July 2022

ESG Analyst Survey 2022: Turning the tanker

Foreword

Fidelity International is rightly proud of its army of investment analysts: experts in their fields who build deep connections with the companies they cover, their suppliers, customers, and competitors. It is all the more powerful, then, that these are the people who don't just focus on the financial aspects but also apply their techniques and insight to sustainable investing analysis, forming an holistic view of a company's actions and how they compare with their peers and the wider world. In this report, the second time we have focussed the survey — and our analysts' minds — on ESG, their responses come together to form a unique view of what's happening in the real world. We have analysed not just the aggregate data to understand the global, regional and sectoral trends but have also interviewed the analysts to get more detail. You'll find their thoughts peppered throughout and I hope you find this ESG Analyst Survey useful.

Richard Edgar
Editor in Chief

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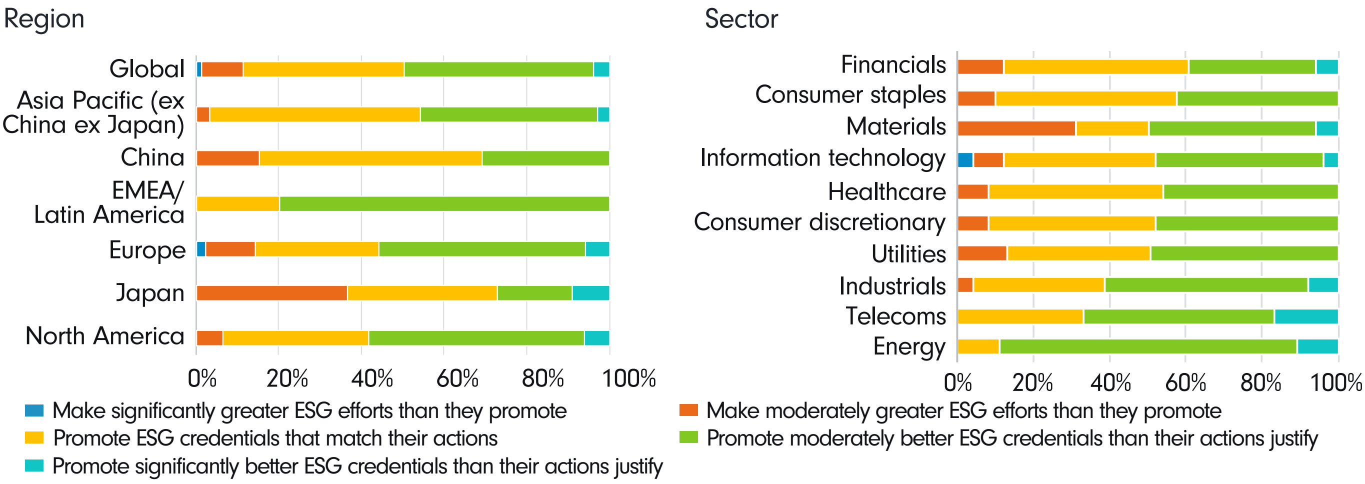
Turning the tanker: Keeping the ESG revolution moving

In the heightened tensions of the current geopolitical environment, the debate around sustainable investing has intensified. On the ground, our 2022 ESG Analyst Survey provides signs of how companies are making progress, but much more needs to be done.

Fidelity's 2022 survey of analysts on sustainability issues comes at a delicate moment. Sustainable investing has grown into a $35 trillion market, but it faces a series of challenges. Regulators are scrutinising every claim, while the market context has been fundamentally changed by war in Ukraine, declines in both bonds and equities, and the biggest flare-up in inflation in decades.

The survey, taking in the views of 161 investment analysts, shows corporates are doing a lot – but there's still more talk than action. On a positive note, around half our analysts think their companies make ESG efforts that match or exceed what they promote. But that still leaves the other half. Examples where the analysts are concerned include an oil company attracting a lot of attention for its renewable investments although this accounts for only a tiny fraction of the overall business; or a swimming pool services company which labels itself as "water management". Almost 90 per cent of our energy sector analysts say their companies promote better ESG credentials than their actions justify.

Chart 1: Fidelity analysts believe some companies promote better ESG credentials than their actions justify



What do you think about your companies' efforts to promote their ESG credentials relative to their actions?" Source: Fidelity International ESG Analyst Survey 2022.

