welcome to brighter

Mercer Investment Solutions Europe

2021 Stewardship Report

A business of Marsh McLennan

Contents

Mercer Investment Solutions Europe (“Mercer ISE[1,2]”) partners with long-term institutional investors with portfolio exposures consistent with being a ‘universal owner’. For these reasons, we regard investment governance and active ownership to be of particular importance in serving the interests of our investors.

This report outlines Mercer ISE’s overall stewardship approach before highlighting our stewardship activities during 2021. It includes a summary of managers’ voting and engagement activities over the period 1 January – 31 December 2021. Aggregate statistics on managers’ voting activities, along with findings from our annual manager engagement survey, provide investors with summary visibility on the most relevant engagement activities. Fund and strategy level data is not included in this report, however, this information can be made available to clients as part of regular reporting.

Overall approach to stewardship

Mercer ISE believes stewardship (or active ownership) helps the realisation of long-term value by providing investors with an opportunity to enhance the value of companies and markets in a manner consistent with long-term investor timeframes.

- We are committed to industry standards of good governance and stewardship and set out our approach to the obligations applicable to us in our Engagement Policy and Sustainability Policy.
- On an annual basis, we publish this Stewardship Report, which sets out how our Engagement Policy is implemented, in line with the requirements of the EU Shareholder Rights Directive II.
- Mercer ISE has signatory status to the UK Stewardship Code, and we have published our Statement of Commitment to the UK Stewardship Code, which provides detail on our overarching approach to stewardship in line with the 12 principles of the Code.

Mercer ISE’s investment approach is to appoint specialist third party asset managers (“managers”) to implement the day-to-day investment management tasks. Therefore, we do not directly select securities but engage managers to do so on our behalf. All securities are held within Mercer funds[3] or third party funds. We expect our appointed managers to adopt standards of good governance and stewardship through voting and engagement practices that include a focus on sustainability risks and other material Environmental, Social and Governance (ESG) themes and topics, consistent with Mercer’s Investment Beliefs and monitor manager’s in line with our commitments set out in our Engagement Policy.

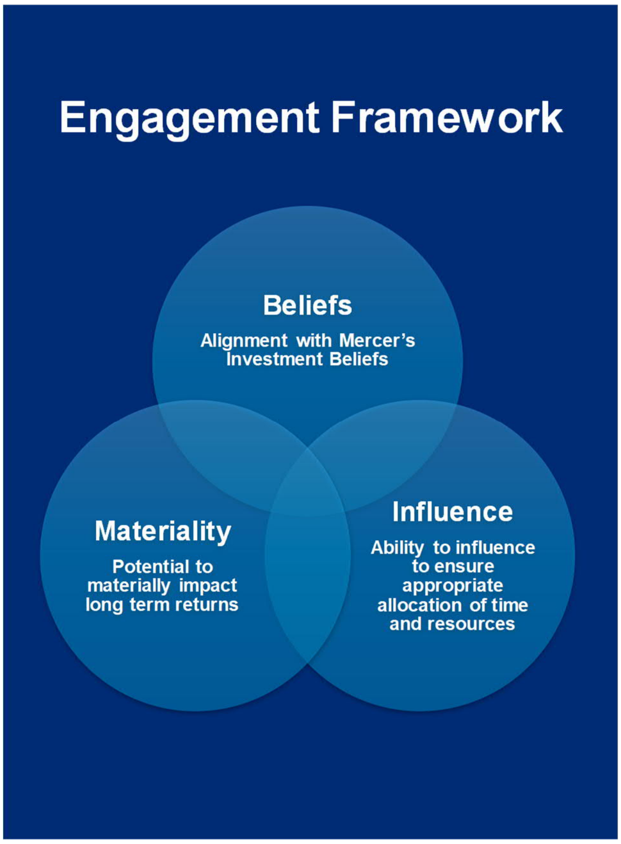
[1] For full information on Mercer ISE please refer to the “Important Notices” section of this report.

[2] This report equally applies to Mercer Global Investments Europe Limited and Mercer Global Investments Management Limited and reference to Mercer ISE throughout should be interpreted to cover both these entities. Notwithstanding the foregoing, certain information in the report may not be applicable to Mercer Global Investments Management Limited given its current structure.

[3] Mercer Funds” are any collective investment scheme, including investment companies, common contractual funds, unit trusts and limited partnerships, for which Mercer Global Investments Europe Limited or any affiliate serves as discretionary investment manager. This includes the Mercer Ireland domiciled UCITS and AIFs for which Mercer Global Investments Management Limited acts as Management Company or Alternative Investment Fund Manager respectively. For further information, please see the “Important Notices” section of this report.

Mercer ISE believes its appointed managers are typically best placed to prioritise particular engagement topics by security. However, we also have 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.

Our stewardship activities are informed by Mercer ISE's Engagement Framework, which considers three main criteria – Beliefs, Materiality and Influence (BMI) and our engagement priorities are expected to intersect meaningfully across the three. This has helped to develop a systematic approach and key principles for considering themes and topics and agreeing portfolio-wide engagement priorities, which currently include **Climate Change, Human Rights & Labour Practices, and Diversity, Equity & Inclusion.**



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

Main approaches to engagement

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 ISE while identifying future engagement areas for prioritisation e.g. biodiversity, pollution and natural resources, living wage, inequity, population health

Sub-investment 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 those who appear to have the most room for improvement.
- **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)
- UK Stewardship Code
- Institutional Investors Group on Climate Change (IIGCC)
- Task Force on Climate-Related Financial Disclosures (TCFD)
- *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 ISE

Monitoring managers

Mercer ISE actively engages with managers through email, calls and during regular meeting cycles. Portfolio managers engage with appointed managers on their overall approach to ESG integration and stewardship, including their policy commitments, integration of ESG considerations across their investment processes and voting and engagement activities. Managers are expected to highlight any concerns that may require engagement with underlying securities, and report on these activities and outcomes to portfolio management teams, with the view to positively influence these over time. Mercer ISE's expectations for ESG integration and effective stewardship by managers is informed by Mercer's ESG ratings and results from the annual manager engagement survey.

The annual manager engagement survey seeks to gather granular strategy-level information from each manager appointed in the Mercer Funds on the approach managers have taken to stewardship, with clear examples provided on engagements and voting activity throughout the previous year, relating to Mercer ISE's engagement priorities. The underlying strategy and fund level information 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.

Manager's proxy voting monitoring also leverages research, reporting and disclosure services from a third party provider, which enables comprehensive disclosure on proxy voting activities. A Proxy Voting Search site is also available, which highlights voting activities related to individual holdings.

2021 Highlights

Signatory of:

STEWARDSHIP CODE | 2021

40+

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

Manager engagement survey

AUM of Funds	No of Managers	No of Strategies	No of Responses
174bn	128	209	296

No of Funds
135

380+ Climate related engagements provided by managers

220+ Diversity related engagements provided by managers

210+ Human rights related engagements provided by managers

Voting activities across funds

509,109	99.3%	12,967	76
Total Proposals Available	% Proposals Voted On	Total unique meetings voted at	Total countries voted across

ESG Integration

ESG Integration
% Funds with Higher or Equivalent ESG Rating relative to GIMD* Universe

95%	81%	80%
Equity	Fixed Income	Alternatives

Climate Change

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

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

Engagements with Managers

ESG integration

We compare managers' ESG ratings to the relevant universe of other strategies in Mercer's Global Investment Management Database (GIMD) in order to understand the relative position of the investment strategy's ESG integration process. Engagements are prioritised with managers with an ESG rating behind that of their peer universe. Highlights from our annual review are provided below.

46 funds*
77 managers
107 strategies…

…reviewed including equities, fixed income, listed property, infrastructure, multi-asset and liquid alternatives

89% Funds with higher or equivalent ESG Rating relative to GIMD Universe**

95%	**81%**	**80%**
Equity	Fixed Income	Alternatives

96% of funds have seen an improved or consistent ESG rating since 2017***

* Mercer multi-client funds represents funds which multiple clients invest in

** Excluding 5 multi-asset funds launched since December 2020, which have not historically been included in the review given an appropriate peer universe is not available

** Excluding 5 multi-asset funds, which have not historically been included in the review given an appropriate peer universe is not available

Notes: While ESG Integration forms part of the investment managers overall investment process, it is not implemented equally across all strategies. Integration depends on the degree to which it may be relevant or applicable to the strategy or asset class. For full information, see the Mercer ISE Sustainability Policy.

Promoting environmental and social characteristics

During 2021, Mercer ISE portfolio managers have had over 40 engagements with the managers across our multi-client funds as we look to further promote environmental and social characteristics across the majority of our multi-client funds in line with the EU Sustainable Finance Disclosure Regulation (SFDR). These engagements will enable 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

Proposed 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

Climate change

Climate change has been a key priority for Mercer ISE for several years now, from monitoring of climate-related metrics, climate scenario modelling and stress testing of portfolios, to setting net zero commitments across a number of our multi-client multi-asset portfolios in March 2021. Mercer ISE 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 EUR 36.7 billion in assets under management as at 31 December 2020. To achieve this, Mercer ISE plans to reduce portfolio relative carbon emissions by at least 45% from 2019 baseline levels by 2030.

Engaging with managers on their approach to embedding climate considerations in their investment decision making and stewardship activities plays an important role in ensuring we are able to meet these commitments. We have been measuring and monitoring the carbon emissions across our multi-client equity funds for some time and have included fixed income funds where emissions data is available and coverage is sufficient.

