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Active Equities Engagement Roadmap

abrdn.com

2024–2026

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01

What is this roadmap?

01

What is this roadmap?

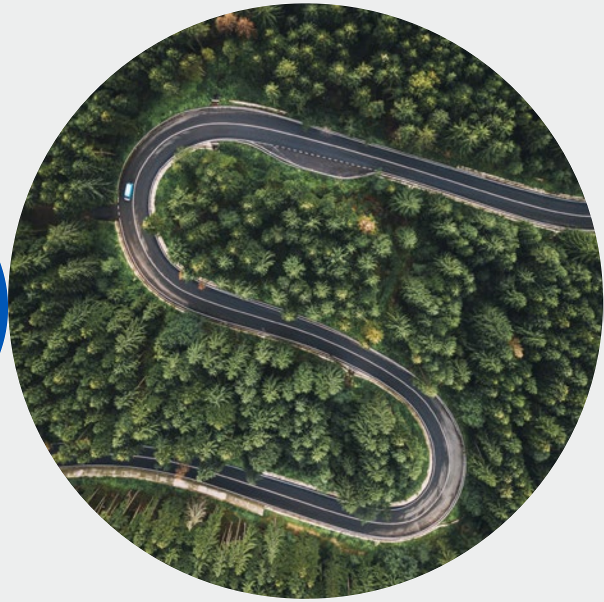
At abrdn, we believe it's our duty to be active and engaged owners of the assets in which we invest. Our aim is to both enhance and preserve the value of our clients' investments by considering a broad range of factors that impact on the long-term success of the company. Through our engagement we seek to improve the financial resilience and performance of investments, sharing insights from our ownership experiences across geographies and asset classes.

This document serves as a roadmap for our engagement activities within Active Equities over the next three years (2024- 2026, inclusive). It is a continuation of, and builds on, our existing investment wide thematic engagement activities which benefit from strong collaboration with the Sustainability Group and other asset classes. While engagement is not new for us, what is new is this roadmap. We have decided to make public our priorities within Active Equities in the forthcoming period to provide transparency to our clients, our portfolio companies, and broader stakeholders. In doing so, it refers to and complements our existing policy documents. It is important to note that much of the document covers our minimum expectations of companies, rather than aspirational targets.

The roadmap aims to highlight the themes most important to us, based on our assessment of the materiality of these issues, and where we will be focusing our attention. While some of these are thematic, others are generalisations of stock-specific engagements. For example, while we don't have wide-spread concern over corporate governance, it is an area that we have been and will continue to be very focused on. We do, however, believe that the market has of late under-prioritised corporate governance, and we expect greater market and regulatory focus in this area in the coming years.

On the other hand, our engagements on climate change are thematic and are across all sectors and geographies. The themes identified in this roadmap may evolve over time, and the roadmap is not exhaustive; while these are generally our thematic priorities, we engage on other issues and themes as part of our ongoing engagement with companies.

The topics we identify are broad by nature, but the document also breaks these down into sub-themes, and identifies issues where we would be focusing attention, based on our assessment of which are most material. For example, while we note that corporate governance is a priority for us, we are particularly focussed on boards, remuneration, and capital allocation. The weights of these sub-topics would vary from company to company, sector to sector, and region to region, and the outcomes we might seek would differ from company to company, largely depending on location and company size. For example, priority themes for a bank may be quite different from those of a semiconductor manufacturing firm; the questions asked of a smaller company in China may differ from those asked of an S&P 500 member or a FTSE 100 constituent. Our engagements recognise the context in which we own and engage with companies, and in all cases, we prioritise the most material factors for discussion for that specific company.



02

Our thematic engagement priorities

Our thematic engagement priorities

Cyber Security

- Information security readiness

Climate change

- Governance of climate change
- Operational decarbonisation
- Just transition

Corporate governance

- Capital allocation and return
- Boards, including composition and diversity
- Remuneration, including quantum and alignment

Supply chain management

- Human rights and forced labour

02

Our thematic engagement priorities

Theme 1 – Corporate Governance

02

Why this topic?

We believe that corporate governance is a key enabler of strong corporate performance. A robust governance structure, with appropriate policies and practises in place, and with talented, experienced, and motivated individuals across an organisation, is a necessary precondition for performance on a range of environmental and social issues, as well as financial performance. High-quality corporate governance plays a role in not only encouraging long-term value creation, but also in ensuring checks and balances are in place, and risk tolerances understood, so that the right people are making decisions for the right reason. Companies should be run in the long-term interests of shareholders (and arguably the interests of long-term shareholders), and culture of strong corporate governance helps manage the risk of a potentially dangerous focus on near-term results, more commonly known as 'short-termism'.

One of our most important roles as owners of a company is the appointment and election of directors. These directors typically owe a legal duty of care to the company and are widely seen as representatives of shareholders. We appoint them to oversee a company, recruit, motivate, and (where necessary) terminate management teams, and to enable the long-term success of an organisation. Directors play a key role in overseeing strategy development and ensuring checks, balances, and internal controls are in place and fit for purpose.

We are concerned that the recent growth in interest in sustainability (effectively, the E and S in ESG), while encouraging, has come at the expense of the G, i.e. corporate governance. While our focus on corporate governance has never faltered, we believe that in recent years there has been insufficient attention paid to the structures and processes necessary to create long-term shareholder wealth.

