WALTER SCOTT

BNY MELLON | INVESTMENT MANAGEMENT

ANNUAL SUSTAINABILITY REPORT

2023

Stock Examples – Companies referred to in this report have been chosen for illustrative purposes only to demonstrate our ESG Integration and Stewardship process and are not intended to be an indication of performance. This information should not be considered a recommendation to buy or sell any particular security. There is no assurance that any securities discussed herein will feature in any future strategy run by us. Any examples discussed are provided purely to help illustrate our investment style or, are given in the context of the theme being explored. The securities discussed do not represent an entire portfolio and in the aggregate may represent only a small percentage of a strategy's holdings.

To help us continually improve our service and in the interest of security, we may monitor and/or record telephone calls.

FOREWORD

JANE HENDERSON
Managing Director

Walter Scott celebrated its 40th birthday last year. Whilst we made sure to mark the milestone, not least by hosting our international client conference in Edinburgh, there was no time to rest on our laurels, particularly in the ever-evolving areas of ESG Integration, Stewardship and Sustainability.

New UK disclosure regulations on the management of climate risks and opportunities came into effect, making TCFD Entity reporting a mandatory requirement rather than a voluntary initiative. Whilst this has helped to bring standardisation and alignment to a complex area of financial services and asset management, we were nevertheless already committed through our investment process to understanding and addressing financially material ESG risks and opportunities pertaining to our investee companies. Continually re-evaluating the balance between 'what could go wrong here?' against 'what should hopefully go right?' is at the heart of long-term active equity management.

Clear and present risks such as the impact of both climate change and climate change policy are increasingly material to most companies, not just the most obviously carbon-intensive utilities, extractive and industrial sectors. It would, for example, be a challenge to evaluate the prospects of a luxury car manufacturer such as Ferrari without giving consideration to the range of transition risks arising under different future climate scenarios. Emerging risks such as AI ethics and biodiversity are also becoming more material, with the leading companies recognising that engaging with voluntary industry initiatives is one of the best ways to help shape future regulation. This report provides an update on our progress in 2023 with respect to continually evolving and refining our approach to ESG integration.

We also discuss these and other topics on a frequent basis with many of our clients, and we are always interested to hear more feedback on our approach to the areas covered in this report. Despite the inherent common sense of understanding and weighing up all potentially material investment considerations, 'ESG' continues to be a divisive topic in the US market in particular, where some

“Clear and present risks such as the impact of both climate change and climate change policy are increasingly material to most companies”

state legislatures are proposing hefty sanctions for investment managers that are perceived to have crossed the fiduciary duty Rubicon on ESG when managing state-linked assets.

Our view is that this polarisation is in part a symptom of the conflation of 'ESG Integration' and 'sustainable investment' in the US market – whilst both activities may give consideration to common factors such as supply chain standards or carbon intensity, when approached correctly they apply different decision-making criteria. It is understandable that pension fund trustees or state regulators would have concerns if they believed that an investment manager was unilaterally (and perhaps covertly) overlaying its own beliefs onto the investment process for a client strategy with straightforward financial objectives. In practice, this should never happen when the right process and oversight is in place – more perspective on this and our process in our ESG Integration section, and details of our own governance of this area in the Strategic Update section that follows.

The US state-level push for greater clarity and renewed focus on fiduciary duty in this area is in some respects surprisingly well aligned with the next wave of regulation from the UK's Financial Conduct Authority, the *Sustainability Disclosure Requirements (SDR) and Investment Labels*. This is the first of a number of regulatory initiatives to mandate stricter fund labelling requirements in this area of asset management, in addition to broadly applicable expectations on industry communications and marketing with respect to ESG and sustainable investment claims. Both ESG sceptics and regulators alike in this case want funds to 'do what they say on the tin'.

At Walter Scott we are broadly supportive of the direction of travel of this regulatory drive and believe that it is ultimately helping our clients by bringing greater clarity to an area of the investment industry that has at times been somewhat opaque. Our own precautionary approach has been developed to clearly differentiate financial materiality driven ESG integration from all kinds of sustainable investment where clients have additional requirements, and to position the latter appropriately in terms of both goals and outcomes – all of which is well aligned with the new regulations.

This, our fourth Walter Scott Sustainability Report, builds on years of developing disclosure in this area and covers a range of themes that are increasingly essential to many of our clients and by extension to our next 40 years of investment management.

We are committed to continually improving in this area. We were pleased to again be reconfirmed as a signatory to the UK Stewardship Code in 2023. The Board and Executive team of Walter Scott remain fully committed to the objectives and ethos of the Code, and the Financial Reporting Council's ongoing work in raising standards across our industry. This report also serves to outline Walter Scott's updated response to the UK Stewardship Code.

If you are interested in finding out more about our work across ESG Integration, Stewardship and Sustainability, please do read this report and get in touch if we can provide further information.

Best regards,

Jane Henderson, Managing Director

“This, our fourth Walter Scott Sustainability Report, builds on years of developing disclosure in this area”

CONTENTS

03
FOREWORD
Jane Henderson, Managing Director

06
UK STEWARDSHIP CODE
Overview of Reporting

08
STRATEGIC UPDATE
Hilda West, Head of Investment Operations and Sustainability

11
ABOUT US
Who we are, what we do and how we do it

15
ESG INTEGRATION
Updates and insights

22
ENGAGEMENT
Highlights from our engagement with companies, including our collaboration with other investors

34
PROXY VOTING
An overview of our approach and recent activity

41
ADDITIONAL OBJECTIVES PORTFOLIOS
Outlining our approach to portfolios with additional sustainability requirements

43
CLIMATE
An update on progress and a summary of key climate-related activity

46
SUSTAINABILITY AT WALTER SCOTT
Our sustainability work in 2023

50
APPENDICES

UK STEWARDSHIP CODE

Overview of Reporting

As referenced in the foreword to this report, our Annual Sustainability Report incorporates our report on progress with respect to the UK Stewardship Code.

We have taken the approach of "integrated reporting" for two principal reasons:

- We believe that it is more helpful and accessible to our clients and stakeholders to have all relevant information in one place relating to our holistic approach to ESG Integration, Stewardship and Sustainability at a firm and portfolio level.
- We further believe that ESG Integration, Stewardship and Sustainability are inextricably connected in practice, and that external disclosure should ideally reflect this.

Having taken this approach, our objective has been to report on our progress across these connected areas in an intuitively understandable and engaging way, that reflects our culture and how we operate as a business. We are however equally committed to ensuring that our reporting meets the requirements for reporting against the 12 principles of the UK Stewardship Code. The table overleaf 'signposts' where relevant information can be found in this report with respect to the principles.

Annual Review

Walter Scott has been analysing corporate governance, business conduct and related considerations as part of its investment research process since inception. More broadly, there has been a focus since inception on putting client interests first and operating with the highest standards of integrity.

In recent years, we have responded to increasing regulation and growing client interest by putting in place appropriate structures and ensuring sufficient organisational resources are being committed to the development of the firm's strategy in this important and rapidly developing area. In that vein, further enhancements were made in 2023 to both the governance of sustainability and the firm's approach to managing and reporting on climate risks and opportunities, details of which can be found in the Strategic Update section of this report.

Similarly, throughout 2023 we continued our long-standing focus on three core elements of our investment process: integrated ESG research, proxy voting and company engagement. Having well-established processes and oversight in place for each of these elements of our work, development in 2023 was therefore more about progressive evolution of our approach wherever helpful to our process. Again, more detail of this work is provided in the Strategic Update section of this report.

In her role as Head of Investment Operations and Sustainability, Hilda West continues to lead efforts across this dimension of our business, bringing teams together to improve our own practices and operations whilst also overseeing the investment and research related aspects of sustainability in its broadest sense. Similarly, Alan Edington continues to be responsible for championing our efforts across ESG Integration, supporting and directing the Research team, whilst retaining stock champion responsibilities. Alan and Hilda also co-chair the Investment Stewardship and Sustainability Committee.

