Mercer

UK Stewardship Code Report

Mercer Investment Solutions Europe

Annual Report for 1 January 2021 to 31 December 2021

welcome to brighter

Introduction

We are pleased to share our 2021 Stewardship Report. This annual report captures the stewardship approach, progress and outcomes of Mercer Investment Solutions Europe (Mercer)[1] over the calendar year 2021 and covers the 12 principles comprising the UK Stewardship Code.

Over 2021 climate change, human rights & labour practices and diversity & inclusion were top of our stewardship agenda. At the same time investment managers responded to growing client expectations, with many becoming signatories to the UK Stewardship Code. While there is always room to improve, the growing importance placed on stewardship within the industry only reinforces our belief that stewardship will continue to play a crucial role in helping our clients meet their investment goals and fiduciary responsibilities.

Mercer has evolved its approach over 2021 to ensure that stewardship continues to form a key role in strategy decisions, manager selection and ongoing monitoring by our investment team and to increase the overall effectiveness of active ownership across the market for the benefit of our clients.

To that end we continued to invest heavily in improving our approach to stewardship. Three highlights stand out:

- The successful launch of our first Global Manager Engagement Dashboard, which has provided meaningful insights and identified priority areas to engage on with appointed managers. This dashboard together with the EU Sustainable Finance Disclosure regulations has driven fruitful engagements with managers, leading to the further incorporation of environmental considerations within their investment approaches.
- The creation of a new Mercer Solutions ESG team, totalling six members by early 2022. Two members are focused solely on stewardship, helping to ensure the successful implementation of Mercer's stewardship policy and effectiveness of stewardship activities.
- Working towards our Net Zero commitments supported by numerous engagements with appointed managers on their consideration and management of climate-related risks, including collaborating with them to reduce emissions across their portfolios.

Going forward Mercer remains committed to continuing to evolve its approach to stewardship by promoting best practice and transparently reporting our activities and outcomes to our clients and the wider market.

This report was reviewed by the Head of Sustainable Investment UK & Europe and the CIO of Mercer MGIE and formally approved by the Mercer MGIE board.

David O'Sullivan

Chief Investment Officer,
Mercer Global Investments Europe Limited

[1] See Important Notices for information on the entities referenced in this report.

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Principle 1

Principle 1

Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Highlights, Outcomes and Focus for Next 12 months

We are pleased with the progress over 2021 in evolving our overall approach to stewardship and meeting our clients' needs. We believe these efforts have led to better outcomes for our clients by enhancing the value of their portfolios, promoting market-wide best practice and helping them meet and exceed regulatory requirements.

Three areas stand out:

1. The development and launch of our Manager Engagement Dashboard - with inputs sourced through our engagements with managers, review of their Mercer assigned ESG ratings and responses to our annual manager engagement survey - has provided meaningful insights and identified priority areas to engage on with appointed managers. Further enhancements to monitor the effectiveness of our engagement activities, measure progress over time and identify cases where further escalation may be needed, has been achieved through capturing goal orientated engagements on our Manager Engagement and UN Global Compact (UNGC) Engagement Trackers.
2. EU Sustainable Finance Disclosure regulations and enhancement of funds to better promote environmental, social and governance characteristics led to numerous engagements with managers, most notably on the incorporation of climate considerations in their investment approach. These will likely not only benefit Mercer portfolios but other strategies managed by appointed managers. These activities led to appointed managers enhancing their approach to considering and in a number of cases supporting decarbonisation efforts.
3. Mercer has committed to target net-zero absolute carbon emissions by 2050 for its discretionary portfolios and the majority of its multi-client, multi asset funds, representing USD 80 billion in assets under management as at 31 December 2021. To achieve this, Mercer plans to reduce portfolio relative carbon emissions by at least 45% from 2019 baseline levels by 2030. Engaging with appointed managers, on their consideration and management of climate-related risks, and working closely with them to reduce emissions, has been an important part of our engagement activities in ensuring we are able to meet these commitments.

The continued improvement in these areas ensures that stewardship continues to form a key role in strategy decisions, manager selection and ongoing monitoring by our investment team and has supported our role in improving the overall level of active ownership across the market and asset classes for the benefit of our clients.

Over the next 12 months and beyond, our sustainability priorities with strong links to stewardship are to:

1. Further strengthen ESG integration by working to improve our appointed managers' ESG ratings through manager engagement and selection decisions.
2. Target net-zero absolute carbon emissions by 2050 for all of our UK, European and Asian clients with discretionary portfolios and the majority of our multi-client, multi-asset funds domiciled in Ireland.
3. Enhance stewardship efforts through improved monitoring and engagement efforts using our Manager Engagement Survey, Manager Engagement Dashboard and Manager Engagement Trackers, while focusing on driving change in line with Mercer's Global Engagement Priorities. To complement our stewardship monitoring exercises, we will begin assessing appointed managers against our stewardship assessment framework, based on the UK Stewardship Code principles over 2022.

More information is provided on each of these aspects later in the report.

Overview of Mercer and Our Purpose

Mercer is a leading provider of investment solutions, offering customised guidance for investment decisions, risk management and investment monitoring services to a broad range of institutional investors, including pension funds, insurance companies, endowments, foundations, and other investors. Mercer's investment solutions capability evolved from its investment consulting business.

Mercer does not invest in companies directly; it selects and combines highly rated specialist managers into funds (both multi-client and bespoke), and for certain clients, those funds into portfolios. We provide a range of funds across equities, fixed income, passive solutions, and alternatives. Furthermore, Mercer provides bespoke funds for some clients.

Our purpose is to support clients in setting, implementing and monitoring their investment strategies through our investment solutions to meet their goals and fiduciary responsibilities. Stewardship plays a key role in this regard.

Mercer has been advising its asset owner clients on a wide range of investment issues relating to sustainability since the formation of its specialist Sustainable Investment ('SI') team in 2004. Typically solutions and services fall into the following key areas: ESG integration, stewardship, screening, sustainable opportunities and climate change, aligned with the EU and UK regulatory expectations for asset owners.

Our Culture and Firm Values Support Our Approach to Stewardship

Mercer, and its parent company Marsh McLennan, have set out beliefs and expectations of how our firm undertakes its business activities in a responsible manner through five key areas: our code of conduct The Greater Good; Our Purpose; Diversity and Inclusion; Sustainability; and Social Impact. All colleagues are expected to understand and act in a consistent manner with these beliefs and policies. Mercer believes in building brighter futures and recognises its responsibility to conduct business in a way that protects and improves the state of the environment for future generations. In 2021 Marsh McLennan launched WeSpire, an internal sustainability platform to promote education and engagement on sustainability issues amongst colleagues.

The Greater Good details our values, ethical commitments and standards of conduct and underpins how we conduct ourselves. As a business, we renewed our commitment to The Greater Good in 2020 with a culture centred on Leadership, Commitment, Trust and Teamwork. This culture is embedded into our relationships with clients and in the way we manage funds on their behalf and provide services. This culture is reflected in our approach to investments through the establishment of our global investment beliefs. See Principle 2 for more information on how we embed sustainability considerations in roles and decision-making for all staff.

Sustainability and Stewardship at the Core of our Global Investment Beliefs

Mercer's approach to investment is grounded in its global investments beliefs. Sustainability is at the core of our investment beliefs and philosophy, being one of five key pillars. More specifically, Mercer believes that stewardship (or active ownership) helps the realisation of long-term value by providing clients with an opportunity to enhance the value of companies and markets in a manner more consistent with long-term investor timeframes. Mercer articulates these sustainability beliefs in its Sustainability Policy, along with clearly defined processes, to ensure sustainability considerations are embedded across all relevant investment solutions.

Mercer's Investment Beliefs

Our culture has enabled us to set a clear top-down view on our approach to stewardship. Mercer's sustainability beliefs coupled with clearly defined processes ensure sustainability and stewardship considerations are embedded across our investment solutions and services. Our five investment beliefs, with extra detail on sustainability, are shown below:

Figure 1. Mercer's Investment Beliefs

Mercer believes a sustainable and responsible investment approach is more likely to create and preserve long-term investment capital and, more specifically, that:

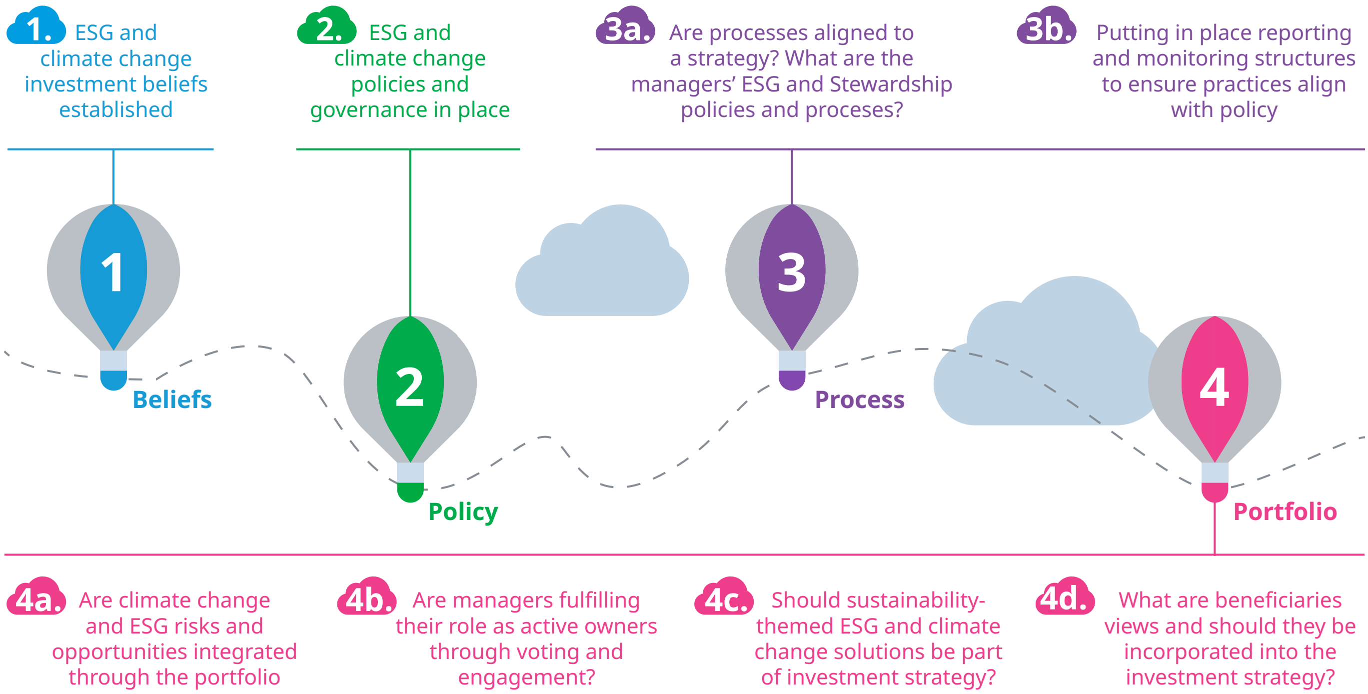
ESG factors can have a material impact on long-term risk and return outcomes and should be integrated into the investment process.	Taking a broader and longer-term perspective on risk, including identifying sustainability themes and trends, is likely to lead to improved risk management and new investment opportunities.	Climate change poses a systemic risk, and investors should consider the potential financial impacts of both the associated transition to a low carbon economy and the physical impacts of different climate outcomes.	Stewardship (or active ownership) supports the realisation of long-term shareholder value by providing investors with an opportunity to enhance the value of companies and markets.

Consequently, Mercer believes that an approach that considers these sustainability risks and opportunities is in the best interests of our clients.

An Overview of our Stewardship Activities

Mercer incorporates stewardship across all four areas of our Sustainable Investment Pathway, shown below, which sets out the key elements of our approach to embedding sustainability considerations across our solutions.

Figure 2. Mercer's Sustainable Investment Pathway



Mercer provides integrated stewardship solutions across belief setting, policy development, manager selection, implementation, and monitoring and engagement processes.

Education and Belief Setting

- Providing training, resources and services via our investment consultants and SI team to support asset owners in meeting regulatory requirements and achieving leading practice.
- Supporting asset owners in determining their beliefs on ESG integration, stewardship and climate change.

Policy Support

Supporting asset owners in preparing key scheme documentation to reflect activities related to ESG integration, stewardship and climate change. Examples include Statement of Investment Principles (SIP), Investment Strategy Statements and Engagement Policy Implementation Statements (implementation statements) as well as supporting disclosures such as Task Force on Climate-Related Financial Disclosures ('TCFD') reporting.

Assessment and Monitoring

- Investment manager assessment and monitoring reports covering an assessment of stewardship, voting and engagement (see Principles 7 and 8 for more details).
- Mercer's investment strategy level ESG ratings across asset classes, which assess the degree to which, alongside other ESG related factors, active ownership practices are incorporated within the investment manager's investment process.
- Tools, analysis and implementation plans to assist clients in understanding and monitoring the sustainability credentials of their investment portfolios and sustainability approaches of their investment managers.

Ongoing Engagement

Ongoing engagement between our investment team and appointed managers on ESG integration, stewardship and climate change. This is informed by formal monitoring of appointed managers across a range of areas.

Identifying Insights and Providing Interventions Through the RITE Framework

The Responsible Investment Total Evaluation (RITE) framework allows UK asset owners to understand where gaps may lie in their governance of sustainability-related investment activities, including stewardship (Insights) and provides asset owners with a set of activities (Interventions) that they could carry out in order to enhance their overall governance and wider implementation of their sustainability beliefs. More detail on the framework is provided below.

Key Stewardship Activities and Outcomes Over 2021

The table below captures the main ways our purpose, strategy, culture and beliefs have come together and enabled us to provide leading stewardship solutions over 2021, along with the outcomes we achieved for our clients.

Table 1. Key Stewardship Areas Over 2021

Area & Approach	Relevant Principle(s)
Training, resources and support: Help clients meet their regulatory requirements with respect to Statement of Investment Principles (SIP) and Implementation Statements. We have supported clients in strengthening their engagement policy approach and provided detailed examples of engagements and significant votes for them to assess the extent and impact of appointed manager's stewardship activities.	5
ESG Integration: Our investment team continue to place great importance on ESG integration and active ownership both in terms of manager selection and monitoring. Engaging with managers to improve their ESG integration practices is a focus area of our investment team to promote greater consideration of ESG factors for the benefit of our clients and the market more broadly. We undertake formal, annual ESG ratings review exercises with improvements tracked and monitored.	7
Stewardship monitoring: Mercer ensures that it integrates stewardship considerations across asset classes and throughout the investment process by incorporating it within manager selection, implementation and monitoring and engagement processes.	6, 9
Climate Change: Mercer's work on Investing in a Time of Climate Change and Analytics for Climate Transition framework, ensures climate change factors, both risks and opportunities, are considered within a net zero consistent framework and reported on in line with the recommendations of the TCFD.	4, 7

Principle 2

Principle 2

Signatories' governance, resources and incentives support stewardship.

Highlights, Outcomes and Focus for Next 12 months

Table 2.

Governance Structure	Our governance structure has supported the business well by successfully leveraging scale, accessing and disseminating specialist stewardship knowledge to our investment teams and helping clients meet and exceed regulatory stewardship requirements. The level of sustainable-related investment and stewardship knowledge across the business continues to grow year on year. Mercer's dedicated Sustainable Investment team continue to advise on best practice across Mercer, however given increasing opportunities to further embed sustainability across our solutions and an increase in regulatory and client requirements and reporting, Mercer has built a dedicated ESG team to drive implementation across its solutions and investment processes. This has included the appointment of a Head of ESG Integration and two hires during 2021 with an additional three hires being added to the team in early 2022. Two of these new hires are wholly focused on stewardship. Over 2021, we helped a growing number of clients produce their first set of implementation statements. Business-wide integration efforts and ESG training schedules in place supported our work by equipping field consultants and providing them with best practice examples. This will, however be an area to keep under review to ensure client teams are always equipped with the latest insights and tools to support clients given the rapidly evolving nature of this space.
Manager Research and Monitoring Processes	Over 2021 we implemented a number of substantial improvements to assessing stewardship within our research process, including fully integrating stewardship to be one of the four factors that shape the rating process for passive strategies and capturing voting and engagement data within our manager database. We also introduced substantial improvements to our stewardship monitoring efforts through the Manager Engagement Survey and Dashboards. We started to see the benefits from these improvements over 2021 with clear progress evidenced relative to the first year of survey responses (see Principle 8 and 9 for more detail). We expect more clients to make use of these research and monitoring services in order to support their implementation statements, and wider stewardship ambitions and evidence the stewardship activities Mercer carries out on their behalf.
Third Party Data Providers	Our third party data providers provide portfolio managers and clients with access to more granular ESG ratings, climate and impact-related data, assisting with identifying trends and supporting more effective manager engagement. A number of specialist providers are used including MSCI, Carbon Delta, ISS, with SBTi data included in our suite of tools over 2021. This data informs and supports our wider net zero engagement activity with appointed managers, particularly as we work with them to transition their portfolios in order to support our net zero commitments across our multi-client multi-asset funds Our appointment of Glass Lewis continues to enable us to monitor appointed managers voting activities, particularly across our engagement priority areas including managers voting actions relating to climate change resolutions and resolutions promoting greater gender diversity across boards.

Supporting Effective Stewardship Through our Governance Structures and Processes

For stewardship to be effective, it is crucial that it is integral to investment decision-making. As such, over the last decade Mercer has evolved its governance approach to embed stewardship at the heart of our investment research, which in turn informs our solutions to our clients. Mercer's governance structure has been designed to benefit from economies of scale, ensure that ESG and stewardship are integrated across the business and help meet client ambition and regulatory needs. Investment consultants who have clients with bespoke needs are able to draw on specialist knowledge from the Sustainable Investment team and the Manager Research team which sits under the Global Strategic Research Committee structure.

Investment Governance Approach to Stewardship

Mercer partners with long-term institutional investors with portfolio exposures consistent with being a 'universal owner'. For these reasons we regard investment governance and good stewardship to be particularly important in serving the interests of our clients. Mercer is committed to best practice stewardship including industry standards of good governance and stewardship as laid out in our Sustainability and Stewardship Policies.

Mercer has put in place a governance structure that enables the effective integration of stewardship activities across our research activities, investment advice[2] and solutions, both in the UK and across the globe.

Our approach to stewardship combines Mercer's global investment research and sustainability-related investment expertise with portfolio management and local investment consultant expertise to deliver meaningful stewardship solutions to our asset owner clients. This approach enables us to adopt a globally consistent approach to stewardship integration across our business.

Figure 3 illustrates the organisational structure and identifies key resources applied to Mercer's stewardship approach. As noted under Principle 1, effective stewardship is a key element of our Global Investment Beliefs. Mercer's Global Investment Beliefs are reviewed and approved by Mercer's Global Policy Committee.

[2]The Mercer Limited UK Stewardship Code report covering our advisory business is available separately.

Figure 3. Governance Structure Overview

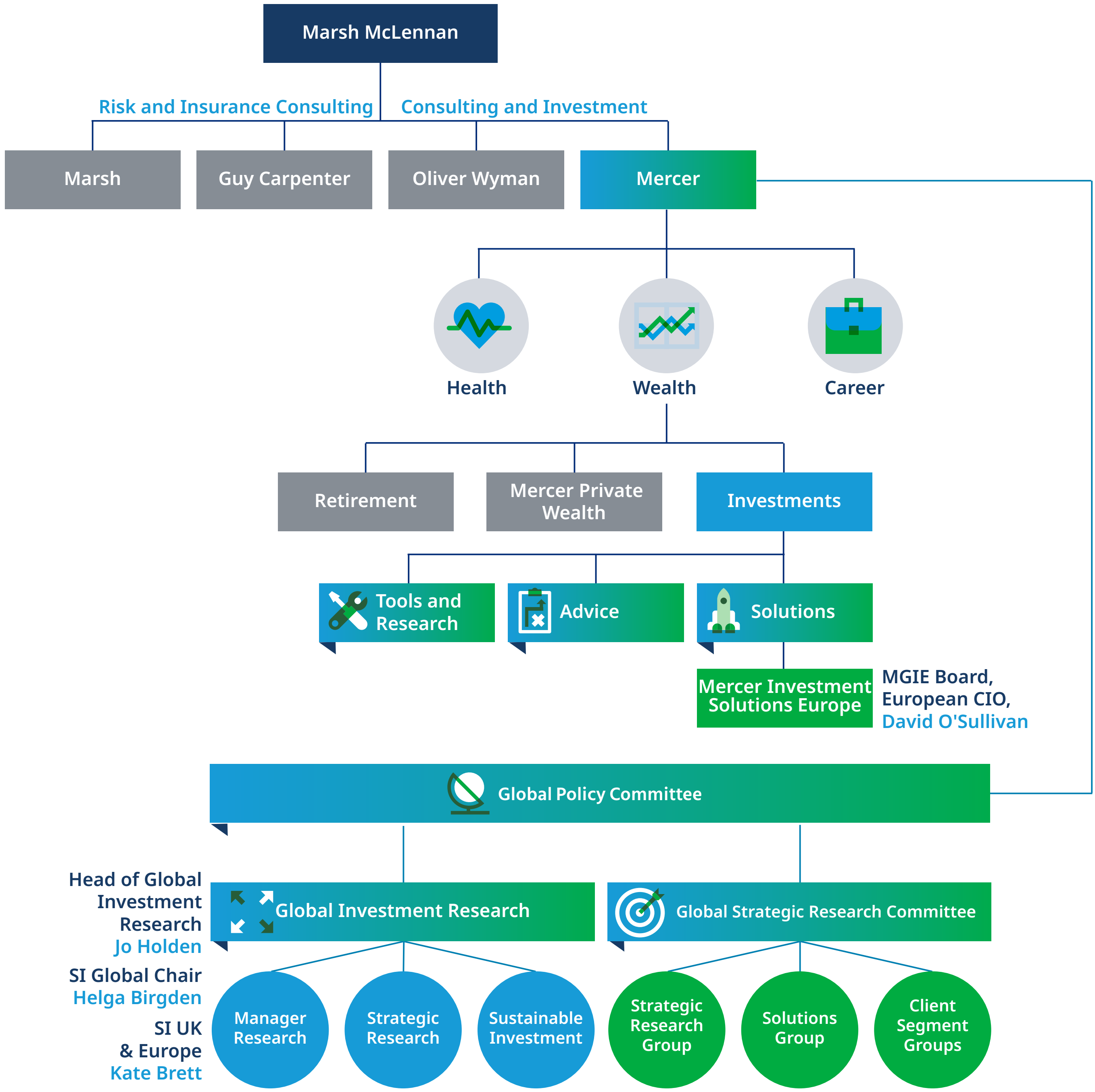


Figure 4.

Mercer's Integrated Sustainability Capability across Europe EMEA

Sustainable Investment team*

Kate Brett Edinburgh | 17 years	**Hill Gaston** Bristol | 11 years	**Andrew Lilley** Geneva | 10 years
Simon Woodhouse London | 4 years	**Chrishan Perera** London | 3 years	**Marguerite Dubois** London | 1 years

Solutions ESG team

Jan-Hein van den Akker Dublin | 27 years Head of ESG Investments	**Inge West** London | 14 years Stewardship Specialist	**Anne Harney** Dublin | 13 years ESG Investment Specialist
Catriona Wood Dublin | 9 years ESG Investment Specialist	**Amit Phillips** Mumbai | 5 years ESG Portfolio Analytics Specialist	**Hayley Grafton** London | 4 years Stewardship Specialist

*The team is further supported by an additional 16 members from the Global Sustainable Investment team, three members from the Global Sustainable Investment Research team and ESG Champions from across the business.