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We will prioritise the following areas

Boards of directors

As we have noted throughout this document, we believe good governance starts with the board. Our focus is on ensuring that the right individuals are appointed to the right roles, and that boards have the right structure, composition, and diversity. While appropriate structures may vary depending on the nature of the company and jurisdiction (e.g. two tier versus unitary boards), and progress and sophistication is to an extent informed by both a company's life cycle status and home market, we will focus on the following areas globally:

- **Board leadership:** We generally prefer that there is a separation of roles between chairman and CEO. The chairman is responsible for leading the board; the CEO is responsible for leading the company. They are two quite distinct roles, and should generally be held by two individuals. In instances where this is not the case, we would consider the particular circumstances of a company, and in particular the scope and availability to shareholders of the lead independent director role. Where there is a combined chairman / CEO role, and no lead independent director, companies should appoint one as a conduit for shareholder communications and dialogue. Our engagements will focus on boards where there is a combined chairman / CEO, and no lead independent director. Our specific requests of boards:
  - **Separate chairman and CEO roles.** These are, at their heart, two separate but complementary roles. One to manage the board; one to manage the company. They should be held by two separate people, independent of one another. Our very strong preference is for an independent chairman, but we recognise that not all jurisdictions have normalised the appointment of an independent chairman.
  - **Appoint a lead independent director.** While our very strong preference is for a separation of roles, where there is strong justification for a combined role, boards should appoint a lead independent director. These individuals should be available to shareholders, who should be able to approach the lead independent director in order to raise concerns, which they may prefer not to raise through normal channels of communication (i.e. with the chairman or senior management).
- **Board structure and composition:** We strongly prefer a demonstrably independent board, comprised of individuals with diverse skill sets, backgrounds, and experiences. Gender diversity is a necessary but insufficient characteristic of overall board diversity. Independence includes independence from major shareholders and management, and requires regular and thoughtful board refreshment and recruitment (the role of the board chairman, working closely with the chairman of a nominating committee or equivalent) in order to avoid group-think. Our engagements will focus on boards where there is no or little demonstrably independent element on the board, and where it is apparent that there is no structured and thoughtful approach to either diversity or board refreshment. Our specific requests of boards:
  - **Maintain a majority independent board.** While we appreciate that in some jurisdictions less than majority independence may be acceptable, we would prefer to see clear movement towards majority independence.
  - **Maintain a diverse board.** The board leadership (primarily the chairman, working with the nominations committee or equivalent) should curate a diverse board to benefit from a mix of views and experiences. This would include, but is not limited to, diversity of skill sets, functional experiences, geographic experiences, gender, ethnic/racial, and cognitive diversity components. Boards should work to set time-bound commitments on diversity, and report against those commitments.
  - **Develop a meaningful board refreshment strategy.** The board should be refreshed regularly, with tenure generally viewed as an inhibitor of independence. Long-serving directors that the board still classed as independent would be a particular focus for us. The board should develop a skills matrix to inform recruitment and refreshment, with board composition reflecting the company's context, both geographically and operationally.

Our views on diversity and inclusion can be found **here**

Remuneration

We will also focus on remuneration, both in terms of the quantum of remuneration and more importantly the alignment of interests. Executive remuneration plans should be structured in a way that measures and rewards genuine performance and value creation (while recognising that not everything important can be quantified), incentivises management teams to excel in the most appropriate areas and over an appropriate time frame, and which creates alignment of interest between management teams and long-term shareholders. While we recognise that remuneration issues vary from region to region, we will focus on the following areas globally:

- **Alignment of interests:** We strongly prefer that the interests of executives and shareholders are aligned. Remuneration policies, along with the overall levels of pay awarded to executives, should be aligned with strategy, and designed to attract and retain talent. Plan structures should incentivise the decisions and behaviours needed to create long-term sustainable shareholder value. Our engagements will focus on companies where it is apparent that there is either a mis-alignment of interests, or where poor quality / obfuscatory disclosure prohibits us from assessing the level of alignment. Our specific requests of boards:
  - **Develop and clearly disclose remuneration policies.** In an annual report or equivalent document, companies should clearly set out the philosophy and structure of remuneration, and the way in which the board believes that the policy will drive long-term, sustainable value creation for all shareholders. Remuneration plans need not be complicated to achieve their stated goal.
  - **Ensure a mix of short-term and long-term stretch performance targets.** Companies should develop remuneration plans that note and recognise short-term effort by executives, but which overwhelmingly focus on long-term time horizons. Metrics should be clear and understandable, and tied to sustainable shareholder wealth creation.
  - **Require equity ownership by executives and non-executives.** Boards and management teams should be aligned with shareholders. Boards should require that executives own shares equivalent to a multiple of their salary (subject to local regulations), and that Non-Executive Directors ("NEDs") / Independent Non-Executive Directors ("INEDs") own shares equivalent to one year of director fees. In order to affect the latter, we encourage boards to include a restricted equity component of directors fees, albeit with no performance conditions attached to vesting. INEDs / NEDs should generally be required to own these shares for the entirety of their appointment.

Capital allocation and return

Our focus will remain on equitable and sensible capital allocation and return, informed by a clear focus on identifiable and communicated metrics and beliefs. While we recognise that standard practice around capital allocation and expected returns vary from region to region, we will focus on the following areas globally:

- **Capital allocation:** One of the primary, long-term responsibilities of boards and management teams is the effective and responsible allocation of capital to generate long-term sustainable shareholder wealth. This has not always been a responsibility well-met. Our engagements will focus on companies where we have concerns over capital allocation. Our specific requests of boards:
  - **Be clear about returns hurdles.** Boards and management teams should have a clear and informed view on a company's cost of capital, and should be able to answer questions on what that cost is. This cost should be realistic (including additional premia for geographic diversification, for example), and dynamic (to incorporate changes in interest rate assumptions, for example). Capital should be allocated only when returns are greater than the cost of capital.
  - **Avoid and/or unwind unnecessary diversification.** Companies should focus on core competencies. Over-extension and over-diversification should be avoided. In particular, management teams should be able to adequately justify investment into – or continuing to own – assets that are demonstrably non-core to the overall business.
  - **Realise value where appropriate.** Boards and management teams without a clear capital allocation / return policy and framework can tend towards asset hoarding. Having allocated capital, it is sometimes necessary for companies to realise value through the sale of an asset / operating entity in order to reinvest at a higher return (or to return capital to shareholders). Management teams should have an excellent justification for continuing to hold assets that are non-core.
- **Capital return:** Related to capital allocation, management teams should have a clear capital return policy. This does not mean that capital should always be returned if it can be put to better use; as long-term investors, we believe that if companies can continue to reinvest and secure a return above the cost of capital, then that should be their primary focus. We do not seek short-term capital return at the expense of long-term growth. However, management teams should be clear about this decision and set expectations for capital return, including the form of capital return, as well as an overall understanding of the limited circumstances in which share buy-backs may be preferable to dividends, for example. Our engagements will focus on companies where we have concerns over capital return decisions. Our specific requests of boards:
  - **Develop and communicate a clear dividend policy.** That is not to say that companies must pay a dividend; we simply ask that companies are clear about the circumstances in which they would pay a dividend, with this decision being linked to reinvestment opportunities (as discussed above).
  - **Use share buybacks judiciously.** Share buybacks can be a helpful way of returning capital to shareholders, particularly where shares are trading at a meaningful discount to intrinsic value. However, too often buybacks are used as a means of maintaining a share price rather than creating value. Management teams should be clear on the scenarios in which they would return capital via a buyback, and the parameters that would guide this. Some of this is market sensitive, and we would not expect management teams to telegraph the minutiae of a buyback. However, we do strongly prefer that management teams are familiar with corporate finance and the particular and peculiar dynamics of share buybacks, and the scenarios in which this may be preferable to, or a complement to, a regular dividend.