Engaging with managers, on their consideration and management of climate-related risks, is an important part of our engagement activities and has contributed to positive outcomes across our portfolios. For example, all of our eight multi-client equity funds have a lower carbon intensity than their benchmark, with five of our multi-client fixed income funds, where there is sufficient data coverage to assess, similarly having a lower carbon intensity than their benchmark.

A particular area of focus of our equity portfolio managers over the last 18 months has been on engagements with systematic managers managing emerging market strategies. These engagements have in a number of cases led to reductions in carbon intensity across strategies, most notably for one emerging market manager who was able to reduce their overall carbon intensity by 70%, without influencing the expected alpha expectation of the strategy. This was achieved by applying tilts to the portfolio using their propriety methodology as opposed to restricting the investment universe.

Our multi-client, multi-asset solutions are constructed using Mercer funds as building blocks, therefore all reductions in carbon intensity contribute positively towards our overall goal of net zero portfolio carbon emissions by 2050. As a direct result of these engagements, our best ideas model growth portfolio has already seen a carbon intensity reduction in the region of 20% compared to 2019 baseline figures, placing us well ahead of our interim target of 45% reduction by 2030.

Diversity Equity and Inclusion

Mercer ISE believes drawing on cognitive and identity diversity in decision-making processes creates better solutions and has therefore included diversity, equity and inclusion as one of the core priorities for our business. Diversity includes gender, age, ethnicity, nationality, prior working experience, qualifications and level of education, together with potentially less visible factors such as disability, sexual orientation, and personal values/beliefs. Mercer ISE promotes practices that encourage gender diversity at a manager and security level. More detail on the approach to and progress of diversity in our underlying managers is provided in the next section focussing on the findings from the annual manager engagement survey.

We consider the diversity profile of managers when selecting managers for our solutions. We have communicated our expectation for increasing diversity across our managers with the majority of our managers supportive of this. Many managers have highlighted that increasing female and diverse representation within their teams is 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 portfolio management 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.

Manager Engagement Survey

The 2021 Manager Engagement Survey was sent to all equity and fixed income managers managing segregated mandates on behalf of Mercer ISE. These included both managers in Mercer's multi-client funds as well as managers in bespoke client funds managed on behalf of Mercer clients. While there are a number of bespoke client funds, where Mercer actively engages and sets stewardship expectations of managers, there are also a number of bespoke client funds where clients have a desire to stay involved in engaging with managers and setting and communicating the expectations of managers, in a vehicle that has been setup for them. In these circumstances their approach may differ from that of Mercer ISE's broader stewardship principles.

The survey focused on four key areas assessing managers' general approach to voting activities and engagement with companies and included focus areas relating to Mercer's engagement priorities.

- General approach to stewardship
- Climate Change
- Human rights and labour practices.
- Diversity, Equity and Inclusion (DEI).

Survey results

AUM of Funds	No of Managers	No of Strategies	No of Responses
174bn	128	209	296

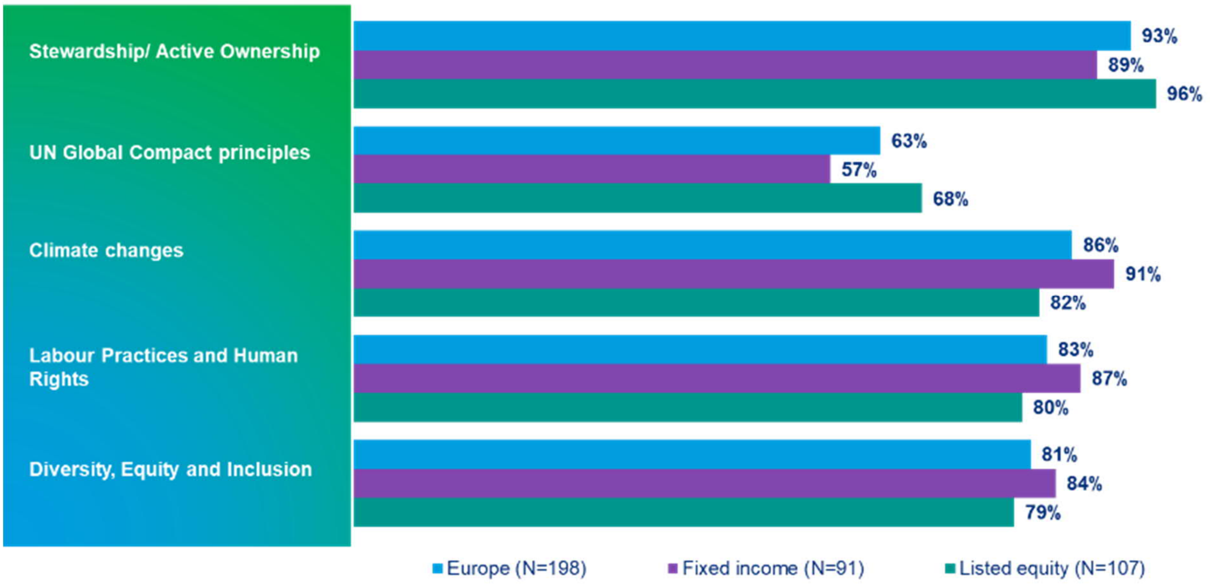
No of Funds
135

Given different approaches to stewardship may occur across different asset classes and strategies, responses were provided at a strategy level to assess voting and engagement approaches at a strategy, rather than firm wide level. Some strategies are also used across multiple funds; therefore, duplicate strategies have been removed, to avoid overstating results.

General approach to stewardship – Policy commitments

Mercer ISE expects its managers to have appropriate policies in place to address key sustainability topics and themes in both their business and investment management approaches. More specifically, Mercer ISE expects its managers to have clear policies relating to the below areas, and will engage with those managers where clearly articulated policies are not in place.

Figure 1: Explicit reference to and/or separate policies that address how the below themes are incorporated into investment management activities

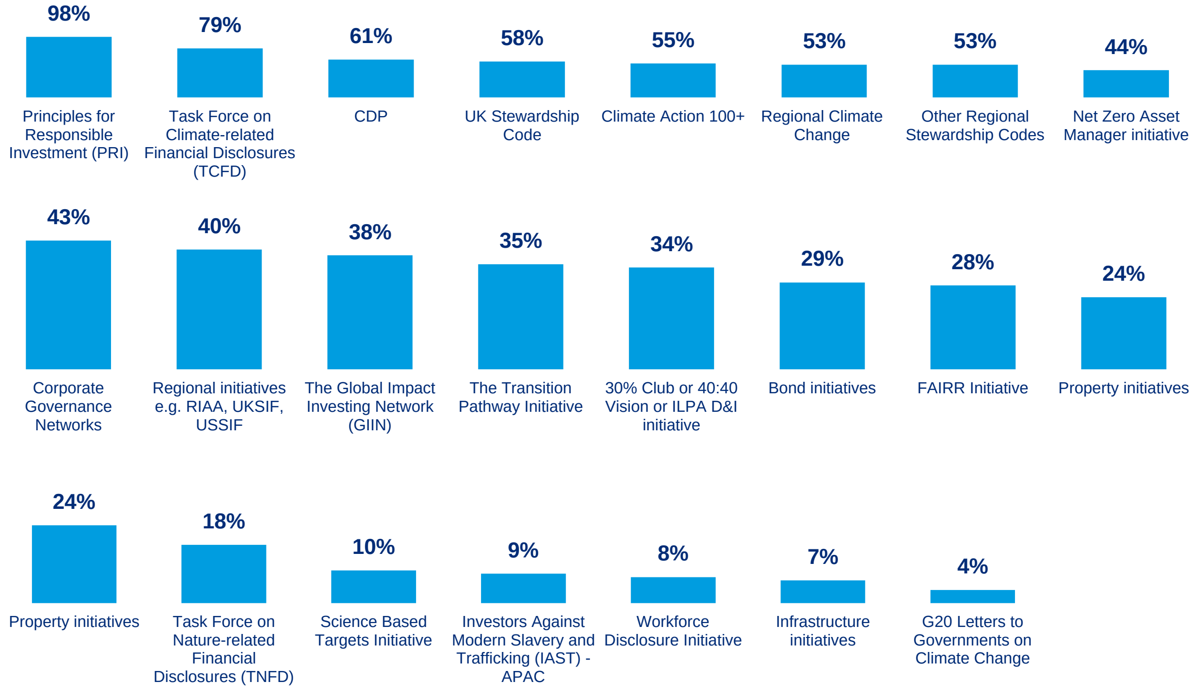


While approximately 80% of managers monitor UN Global Compact (UNGC) principles, just over 60% of managers explicitly reference these within their policies. Mercer ISE has specifically communicated its expectations of managers within its multi-client funds to monitor and engage with any holdings flagged to be in breach of UNGC principles, and to have clear escalation policies in place. While this expectation may be the case across some bespoke client funds, it is not an expectation across all.

General approach to stewardship – Collaborative initiatives

Mercer ISE actively supports and/or is a member of a number of industry initiatives as highlighted earlier. We assess which networks, initiatives or associations that facilitate collaborative engagement with companies and policymakers on material ESG issues our managers are a member or supporter/signatory of, to understand the alignment of our priorities with that of our managers.

Figure 2: Membership of networks, initiatives or associations that facilitate collaborative engagement



Given the importance of climate change, there are a number of industry initiatives in the market that promote enhanced disclosure on and management of climate change risks, which a significant amount of managers are signatories to. These include the Task Force on Climate-related Financial Disclosures (TCFD), the Carbon Disclosure Project (CDP), Climate Action 100+, the Net Zero Asset Manager (NZAM) initiative, the Transition Pathway Initiative (TPI), the Science Based Targets Initiative (SBTi), and a number of regional Investor Groups on Climate Change.