# of years = Years of relevant industry experience

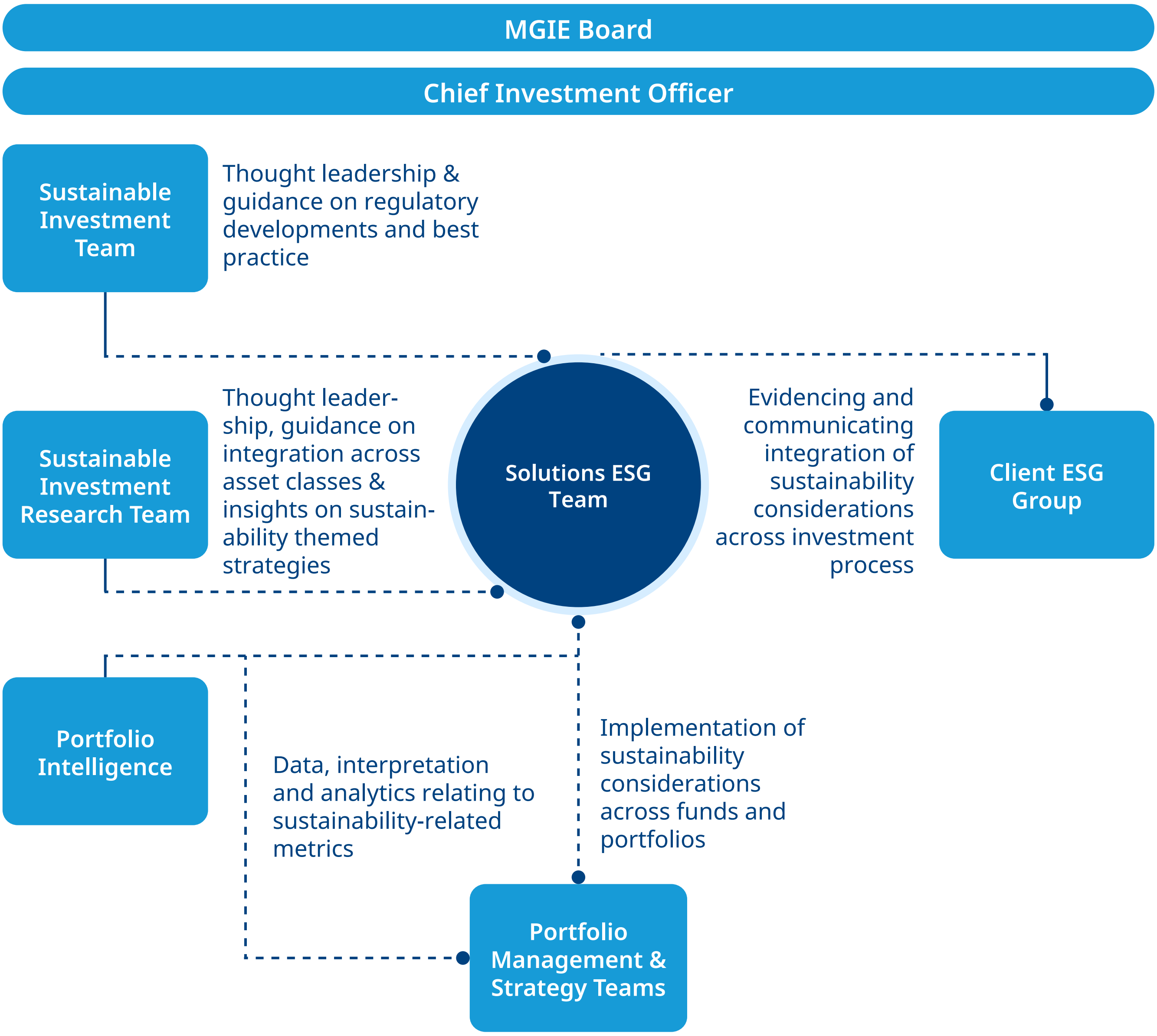
Mercer's specialist global SI team sits at the heart of our approach to stewardship. The SI team was formed in 2004 and has extensive experience of advising leading global institutions on sustainability issues. The team currently has 23 experienced professionals across the globe.

The SI team is responsible for determining the approach to stewardship, understanding and integrating global stewardship expectations into our research, developing and maintaining our stewardship assessment criteria, reviewing investment manager practice against global stewardship codes, developing client reporting templates and advising asset owners on their approach to stewardship.

Mercer was an early supporter of the UK Stewardship Code and has continued to evolve its approach. The SI team has extensive experience of advising on stewardship with several team members providing advice on stewardship since the launch of the UK Code back in 2010, as well as subsequent regional codes, such as the Australian code and the Japanese code. The diverse nature of the team, by gender, background, experience and thought enables them to provide well-rounded advice. The team's varied experience includes a mix of those with investment and broad ESG research focused backgrounds to those with specialisms in corporate governance, engagement, policy development, social impact measurement and climate change.

Mercer's SI team assists Mercer in designing and implementing its stewardship and sustainable investing strategy through advice, implementation and monitoring services. The table below details where responsibility lies for implementing Mercer's approach to investing sustainably and stewardship more specifically.

Figure 5. Oversight for Sustainable Investing Activities



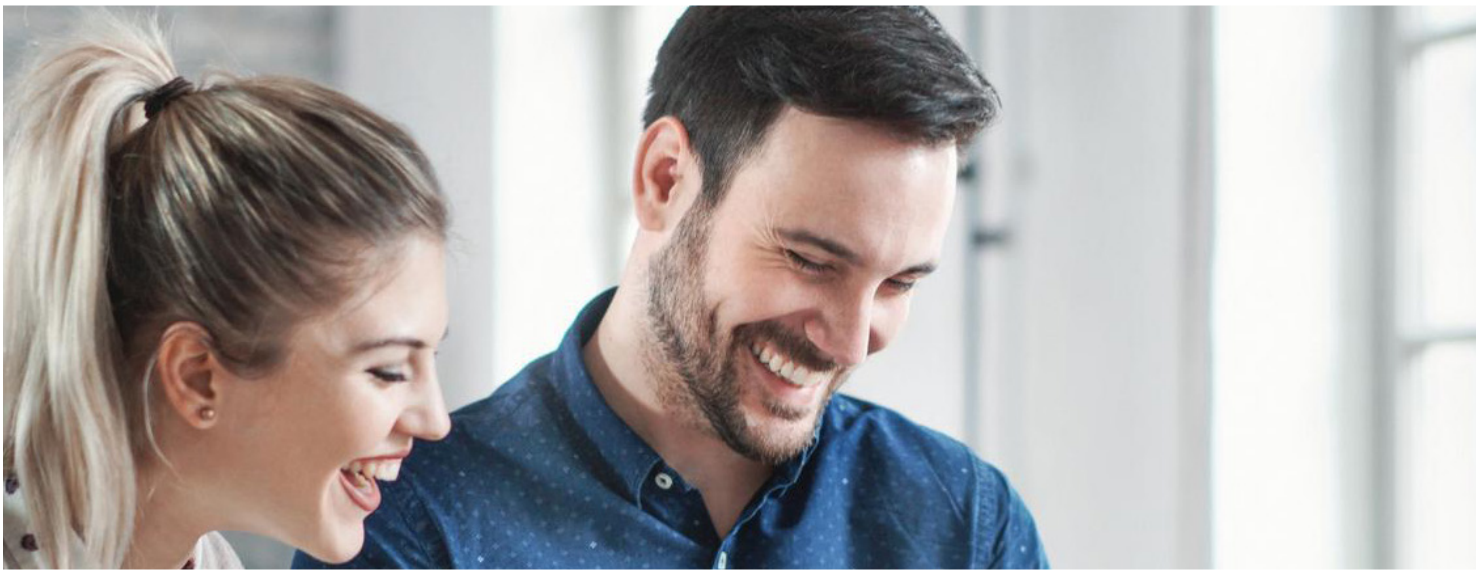


Table 3. Roles and Responsibilities for Implementing Sustainable Investing and Stewardship

Role	Areas of responsibility
Board of Directors	The Board of Directors for Mercer Global Investments Europe Limited has oversight responsibility for the investment management of the Mercer Funds. The Board receives updates on stewardship practices as part of annual updates on implementation of the Sustainability and Stewardship Policies.
Mercer Chief Investment Officer (CIO)	Mercer's Chief Investment Officer (CIO), David O'Sullivan, sets expectations and provides direction to portfolio managers and management committees on the implementation of the Sustainability and Stewardship Policies, and reviews and assesses results. As the CIO, David reports regularly to business management and the Board.
Mercer Solutions ESG team and UK Sustainability Integration Lead (new for 2021)	Over 2021 and in early 2022 six dedicated sustainability professionals were added to the newly formed dedicated Mercer Solutions ESG team led by Jan-Hein van den Akker, Head of ESG Integration. These new colleagues are supported by the SI team, as well as by the newly appointed UK Sustainability Integration Lead, who is responsible for disseminating best practice learnings to UK investment consultants, ensuring they are equipped to meet regulatory requirements such as implementation statements. The Mercer Solutions ESG team, works closely with portfolio managers, to ensure good stewardship practices are incorporated into the investment solutions and services across relevant areas. Two of these new hires are wholly focused on stewardship, helping to ensure the successful implementation of Mercer's stewardship policy and effectiveness of impactful stewardship activities.
Head of Sustainable Investment – UK and Europe	With respect to providing asset owner advice on stewardship, David is supported by the Head of SI for UK and Europe, Kate Brett, as well as the wider SI team, which generates intellectual capital, provides resources and equips investment consultants on areas such as ESG integration, stewardship and climate change.
Global Head of Sustainable Investment Manager Research	Dave is also supported by Sarika Goel, Mercer's Global Head of SI Manager Research, who is responsible for integrating stewardship considerations into Mercer's manager research and ESG ratings processes.
Mercer Investment Solutions Global ESG Integration Committee (EIC).	The EIC consists of representatives from the global investment, sustainable investment and portfolio intelligence teams, including regional CIO's and SI leaders. The EIC, which meets quarterly, is responsible for overseeing and coordinating the approach to ESG integration across the Global Investment Solutions business, developing and/or reviewing SI frameworks and policies on ESG matters and sharing ideas, learnings and keeping up to date with best-practice ESG integration. The Committee is Co-Chaired by Jillian Reid, Mercer's Global Solutions Leader for Sustainable Investment.
European ESG Co-Ordination Group (ECG)	The ECG consists of representatives from the ESG investment, sustainable investment, compliance, portfolio intelligence, client and business development teams. The ECG meets monthly to address key issues related to the development and implementation of the Sustainability and Stewardship Policies and other ESG related matters. The ECG is chaired by Jan-Hein van den Akker, Mercer's Head of ESG Integration.

Role	Areas of responsibility
Investment management team with support of wider global resources	As CIO of Mercer, David has the leadership and support of the Global CIO, Hooman Kaveh, who also reinforces the growing importance of stewardship considerations and monitoring of developments within investment decisions in global CIO meetings and governance committees. The CIO team globally, is also guided by Mercer's investment governance structure and research committees, charged with reviewing and setting guidance on Mercer's intellectual capital development and 'house views'. This includes the Global Strategic Research Committee, chaired by Jo Holden, Global Head of Research, which ultimately reviews stewardship-related research such as Mercer's series titled 'From shareholder to stakeholder'.

Remuneration, Appraisal and Personal Development

All SI team members and Mercer ESG team members have annual performance goals aligned with the success of the integration of ESG issues. These goals cover delivering for our clients, industry engagement, and maintaining leading research and tools. More specifically, overall year end assessments and discretionary bonuses for the two Mercer ESG team members will be impacted by meeting specific stewardship-related goals. These include ensuring effective implementation of Mercer's Stewardship Policy, achieved through working closely with the investment team, and collaborating with them in their engagements with appointed managers to promote more robust stewardship practice; prioritising, executing on, tracking and escalating engagement opportunities based on Mercer's Engagement Priorities Framework, identifying and participating in collaborative initiatives and enhancing monitoring and reporting of appointed manager's voting and engagement activities.

For the Mercer investment team there is ongoing work to update remuneration arrangements more widely across the business to integrate non-financial methodologies in order to promote sound and effective risk management with respect to sustainability risks. For example, Mercer has included specific objectives in the annual goal setting process for all staff relating to the incorporation of sustainability considerations in roles and decision-making. Additional goals, relating to understanding and promoting Mercer's sustainability beliefs and implementing the key principles embedded in Mercer's Sustainability Policy, are assigned to those with investment management responsibilities.

Wider integration within the business

While investment teams are able to draw on the resources and expertise of the SI team, Mercer sees ESG integration across the firm as critical to success. As such, investment teams are expected to develop their expertise, with the guidance of the SI team, which is expected to keep the investment team informed of key developments and research in the sustainable investing industry.

To further embed ESG integration within the business, all investment staff are encouraged to complete the CFA Certificate in ESG Investing. Furthermore, over 2021, a number of investment staff participated in the pilot program for the CFA Certificate in Climate and Investing.

Training

Over the past year, Mercer have held a number of training sessions both with specific teams and across the wider business. These covered a variety of ESG topics including EU Sustainable Finance Disclosure Regulatory updates, assessing the ESG ratings of the Mercer Funds against their respective universes using Mercer's proprietary ESG ratings framework, and general annual updates relating to work covering all four pillars of our sustainability approach i.e. ESG integration, stewardship, sustainability-themed investments and screening. A number of additional training sessions were held between the ESG and the investment teams to emphasise priority areas and highlight expectations for portfolio Managers in their engagements with managers and subsequent monitoring and reporting of engagement outcomes utilising the Manager Engagement Trackers.

As part of the delivery model for these webinars, members of either the ESG team, investment team or SI team present collectively on these topics, demonstrating ESG knowledge and integration within the business.

There is regular information sharing between the SI, ESG and investment teams, with topics and training selected based on the implementation requirements of the annual work plan designed jointly by the CIO, ESG team and the SI team.

Diversity and Inclusion

Building an inclusive culture and diverse workforce is a business imperative for Marsh McLennan (MMC), with a global cross-enterprise strategy which is then refined at an enterprise and country level. Our business and leadership teams are organised around clear, measurable goals to progress our culture and the diversity of our workforce including to those who are responsible for carrying out stewardship activities.

Mercer has developed its own DEI (Diversity, Equity & Inclusion) policy. In 2021 we carried out a comprehensive review of our DEI strategy, partnering with Mercer's Career business.

In addition to the above Mercer has committed to 30% female identifying key decision makers (KDM) across our portfolios by 2030. This commitment will apply to both the KDMs within our own investments team and the teams of appointed managers responsible for our fully discretionary funds. As at 31 December 2021, 33% of the KDM's within Mercer's team identify as female, and we are committed to working towards our long term target of 50%.

We continue to make significant progress, delivering on our commitments to increasing representation, facilitating empowerment and creating impact beyond our company. Each year, we implement specific programmes to support our Inclusion & Diversity agenda. We are EDGE certified, which is the certification standard for gender and intersectional equity.

Overview of Stewardship Processes

Given the importance placed on stewardship to support the realisation of long-term shareholder value, Mercer has developed internal investment processes to include:

- Specific references to stewardship in our global investment beliefs (see Principle 1).
- Established manager research approaches by asset class to explicitly incorporate relevant stewardship or active ownership considerations, including voting and engagement, as part of our longstanding policy to consider and improve the ESG Ratings of appointed managers over time.
- Annual stewardship reporting covering voting and engagement and summarised in this report.
- The creation of an investment manager focused Stewardship Assessment Framework, utilising Mercer's Engagement Survey to assess manager's stewardship practices, the Manager Engagement Dashboard to identify engagement priorities and track progress over time, and the Manager Engagement Tracker's to evidence engagements, outcomes and escalations across investment strategies.

These processes have been developed over time to ensure that stewardship considerations are embedded throughout our solutions.

Manager Research and Systems

Mercer's global manager research team assesses the degree to which ESG and active ownership factors are incorporated into the investment process of appointed managers at the strategy level and assign them an ESG rating (see Principle 7 for more detail).

MercerInsight is the database underpinning much of the strategy-specific data, which captures ESG data across a number of areas. We continually seek to improve the ESG and stewardship data captured in this database and have implemented a number of enhancements over 2021.

Stewardship Research and Process Enhancements Over 2021

1. Database – MercerInsight

There are a significant number of new ESG, climate related and diversity & inclusion (D&I) questions that have been added to MercerInsight for managers to populate. These include general firm-level information on stewardship policies, as well as a breakdown of engagements across environmental, social and corporate governance (ESG) issues and voting outcomes over the most recent year.

There is further detail around climate specific voting policies and initiatives that we are now asking managers to complete along with several strategy level questions around ESG integration, strategy specific engagement, exclusions, climate change, and other impact-related questions. The diversity section includes topics such as the gender pay gap, D&I initiatives and commitments as well as hiring and employee best practices around D&I. Over 2021, there has been an increase in managers populating these questions in our manager database.

2. Research Reports – Active strategies

Amongst other changes, we have updated our active strategy research reports to provide additional metrics on climate transition and D&I. This includes a new D&I page capturing manager related information at the firm, investment team and investment strategy levels. These changes are expected to go live in late 2022.

3. Fully Integrating Stewardship into the Four Factor Rating process for passive strategies

We combined two of the existing passive factors (Portfolio Construction and Implementation & Risk Management) to form a single factor while introducing Stewardship as one of the four factors used to assess managers. We will be responsible for framing an opinion on a manager's proficiency in replicating indices, which will include an assessment of the firm's stewardship of the assets on behalf of clients. See the Principle 7 for more information on our ESG rating methodology.

Use of Third Party Data Providers

We make use of third party data providers for a number of functions. The table below lists the main third party data providers and their use.

Mercer is due to review the third party appointments for ESG data and services over 2022-23.

Table 4. Overview of Third Party Data Providers

Data provider	Comment
Glass Lewis	Mercer uses Glass Lewis to assist with the reporting of voting statistics across all multi-client and bespoke funds at an aggregated, fund specific and strategy level. The reporting from Glass Lewis enables us to not only identify how all votes have been voted, but also provides us with granular data relating to specific voting themes across all management and shareholder resolutions which provides specific insights aligned to our Engagement Priorities e.g. Shareholder Proposals relating to Climate Change and Board Diversity. Public disclosure of voting results is maintained by Glass Lewis on our dedicated website.
ISS-Ethix	Mercer has appointed ISS-Ethix to assist in identifying securities for exclusion across a number of Mercer Funds as well as portfolio screening for high-severity ESG-related risks as flagged according to the UN Global Compact ("UNGC") Principles that relate to human rights, labour, environment and corruption issues. Identified instances across active equity and fixed income funds are flagged and raised with underlying managers for engagement purposes and potential exclusion in future in line with Mercer's UNGC Engagement Framework. Over 2022, screening for high severity incidents will expand to include passive equity funds as we look to use this methodology to support the promotion of good governance practices, particularly across funds classified as Article 8 as per the Sustainable Finance Disclosure Regulations (SFDR). ISS is also used for the net environmental and social Sustainable Development Goals (SDG) mapping of a number of funds, and to provide metrics on exposure to green revenues, which is used as an input into our Analytics for Climate Transition (ACT) tool.
MSCI	Mercer has access to MSCI ESG Research and utilises their bottom up company-level ESG ratings and climate related metrics to monitor portfolio holdings. These metrics are reviewed quarterly at investment risk management committee meetings and more frequently where required and further used as an engagement tool with managers to ensure they are doing what their process commits them to undertake. Metrics are also used as an input to the ACT tool to assist with our transition commitments and reporting in line with TCFD requirements. More recently we have extended our services to include the module relating to Sustainable Finance Disclosure Regulation (SFDR) to assist in monitoring Principle Adverse Impact indicators and other metrics required as part of SFDR which will further provide insights for engagements with managers.

Principle 3

Principle 3

Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

Highlights, Outcomes and Focus for Next 12 months

Mercer does not invest in companies directly and as such this limits the potential for conflicts of interest in relationship to stewardship. We will continue to monitor appointed manager conflicts of interest though our quarterly due diligence questionnaire, results of which are provided below.

Mercer's Overall Approach to Conflicts of Interest

Mercer takes all reasonable steps to prevent conflicts of interest from adversely affecting the interests of our clients. Our conflicts of interest policy explains how we identify, prevent and manage actual or potential conflicts of interest which may arise between our clients and ourselves, or between one client and another, in circumstances where we are providing our products and services.

When considering whether a conflict of interest does, or has the potential to exist, Mercer's Conflicts of Interest Policy has a list of criteria to consider. The following will be taken into account as appropriate:

- Is Mercer likely to make a financial gain, or avoid a financial loss, at a client's expense?
- Does Mercer have an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is separate and distinct from the client's interest in that outcome?
- Does Mercer have a financial or other incentive to favour the interests of one client (or group of clients) over the interests of another client?
- When providing a service to a client, does Mercer receive or will it receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard fee for that service?

Our conflicts of interest policy does not include specific reference to stewardship. Mercer does not invest in companies directly and as such this limits the potential for conflicts of interest in relationship to stewardship. Instead voting rights and responsibilities typically sit with the appointed managers as laid out in investment management agreements and investment guidelines.

In recognising best practice Mercer's Conflicts of Interest Policy is kept under constant review.

Managing conflicts arising from the Investment Solutions business

Over 2021 investment consultants and other colleagues continued to identify conflicts arising when discussing with clients governance options including offerings from the Investment Solutions business. These were managed by following strict protocols. Mitigating actions included requiring:

- Investment Solutions and Mercer Funds only to be offered to a client if Mercer reasonably believed it would be appropriate for the client's needs.
- A requirement to clearly outline the difference between working with Mercer under an advisory-only approach and under an Investment Solutions approach.
- Clear disclosures regarding fees (to Mercer and the appointed managers) and services were provided to clients as part of the decision making process.

Expectations and monitoring of appointed managers and their conflicts of interest policies

Mercer expects its appointed managers to have policies and procedures in place designed to manage their own conflicts of interest in relation to stewardship. As part of its review and appointment process, Mercer assesses whether its appointed managers have policies and procedures that are designed to manage conflicts in relation to stewardship. As part of quarterly due diligence questionnaires, managers are required to report on their conflicts of interest policy and the procedures that allow them to adhere to that policy.

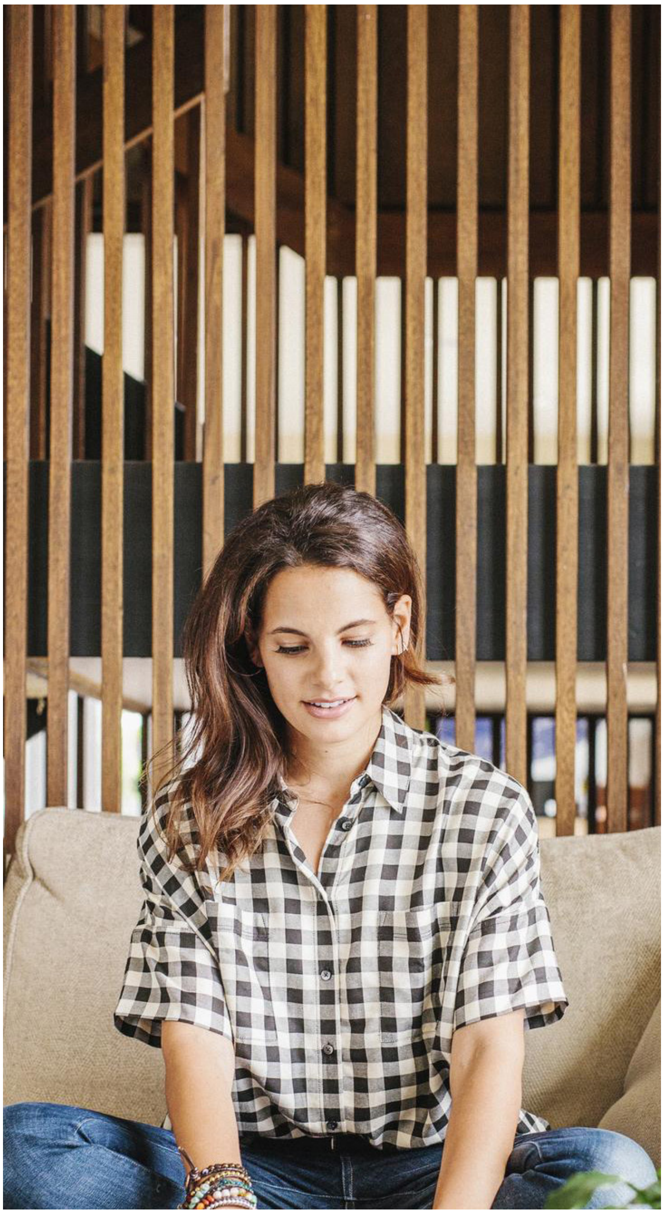
In our year under review there were four reported conflicts of interests which were explained by appointed managers. Conflicts of interest relating to voting activity arose in two cases where the appointed manager invested in different parts of the company's capital structure (e.g. common shares and debt) which could create a conflict between equity and bondholders and for the other two cases, where the appointed manager had a business relationship with the issuer. The managers confirmed their overall approach to managing potential conflicts of interest, which included reviews from Proxy Oversight Committees before executing the vote, in the first two instances, and voting in line with the recommendations of their proxy advisor, in the second two.