02

Our thematic engagement priorities

Theme 2 –
Climate Change

02

Why this topic?

Climate change is one of the most significant challenges of the 21st century, and has significant implications for society as well as investors. We view climate risk as a financial risk, and as such we are focused on getting a better understanding of ways that our investments can help mitigate climate change globally, and in turn, mitigate investment risks. Decarbonisation of energy and power (including the decarbonisation of transport and industrial sectors, among others) is central to this climate change mitigation. Other facets are more challenging: addressing hard-to-abate emissions is complex, but with the right technology and sufficient capital deployed, these hurdles are not insurmountable.

Technology and science are ever-evolving in this field. The energy transition is underway in many parts of the world; and policy changes, falling costs of renewable energy, and changes in public perception are happening at a rapid pace.

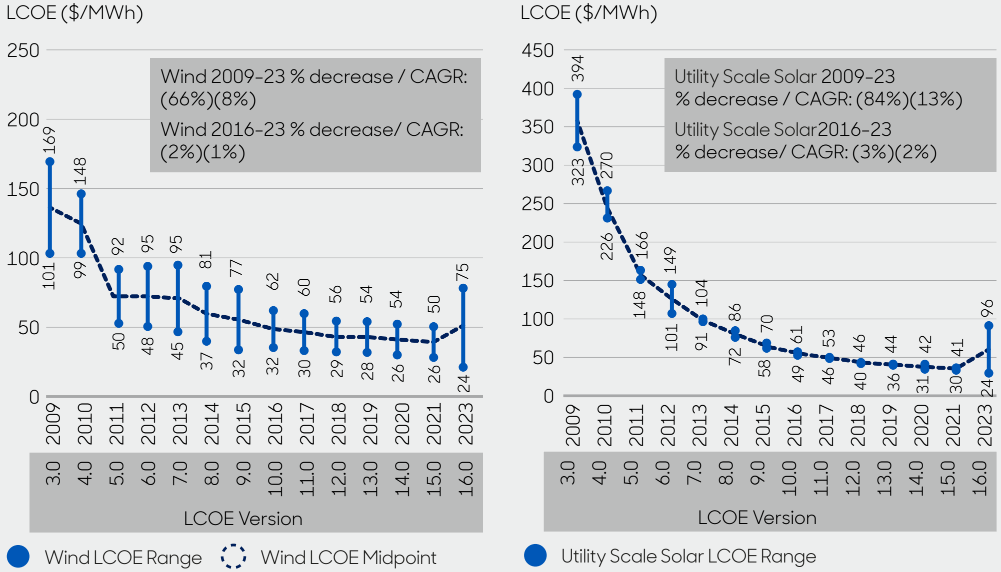
As investors, we have a role to play both in helping to fund new technologies to combat climate change and its effects, and in helping drive decarbonisation across our portfolios through engagement. Assessing the risks and opportunities of climate change is a core driver of this. In particular, we consider:

Transition risks and opportunities. These arise due to the transition to a low carbon economy. Governments can take robust climate change mitigation action to reduce emissions and transition to a low carbon economy including, for example, carbon taxes. These targets, policies and regulation can have a considerable impact on high-emitting companies, but can also represent opportunities for companies that are well placed. Our focus is on understanding how our portfolio companies are positioned in relation to transition.

Physical risks and opportunities. These arise due to the continued increase in temperatures and extreme weather events. Insufficient climate change mitigation action will lead to more severe and frequent physical damage, potentially resulting in financial implications, including damage to crops and infrastructure and the need for physical adaptation such as flood defences. Our focus is on understanding the physical risks that might affect our portfolio companies.

This requires a deep understanding of companies and industries, as well as climate change. We supplement our understandings of industries and markets with specialist research tools that help us better understand the effects of climate change. As investors, we are particularly interested in the various pathways that climate change action might take, including both policy and technology pathways. Governments can act in a number of ways, and can either accelerate or decelerate action on climate change. Carbon taxes, for example, are one tool that governments have at their disposal. Technology also changes, and as technology has advanced, costs have come down, and renewable energy is now competitive with fossil-fuel-derived energy in many cases.

Levelized Cost of Energy Comparison—Historical Renewable Energy LCOE



Source: Lazard's Levelized Cost Of Energy Analysis — Version 16.0[1]

Given these multiple pathways, we believe that climate scenario analysis provides a forward looking, quantitative assessment of the financial effects of climate risks and opportunities on the value of assets under different climate pathways. As a result, we work in partnership with Planetrics to quantify the effects of climate scenarios where a probability weighted view based on a range of off-the-shelf and bespoke scenarios is taken. This allows us to model a quantitative financial effect under 15 different climate risk scenarios at both the stock level and portfolio level. Our climate scenario analysis tool plays a key role in supporting our engagements, helping us to identify which companies may be most at risk from climate change, and allowing us to engage with companies supported by a rigorous scientific perspective and framework. Seven distinct impact channels provide us with a clear way to interpret the factors that underpin the asset-level impairment or uplift generated by the scenario analysis.