However, the gap between aspirations and reality is in itself a sign that companies know what they are supposed to be doing, even if their claims are exaggerated. We know the focus on ESG at companies we invest in is growing. The survey shows 56 per cent of boards now have direct oversight of sustainability, up from 52 per cent last year. Companies are responding to regulatory and investor pressure. The challenge is to help firms set out plans that are ambitious and effective but not out of reach or oversold, and which can then be regularly monitored and updated.

Boards now are not just promising to disclose ESG-relevant data, they are hiring departments to count and publish it, just as their accountants publish financial data.

The investment world's ability to do this is still developing but powerful, significant changes are happening, and these are worth retaining. In the survey, our analysts provide detailed accounts of both collaborative and direct one-on-one engagements with companies, where they ask hard questions of senior management based on detailed assessments of their E, S and G plans. Importantly, these are the same financial analysts we have long tasked with watching companies and sectors for investment opportunities: they know these businesses and they know the company managers involved.

Boards now are not just promising to disclose ESG-relevant data, they are hiring departments to count and publish it, just as their accountants publish financial data. This creates baselines from which we all can start to measure in a convincing way whether companies are really making progress. Take net zero carbon targets. The survey shows they look further away for some sectors than a year ago. This reflects the scale of the acceleration necessary but also that we are better equipped to measure the corporate plans to get there.

The scope of activity is broadening, too. A year ago, greenhouse gas emissions and governance dominated conversations with CEOs. This year they and their management teams can answer meaningfully on plastics and deforestation, biodiversity, and water management. US companies, which have trailed behind Europe, are starting to catch up.

There is real complexity, especially around the energy transition. Take an energy company still wedded to coal. Simply dumping the stock lets other investors, uninterested in climate impact, pick up a bargain. Working with the company on its sustainability plan, supporting acquisitions, encouraging it to maintain local industry, to effect change in its suppliers and clients: this is a real transition. Clearer definitions help us all get closer to making the sophisticated, non-binary choices that the green transition demands.

Change the game

Far from being discouraged, the increased scrutiny and increased corporate focus suggests to me that change is real. It does, however, highlight that there is often a disconnect between the short-term nature of markets and the long-term planning required when dealing with climate change, and making communities more stable and resilient. But the answer is not to give up on trying to use the financial system to bring about change. Rather the system itself must change by adopting agreed global definitions and standards, and by shining a light on the inevitable complexity of transitioning to a greener, more inclusive economy.

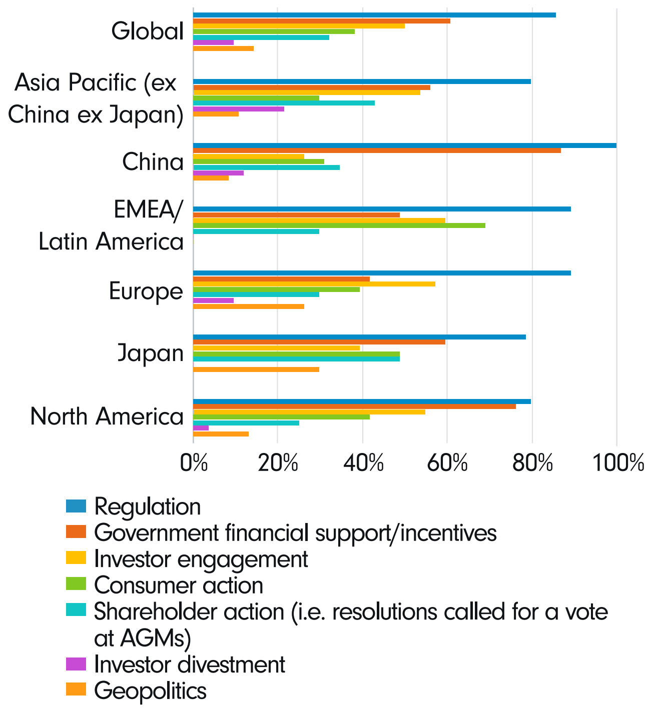
In for the long haul on engagement

From the push for sustainable air fuel to mining workers' rights and deforestation, Fidelity analysts' engagements with companies over the past year show the conversation on climate and sustainability is deepening. There is no silver bullet, but our role as investors is to stay the course.