"Walter Scott has been analysing corporate governance, business conduct and related considerations as part of its investment research process since inception"

STEWARDSHIP CODE MATRIX

	UK Stewardship Code Principle	Covered in sections:
1	Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.	- Foreword - About Us - Strategic Update - ESG Integration - Sustainability at Walter Scott
2	Signatories' governance, resources and incentives support stewardship.	- About Us - UK Stewardship Code Overview of Reporting - Strategic Update - ESG Integration - Additional Objectives Portfolios - Appendix A
3	Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.	- Appendix A
4	Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.	- Engagement - Climate - Appendix A
5	Signatories review their policies, assure their processes and assess the effectiveness of their activities.	- Proxy Voting - Appendix A
6	Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.	- Foreword - About Us - Strategic Update - ESG Integration - Proxy Voting - Additional Objectives Portfolios - Appendix A
7	Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.	- ESG Integration - Engagement - Proxy Voting - Additional Objectives Portfolios - Appendix A
8	Signatories monitor and hold to account managers and/or service providers.	- Appendix A
9	Signatories engage with issuers to maintain or enhance the value of assets.	- ESG Integration - Engagement - Proxy Voting - Appendix A
10	Signatories, where necessary, participate in collaborative engagement to influence issuers.	- Engagement - Appendix A
11	Signatories, where necessary, escalate stewardship activities to influence issuers.	- Engagement
12	Signatories actively exercise their rights and responsibilities.	- Engagement - Proxy Voting - Appendix A

STRATEGIC UPDATE

HILDA WEST
Head of Investment Operations and Sustainability

Walter Scott continued its long-standing focus on ESG Integration, Stewardship and Sustainability in 2023. In addition to the ongoing work on ESG research, proxy voting and company engagement across our client portfolios, 2023 was a milestone year in terms of the evolution of our work in this area.

The firm made significant enhancements to both the governance of sustainability and its approach to managing and reporting on climate risks and opportunities.

SUSTAINABILITY GOVERNANCE AND RESOURCES

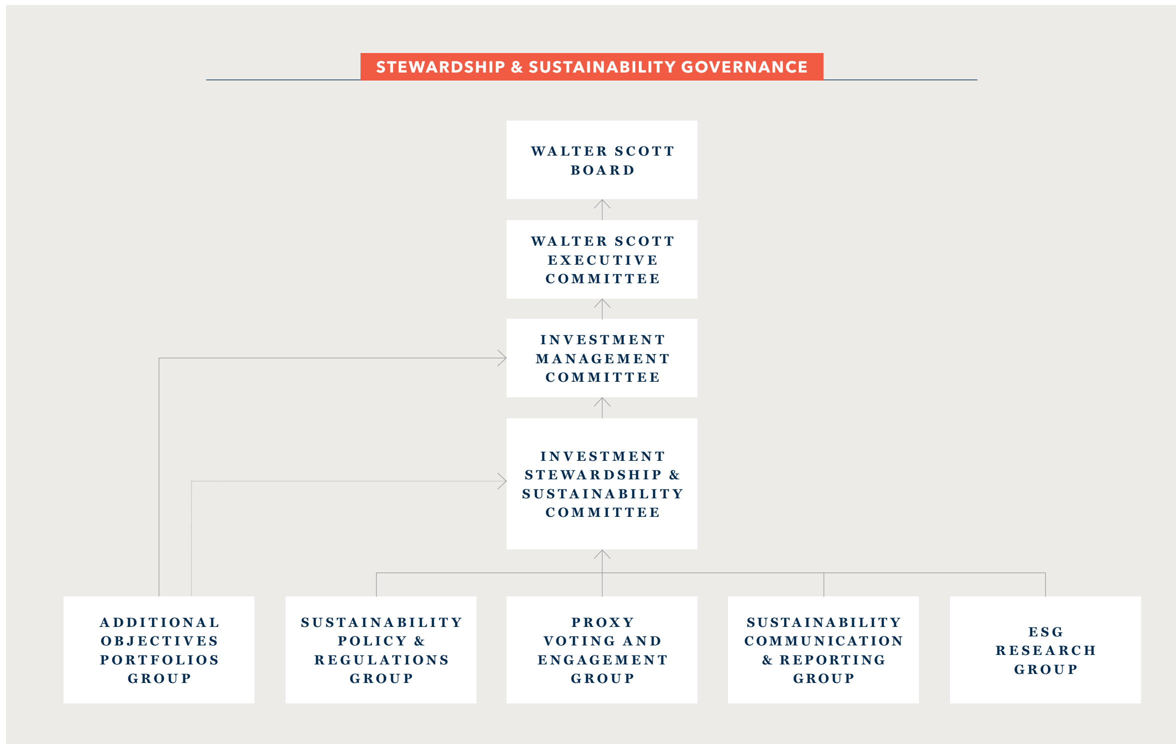
Analysis of relevant corporate governance and business conduct considerations has always been an integral part of Walter Scott's investment research process. More broadly, the firm has had a focus since inception on putting client interests first and operating with the highest standards of integrity.

In response to increasing regulation with the advent of the EU Sustainable Finance Disclosure Regulation (SFDR) in early 2021, and growing client interest over a number of years, the firm established an ESG Steering Group, supported by a number of project groups. The intention was to ensure that sufficient organisational resources were being committed to the development of the firm's strategy in this important and rapidly developing area.

Separately to the creation of the ESG Steering Group, Walter Scott also created an Investment Stewardship Committee in 2021 to oversee the evolution of the firm's commitment to active ownership and alignment with the UK Stewardship Code. Walter Scott supported the implementation of the UK Stewardship Code issued by the Financial Reporting Council (FRC) in July 2010 and its subsequent revisions. In 2020, the UK Stewardship Code was significantly revised, setting a higher bar for stewardship standards and reporting expectations. Walter Scott has been a signatory to the revised 2020 Code since inception of the Signatory List in September 2021.

Collectively, these two groups oversaw the development of a number of new processes, such as our 'engagement for change' framework and our 'additional objectives portfolios' methodology for managing assets in line with sustainability requirements such as EU SFDR Article 8. The firm also expanded Walter Scott's sustainability reporting and disclosure over several

“[Walter Scott] has had a focus since inception on putting client interests first and operating with the highest standards of integrity”



years, publishing a significantly expanded Sustainability Report and the firm's first comprehensive TCFD Entity Report in 2023.

With a number of milestones completed, but an ever-evolving regulatory landscape for ESG and sustainable investment, we undertook a review of our governance and resources in this area in 2023 and took the decision to merge the two forums into a 'business-as-usual' structure, overseen by the Investment Stewardship and Sustainability Committee (ISSC). The ISSC provides consolidated senior oversight to all of our investment-related work in this area, embedding the long-term strategic importance to our firm of our approach to managing sustainability-related risks and opportunities across our business. Underscoring this importance, the firm's MD is a member of the new ISSC.

The ISSC is in turn supported by specialist groups that oversee specific areas of responsibility:

- **Proxy Voting & Engagement Group** (**PVEG**) – The PVEG is responsible for overseeing the firm's ongoing approach to (and reporting on) proxy voting and engagement activity, escalating decisions to the ISSC as required.
- **Sustainability Policy & Regulation Group** (**SPRG**) – The SPRG is responsible for the identification and interpretation of relevant sustainability & disclosure policies and regulations to determine their applicability to Walter Scott.
- **Sustainability Communications and Reporting Group** (**SCRG**) – The purpose of the SCRG is to oversee the end-to-end production of all mandatory stewardship, sustainability and ESG disclosures, as well as any additional sustainability communications.
- **ESG Research Group** (**ESGRG**) – The purpose of the ESGRG is to provide analysis, direction and support to the firm's investment research on ESG issues.
- **Additional Objectives Portfolios Group** (**AOPG**) – under delegation from the Walter Scott Investment Management Committee (IMC), the AOPG is responsible for reviewing and approving supplementary governance and sustainability assessments undertaken as part of the AOP process, in addition to monitoring any relevant additional portfolio level governance and sustainability considerations (such as client specific 'Sustainable Investment' thresholds).

“We believe that our progress over the last three years has ensured that we are now well placed to continue to meet the evolving expectations of our clients”

In addition to evolving our sustainability governance, we have also been increasing our resources in this area, with a number of Stewardship and Sustainability staff now based in our Research Operations team and reporting to the Head of Investment Operations and Sustainability. This team supports stock champions, the Investment Executive and other colleagues in a range of ESG-focused areas.

CLIMATE

The other area where we made significant progress in 2023 was with respect to climate risk and disclosure. For several years, we have been analysing climate risks and opportunities wherever material to our investments and have included an element of structured climate scenario analysis in our Integrity document since 2021. We have also been disclosing progressively more information on our approach to managing climate-related risks and opportunities in recent years, producing our first standalone climate report in 2022. In 2023, we further enhanced our existing approach, details of which are provided in the Climate section of this report.

ESG INTEGRATION AND STEWARDSHIP ACTIVITY

ESG research, proxy voting and engagement are fundamental elements of the stock champions' role, with additional operational and analytical support provided by Stewardship and Sustainability colleagues in Research Operations.

The focus of our work in this area in 2023 was the progressive evolution of our approach wherever helpful to our process. For example, we updated our proxy voting policy to place more emphasis on director independence on boards and committees. The updated policy was sent to all investee companies, noting the focus on independence. Where it was deemed appropriate, we proactively engaged with a number of relevant holdings to discuss the changes. Further details are provided in the Proxy Voting and Engagement sections of this report.