For more information on our climate scenario analysis, see **here.**

We joined the NZAM (Net Zero Asset Management) initiative to demonstrate our support for the global net zero 2050 goal. The core commitment is to support the goal of net zero greenhouse gas ('GHG') emissions by 2050, in line with global efforts to limit warming to 1.5°C ('net zero emissions by 2050 or sooner'). It also commits to support investing aligned with net zero emissions by 2050 or sooner. We have also committed to reduce the carbon intensity of our assets by 50% by 2030 vs a 2019 baseline.[2]

More information on our approach to climate change can be found **here.**

[1] See: **www.lazard.com/research-insights/2023-levelized-cost-of-energyplus**

[2] Assets initially in scope are Equities, Credit, Active Quants, Real Estate and selected Multi-Asset strategies. More detail on our baseline and implementation approach will be published in a separate target setting paper. abrdn is committed to this decarbonisation path on the expectation that climate policy will strengthen globally and will review its commitments on a regular basis to reflect policy developments and client commitments. See **www.abrdn.com/corporate/media-centre/media-centre-news-article/abrdn-sets-target-to-reduce-the-carbon-intensity**

02

We will prioritise the following areas

Governance of climate change

As we've noted throughout this document, we believe good governance is the key to strong performance on environmental and social issues. Climate change is no different. While we recognise that different companies in different industries and/or regions will have different roles to play, we will focus on the following areas globally:

- **Climate change strategy and reporting:** We believe that boards of directors should play a strong role in overseeing the development of a climate change strategy. Our engagements will focus on companies where we have concerns over a lack of climate change strategy, or a lack of communication over that strategy, and therefore increased potential for financial risk. Our specific requests of boards:
  - **Stay informed on climate change:** The board should ensure that it is regularly updated on latest developments in climate change, including through the use of external experts.
  - **Identify material risks and opportunities from climate change:** The board should ensure that the material risks and opportunities from climate change are identified, and that their potential financial effect along the company's value chain is assessed and understood. This should include both transition and physical risk. Companies should conduct climate scenario analyses, and should be prepared to discuss the outcomes of these scenario analyses with shareholders, including the board's view of the resilience of the business model in an energy transition.
  - **Develop a carbon footprint:** the board should be clear on scope 1 emissions (i.e. those from sources owned or controlled by a company) and scope 2 emissions (i.e. indirect emissions from purchased energy), and disclose material sources of emissions in line with a recognised international methodology. While scope 3 emissions (i.e. other indirect emissions that are not controlled by the company, including those emitted by customers) are more challenging to map, boards should ensure that there are processes to attempt to map these emissions to the extent possible.
  - **Develop and communicate clear decarbonisation and climate change strategies.** The board should work with management teams to develop clear, comprehensive, and credible strategies to address climate change, covering both mitigation and adaptation, while also developing a strategy for decarbonisation (see below for more on this point). These strategies should be tailored to and relevant for the company's industry and region, and should be part of longer-term business planning. This should include, for example, the setting of a net zero target, preferably by 2050 or earlier, verified by Science Based Targets initiative (SBTi)[3] Boards and management teams should also set interim decarbonisation targets (rather than a 2050 target); provide guidance on the most material actions required in their transition strategy, including potential capex required; and provide insight and detail into how these actions will contribute to reducing emissions; Companies should not be limited by the Nationally Determined Contributions (NDCs) of their respective home countries, but should ensure that they are at least as ambitious as respective NDCs.[4] Boards should be clear in communicating the strategy to meet any net zero target and the impact on the company of that strategy (costs, benefits, opportunities, risks etc).
  - **Report on climate change.** The board should ensure that the company regularly reports on its climate change strategy, including progress against any targets set. This should include a consideration of risks and opportunities, and should be in a format that is recognisable and generally accepted. We expect investee companies to apply Task Force on Climate-Related Financial Disclosures (TCFD) recommendations to their climate data reporting.[5]

[3] For more information on SBTi, see **here**. We are aware that not all sectors are covered by SBTi.
[4] For more on NDCs, see **here**.
[5] Task Force on Climate-related Financial Disclosures (TCFD). TCFD has developed a framework to help public companies and other organizations more effectively disclose climate-related risks and opportunities through their existing reporting processes. For more information, see **here**.

02
We will prioritise the following areas

Operational decarbonisation

As noted above, companies in different industries and regions will have different roles to play. However, decarbonising a company's operations is a key factor in decarbonising the economy. To that end, we will focus on the following areas globally:

- **Carbon identification and reduction:** We believe that boards should have a clear view of a company's carbon footprint, across scopes 1 and 2, and with increasing focus on scope 3. Our engagements will focus on companies where we have concerns that operational decarbonisation is happening at an inadequate pace and/or where boards are focusing insufficient attention on decarbonisation. Our specific requests of boards:
  - **Identify technologies required to decarbonise:** Some decarbonisation is easier to achieve than others. Some involve straightforward changes to operating processes, choices about renewable energy (where available), and so on. Others are more challenging, particularly in hard-to-abate sectors. But, regardless of sector, companies should invest adequately in programmes and technologies to improve operational efficiency and reduce carbon emissions.
  - **Minimise the use of offsets:** While there is a role for carbon offsets (including voluntary carbon credits), the use of these offsets should be minimised. Offsets should not form a core plan of a decarbonisation strategy; companies need to actively reduce the carbon intensity of operations, rather than purchasing offsets to offset the emissions from business-as-usual emissions. Carbon offsets can and should be used to offset residual emissions where no viable alternative is available to reduce carbon emissions further. Companies should be clear and transparent on their use of offsets, and ensure that only high-quality and verified offsets are purchased. Companies should be clear in their reporting as to the use of, and governance of the use of, carbon offsets.

There are some sectors where 'operational decarbonisation' may have a different implication. For example, financial services does not have a sizeable carbon footprint versus heavy industry, yet it plays a key enabling role in combatting climate change. Financial services firms, including banks and asset managers, should set a clear strategy for aligning lending or investing practises with a net zero goal, including a thoughtful approach to fossil fuel financing, and approaches to transition financing.

Role of the 'Just Transition'

We strongly encourage companies to consider the social dimension of the energy transition to ensure it is inclusive and 'just'. This means worker and community needs are considered on the path to a low-carbon economy so they are not left stranded. Other social aspects, such as affordability and reliability of energy supply are also important.