Conflicts of interest and stewardship

Mercer recognises and manages the potential conflict between the interests of clients and those of the broader organisation. Mercer typically delegates all vote execution and company-level engagement to appointed managers and monitors their approach to voting and engagements, rather than making specific voting and engagement decisions. Mercer retains the right to direct a 'Super Vote' to override a manager's vote on any resolution in circumstances where Mercer believes consistency on a significant matter is in the best interest of investors. While Mercer has not exercised this right yet, in determining such votes, Mercer will consider its proxy advisor's recommendation, the view of its investment managers and best practice guidelines and Mercer's Global Engagement Priorities. Mercer may also conduct its own research or engage with the relevant company to inform its decision on a Super Vote, in these circumstances. Potential conflicts that could arise include holdings in relation to Mercer's parent company stock, Marsh McLennan companies (MMC), however this is mitigated through the delegation of all vote execution and company-level engagement to appointed managers.

Mercer will endeavour to prioritise topics for engagement that are in the best interests of our clients. However, given Mercer's broad client base, there may be cases where the nature of a client's business is in conflict with that. This would not limit Mercer from advocating for these engagement activities, and where these engagement activities occur, the investment team will communicate the engagement priorities to client relationship teams so they can consider the sensitivities for Mercer clients or prospects.

A similar approach is adopted in the case where companies, who are also clients of Mercer, are excluded across Mercer Funds given the nature of their business, based on Mercer's Exclusions Framework.



Principle 4

Principle 4

Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

Highlights, Outcomes and Focus for Next 12 months

Over 2021 we supported the creation of various frameworks, guides, toolkits and improved disclosures across stewardship, climate change, human rights and diversity & inclusion. These in turn enhanced our approach to identifying and responding to market-wide and systemic risks and active support for a number of collaborative industry initiatives across Mercer and Mercer Limited.

Climate change was a key priority for us over 2021 and will remain an area of focus into 2022 and beyond. Mercer Limited's involvement in climate change initiatives has helped move the market forward and supported the development of tools such as the ICSWG Guide for Assessing Climate Competency of Investment Consultants and the IIGCC Net Zero Stewardship Toolkit. Mercer MGIE leverages off Mercer Limited's involvement in initiatives such as these and together we believe our leadership has helped shape the market, helped promote greater consideration of sustainability risks and opportunities and, going forward, supports the widespread adoption of net zero frameworks across the institutional investor markets that we serve.

Our integrated approach to climate change means that all clients benefit from climate change considerations, and they are clear on what role stewardship can play in helping companies transition to a low-carbon pathway (see Principle 7). We are proud of our commitment to adopt a net zero approach by 2050. Implementing our net zero approach was a key focus over 2021 as we continue to both decarbonise and better align our best ideas model growth portfolio with a low carbon future.

We are also focused on the following areas:

- Our partnership with the World Economic Forum and producing industry leading risk reports remains an important way of not only identifying key investment risks but also working with leading investors on understanding how to turn these risks into opportunities on areas such as navigating the interest rate environment and water.
- Diversity and Inclusion: We see continued focus on the approach investment managers and companies take to inclusion & diversity and are taking an active approach in engaging with managers to encourage progress across the industry. This topic has benefitted from enhancements to our manager research process and we have joined the Diversity Project and 30% Club, further supporting our commitment (see Principle 2 and 8 for more information). We believe these actions will help equip ourselves and our clients to continue to drive better investment manager and company behaviour in these areas and further align portfolios with this important theme going forward. We have started to measure gender diversity relative to benchmark at the portfolio level with the intention of engaging with managers managing strategies whose diversity characteristics lag the market.
- Biodiversity: Market-wide progress on biodiversity risks is less developed but we expect rapid progress in the coming years and we are committed to shaping the market's approach to these critical areas by supporting the Taskforce on Nature-related Financial Disclosures (TNFD), assessing our equity portfolios for biodiversity risk and developing thought pieces.
- The Covid-19 pandemic has brought an increasing focus on the consideration of social issues including how companies treat their workers, and broader human rights considerations. This topic has benefitted from enhancements to our manager engagement reporting with greater insights into how managers are responding to human rights and labour issues (see Principle 9).

While we are pleased with the progress on climate change, both in terms of collaborative outputs and portfolio alignment, we recognise that efforts to limit warming will fail unless countries play their role and there is widespread adoption of credible net zero targets across all asset classes and the investment supply chain. Further, there is more work to be done to identify and incorporate other key market and systemic risks, such as biodiversity, equality and human rights and labour practices, into our engagement efforts and to align our portfolios accordingly.

Identifying Market Wide and Systemic Risks for Engagement

Mercer's Global Investment Policy Committee (GIPC) is the governance body responsible for overseeing Mercer's Global Investment Research policies and priorities including it's approach to market wide and systemic risks such as climate change, including our approach to net zero.

Mercer prioritises market wide and systemic risks for engagement where they meet Mercer's Investment Engagement Framework criteria across three areas: Beliefs, Materiality and Influence.

The primary market wide and systemic risk that meet this criteria is climate change. However we also recognise the importance of Diversity & Inclusion and Human Rights and Labour Practices to well-functioning markets.

See Principle 9 for more detail on Mercer's Investment Engagement Framework and how this relates to Beliefs, Materiality and Influence.

Prioritising Action on Climate Change and Transition

Mercer has committed to target net-zero absolute carbon emissions by 2050 for its discretionary portfolios and the majority of its multi-client, multi asset funds, representing USD 80 billion in assets under management as at 31 December 2021. To achieve this, Mercer plans to reduce portfolio relative carbon emissions by at least 45% from 2019 baseline levels by 2030. See Principle 7 for more information on our decarbonisation progress against this objective.

Mercer believes its net zero commitment is aligned with the best economic outcome for investors. Climate change poses a systemic risk, with financial impacts driven by transition and physical risks. Both of these present both risks and opportunities to investors, as outlined in Mercer's Investing in a Time of Climate Change (2019) report.

Mercer undertakes specific analysis into a low-carbon transition to support the increasing investor focus to target a 1.5°C scenario as a priority. We utilise Mercer's Analytics for Climate Transition (ACT) tool to analyse a range of funds and portfolios. The ACT tool's step-by-step approach, shown below, analyses Mercer's funds and portfolios for their transition alignment. We continue to develop our Analytics for Climate Transition tool to better capture physical risks and the number of companies adopting net zero targets.

Mercer integrates climate analysis insights into manager selection and monitoring processes, as well as portfolio construction. Potential financial impacts are also considered at a client portfolio level in certain cases, for example, where Mercer has discretion over the asset allocation of the client's portfolio.

Mercer's overall approach to climate-related financial risks and opportunities is consistent with the Financial Stability Board's TCFD framework disclosure and appointed managers are encouraged to report in line with it. Mercer's Climate Change Management report highlights our approach to the TCFD framework in more detail, including example analysis on strategy and targets and metrics. Another area of focus is helping our larger clients to meet the expectations of new climate disclosure regulations as well as working with clients to set their own net zero objectives, including those wishing to set ambitious targets.

See Principle 7 for more information on climate related metrics and what has driven portfolio decarbonisation and Principles 9 and 12 for how Mercer monitors appointed managers on their climate change voting and engagement activities.

Figure 6. Mercer's Analytics for Climate Transition (ACT) Overview.

Systemic Risks Beyond Climate Change

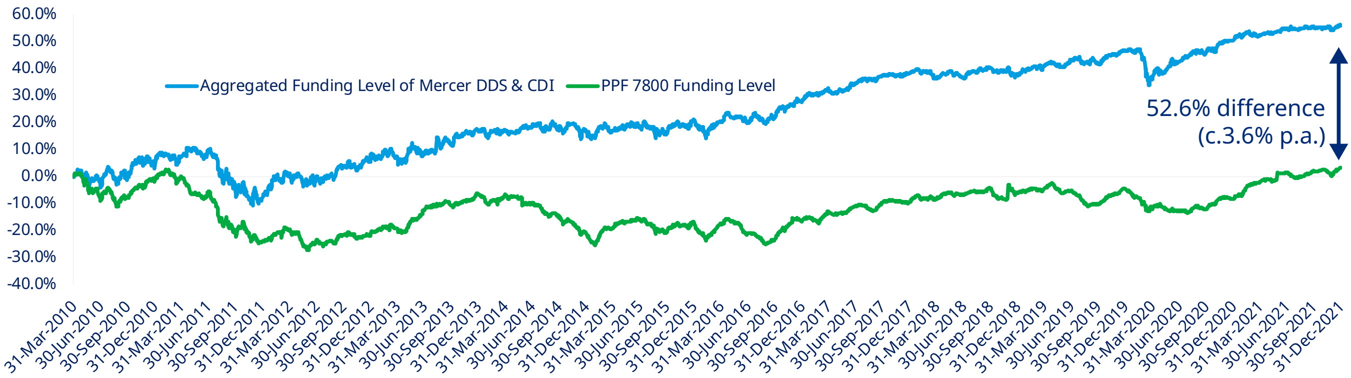
Mercer benefits from thought leadership and wider work across our global firm as well as from our parent company Marsh McLennan on other systemic risks. For example, over 2020 the World Economic Forum, in collaboration with Mercer, published the report 'Transformational Investment: Converting Global Systemic Risks into Sustainable Returns'. This seeks to address some of the long-term, global systemic risks facing our economy, society and the planet through an investment lens. The key topics covered are shown in the diagram below.

Table 5. Transformational Investment: Converting Global Systemic Risks into Sustainable Returns

Climate change	Ability for governments and businesses to address climate change, protect populations and adapt
Water security	Exposures to declining quality or quantity of fresh water, affecting human health or economic activity
Geopolitical stability	Implications of rising global inequality, populism, protectionism, interstate conflict and threats to free trade
Technological evolution	Risks and opportunities associated with technological advances, inadequate infrastructure and networks, cyberattacks
Demographic shifts	Implications of ageing populations globally, demographic imbalances between rapidly ageing regions and those entering demographic transition, and impact of migration
Low and negative real long-term interest rates	Implications on monetary policy and return requirements for investors and stakeholders of sustained near zero or negative real long-term interest rates

We work with clients across all of these areas. For Mercer clients we are most progressed on aligning portfolios with climate change (detailed above) and helping clients navigate low and negative real long term interest rates. We plan on progressing our work on water risks and opportunities over 2022. Our risk management work is key to our clients' approach to hedging interest rate and inflation exposure and we believe this has led to better risk-adjusted outcomes through stronger funding levels. We work closely with LDI managers who are in regular communication with the Debt Management Office to relay investor demand for fixed and inflation-linked bonds and the maturity profile.

Figure 7. Mercer Clients vs PPF 7800 Funding Level*



Source: Mercer estimates, State Street Fund Services (Ireland) Limited and Pension Protection Fund (PPF) 7800 published data.

Biodiversity

Mercer Limited joined the TNFD as a Forum member in early 2022 and are working with Mercer to explore pilot testing of the framework across a number of Mercer Funds. Mercer also intends to formally integrate biodiversity related questions in its 2022 annual Manager Engagement Survey to better understand how managers are incorporating biodiversity considerations across their investment processes. Mercer has also authored Biodiversity on the Brink and is working on additional papers in the series to stay ahead of this important topic. This series, which includes collaboration from the Sustainable Investment, Sustainable Investment Research and ESG teams, will also aim to assess and monitor the universe of strategies that aim to promote biodiversity for consideration in funds.

Promoting diversity of key decision makers within the investment management industry

Mercer is working to improve diversity, including cognitive and experiential diversity, within the investment management industry. Mercer has set itself a goal that by 2030 at least 30% of the key decision-makers (KDMs) within the appointed managers we use in Mercer portfolios will identify as female ("30 by 2030"), with a longer-term goal to reach 50%. Please see Principle 8 for more detail.

*The blue line in the chart shows the average funding level improvement of Mercer's fiduciary clients based on aggregated assets and liability (adjusted to be on a gilts flat or CDI basis) values from unconstrained delegated clients with inception dates before 31 December 2020. These funding levels are net of fees and include deficit contributions up to 31 December 2021. Clients included have a de-risking journey plan based on funding level triggers, where Mercer has full discretion for the composition of both the growth and matching portfolios, or have a CDI portfolio for those that have reached self sufficiency.

The green line in the chart shows the PPF 7800 aggregated funding level improvement, which includes both schemes with a funding level deficit and schemes with a funding level surplus. The PPF 7800 data is based on aggregate asset and liability values published in the 7800 index, daily data has been estimated by Mercer using a similar approach to the PPF transformation appendix methodology. Please note that the restated liabilities have been used for the PPF data so there will be jumps in the PPF funding level at these dates: 30 April 2011, 30 May 2014, 30 Nov 2016, 30 Nov 2018 and 31 May 2021.

Inclusion & diversity, treatment of workers and the Covid-19 Pandemic

2021 was another challenging year for many of our clients. The impact of the Covid-19 pandemic in its second year was far reaching. From a stewardship perspective it continued to thrust social issues to the fore. In addition to diversity & inclusion, the pandemic has continued to bring attention to how companies treat their workers, in the form of human rights & labour practices.

Mercer has recognized the importance of these issues as highlighted by our Global Engagement Priorities. Through our 2021 Manager Engagement Survey, we have specifically requested feedback from appointed managers on their approach to human rights and labour practices and diversity within their investment process, with these results influencing appointed manager engagements over 2021. Please see Principles 8 and 9 for more details on our engagement approach to these themes and Principle 2 for more details on the enhancement to our manager research process with respect to diversity and inclusion.

ESG-related risks as flagged according to the UN Global Compact (UNGC) Principles

The United Nations Global Compact Principles provides another lens through which to monitor market-wide and systemic issues impacting individual issuers. Mercer screens and monitors listed equity and fixed income portfolios for high-severity ESG-related risks as flagged according to the UNGC Principles that relate to human rights, labour, environment and corruption issues, as identified by our appointed external ESG research provider. Please see Principle 9 for more detail.

Collaborative Engagement

Mercer recognises the importance of supporting the functioning of markets through industry initiatives and collaboration. Mercer believes that appropriate investor collaboration is the most effective manner in which to engage, particularly at times of significant corporate or wider economic concerns. We undertake policy engagement through different initiatives and associations to drive best practice and consistency of disclosure on ESG issues. We also monitor appointed managers' participation in collaborative initiatives (see Principle 10). Mercer also leverages off the involvement from the broader Mercer business's involvement in and contribution to collaborative industry initiatives.

Over 2021 Mercer collaborated with industry groups across a number of issues aimed at improving market wide practices and managing systemic risks. See Principle 10 for more information on our criteria for undertaking collaborative engagement.

Table 6. Overview of Collaborative Initiatives

Initiative	Involvement, activity and outcomes over 2021
Broad Sustainability	
Investment Consultants Sustainability Working Group*	The aim of the group is to improve sustainability-related investment practices across the investment consulting industry in the UK. Jo Holden, Head of Global Investment Research, co-chairs the group. Mercer is an active member of several work streams, including those on regulation, asset owners, stewardship and innovation. These in turn have produced the Trustee Guide for Assessing Climate Competency of Investment Consultants and Engagement Reporting Guide.
Climate change	
Institutional Investors Group on Climate Change (IIGCC)*	Mercer actively participated by joining member calls and providing input/feedback on the following IIGCC Paris Aligned Investing Initiative working groups: stewardship, listed equity and corporate fixed income. Participation in working group calls has supported the production of a Net Zero Stewardship Toolkit.

Initiative	Involvement, activity and outcomes over 2021
Climate Action 100+**	As a member we use CA100+ research to assist with identifying significant votes and monitor the contribution our appointed managers make to the initiative. We are evaluating opportunities to increase our support of and involvement in the initiative over 2022-23.
Biodiversity	
Taskforce on Nature-related Financial Disclosures*	Mercer is a Forum member. We expect biodiversity to play an increasingly important role in investment portfolios over the coming years. We will report on our contribution to the Taskforce in our 2022 report.
Diversity	
30% Club**	Mercer is a member of this campaign and has set itself a goal that by 2030 at least 30% of the key decision-makers (KDMs) within the external managers we use in Mercer solutions will identify as female ("30 by 2030").
The Diversity Project**	Mercer is a member of The Diversity Project which seeks to accelerate progress towards a more inclusive culture in the investment and savings profession. Mercer took part in the Diversity Project Investment Springboard and CASP mentoring programs, focussed on school and university students from low socio-economic backgrounds and the LiFT leadership training programme. Further, our DEI Lead took part in the Fish out of Water campaign, with a focus on LGBT+ inclusion, and Mercer produced two articles for the Gender by Design Compendium.

* Undertaken in Mercer Limited's name. ** Mercer Investment Solutions Europe's name.

Principle 5

Principle 5

Signatories review their policies, assure their processes and assess the effectiveness of their activities

Highlights, Outcomes and Focus for Next 12 Months

Our policies, processes and activities were reviewed as part of the annual review process and led to a number of changes, particularly in light of the EU Sustainable Finance Disclosure (SFDR) and Taxonomy Regulations coming in effect, which Mercer is required to adhere to. In addition to providing greater clarity on how sustainability risks and opportunities are considered across our investment process in our Sustainability Policy, Mercer has also integrated sustainability considerations into its remuneration policies and developed policies and approaches to considering Principle Adverse Impacts within our investment process.

As the regulatory requirements continued to evolve through 2021 and into 2022, Mercer has been continuously evolving and enhancing its approach to meet these regulations. Compliance with SFDR regulations has been one of the primary drivers leading to the establishment of a dedicated ESG team within Mercer to support these and other efforts to promote sustainability considerations and implement effective integration of sustainability considerations (see Principle 2).

Mercer governance structures ensures policies are updated annually and adhered to with compliance against policy principles monitored through sustainability related risks being included and monitored across business risk registers.

While there are substantial internal review processes already in place Mercer Limited is undertaking a review of our approach to internal assurance processes in relation to stewardship over 2022-23. We will be working with our internal audit and compliance teams on how to assess and strengthen our internal assurance process. This is likely to cover areas such as implementation statements and stewardship reports.

With the pace of regulatory requirements accelerating we will continue to ensure that our policy review and assurance processes, and their documentation, remain fit for purpose. We intend to keep them under review in 2022. Given the increase in scope of sustainability related considerations being embedded across portfolios driven by regulation, and increasing integration and stewardship efforts, additional processes and resources have been put in place to ensure we are able to deliver on our commitments to clients. We will be undertaking a governance review over 2022/23 to specifically ensure all new processes are appropriately resourced, documented and governed by appropriate structures.

Key Drivers for Reviewing Policies, Processes and Activities

Mercer reviews its policies, processes and activities on an ongoing basis to ensure we continue to meet our clients' stewardship and wider sustainability needs. There are typically three drivers that might lead to a review of and change to underlying policies, processes and activities. We provide relevant examples against all three over 2021 below:

1. **Regulation.** In line with SFDR requirements, we evolved and publically disclosed multiple policies, as mentioned above, and formalised processes and responsibilities of various ESG activities across the business.
2. **Evolving best practice.** In our view the UK Stewardship Code 2020 represents a best practice reporting framework. As such we enhanced a number of reports, including providing more detail on key votes and engagements, covering engagements we are having with our appointed managers, and those they are having with issuers they invest in, within the 2021 Stewardship Report, to provide more insights to clients (see Principle 12 for a summary of this reporting).
3. **Continuing focus on key themes.** As described in Principle 9, we have updated our Manager Engagement Survey to provide additional details on risks associated with climate change and human rights & labour practices and supporting DEI. These represent three key themes for Mercer and we seek to continually improve our approach to addressing them.

The reviews underpinning these areas are internal given the bespoke nature of the solutions we provide to clients and the proprietary nature of our ratings and assessment approaches. However clients regularly provide feedback. Further, as stated in Principle 6, the portfolio managers and ESG team use the findings from manager research reports, manager engagement survey results and review of manager materials to engage with appointed managers. As appointed managers respond to our findings this provides a useful feedback loop for understanding the quality and effectiveness of our processes.

Policy Governance and Review

Mercer maintains a Sustainability Policy and Stewardship Policy.

Responsibility for continued compliance with these policies extends across many areas of the Mercer business, with all employees expected to support Mercer in undertaking its activities in a responsible manner.

Employees are expected to include sustainability considerations, where possible, and relevant, in their roles and in their decision making process.

Mercer has documented processes aimed at delivering on the expectations contained in these policies. Annual work plans provide the necessary framework to ensure policy expectations are implemented across investment portfolios and assist with internal monitoring and oversight from various committees.

The Boards of the different Mercer entities are responsible for approving the policies, and reviewing updates from Mercer on the implementation of the policies, including annual updates on the integration of sustainability risks, climate-related activities and net-zero commitments and stewardship activities.

Mercer's sustainable investing activities are overseen by the Chief Investment Officer (CIO), who is responsible for ensuring processes and practices are in place to manage sustainability risks across portfolios. Mercer's ESG, Portfolio Management, Strategy and Portfolio Intelligence teams are responsible for the implementation of the policy and in ensuring sustainability considerations are embedded across investment activities, more specifically in identifying, assessing, monitoring and managing sustainability risks and opportunities.

Policy updates are led by the ESG team (with input from the SI and SI Research teams) and approved by the CIO and Head of Compliance and the Boards of Mercer on at least an annual basis. More frequent updates may take place if a meaningful change is made in the way sustainability risks are considered or where relevant regulation or legislation requirements change.

Process for Reviewing Manager Research and Stewardship Monitoring Frameworks

Mercer has a clear approach to reviewing and updating manager research and stewardship monitoring frameworks. Of most relevance to stewardship are the Manager Research Framework and Stewardship Assessment Framework. When these are updated they go through a rigorous process of internal peer review and challenge from an asset class and product category specific research committee, with input from a diverse set of colleagues specialised in the respective area, before they are finalised. Manager research ratings are subject to approval from an internal research committee, the ratings ratification committee, which ensures consistency across regions and assets classes as appropriate.

The Stewardship Monitoring Framework has been through internal peer review, with input from the Global Head of Sustainable Investment Manager Research, Mercer's ESG team and SI team colleagues. Mercer may seek external input and review, as was the case with the Stewardship Assessment Framework, which has been shared with the UK Financial Reporting Council (FRC) for comment.

The relevant SI, Manager Research and SI Research teams have primary and day-to-day responsibility for the implementation of the ratings and assessment frameworks respectively, dealing with any queries on it, and implementing internal control systems and procedures.

Ensuring Our Reporting is Fair, Balanced and Understandable

All regular reporting provided to clients, as well as manager research reports, are subject to our peer review process to ensure effective client stewardship. The process includes three stages: 'do', 'check' and 'review'. The review stage is undertaken by a colleague who was not involved in producing the report. This approach ensures that reports provided to clients has been through multiple layers of review and challenge by colleagues with the appropriate qualifications, authorisations and knowledge to ensure that we are providing accurate and relevant information in a clear, balanced and concise manner. This, along with clear research and monitoring frameworks and internal stewardship processes, is key to ensuring reporting is fair, balanced and understandable.

In addition, the compliance team reviews publicly disclosed stewardship reports and related policies and provides advice on regulatory developments in this space.

Internal assurance

Mercer follows a 'Three Lines of Defence' model to manage risk across the business. This allows us to identify, assess and manage risks in a proportionate manner, while meeting client, shareholder and regulatory expectations.

1. The first line of defence is undertaken within the relevant business function which owns and manages risk. In this context the ESG team and portfolio managers are responsible for defining and documenting processes for implementing engagement activities and the outcome of these. These processes may relate to documenting and tracking engagements with managers; distributing and collating results from the manager engagement survey, and summarising and reporting on engagement activities. Across all these areas, and others relating to engagement activities and the reporting thereof, the ESG team and portfolio managers, are expected to follow the peer review process (see above for more detail on this process).
2. The second line of defence is the risk and compliance teams overseeing the management of risk. In addition to the annual review of policies relating to stewardship, our compliance team undertakes periodic monitoring reviews of processes underlying engagement activities as well as the reporting provided as a result of these activities.
3. The third line of defence is the internal audit team or other functions that might provide independent assurance.

In addition, our clients and appointed managers take a number of approaches to assurance with both external and internal assurance undertaken on their stewardship activities. Clients may also seek legal advice on documents such as SIPs and Implementation Statements.

Principle 6

Principle 6

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

Highlights, Outcomes and Focus for Next 12 Months

Over 2021, our various reports and monitoring exercises, including our annual Stewardship Report and annual Client ESG Report, have supported our asset owner clients to be effective stewards and equip them to understand the actions being taken by Mercer and their appointed managers on their behalf, including the tangible outcomes from engagements between Mercer and appointed managers.

Over 2021, we continued to proactively seek out client views on a range of investment-related topics including stewardship, through:

- Centralised surveys, such as the European Insights Reports.
- General ESG training sessions and belief setting workshops, which provides important insights into what matters most for clients and their beneficiaries.
- Pulse surveys and more structured feedback conversations called "Client Experience Measurements" (CEMs).
- A Mercer client survey to specifically capture clients' views on Mercer's Engagement Priority areas and assess the level of alignment with what they deem important.