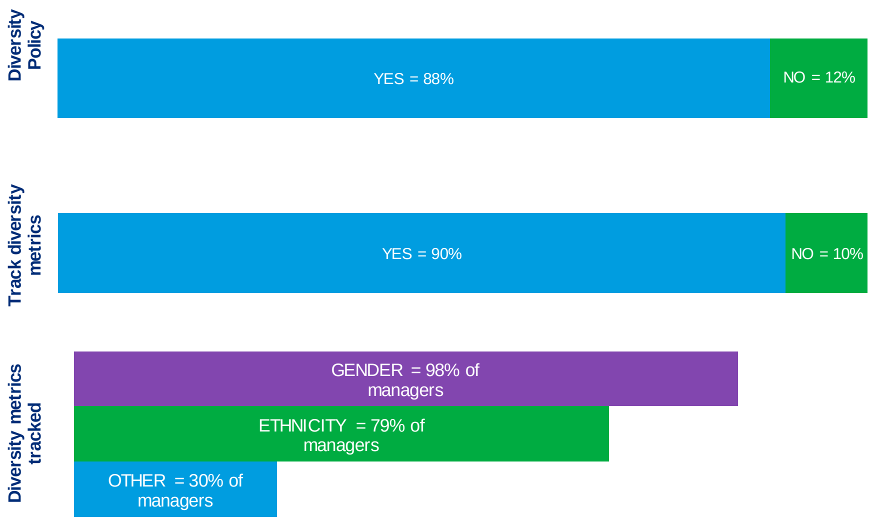
While we acknowledge the time and commitment involved in signing up to and actively contributing to these initiatives is varied, and some, particularly smaller boutique managers, may not have the resources to commit to these, we will prioritise engaging with those managers where we believe greater involvement and commitment can be expected.

For example, there are a number of managers who have not made a statement of commitment to the UK Stewardship Code, given the jurisdiction in which they are based, while others may support other regional stewardship codes more relevant to their jurisdiction. 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.

General approach to stewardship – Diversity at an organizational level

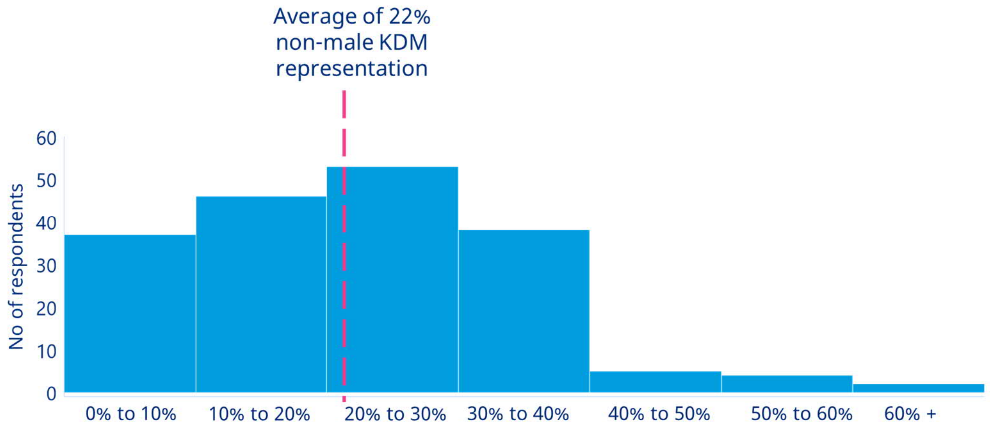
Managers were asked to respond to a range of questions on the topic of diversity, from their policies in place and firm-level diversity statistics, to evidencing diversity-related engagements. Highlights are shown below, with further detail on diversity-related engagement and voting activities provided later in the report.

Figure 3: Policy commitments to and diversity metrics tracked at an organisational level



The majority of managers have a diversity policy in place with approximately half of those without, stating that while they have yet to develop a formal policy, they do track diversity metrics and consider diversity in hires, where possible. Gender diversity is tracked by almost all mangers, with a large proportion also tracking ethnic diversity. Other common diversity metrics include age, disability, military veteran status as well as sexual orientation, with nationality, education and languages spoken also referenced. While the majority do track diversity metrics, the extent of public disclosure of metrics extending beyond gender, may be limited due to data protection rules across many regions.

Figure 3: Diversity amongst Key Decision Makers (KDMs)

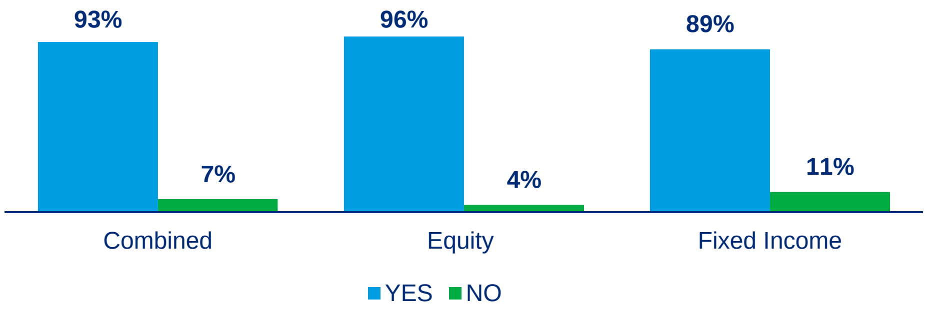


There are various industry initiatives and increasing guidance focused on promoting and improving disclosure on improving gender diversity[4]. Engaging with managers on their approach to improving diversity across their teams, including through training, development and mentorship, is an important component of our portfolio managers engagements with managers, as we seek to promote an increase in diversity across the industry.

Engagement processes and priorities

As Mercer ISE would expect, most managers engage with companies and issuers on material ESG issues. While engagement activity is unsurprisingly higher across equity strategies, than in fixed income, this number is surprisingly not material. There are however a few managers who disclosed that they do not undertake any engagements These largely relate to fixed income mandates, where managers believe they have limited opportunities to engage, particularly where underlying investments are in sovereign bonds. A small minority of equity managers also disclosed that they do not undertake any engagements. These largely relate to strategies that are quantitative in nature with less relevance placed on engaging on ESG factors due to high turnover/lower holding period of their stocks as well as a few boutique managers with resource constraints. We will continue to review managers who fall into this category, focusing on those who have further opportunity to improve stewardship practices, in line with what can be reasonably expected for their asset class.

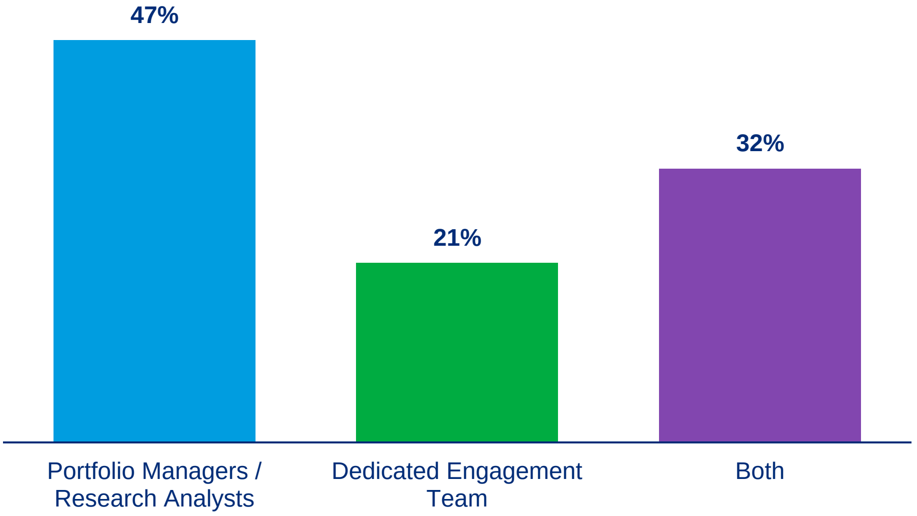
Figure 4: Managers engaging on ESG issues



[4] https://30percentclub.org/; https://www.fca.org.uk/news/press-releases/fca-finalises-proposals-boost-disclosure-diversity-listed-company-boards-executive-committees

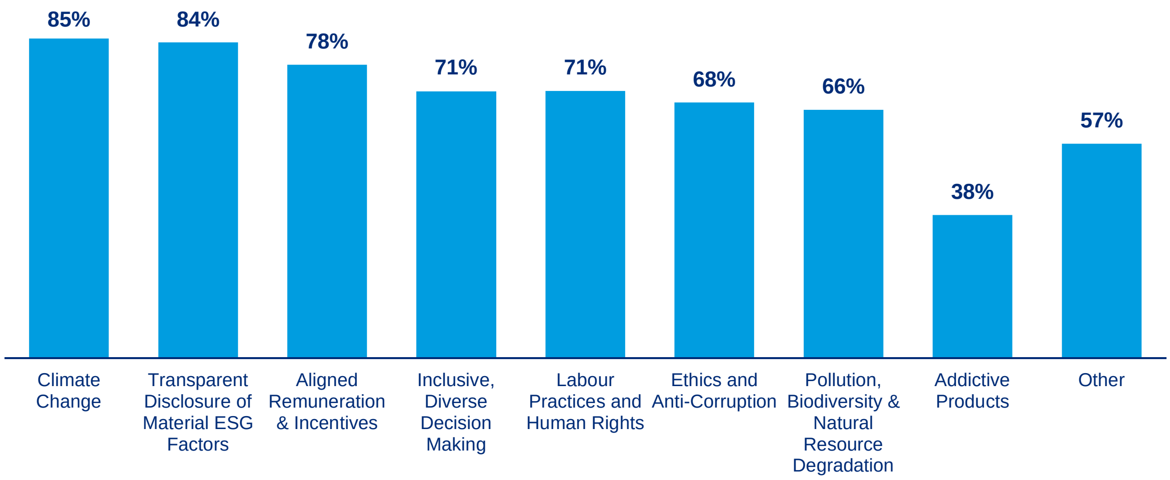
Portfolio managers or research analysts are responsible for engagements across almost half of all strategies, with less than a quarter using a dedicated engagement team, with the results consistent across both equity and fixed income approaches. It is pleasing to note, that close to a third use a combination of both, which is likely to bring together both subject matter expertise on relevant ESG issues as well as ensuring topics covered are both relevant and material to the portfolio.