02

Our thematic engagement priorities

Theme 3 – Cyber Security

02

Why this topic?

An issue of significant and growing importance, we believe that companies which manage their information security risks appropriately will not only be more resilient operationally, but will be rewarded by customers.

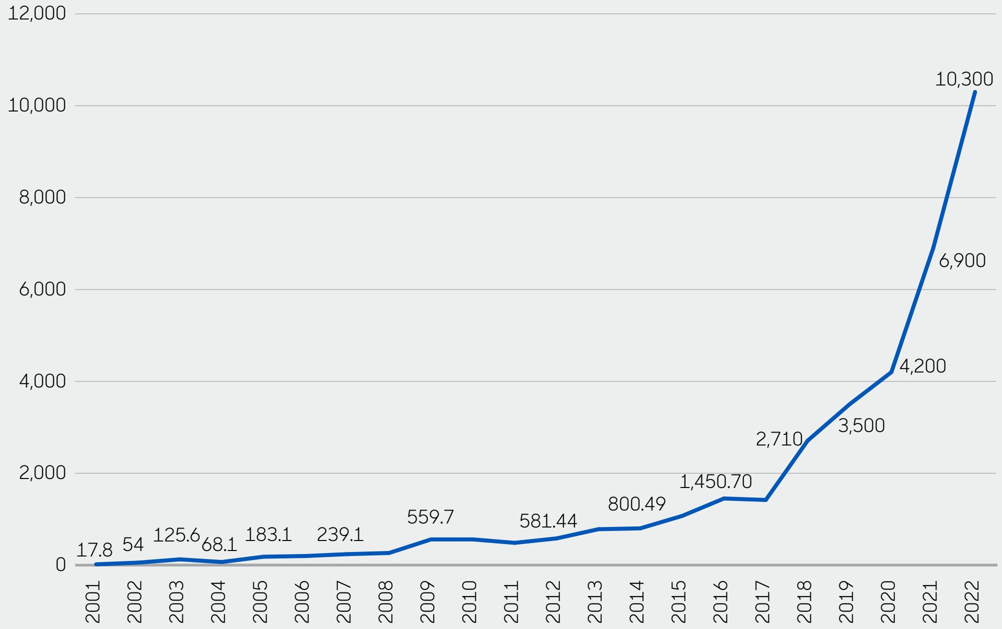
Companies increasingly depend on and make use of personal data and information, and are increasingly interconnected. Customers place their trust in companies to manage and protect their personal information. In addition to this personal data risk, there is an increasing focus on the cyber-preparedness of companies which operate critical infrastructure, including national energy grids, power generation, transportation, and so on. With the interconnectedness of critical infrastructure, attacks can target utility firms' SCADA (supervisory control and data acquisition) systems and access and control sensitive and critical infrastructure. Hacking of and unauthorised access to critical infrastructure can present very substantial risk to an entire country.

Secure and reliable systems are, therefore, a prerequisite for business across a number of sectors. With the growth of the internet as a medium for business, the prevalence of cloud-based technology and the widespread saving and sharing of personal data, we have also seen a concomitant growth in hacking and cyber incidents. These can be material both in terms of immediate financial loss (in the form of fines etc.) and longer-term impact (e.g. in the form of diminished customer trust). There are few 'barriers to entry' for hacking, and the cost (to the hacker) is decreasing given broader availably of tools with which to conduct an attack.

Looking forward, there is increased information security risk given the pervasion of new, internet enabled technologies, including the Internet of Things.[6] In addition, while cyber security used to be primarily the focus of financial services and healthcare, for example, our focus has also turned to the resilience of critical infrastructure energy grids to cyber incidents, and our engagements have focused and will continue to focus on this given the material and extreme implications that this risk presents.

Amount of monetary damage caused by reported cyber crime to the IC3 from 2001 to 2021

Total damage (US $m)



Source: **https://www.statista.com/statistics/267132/total-damage-caused-by-by-cyber-crime-in-the-us/**

[6] The "... Internet of Things, refers to the collective network of connected devices and the technology that facilitates communication between devices and the cloud, as well as between the devices themselves". See **here**.

02

We will prioritise the following areas

Information security readiness

With the heightened risk of cyber attacks, as well as the material financial and operational effects that these cyber attacks can have, our focus is on the role of the board. We will focus on the following areas globally:

- Governance structures and processes: While boards do not have operational responsibility for cyber security preparation, they have oversight of the organisation's approach to cyber security. Our engagements will focus on companies that we believe are operating in high-risk environments, and/or where we believe management teams have not sufficiently addressed the risk of cyber security events, and/or where companies have been the victim of a cyber event and we wish to assess responses and changes. Our specific requests of boards:
  - **Stay informed on cyber-security:** The board should ensure that it is regularly updated on the latest developments in cyber security, including through the use of external experts, in order to exercise oversight of organisational cyber risks. The board should be able to constructively challenge Chief information Officers and/or Chief Security Officers on cyber security from a position of cyber literacy. It may be that, for some sectors, the board wishes to recruit a board member with specific experience of cyber security. This does not mean that one individual is then responsible for the board's view on and approach to cyber security – this is the role of the entire board – but that the significance of the risk elevates the need for specific expertise on the board.
  - **Ensure the right structure is in place:** At the board level, the board may wish to endow a specific committee with responsibility for formulating and monitoring the board's approach to cyber security. This could be the audit / risk committee. While we have no preference as to specific committees and structures, and recognise that some committees already have specialised and onerous requirements (notably audit committees), boards should be clear as to where responsibility sits. Boards should similarly work with management teams to ensure that executive responsibility for cyber security is well formulated and communicated, and that capable individuals are recruited to the appropriate positions (including adequately qualified and accountable cyber experts, appropriate for the scale of the business). While cyber security is the responsibility of the entire organisation, there needs to be a clear understanding of which individuals do what, both in preparation for and response to an attack.
  - **Develop a cyber security strategy:** Boards should work with management teams to develop a resilience strategy, to ensure that the organisation is prepared for an attack. Boards should work with management teams to identify those threats and weaknesses which are most likely to cause operational and/or financial harm. In addition to this, boards should ensure that regular testing of this strategy is undertaken, including penetration testing of critical assets by specialist third parties. This could also include wider-scale simulations and cyber exercises, involving a crisis response strategy. This testing of response plans should not just involve the IT department, but all senior management and the board, so as to ensure senior leaders are aware of the way the company will manage its response, as well as their role following a cyber attack.
  - **Report on cyber-security:** Boards should ensure that the approaches, structures, and processes discussed above are communicated to investors and broader stakeholders. This could be in the annual report or equivalent and, while we don't prescribe the format or granularity (and recognise that some of the organisation's activities are sensitive and should not be disclosed), the reporting should cover the organisations overall approach to cybersecurity risk management, its strategy for defending and preparing the organisation, the resources allocated to defending and preparing the organisation (including the required human capital resources), and overall governance of cyber security.