This combination of approaches has enabled us to listen to the voice of our clients, providing feedback on our reporting and communication efforts, and more deeply understand and meet their needs. The results from the survey, which focused on engagement priorities, highlighted that there is alignment between Mercer engagement priorities and that of clients, specifically regarding Climate Change and Human Rights considerations, however less alignment with Diversity, Equity and Inclusion, was observed.

We have successfully communicated with clients and addressed their needs using a variety of approaches and offerings described above that we view as demonstrably effective. This is evidenced by the fact that we have been able to educate, and provide investment solutions which has resulted in a large number of clients meeting SIP, implementation statement and wider stewardship requirements to a high standard. We are, however always seeking to improve.

More specifically, we have improved key elements of our stewardship monitoring program including through the use of our annual Management Engagement Survey. Over the last 12 months we believe this development has led to more targeted and insightful insights shared with our clients. A continued focus for 2022 will be on having and evidencing more impactful engagements with appointed managers and assisting our clients in understanding progress being made and outcomes achieved. We believe we are well placed to assist with this given our evolving approach to implementing effective stewardship as well as our full, and longstanding, support for the Code.

Our Clients and Asset Classes

Mercer partners with long-term institutional investors with portfolio exposures consistent with being a 'universal owner', including pension funds, insurance companies, endowments, foundations, and other investors. For these reasons, we regard investment governance and good stewardship to be particularly important in serving investor interests. The charts below shows the client, asset class and geographical breakdown of the Mercer assets under management (AUM) of c.£115bn as at 31 December 2021.

Table 7. AUM by client type

Type	AUM
Wealth Management	7%
Endowments & Foundations	2%
Insurance	5%
DC	16%
DB	70%
Total	**100%**

Source: Mercer. Data as at 31 December 2021

Table 8. AUM across client geographical region

Type	AUM
UK	44%
Europe (ex UK)	51%
IMETA (India, Middle East, Turkey and Africa)	0.2%
Asia Pacific	2%
Other	3%
Total	**100%**

Source: Mercer. Data as at 31 December 2021

Figure 8. AUM across asset classes

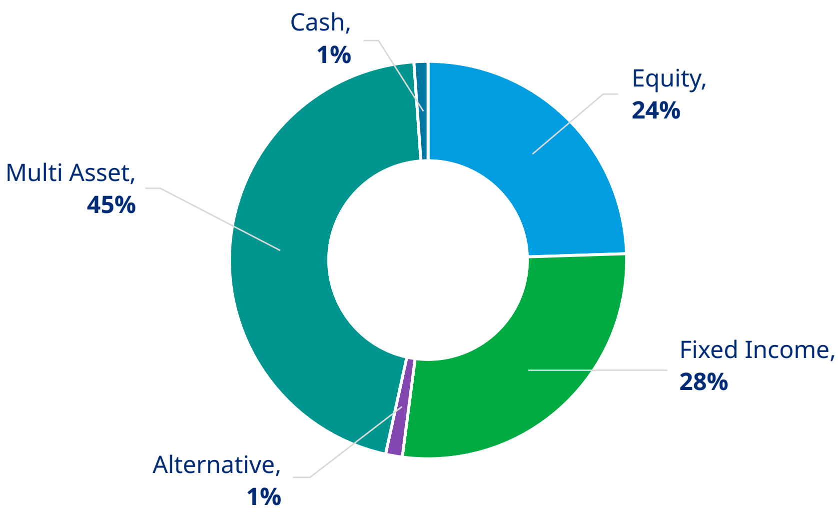


Table 9. Assets under management by country of exposure

Type	AUM
North America	42%
UK	10%
Europe (ex UK)	17%
Middle East and Africa	3%
Latam	5%
Asia Pacific	16%
Other*	7%
Total	**100%**

Source: Barra. Data as at 31 December 2021.
*Other includes World and assets with no known country exposure

Stewardship Monitoring: Communicating Activities and Outcomes

Mercer explicitly monitors stewardship activities undertaken within the funds and portfolios under management by seeking disclosure from appointed managers and reports to clients on its monitoring processes of its managers and their voting and engagement activity on at least an annual basis.

We recognise the pivotal role Mercer has in monitoring its appointed manager's stewardship activities and promoting more effective stewardship practices, including ensuring attention is given to more strategic themes and topics.

Mercer believes providing this information is central to the discharge of its stewardship responsibilities to its clients. As part of our commitment to providing clear and transparent reporting on our implementation activities, we provide regular updates to clients including through formal quarterly and annual updates. We provide a summary of the annual reports below.

Figure 9. Summary of annual reports

Annual Stewardship Report

- Requirement under SRD II
- Publicly available on our website
- Sets out stewardship activity over 2021 at an aggregated level

Commitment to UK Stewardship Code

- Signatories to the Code
- Publicly available on our website
- Sets out our approach to the 12 principles in the Code

Annual Manager Engagement Survey

- Demonstrates the level of engagement undertaken by managers throughout 2021
- Used by portfolio managers to drive engagements with managers

Voting Report

- Voting statistics over 2021 split out per Fund
- Provides deeper insight into voting behaviors at a fund level

Stewardship Assessment Framework Overview

The Stewardship Assessment Framework is being rolled out over 2022. This will be a policy, implementation and reporting review that applies the principles of the 2020 UK Stewardship Code. It will be launched in 2022 and is an evolution of the previous stewardship assessment report based on the UK Stewardship Code 2012. This framework will assign a summary overall rating as well as assessing investment managers' stewardship activities across five key areas:

1. Governance, Policy & Firm-wide commitment
2. Mercer ESG ratings
3. Engagement
4. Voting (listed equities only)
5. Transparency and Reporting including bespoke client needs

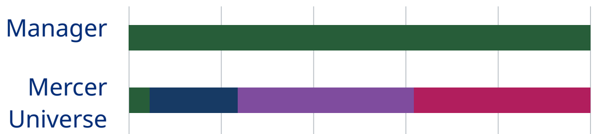
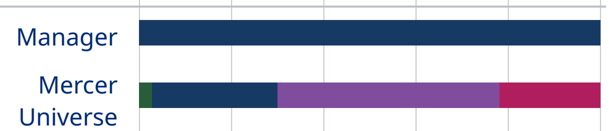
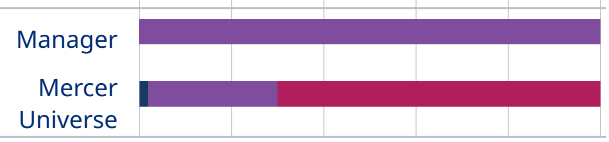
Further monitoring of ESG integration

In addition to the stewardship monitoring described above, Mercer carries out additional annual integration, monitoring and reporting of the following across relevant portfolios:

- ESG ratings, carbon intensity and diversity related metrics are included in quarterly performance reports.
- ESG ratings are reviewed against asset class peer groups for equity, fixed income, property, infrastructure, diversified alternatives and multi-asset funds on a quarterly basis with a formal report published on an annual basis.
- Climate scenario modelling and stress testing of diversified multi-asset portfolios.
- Climate related metrics across portfolios where data coverage is sufficient is provided on request and to support clients with TCFD disclosure requirements.
- Additional annual reporting on sustainability related metrics for portfolios with a specific focus on sustainability.

We use the findings from these monitoring reports as a basis to engage with appointed managers (see Principle 9 for more information).

Table 10. Example Summary Findings from ESG Rating Exercise

Asset Class	Manager	ESG rating	GIMD universe average	Target for improvement?	Rating distribution chart
Passive Equity	Manager 1	1	3.1	No	
Emerging Market Equity	Manager 2	2	2.9	No	
Multi Asset	Manager 3	3	3.7	No	

Monitoring ESG Integration and Stewardship Across Different Investment Arrangements

Mercer's investment arrangements are a combination of segregated mandates with appointed managers or investments in pooled vehicles. For the majority of clients, these segregated and pooled arrangements are combined into Mercer Funds and for certain clients, these funds are combined into portfolios. Mercer actively monitors its appointed managers on ESG integration and stewardship, consistent with Mercer's Sustainability Policy; however, application may vary depending on the degree of discretion available (which is expected to be higher in segregated mandates relative to pooled vehicles) in which the Mercer Funds invest.

Managing to appropriate time horizons

The majority of our clients have long term time horizons and Mercer in turn seeks to generate long term sustainable returns to align with these horizons. When setting an investment strategy for a client we take into account their short, medium and long term objectives and seek to ensure our overall approach, including stewardship approach, aligns with this. Clients with longer time horizons typically have long term holdings in investments (e.g. equities) making long term risks and opportunities highly relevant, including market-wide risks. However even clients with shorter horizons and investments in instruments that mature over a shorter period of time (e.g. corporate bonds) can be exposed to rapid repricing through ESG and wider risks. Stewardship therefore is still important but more from a risk perspective. We recognise shorter time horizons also increase liquidity requirements which in turn limits the ability to invest with, and by extension engage with, certain areas of the market. Our investment ratings (see Principle 7) also seek to assess whether the investment horizon of the manager aligns with an ability to implement ESG views effectively.

Climate change risks over the short, medium and long term

Consistent with our climate change scenario analysis findings we believe that transition risks are likely to be most material over the short to medium term, with physical risks dominating over the longer term. We also recognise potential short term risks from rapid market repricing due to unexpected climate change policies (for example, unforeseen introduction of carbon pricing to certain markets). Therefore even for clients with short horizons (e.g. targeting buy-out in 3-5 years) we seek to consider what can be done in terms of stewardship and engagement with appointed managers to make portfolios more resilient to the risks of climate change and other risks, and also more attractive to insurers.

Managing assets in line with investors stewardship and investment policies

Mercer assists its clients with drafting investment policies and then manages investments strategies in line with them, reporting against key areas. The adoption of implementation statements has provided the opportunity for pension schemes to formally document the practical implementation of various stewardship policies found within Statements of Investment Principles. We have assisted clients with drafting these reports which has provided the opportunity to ensure what is articulated is implemented in practice.

The majority of Mercer's clients invest in a fiduciary arrangement with Mercer appointed as discretionary investment manager with responsibility for the day-to-day management of client's assets. For the majority of clients, assets are invested in a range of specialist pooled funds ("Mercer Funds"). Mercer are responsible for the appointment and monitoring of suitably diversified specialist third party investment managers for each Mercer Fund's assets.

Under these arrangements, clients accept that they do not have the ability to directly determine the engagement or voting policies or arrangements of the managers of the Mercer Funds. However, clients expect Mercer to manage assets in a manner, as far as is practicably possible, that is consistent with their engagement policy as well as broader investment policies. As detailed above, clients review regular stewardship and sustainability/ESG integration reports from Mercer, in order to consider whether their policies are being properly implemented. These reviews are generally supplemented with a detailed presentation to clients, on at least an annual basis, to highlight how Mercer has carried out its fiduciary responsibilities and integrated sustainability considerations across its investment process. This furthermore provides an opportunity for Mercer to gather feedback from clients on any additional areas they feel should be addressed.

Furthermore, Mercer as an asset manager and certain European institutional investor clients have consistent obligations under the Shareholder Rights Directive II. This helps align stewardship activities and policies.

Seeking Client Views

We actively seek out client feedback through various channels, ranging from formal client surveys and reviews to ongoing discussions and queries from clients. We have chosen this mix of approaches to client feedback for a number of reasons. Feedback through bottom up, direct client interactions can provide deeper insights and improvements (for example on technical aspects to mandate design), while we can achieve a better understanding of broad client consensus and themes through surveys asking a consistent set of questions.

Following completion of each European Asset Allocation Survey we take account of client and investment consultant feedback, with an aim to identify areas for improvement. For the 2021 survey, this led us splitting what was the European Asset Allocation Survey into four separate surveys which now make up the European Insight Reports - DB trends, UK DB de-risking, DC trends and Sustainable Investment. This change was made to make the findings from our client survey more “bite sized” and digestible. This more granular approach, including the introduction of a Sustainable Investment report has provided more granular insights into investors’ sustainability expectations and needs.

Our latest Sustainable Investment report captures information from 850 institutional investors across 12 countries, reflecting total assets of over €1 trillion. It identified four important findings all of which are key areas of focus for Mercer as a business:

1. ESG remains the new normal: The vast majority of investors have firmly embedded ESG considerations into their investment considerations, a trend that has strengthened during the Covid-19 crisis.
2. E to the fore of ESG: When asked to rate the importance of environmental, social and governance considerations, respondents, with the exception of Ireland, responded that the environment was the most important area of focus.
3. ESG broadening: Climate change and governance are becoming well-trodden areas of fiduciary scrutiny. This year we asked respondents whether they are expanding the scope of their sustainability activities. A significant minority plan to focus more on social issues, other environmental issues (such as biodiversity) and DEI.
4. Stewardship across the board: Stewardship is mainly thought of in relationship to equity mandates. However, increasingly it is applied across the board, to both fixed income and alternatives portfolios.

“Client Experience Measurements” (CEMs), which entail a conversation between clients and an independent (i.e. a person not part of the day-to-day client team) contact from Mercer, enable us to listen to the voice of our clients and deeply understand their needs. These provide an opportunity for clients to feedback on our service, including whether we are meeting their stewardship needs, and highlight their key priorities. The 2021 annual review of CEMs covering the UK generally found consistently high scores and highlighted a number of areas of strength, including our people and quality of our advice. Notwithstanding this, we recognise that a lot of the work we do for clients is complex, and a key challenge is ensuring we deliver straightforward and easy to understand advice. We continually evolve our advice to make technical issues accessible to clients, often by agreeing key messaging and guidance in working groups that contain specialists before disseminating more widely, and the case study below on implementation statements shows one way we have addressed this issue.

There are clear processes in place where client CEM scores fall below a certain threshold, to ensure Mercer takes action to meet client needs and expectations. Over 2021, we met our target number of ‘face-to-face’ CEMs across the business and have set a similar target for 2022.

ESG beliefs surveys are an important way to understand client preferences and their beliefs and views on a range of sustainability themes, implementation approaches and on how to be an active owner. We use the outputs to refine their investment policies and embed their key beliefs in strategic asset allocation and manager selection and retention decisions.

We have a number of clients who are recognised as global sustainability leaders and these client interactions in particular have supported and driven proactive efforts to incorporate greater consideration of sustainability factors throughout our funds. We have launched a number of funds with sustainability characteristics based on client feedback and demand. These funds focus on promoting environmental and/or social characteristics and incorporate a number of exclusions, which have also been informed by client discussions and our view of their suitability.

We actively encourage client facing consultants to provide comments and feedback to our manager research and intellectual capital teams on the challenges, needs and expectations of our clients. This ensures we develop our solutions in a way that best meets the needs of our clients and helps us to innovate and drive new ideas. The ESG team, with support from the SI team, focuses on addressing common questions through training materials and guidance issued to the wider field.

The monthly meeting of the European ESG Co-Ordination Group (ECG) (see Principle 2 for more information) is an important forum to ensure views and needs of clients and prospects make it into the development of solutions and reporting considerations.

Case study

Taking on client feedback to improve implementation statements

Following the publishing of many clients' inaugural engagement policy implementation statements over 2020, investment consultants relayed client feedback on information we provided. As a result, we implemented this feedback into the data collection and reporting process over 2021, subsequently enhancing our reporting to better illustrate metrics in a clear and member-friendly format, while also capturing additional relevant details such as the outcome of significant proposals and the exercise rate of voting rights across funds. We have also evolved the implementation statements to be clearer on actions and outcomes, as well as incorporating more diagrams and charts to make it clearer to understand.

More recently, as a result of the regulatory changes to reporting, clients' auditors have also increased their oversight/assessment of stewardship reporting in the implementation statement, which now requires further detail. We have enhanced our process to capture this demand and are committed to developing this further as a key component of our firm-level stewardship efforts.

Evaluating the effectiveness of seeking client views, understanding their needs and communicating with them

We have successfully communicated with clients and addressed their needs using a variety of approaches and offerings that we view as demonstrably effective. This is evidenced by the fact that we have been able to educate and offer solutions and services which have resulted in a large number of clients meeting Statement of Investment Principles (SIP), implementation statement and wider stewardship requirements to a high standard.

Specifically, CEMs, alongside processes to capture day-to-day client feedback, have helped assess and improve the effectiveness of our chosen approaches. As part of the annual review of CEMs we analyse year-on-year trends and scores across different topics to understand where we are making progress and areas for improvement. We are however always seeking to improve.

The introduction of Investment Consultant Objectives, a requirement of the CMA Order, is another avenue for clients to assess the effectiveness of the investment consultants working with our clients. We pride ourselves on having strong relationships with our clients so any potential concerns or issues are raised and addressed early.

Improving standards and communication across the Industry

The Investment Consultants Sustainability Working Group (ICSWG) is an important means by which Mercer, and the investment consulting industry as a whole, can communicate progress being made on ESG and stewardship to institutional clients. Our work with the ICSWG and the resulting Trustee Guide for Assessing Climate Competency of Investment Consultants should enable clients to better understand what represents good and best practice with respect to their investment consultants. The ICSWG Engagement Reporting Guide should provide more consistent engagement reporting delivered by asset managers and platform providers to institutional clients. Mercer Limited's insights from its contribution to the ICSWG has been shared with Mercer and have been a key driver in shaping Mercer's approach to stewardship and staying at the forefront of best practice.

Principle 7

Principle 7

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

Highlights, Outcomes and Focus for Next 12 months

We continue to use Mercer ESG ratings as a consideration in appointing mandates and assessing appointed managers' approaches to ESG and active ownership. This has in some cases led to Mercer replacing appointed managers with other strategies managed by managers with higher ESG ratings on a number of occasions over 2021 and in previous years. In most cases however, we prefer to take a long term approach and engage with managers with lower ESG ratings, in order to drive greater integration of ESG considerations into their investment process, for the benefit of not only our clients, but their broader client base too. As a result:

- Over 64% of Mercer Funds have seen their average ESG ratings improve over the last four years.
- 9 underlying strategies' ESG ratings were upgraded during 2021

As with our review of manager ESG ratings, in line with our focus on climate change, Mercer also actively monitors the carbon intensity of mandates and will engage with managers, in order to drive greater integration of climate considerations. As a result:

- 89% of active equity funds have lower carbon intensity than their respective benchmarks which in part reflects positive engagement efforts.

ESG Integration

As a provider of investment solutions we believe that analysing exposure to, and management of, sustainability factors, in addition to traditional financial analysis, enhances our ability to deliver long-term sustainable returns and better overall investment outcomes. Therefore, core to our investment processes across asset classes is the underlying investment managers' approach to integrating sustainability considerations into their investment process, including how it informs security selection and portfolio construction, while acknowledging that the degree of relevance or materiality may vary between asset classes.

Assessing the ESG capabilities of appointed managers is key to incorporating sustainability factors into our investment process and across our funds. We believe we can have the most influence through manager and strategy-level assessments and use these to inform our manager selection process.

Table 11. Key ESG issues

Environmental	Social	Governance
• Climate change • Water • Waste and pollution • Biodiversity	• Labour standards and modern slavery (including the supply chain) • Human rights and community impacts • Health and safety • Social inequality/demographics/consumption	• Board diversity, composition, independence and effectiveness • Executive remuneration • Conduct, culture and ethics • Shareholder rights

Mercer ESG Ratings

Investment teams leverage Mercer's global research capabilities to identify specialist third-party investment managers for inclusion in Mercer Funds. Across asset classes, selection and monitoring processes for potential and appointed managers include Mercer's ESG Ratings and associated commentary from the Manager Research team. Expectations for strategies within multi-client funds are set as ESG3 or above, where practicable and relevant to the strategy.

Figure 10. Overview of Mercer ESG ratings

ESG ratings are assigned by Mercer's global manager research team. They are on a scale from ESG1 (highest) to ESG4 (lowest) and assess how well manager's integrate ESG factors into their investment processes.

	ESG1	ESG2	ESG3	ESG4
Active	Leading approach to integration, where ESG is embedded in investment philosophy; strong on stewardship, which is a core part of process	Consistent and repeatable process to ESG integration (focus on risk management); well-developed evidence of stewardship	Well-developed G integration; less consistency in E&S; stewardship process is ad hoc, but indications of progress	Little or no integration of ESG factors or stewardship into core processes and no indication of future change

Ratings for passive equity strategies differentiate how well firms undertake their stewardship activities such as voting (where relevant and applicable), engagement, industry collaboration and reporting.

	ESGp1	ESGp2	ESGp3	ESGp4
Passive	Leaders in Voting & Engagement (V&E) across ESG; stewardship activities and ESG initiatives undertaken consistently at a global level; clear link between engagement and voting actions	Strong approach to V&E across ESG topics and initiatives at a regional level, with progress made at a global level; working toward clearer links between V&E	Focus of V&E tends to be on governance topics only or more regionally focused with less evidence of E&S (in voting and engagement, as well as other internal ESG initiatives)	Little or no initiatives taken on developing a global V&E capability, reactive engagements; and little progress made on other ESG initiatives

ESG ratings are derived from assessment criteria that vary according to asset class and are relative to what Mercer believes is "best practice" ESG integration. This assessment typically follows the overall manager research approach to investment ratings with a focus on four key factors that derive the overall view and rating for a strategy. We lay out the four factors for active and passive strategies below.

Our proprietary ESG ratings policy details the relevance of ESG to risk and return drivers by asset class, including best practice across E, S and G issues. Please see the appendix for more information on ESG ratings distribution by asset class.

Figure 11. Mercer ESG Ratings: the four factors

Active (All asset classes)	**Idea generation** • ESG factors integrated into active fund positions as a source of value added • Identification of material ESG factors – skill of team members, data sourcing	**Resources & Implementation** • Skill set of resources. • Effectiveness of engagement outcomes	**Portfolio construction** • Efforts to integrate ESG-driven views into the portfolio's construction	**Business management** • Firm-level support for ESG integration, engagement activities and transparency
Passive (equities)	**Voting and engagement** • Policy, process and prioritisation • Quality of engagements	**ESG integration** • Data analysis to enhance active ownership	**Resources and implementation** • Skill set of resources • Effectiveness of engagement outcomes	**Firm–wide commitment** • Collaborative initiatives and engagement with regulators and policymakers

The approach managers adopt to stewardship is part of the four factors assessed in Mercer's ESG ratings framework, thereby impacting their overall ESG rating. This is particularly true for passive ESG ratings. Our ratings also consider if the investment horizon of the manager aligns with an ability to implement ESG views effectively, such as the long-terms impacts of climate change.

We typically see listed equity managers demonstrating the most widespread adoption of good stewardship practices. For other asset classes the approach is mixed, however we have seen a notable increase in activities and disclosure from fixed income managers, particularly with respect to corporate bonds (please see Principle 12 for more detail on stewardship expectations for asset classes beyond listed equity).

The improvement in ESG ratings over time (see below) is a result of both mandate changes and manager ESG ratings improvements. Mercer believes that its engagement with its appointed managers has been a key factor in improving managers' ESG ratings. Mercer will continue to work towards improving ESG ratings across its funds where possible.

Summary 2021 Annual ESG Ratings Review

Our investments team consider manager ESG ratings prior to appointment and on an ongoing basis, and actively seek to appoint better ESG rated strategies that fit the required investment criteria for the solution. The team also actively engage with managers on improving their ESG integration processes, from carbon emission reductions to improved diversity representation on the team.

ESG Integration

% Funds with Higher or Equivalent ESG Rating relative to MercerInsight Universe

95%	81%	80%
Equity	Fixed Income	Alternatives

46 Multi-client solutions reviewed as part of our annual ESG ratings review across equities, fixed income, listed property, infrastructure, multi-asset and liquid alternatives

64%* Of funds have seen their ESG rating improve over the past 4 years

89%** Of funds are ahead or in line with their respective peer group universe

*Excluding multi-asset funds (5) analysed for the first time this year and funds launched since 2017 (16)

**Excluding multi-asset funds (5) | Source: Mercer

Case Study: ESG rating improvements over time

Manager	Engagement	Outcome
Low Vol & European Equity manager ESG3 in 2018	Mercer held 2 research meetings with the manager to discuss ESG, and began our due diligence with an investigation into the impact of ESG signals on the strategies. The manager also spoke about its stewardship and engagement efforts.	The manager was able to provide evidence that ESG risks and opportunities were incorporated throughout multiple portfolios including their Low Vol and European Equity strategies appointed to the Mercer Funds. **ESG2 ratings awarded in Dec 2021 & Jan 2022 respectively**
Fixed income manager ESG3 in 2017	The manager mentioned development of an ESG scoring system to our Manager Research Group, but were unable to demonstrate its use in practice. Following our PM team's feedback, the manager showcased their newly formed ESG research team, and the introduction of the new ESG impact rating process.	The manager is actively integrating ESG scoring through the work of their new ESG research team. **ESG2 rating awarded in 2020**

Case study

How ESG ratings, stewardship and time horizon considerations impact investment portfolios

Example 1: Mercer Passive Equity Manager Appointment

We undertook extensive market research on ESG indexes before appointing a manager to manage a passive equity fund with an ESG focus. Stewardship was a key consideration both in terms of appointed manager capabilities and how it related to index construction. We awarded the mandate to a manager with our highest passive equity ESG rating – ESGp1. The ESGp1 reflects a best in class approach to stewardship within passive equity, including a long time horizon and commitment to engage with underlying companies over multiple years.