Further to all of the above, over 2023 we continued to embed our ‘Additional Objectives Portfolios’ methodology and process for evaluating the suitability of holdings for funds where our clients have supplementary sustainability requirements, such as SFDR Article 8, and we now are giving careful consideration to newer regulatory arrangements such as the UK’s Sustainability Disclosure Requirements (SDR). A number of other regulators are also currently working on additional sustainability-related disclosure requirements. It is a well-worn cliché, but with respect to ESG and sustainable investment regulations for the foreseeable future, the only constant in life is change, meriting the dedicated ‘business-as-usual’ policy and regulations group detailed in the governance update above.

Taken together, we believe that our progress over the last three years has ensured that we are now placed to continue to meet the evolving expectations of our clients.

ABOUT US

Walter Scott was founded in Edinburgh in 1983 as a global equity investment manager serving institutional clients. An early focus on the UK subsidiaries of US companies led to the development of a broad institutional client base in North America and then later around the world. Today, Walter Scott manages US$82.5 billion (as at 31st December 2023) in assets for institutional clients and distribution partners in all major regions.

The firm has maintained its investment philosophy and process, deliberately and consistently. A long-term investment outlook underpinned by rigorous research and highly selective investment are hallmarks of Walter Scott's approach.

Team-based research and investment decision making are also critical characteristics with members of the Walter Scott Research team responsible for all aspects of company analysis, as well as engagement and proxy voting. Edinburgh has remained Walter Scott's home since 1983, and we added a client service presence in Boston in 2019.

With a well-defined and consistently pursued investment approach, the firm's stated objective has also remained unchanged. That objective is to achieve a real rate of return of 7-10% annualised over the long term. Our 'buy and hold' investment approach rests upon a long-term holding period, enabling companies to grow over industrial and market cycles and allowing the compounding of growth over time. So too, therefore, the returns we seek to deliver for clients are long-term in nature.

From the firm's early days, the founders were acutely aware that investment performance can only ever rely on best efforts, whilst recognising that in terms of client service and administration there could be no excuse for anything less than excellence. On that commitment the firm's business strategy was born, with a focus first and foremost on existing clients. Much of Walter Scott's success over time has come from that starting premise and those values continue to shape the firm's strategy today. Clients whose tenure exceeds ten years account for 80% of the firm's assets under management, and additional funding from existing clients has been an important part of the firm's growth.

CULTURE

Walter Scott's consistently applied investment philosophy and process, alongside its consistent client-first business strategy have been key pillars of the firm's success. Culture has also played an important role in that success, a culture set out by the firm's founders, and which endures today. That strong and distinctive culture has, of course, not endured through mere chance, rather it has been protected and nurtured.

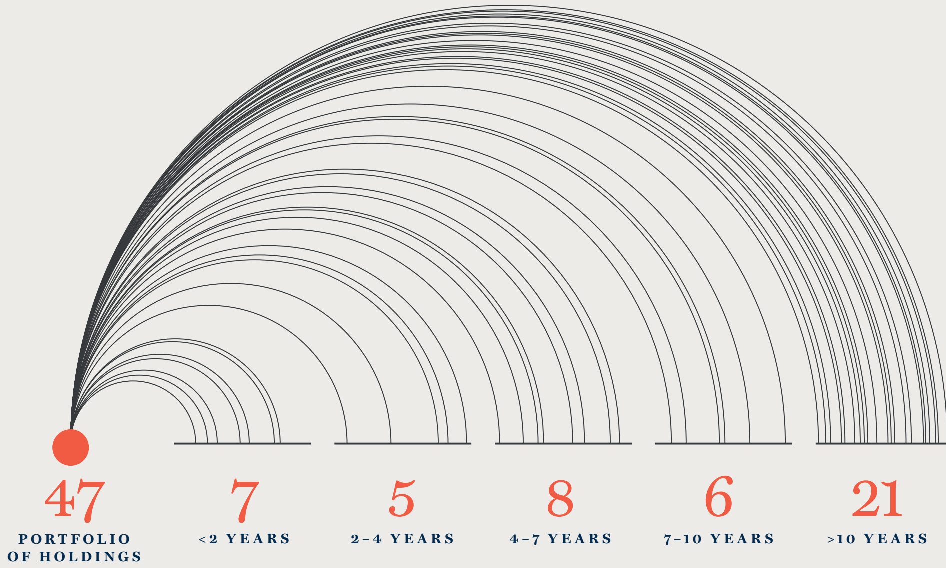
Long tenure of staff is another of Walter Scott's defining characteristics and one that has played an important part in a cohesive, collegiate, and meritocratic culture. Of the nine-strong Executive Management Committee, six have worked at Walter Scott for longer than ten years, and four of those individuals for over 25 years. Similarly, of the 21 individuals that make up the core investment team, ten have worked at Walter Scott for over a decade and three for more than 25 years.

That said, here again, the Board and senior management recognise the need to work hard to maintain that record of tenure, appreciating the need to protect Walter Scott's culture whilst also ensuring it is appropriate today in fostering a diverse, equitable and inclusive environment for new recruits as well as longstanding team members.

OWNERSHIP

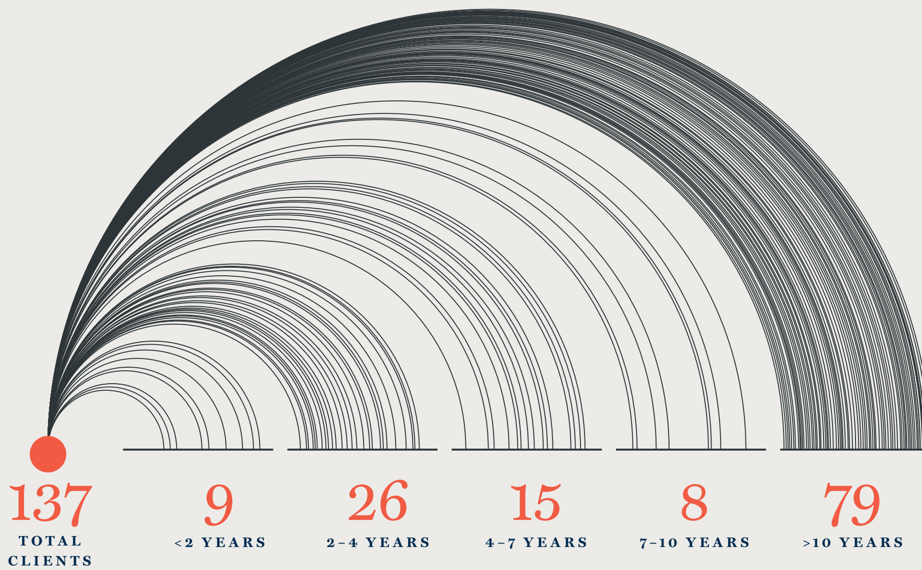
Walter Scott has been a 100%-owned subsidiary of BNY Mellon since 2007, one of a number of investment boutiques within its Investment Management division. The firm operates autonomously within that structure with BNY Mellon representation on the Walter Scott Board of Directors. The Board consists of an independent non-executive chair, four executive directors, including Walter Scott's managing director, and four other non-executive directors, three of whom are independent non-executive directors and the other being the CEO of BNY Mellon Investment Management who acts as a group non-executive director.