02

Our thematic engagement priorities

Theme 4 – Supply Chain Management and Human Rights

02

Why this topic?

Companies are under scrutiny from consumers, civil society and regulators regarding the treatment of both their direct employees and the workers along their supply chains. Supply chains are increasingly fragmented and removed from the consumer, yet with the advent of new technology and social media the management of supply chains is an increasingly visible component of companies' behaviour.

At abrdn, we have a responsibility to respect human rights in our own activities by understanding the ways in which our investments affect the rights of others. This responsibility was formalised by the United Nations and the Organisation for Economic Cooperation and Development in 2011. Since then, expectations – from employees, beneficiaries, clients, governments and wider society – have only increased. Such expectations have been driven by growing visibility and urgency around human rights issues, as well as by a better understanding of investors' role in shaping real world outcomes.

We have developed a comprehensive internal framework for assessing human rights risks, including modern slavery. We ensure that our investment teams globally are well versed on the issues, so that they can assess them confidently.

As part of our investment process, we research and analyse companies' labour and supply chain issues, including around forced labour and modern slavery. We have made clear – and continue to make clear to companies – our zero tolerance for forced labour in supply chains. Where we identify risks around human rights, it's our main priority to ensure that our portfolio companies are not involved, either directly though their operations or indirectly through their supply chains. If our due diligence or engagement progress is unsatisfactory, we will not buy or own shares in the company. This is non-negotiable for us, made possible by our active approach to investing, and we have in the past divested from companies due to concerns around human rights.

For more on our approach to Business and Human Rights, see **here.**

[6] The "... Internet of Things, refers to the collective network of connected devices and the technology that facilitates communication between devices and the cloud, as well as between the devices themselves". See **here**.

02

We will prioritise the following areas

Human rights and forced labour

We believe that a renewed and steadfast focus on supply chain management and worker and human rights is critical. There is increased customer focus on the issue, increased stakeholder and society focus, and increased political focus. Moreover, we recognise the increasing regulatory requirements around the globe which effect many industries, including the heightened human rights supply chain due diligence requirements in several countries. Our focus will be on companies in high risk industries or geographies, and includes the effects of companies' supply chains on local populations/environments.

- **Supply chains.** Our engagements will focus on companies in high risk geographies or industries, and/or where we have material concerns. Our specific requests of boards:
  - **Map the extent of its operations and supply chains (including beyond the first tier), with a focus on labour risk.** Companies should identify the main categories of raw materials and/or social inputs that contribute to end products, identify suppliers across the value chain, classify them by sourcing country, and focus on human rights risks that may be relevant for a particular jurisdiction.
  - **Develop policies, processes, and control mechanisms.** Companies should identify salient Human Rights risks (for example, migrant or forced labour), and develop policies that would manage these risks through supply chain management. These policies, and performance against these policies, should be disclosed to the market. This should include a detailed policy on child labour, and (where appropriate) detailed policies on conflict minerals. Policies should be consistent with ILO and other relevant frameworks, conventions, and principles, including the principle of Free Prior and Informed Consent (FPIC). Companies should also ensure that processes to implement and monitor implementation of policies, including inspection and verification, are in place.
  - **Regularly audit and inspect supply chains.** In order to monitor ongoing compliance with their stated policies and codes, companies should conduct both regular and unannounced visits to suppliers (including lower tier suppliers), to conduct documentation reviews, off-site interviews with workers, and visits to associated production facilities and worker housing / dormitories. Companies should disclose the outcomes of these inspections, if not by absolute score then in groups (e.g. top tier performers, etc.). This could also include disclosure on the number or percentage of suppliers where issues were found. Companies should also make use of credible third-party audit and inspection firms to provide an independent view of compliance.
  - **Incorporate supply chain excellence into purchasing decisions.** Companies should rate suppliers based on their implementation performance, with purchasing priority in future procurement informed by reference to the relevant scores, including performance on labour management. Companies should clearly disclose in annual reports or equivalent the way in which this is done. Companies should develop and disclose a sourcing/purchasing policy that incorporates responsible supply chain management.

03

Context for this engagement roadmap

03

Context for this engagement roadmap

Environmental, social and corporate governance factors (ESG) are central to our approach to active equity investing at abrdn. We believe that ESG factors are financially material and can impact a company's performance, either positively or negatively. We also believe that companies that are well managed, and consider long-term risks and opportunities around ESG issues, should outperform over the long term. It follows, then, that we believe that ESG integration leads to better risk-adjusted returns for our clients, and that having a better understanding of financially material issues allows us to make better investments, and hence provide better outcomes, for our clients. We also use our ESG approach to encourage higher standards and support companies that work towards a more sustainable and equitable world.

Understanding ESG risks and opportunities, alongside other financial metrics, is therefore an intrinsic part of our investment process.

For all companies we actively invest in, we identify the key ESG risks and opportunities before we invest. This includes what we might refer to as macro and micro ESG issues.

- **Macro ESG factors** are broad thematic issues that affect companies and the products and services they provide, typically across a variety of industries and geographies. These include issues like climate change and diversity. These are secular, industry-impacting trends that may present a clear risk or opportunity for a company.
- **Micro ESG factors** are company/industry specific issues that relate to how a company's products or services are made or delivered. This may include supply chain management or employee engagement.