Example 2: Active Sustainable Equity manager appointment

Our sustainability-themed global equity solution provides exposure to strategies which display best practice in integrating ESG into their investment considerations and stewardship practices, have exposure to companies expected to benefit from addressing climate change, resource scarcity and social development challenges and applies screening to the strategies to mitigate material exposures to sectors with key ethical concerns. We blend managers with complimentary investment styles, a range of thematic exposures and strong, outcome-oriented stewardship practices, in line with Mercer's best thinking. When selecting managers for this strategy, we have limited the candidate universe to those strategies which have achieved ESG1 or ESG2 ratings to ensure only those strategies which display best practice in ESG integration are appointed. The appointed managers in the strategy are strongly aligned with our core investment belief that integrating sustainability considerations is more likely to create and preserve long-term investment capital, particularly as sustainability themes play out over an extended period of time.

Both of these examples align with the multi-decade horizon of our sustainability focused clients, a number of whom have set or are exploring setting net zero targets by 2050 or earlier.

Example 3: Allocating to Sustainability-themed Investments

The strategic asset allocation of diversified growth portfolios is informed by the results of Mercer's climate scenario modelling work with short, medium and long term projections. It has seen the allocation to sustainability themed investments double over the last two years in the majority of multi asset portfolios based on these results, particularly in relation to transition opportunities in the short to medium term.

Monitoring Climate Related Metrics

Monitoring climate related metrics provides an additional means to assess the level of ESG considerations across portfolios in relation to climate change risks.

Carbon intensity, along with additional metrics, are monitored across portfolios on a regular basis by the investments team, with a formal review taking place annually and shared with clients as part of annual client reporting. The results from these reviews provide additional insights for portfolio managers to use to engage with appointed managers on their management of climate change risk and opportunities. Engagements with managers managing funds with higher carbon intensity than their respective benchmarks, has led to improvements through reductions in the overall carbon intensity of funds.

Figure 12. Carbon footprinting monitoring

Summary Results

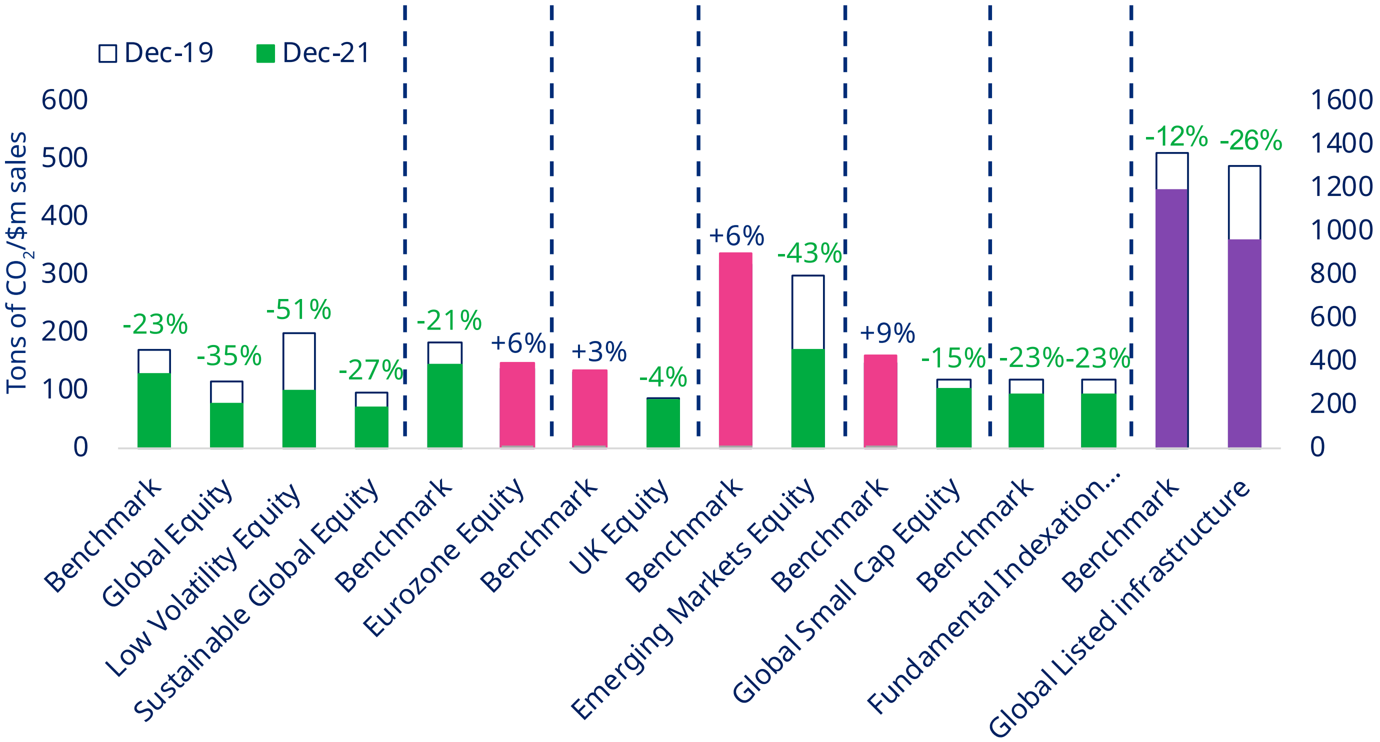
On average funds are **32%** more carbon efficient than their respective benchmarks

89% of active equity funds have lower carbon intensity than their respective benchmarks

21% WACI reduction since 2019 baseline levels for Mercer's model growth portfolio

WACI reduction figure based on Strategic Asset Allocation

Active Equity WACI change over time – December 2019 to December 2021



Source: ©2022 MSCI ESG Research Inc. Reproduced by permission.

Data as at 31 December 2021

*Note: Mercer Global Listed Infrastructure Fund on secondary axis on RHS – same units (i.e., tons Co2/$m Sales)

Case study

Engagement with managers to better integrate climate considerations

Mercer Passive Equity Manager Appointment

During both 2020 and 2021 we engaged with systematic managers across our funds in relation to their carbon footprint. These engagements included engagements with a manager, which also happened to be the only manager across the multi-client equity funds to have an ESG 4 rating. Engagements focused on working with the manager to embed environmental considerations within their investment process. These engagements not only led to considerable reductions (i.e. c.70%) in carbon intensity in one of the underlying strategies managed on behalf of Mercer, but further led them to consider similar approaches across their broader asset base. The carbon intensity reductions where achieved by applying tilts to the portfolio using their proprietary methodology, as opposed to restricting the investment universe, and were achieved without influencing the expected alpha expectations of the strategy.

This contributed to an overall improvement in the Fund's carbon intensity of 44% resulting in the Fund's carbon intensity being 50% below its respective benchmark.

Fund now has **50% lower carbon footprint** than its benchmark

44% reduction in Weighted Average Carbon Intensity between June 20 and June 21

Case study

Making progress on our net zero commitment

Our multi-client, multi-asset solutions are constructed using Mercer Funds as building blocks, therefore all reductions in carbon intensity from individual funds contribute positively towards our overall goal of net zero portfolio carbon emissions by 2050. Our engagements with managers and resulting reductions in carbon intensity across their strategies, have contributed to our best ideas model growth portfolio already seeing a carbon intensity reduction in the region of 20% compared to 2019 baseline figures (based on SAA), placing us on track to achieve our interim target of 45% reduction by 2030.

Aligning time horizons with stewardship and investment considerations in mandates

As described in Principle 6 the majority of our clients have long term horizons and as such we seek to align mandate design with long term value creation. Mercer's ESG ratings consider if the investment horizon of the manager aligns with an ability to implement ESG views effectively, including long-term sustainability themes such as climate change.

Asset classes and strategies such as fundamental equity and private markets naturally have long time horizons, typically expressed through long term holdings in investments, increasing the likelihood that long term risks and opportunities will materialise during the holding period. Effective ESG integration and stewardship are key ways to mitigate these risks. One example of this is the importance we place on the stewardship capabilities of passive equity managers in the selection process.

However when appointing mangers we are mindful that even approaches that invest in instruments that mature over a short to medium period of time (e.g, corporate bonds) can be exposed to rapid repricing through ESG and wider risks, and managers often re-lend to the same creditor. Therefore stewardship is still important for maintaining and enhancing value.

In addition, the design and award of mandates across all asset classes considers, as relevant, time-related factors such as expected turnover, stability of the investment team and fee structures that incentivise long term value creation for the benefit our clients.

Principle 8

Principle 8

Signatories monitor and hold to account managers and/or service providers.

Highlights, Outcomes and Focus for Next 12 Months

Mercer has processes in place for monitoring and tracking engagement and escalation activities with appointed managers. Our annual Manager Engagement Survey results (see Principle 9) were used to populate newly introduced Engagement Dashboards which guide our portfolio managers' engagement activity with managers on their stewardship approaches with the view to positively influence these over time. Engagement Trackers were implemented over 2021 to better capture, monitor and communicate our ongoing engagement activity, both at manager level and underlying company level. If ongoing engagements do not see progress, the company/issuer may be eligible for escalation activity and potential exclusion in future.

Our Manager Engagement Trackers will enable our investment team to see tangible improvements over 2022 on the specific topics they are engaging with managers on, as well as areas that require further escalation when our expectations are not being met. Engagements with appointed managers includes ensuring they have formal policies in place relating to assessing, disclosing and monitoring climate and human rights related risks and promoting diversity both in their own operations and that of the companies and issuers they invest in. See Principle 9 for more information on priority engagement areas with appointed managers and the tangible results from these efforts.

Our historic and current stewardship, ESG rating and carbon footprinting assessments have led to fruitful engagements between our investment team and appointed investment managers with tangible improvements (see Principle 7 for further detail).

We have communicated our expectations with managers to support our 30 by 2030 Diversity, Equity and Inclusion goal. The majority of managers are supportive of this with many highlighting that increasing female and diverse representation within their teams was a firm priority for them as well.

Our ongoing reviews have confirmed that our third party data providers have been able to meet our needs by providing data of an acceptable level of quality and breadth of coverage. They have been receptive to a number of changes required to keep pace with regulatory developments and client aspirations in areas such as net zero investing, impact/SDG alignment reporting and SFDR. This is an area to keep under further review as client needs and regulations evolve.

Holding appointed managers to account and escalating engagement

Mercer actively engages with managers through email, calls and during regular meeting cycles on the back of regular reviews and monitoring exercises (see responses under Principles 6, 7 and 9 for details on the reports, monitoring exercises and surveys used by Mercer to monitor appointed managers). Managers are expected to highlight any concerns that may require engagement with underlying securities, and report on these activities and outcomes to the investment team, with the view to positively influence these over time.

The underlying strategy and fund level information from the annual Manager Engagement Survey (see Principle 9) provides an important source of information used to construct Manager Engagement Dashboards at the strategy level, which highlight key areas of focus for regular discussions with managers throughout the year. These goal-orientated engagements are captured on a Manager Engagement Tracker to monitor progress over time and identify cases where further escalation may be needed.

Case study

Promoting environmental and social characteristics with Mercer's appointed managers

During 2021, Mercer portfolio managers undertook over 40 engagements with appointed managers across our multi-client funds as we looked to further promote environmental and social characteristics across the majority of our multi-client funds in line with the EU SFDR. These engagements have enabled us to set binding commitments for our funds to promote environmental and social characteristics, with no expected impact on alpha generation expectations or risk characteristics.

40+

Engagements facilitating further promotion of environmental and social characteristics

Binding characteristics:

- Lower carbon emissions and/or elimination of high carbon emitters from portfolios (unless there is evidence of a strong transition capacity and commitment)
- Expanded set of exclusions focused on reducing the environmental impact of the funds
- Enhanced UN Global Compact monitoring, engagement and escalation framework to promote good governance practices

While the binding commitments have been set at an overall fund level, the approach taken by individual managers to contribute to achieving these binding characteristics has varied and includes:

- Identifying and avoiding issuers that participate in specific areas deemed to be harmful from an environmental, social or governance perspective (e.g. issuers with large carbon footprints or poor human rights policies)
- Identifying and investing in issuers that proactively seek to manage social & environmental factors as well as generate sustainable returns (e.g. development of solutions that improve efficiency or reduced use of natural resources or accessibility to healthcare)
- Implementing exclusions for issuers deemed to have material ESG issues intrinsic to their business or economic activities (e.g. tobacco, controversial weapons, companies flagged for high severity UNGC incidents)

In many cases the above approaches include:

- Threshold based activity monitoring
- Security level ESG assessments using proprietary assessment frameworks with associated minimum ESG rating requirements
- Adjusting position sizes to reflect issuer's ESG characteristics

These engagements have resulted in, for example, six active equity funds aiming to achieve 20% lower carbon intensity relative to their respective benchmarks and eight active fixed income funds aiming to remove the worst carbon emitters with the lowest carbon transition potential from their investment opportunity set. In addition to these commitments, additional exclusions related to minimising exposure to thermal coal extraction, artic drilling and oil tar sand mining have further been introduced across these funds as well as across passive funds classified as Article 8, to further promote environmental characteristics across our solutions.

With regard to Mercer escalation with appointed managers, our monitoring process tracks improvements from previous monitoring reports, identifies areas for future improvements and provides feedback to managers. During the monitoring process, if appointed managers fail to comply, explain their governance principles or respond to our feedback, ongoing stewardship or other concerns will be escalated to the Mercer CIO. The CIO will engage with the appointed manager directly in the first instance. If there is no indication of improvement, stewardship concerns will be viewed as a meaningful consideration, alongside other investment factors, in subsequent retention or termination decisions for that appointed manager.

Case study

"30 by 2030" Diversity of Key Decision Makers

Mercer has set itself a goal that by 2030 at least 30% of the key decision-makers (KDMs) within the external managers we use in Mercer Funds will identify as female, with a longer-term goal to reach 50% representation.

We have communicated our expectations with managers to support our 30 by 2030 goal as part of our regular engagements with them. Where managers are not meeting our target of 30% female identifying Key Decision Maker representation, our portfolio managers will engage with them, with the aim of encouraging progress. We recognise that "30 by 2030" is a long-term goal and we are not expecting managers to change their KDM line up overnight, but we are hopeful to see incremental changes over the coming years and evidence of efforts to support this through training, development and mentorship. The majority of managers are supportive of this with many highlighting that increasing female identifying and diverse representation within their teams was a firm priority on their side too and we have already seen positive outcomes from these engagements.

For example, across one of our fixed income funds, we raised a concern with the manager relating to the lack of female representation within the investments team assigned to the strategy. The manager subsequently brought a seasoned female portfolio manager into the team, signalling their willingness to promote and make way for female colleagues to progress within their business.

Within the fixed income universe, according to data on MercerInsight, the average fund has 8% female KDM's and within the average EMEA active equity universe the average is 12%. Figures relating to Mercer's fixed income and active equity funds currently stand slightly ahead of the universe at 9% and 13%.

We conducted an initial assessment of our own investment team's diversity statistics during 2021, and are pleased to report that Mercer is already ahead of our 30 by 2030 objective, both at a regional (38%) and international level (33%).

Case study

Passive equity manager

We have been engaging with one of our passive equity managers since their appointment when they had an ESG rating of ESGp4. Their ESG rating was raised to ESGp3 following a number of enhancements to their approach however we continued to engage with the manager and have since seen a number of notable improvements across a number of areas:

- **Resourcing:** There is now a dedicated and experienced responsible investment (RI) team of five, with a strong lead as Head of RI. Their ESG specialists also have relevant industry backgrounds and strong academic credentials.
- **Stewardship themes:** Clear themes across Climate Change, Natural Capital, Human Rights and Corporate Governance have been established which have enabled a structured framework for direct and targeted collaborative engagements.
- **Disclosure:** Reporting on voting and engagement activities has increased and is more granular across themes.
- **Voting:** A custom voting policy has been developed with their proxy voting advisor to reflect wider strategic objectives from the firm.
- **Engagement:** An engagement overlay service provider has been appointed, with engagements prioritised based on laggards across key themes.
- **Commitees:** A number of internal committees dedicated to stewardship activities have been set up.

While these changes are notable, they have retained their ESG rating of ESGp3 during their latest review, given their peer relative performance in a rapidly evolving space and given the limited time between these changes being implemented and Mercer's ESG review. Further time is needed to evidence the quality and commitment of these changes, which may result in a revision to their rating during their next review. Mercer will continue to engage with the manager on the outcomes of these enhancements and on building on the progress they have made.

Holding Third Party Data Providers to Account

Mercer undertakes regular reviews of its third party data providers (see Principle 2 for a list of our providers). During 2019, Mercer conducted an extensive third party data provider review across four key areas: ESG ratings and metrics, impact metrics, vote reporting and exclusions. Having reliable data providers is key to meeting our client's sustainability needs. It enables Mercer to interrogate their portfolios using a variety of metrics and data and clearly report voting activity undertaken on their behalf. This in depth review, supported by a formal scoring system across key categories, allowed Mercer to compare and contrast the capabilities across a number of providers, and resulted in a number of changes to Mercer's third party provider line-up. We will be undertaking a similar review over 2022/23.

Mercer has ongoing dialogue with its providers in order to improve the level of service and disclosure, and quality of data received. For example, over 2021, there were a number of engagements with our ESG ratings and metrics data provider in order to assess the level of metrics available based on the draft level 2 regulations of the Sustainable Finance Disclosure Regulations and to better understand evolving metrics such as implied temperature rise and SBTi targets.

In addition to ongoing dialogue we also hold a more formal annual check-in with our key data providers in order to ensure we continue to benefit as much as possible from their capabilities and offerings. Meetings have provided us with an opportunity to discuss improvements – for example pushing for the inclusion of scope 3 carbon emissions data within various tools and greater transparency on voting data in line with specific requirements under the Shareholder Rights Directive II (SRD II) – and understand upcoming enhancements to the offerings, such as the inclusion of biodiversity and diversity data.

Principle 9

Principle 9

Signatories engage with issuers to maintain or enhance the value of assets.

Highlights, Outcomes and Focus for Next 12 months

Over 2021 our engagement approach continued its focus on three engagement themes – Climate Change, Diversity and Human Rights & Labour Practices. This was enhanced by engagement on the findings from our first Manager Engagement Survey covering over 90 listed equity and fixed income managers which captured appointed manager engagement methods, actions and outcomes over 2020. Our second survey, covering 2021 and conducted on a global scale for the first time, was updated to more closely monitor high severity incidents relating to the United Nations Global Compact Principles, enabling greater oversight and accountability.

We saw key manager improvements in the areas of undertaking TCFD reporting with 64% confirming they have prepared a climate change disclosure statement in line with TCFD recommendations, compared with 47% last year. We have also seen an increase in managers monitoring climate metrics, setting decarbonisation targets and developing formal policies to address human rights risks and undertaking human rights risk assessments. The Manager Engagement Survey did however identify a minority of listed equity and fixed income managers where improvements over time were not observed or where there was a lack of evidence relating to stewardship activities, which will be the subject of targeted engagement by the investment team, as we work towards improving manager's stewardship practices.

Looking ahead to the rest of 2022 we will be using the results from the second Manager Engagement Survey to drive further engagements with appointed managers. We will be focusing on encouraging and working with appointed managers of multi-client funds with the most room for improvement to improve their approach to stewardship, whether it be through formalising their approaches through policy development, collaborating and supporting industry initiatives and actively engaging with issuers and escalating engagement activity, across priority areas relating to climate change, human rights and labour practices and diversity.

We continue to evolve our stewardship approach and have the following areas for improvements over the next 18-24 months. These includes refining and targeting specific holdings for engagement via our appointed managers in line with our engagement priority themes and to better capture the outcomes.

Overall Approach to Engagement

Mercer appoints managers that are expected to adopt voting and engagement practices that include a focus on material ESG topics including governance and strategy, together with relevant environmental and social topics, consistent with Mercer's Investment Beliefs.

Mercer's publicly available Engagement Policy describes in further detail how it integrates stewardship, through engagement and voting activities, into its investment strategy.

Mercer believes its appointed managers are typically best placed to prioritise particular engagement topics by company. Therefore, in most instances, corporate engagement implementation is delegated to the appointed investment managers, who are encouraged to engage with portfolio companies and issuers on material ESG issues with the aim of improving long-term risk adjusted returns and the stability of financial markets.

The charts below lay out our framework and overarching approach to engagement across clients (see Principle 6), appointed managers (see Principles 6, 8 and 9) and collaborative initiatives (see Principles 4 and 10).

Figure 13. Mercer's Enhanced Engagement Framework

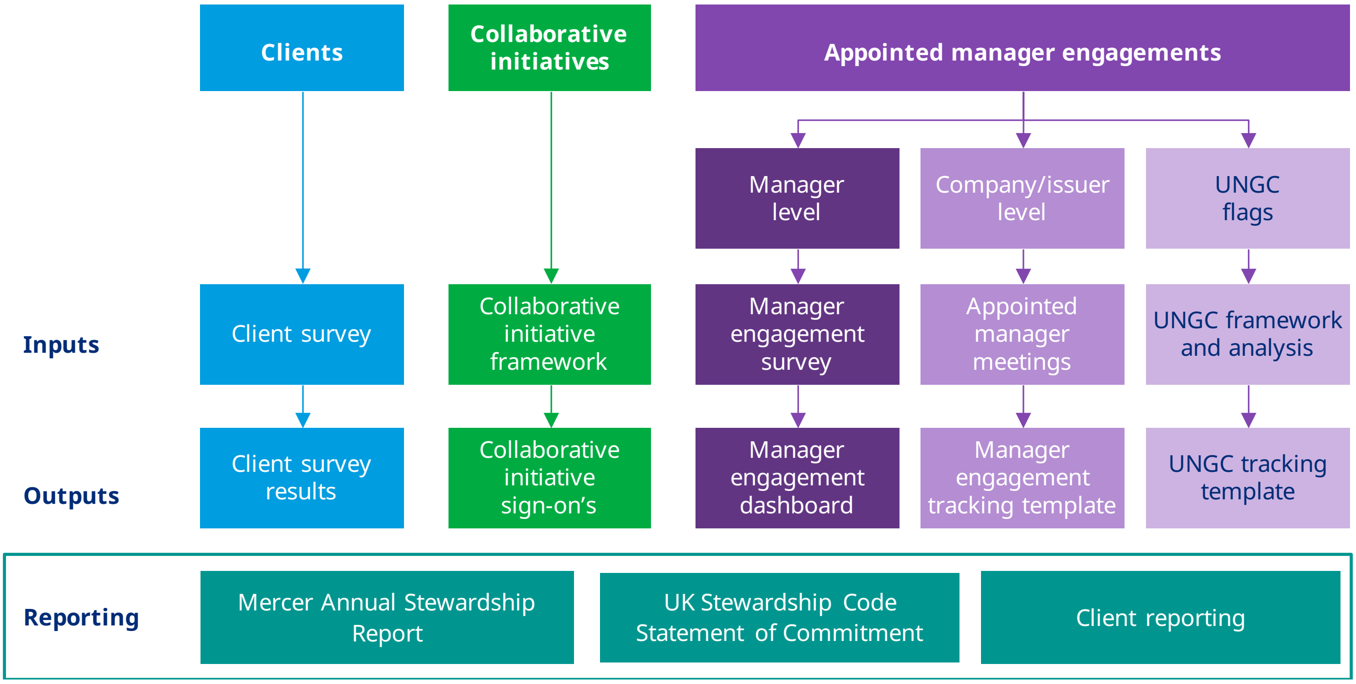


Figure 14. Approaches to engagement across clients, appointed managers and collaborative initiatives.