BUY AND HOLD

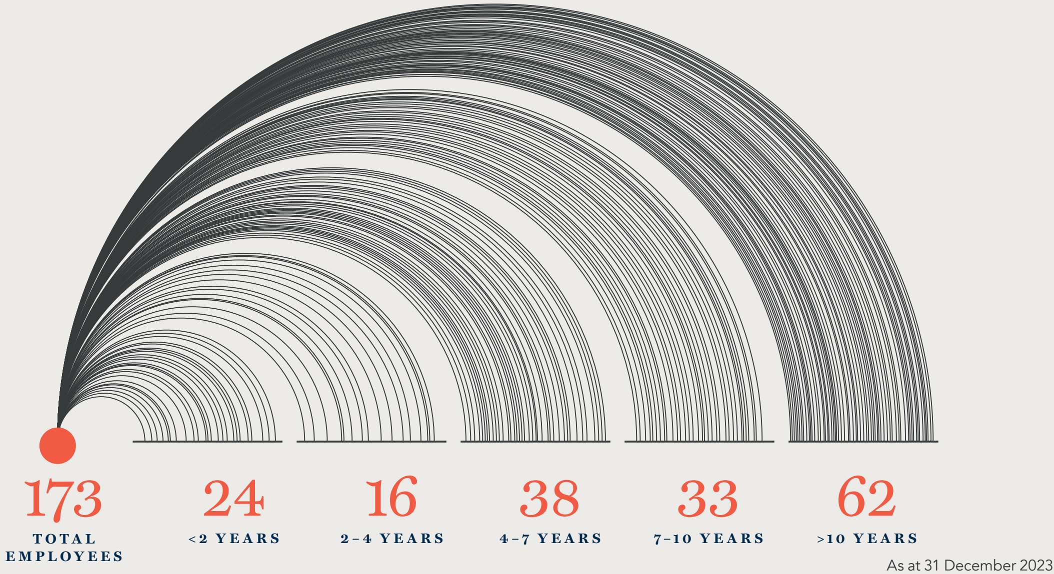


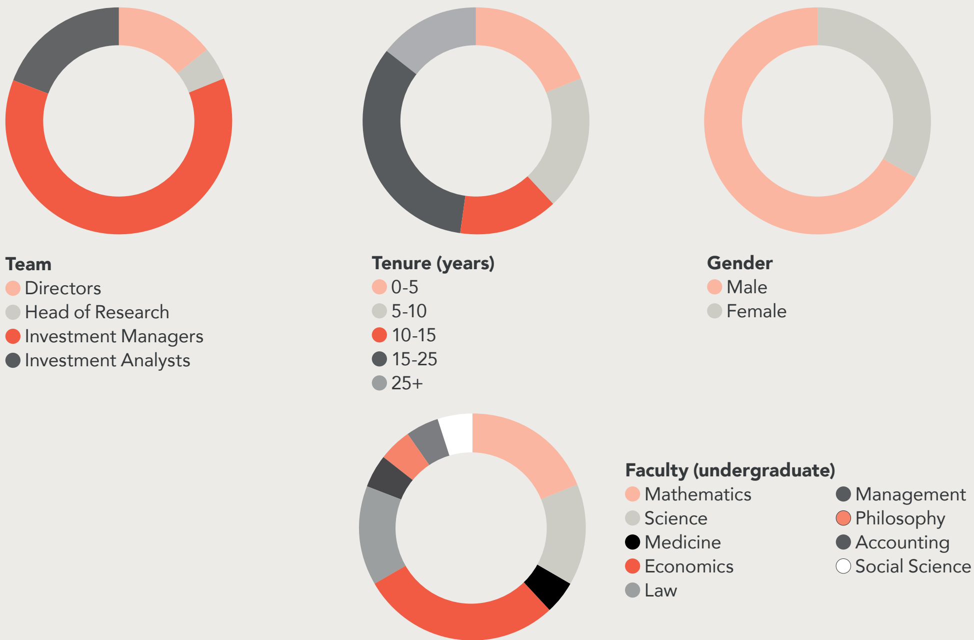
As at 31 December 2023. Source: Walter Scott. A representative USD-based global portfolio was used to illustrate this. Stocks sold and then re-purchased only include the duration held since most recent purchase.

CLIENT LONGEVITY



As at 31 December 2023


EMPLOYEE TENURE
173
TOTAL EMPLOYEES
24
<2 YEARS
16
2–4 YEARS
38
4–7 YEARS
33
7–10 YEARS
62
>10 YEARS
As at 31 December 2023


INVESTMENT EXECUTIVE AND RESEARCH TEAM
Team
Directors
Head of Research
Investment Managers
Investment Analysts
Tenure (years)
0-5
5-10
10-15
15-25
25+
Gender
Male
Female
Faculty (undergraduate)
Mathematics
Science
Medicine
Economics
Law
Management
Philosophy
Accounting
Social Science
As at 31 December 2023

WALTER SCOTT IN NUMBERS

WALTER SCOTT

1983
Walter Scott & Partners Limited founded

173
Employees

$82.5BN
Assets Under Management

137
Clients in 18 countries

INVESTMENT APPROACH

1
—TEAM—
One investment team manages all portfolios collectively

1
—PHILOSOPHY & PROCESS—
Consistently applied investment philosophy and process since 1983

1
—ASSET CLASS—
Sole focus on global equities

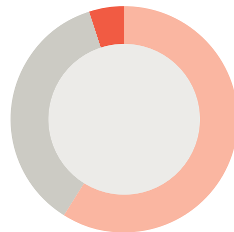
CLIENTS

10.4
Average years length of client relationship

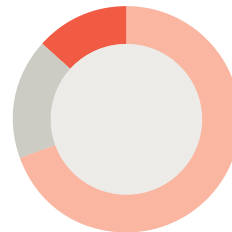
80
% of AUM managed for clients with tenure >10 years

57
% of AUM managed for clients with tenure >15 years

ASSETS

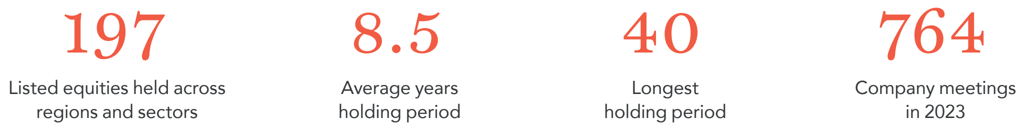


AUM by Product
- Global – 61%
- EAFE – 37%
- Other – 2%



AUM by Region
- North America – 70%
- Asia Pacific – 16%
- EMEA & ROW – 14%

OUR COMPANIES



197
Listed equities held across regions and sectors

8.5
Average years holding period

40
Longest holding period

764
Company meetings in 2023

Source: Walter Scott, all figures as at 31st December 2023

ESG INTEGRATION

After the pandemic-related disruption of the previous couple of years, the Research team enjoyed a full year of travel and face-to-face meetings with company management teams, industry experts and external stakeholders in 2023. ESG considerations continued to play a prominent role in many of these discussions, unsurprisingly so given the increasingly financially material consequences of inadequate adherence to regulatory standards and the reputational risk of poor ESG practices. The Engagement section of this report provides further details on our engagements in 2023.

One high-profile example of financially material ESG considerations in 2023 was Johnson & Johnson, which has faced long-running allegations that its talc-based baby powder contained asbestos and had caused women to develop ovarian cancer. Whilst the company has always maintained its innocence, a US court ruling in early 2023 paved the way for an extremely lengthy, and potentially costly, legal overhang. Having engaged with J&J on numerous occasions on this issue, we viewed the ruling as a significant risk. Coming as it did at a time when the company was also going through the complex demerger of its consumer health division and facing questions about the growth outlook for its pharma business, we took the decision to exit our position.

WHAT WE CONSIDER

We don't believe that ESG is a separate construct or a methodology that can be usefully applied in isolation from the financial analysis of our investments. For us, ESG risks and opportunities are research inputs. ESG is shorthand for a number of issues that we think can potentially be important to the long-term success of our investments:

ENVIRONMENTAL CONSIDERATIONS
Biodiversity risks and impact; water and natural resource usage; circular economy; pollution controls and waste management.

CLIMATE CONSIDERATIONS
Physical climate risks; 'Paris alignment' and transition-related risks and opportunities; climate strategy; climate-related disclosures.

SOCIAL CONSIDERATIONS AND HUMAN CAPITAL
Bribery and corruption; tax practices; cyber security; AI ethics & data privacy; corporate conduct and culture; product safety and consumer protection.

Human capital management; diversity and inclusion; employee relations; labour rights and human rights in the workplace and supply chain; community engagement and social license to operate.

CORPORATE GOVERNANCE
Board and committee composition – independence, diversity, skills and experience; director commitment; share structures and voting standards; director and executive remuneration; succession planning and board development.

Related-party transactions and conflicts of interest; auditor independence; corporate disclosure; shareholder protection and rights; capital allocation and dividend policy; capital issuance and dilution; poison pills and anti-takeover practices; political donations.

KEY ESG INTEGRATION ISSUES RESEARCHED AND DISCUSSED IN 2023

Sector / Region	Key issues and relevant holdings
Consumer Staples	– Evolution of electric vehicle market (Alimentation Couche-Tard)
Consumer Discretionary	– Supply chain governance (Inditex, Nike, TJX Companies) – Health & nutrition (Greggs)
Healthcare	– Access to medicine (Novartis, Novo Nordisk)
Industrials	– Transportation-related carbon emissions (Canadian National Railway, ODFL)
Information Technology	– Employee retention (Cognizant, OBIC) – Supply chain resilience (Cognex, ASM International, Texas Instruments) – Artificial Intelligence (Adobe, Dassault Systèmes) – Antitrust (Alphabet)
Materials	– Hydrogen (Air Liquide, Linde)

To further build on our ESG integration efforts, we added new resource to our Research Operations team, which plays a crucial role in supporting the Research team in its stewardship and sustainability efforts.

On climate, our Integrity document, the key tool in our ESG analysis, evolved to include a third climate scenario – 'delayed transition' – whilst we also carried out an enhanced climate analysis on a number of holdings that we believe to be more exposed to climate risks.

Finally, our new ESG Benchmarking and Risk Review is collated and presented to the Research team on a quarterly basis, with the aim of providing an insight into Walter Scott's current exposures (in absolute and relative terms) from the perspective of the firm, portfolio, investee companies, and more. Additionally, longer-term trends are observed for Walter Scott's investee companies and the wider market. Ultimately, this review aims to capture financially material ESG risks and opportunities relevant to Walter Scott, and to prompt further discussion and analysis.