Messages from the front line

Fidelity's second annual ESG survey, based on almost 200 responses from equity and fixed income analysts,[1] shows corporate managers are struggling with the challenges generated by the war in Ukraine and a global slowdown, but that the focus on climate transition and social factors has not gone away. This is partly due to increasing investor engagement on the issues, alongside growing regulatory intervention and government incentives.

Chart 2: Corporates respond to rules, incentives, and investor pressure on the environment



"What do you think will drive changes in environmental practices at your companies over the next 12 months?" Chart shows the proportion ranking each factor as one of the top three most important. Source: Fidelity International ESG Analyst Survey 2022.

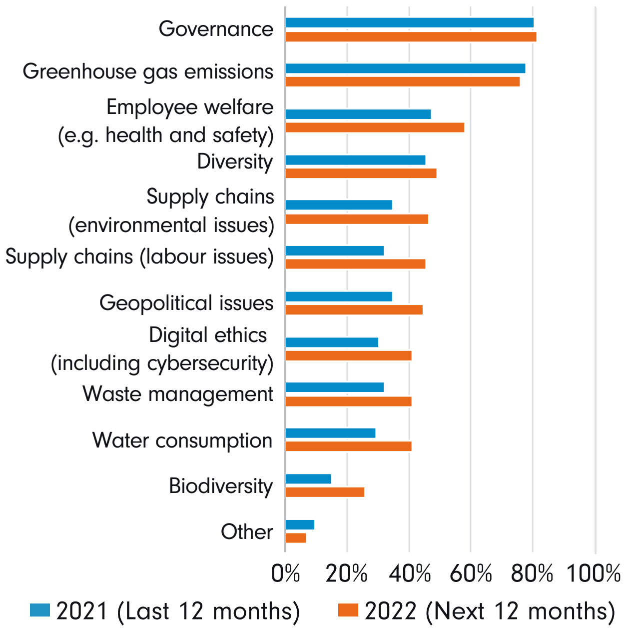
[1] Some responded more than once depending on their sector coverage.

There are clear regional distinctions. In China, where many companies are still early in their sustainability activity, government initiatives and regulation dominate and investors are only just becoming a deeper part of the process. The first year of the Biden administration sees analysts point to regulation and government support as the biggest drivers of an acceleration in change in the US, too, while in Europe, further ahead in the process, investors play a more significant role, alongside regulation.

After the disruptions of the past year, supply chains are in focus, especially labour concerns, which show the largest increase in mentions by the analysts.

"At this stage the focus is very much around relationship building and encouraging greater disclosure," says one analyst who covers the financial sector. "That's particularly the case for US companies which are less advanced with their ESG plans compared to companies in Europe."

Chart 3: Analysts expect to tackle a broader range of ESG issues



"What ESG issues have you engaged with companies on over the last 12 months?" and "What ESG issues do you expect to engage on over the next 12 months?" Source: Fidelity International ESG Analyst Survey 2022.

Hothouse topics

Our analysts report that - after governance - greenhouse gas emissions continue to dominate discussions in their meetings with boards and management teams, while there is a marked increase in interactions across the board on social topics like employee welfare and diversity. After the disruptions of the past year, supply chains are in focus, especially labour concerns, which show the largest increase in mentions by the analysts. But the natural world is a key concern too and, from a low base, biodiversity features in 26 per cent of analysts' conversations, with our team expecting that to rise in the year ahead.

These issues are still low on the agenda for telecoms, industrials and banks, but consumer staples producers for example are digging in, investing in programmes to cut consumption of new plastics, source more sustainably and reduce their impact on the oceans.

"Companies are more aware of their environmental footprint and are starting to take action and participate, primarily as financial sponsors, in projects to offset the negative impact," says a consumer discretionary analyst. "In my area, for example, cruise operators are contributing to projects that either clean the ocean or protect certain endangered ocean species."

Top drawer

These discussions aren't just handled by Investor Relations teams. We record higher engagement with sustainability issues by chief executives. Already high in 2021, it rose again over the past year. In Europe, which is leading on the energy transition, some 60 per cent of engagements have been with the C-suite.