Clients

Regular feedback from clients on what matters most to them and their beneficiaries

Client Engagement Survey

Highlighted general alignment of client engagement priorities with that of Mercer while identifying future engagement areas for prioritisation e.g. biodiversity, pollution and natural resources, living wage, inequity, population health

Appointed managers

Manager level engagements

- Assessment of and engagement on policies, processes and portfolios to promote industry best practice while focusing on engagement priority areas
- **Manager dashboards** to prioritise engagements with managers with a particular focus on laggards
- **Manager engagement trackers** to track, monitor and facilitate escalation of goal-orientated engagements

Security specific engagements

- Monitoring and reporting on security level voting activity and engagements linked to engagement priorities

Collaborative initiatives

Supporting industry best practice

- Principles for Responsible Investment (PRI)
- Institutional Investors Group on Climate Change (IIGCC)
- Task Force on Climate-Related Financial Disclosures (TCFD)
- 30% Club - UK Chapter
- Diversity Project
- *Task Force on Nature-Related Financial Disclosures (TNFD)
- *Climate Action 100+ (CA100+)
- *UK Sustainable Investment and Finance Association (UKSIF)
- *Carbon Disclosure Project (CDP)
- *Transition Pathway Initiative (TPI)
- *Global Impact Investing Initiative (GIIN)

*Participation primarily via Mercer's Sustainable Investment team, which provides advice to Mercer Investment Solutions Europe

Prioritising Engagement Themes and Topics

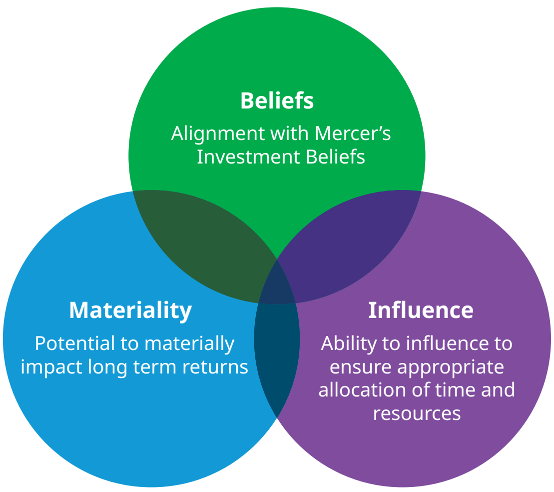
Mercer, as a fiduciary, also has a pivotal role to play in relation to more strategic themes and topics with the aim of protecting economic value, improving long-term investment outcomes, identifying and managing risks and contributing to more sustainable and stable global financial markets. Mercer has developed an Investment Engagement Framework, which serves as a tool to enable Mercer to prioritise where to focus its time and resource. This framework has helped to:

- Develop a systematic approach for agreeing portfolio-wide engagement priorities.
- Document the specific definitions and implementation procedures for approving and amending engagement priorities.
- Articulate the governance procedures for monitoring and escalating engagement priorities and implementation in regional investment portfolios.

Mercer's Investment Engagement Framework considers three main criteria – Beliefs, Materiality and Influence (BMI) and engagement priorities are expected to intersect meaningfully across all three.

Figure 15. Mercer's Investment Engagement Framework Criteria

Engagement Framework



The following key themes underpin our engagement priorities:

Figure 16. Mercer 2021 Engagement Priorities

E	S	G
Climate Change	**Human rights & labour practices**	**Diversity, Equity & Inclusion**
Climate-related financial impacts are driven by the associated transition to a low-carbon economy and the physical damages of different climate outcomes – well below 2C is both an imperative and an opportunity	Workforce and supply chain safety and human rights practices should avoid contributing to modern slavery, exploitation and other human rights abuses – these can contribute to economic instability, the threat of social tension and subsequent political instability; and negatively impact beneficiaries for economic and health reasons	Including cognitive and identity diversity in decision-making processes is expected to create better outcomes and solutions

Specific questions in relation to these themes formed part of the 2021 Manager Engagement Survey covering all equity and fixed income appointed managers. In addition managers must complete a number of additional questions in MercerInsight, which addresses themes relating to both climate change and diversity.

Mercer's Annual Manager Engagement Survey

In 2020 Mercer conducted its first annual survey with appointed managers on their engagement approach and outcomes, capturing their activities on priority themes and topics as part of their stewardship activities at a mandate level. Over 2021 these insights informed engagements between Mercer's investment team and appointed managers to promote good stewardship of investments. More specifically, it provided Mercer with a means to assess the stewardship activities of all managers on a relative basis, and to provide a means to prioritise engagements with those managers whom Mercer believes have the greatest room for improvement.

To support the long term nature of engagement, the outcomes from the engagements are documented and monitored on Mercer's Management Engagement Trackers, with a number of examples included throughout the report on engagements and the outcomes of these (see Principle 8) .

In 2021, Mercer's second Manager Engagement Survey was sent to all equity and fixed income managers managing segregated mandates on behalf of Mercer covering all relevant geographies, with responses provided at a mandate level. Responses were received from appointed managers representing assets under management 81% higher in value than last year as we expanded the survey to a global scale.

Figure 17. Survey overview

No. of Responses	No. of Unique Mandates	No. of Managers
296	209	128

No. of Funds	AUM of Funds
135	$ 174bn

Figure 18. Summary of Manager Engagement Survey Highlights

40+
Engagements with managers to further promote environmental and social characteristics across funds

380+
Climate related engagements provided by managers

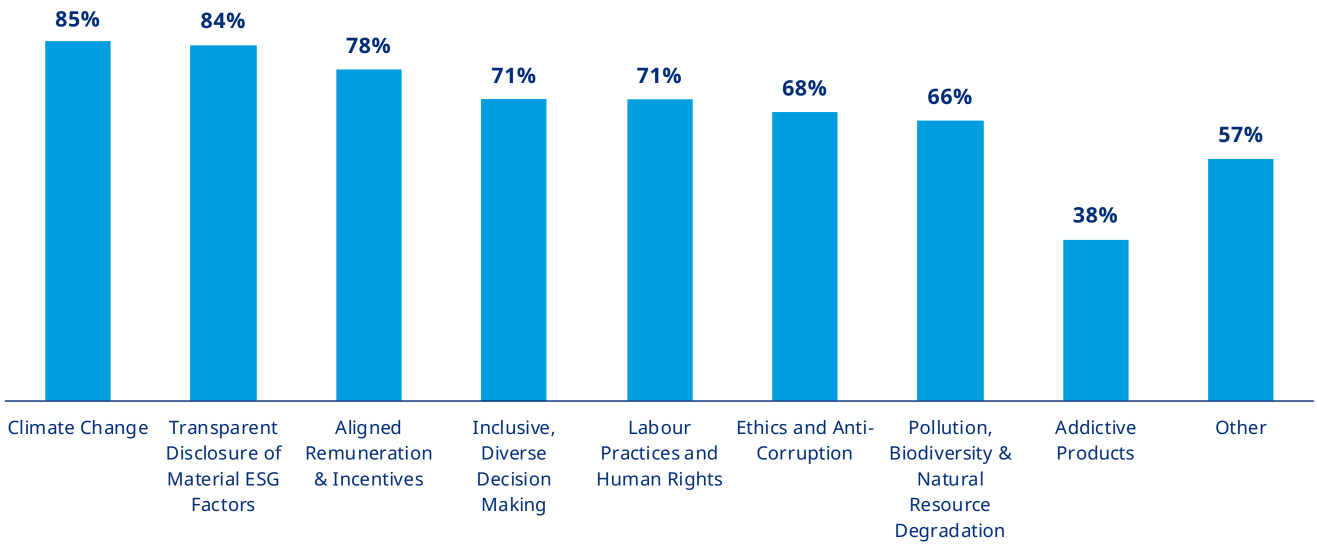
220+
Diversity related engagements provided by managers

210+
Human rights related engagements provided by managers

Mercer's 2021 Annual Stewardship Report provides a comprehensive overview on manager responses, with a few select examples included below.

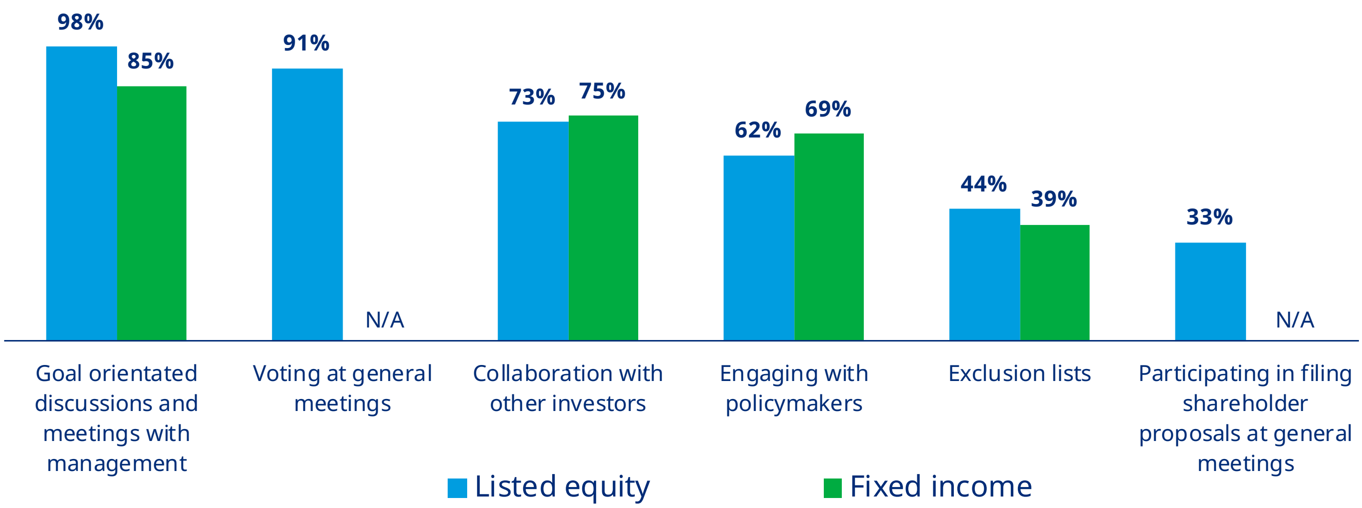
A large majority of managers highlighted alignment between their and Mercer's engagement priorities. While Transparent Disclosure of Material ESG Factors was ranked as the top priority in 2020, marginally higher than Climate Change, we have unsurprisingly seen Climate Change move to the top of the list during 2021. While these are generally common priority areas, the majority of managers do note that they will focus on those ESG issues most material to the company or issuer. Additional areas of focus relate predominantly to governance related topics and themes that are moving further up the investor agenda such as the circular economy and resource efficiency, income inequality, cybersecurity and alignment with the UN Sustainable Development Goals (UN SDGs).

Figure 19. Appointed Manager Engagement Priorities



There are some nuances in the approaches to engagement taken by managers across different asset classes, with the main difference in equities, which allow managers to exercise voting rights attached to investments, which is not available to fixed income managers. Across both asset classes goal-orientated engagements form the bulk of engagements, followed by collaborating with other investors and engaging with policy makers, with the latter unsurprisingly having a slightly higher focus with fixed income investors. The results further highlight an alignment with Mercer's preference for engagement over divestment, highlighted by a lower preference being given to the use of exclusion lists.

Figure 20. Appointed Manager Engagement Implementation



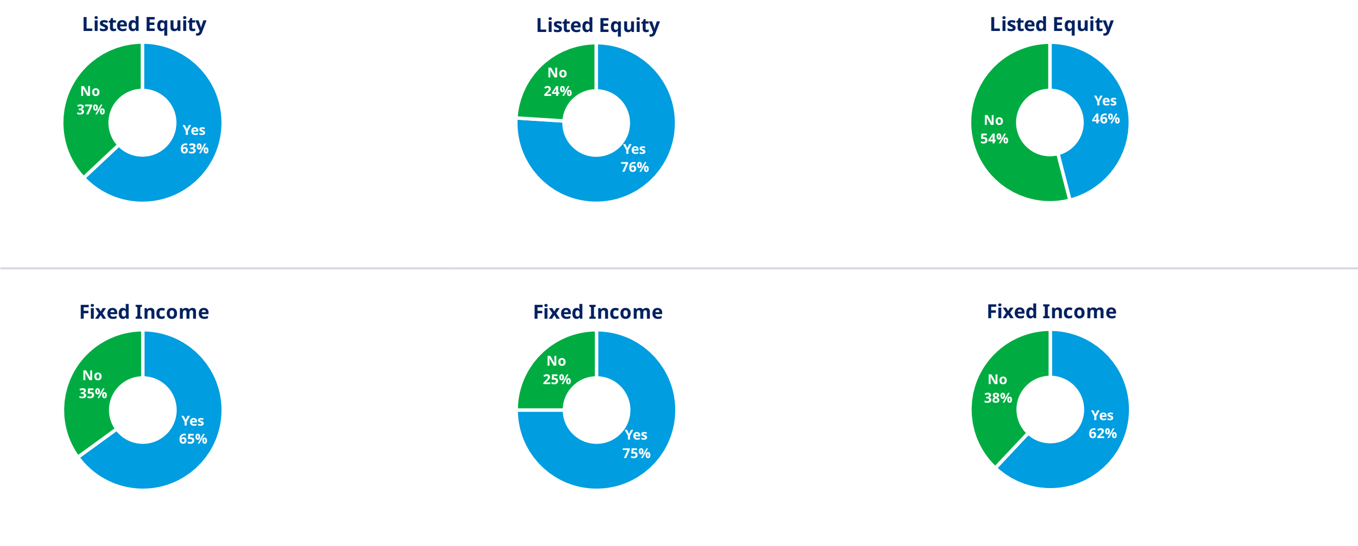
Over three quarters of managers support the Task Force on Climate-related Financial Disclosures (TCFD), with nearly two thirds already reporting in line with the TCFD recommendations across both equities and fixed income, with the remaining supporters currently not reporting, stating the likelihood of them preparing such disclosures in the near future. This is in contrast to last year's results, where less than half of managers reported in line with the recommendations, highlighting greater commitment across the industry to improving disclosure.

We were also pleased to see that over three quarters of the strategies employed in the Mercer Funds have set climate transition targets, or intend to in the next 1 to 2 years. Mercer will specifically engage with those manager's in its multi-client funds who have stated no intention, to understand the rationale for this, with a view to encourage target setting, where possible.

Transition risks have largely dominated the climate agenda thus far given its immediate impact, relative to physical risks, which while already evident, are likely to have a more pronounced impact in the long term. Investors need to consider not only the financial implication of climate risks but also the physical impacts of potential climate change scenarios. We are pleased to see that the majority of managers currently do consider physical damages, or intend to in the next 1 to 2 years. We will specifically engage with those managers in the multi-client funds who have stated no intention, to understand the rationale for this, with a view to encourage physical climate risk assessments, where possible.

Table 12. Climate Change

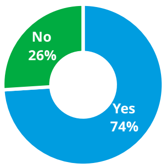
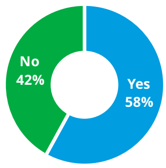
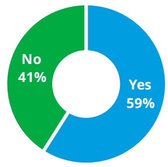
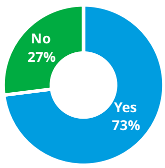
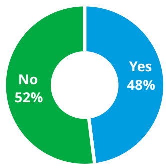
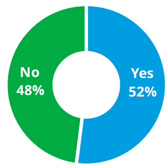
Managers reporting in line with TCFD	Managers who have, or plan to, set climate transition targets	Managers undertaking physical risk assessments



We encourage managers to formalise their approach via documented policies and procedural risk assessments within investment portfolios, to identify high-risk companies and evidence the actions they have taken to try to resolve the issue identified, with over 70% of managers across both equities and fixed income having policy commitments in place.

While the majority of managers have a policy in place to address human rights and labour practices risks, it was a common theme across a number of managers to consider these risks as part of the pre-investment due diligence process, which if evident, resulted in manager's not including the holding in their investment universe. This has likely contributed to a lower level of human rights or labour practices risk assessments across holdings, as well as fewer engagements than can be seen across themes relating to climate and diversity, equity and inclusion.

Table 13. Human Rights and Labour Practices

Mandates with policy-level commitments to assess and address human rights and labour practices	Mandates which assess human rights or labour risks	Mandates which engage on human rights or labour related topics
Listed Equity 	**Listed Equity** 	**Listed Equity** 
Fixed Income 	**Fixed Income** 	**Fixed Income** 

More than two thirds of both equity and fixed income managers have set diversity expectations for management and board members of investee companies and issuers including metrics and targets.

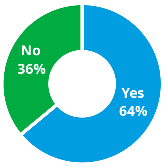
Managers have provided over 220 engagement examples on the topic of diversity, equity and inclusion, with many engagements targeting traditionally non-diverse sectors, such as mining and financial services. Pay equity has also been a key focus for many managers, with about a third of managers supportive of industry initiatives such as the 30% Club or 40:40 Vision. Managers sought greater disclosure and policy implementation on the topic over 2021, with some incrementally increasing their minimum expectations and actively voting against management where these were not met.

We are pleased to see other diversity imbalances outside of gender addressed by managers through active engagements, although we acknowledge that given current data availability, gender is most easily tracked and managed, and therefore the most common theme observed in the engagement examples provided.

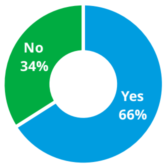
Table 14. Diversity, Equity and Inclusion

Mandates which have set diversity expectations for management and board members of investee companies	Mandates whose diversity expectations include metrics and targets	Mandates which engage on Diversity, Equity and Inclusion related topics

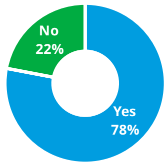
Listed Equity



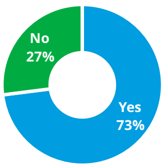
Listed Equity



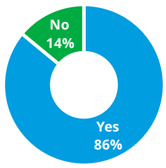
Listed Equity



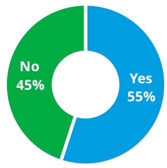
Fixed Income



Fixed Income



Fixed Income



Listed equity appointed managers engaging on our client's behalf

	Engagement Example Climate Change	Engagement Example Human Rights & Labour Practices	Engagement Example Diversity, Equity & Inclusion
Sector	Downstream oil sector	Technology	Multiple
Issue	Company was not disclosing any carbon metrics or providing any indication of their ESG initiatives	Potential infringements on labour rights laws	Identified a sub-set of 50 portfolio holdings with male-only board members.
Action	Manager wrote a letter to the company as part of the CDP's Non-Disclosure Campaign Project encouraging them to disclose in line with the CDP questionnaire.	Manager held face-to-face and video meetings with management to understand the issues and legal situation further.	Manager wrote multiple letters to the boards on the matter over a number of years.
Outcome	Company has agreed to start disclosing in line with CDP and manager will continue to monitor progress and engage.	Manager is satisfied that the company followed relevant laws. They acknowledge that the issues are complex and will continue the engagement.	Subsequently, more than 30 of those identified companies have since appointed a woman director.

UNGC Engagement Framework

Mercer screens and monitors listed portfolios for high-severity ESG-related risks as flagged according to the UNGC principles that relate to human rights, labour, environment and corruption issues, as identified by our appointed external ESG research provider. In response to identified incidents, we will engage with the managers owning those companies and seek their views on the risk, return and reputation implications as well as engagement insights on the issue. It is a key source of potential escalation with appointed managers if we do not see sufficient progress on the outcomes of engagements managers are having with companies and issuers.

Our UNGC Engagement Framework, which includes our approach to monitoring, engagement and escalation, is detailed below. This framework is currently applied to the majority of equity and fixed income funds.

UNGC engagement framework Prioritising High Severity ESG-related risks

- Our appointed external ESG research provider identifies companies for high-severity incidents under the UNGC principles, which is shared with appointed investment managers to assist in their monitoring.
- Engagements with managers holding companies with high-severity incidents are prioritised based on the duration of incident and holding period of manager.

Engaging with Managers

- Where a manager is identified as having exposure to a prioritised company with a high severity incident, the manager is expected to communicate at least annually where they are undertaking engagement with prioritised holdings and progress being made, which is tracked internally.
- In addition, managers have the opportunity to provide detail on their approach to monitoring UNGC-related incidents, including examples of any engagements and outcomes, in the annual Manager Engagement Survey.

Oversight and Escalation

- An escalation process, which may result in exclusion, will respond to instances where:
  - Triggers are met on duration, where a high severity incident has been open for a predefined period without a company demonstrating sufficient remediation and where the manager has held the company for that same predefined period, without a company demonstrating sufficient remediation in response to manager engagement.
  - Manager(s) views on the associated financial and reputational risk are high and likelihood for remediation are low.
  - The issue is pervasive to the entire company, as opposed to a single incident or an issue related to one part of the company.
  - The potential risk/return impacts of exclusion if implemented are low – although exclusion for higher materiality companies is possible for persistent remediation failures

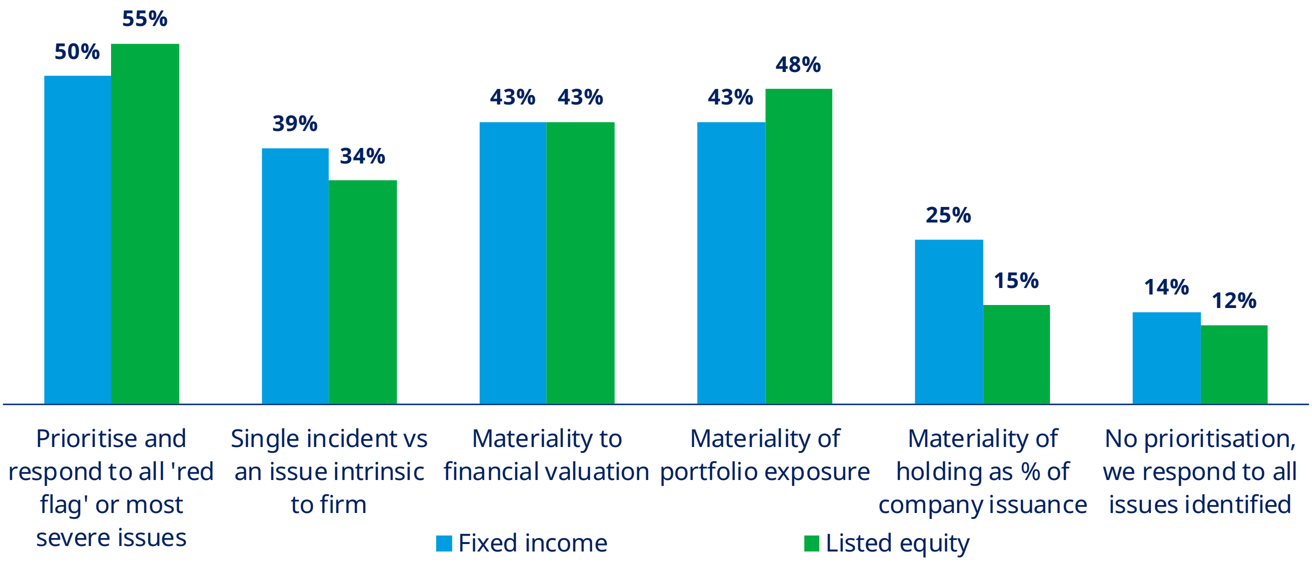
An internal approval committee reviews proposals and if an exclusion decision is taken, the company will be moved from the UNGC list to the exclusion list.

Case study

UN Global Compact monitoring and engagement

We have recently enhanced our UNGC engagement and escalation framework to enable greater oversight and accountability by monitoring factors relating to the severity and duration of the identified breach, investment holding period, materiality of holding and outcomes of engagement. In response to identified breaches, we engage with managers and seek their views on the risk, return and reputation implications on the holding, as well as engagement insights on the issue. This framework further assists in assessing whether investments follow good governance practices as required under the Sustainable Finance Disclosure Regulations (SFDR).

Figure 21. Appointed manager prioritisation of UNGC engagements



While approximately 80% of managers monitor UNGC principles, just over 60% of managers explicitly reference these within their policies. Mercer has specifically communicated its expectations of managers within its multi-client funds to monitor and engage with any holdings flagged to be in breach of UNGC principles, and to have clear escalation policies in place.

Engaging Directly with Companies

Mercer may also engage directly with companies directly but this is rare as we believe our appointed managers are best placed to engage directly with companies, given they are expected to have detailed knowledge of both the governance and the operations of the companies they invest in along with established relationships with management and are therefore best placed to have more impactful engagements for the benefit of both Mercer clients, as well as across other client portfolios which may have exposure to the same issuer. Through our monitoring activities, we will however, monitor the engagements appointed managers are having with companies and issuers and similarly flag any issuers we may have concerns with. There were no direct engagements with companies over 2021.

Principle 10

Principle 10

Signatories, where necessary, participate in collaborative engagement to influence issuers.

