending and lobbying activities.

Morningstar Sustainalytics will usually recommend a vote AGAINST resolutions that:

- seek to limit or challenge charitable contributions based on companies philanthropic programmes;
- seek to restrict all political speech by executives; or
- would likely weaken corporate accountability for political influence.

3.7 Corporate Purpose and Corporate Governance

The traditional 'shareholder primacy' model of governance – which in many cases emphasises the near- and medium-term financial interests of shareholders – is increasingly being challenged by a new paradigm, often framed as 'stakeholder capitalism' or 'enhanced shareholder value'. Within this paradigm, the board is responsible for setting the purpose and strategic direction of the company to deliver sustainable returns, while being cognisant of broader societal priorities and stakeholder interests.

When it comes to the specifics, we expect boards to put in place governance arrangements that underpin corporate accountability, including incentive structures, succession plans, and channels for reporting and engagement with shareholders and other stakeholders. We also expect boards to monitor the implementation of corporate strategy by identifying, tracking, and evaluating management on key metrics, including metrics relevant to the human and natural capitals supporting resilient business models. With growing attention on the capacity of boards to navigate multi-faceted global sustainability challenges, such as the energy transition to a net zero world, expectations on individual board directors have increased considerably, compared to expectations under the narrower 'shareholder primacy' model of governance. We believe this places significant emphasis on individual director qualities, the competence and diversity of the board as a whole, as well as processes for board evaluation and renewal.

3.7.1 Governance of non-financial stakeholder interests

Shareholders regularly propose proxy ballot items to advance specific approaches to the governance of non-financial stakeholder interests. Morningstar Sustainalytics will usually recommend a vote FOR resolutions requesting:

- measures that strengthen board-level responsibility for, and competence in overseeing, environmental and social risks and opportunities;
- measures that strengthen the alignment between strategic sustainability goals and senior management performance evaluation and incentive pay;
- measures to ensure board diversity in terms of personal and professional characteristics, taking into consideration the expertise needed for effective governance and strategic oversight;
- measures to balance board gender representation within a competitive framework for board elections;
- reporting on workplace pay disparities where the request is feasible, would give investors useful information, and the requested disclosure is not already mandated (such as where CEO to median worker pay ratio disclosures are required);
- public disclosure of a company's responsible taxation approach as well as reporting on relevant business activities and tax payments on a country-by-country basis.

In the context of existing board-level arrangements, Morningstar Sustainalytics will evaluate, on a case-by-case basis, shareholder resolutions requesting:

- the formation of new board committees with specific environmental or social oversight responsibilities;
- the nomination of board candidates with specific environmental or social expertise;
- the nomination of non-management employees in board elections;
- the incorporation of specific benchmarks and metrics into CEO and senior executive incentive pay arrangements;
- the adoption of specific approaches to pay disparity reporting beyond mandatory pay ratio disclosures.

In the absence of a compelling company-specific case or the board's support for the motion, Morningstar Sustainalytics will usually recommend a vote AGAINST shareholder resolutions requesting the adoption of a new corporate form and will evaluate on a case-by-case basis similar resolutions put forward by management, taking into consideration broader stakeholder benefits.

3.7.2 Corporate accountability to shareholders

Good governance is a pre-requisite for sustainable investment returns as it underpins accountability of the board and senior management to the company's stakeholders, including financial stakeholders. Traditionally shareholders have strongly supported governance measures serving shareholders'

financial interests – such as those extending shareholder rights to elect directors and veto remuneration practices. However, governance measures that give shareholders a stronger voice in the oversight of companies in which they invest also serve stakeholders where they create transparency and accountable leadership, and foster board-level capacity to navigate sustainability challenges. Therefore, we view many of the traditional governance resolutions that come to vote annually at shareholder meetings as equally relevant to emerging sustainability governance challenges. Our recommendations are guided by the ICGN's Global Governance Principles, which, on page 4, defines corporate governance as "…the system by which companies and boards are directed and controlled based on the principles of fairness, accountability, responsibility, and transparency within a framework of effective governance controls."