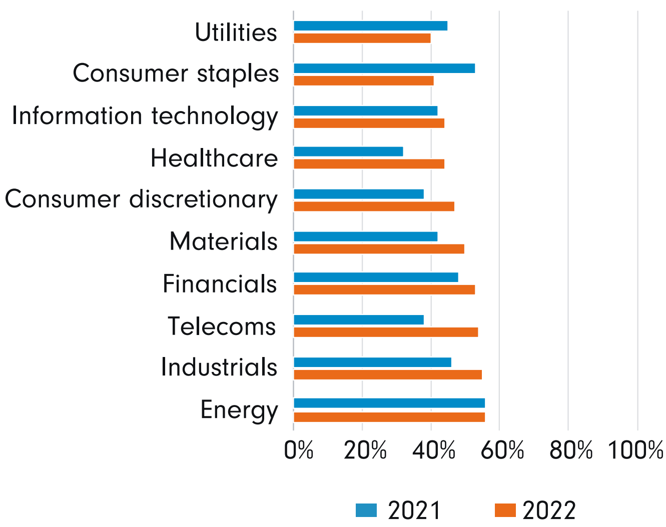
This is a global phenomenon, as corporate leaders engage more in almost every market and sector.

"The companies 'get it' and the aim is to help them by increments rather than by delivering a transformational moment," says one analyst who covers commodities producers and other materials companies, many of them in emerging markets. "Companies are embracing ESG and change in general, but we have to remember that the majority are state-owned enterprises. They cannot be patronised."

Engagement with the C-suite has not risen across the board, however. In the utilities and consumer staples sectors, for example, the share of meetings with company leaders have fallen off slightly from last year.

"In some areas there are signs that CEOs and CFOs are engaging less," says another analyst. "Sometimes that may reflect companies finally getting serious, in others there is less engagement at that level now, possibly because the agenda has been set."

Chart 4: Around half of all engagements are with C-suite



"Thinking about all of your ESG engagements over the past year, what proportion of them have been with the C-suite?" Source: Fidelity International ESG Analyst Survey 2022.

Making a difference

Dotted among the survey responses are examples of the small but necessary changes being made by companies with which we and other asset managers have engaged. In one example, following meetings with our analysts, China Power International announced a detailed green energy transition plan with a clear 2025 target for the percentage of capacity and revenue it would generate from renewables. This was largely driven by top-down changes announced at a government level but the company's management were also keen to respond to the needs of international investors and we had specifically raised the need for a revenue-based target.

In another example, we used the intelligence gathered from engagements with senior management at UK banks to steer our voting decisions on shareholder resolutions. We believe this helped us to support banks and senior managers who were genuinely moving forward on climate policy, and to oppose those who talked a good game but did little.

Nevertheless, it is often impossible to point to the exact moment when engagement made a difference and prompted real change. "At large cap level, it is a fallacy that we turn up to a meeting, talk about ESG and the company goes 'oh wow' and it's transformative," says the same materials analyst quoted above. "It's about multiple discussions and inching out gains over time."

Harder choices ahead

Banks, which can afford to employ departments to do the work, are pressing ahead with better environmental disclosure, laying the foundation for more difficult decisions ahead.

"Disclosure is easy, and managers don't mind committing to it," says an analyst who covers European banks. "You make the commitment, appoint some people to do it and it gets done. The bigger problem is what comes after: banks can't finance a green economy if the economy itself isn't moving in the right direction."

Standardisation of disclosures should help other companies, but some are also having to make tough choices such as what to fund and when, given capital pressures and the absence in many sectors of the technologies required to complete the transition. Our air industry analysts, for example, say Boeing, Airbus and a raft of engine producers are diving into the process of delivering lower carbon planes.

"They all know there is a huge competitive advantage for whoever gets there first," says one. "However, the tech is still in university labs. Electric is not really viable. The density of batteries needs to be much, much higher. In 10 years, it will be a very different story, but you cannot solve that problem just by throwing money at it."

Collaboration can be effective

In several cases, we have engaged with companies alongside other asset managers advocating for similar agendas. More than a third of European analysts, and over 40 per cent of those covering China, say doing so can carry more weight than engagement on our own.

Banks, which can afford to employ departments to do the work, are pressing ahead with better environmental disclosure, laying the foundation for more difficult decisions ahead.

Our small group interaction with Bank of China last year, for example, gave the company clear recommendations on green finance and target-setting, much of which its management then delivered in a detailed action plan to reduce its carbon footprint that included environmental stress tests.