Highlights, Outcomes and Focus for Next 12 Months

Most of Mercer's collaborative engagement efforts undertaken in our name are focused on improving the long-term sustainability of capital markets. Therefore collaborative work through various initiatives focused on industry and market-wide improvements across climate change, stewardship and diversity & inclusion (see Principle 4 for more detail) featured more prominently than activities aimed at individual issuers. With the insights from our Manager Engagement Survey we have better visibility of the collaborative engagement initiatives managers contribute to on our clients' behalf. Over 2021, we focused on better capturing the level of participation of managers in these initiatives, leading to engagement focused on encouraging managers to consider supporting these initiatives where participation was lacking. We expanded our own collaborative initiative activities by joining the UK investors' chapter of the 30% Club and are working towards becoming a signatory to the Net Zero Asset Managers initiative.

In 2022 Mercer will be re-visiting which collaborative initiatives to spend our time and resources on that are aligned with our engagement priorities, including those primarily responsible for relationships and contributions. We expect this to lead to more effective and targeted contributions to collaborative initiatives and their stated objectives. We also plan to evolve the Manager Engagement Survey to more fully capture the outcomes from collaborative initiatives undertaken by appointed managers and continue to work with those appointed managers that are undertaking limited collaborative engagement activity.

Mercer's Approach to Collaborative Engagement

Mercer believes that appropriate investor collaboration is the most effective manner in which to engage, particularly at times of significant corporate or wider economic concerns.

Globally, Mercer is party to a number of collaborative investor initiatives focused on improving the long-term sustainability of capital markets. We participate in collaborative engagements where:

- The topic has been deemed important after being assessed through the Engagement Priorities Framework.
- The objective of the engagement would be better achieved through involvement in local and global initiatives that facilitate collaborative engagement where these mechanisms have a more significant potential to influence outcomes.
- The engagement co-ordinator is one or more reputable membership organisations, typically where a Mercer entity is already a member, and is therefore more likely to demonstrate credibility and positive reputation associations for Mercer and its clients.

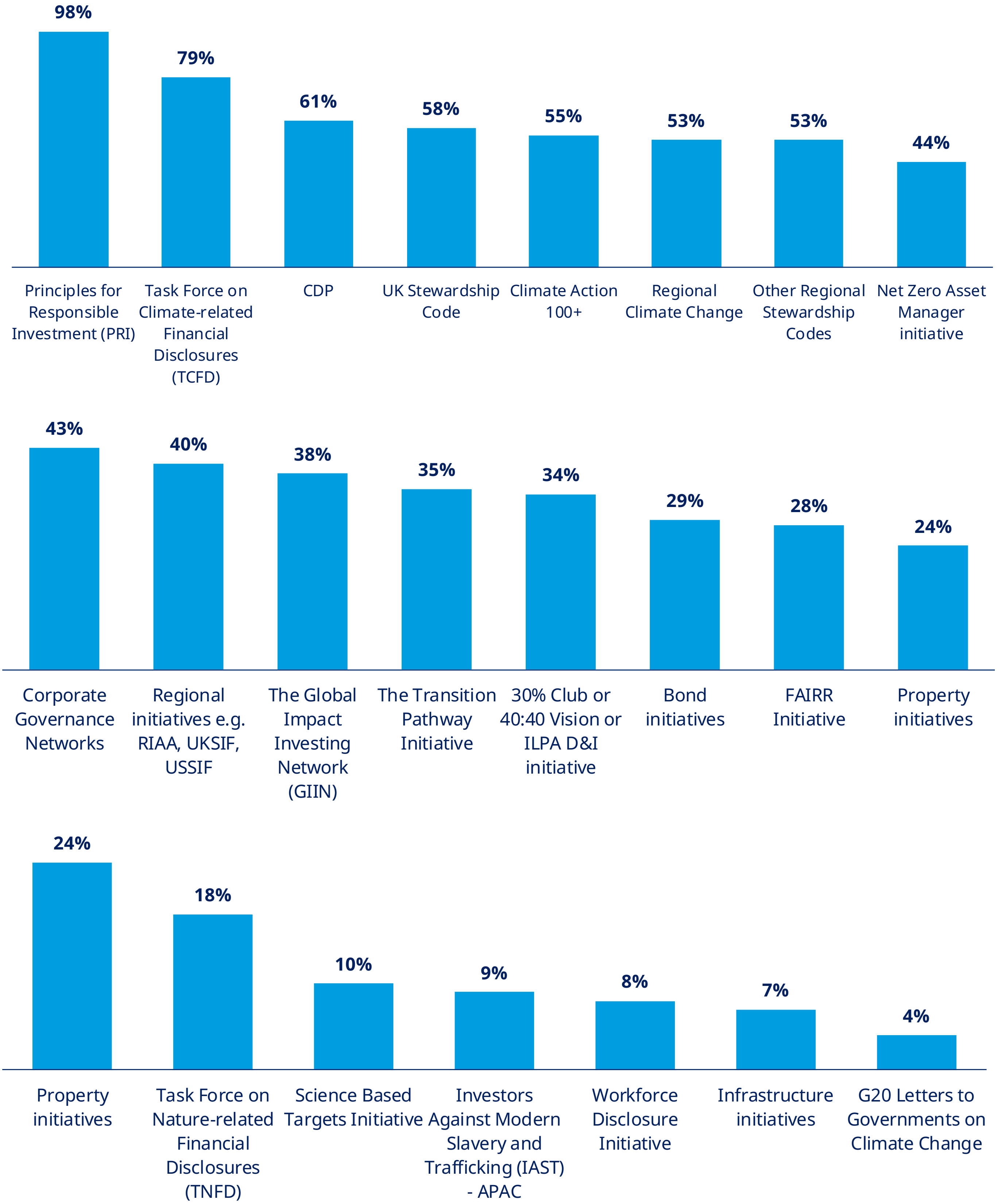
Over 2021 Mercer collaborated with industry groups across a number of issues. Those collaborations and their outcomes which focused on market-wide sustainability efforts and risk management, for example climate change, diversity & inclusion and stewardship, are covered in Principle 4 and figure 13 in Principle 9.

Appointed Managers Undertaking Collaborative Engagement

Mercer does not typically directly select securities and as such did not undertake any company-focused collaborative engagements over 2021. Rather, Mercer supports its clients in monitoring the stewardship and engagement activities of appointed managers, including the assessment of their capabilities with respect to collaborative engagement. This is captured in our ESG ratings and as part of the annual review of managers' stewardships activities. See Principles 7 and 9 for more information.

Mercer reviews the extent to which it's appointed managers are open to and actively participate in investor initiatives with respect to stewardship. Mercer's global research database, MercerInsight, also captures investment manager participation in collaborative investor initiatives on ESG and stewardship. The Manager Engagement Survey, now in its second year, sought relevant examples of participation in collaborative activity. The table below highlights the percentage of mandates managed by listed equity and fixed income managers where managers support industry initiatives through their membership or signatory status.

Figure 22. Membership of networks, initiatives or associations that facilitate collaborative engagement



Case Studies

Appointed Managers Collaborative Engagements

Listed Equity – Multinational Bank

An NGO proposed a shareholder resolution which called for the multinational bank to phase out fossil fuels on a sector-based approach. The company's board had itself proposed its own climate resolution, which it believed to be better suited and more aligned to net zero than the NGO's proposed resolution. The appointed manager engaged with both the company and the NGO to encourage them to reach agreement on a single climate resolution, which would be recommended by the company's board. The manager met with a number of members of the company's board (including the chair, chief executive and head of sustainability) in a collective meeting arranged by The Investor Forum. The manager then met separately with the NGO. The manager made it clear in both meetings that it did not see a large gap between the two resolutions, and that it would be better for shareholders if a single resolution could be negotiated. The NGO and board subsequently agreed to a single resolution, with the company also agreeing to put its climate transition plans to a shareholder vote in future. The resolution included the company committing to net zero by 2050, phasing out the financing of coal power by 2030 in the EU, and 2040 in other markets, as well as regular reporting on its progress. The resolution passed with over 99% of shareholders voting in favour.

Fixed Income – Climate Change

In early 2021, under the theme of Climate Action, the manager concluded engagements it had been having over the past 3 years, both on an individual and collaborative basis, with 12 companies in the electric utilities, oil and gas, chemical and industrial sector. Of these, two companies were engaged with via the collaborative engagement platform Climate Action 100+, where the manager acted as lead investor in the engagements. Overall, the manager believes that they, along with other investors through the collaborative platform, were successful in their engagements with 50% of the companies, as evidenced by enhanced disclosures, implementation of governance frameworks on climate related issues, actions to reduce greenhouse gas emissions and climate risk management.

While the engagements came to an end under the Climate Action theme, the manager continued to lead the collaborative engagements with the two companies under Climate Action 100+ as part of a new theme – Net-zero carbon emissions – and collaborated actively on four others. Over 2021, positive progress was observed across over 30% of companies engaged, including one of the companies where the manager acted as lead.

Throughout 2021, the manager continued to engage with the company with a focus on setting long-term targets for its scope 3 emissions from natural gas sales to customers and on a decarbonisation strategy for its natural gas activities. Towards the end of 2021, the company publically committed to fully decarbonising by 2040, bringing forward its previous net zero target by a decade. To meet this target, the company has committed to generate and sell energy exclusively from renewable sources.

While we acknowledge the time and commitment involved in signing up to and actively contributing to these initiatives is varied, and some, particularly smaller boutique managers, may not have the resources to commit to a large number, we will prioritise engaging with those managers where we believe greater involvement and commitment can be expected. For example, the 2% of managers not signatories to the UN supported Principles for Responsible Investment was identified as a key focus area of engagement, as well as TCFD. We believe our engagements with managers, and signalling the importance and our expectation of ESG integration, is key to driving improvement in the industry, and we have already seen in early 2022, one of the managers signing the PRI. With respect to the UK Stewardship Code, we are actively engaging with those managers in our multi-client funds who are not signatories, encouraging them to consider supporting the code, as a commitment to supporting stewardship best practice and collaboration.

Principle 11

Principle 11

Signatories, where necessary, escalate stewardship activities to influence issuers.

Highlights, Outcomes and Focus for Next 12 Months

Findings from our Manager Engagement Survey indicate appointed managers are escalating engagement, for example, through voting 'Against' management, divesting or engaging collaboratively with other investors. We made a number of enhancements in time for the second year of this survey in order to better understand appointed managers' escalation approaches. This included an explicit question around next steps when engagements were failing. It provided valuable insights for us to assess alignment with our own best thinking on escalation versus divestment. We were pleased to see that managers are aligned with Mercer's overarching principle of preferring an integration and engagement-based approach as opposed to divestment, however noting that where engagements have been stalling or failing, divestment was one of the most common escalation approaches, and more so across fixed income where opportunities to engage may be more limited. We will continue to gather insights into escalation approaches going forward, given this was the first year we included this question. As we build up year-on-year monitoring, we will be able to better track the escalation approaches of appointed managers and their effectiveness.

Mercer's Stewardship Assessment Framework considers the extent to which each appointed manager complies with each underlying Principle of the Code, as detailed under Principle 6. As we begin to assess managers against this revised framework, we will be able to improve our assessment of managers' approach to escalation.

Over the next 12 months we plan to evolve the Manager Engagement Survey to more fully capture the outcomes from escalation activity undertaken by appointed managers. We will use the Manager Engagement Dashboard to monitor escalation commitments over time and to hold appointed managers to account. We will continue to engage with appointed managers that are undertaking limited escalation activity.

Appointed Managers Escalating Engagements

Mercer expects its appointed managers to adopt clear guidelines on escalation processes and to report on these activities and outcomes. Mercer supports its clients in monitoring the stewardship and engagement activities of appointed managers, including the assessment of external investment managers' capabilities with respect to the escalation of engagement activities. Our stewardship monitoring actively seeks out examples where voting decisions — for example, against management — and other activities such as divestment have been a deliberate escalation following initial engagement. Equity and fixed income appointed managers will be assessed on their approach to escalation and how this links to the investment process and voting as part of the annual stewardship review exercise to be undertaken in 2022. The findings will be used to engage with appointed managers on their approach to escalation and areas for improvement.

Case studies

Escalation leading to divestment

The manager engaged with the company on the potential stranded asset risks related to the company's gas transmission business as a consequence of the transition to net zero. The manager further discussed governance principles related to the company's strategy for the gas transmission business and for acquisition activity. The company's response has been to seek to grow the business by acquisition while largely ignoring the emerging hydrogen opportunities, which, according to the manager, raised the risks associated with the company.

The manager raised these issues with the CFO in the first instance, then escalated the discussion to the CEO and given responses were unsatisfactory, escalated the discussion to the chairman of the board. These escalations were however unsuccessful, with the company disagreeing with the manager's assessment of the risks both associated with asset stranding and their broader acquisition strategy. As a result the manager divested its holding in the company.

EM Core Fundamental Equity Fund – Mining company

In early 2021, a fuel tank owned by one of the company's subsidiaries, leaked and spilled about approximately 150,000 barrels of diesel fuel. In addition, the company had reported two additional environmental and health & safety incidents over the course of 2020-21. The manager had being engaging with the company for three years based on another breach of a UNGC environmental principle related to excessive sulphur emissions, however in 2018, the company provided sufficient evidence that the violation had been lifted.

The combination of the oil spill and additional two incidents, triggered the manager's concern with regards to a general lack of oversight and lapses in risk management in the wider parent company. In view of the engagement history over the past few years, the manager chose in June 2020 to have a focused engagement period of one year, with strict objectives and expectations of significant progress. Following this period, the manager concluded that the environmental breaches at the company were systemic in nature and in breach of UNGC principles and regarded a continuation of engagement with the company not useful. They subsequently added the company to their exclusion list.

Eurozone Equity Fund – Interactive entertainment and gaming corporation

The manager engaged with the lead independent director at the company following allegations of workplace discrimination and sexual harassment. This was a follow-up discussion to the engagement letter that was sent to the Board earlier in 2021, where the manager had outlined five key expectations for improvement. The lead independent director acknowledged that there was a crisis of employee confidence but believed that the company had adequate policies in place to retain key creative talent and also affirmed that for now the Board had full confidence in the CEO's willingness to fix the problem. The manager viewed this as a substantial risk to the company that could lead to losing key creative talent, which would impair its ability to effectively operate, given the company's reliance on key creative talent as an interactive entertainment and gaming corporation. This led to the manager lowering their proprietary ESG Quality Level rating, which led to a divestment of the holding as a result of the deteriorating ESG profile of the company.

Case studies

Escalation through voting activities

Managers have provided numerous examples where failed engagements have been escalated to votes against management. A few examples, highlighting circumstances surrounding these, with specific reference to Mercer's Engagement Priorities include:

Diversity

The manager abstained from voting on the proposed re-election of board members given it would not improve the independence or diversity of the Board, which the manager expects to be >50% and >30% respectively. The manager further communicated their intention to management and have stated that if the resolution comes up again next year, with no proposed improvements to diversity or independence that they will vote against the resolutions.

In addition to this, numerous examples have also been shared where managers have voted against the election of certain directors given a lack of diversity on boards. In most cases these are related to gender diversity, with managers calling for at least one female board member and or > 20% female representation, with a growing focus on increasing representation of ethnic minorities as well.

There are also circumstances where managers may first abstain from supporting certain resolutions which do not improve board diversity and then engage with managers, to signal dissatisfaction and provide management with the opportunity to address the issues, which if not addressed over a satisfactory period, will then lead to escalation in the form of a vote against management.

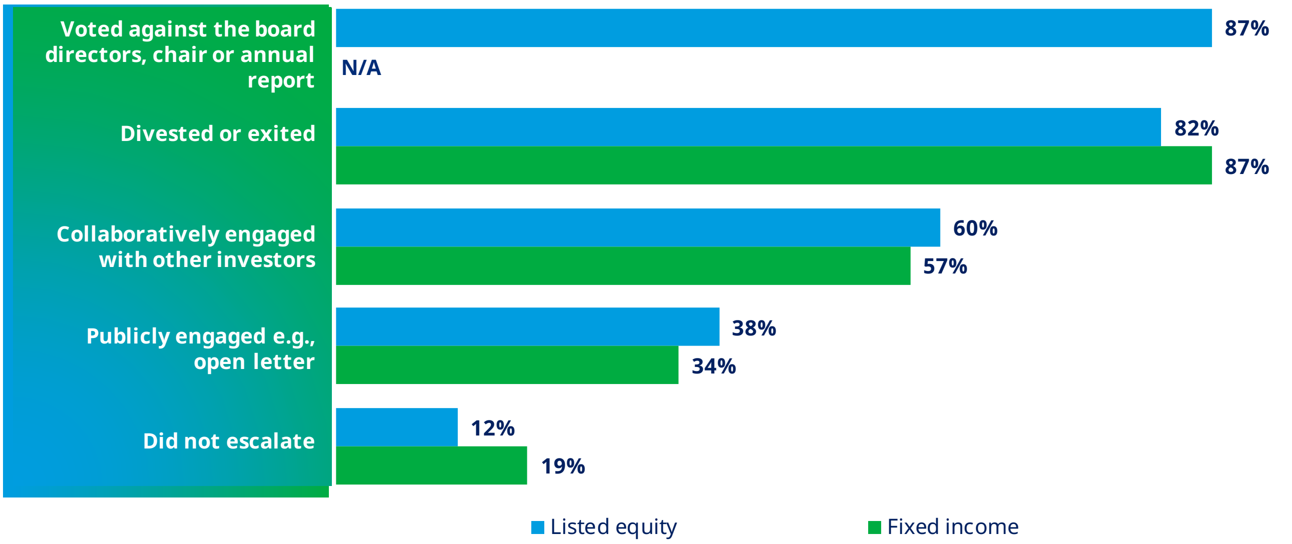
Climate Change

The manager voted against management and in favour of two shareholder proposals that requested the company to adopt GHG reduction targets, covering both emissions from operations and energy products and report on how its lobbying activities align with the Paris Agreement. Following this, the manager escalated its engagement with the company by seeking to discuss the proposals and explain its rationale for voting in favour of both given its view that adopting GHG targets and enhancing disclosure around climate-related lobbying activities would bring the company better in line with peers, the TCFD recommendations and the manager's expectations. A few months later the company announced targets to reduce Scope 1, 2 and 3 emissions and further published its Sustainability Report with details on its decarbonisation strategy, climate strategy, which included expanding low-carbon solutions, and enhanced disclosure in line with TCFD along with a Lobbying Activities report. The manager continues to engage to improve disclosure and support the company in enhancing its climate strategy.

We believe that having updates on prior engagement examples is key to effectively monitoring when, how and why an appointed manager has escalated a particular engagement, including when participating collaboratively with other investors.

Manager Engagement Survey: managers are escalating engagement when voting against management recommendations

The table below summarises managers' next steps where engagements have been stalling or failing.



Over 2021 we enhanced our ability to track manager escalation efforts. The Manager Engagement Survey specifically asks for engagement across our engagement priority areas. Managers are required to provide detail on goal-orientated engagements and comment on the outcome of engagements. As part of engagements with managers, we will consider examples of engagements where escalation and additional engagements are required given issues have not been sufficiently resolved and follow-up with managers on these.

Principle 12

Principle 12

Signatories actively exercise their rights and responsibilities.

Highlights, Outcomes and Focus for Next 12 Months

Our focus over 2021 has been to evolve our voting reports, first introduced in 2020, to assess listed equity appointed managers more closely. Amongst various enhancements over 2021 we have sought to more clearly capture and report the rationale for significant votes and the outcomes from resolutions.

Looking ahead to the rest of 2022 we are making further enhancements to the oversight and monitoring of manager voting activity, with a particular focus on better capturing voting outcomes and encouraging transparent voting disclosure by all equity managers where possible, particularly those not signatories to the UK Stewardship Code. We will also focus on more clearly engaging with managers on how they have voted on significant votes, and are exploring how to proactively approach significant votes before they occur.

We've strengthened our approach over the last 12 months and will continue to build on the momentum generated by our ESG ratings, climate analysis and Manager Engagement Survey results across our equity, fixed income and multi asset funds. Over the next 12-24 months Mercer will be progressively assessing appointed managers in these asset classes against the revised Stewardship Assessment Framework (see principle 6). Engaging with managers on the findings will be a key focus. The 2021 roll out was delayed but will benefit from a growing number of managers publicly reporting in line with the UK Stewardship Code itself.

Stewardship Expectations of Appointed Managers

Mercer regards investment governance and active ownership of particular importance in serving the interests of our investors and adopts a stewardship program that includes a range of voting and engagement activities. Appointed managers are expected to report in line with established best practice, including aligning their reporting with the requirements of the UK Stewardship Code and the EU Shareholder Rights Directive, where possible. In order to meet our clients' needs Mercer expects appointed managers of the multi-client Mercer Funds to fulfil their responsibilities where relevant under four components:

Share Voting

All shares are to be voted by appointed equity managers in a manner deemed most likely to protect and enhance the long-term value of a security as an asset to the portfolio. Mercer has delegated share voting to its appointed equity managers, and expects them to vote all shares at all companies for all company resolutions, unless there is a qualification or exception.

Engagement

Mercer expects managers appointed to Mercer Funds to adopt clear guidelines on their engagement activities and escalation processes and to report on these activities and outcomes. See Principles 9-11 for more information on engagement activities.

Disclosure

Voting and engagement activities of managers appointed by Mercer are to be reviewed regularly, including voting records and statistics, along with engagement examples, reported on at least annually in-line with required reporting guidelines including for example those required by the UK Stewardship Code and the EU Shareholder Rights Directive II.

Public Policy Participation

Engagement may be undertaken with regulators, and sometimes governments, to recommend changes or express views on proposed changes to regulatory regimes where this is deemed important to protect the rights and enhance the interests of shareholders.

Voting Policy

Mercer's voting policy is summarised below.

Share Voting

Mercer regards voting its shares as important to our fiduciary responsibility.

As part of its investment model, proxy voting responsibility is given to listed equity investment managers with an expectation that all shares are to be voted in a manner deemed most likely to protect and enhance long term value. Mercer carefully evaluates each appointed manager's capability in ESG engagement and proxy voting, as part of the manager selection process, to ensure it is representing Mercer's commitment to good governance, integration of sustainability considerations and long-term value creation

Mercer expects its investment managers to establish their own voting policy that sets out the principles and guidelines under which rights to vote are exercised. Mercer engages the services of proxy advisor CGI Glass Lewis to facilitate the collation and reporting of proxy voting data. Mercer's proxy voting records are available online via the Proxy Voting Search site, where you can search by region and company over the prior six months.

Disclosure of significant votes

We have based our definition of significant votes for reporting in line with the requirements of SRD II on our Global Engagement Priorities, supported by our Beliefs, Materiality and Impact (BMI) Framework. Significant votes focus on shareholder resolutions relating to priority engagement themes, while taking into account the size of holding across funds and controversial proposals.

Managers also provide disclosure on votes they deem to be significant, based on their definition, via the annual Manager Engagement Survey.

Strengthening our approach to significant votes

To strengthen our approach in this area we are exploring changing our appointed equity manager investment guidelines to request:

- That all votes for board directors are aligned with the aim of having a minimum of 30% female representation on corporate boards
- Appointed managers challenge the re-election of boards that have shown persistent inaction on climate change and/or climate-related disclosures and vote against the (re-)appointment of directors that are not supportive towards aligning their business with the climate transition

Voting Exceptions

Mercer's objective is for its appointed managers to vote on all shares in which the Mercer Funds invest, with the following qualifications and exceptions:

- Conflicts of interest: Mercer assesses whether appointed managers have policies and procedures that manage conflicts in relation to stewardship. Appointed managers are required to report on any conflicts of interest and demonstrate that they have adhered to their conflicts of interest policy and reported any breaches. See Principle 3 for more information on conflicts of interest.
- Power of attorney (PoA) markets: There are some international markets where voting may only be carried out by an individual actually attending the meeting in person. The rules on PoA vary by market, apply for different periods of time and have various cost implications. Mercer expects appointed managers to have PoAs in place for larger markets but accepts that a cost/benefit view can be taken on smaller markets that employ this structure, meaning that there may be some smaller markets where shares may not be voted.
- Share-blocking markets: There are some markets that place regulatory barriers to voting, usually in the form of limitations on trading of shares if a vote is enacted. Our expectation is that managers will vote in these markets but we accept that, on occasion, appointed managers may not cast all votes.
- Securities Lending: Mercer operates a Securities Lending Program for the benefit of investors. Securities lending is when securities are loaned to third parties in order to earn additional investment returns. Mercer's securities lending program is managed and implemented by an external Securities Lending Agent (SLA). The SLA has established processes to recall shares on loan for voting purposes ahead of an AGM and we expect that this will not affect our objective to vote on all shares.
- Securities Lending Collateral: Mercer's stock lending program is a fully collateralised program, managed and implemented by an external SLA. Mercer's custodian or a sub-custodian holds collateral posted by borrowers in a segregated account. Mercer would not expect to ever take receipt of these securities, or vote on them. Collateral is therefore not governed by Mercer's Stewardship Policy.