KNOWLEDGE SHARING AND TRAINING

Our commitment to knowledge sharing and continuous development in the area of sustainability continued in 2023.

Every member of the investment team (including Client Service) is encouraged to deepen their knowledge by attending seminars, conferences, and events. In 2023, Alan Edington, Investment Manager – ESG Integration, attended the fall conference of the Council of Institutional Investors in California (see page 20), as well as a sustainable investing summit in Amsterdam and an ICGN conference in Toronto. Two members of Research Operations also attended an ICGN Governance, Stewardship and Sustainability course. This course was subsequently segmented into three individual courses – Governance Fundamentals, Stewardship Fundamentals and Sustainability Fundamentals. A member of Research Operations completed all three courses.

In May 2023, Walter Scott's fifth Research Conference in Edinburgh saw clients from around the world gather with our own team to listen to speakers from academia, politics, journalism, music, and business. Amongst the speakers was Peter Tertzakian, Deputy Director at the ARC Energy Research Institute and author of *A Thousand Barrels a Second*, who considered the challenges of analysing, managing and monitoring risk and return in the global energy transition (see page 17). Also speaking was Helle Kristoffersen, President of Strategy and Sustainability at TotalEnergies, who outlined her company's transition approach to today's energy shift.

As in previous years, we invited several external speakers to present to the Research team throughout the year, with the aim of sharing insights and challenging our understanding of sustainability-related issues. In June, Dr Scott Moore from the University of Pennsylvania presented on the implications of decarbonisation and ESG for China's economic outlook, whilst in July, Rob West of Thunder Said Energy shared his views on the global energy transition. On a Research team away day in August, PwC held an interactive session on climate scenario analysis. A member

HOW TO GET FROM A TO B IN A GLOBAL ENERGY TRANSITION

The complexity of the global energy transition is a significant long-term challenge for investors as the familiar and long-dominant energy system gradually gives way to a new and still-uncertain paradigm. At Walter Scott's 2023 Research Conference, two guest speakers took a closer look at the reality of the transition and some of the many associated risks and opportunities.

Drawing on previous transitions in history, Peter Tertzakian, Deputy Director at the ARC Energy Research Institute and author of *A Thousand Barrels a Second*, considered how investors can build a framework to help them better analyse, manage and monitor risk and return in today's energy shift. Meanwhile, Helle Kristoffersen, President of Strategy and Sustainability at TotalEnergies, outlined her company's transition approach and emphasised the importance of supporting and investing in today's energy system, whilst at the same time investing in a cleaner, more sustainable future.

In *Farewell to the Horse*, Ulrich Raulff's elegiac study of the role of the horse in human history, the reader is asked to imagine the sights and smells of New York in the late 19th century, when some 130,000 of our equine friends toiled within the city at any one time:

"What must it have felt like to walk along Broadway and have to dodge horse carcasses and carriages wedged into gridlock? How must a city like New York have reeked, when its horses produced 1,100 tonnes of manure and 270,000 litres of urine daily, and when twenty dead horses were transported away every day?"

For the residents of New York, the horse-powered economy was an environmental hazard to be endured. Aside from the daily assault on the senses, accidents were commonplace – in 1867, horse-powered transport caused four fatalities and a further forty injuries in New York every week – and the accumulation of effluence was a breeding ground for disease.

But at the same time as horsepower was reaching its apogee, the seeds of its destruction were being sown in the American Midwest. In 1903, Henry Ford founded his eponymous motor company in Detroit, Michigan. In a little under two decades, Ford's pioneering use of the moving assembly line would make automobiles affordable to the average American. As the country enthusiastically embraced the arrival of this new, more convenient, 'cleaner' technology, the horse would soon disappear almost entirely from city life, 'transitioned' away by the internal combustion engine and manufacturing innovation.

As Peter Tertzakian explained, the replacement of the horse by the automobile was, at root, an energy transition for turning a wheel. What is important to understand, however, is that such transitions entail not simply the replacement of one technology with another, but the wholesale replacement of one supply chain with another. For investors, this has profound implications.

What would an investor in the early years of the 20th Century have made of the advent of the automobile? With a little foresight, they might have concluded that it didn't look so good for farmers. According to Ulrich Raulff, eight million tonnes of hay and almost nine million tonnes of oats were produced every year to feed the three million horses working in American cities in 1900. At the same time, however, a whole new supply chain was emerging: oil wells, refineries, pipelines, fuelling stations. Evidently, the move from System A – the horse – to System B – the automobile – brought opportunities as well as risks.

That systemic change is analogous – up to a point – with what we are seeing with today's move to decarbonise the global economy. If we stay with the example of turning a wheel, electric vehicles demand a different supply chain from those with internal combustion engines. With little need for the old infrastructure of oil wells, refineries, and pipelines, the focus is instead on primary energy sources like wind or solar, electricity which requires transmission, charging stations and batteries. Understand changing supply chains – the move from System A to System B – and the investor is better placed to understand the emerging risks and opportunities of the transition.

Today's transition differs from previous instances in a couple of crucial aspects, however. First, the sheer number of new and nascent technologies and energy sources associated with the transition means that there is little clarity around which supply chains will emerge as dominant. Second, the world is awash with policies, regulations and incentives designed to encourage the use of some technologies and energy sources and to discourage the use of others.

How likely are these policies, regulations and incentives to endure, particularly in today's polarised political landscape? Remove a favourable regulation or incentive and an entire supply chain can be rendered financially unsustainable. The presence of these variables lends today's transition an unprecedented level of complexity from an investment perspective.

It is tempting to think that transitions result in the decline of those companies dominant in the incumbent modality; that the investment opportunities of the future belong only to the start-ups and disruptors. This is not necessarily the case. Using the analogy of the sailing industry, Peter Tertzakian pointed to the century or so that it took the new technology of coal-fired steamships to surpass in speed the wind-powered clipper. Why? Because when faced by the threat of the steam age, the sailing industry innovated, experimenting with design and materials to make faster and more efficient vessels. The lesson: don't underestimate the ability of incumbents to successfully navigate transition by leveraging their already considerable expertise and resources.

Transition-focused innovation is something we discuss regularly with incumbent companies, whether that's industrial-gases leaders Linde and Air Liquide's work on hydrogen and other energy sources or Ferrari's push into ultra high-end electric vehicles. It's a theme that was taken up at the conference by Helle Kristoffersen of TotalEnergies (Total), a company that has pivoted to successfully establish a position in the vanguard of decarbonisation without compromising the performance of its long-established fossil fuels business.

Total's pragmatic approach to transition starts from the inescapable fact that in the short-to-medium term the world still needs fossil fuels. System A therefore requires significant ongoing support and investment. Total invests around one-third of its annual capital budget into maintaining its existing oil and gas businesses, and around another third on new oil and gas projects. The company takes a highly disciplined approach to new ventures, investing only in low emission and low-cost oil and gas as a means of securing financial resilience in an environment of low demand or carbon pricing. The risk of stranded assets is a real one as the transition matures.

The other third of Total's investment is in low-carbon energies, where the company takes a similarly disciplined approach. Using its high-margin oil and gas businesses to fund the creation of a large renewables business, the company has established structural advantages in the nascent but rapidly growing industries of offshore wind, hydrogen, and carbon capture and storage. Total aims to be one of the largest renewable operators globally by 2030.

Key to the Total transition story, however, has been its long-term strategic view that natural gas – specifically liquefied natural gas (LNG) – would be a vital bridge from System A to System B given it produces 60% less carbon per unit of generated energy when burnt relative to coal. Whilst that decision has been subject to a fair degree of investor scepticism over the years, it is now playing out largely as management expected. Today, Total is the number two player globally and expects to see this business double by 2030 as LNG increasingly facilitates the transition away from coal-fired power generation, particularly in Asia.

Running through the presentations of both Peter Tertzakian and Helle Kristoffersen was the common thread of complexity. The world is in the early stages of an epochal shift in how it produces and consumes energy, one of the fundamental building blocks of humanity's progress and prosperity. How that transition evolves is still the subject of huge conjecture, however, and potential scenarios and permutations abound.

Faced with this uncertainty, we will continue with our proprietary research and our conversations with external experts, policymakers and industry leaders, as we endeavour to better analyse and understand the financially material risks and opportunities presented by the energy transition. Our work in this area will, as ever, be guided by data and real-world insights, and in line with our aim of investing in strong businesses that can consistently compound wealth for our clients over the long term.

“Don't underestimate the ability of incumbents to successfully navigate transition by leveraging their already considerable expertise and resources”

of the Research team also presented on the risk and opportunities presented by the energy transition, prompting discussion around potential areas of focus for future research and analysis. In December, US Compensation specialist Steve O'Byrne spoke on key developments and considerations in US executive remuneration.