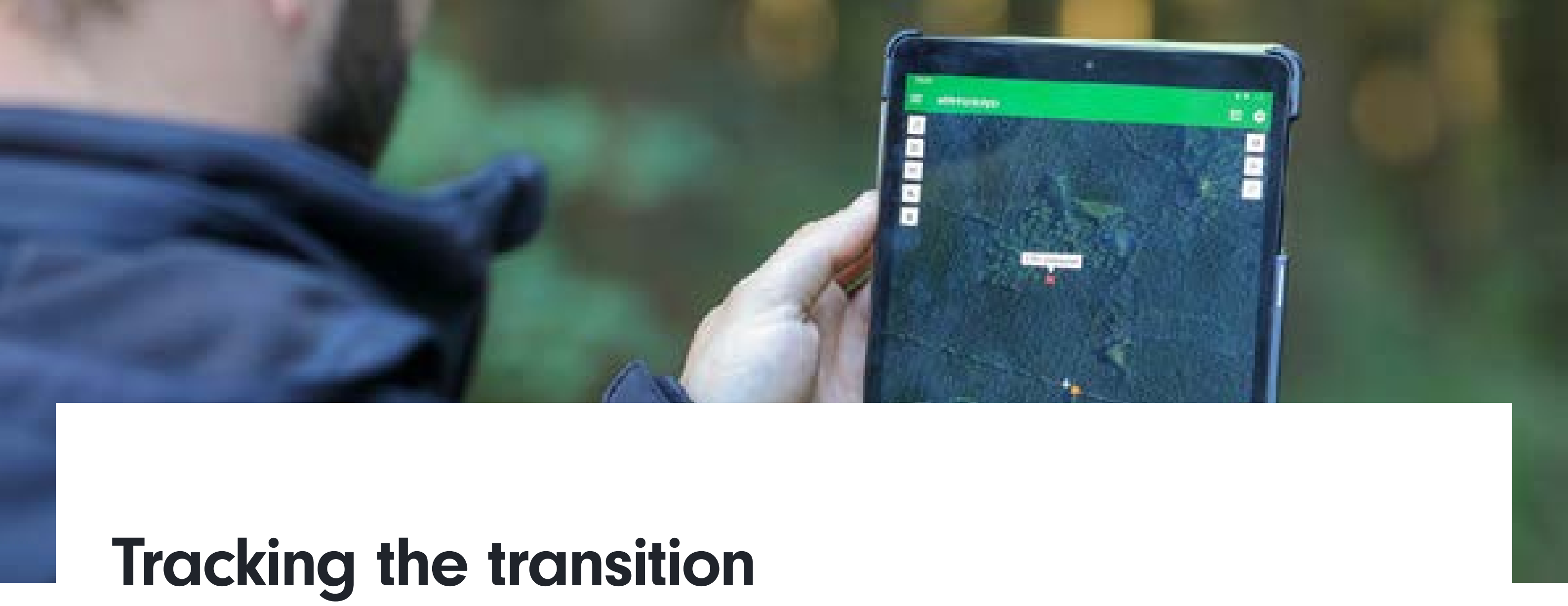
The sectoral expertise of financial analysts has often proved important. They have long-standing relationships with companies and appreciate the challenges they face.

"These are companies invariably we have been covering as financial investments for some time: we understand their businesses," says one banking analyst. "So we are not just shouting at banks about ending oil and gas investing. But we are also able to be honest with management in ways that others cannot be."

Police the detail

Fidelity is not an activist investor. Even in groups with other shareholders and asset managers, we won't always achieve things we want to. But we are active stewards of our client's capital and by engaging continually with companies we know well, and sharing what works, we can help to bring about lasting change.

"There has been some push back. You will hear people in the US ask: 'who made asset managers God'?" says another analyst who covers US and European airlines and aerospace firms. "Our job is to do the detail. To make sure that climate targets are finding their way into the LTIPs, that they are being measured correctly. And that there are reasonable goalposts along the way. That will be our role."