Figure 5: Roles responsible for engagement



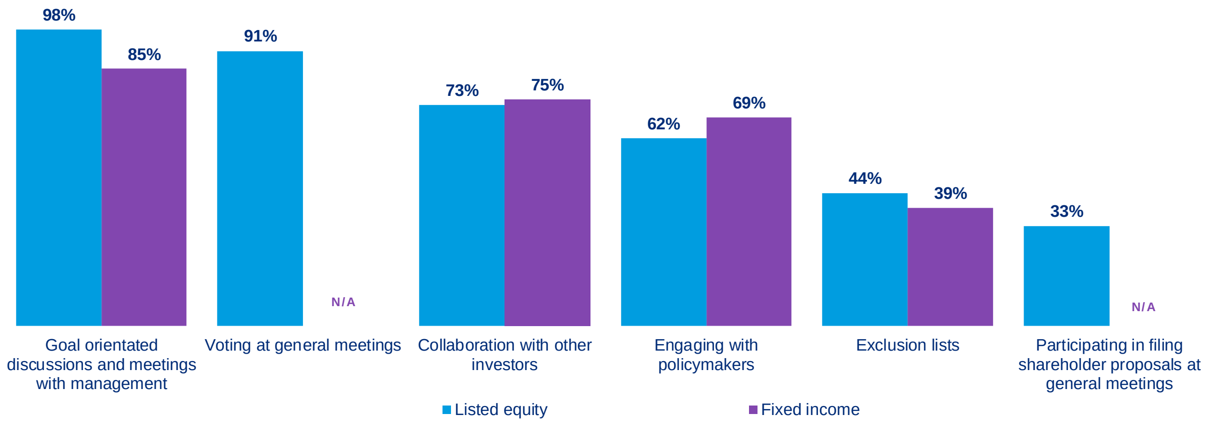
Mercer ISE has defined a number of priority areas for engagement with a large majority of managers highlighting alignment with their own engagement priorities. While Transparent Disclosure of Material ESG Factors was ranked as the top priority in 2020, marginally higher than Climate Change, we have unsurprisingly 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 6: Engagement priorities



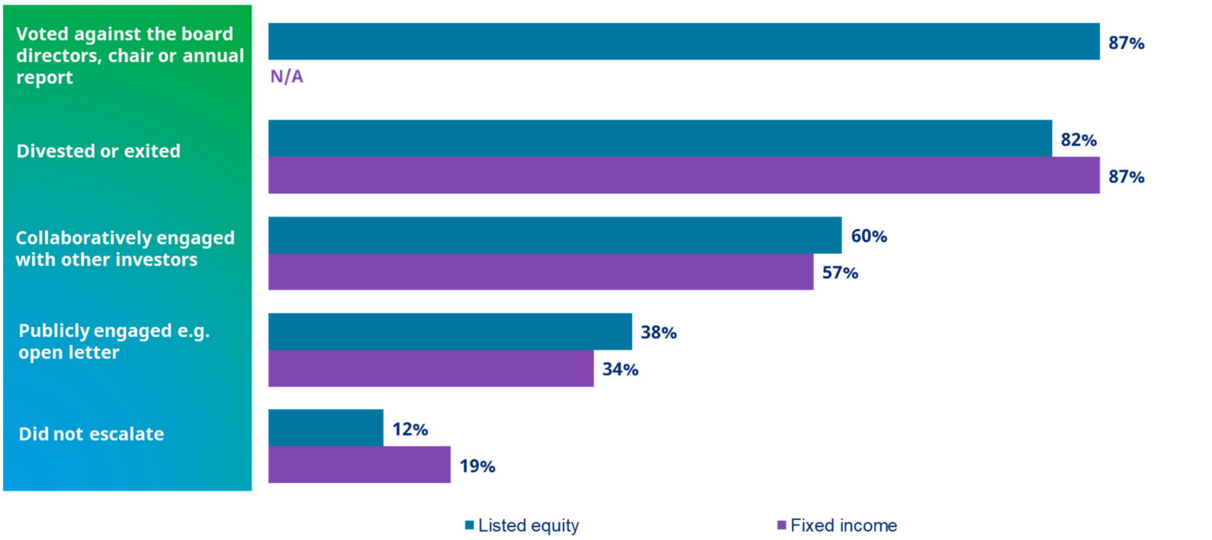
There are some nuances in the approaches to engagement taken by managers across different asset classes, with the main difference in equities, which allow managers to exercise voting rights attached to investments, which is not available to fixed income managers. Across both asset classes goal-orientated 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.

Figure 7: Engagement implementation



The results further show 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 is the most common approach, and more so across fixed income where opportunities to engage may be more limited.

Figure 8: Escalation of engagements

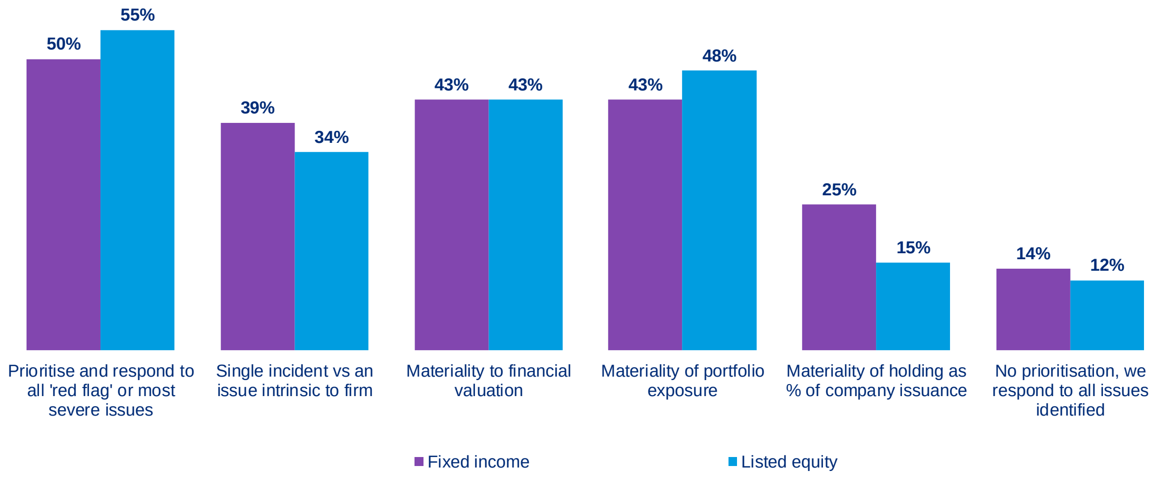


UN Global Compact monitoring

Mercer ISE monitors high-severity breaches of the United Nations' Global Compact (UNGC) Principles that relate to human rights, environmental and corruption issues, across its actively managed multi-client equity and fixed income funds. 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).

While it is evident that different factors may impact prioritisation of UNGC related engagements, only half of all managers stated that they will prioritise and respond to the most severe issues. Our enhanced UNGC engagement and escalation framework mentioned above aims to ensure high-severity breaches are monitored appropriately, in line with our framework, and in addition to the monitoring carried out by managers. Similar to managers' general approach to engagement, here too we see a preference for engagement rather than divesting at the earliest opportunity, as once divested the ability to positively influence through voting and engagement, is no longer available.

Figure 9: Prioritisation of UNGC engagements



As part of the survey, we asked managers with holdings flagged to be in breach of UNGC principles, to provide three examples of significant engagements they had undertaken with companies or issuers flagged, to assess manager's approaches. Examples of responses provided by managers are include below.

Table 1: UNGC engagement examples

	Example 1	Example 2	Example 3
Sector	**Mining**	**Mining**	**Hydropower**
Issue	Environmental, human rights and labour controversies relating to emerging markets operations and insufficient disclosure and target setting	Industry-level inquiry found gaps in policies and systems to protect employees and issues with workplace culture including sexual harassment.	Human rights concerns and negative impact on Indigenous populations regarding a specific project undertaken by a joint venture.
Action	Engaged with the objective of encouraging the company to improve the management of controversial issues and systematically disclose its approach and performance	Highlighted concerns about the seriousness of the issue and the need for transparency and evidence on what the company is doing on prevention and response measures - both within their company but also collectively at an industry level. Also shared observations that any response should identify opportunities for improving employee engagement around equality and inclusion more broadly.	Following prior discussions with management and the UNGC ratings provider, the manager wrote to the company to express their expectation of remediation on the negative impact experienced by the Indigenous population. The manager requested that they be included in the process of setting out the remediation fund and policies already announced and going forward, as well as obtaining third party verification of the impact of these policies.
Outcome	The company has recently begun to improve its group wide approach to sustainability by becoming a member of the UN Global Compact. It has also outlined steps to enhance its management of environmental and social controversies over the next two years through implementing a group wide approach to water management and the management of human rights issues, including in its emerging market operations.	The company has taken steps to improve workplace culture such as better screening processes during the hiring process and improvements in security measures on mine sites, with a range of further improvements planned for 2022, with completion tied to remuneration. They also outlined steps to advance their goal of achieving a gender-balanced workforce by 2025 and other steps towards improving conduct and culture.	The company has strengthened their role as shareholders with the joint ventures in which they hold interests. These actions have prioritised awareness of better environmental and social practices, such as human rights. In September 2021, the UNGC ratings provider upgraded the red UNGC flag to amber, recognising remediation measures being initiated.