Shareholders frequently propose resolutions aimed at strengthening board oversight, remuneration practices, and the accountability of the board and senior management to shareholders. The company may also propose new governance arrangements impacting its bylaws.

We would generally recommend a vote FOR resolutions that strengthen senior management's accountability to shareholders, including resolutions requesting:

- an independent board chairperson;
- enhanced transparency around governance arrangements;
- that companies host an in-person annual general meeting, where virtual meeting attendance is offered;
- elimination of supermajority voting requirements, unless there is a compelling reason not to do so;
- shareholders' right to call special meetings, and the lowering of ownership requirements to a threshold that makes the right reasonably exercisable;
- shareholders' right to take action by written consent, unless the company has a controlling shareholder;
- board election provisions that strengthen shareholder oversight, such as election of board members by a majority of votes cast, annual election of all directors and effective shareholder access to the company's proxy to nominate director candidates;
- equal voting rights among shareholders, often referred to as the one-share-one vote principle, with recognition of a reasonable grace period following the first public offering of shares for companies to collapse dual class share structures entailing uneven voting rights;
- shareholder approval of a new or renewed senior management pay package that provides for severance or termination payments above a reasonable threshold;
- disclosure of clawback provisions and strengthening senior executive clawback policies to take account of conduct, even if not deemed to be misconduct, leading to restated financial information, as well as disclosure of recoupment deliberation outcomes;;

- shareholder approval of termination pay arrangements that exceed reasonable thresholds;
- shareholder approval of provisions or bylaw amendments that set advance notice deadlines for shareholders to submit director nominations, to avoid situations where boards may adopt tight deadlines that deter legitimate efforts to seek board representation; and
- stronger rights for shareholders to file shareholder resolutions.

In all cases, our analysis considers the supporting arguments of each proposal alongside the company's governance arrangements, recent record of shareholder voting, and the specific sustainability challenges facing the company.

3.8 Sustainability Reporting

Several regulatory developments in 2022 and 2023 have advanced standardized sustainability reporting broadly modelled on the TCFD framework (see section 2.1 above).

In markets where sustainability reporting is not mandatory, Morningstar Sustainalytics will generally recommend a vote FOR resolutions requesting that companies provide standardized sustainability reporting consistent with one of the widely recognized reporting frameworks such as the TCFD recommendations, IFRS S1 and IFRS S2, the new TNFD framework or the GRI standards. Given efforts to ensure interoperability among these standards as well as between the IFRS S1 and S2 and mandatory disclosures required under CSRD, we would consider reporting aligned to any of the existing frameworks as fulfilling this request.

In markets requiring that non-financial, or sustainability, reports be approved by shareholders at the annual general meeting, Morningstar Sustainalytics will generally recommend a vote FOR approval unless concerns have been raised by the external assurance provider. Additionally, we will consider recent evidence of violations or incidents leading to significant negative impacts on the environment, human rights, or employees.

Morningtar Sustainalytics will consider, on a case-by-case basis, resolutions requesting that companies submit their sustainability reports to an annual or regular shareholder approval vote, taking account of applicable mandatory reporting and assurance requirements and the company's sustainability due diligence, engagement and outreach efforts.

4 Voting Against Management Proposals

Voting against management proposals is a powerful strategy for addressing governance weaknesses where management has failed to act on investors' concerns. Escalation entails voting against management on key governance-linked ballot items or filing shareholder resolutions to address concerns. As an investor-driven active ownership strategy endorsed by prominent investor stewardship codes and investor coalitions, escalating a vote against management has greatest leverage when

executed according to a clearly communicated voting strategy and when it is triggered by well-recognized indicators.

The ESG Voting Policy Overlay offers voting recommendations on selected management-sponsored ballot items triggered by:

- research signals based on theme-specific indicators comprising Morningstar Sustainalytics' ESG Risk Rating,
- engagement signals based on documented lack of progress made under one or more of Morningstar Sustainalytics' engagement strategies,
- climate governance signals based on analysis of heavy emitter climate target-linked incentives,
- controversy signals based on recent high-profile incidents that reveal severe corporate governance weaknesses.