Tracking the transition

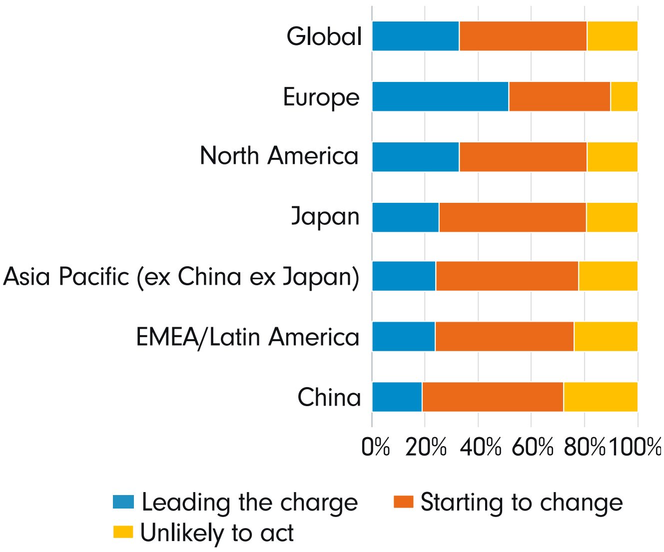
Fidelity International's second annual ESG Analyst Survey finds signs of year-on-year progress towards net zero, but there's a long way to go to get to a more sustainable economy.

This year's Fidelity International ESG Analyst Survey finds tangible signs of corporate progress towards net zero, despite the impact of the war in Ukraine and an increase in the immediate demand for substitute fossil fuels (including coal) to alleviate higher prices. We asked our analysts about this transition, and they report positive developments on some of Fidelity's key sustainability themes for 2022 such as deforestation. More analysts also report a strengthening of the link between management pay and ESG issues over the last 12 months.

Net zero: Europe still leads but Chinese firms are starting to change

Among regions, Europe is still out in front on the transition to net zero, with analysts covering companies there reporting the highest proportion that are "leading the charge".

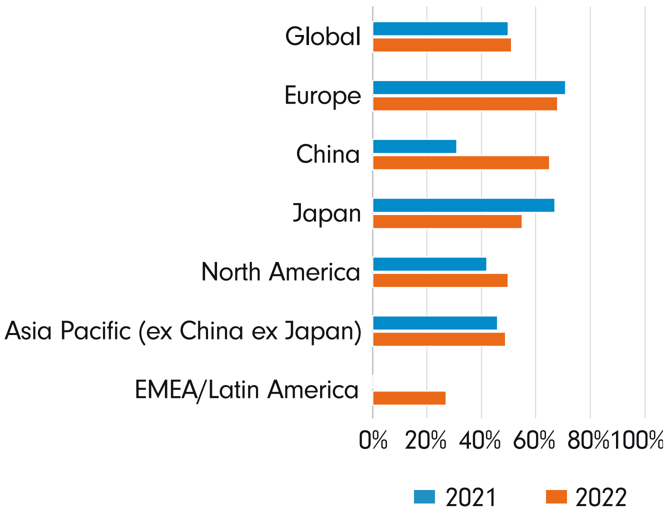
Chart 5: Europe still leading the charge on net zero



"When it comes to the transition to a low carbon economy, what proportion of your companies are likely to take the following actions." Source: Fidelity International ESG Analyst Survey 2022.

China meanwhile has the smallest proportion of "leading the charge" companies. However, more than half of Chinese companies are starting to change, according to our analysts. This is reflected in the proportion of analysts who say Chinese companies will meet net zero by 2050, which has more than doubled from last year to 65 per cent. This is a remarkable development, reflecting strong steers from central government.

Chart 6: Increasing confidence that Chinese companies can meet net zero by 2050



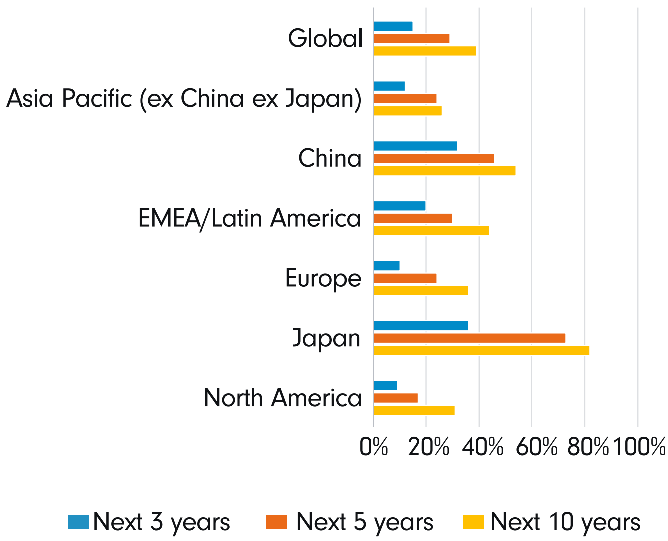
"How confident are you that your companies' emissions targets are ambitious enoughto meet net zero by 2050?" Scale of 1-7, where 1 is not confident at all and 7is very confident. Chart shows the proportion answering 5-7. Source: Fidelity International ESG Analyst Survey 2022.