Priority Engagement Areas – Climate Change

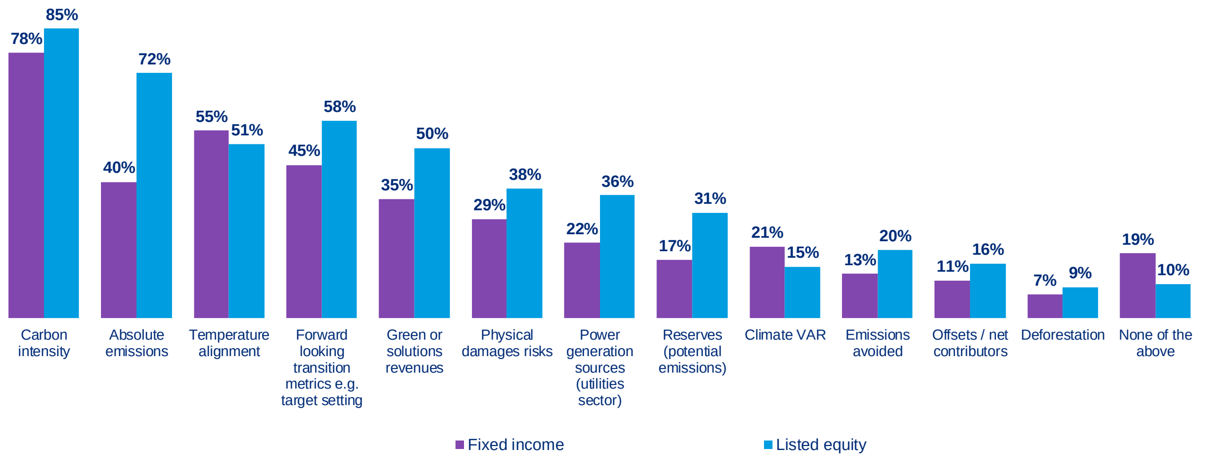
That climate change poses a systemic risk and investors should consider the potential financial impacts of both the associated transition to a low-carbon economy and the physical impacts of different climate outcomes, is one of Mercer's core sustainability beliefs and therefore a priority engagement topic. Mercer ISE engages with managers on their approach to considering climate related risks and opportunities, with the results of the engagement survey used as an additional tool to promote greater consideration and integration of climate change risks and opportunities into the investment process of managers.

As seen earlier, 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, likely to be 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. This improvement is also likely a result of greater regulation in this space, for example in the UK where TCFD reporting is becoming mandatory for schemes over a certain size.

Figure 10: Reporting in line with TCFD recommendations

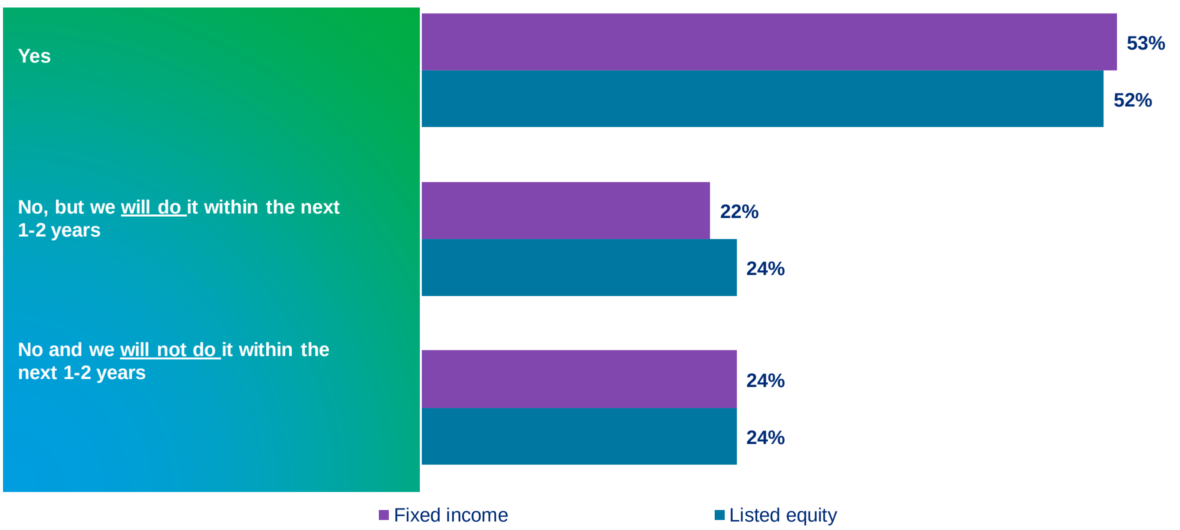
Along with recommendations relating to governance, strategy and risk management of climate-related risks, the TCFD calls for the disclosure of metrics and targets used to assess and manage relevant climate-related risks and opportunities. Across the majority of mandates managed by managers, various climate-related metrics are tracked including carbon intensity, absolute emissions, temperature alignment and forward-looking transition metrics.

Figure 11: Climate-related metrics tracked



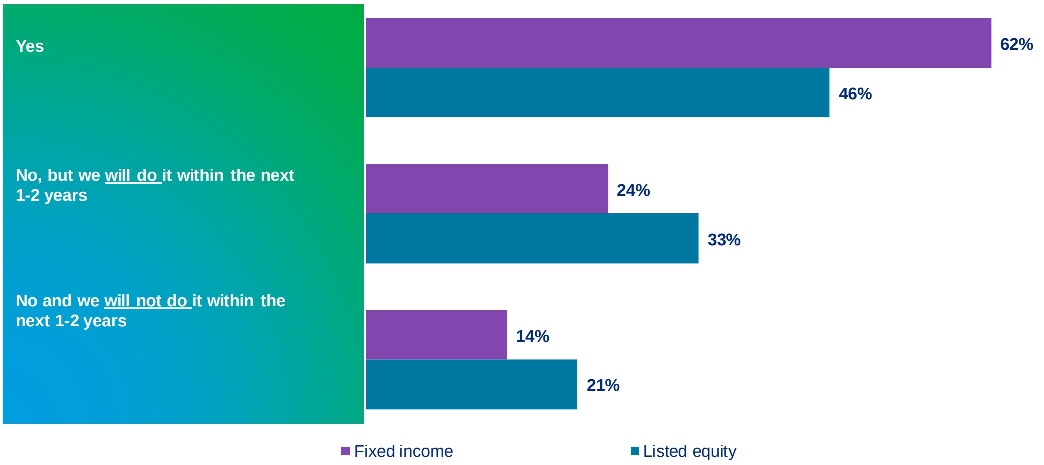
We are also pleased to see that over three quarters of the strategies employed in the Mercer Funds have set climate transition targets, or intend to in the next 1 to 2 years. Mercer ISE will specifically engage with those manager's in its multi-client funds who have stated no intention, to understand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

Figure 12: Setting climate transition targets



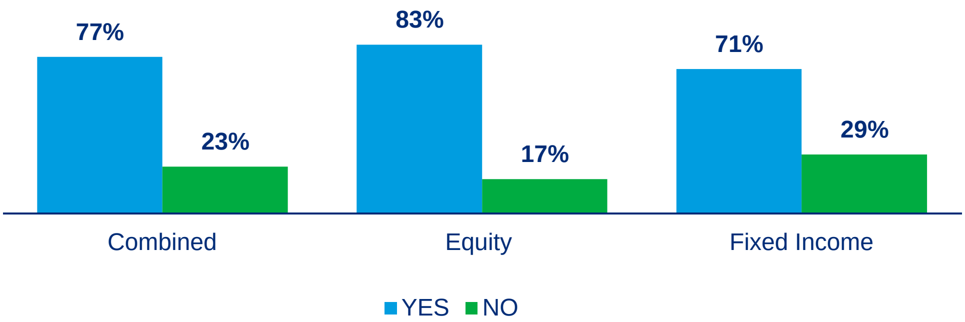
Transition risks have largely dominated the climate agenda thus far given its immediate impact, relative to physical risks, which while already evident, are likely to have a more pronounced impact in the long term. Investors need to consider not only the financial implication of climate risks but also 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.

Figure 13: Monitoring physical climate risks



Our managers have been actively engaging with companies and issuers on the topic of climate change, with over 75% of managers having conducted engagements on the topic. Unsurprisingly, engagement is more frequent amongst equity managers, however fixed income managers are close behind. There are, however some managers, who do not engage as part of their investment process. This may be the case for some fixed income mandates where managers believe they have limited opportunities to engage (e.g. those investing in sovereign bonds). Other strategies falling into this category may include quantitative strategies (where high turnover of holdings leads to less relevance placed on engaging on ESG factors) and smaller boutique managers (where resource capacity and ability to influence were cited as a reason for lack of engagement).