We integrate ESG across the investment process, and ESG integration doesn't end with the investment decision. We actively engage with the companies in which we invest, and combine information and insights from these meetings with the insights of our investment managers, ESG equity analysts and central ESG investment team. In our research and analysis of these ESG issues, we identify any concerns we may wish to discuss with companies. We then set engagement objectives according to the circumstances at each company.

- **Idea generation**: Understanding themes and dynamics inherent in companies, sectors and countries, we are able to use ESG as a lens to generate new investment ideas for our portfolios. This could include companies that are well placed to help in climate transition or companies that are managing their supply chain in a way that makes them more attractive to global clients.
- **Research**: ESG disclosure can sometimes be lower quality than might otherwise be preferred, particularly but not exclusively in emerging markets; this means that while it may be challenging to collect information, it also means that extensive company due diligence can uncover investment opportunities and risks. We also integrate ESG research into our company research and meetings to better understand the way that management teams are thinking about ESG issues material to their business, and managing risks and opportunities. These insights help our analysts better assess the quality of, and investment case for, a company. Using our research capabilities, including on-site, face-to-face visits, we are able to develop an informed view of every company and exploit any pricing inefficiency that may exist.
- **Buy/sell**: At this stage we must weigh the decision to buy (or sell) a company. We have a quality threshold for investment, and ESG is a key and non-negotiable part of this.
- **Portfolio Construction**: While a simplification, the better quality a company and the more conviction we have in the company, the more of that company we may elect to buy (while being sensitive to valuations). ESG is a key part of the discussion around 'position sizing', or how much of a company to buy.
- **Engagement**: We continue discussing ESG issues with senior management over the course of the investment, both to protect and enhance the value of investments through constructive challenge and debate around strategy and execution, with the mutual aim of fostering sustainable shareholder returns. In our view, engaging actively with companies is the key to forming an accurate, forward-looking view of ESG factors and driving positive change from within.

ESG refers to the consideration of Environmental, Social, and Governance factors in the investment process. Specifically:

Environmental factors relate to how a company affects its environment. For example, they could include its energy consumption, waste disposal, land development and carbon footprint, among others. They also concern how the environment might affect the company (for example, the effect of climate change).

Social factors involve a company's relationship with its employees, its approach to issues like diversity and inclusion, labour standards (including along the company's supply chain) and its approach to human rights. They also cover data protection and security.

Corporate governance factors can include a company's corporate decision-making structure, approach to risk management, independence of board members, treatment of minority shareholders, executive compensation and political contributions, among others.

04

Why do we engage?

04

Why do we engage?

Engagement is an important part of our investment process: we see engagement not only as a right but as an obligation of investors, in our role as owners of companies. We engage actively and regularly with companies in which we are or may become an investor. We believe that informed and constructive engagement helps to foster better companies, enhancing the value of our investments. There are generally two core reasons for engagement: to understand more about a company's strategy and performance, or encourage best practice and drive change.

Active engagement involves regular, candid communication with management teams (or boards of directors) of portfolio companies to discuss a broad range of ESG issues that are material to sustainable long-term returns, either positively or negatively, including both risks and opportunities. Our focus is on the factors which we believe to have the greatest potential to enhance or undermine our investment case. Sometimes we seek more information, exchange views on specific issues, encourage better disclosure; and at other times, we encourage change (including either corporate strategy, capital allocation, or climate change strategy). Our engagements cover a range of ESG issues, including but not limited to board composition, remuneration, audit, climate change, labour issues, human rights, bribery and corruption.

Our engagements also give us an opportunity to source additional information and potentially:

Identify an information gap: if a company does not disclose ESG information and the market is unable to form a robust view of its quality, its shares may be priced inefficiently. Using our research capabilities including on-site, face-to-face visits, we are able to develop an informed view of every company and identify any pricing inefficiency that we judge may exist

Close the information gap: if we own a company that is misunderstood by the market, we can work constructively with the company's management team to encourage improved and enhanced disclosure, allowing the market to better understand, and hence better price, the company's securities.

As part of these engagements, and where we are seeking to encourage change, companies are strongly encouraged to set clear targets or key performance indicators on all material ESG risks, so as to enable performance monitoring.

05

How do we engage?

05

How do we engage?

Our preference is generally for our engagements to be bilateral and conducted in a way that allows for full and frank exchange of ideas. We generally prefer that our engagements are not conducted through the popular press.

As an active investor, we can engage with companies directly in a number of ways:

- **Face-to-face meetings** with board members, senior executives and decision makers;
- **On-site visits** to see progress in action;
- **AGM attendance** to push for innovation and change;
- **Exercise rights as a shareholder** through voting and provide transparency around the rationale and expectations behind our votes;
- **Collaborative engagements with other investors** who may be seeking to achieve similar change from a single investment or a range of investments;
- **Meetings with ex-employees, customers, suppliers, stakeholders** or other experts to verify information provided by staff;
- **Divestment** in certain instances where a company's actions, strategy or plans don't meet our expectations or benchmarks.

In planning company engagements, our approach is to focus attention on either a) thematic issues[8] where we believe a theme represents a significant risk or opportunity across sectors and geographies (including, for example, climate change), or b) stock-specific engagements, i.e. companies where we have identified priority issues that require further dialogue.[9]

[8] We conduct thematic research to assess how changes in ESG issues could impact investment behaviours and therefore negatively or positively impact companies in which we invest. Conducting thematic research also enables us to conclude what should be deemed best practice to manage a given ESG issue. This could include, for example, engagements on diversity and inclusion, climate change in the aviation sector, or approaches to cyber security.

[9] There are also instances where engagement is reactive, i.e. where an event has occurred that requires heightened engagement dialogue. While this could occur for a number of reasons, including a privatisation offer, through our extensive due diligence we seek to minimise the frequency of event-driven engagements.