Monitoring shares and voting rights

The primary mechanism for monitoring whether listed equity appointed managers have exercised their shares and voting rights on our behalf is through the preparation of quarterly voting summaries for all listed equity funds for the benefit of assisting clients in the preparation of their implementation statements. Aggregated results are further provided in the annual Stewardship Report. Mercer's proxy monitoring leverages reporting and disclosures from Glass Lewis, enhancing oversight of appointed managers' approach to exercising voting rights (see Principle 2) and underpins the quarterly voting summaries which includes information on how managers have voted, whether for or against management, abstentions and where votes were not actioned. We receive voting data via Glass Lewis – who sources it directly from the custodians – providing an independent source of voting activities.

This supports our efforts to monitor whether managers are exercising their voting rights to the fullest extent possible and providing insights where voting is not possible or practical.

2021 Proxy Voting Highlights

Mercer undertakes an annual assessment of the listed equity managers' approaches to stewardship as described in further detail under Principle 6. Our focus over 2021 has been to more clearly capture the rationale and outcomes from resolutions and identify any split voting activity across significant votes. For Mercer this has meant evaluating trends in voting activity across various themes, with a particular focus on how appointed managers have voted on shareholder proposals relating to Mercer Engagement Priority areas. Below we provide 2021 Proxy voting highlights aggregated across all segregated mandates, with voting rights attached, which are managed on behalf of Mercer by its managers. Fund specific statistics are available to investors in multi-client and bespoke funds on request.

Table 15. Summary statistics across all segregated equity funds

Total Proposals Available	% Proposals Voted On
59,109	99.3%
Total unique meetings voted at	**Total countries voted across**
12,967	76

Only a small percentage of votes where not actioned, which largely relate to circumstances where managers have explicitly opted to not vote at a meeting due to share-blocking or power of attorney markets, or where conflicts of interest may be present.

Figure 23. Summary of voting activity across both management and shareholder proposals

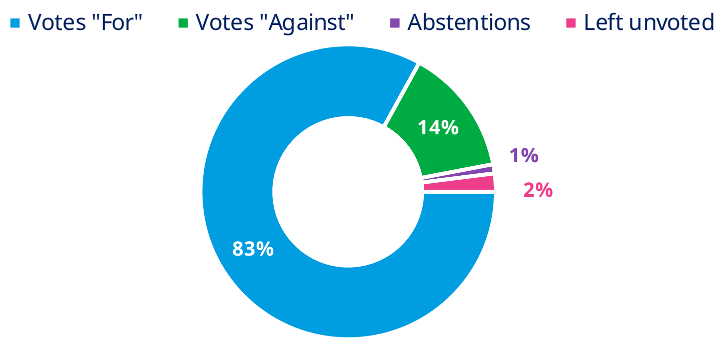


Figure 24. Summary of voting activity relating to management proposals

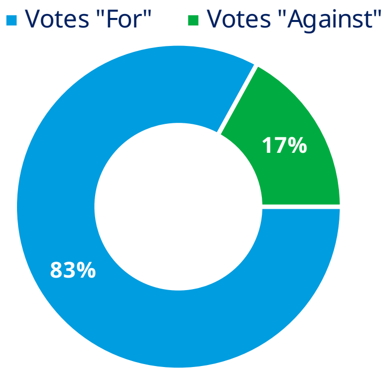


Figure 25. Regional breakdown of meetings

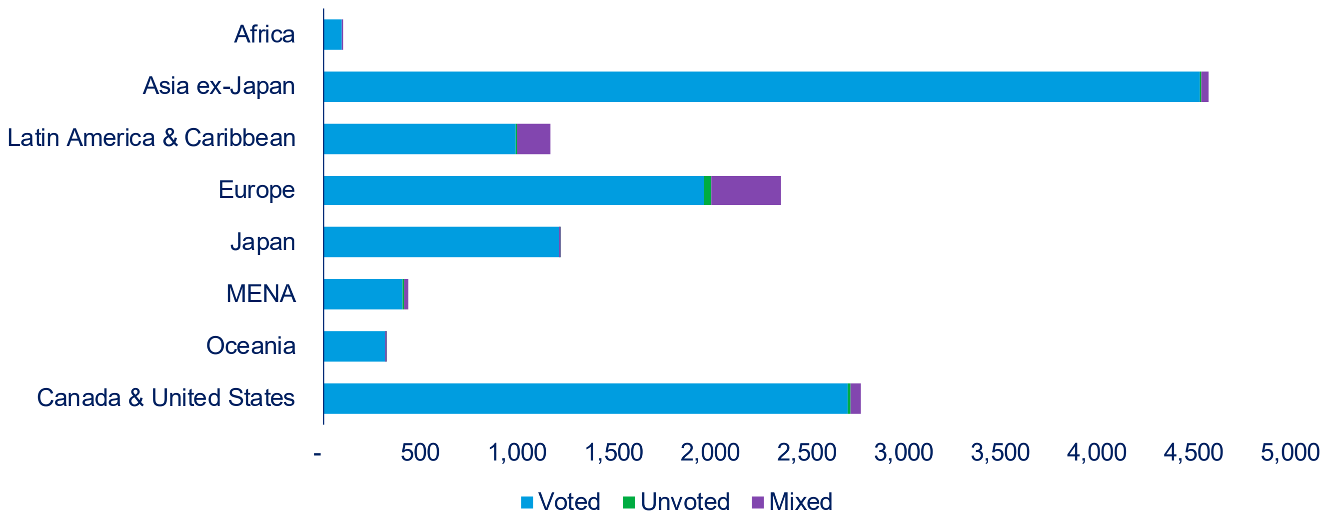


Figure 26. Proposals by topic

Board related proposals represent over half of all proposals voted on with shareholder proposals (SHP) only making up 1% of all proposals.

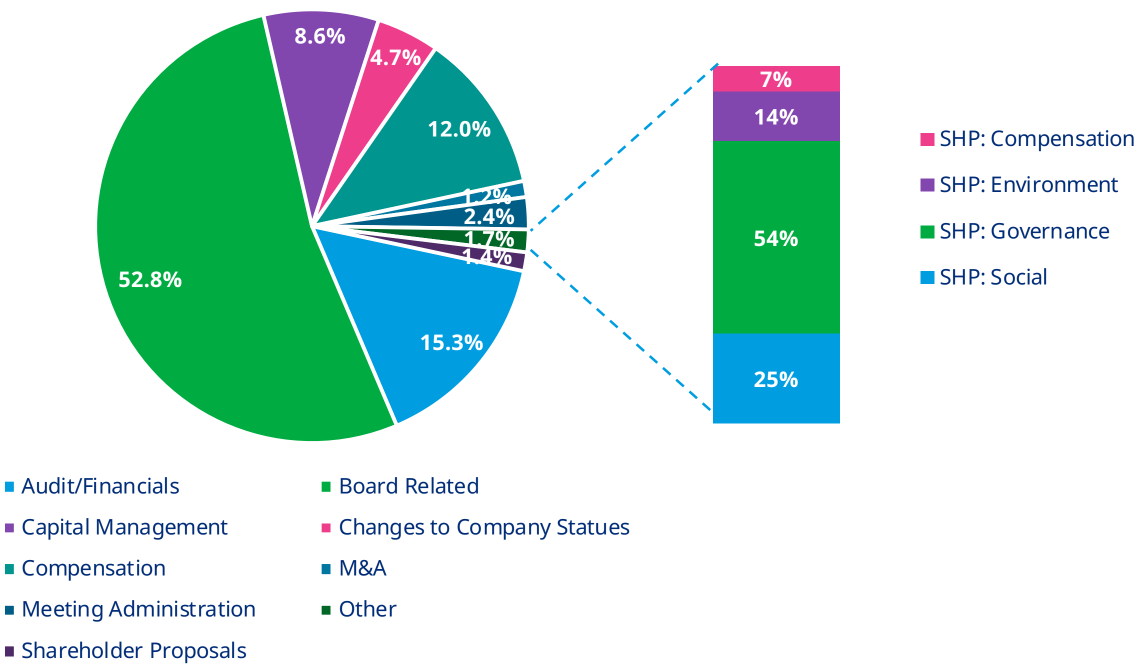
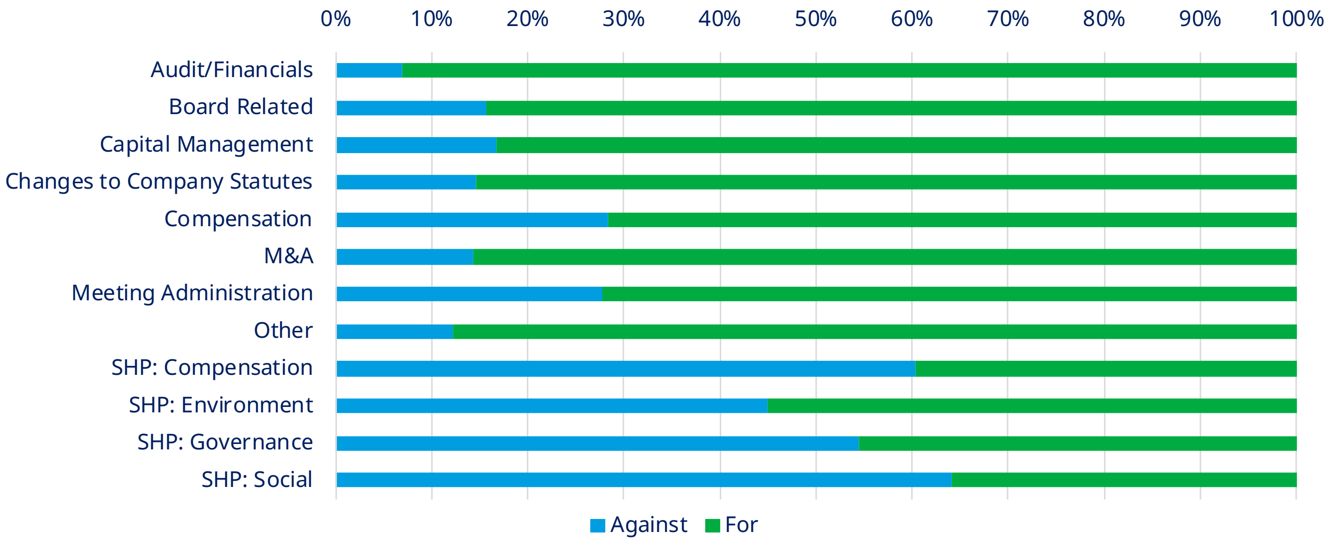


Figure 27. Votes for and against management according to topic



As part of monitoring managers' approaches to voting, Mercer assesses how active managers are in voting against management particularly on areas relating to Mercer's engagement priorities and further seeks to obtain the rationale behind voting activities. Observing an alignment between a manager's engagements and voting activities is helpful in assessing effective stewardship.

Between 35% - 50% of appointed managers reported having voted at least once against management on resolutions covering Mercer's engagement priorities. Mercer portfolio managers will use these results to inform their engagements with managers on their voting activities.

Figure 28. Votes against management on climate related resolutions

Figure 29. Votes against management on human rights or labour related resolutions

Figure 30. Votes against management on diversity related resolutions

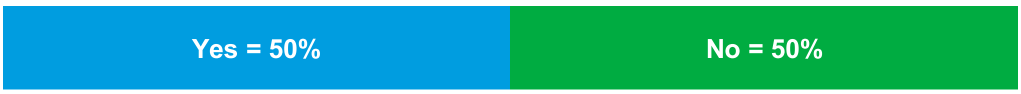


Table 16. Rationale and outcomes for a sample of significant votes relating to shareholder proposals over 2021.

Issuer	Vote Category	Proposal	Decision	Rationale	Outcome
BHP plc	Shareholder Proposal: Environmental	Shareholder Proposal Regarding Lobbying Alignment with the Paris Agreement	For	Managers collectively voted in favour given it promoted transparency on political lobbying and the alignment of lobbying activities with global climate change efforts.	Failed (c. 10% voted for)
BP plc	Shareholder Proposal: Environmental	Shareholder Proposal Regarding GHG Reduction Targets	Against	Managers collectively voted against this resolution, noting that although the company will be expected to deliver on its stated climate ambitions in the future, its current climate reporting, which includes short, medium and long-term objectives and targets, is considered to be a sufficient and appropriate.	Failed (c. 20% voted for)
Amazon	Shareholder Proposal: Diversity	Shareholder Proposal regarding Disclosure of median gender and racial pay gap across the whole business (not just UK)	Split	Managers in support believed this proposal requested data which would be useful in understanding the issuer's efforts to promote equality and inclusion in the business. A collection of the managers subsequently engaged with the company. They believe the company provides demographic data on its website and outlines good pay parity across employees in the same jobs. However, women and minorities are underrepresented in leadership positions compared with the broader workforce.	Failed (c.25% voted for)
Amazon	Shareholder Proposal: Governance	Shareholder Proposal Regarding improved transparency of the company’s corporate lobbying policies and governance	Split	Some managers supported the resolution to increase disclosure on lobbying payments and policy as they believed the additional information will be helpful to understanding the company's practice in this area. The company does provide good disclosure of its direct political expenditures and there is board level oversight of its activities by the audit committee. However, areas for improvement relate to greater transparency in relation to indirect spending through trade associations, coalitions and charities. Whilst the company discloses the gross amounts of trade association payments, in line with some peers.	Failed (c. 34% voted for)

Issuer	Vote Category	Proposal	Decision	Rationale	Outcome
Microsoft	Shareholder Proposal: Compensation	Shareholder Proposal regarding Median Gender and Racial Pay Equity Report	Split	The company was being asked to report on median pay gaps across race and gender. While the company provides granular workforce diversity data, this proposal goes beyond existing disclosure by showing any structural inequalities which may exist within the organisation.	Failed (c. 40% voted for)
Alphabet	Shareholder Proposal: Governance	Shareholder Proposal Regarding Human Rights/ Civil Rights Expertise on Board	Split	Managers who voted for considered it warranted because continued controversies call into question the extent to which the existing board provides adequate oversight on risks the company's technologies present to human and civil rights.	Failed (c. 10% voted for)
Microsoft Corp.	Shareholder Proposal: Diversity	Shareholder Proposal regarding report on median pay gaps across race and gender	Split	The company is being asked to report on median pay gaps across race and gender. While the company provides granular workforce diversity data, this proposal goes beyond existing disclosure by showing any structural inequalities which may exist within the organisation.	Failed (c. 40% voted for)
Tesla	Shareholder Proposal: Diversity	Shareholder Proposal regarding Diversity and Inclusion Report	Split	While the company provides some information on its diversity and inclusion efforts, company strategy and approaches are broadly stated, it does not disclose goals or key metrics that it uses to judge the success of its programs. The company lacks comprehensive diversity metrics reporting and does not report several years of data that would help investors understand trends. Without further disclosure, it is difficult to assess the efficacy of the company's diversity programs and initiatives. Furthermore, the company has historically been involved in lawsuits relating to employee discrimination. Increased disclosure on the company's diversity, equity and inclusion efforts, would benefit shareholders in assessing the company's oversight of associated risks.	Passed
Dollarama Inc.	Shareholder Proposal: Social	Shareholder Proposal regarding reporting on risks to Human Rights arising	Split	Managers voted for this proposal on management of human rights risks from the issuer’s use of third-party staffing agencies for warehouse and distribution operations. It was noted that managers have seen controversies arise at firms in the industry over warehouse working conditions and this is a materially financial issue for issuers given their reliance on a robust, healthy and sustainable workforce.	Failed (c. 21% voted for)

Issuer	Vote Category	Proposal	Decision	Rationale	Outcome
Nestle	Management Proposal: Environmental	Advisory Vote on Climate Roadmap	For	Managers' votes for this proposal is warranted as the company expresses its vision and commitments to halve its emissions by 2030 and achieve net zero emissions by 2050. It is a new initiative that allows Nestle shareholders to have a direct advisory vote on the company's climate roadmap. The company's climate transition plan includes clear targets for 2030 and the governance structure for addressing and dealing with the climate topics is transparent and appears robust.	Passed
Exxon	Shareholder Proposal: Environmental	Shareholder Proposal Regarding Lobbying Activity Alignment with the Paris Agreement	For	Managers collectively voted in favour given it promoted transparency around political lobbying and the alignment of lobbying activities with global climate change efforts.	Passed

In order to provide more information for clients on how Mercer is exercising our proxy votes within our portfolios, we have enabled a Proxy Voting Search site, where you can search for particular proxy votes over the prior six months. This is updated every six months.

Stewardship Beyond Listed Equities: Fixed Income, Private Equity, Private Debt, Property, Infrastructure

As mentioned previously, appointed managers are monitored on their ESG rating annually and stewardship, being one of the four factors contributing to this rating, is likely to be discussed as part of this process.

The relevance of stewardship for non-listed equity asset classes

Below we lay out some of the key characteristics we expect to see from appointed managers seeking to demonstrate leadership in stewardship across various asset classes.

Fixed Income

Leading fixed income managers tend to have an explicit focus on ESG factors within the investment process and demonstrate a greater level of activity around engagement with issuers as well as collaboration with other industry participants. More specifically, leading managers engage with issuers in order to enhance their creditworthiness, such as engaging with companies on issues related to corporate governance standards, human rights issues and environmental policies, consequently demonstrating the benefits of engagement.

Private Equity & Private Debt

The nature of private equity investment is that funds typically have meaningful stakes in companies, meaning that they have influence and/or outright control over management and significant decision-making. Private equity funds are able to do this by concentrating ownership, unlike in listed companies. As such, private equity owners will often have influence over and/or control of the board of directors, and will seek to align management's interest with their own and ensure that material ESG issues are incorporated into the running of companies. This is a very active approach to governance. For Private Debt stewardship remains incredibly important but we recognise there is typically less control for private debt investors over a board of directors and therefore less ability to influence companies. Shaping the terms of a loan can be an effective method to influence an issuer and hold them to account.

Real Estate

Market leading managers demonstrate a 'hands on' approach to project management (to the extent that their ownership positions permit) and proactively seek to address wider sustainability issues and develop voluntary guidelines and industry initiatives to promote sustainable development. These managers also demonstrate high levels of governance (transparency and accountability). Often managers will have set asset-level sustainability plans and work with relevant stakeholders and professionals, including third party sustainability experts, to achieve these over time.

Infrastructure

Infrastructure managers that lead on stewardship use their influence to incorporate ESG considerations both during the due diligence and asset management phases. Managers focused on active ownership are typically actively involved in industry-wide collaborations (for example, UNPRI) and may be involved in helping to develop voluntary guidelines and industry initiatives to promote sustainable development. Leading managers will place significant emphasis on governance aspects – through strong ownership positions, active engagement with management (including hiring, firing and even getting involved directly) and working with other key stakeholders – as well as the social aspects – through relationship/stakeholder management, working with local communities, health and safety standards and employee engagement.

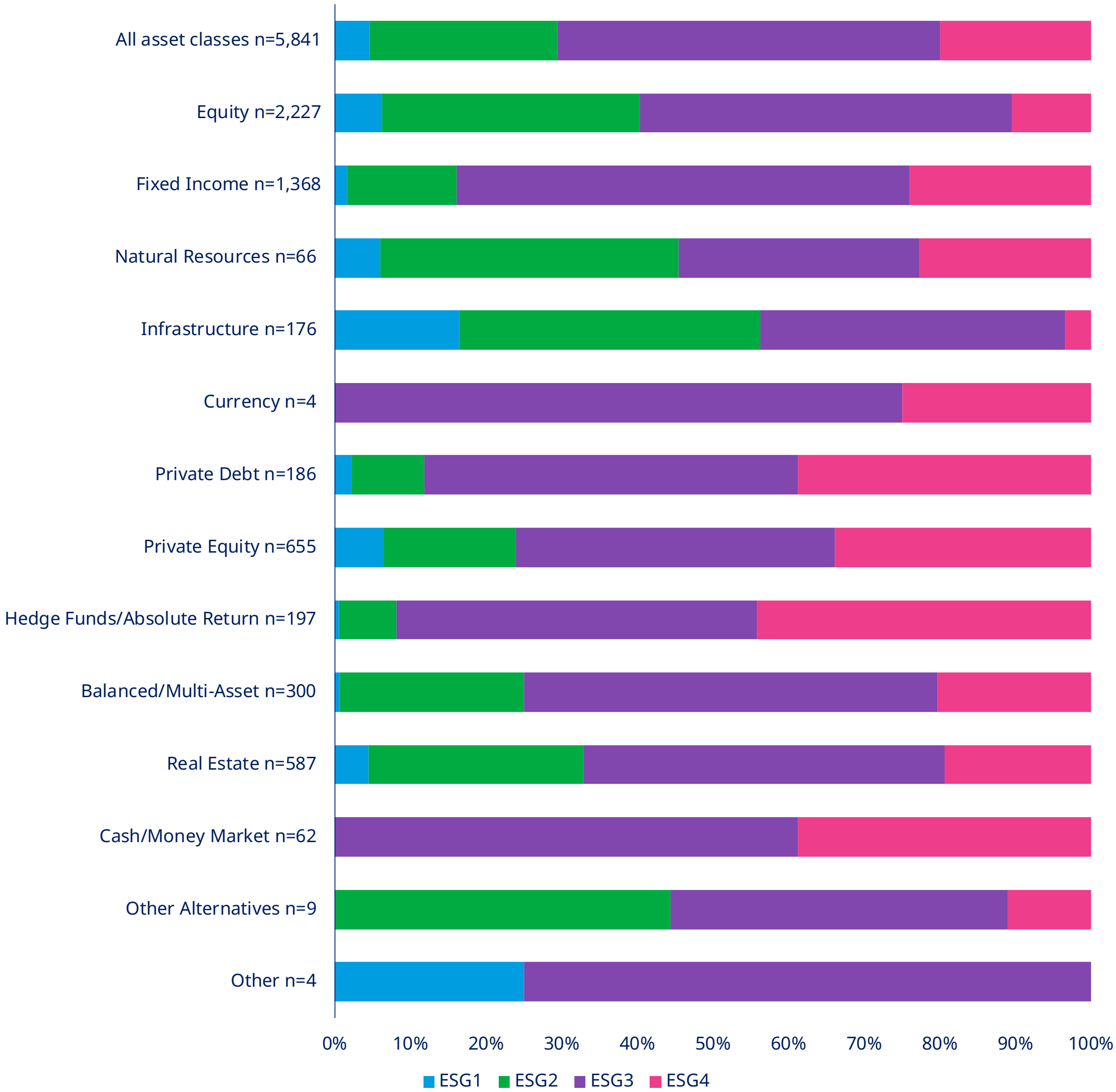
Appendix

Appendix

Mercer's ESG ratings distribution across Asset Classes

The following chart illustrates the current state of ESG ratings distributions by asset class across over 5500+ strategies. Approximately 29% of strategies achieve an ESG1 or ESG2 rating.

Distruibution of 5,500+ Mercer ESG Ratings



Source: Mercer. Notes: ESGp ratings for passive equity are applied at manager level and are not included in the total strategy count. ESG ratings on sub-advised strategies are also excluded from the total to avoid double counting. Analysis as at December 2021

ESG Integration and the Availability of Sustainability Themed Strategies by Asset Class

The figure below summarises Mercer's view on the current state of ESG integration as reflected by Mercer's ESG ratings across mainstream strategies and the range of sustainability-themed investment strategies available.

	Manager Progress on ESG Integration[1]	Availability of Sustainability Themed Strategies[2]
Public Equity (Active)	Medium/High	Medium/Low
Fixed Income	Medium/Low	Low
Real Estate	Medium/High	Low
Private Equity and Debt	Medium/High	Medium/Low
Infrastructure	High	Medium/High
Natural Resources[3]	Medium/High	Medium/High
Hedge Funds	Low	Low

● High ● Medium/High ● Medium/Low ● Low

Source: Mercer. Note: Low: <5%; Low/Medium: 5–10%; Medium: 11–20%; Medium/High: 21–40%; High: >40% (As at December 2018).

[1]Refers to the percent distribution of ESG1 and 2 rated strategies in GIMD, where available.

[2]Refers to the percent distribution of sustainability themed strategies compared to mainstream by asset class – noting equities is a large universe so the low relative number is not actually a low absolute number.

[3]Conservative view – Research updates in this asset class may result in a more favourable view than is currently held.

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