Figure 14: Climate related engagements



As part of the survey, we asked managers to highlight three examples of significant engagements they had undertaken with companies or issuers on climate change within each strategy, with over 380 examples of climate-related engagements provided. As expected, there were cases where multiple managers provided evidence of their engagements with the same company or issuer, which provided us with insight into the different approaches and areas of focus across managers. This was particularly the case relating to holdings in the energy, oil and gas sectors.

Common themes observed in our managers' climate- related engagements included: seeking additional public disclosures, defined transition plans along with net-zero targets, and identified material physical risks due to climate change. We are pleased to see some considerable progress on the back of many of these engagements, with a few examples shown below.

Table 2: Climate-related engagement examples

	Example 1	Example 2	Example 3
Sector	**Downstream oil sector**	**Construction**	**Manufacturing**
Issue	Company was not disclosing any carbon metrics or providing any indication of their ESG initiatives	No link to sustainability in Long Term Incentive Plan, despite the manager believing their business model is highly aligned with sustainability drivers.	Lack of progress on emissions reduction.
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 wrote a letter to the Chairman of the Board sharing their belief that metrics related to the rate of building renovation and energy consumption per square meter of floor space, would help align management compensation with the company's existing target of long-term carbon neutrality.	Manager wrote a letter to the President & CEO highlighting that climate risks in relation to the company's GHG emissions would have a material effect on the company's long-term profitability as their peers were progressing much faster in this area.
Outcome	Company has agreed to start disclosing in line with CDP and manager will continue to monitor progress and engage.	Subsequent to the manager's engagement, the company announced their Sustainability Performance Index, a new KPI that includes various ESG components. This will form part of the Long Term Incentive Plan and impact management remuneration.	The CEO acknowledged the firm's shortcomings and outlined steps to make the business carbon neutral by 2040 (Scopes 1&2), and plans to implement a supply chain emission (Scope 3) reduction plan in 2025. There are also plans to set up an ESG taskforce reporting directly to the CEO, and will provide details on emissions as part of the financial reporting, plus an integrated ESG report.

Observing an alignment between a managers engagement and voting activities is helpful in assessing effective stewardship. Over 40% of managers reported having voted at least once against management on climate change resolutions. These votes supported proposals that increased transparency to risks posed to the companies by climate change, for example on increasing reporting on climate change and GHG reduction. This allows for better transparency on the company's management of climate change risks and the impacts that climate change-related regulations might have on the company and its operations.

Figure 15: Votes against management on climate related resolutions

Table 3: Examples of votes against management on climate related resolutions

	Example 1	Example 2	Example 3
Sector	Multinational Conglomerate	Transportation	Financial Services
Issue	Report on climate-related risks and opportunities	Alignment with the Paris Agreement	To adopt measured environmental impact reduction objectives
Action	Manager supported the proposal as an assessment of the company's climate-related risks and opportunities would allow shareholders to understand how the company is managing systemic risks posed by climate change and the transition to a low carbon economy.	Manager supported the proposal given its simplicity and achievability, which would further support and strengthen the brand.	Manager supported the proposal to improve disclosure and commitments
Outcome	Proposal passed	Proposal passed	Proposal passed

Priority Engagement Areas – Human Rights and Labour Practices

Another priority area of engagement for Mercer ISE relates to labour and workforce practices and supply chain safety, as well as human rights practices that avoid contributing to modern slavery, exploitation and other human rights abuses. This is a growing investor concern due to the potential effects on economic growth, unproductive economic activity, rent-seeking and economic instability; the threat of social tension and subsequent political instability; and the impacts on beneficiaries for economic and health reasons.

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.

Figure 15: Policy commitment to assess and address human rights and labour practices

A number of managers have developed specific risk identification frameworks to assess the extent of human rights or labour practices related risks within the companies in their coverage universes, as well as within the supply chains of those companies. For example, a number of managers have developed proprietary frameworks and toolkits, which examine companies and their suppliers through multiple lenses including vulnerable populations as the workforce; high-risk geographies; high-risk products and services; high-risk business models; complex supply chains and whether there are pressures such as short lead times or cost pressures.

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. Where this has been the case, the majority of managers have stated that they would engage, if the prevalence of labour practices or human rights abuses arose.

Figure 16: Assessments to assess human rights or labour risks

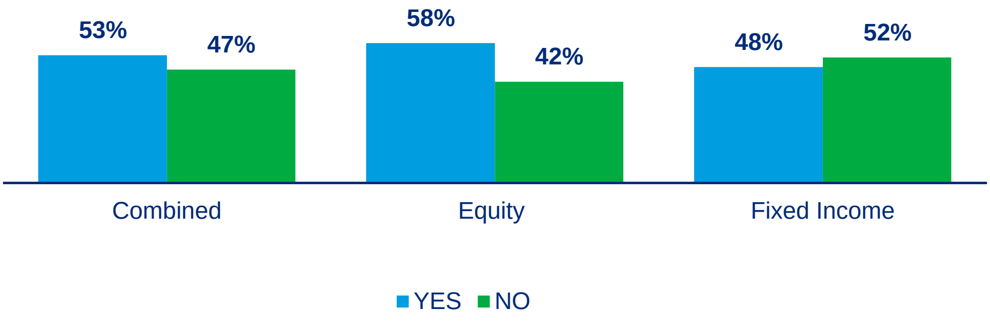
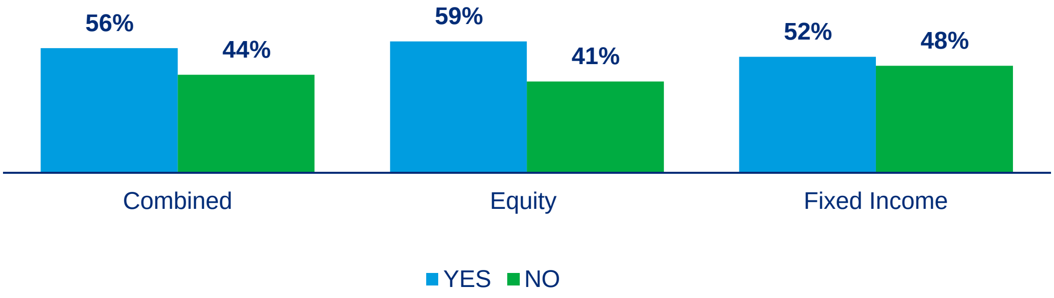


Figure 17: Human rights or labour related engagements



We asked managers to highlight three examples of significant engagements they had undertaken with companies or issuers on human rights and labour practices within each strategy, with over 210 examples provided. As with climate related engagements, there were cases where multiple managers provided evidence of their engagements with the same company or issuer, which was particularly the case relating to holdings in the mining and manufacturing sectors. There was some negative publicity around a small percentage of common holdings across solutions during the year, however we were pleased to see that multiple managers are actively engaging with these companies to identify and address the issue.

Common themes we saw across company-level engagements included managers seeking clarity on supply-chain labour standards, health and safety practices in labour-intensive industries, and potential modern slavery risk in areas such as Xinjiang following the raised concerns regarding forced labour in the region.

Table 4: Human rights or labour related engagement examples

	Example 1	Example 2	Example 3
Sector	**Technology**	**Manufacturing**	**Manufacturing**
Issue	Potential infringements on labour rights laws	Identified the risk of forced labour in the Xinjiang region of China relating to two separate clothing manufacturers	Lack of disclosures around labour standard audits, chemical safety certifications leading to negative publicity on the company
Action	Manager held face-to-face and video meetings with management to understand the issues and legal situation further.	Manager engaged with the companies to understand the extent to which they have been able to fully audit their supply chains.	Manager engaged with management on their ESG policies, specifically on the setting and tracking of labour policy targets, and raised concerns around the company's plan to move operations to higher-risk Asian countries.
Outcome	Manager is satisfied that the company followed relevant laws. They acknowledge that the issues are complex and will continue the engagement.	Manager has concluded that both companies are responding appropriately to ensure compliance with global standards for sourcing cotton, including within the Xinjiang region.	Manager reduced their ESG rating of the company until further information on the company's labour strategy and long-term target tracking is made available.

Observing an alignment between a managers engagement and voting activities is helpful in assessing effective stewardship. Over a third of managers reported having voted at least once against management on human rights and labour related resolutions, indicating managers are actively considering such proposals.

Figure 18: Votes against management on human rights or labour related resolutions

Table 5: Examples of votes against management on human rights and labour related resolutions

	Example 1	Example 2	Example 3
Sector	**Pharmaceutical**	**Technology**	**Pharmaceutical**
Issue	Shareholder Proposals regarding access to COVID-19 products at three of the largest international pharmaceutical companies.	Several shareholder proposals against this same company regarding gender and racial pay equity, workplace sexual harassment policies, and the implementation of the Fair Chance Business Pledge.	Shareholder Proposal Regarding Racial Impact Audit
Action	All nine managers invested in the three companies voted for the proposals and against management, as they support equal access to COVID-19 products around the world given that the public funded much of the R&D, manufacturing and distribution.	Manager voted in support of these proposals, as they continue to advocate for the adoption of strong human rights due diligence processes that assess, mitigate and remediate potential human rights risks.	Managers voted in support of this proposal as they believe the requested audit would help to identify and mitigate potentially significant risks.
Outcome	All 3 proposals failed, however each gained c30% support, showing that there is significant pressure from shareholders on this topic.	Proposals passed	Proposal passed

Priority Engagement Areas – Diversity, Equity and Inclusion

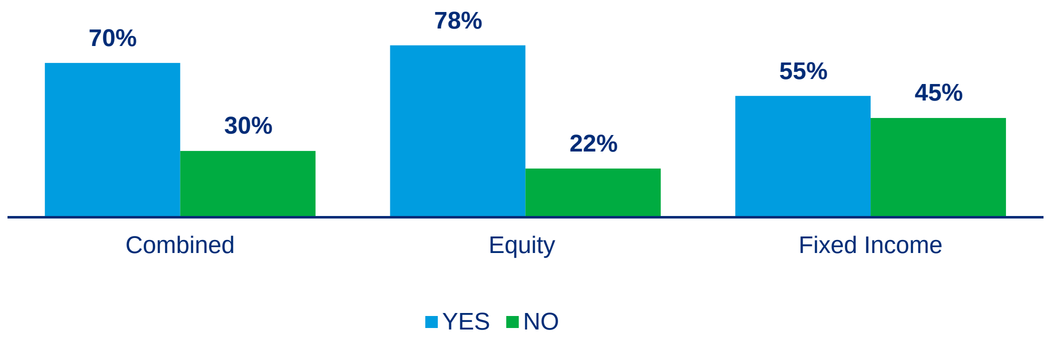
More than two thirds of equity managers have set diversity expectations for management and board members of investee companies including metrics and targets. While unsurprisingly gender expectations take priority, over a third of managers have also set expectations for ethnic diversity with additional metrics outside of these also tracked, most specifically disability, sexual orientation, and veteran status.