It's also important that our wider company understands developments in our approach to ESG and changes in the broader sustainable investing landscape. In 2023, a knowledge transfer workshop covering ESG Integration, Stewardship and Sustainability was delivered to all Walter Scott employees.

THE YEAR AHEAD

Unsurprisingly, the regulatory environment will continue to evolve in 2024 and the Research team will continue to keep abreast of developments and their potential impacts on our portfolio companies.

Europe will again be in the vanguard of regulatory change, with the European Union's (EU) Corporate Sustainability Reporting Directive (CSRD) coming into force for the 2024 financial year for the first tranche of qualifying companies. Many of our investee companies will be in scope. The aim of the directive is to standardise and simplify sustainability reporting, ensuring that "investors and other stakeholders have access to the information they need to assess the impact of companies on people and the environment and for investors to assess financial risks and opportunities arising from climate change and other sustainability issues."

Final agreement on the EU's Corporate Sustainability Due Diligence Directive is also likely in 2024, a provisional deal having been reached in December 2023. The directive will set obligations for "large companies regarding actual and potential adverse impacts on human rights and the environment, with respect to their own operations, those of their subsidiaries, and those carried out by their business partners". Again, many of our investee companies will be in scope and, as with the CSRD, the ramifications will be felt beyond the borders of the EU.

In the US, the SEC released new climate disclosure rules in March 2024. The rule will require qualifying companies to report on "climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition."

Regulation aside, it would come as little surprise if ESG was again pulled into the political debate, particularly with elections coming up in the US, UK and EU. Despite the level of political noise associated with the topic, we will remain focused on analysing and assessing those risks and opportunities, whether ESG-related or otherwise, that we deem to be financially material to our investee companies.

Given the above, we will continue to invest in the ESG capabilities of our Research and Research Operations teams in 2024 to ensure that we are best placed to compound wealth for our clients over the long term. As part of this, we will continue to survey the industry landscape for additional value-add data providers to complement our existing provider, MSCI.

REPORTING BACK FROM THE COUNCIL OF INSTITUTIONAL INVESTORS FALL CONFERENCE

ALAN EDINGTON
Investment Manager – ESG Integration

Given the often vexed public debate around matters ESG in the United States, a conference attended by institutional investors from across the country – both so-called 'red' states and 'blue' – might have been expected to be a somewhat combative affair. Instead, the Council for Institutional Investors' Fall gathering in Los Angeles was refreshingly non-partisan.

Rather than highlight division and discord, three days of debate and discussion suggested that most participants had, if not identical views on every issue, then at least a shared philosophical approach to ESG. Namely, that consideration of all financially material risks and opportunities is entirely consistent with fiduciary duty. Having watched the increasing polarisation of political views of ESG with some dismay, we welcome this insight into the way that asset owners are really thinking, which reflects our own understanding and approach.

Titled 'Next Frontiers for Governance' the conference traversed a range of issues, from the high-level – diversity, geopolitics – to the more granular. There were also some fascinating snippets, one favourite being the fact that 89% of directors of S&P 500 companies believe that at least one of their fellow directors should be replaced!

One topic of discussion that felt particularly apposite given the California setting was the increasing number of dual-class share structures, a trend which has in recent years been driven by the West Coast technology sector. According to data compiled by Jay R. Ritter, Cordell Professor of Finance at the University of Florida, 50% of tech companies that listed in 2022 opted for a dual-class share structure, up from 47% the previous year and a mere 15% ten years prior.

Granting some shareholders superior voting rights, dual-class share structures prove popular with founder-led companies, typically enabling those individuals to access capital markets without ceding effective control of the company. As a firm, our preference, which aligns with that of the broader investment management industry, is for a 'one share, one vote' voting structure for ordinary or common shares, and we discourage structures that give certain shareholders influence or control disproportionate to their economic interests (although such structures are not a barrier to ownership if we believe the investment will generate sufficient long-term wealth for clients).

During the conference session, participants cited evidence to suggest that whilst the dual-class structure offers some benefits in the years

> *“89% of directors of S&P 500 companies believe that at least one of their fellow directors should be replaced”*

“A pragmatic approach to the issue of dual-class share structures is, we believe, the most appropriate one”

immediately following an initial public offering, trust and value creation starts to decline after a period of around seven years. Furthermore, it was argued that management teams of companies with these structures in place can be less likely to engage with shareholders and be harder to hold to account. Examples of ‘cronyism’ at board level are also more prevalent where power is concentrated in the hands of a single person or a narrow group of individuals.

From our perspective, these are all valid concerns and help in part to explain our preference for ‘one share, one vote’. Certainly, the declining utility of dual-class structures over time is why we favour ‘sunset’ mechanisms where such structures already exist. Overall, however, we approach the issue on a case-by-case basis, researching the detail of the structure in place and engaging with management where appropriate to gain a comprehensive overview of its rationale and implementation, whilst at the same time outlining our preferences and expectations.

A pragmatic approach to the issue of dual-class share structures is, we believe, the most appropriate one. Whilst it is right to have a clearly defined stance on what good looks like and to communicate that view to companies, it would be wrong to have a hard ‘red line’ on an issue often marked by significant nuance. Not all dual-class structures are inherently inimical to the interests of minority shareholders. It is for us as responsible stewards of our clients’ assets to assess and balance the risks and opportunities involved and to proceed accordingly.

ENGAGEMENT

At Walter Scott, stewardship is the careful allocation, management and oversight of capital to create long-term value for our clients and beneficiaries. Good stewardship involves thorough background research, structured, purposeful dialogue or engagement with companies and considered voting of shares.

We are members of the International Corporate Governance Network, which works to promote effective standards of corporate governance and investor stewardship. We endorse its stewardship principles and align with its governance principles.

Responsibility for engagement and proxy voting sits with our Research team and Investment Executive, overseen by our Investment Stewardship & Sustainability Committee and supported by the Proxy Voting and Engagement Group and Research Operations.

Dialogue with companies has always been an important and valued part of our investment process. Through engagement, we signal our intentions and expectations as a long-term shareholder, building enduring relationships and achieving a more complete understanding of a company's strategy and practices.

We split our engagement between Engagement for Information and Engagement for Change. The latter will always be less numerous given the rigour of our pre-investment research into a company and our concentrated number of holdings. Our approach to engaging for change is pragmatic and constructive. Working with the Investment Stewardship & Sustainability Committee, stock champions must judge the significance of the issue and the likelihood that dialogue will drive change before a formal engagement for change is instigated. This helps us to prioritise and focus our efforts where they have the greatest chance of success.

ENGAGEMENT IN 2023

Having welcomed the return of face-to-face meetings in 2022, we undertook a series of overseas research trips this year. Many of these trips were extensive in nature, with several members of the Research team visiting countries and regions for a number of weeks. Trips are a critical part of our investment process, providing us with important 'on the ground' insights. Some examples of the meetings and the subjects discussed on these trips are included in the pages that follow.

Reflecting our view that companies should adhere to high standards of climate disclosure, we continued to encourage investee companies to align their reporting with the Task Force on Climate-Related Financial Disclosures and the CDP disclosure framework. Alignment not only offers investors greater insight into how a company's business strategy takes climate into account, it also provides a simple and consistent framework for obtaining comparable and useful information. Whilst we appreciate that companies have many competing pressures, climate is a critical medium-to-long-term issue that will have to be addressed.

ENGAGEMENT FOR INFORMATION

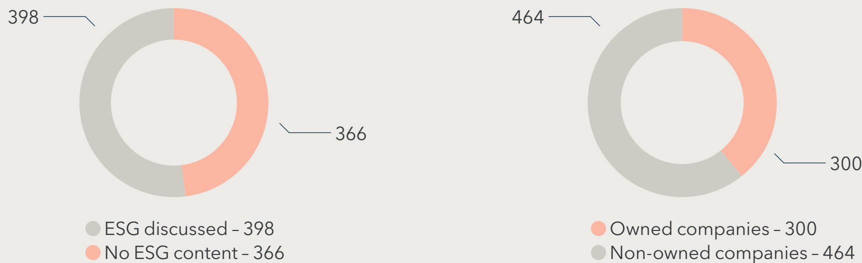
Prudential Plc

Prudential's business has undergone significant upheaval in recent years, with the demergers of its UK-based M&G business in 2019 and US-based Jackson business two years later. Today, the business is very much an Asia-focused insurance company. Change on this scale brings real challenges, however, and a call with Prudential's chair, Baroness Shriti Vadera, was an opportunity to get further insight into how some these challenges are progressing.