One analyst covering Chinese industrials says: "Given the priority that China puts on net zero and increasing investor awareness, most Chinese aviation and logistics companies have started initiatives on the energy transition".

Several other China-focused analysts echo this sentiment that Chinese companies are responding to top-down cues following Beijing's 2020 announcement that it is targeting net zero by 2060. However, it's not an entirely positive story: others note that some of the country's businesses are "still early in their ESG journey".

As occurred last year, analysts in aggregate see more opportunity than risk from the green transition, especially over the long term. Japan stands out, with significant opportunities expected to emerge in autos, consumer staples and semiconductors over the next decade. China is also likely to benefit from green opportunities and is already a leader in areas such as solar panels.

Chart 7: Japan and China set to embrace transition opportunities



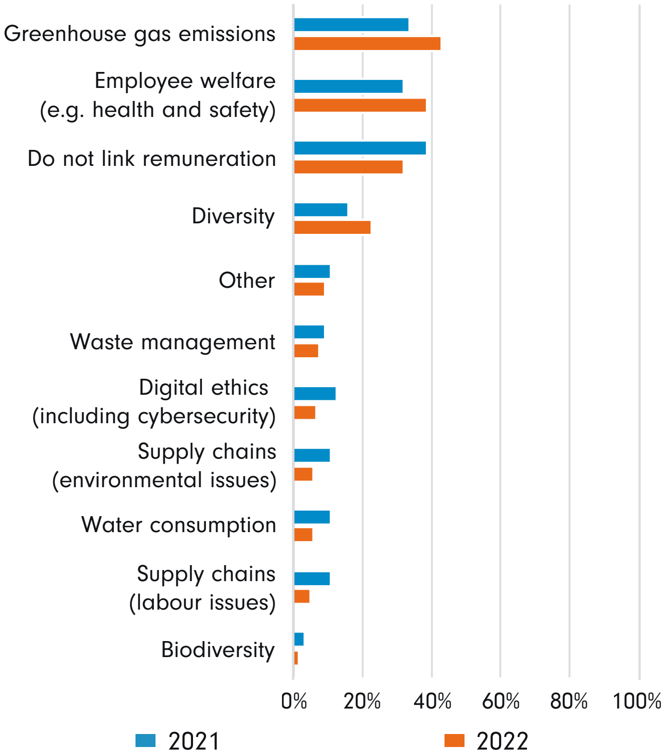
"How significant are the potential business opportunities arising for your companiesover the following timescales as a result of the transition to a low carboneconomy?" Scale of 1-7, where 1 is not significant and 7 is very significant.Charts show the proportion answering 5-7 (significant opportunities). Source: Fidelity International ESG Analyst Survey 2022.

"Semiconductor tech improvement is itself a source of energy efficiency," says one Japan analyst covering the IT sector, "while digitalisation is a source of semiconductor demand."

More companies adopting policies on key ESG issues

Looking more closely at companies' actions, our analysts note several areas of progress. For example, the number of analysts reporting that the companies they cover now link senior managers' pay to greenhouse gas (GHG) emissions has increased.

Chart 8: More companies are linking emissions to bosses' pay



"Do your companies currently link the remuneration of senior management to any of the following ESG issues?" Chart shows the proportion of analysts answering that companies in their coverage link remuneration of senior management to a given ESG issue Source: Fidelity International ESG Analyst Survey 2022.