Figure 19: Diversity expectations for management and board members of investee companies

Figure 20: Metrics and targets included in diversity expectations

Our managers have been actively engaging with companies and issuers on the topic of diversity, equity and inclusion. Unsurprisingly, engagement is more frequent amongst equity managers relative to fixed income managers where opportunity for engagement on the topic may be less relevant.

Figure 21: Diversity, Equity and Inclusion related engagements



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 diversity 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 the more easily tracked and managed, and therefore the most common theme observed in the engagement examples provided.

Table 6: Diversity, equity and inclusion related engagement examples

	Example 1	Example 2	Example 3
Sector	**All**	**Online Retailer**	**Financial Services**
Issue	Identified a sub-set of 50 portfolio holdings with male-only board members.	Identified potential weakness in integrating diversity and inclusion into the talent management process	Identified a lack of diversity disclosures
Action	Manager wrote multiple letters to the boards on the matter over a number of years.	Manager engaged with the company to understand its talent management process, encouraging it to strengthen its integration of diversity, equity and inclusion.	Manager organised a call with the company and encouraged them to put together an EEO-1 report, which captures detailed breakdowns of employee base by ethnicity, race, gender and other key demographic characteristics, and to publish the results publicly.
Outcome	Subsequently, more than 30 of those identified companies have since appointed a woman director.	The company has recently redesigned its interview process to ensure equity and mitigate bias with specific processes to make sure all applicants are evaluated for the same skills matched to the role. They have updated their corporate governance guidelines, committing to actively seeking out diverse candidates for board nominees and today have over 50% of both the executive team and board comprised of women.	The company were receptive to the feedback and agreed to consider providing an EEO-1 report. Constructively, they highlighted a number of other ongoing diversity initiatives, including a specific focus on veteran hiring/training, which they are particularly proud of.

We are also pleased to see that 50% of our equity managers have also used their shareholder voice where expectations on diversity, equity and inclusion have not been, to vote against directors in this instance.

Figure 22: Votes against management on diversity related resolutions

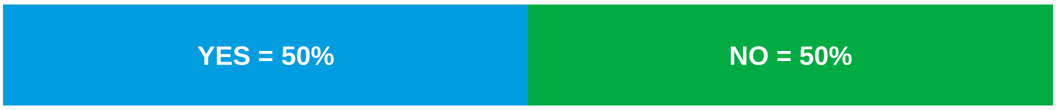


Table 7: Examples of votes against management on diversity related resolutions

	Example 1	Example 2	Example 3
Sector	**Technology**	**Transport**	**Retail**
Issue	Election of a male Director	Report on EEO	Re-election of director
Action	Manager voted against the election of the Chair of the Nomination Committee as the gender balance on the Board is not considered to be in line with their expectation for this market.	Manager voted in favour of proposal as additional diversity-related disclosure would allow them to better assess the effectiveness of the company's diversity initiatives and its management of related risks.	Manager voted against re-election as the Director in question was considered accountable for the lack of gender diversity the Board. Only 17% of the Board comprises women, the lowest percentage in the FTSE 100.
Outcome	Director was re-elected, but only with a 51% majority.	Proposal passed	Director was re-elected, (77% in favour). While the vast majority of shareholders supported the re-election, the Company understands that the primary reason for those who did not do so was a concern over the level of gender diversity on the Company Board. During the year, the Nomination Committee undertook a review of the Board's composition (including its gender balance). The Company is focused on improving Board diversity, and in January started a recruitment process for another director, from an all-female short list.

Proxy Voting

Introduction

As a shareholder of publicly listed companies, Mercer ISE has the right to vote at shareholder meetings. We regard voting our shares as important to our fiduciary responsibility. Consistent with our investment model, we outsource proxy voting responsibility to appointed listed equity investment managers and expect all shares to be voted in a manner deemed most likely to protect and enhance long-term value. We carefully evaluate each manager's capability in proxy voting as part of the manager selection process.

Use of proxy voting advisors

Mercer ISE accepts that managers may have detailed knowledge of both the governance and the operations of investee companies and has therefore enabled managers to vote based on their own proxy-voting execution policy. As we do not vote shares directly, we do not use the policy services of a proxy voting advisor. We do however monitor the use of proxy voting advisors by underlying managers and also have access to research and reporting and disclosure services.

Majority of managers use a proxy advisor (85%), with two key players dominating this space namely, ISS and Glass Lewis.

Figure 23: Third-party proxy voting advisors used

Split votes

The outsourcing of proxy voting responsibilities may result in split votes across managers. Where we believe consistency on a significant matter is necessary, and to ensure it is representing our commitment to good governance, sustainable investment and long-term value creation, we may instruct managers via Investment Management Agreements or other means to vote in line with our **Engagement Priorities** in order to ensure consistency across managers.

Disclosure of significant votes

Over 2021, there has been a greater focus on the public disclosure of significant votes, particularly in regions such as Europe and the UK. There is a level of discretion available to managers as to what constitutes a significant vote; however, some guidance has been provided by the industry. Definitions include whether there is a particular interest in a specific vote relating to an issue, theme or impact; the potential impact on financial outcome; the potential impact on stewardship outcome; size of holding in the fund/mandate; whether the vote was high-profile or controversial or where the manager was subject to a conflict of interest.

As we outsource our voting activities to managers, disclosure of significant votes by underlying managers may differ based on definitions used by managers. While we monitor the disclosures of significant votes by underlying managers, we have further supplemented our approach based on our own definition guided by our **Engagement Priorities**, and based on our Beliefs, Materiality and Impact (BMI) Framework. In order to monitor and report on managers voting activities, significant votes highlight shareholder proposals with specific focus on Mercer ISE's engagement priority areas, while taking into account the size of holding across funds.

As described earlier, definitions on what constitutes a significant vote differs across managers and from the survey highlight the below.

Examples of definitions of significant votes used by managers, based on survey responses include:

- Any vote cast against management
- Determined by market opinion, media scrutiny or an internal view, such as where we have opposed the financial statements.
- Based on a focus list of companies
- On companies with poor governance scores
- All shareholder proposals, all remuneration proposals, all votes against management not already included and excluding routine items.

Public disclosure of voting records

In order to provide more information on how proxy votes are exercised within multi-client funds, a **Proxy Voting Search** site has been enabled, which is updated every six months, which discloses proxy votes over the prior six-month period.

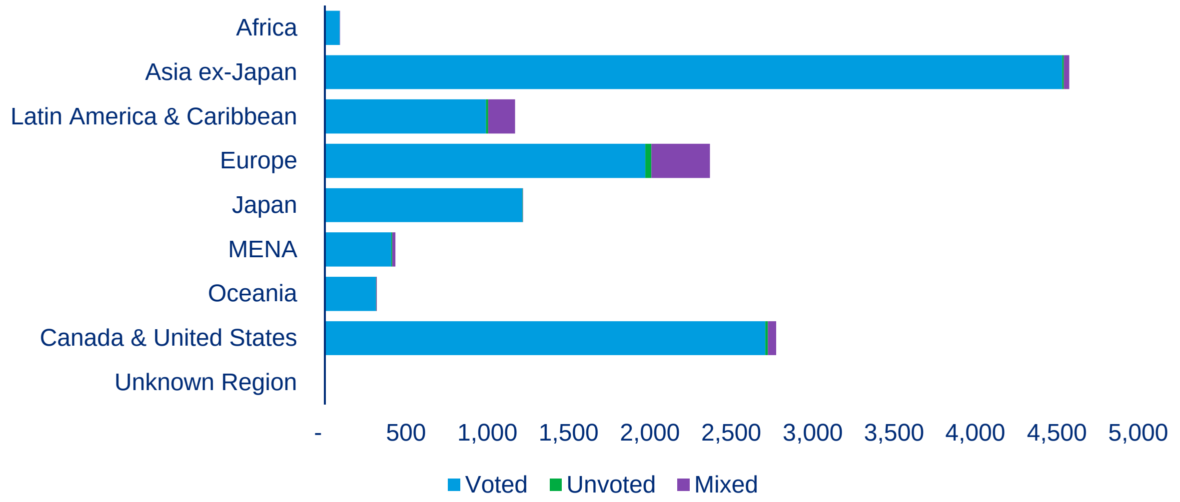
2021 Proxy Voting Highlights

The statistics below represent the aggregated results of voting activities across all segregated mandates, with voting rights attached, which are managed on behalf of Mercer ISE by its managers. Fund specific statistics are available to investors in multi-client and bespoke funds on request.