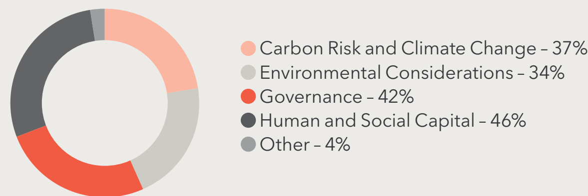
One pressing matter facing the business was the need to appoint a new CEO whose experience reflected the shift from a "global financial holding company" to an "Asian operating

"Trips are a critical part of our investment process, providing us with important 'on the ground' insights"

COMPANY MEETINGS



MEETINGS WITH ESG CONTENT SPLIT BY SUBJECT[1]



[1]More than one subject might be raised in a single meeting

company." After an exhaustive process, Anil Wadhwani, President and CEO of Manulife Asia, was appointed.

Mr. Wadhwani, whose three decades of industry experience was gained predominantly in Asia, assumed his new role in late February 2023.

Personnel changes have also been required at board level. According to Baroness Vadera, a significant refresh was required following the demergers of M&G and Jackson. With several directors reaching their term limits, the business took the opportunity to appoint board members with greater Asia and digital experience. Whilst this has resulted in a relatively young board, Baroness Vadera believes appropriate experience is more important than a well-tenured board lacking in the requisite skillset to drive the business forward.

Executive remuneration practices are also under review. Prudential's board has been testing shareholder appetite for a remuneration model more aligned with the company's Asian peers. This year the board is seeking permission to pay more of the CEO's annual bonus in cash rather than stock, which is common practice in Asia. Other changes have also been floated, including the incorporation of more restricted stock units. However, UK shareholders, subject to a different regulatory regime, have pushed back on these changes, leading to the plans being put on hold for now. Given this could impact the recruitment of a future CEO, we discussed how Prudential might reorient its shareholder base away from the UK towards Asia.

Ferrari

A first one-to-one meeting with the new CEO of Ferrari, Benedetto Vigna, was a chance to get his views on a range of issues, among them electrification and the long-term outlook for the internal combustion engine (ICE). Mr Vigna is convinced that Ferrari can succeed in the electric-vehicle (EV) space, thanks particularly to the company's world-class mechanical and electrical engineering talent, and customer demand for Ferrari to produce EVs.

“On our many trips to America’s Midwest, we’ve always come away impressed by the culture of so many of the companies visited”

There is a chance that the production of EVs may lose Ferrari some customers, but Mr Vigna thinks the business will gain many others. The average age of a Ferrari customer has declined over time, and Generation Z places greater importance on environmental factors than their predecessors. It’s important for an all-electric Ferrari to be a unique proposition when it comes to design, performance and emotion.

With respect to performance, there are myriad contributing attributes, many of which are the same for ICE and EVs. For example, Ferrari Active Suspension Technology developed for the heavier-than-average Purosangue model can also be used in the EVs where battery weight is a key consideration. The process will involve a focus within the company on the parts of the car which make Ferrari unique, whilst outsourcing the production of non-core elements to partners.

Demand for Ferrari’s ICE vehicles will remain strong, however, and Mr. Vigna sees biofuels as key to meeting tightening environmental regulations. He believes that steps taken by Formula One to become more sustainable will help drive Ferrari’s own strategy in this area.

Inditex
A trip to Inditex’s headquarters in northern Spain was an opportunity to discuss the ongoing evolution of the Zara owner’s sustainability strategy. In recent years, Inditex has worked hard to increase the sustainability of its product offering and our view of the company as a sustainability leader within the fast-fashion industry has been central to our investment decision making. At the core of the company’s strategy was the ‘Join Life’ label, which was attached to products that incorporated sustainable raw materials or that were manufactured in environmentally sustainable facilities.

By 2022, over 60% of products qualified as Join Life. Now, however, Inditex plans to remove the Join Life label. This isn’t because the business is retreating from its sustainability ambitions but because it wants to be known for producing sustainable products across its full offering, not just a subsection of it. The new sustainability strategy will be outlined at or around the time of the company’s AGM and will include new targets and KPIs.

“As a major global apparel retailer, Inditex has historically led peers in addressing concerns around integrity and sustainability. It is in the early stages of transitioning its products towards more sustainable sourcing practices. If it can execute this transition more successfully than peers then it could provide the group with a source of further competitive advantage.”
Excerpt from Walter Scott’s Inditex Integrity document

During our meeting, Inditex representatives spoke enthusiastically about developments in garment recycling technology, as well as the growth in capacity of natural viscose materials, such as lyocell. Reflecting this, the company is supporting a Portuguese business which is in the process of building a huge new lyocell plant in northern Spain. Inditex also expects to be a commercial beneficiary of increasing transparency around sustainability, citing the EU’s taxonomy legislation as a potentially important competitive differentiator over time.

O’Reilly Automotive
“Culture eats strategy for breakfast” may have become something of a cliché but it remains a pithy reminder of the importance of a company’s internal working practices in driving long-term outperformance. On our many trips to America’s Midwest, we’ve always come away impressed by the culture of so many of the companies visited, with pride, humility, long tenure, and innovation often defining characteristics. One such company is O’Reilly Automotive, the Missouri-based specialty retailer of auto aftermarket parts, tools, supplies, equipment and accessories.

In February, we caught up with the company to discuss a range of issues, including the role of culture in O’Reilly’s enduring success. According to the company, culture is O’Reilly’s biggest competitive advantage, and the development of human capital the organisation’s number one focus.

O’Reilly’s philosophy is to nurture talent internally and a vast majority of senior management, district managers and store managers have been promoted from within. Over 220 senior managers and over

280 corporate managers with an average of twenty and sixteen years respectively are the bedrock of the business. Every store manager reports directly to a district manager who was previously a store manager. There is a level of specialism and expertise throughout the workforce that sets the company apart from many of its peers. Customers receive a highly consulted service at an O'Reilly store, with extensively trained Professional Parts People serving customers at dedicated counters. Having started out with one store and thirteen people in 1957, O'Reilly now has some 85,000 employees across over 5,700 stores. On this scale, maintaining a consistent culture requires hard work; however, twenty-nine consecutive years of sales and earnings growth, despite recessions and pandemics, suggests O'Reilly has been successful in its efforts. The company's solid foundations and differentiated culture are key competitive advantages, in our view, and core to our decision to invest.

Nike

Supply chain risk remains a major focus for the global apparel industry and a meeting with Nike was an opportunity to discuss how the company's approach is evolving. Nike's strategy can effectively be broken down into three elements. The first is reducing the time between design and consumer availability. Central to this is the company's 'Express Lane' initiative, which the business views as a major competitive advantage. The second element is focused on ensuring supply chain resiliency. This involves reducing manufacturing concentration risk by geography and style of product. The third and final element is responsibility within the supply chain. On this front, Nike is pursuing a number of initiatives. One is to try and encourage higher employee retention at factories by creating a better working environment. Part of the emphasis is on gender representation and appropriate levels of health & safety. Fundamentally, a better working environment equals higher employee retention and therefore less financially material supply chain risk.

Nike is also working to ensure that its suppliers adhere to high standards of conduct, which began with tier one suppliers and is now starting to migrate down to tier two, and the company also has a number of initiatives focused on raw material risk. On this latter point – a complex and highly sensitive area – trust and verification of raw materials is the key goal.

How can Nike ensure there are no inappropriate raw materials working their way into its supply chain? To date, the company hasn't wanted to communicate too widely many of the initiatives being trialled because the business is not yet in a position to scale a solution for the materials that matter most. This is an industry wide issue but Nike is showing leadership.

Air Liquide

A visit to Air Liquide's innovation centre near Grenoble was an opportunity to learn more about some of the company's work to develop more environmentally friendly energy sources. Innovation has always been important to Air Liquide and the company currently spends in excess of €300 million on it every year. Grenoble is one of its six innovation centres (Tokyo, Shanghai, Delaware, Paris and Frankfurt are the others) and the only one with production capabilities.

Much of the technology being developed at Grenoble is still at the nascent stage and accounts for only a small part of Air Liquide's activities but there are some areas where the company has already established a strong market position. The business gained an early mover advantage by partnering with the French state to develop cryogenic and hydrogen liquefaction technology for Europe's space programme. Air Liquide believes the future of transport will involve more than one technology and that hydrogen is likely to be the fuel of choice for commercial vehicles and aviation. Management is particularly excited about the latter. The key issue for now concerns the size of the fuel tank. Whilst a hydrogen tank is only one quarter of the weight of a traditional kerosene tank, it is three times the volume. Finding space on an aircraft to fit this is therefore a major challenge.

Through its partnership with Airbus, however, Air Liquide is making progress on developing a solution. By 2026, Airbus aims to have one engine out of four running on hydrogen and the technology is expected to be fully commercial a decade later.

DEFINING ENGAGEMENT

We distinguish between two types of engagement:

Engagement for Information – a meeting or correspondence involving a two-way exchange of information.