For qualified ballots, a *research or engagement escalation vote* recommendation will advise investors to vote AGAINST one of the following ballot items where offered, in order of the priority, except in the case of Thematic Stewardship Engagement cases where an ABSTAIN vote may be recommended:

1. re-election of members of the Sustainability Committee;
2. re-election of the members of the Governance Committee (where there are concerns about quality of board oversight),
3. re-election of members of the Compensation Committee (where there are concerns about incentive alignment),
4. re-election of members of the Audit Committee (where there are concerns about transparency and reporting),
5. re-election of the board Chairperson (except where the Chair is also the CEO) or the Lead Independent Director; or
6. approval of annual accounts or report.

In situations where a company only provides shareholders with a bundled slate vote to elect its directors – instead of individual proposals to elect each director – shareholders are left with an all or nothing choice. In the case of research or engagement escalation votes, and in the absence of an option other than recommending a vote AGAINST the entire board, we may recommend an ABSTAIN vote on proposals to elect a slate of directors in order to signal concern.

Where deemed necessary, a *climate governance-triggered vote* recommendation signaled by incentive misalignment will advise investors to vote AGAINST the company's say-on-pay vote or similar resolution.

Escalation votes triggered by engagement considerations are developed in collaboration with Stewardship Services' Engagement Managers and inputs are sought from in-house ESG experts, where appropriate. Furthermore, Engagement Managers' will make a final attempt to re-establish engagement prior to advancing a vote recommendation against management.

In addition to formal escalation triggers, an escalation voting recommendation may also be initiated where an Engagement Manager or client believes that a well-timed vote against management would accelerate engagement progress on a key ESG issue or theme. In such cases, the Voting Team would work with the Engagement Manager to identify the appropriate ballot item on which to recommend an escalation vote.

4.1 Research Signals

The objective of this voting strategy is to identify companies with weak management of priority ESG risks linked to topics with strong investor momentum, and to escalate investor concerns via votes on key governance-linked ballot initiatives.

Morningstar Sustainalytics identifies priority investor ESG themes by tracking investor proxy voting and engagement trends across markets using Morningstar's Proxy Voting Database and investor stewardship insights.

Priority themes in 2025 include:

- Biodiversity
- Circular Economy
- Climate change
- Diversity, equity, and inclusion
- Human Rights

We track selected ESG Risk Rating indicators mapped to the themes to identify where management of these identified topics is assessed as being weak and where the company is not already being engaged on the topic. Where this is the case, we will consider voting against management on selected ballot items being put forward for a shareholder vote at the company's shareholder meeting.

4.2 Engagement Escalation Signals

Engagement escalation involves a clear and credible commitment to a time-bound course of action that encourages companies to make satisfactory progress towards investors' engagement goals.

Investors recognize that effective engagement is based on a shared commitment between companies and their investors to mitigate ESG risks, enhance resilience and build long-term value. However, effective engagement often takes place in the shadow of an escalation strategy that may be activated should companies resist engaging with shareholders or fail to make progress towards investor-driven milestones within a reasonable timeframe.

Engagement escalation can encompass a range of actions that precede or extend beyond proxy voting – from investor letters to shareholder resolution filing. The objective of the ESG Voting Policy Overlay's proxy voting escalation strategy is to identify companies with weak engagement track records and to escalate investor concerns via votes on key governance-linked ballot initiatives.

Within the Stewardship Service's broader engagement escalation framework, we explore all avenues of stewardship with a focus on constructive company dialogue. When ongoing engagement efforts fail, the Engagement Team may choose to trigger the vote escalation process.

Escalation voting recommendations take into consideration our engagement dialogue, the engagement objectives, companies' responses, and the timing of the company's AGM in relation to ongoing engagement activities.

Where investors choose to follow our escalation voting recommendations, they are supported in communicating their voting intentions to the company and encouraging the company to engage with Morningstar Sustainalytics. Following the initial escalation voting recommendation, Engagement Managers continue to reach out to companies leading up to the AGM with the aim of re-starting engagement. If the company is willing to re-enter some form of dialogue, the Engagement Manager would then decide whether to revoke the voting recommendation. In such cases, we inform clients of the change in recommendation.