Summary statistics across all segregated equity funds

509,109	**99.3%**
Total Proposals Available	**% Proposals Voted On**
12,967	**76**
Total unique meetings voted at	**Total countries voted across**

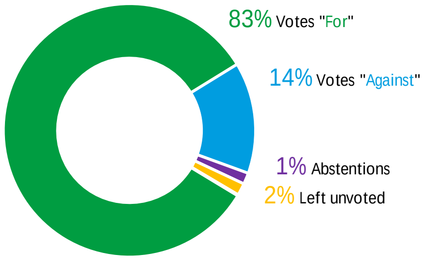
Regional breakdown of meetings



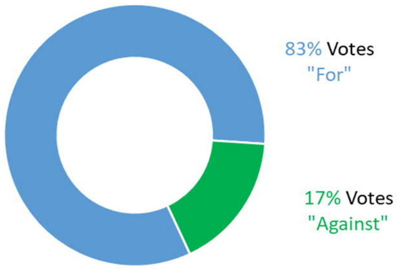
*Mixed: where managers actions have differed across a specific meeting e.g. where one manager may have exercised their voting rights, while another may have opted to not vote at a meeting.

Summary of voting activity across both management and shareholder proposals

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

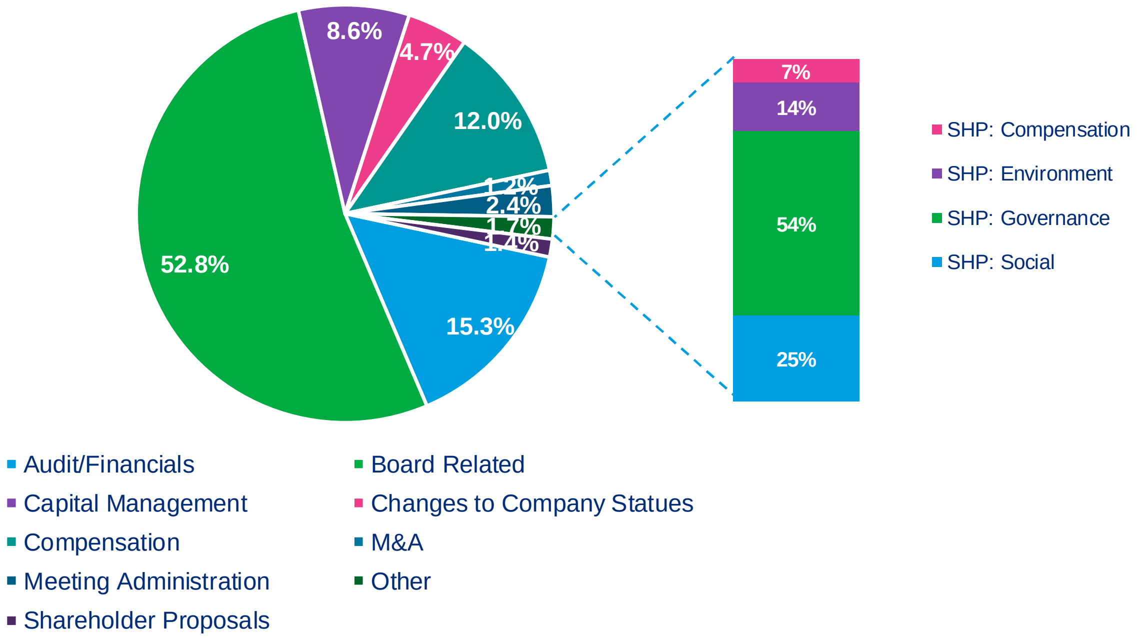


Summary of voting activity relating to management proposals



Proposals by topic

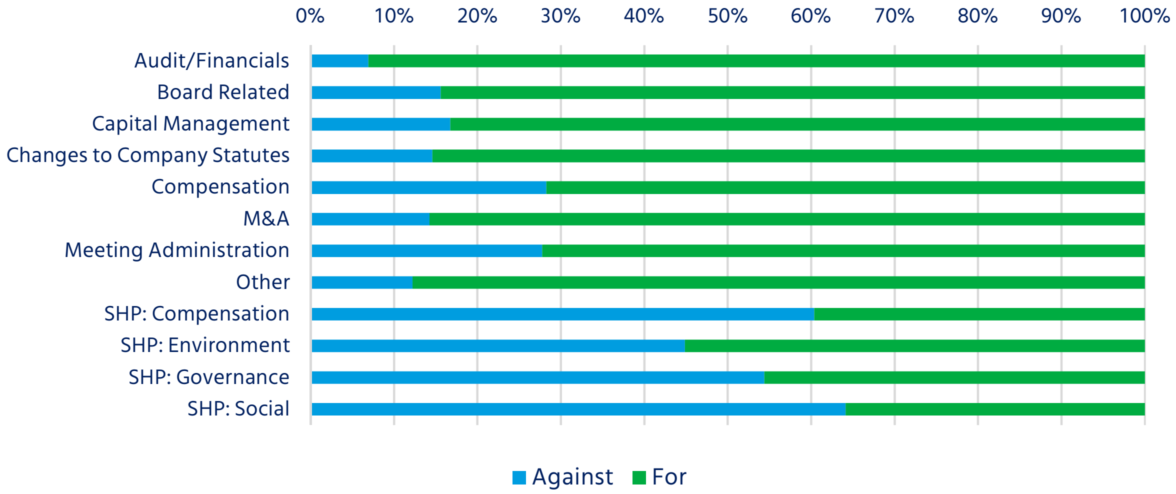
Board related proposals represent over half of all proposals voted on with shareholder proposals only making up 1% of all proposals.



Votes against management according to topic

Approximately 17% of votes are against management, with the majority of these related to shareholder proposals where managers voted in favour of socially related shareholder proposals, followed by compensation and governance related shareholder proposals, and finally environmental related shareholder proposals.

We have observed that a range of between 5% and 20% of votes against management can be expected, with 17% demonstrating that managers are actively consideration their position and using this tool as a way of encouraging improved alignment between management and long-term shareholder value.



As part monitoring of managers' approaches to voting, Mercer ISE assesses how active managers are in voting against management particularly on areas relating to Mercer's engagement priorities and seeks to obtain the rationale behind voting activities. Mercer ISE portfolio managers will use these results to inform their engagements with managers on their voting activities.

Sample of significant votes relating to shareholder proposals

Issuer	Vote Category	Proposal	Decision	Vote Outcome
BHP plc	Shareholder Proposal: Environmental	Shareholder Proposal Regarding Lobbying Alignment with the Paris Agreement	For	Failed (c. 10% voted for)
Rationale	Managers collectively voted in favour as it promoted transparency on political lobbying and the alignment of lobbying activities with global climate change efforts.			
BP plc	Shareholder Proposal: Environmental	Shareholder Proposal Regarding GHG Reduction Targets	Against	Failed (c. 20% voted for)
Rationale	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 sufficient and appropriate.			
Amazon	Shareholder Proposal: Diversity	Shareholder Proposal regarding Disclosure of median gender and racial pay gap across the whole business (not just UK)	Split	Failed (c. 25% voted for)
Rationale	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.			
Amazon	Shareholder Proposal: Governance	Shareholder Proposal Regarding improved transparency of the company’s corporate lobbying policies and governance	Split	Failed (c. 34% voted for)
Rationale	Some managers supported the resolution as they believed the additional information will be helpful to understanding the company's approach. 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 transparency on indirect spending through trade associations, coalitions and charities.			
Microsoft	Shareholder Proposal: Compensation and Diversity	Shareholder Proposal Regarding Median Gender and Racial Pay Equity Report	Split	Failed (c. 40% voted for)
Rationale	While the company provides granular workforce diversity data, this proposal called for additional disclosure to highlight potential structural inequalities, which may exist within the organisation.			

Issuer	Vote Category	Proposal	Decision	Vote Outcome
Alphabet	Shareholder Proposal: Governance	Shareholder Proposal Regarding Human Rights/Civil Rights Expertise on Board	Split	Failed (c. 10% voted for)
Rationale	Managers who voted for the proposal given continued controversies raise concern on the extent to which the existing board provides adequate oversight on risks the company's technologies may present to human and civil rights.			
Tesla	Shareholder Proposal: Diversity	Shareholder Proposal regarding Diversity and Inclusion Report	Split	Passed
Rationale	Managers who voted for the proposal believe that while the company provides some information on its diversity and inclusion efforts, 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 and making it 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, including quantitative, comparable data, would benefit shareholders in assessing the company's oversight of associated risks.			
Dollarama Inc.	Shareholder Proposal: Social	Shareholder Proposal regarding reporting on risks to Human Rights arising	Split	Failed (c. 21% voted for)
Rationale	Managers who voted for this proposal were in favor of more disclosure on the management of human rights risks from the use of third-party staffing agencies for warehouse and distribution operations, particularly given the controversies noted more broadly across the industry and the reliance on a robust, healthy and sustainable workforce.			
Nestle	Management Proposal: Environmental	Advisory Vote on Climate Roadmap	For	Passed
Rationale	Managers collectively voted for this proposal 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 topics related to climate is transparent and appears robust.			
Exxon	Shareholder Proposal: Environmental	Shareholder Proposal Regarding Lobbying Activity Alignment with the Paris Agreement	For	Passed
Rationale	Managers collectively voted in favour given it promoted transparency around political lobbying and the alignment of lobbying activities with global climate change efforts.			

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