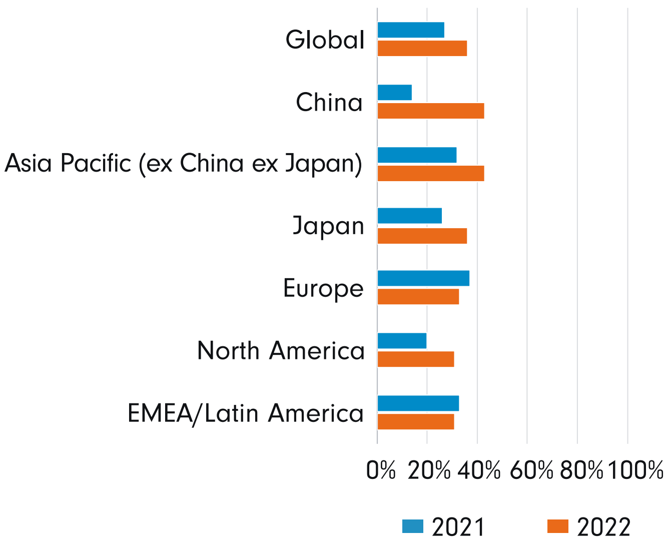
Forty-three per cent of analysts say the companies they cover now link GHG emissions to executive remuneration (up from 34 per cent last year), while 39 per cent say their companies link senior pay to employee welfare (up from 32 per cent). Both responses are now more common than "do not link", although this remains the most popular answer among China and Japan-focused analysts.

Having a policy and having a good policy are two different things, and approaches vary across sectors.

Progress on Fidelity's core sustainability themes

Our analysts are also reporting an increase in the proportion of companies with formal policies on other environmental issues such as deforestation, which is a key sustainability theme for Fidelity in 2022, following a pledge we made alongside other investors at the time of COP26.

Chart 9: Deforestation climbs the agenda (slowly)

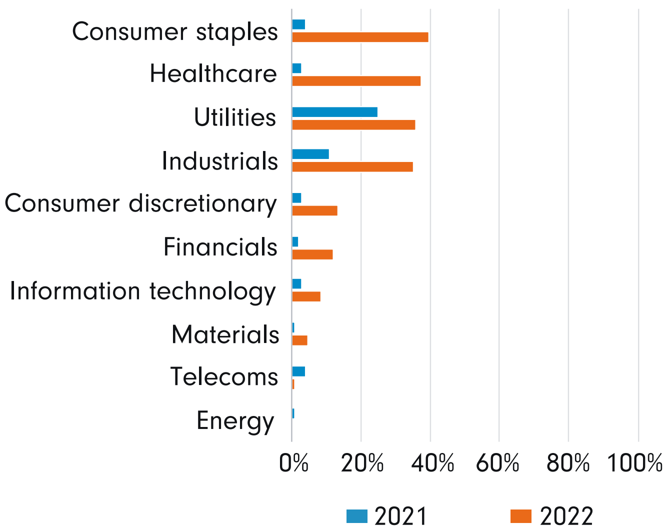


"What proportion of your companies have policies in place to address deforestation?" Source: Fidelity International ESG Analyst Survey 2022.

Unfortunately, there is still a majority of companies which don't have these kinds of policies. Moreover, having a policy and having a good policy are two different things, and approaches vary across sectors. One analyst covering European healthcare finds their companies' biodiversity policies are "mostly just lip service, high-level and feel quite boilerplate, with very few concrete examples", while one Europe-focused energy analyst says for his sector "emissions are the priority".

Another core theme is the just transition. This is the idea that the move to a greener economy risks economically harming some individuals and communities, such as those working in the fossil fuel industry, and that efforts should be made to mitigate these risks. Here too there are signs of incremental progress, with a greater proportion of businesses having announced initiatives to promote a just transition by supporting displaced employees.

Chart 10: Just transition initiatives on the rise



""What proportion of your companies have announced intiatives to support employees displaced by the move to a low carbon economy over the next decade?" Source: Fidelity International ESG Analyst Survey 2022.

Energy stands out as a stark exception. Not only are there very few initiatives underway to retrain workers but in another survey question we asked, 90 per cent of our energy analysts say the sector is highly vulnerable to future job losses. This suggests that workers are likely to shift sector entirely - or end up unemployed - rather than be retrained for new roles.

Progress is slow - but it is happening

Transitioning to a sustainable economy is fraught with challenges. Progress is slower than we would like but it is happening. Identifying those companies taking concrete actions - such as tackling their deforestation impact or mitigating the social impact of shifting to new technologies - is crucial to supporting the transition and allocating capital to where it can do the most good.

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