In the case of stock-specific engagements, there are many factors that might drive our engagement activity These engagements focus on the factors which we believe to have the greatest potential to enhance or undermine our investment case, including:

- Issues identified as part of due diligence
- Size of holding
- Internal ESG ratings, including overall house rating and ratings from different investment desks
- External ratings, including providers such as MSCI
- Milestones, where we have asked for actions from a company and seek to measure response
- Voting resolutions

The meeting note we prepare on every engagement identifies the objectives for the engagement as well as the milestones, allowing us to identify success markers at the start of the engagement, and monitor (and report on) our engagements on an ongoing basis. This is important, given some of the outcomes we are expecting will not be immediate, and it may be appropriate to set an engagement milestone which allows us to assess which steps the company has taken after our engagement. These milestones are created and tracked in relation to company engagement and the company's progress, or lack of, against these milestones, which in turn informs the company's ESG ratings. We advise companies of the areas where we wish to see improvement and carry out desktop analysis or further engagement to measure progress.

In every engagement, we have a wide pool of resources on which to draw. We have ESG expertise embedded within our active equity investment teams, and complement this through collaboration across asset classes, sharing research, experiences and understanding. Our on-desk equity investment analysts are supported by on-desk ESG analysts, who bring specialist knowledge and capabilities to the process. In addition, we also draw on the insights of abrdn's Research Institute.

05

How do we engage?

In all cases our approach is to draw on our experience as owners of companies, globally. As a large investor, and with a long history of investing in public market across multiple geographies and asset classes, we are able to draw on the experience of our investment teams and constructively challenge management teams accordingly. This is an area of expertise that many of our portfolio companies are appreciative of; our ability to draw on insights garnered across industries and regions, and across company growth stages, is enabled by our global footprint of investment professionals.

As a final note, it's important to recognise that engagement takes time and patience. While 'quick wins' may be alluring and press worthy, meaningful change is often achieved only after a sustained period of engagement. Some of our most successful engagements run for a number of years, and can span changes in management teams. The key to a successful engagement is to develop a credible, realistic and constructive engagement strategy while building rapport and trust with management. Being close to decision makers means investors can engage with them more effectively. Patience is important, although as stewards of our clients' capital our patience is not infinite.

For more on our approach to Business and Human Rights, see **here.**

06

Escalation and divestment

06

How do we engage?

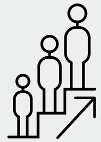
There are many routes to a successful engagement, and the individuals we speak with vary according to the topics we wish to discuss. Some issues are best discussed with senior managers (i.e. the level immediately below and reporting to the C-suite), some with senior executives (i.e. CEO / CFO), and some with senior non-executives (i.e. Chairman or senior INED).

Where we wish to discuss specific topics around operational management (for example, supply chain management or climate change) we would generally prefer to speak with a relevant department head. This allows us to explore in great detail the approach a company is taking to, for example, human rights risks in supply chains, or climate change. Speaking with subject matter experts is helpful in understanding the way the company is addressing a risk.

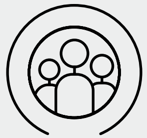
However, where we wish to focus on broader operational issues, capital allocation, and/or the execution of strategy, we would generally prefer to meet with senior members of the executive team. Here, we may want to discuss issues around capital allocation (including investment hurdle rates), balance sheet management (including assumptions and preferences around leverage, and/or capital return strategies), or geographic expansion (including the depth and experience of management teams necessary to expand into new geographies).

Finally, where we wish to discuss issues relating to the long-term stewardship of the company, we would generally prefer to meet with the chairman, or the lead independent director (as appropriate). It may be that we have material concerns around strategy, and wish to communicate these to the board. It may be that we wish to communicate our view on a particular issue which we believe the management team is not focussing on. Or, it may be that we believe the company has an inappropriate or inadequate approach to realising value inherent in assets or capabilities.

Where we have concerns that the normal channels of our communication have not succeeded in laying to rest or addressing effectively, we will escalate these issues. Typically, this will be by proactively seeking additional meetings with members of the board, both executive and non-executive, and making our comments in an increasingly formal way.

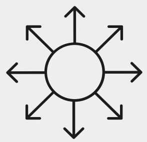


1. We may escalate our engagement to more senior individuals, if we believe that insufficient attention is being paid to an issue, or where we have concerns over operational performance. We do this to ensure that our views are being heard and appropriate action is being taken. We recognise that our engagements are long-term, and that progress may take months or even years. However, risks are material and our patience is not infinite, and so where we feel we are not seeing sufficient progress, and that consequently our client's interests are not being protected, we escalate in order to ensure continued momentum.



2. In some cases, we may request that our engagement continues with the chairman, the senior independent director, the independent directors, the company's advisers, or, from time to time, other shareholders. We recognise the benefits that can accrue from collective engagement with other investors, and welcome discussions with like-minded investors.

3. One additional escalation avenue is the expression of our views in public fora, including at a company's Annual General Meeting. While this is not our preferred method of engagement, it may be necessary to voice our views in a way that is more public. Voting our shares in accordance with our views is also part of this.



4. In rare instances, and if we believe that concerns relating to ESG factors are significant, and where we've been unable to elicit the changes we consider necessary to either maximise shareholder return or mitigate potential risks, we may consider divesting from an investment to protect our clients' portfolios.

07

How will we be reporting on this?

06

How will we be reporting on this?

We believe that not only is it our responsibility to actively engage with our portfolio companies, but also to proactively inform our clients and stakeholders of our stewardship activities. We have long published regular reports that detail our stewardship activities, including breakdowns of engagements by country and topic. These reports include discussions of notable engagements, including a discussion of where in the engagement life cycle a meeting sat.

Two key documents are part of our regular reporting to clients and stakeholders:

1. Annual stewardship report: This report discloses how stewardship has been applied in relation to the principles of the UK stewardship code, and is subject to accreditation by the UK Financial Reporting Council.
2. Annual Voting policy guidelines report: this report includes details of our voting policies and guidance that will be applied in the coming year.

In addition to these reports, we also communicate regularly on various topics linked to engagement, for example: our engagement approach to the mining sector, and to diversity, equity and inclusion.

We also publish regular updates of our voting activities, allowing clients to have full transparency over the way we voted at AGMs / EGMs.

Monitoring progress against and outcomes of engagements is a vital part of this roadmap, as is reporting against this progress. We undertake to report on our progress against these priorities at regular intervals, including a disclosure of the number of engagements on these particular topics by region, along with case studies of engagements of note.

For more on our active ownership approach and reporting, see **here**.

For more on our proxy voting reporting, see **here**.

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