4.3. Climate Governance Signals

Many large institutional investors have committed to support the goal of net zero GHG emissions by 2050, and to setting and reviewing interim targets consistent with this ambition. In order to do this, challenging short-, medium-, and long-term decarbonization milestones must be achieved by companies in investors' portfolios. Failure to achieve rapid economic decarbonization creates systemic risks for investors. At the same time, new investment opportunities arise as the global economy and energy system transforms.

The objective of this strategy is to support our clients to use their proxy votes to advance climate-competent governance practices at companies that are among the heaviest emitters in the global economy. These companies are significantly exposed to climate transition risk and therefore also have the potential to create momentum in advancing the global energy transition.

In formulating our recommendations, we scrutinize the climate transition plans, carbon risk exposure, and governance practices. Where companies have failed to set meaningful decarbonization targets in line with a climate strategy that references a credible net zero emissions reduction pathway, such as the IEA's 2050 Net Zero Roadmap, and align senior management performance metrics and incentives with this strategy - or where company disclosures provide insufficient evidence of alignment between decarbonization goals and senior management performance metrics - we will recommend that investors vote AGAINST on the advisory approval of named executive officer compensation or other climate-linked management resolutions.

In evaluating incentive pay target alignment with emission reduction goals, we apply the following considerations:

- Are targets expressed in quantitative and observable measures?
- Do emissions reduction targets guiding incentive pay reference the Paris Climate Goal of net zero global emissions by 2050?

- Are emissions reduction targets included in long-term incentive pay arrangements?
- Are emissions reduction targets expressed as carbon intensity or absolute targets?
- Are emissions reduction targets sufficiently weighted within the overall incentive framework?
- Do pay disclosures provide the necessary detail for investors to evaluate the contribution of emissions reduction targets to total pay?

Given how rapidly companies are incorporating sustainability considerations into incentive pay arrangements as well as the increasing urgency for companies to respond to changing physical risks and the anticipated global energy transition, support for a company's climate governance practices in one year does not necessarily mean that we will recommend support for the same arrangements in subsequent years.

Our research draws primarily on companies' corporate governance and climate disclosures to examine how oversight and incentive structures link to climate targets and metrics. It also examines Morningstar Sustainalytics' ESG research, as well as various ESG Stakeholder Governance indicators. In addition, we weigh historical proxy votes, and findings presented in public datasets compiled by climate-focused investor-led initiatives.

Informed investor voting at companies most exposed to climate transition risks, where boards and senior management are failing to set and meaningfully pursue rigorous climate-related targets, offers investors a powerful strategy for making progress towards their portfolio-level climate commitments.

4.4. Controversy Signals

In recent years, high-profile corporate scandals such as environmental pollution incidents, workplace sexual harassment, systemic patterns of pay discrimination and failure to detect fraudulent transactions have led to legal consequences, erosion of shareholder value and negative impacts on key stakeholder groups. Such incidents may reveal lapses in governance oversight of material environmental, social and business ethics factors and may have significant negative consequences for investors and other corporate stakeholders.

The objective of this strategy is to leverage Morningstar Sustainalytics' controversies database to identify companies that have experienced one or more significant recent controversy, or that have failed to manage the fallout of ongoing significant incidents. We subsequently identify areas where stronger corporate governance may better mitigate the impacts of existing controversies or avoid future controversies. If, when companies announce an upcoming AGM, the controversy remains unresolved and where the analyst outlook for the incident resolution remains negative or neutral (negative for Category 3 incidents and negative or neutral for Category 4 and 5 incidents), we may consider whether a vote against one or more management-sponsored ballot measures would effectively signal shareholders' governance concerns to corporate boards and management, thereby encouraging timely action.

Our research will draw on Morningstar Sustainalytics' Controversies Database, including the insights of research analysts and their outlook for the company in the context of the relevant incident.

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