Engagement for Change – typically a series of one- to-one meetings and correspondence, where we seek influence with a defined objective. An engagement for change will often relate to sustainability issues and our tailored approach enables us to focus on the issues or concerns material to each company. Through constructive dialogue, we encourage management to take the steps necessary to address areas of concern. Engagements for change are very often long-term in nature, involving numerous meetings with management and close monitoring of progress.

Our experience of engaging with companies suggests there is no perfect sustainability scorecard and all companies face different issues of varying materiality. Given the rigour of our analysis before making an initial investment, we find the need for engagements for change relatively limited when compared to engagements for information.

The decision to pursue a specific engagement objective can come from a number of sources:

- The stock champion responsible for a company identifies an objective and seeks confirmation to proceed from the Proxy Voting and Engagement Group (PVEG) and the Investment Stewardship and Sustainability Committee (ISSC).
- Another member of the Research Team or Investment Executive identifies an objective and flags this to the stock champion responsible for the company. Agreement to proceed is then sought from the PVEG in the first instance and then subsequently the ISSC.
- The PVEG identifies engagement objectives for specific companies or a thematic engagement across multiple companies.

The criteria for engagement for change considered by the stock champion and the ISSC include:

Does the company:

- have financially material risks and/or opportunities where change, in our view, would benefit shareholders,
- that are addressable,
- where dialogue would contribute to change.

Where the answer to each of these is affirmative then the ISSC has discretion to conclude that we should engage for change. The Committee and stock champion will agree objectives, which will be communicated to the company in question.

Progress on an engagement for change is tracked and recorded through a number of potential stages:

- **Stage 1** – Raise the issue with the company (typically in writing)
- **Stage 2** – Company responds acknowledging that there is an issue
- **Stage 3** – Company demonstrates a plan to address issue
- **Stage 4** – Issue has been addressed, with evidence
- **Stage 5** – Issue has not been addressed – after consideration, the company reject our change objective
- **Stage 6** – The objective is no longer relevant (we have either sold the stock or the situation has evolved).

Should an engagement for change reach stage 5 or if the company has not acknowledged the issue, the ISSC (advised by the PVEG) will consider escalating the issue. Issues are considered on a case-by-case basis, but possible escalation strategies can include:

- Communication with more senior management or board member
- A formal letter
- Engagement with the chairperson of the relevant board committee
- Voting against or abstaining on management proposals
- Collaboration with other investors.

Typically, our preference is to use our influence as long-term owners to engage with companies on areas of concern rather than divest. However, should our escalation strategy prove unsuccessful, we may choose to sell our investment.

OUR 2023 ENGAGEMENTS FOR CHANGE

The rigorous research we conduct prior to investing means that engagements for change are relatively rare in any given year.

INTUITIVE SURGICAL

Objectives: To encourage disclosure of scope 1 and scope 2 emissions.

Stage: Resolved

Update: We have corresponded extensively with Intuitive Surgical on its sustainability credentials in recent years, including on how best it can improve its carbon strategy and disclosure. In that time, the company announced it was committed to aligning its external reporting with recognized disclosure standards, including those used by CDP and that it would issue incremental disclosure in its 2022 sustainability report, to be issued in the first quarter of 2023. The published report provided validated greenhouse gas emissions for scope 1 and scope 2 and completed an inventory for scope 3.

Next Steps/Conclusions: Resolved

ARIAKE JAPAN

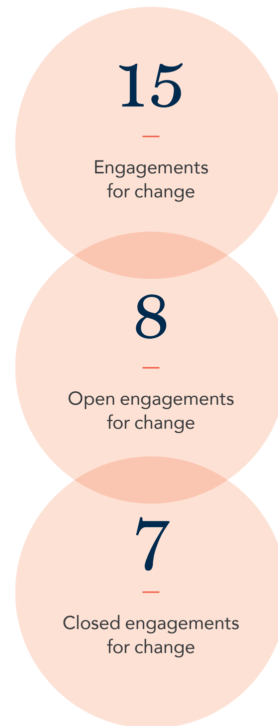
Objectives: Encourage CEO and Chair role to be split, as well as greater board independence.

Stage: Acknowledged

Update: In July, we wrote to Ariake expressing our ongoing concerns regarding board independence. With three independent outside directors, Ariake's board independence is currently below what we would consider best practice in line with the Japanese Corporate Governance Code. Furthermore, one of the independent outside directors provides professional services to Ariake, which could further impact the level of independence.

Next Steps/Conclusion: A request for a meeting to discuss the issues has been lodged with the company. Pending a meeting, we will continue to monitor progress. In previous conversations, management has stressed that it is keen to increase the independence of the board in accordance with the Japanese Corporate Governance Code.

ENGAGEMENTS FOR CHANGE 2023



JARDINE MATHESON

Objectives: Encourage improvement on a range of ESG issues, including divestment of coal assets and palm oil assets.

Stage: Acknowledged

Update: At a meeting in Hong Kong in September 2023, management delivered a robust defence of the company's approach to both palm oil and coal, particularly in regard to Astra International (in which JM has a 38% effective interest). Regarding palm oil, whilst disposing of the plantations would be the easy thing to do given they are neither financially material nor integral to long-term strategy, management believes this would not be the right thing to do. Astra is committed to

supporting the Indonesian economy, of which palm oil is a critical component. The industry is responsible for around two million jobs in the rural economy and supports a vulnerable section of the population. Moreover, the world has no substitute at scale for palm oil, which is an important component of the food supply chain. According to management, Astra should be considered a responsible owner given it goes beyond the standards set by the Roundtable on Sustainable Palm Oil.

Regarding coal, management was clear that there will be no new coal investment. That said, coal remains critical to the Indonesian economy for now, with no cheap power alternatives coming online in the near term. Indonesia has a net zero 2060 target, in accordance with global climate change targets for a just transition, and Astra will be a key enabler through investment in renewable energy and battery minerals. However, it will also continue to operate coal assets responsibly and in line with the country's decarbonisation plans. Management is adamant that this is the optimal solution and that to divest to a local owner would have a negative environmental impact.

Next Steps/Conclusions: Whilst both these issues call for nuance, we do think that exposure to assets such as palm oil and coal carries risks for JM, whether through pressure on asset owners to divest or costs related to managing the environmental impact. As such, we will continue to engage with management and explore potential resolutions.

PAYCHEX

Objectives: Greater board and committee independence

Stage: Acknowledged

Update: In November, we initiated an engagement for change with Paychex, the purpose of which is to encourage greater independence at both board and board committee level. In our view, companies should follow international best practice in terms of corporate governance in order to minimise the risk of mismanagement and the concomitant potential financial implications. On some measures, Paychex falls short of accepted best practice.

In recent years, Paychex has taken some steps to refresh the membership of its board, including the appointment of two new non-executive directors. However, we feel that there is more that the company can do to expedite this shift.

In respect of overall board independence, Paychex sits below our expectation of majority independence due to the number of long-tenured directors (we presume directors are not independent if they have served on the board for ten or more years). Whilst we welcome the recent addition of the independent non-executive Theresa Payton, we would like to see further steps taken to refresh membership whilst retaining an appropriate balance of skills and experience.

Regarding an independent chair of the board, we understand the reasons why Martin Mucci, who recently stepped down as CEO, currently holds that role. However, in such circumstances, it is our strong preference for a lead independent director to provide independent oversight. Ideally, this should be a shorter-tenured independent non-executive director than is currently the case.

Board committee membership has been a further area of discussion with our engagement focused on the level of independence within certain board committees.

Whilst the changes proposed appear significant on first inspection, they could be addressed with some relatively small changes to the current structure of the board by adding more independent directors or replacing a small number of existing long-tenured independent non-executive directors.

Next Steps/Conclusion: Paychex has acknowledged our preferences in this area and the board is committed to further enhancements to the board structure in the years ahead. We will continue to engage with the company in 2024 as it seeks to implement further change.

CASE STUDY: COSTCO AND THE MERITS OF A PRAGMATIC APPROACH TO ENGAGEMENT

MATTHEW GERLACH
Investment Manager

For more than two centuries, the elected board of directors has been the bedrock of corporate management. In 1811, the New York state legislature passed the first general incorporation act, decreeing that a company's "stock, property and concerns… shall be managed and conducted by trustees, who, except those for the first year, shall be elected".

Today, the importance of the board of directors to long-term corporate success and the protection of shareholder interests is beyond dispute. Regrettably, it is also abundantly clear that the board can play a central role in corporate collapse, whether through wilful malfeasance, negligence or plain old incompetence. From Enron and WorldCom to Parmalat and Wirecard, recent history is littered with tawdry tales of boardrooms failing in their duties.

Given this importance, it's little wonder that a great deal of ink has been spilled over the years defining what a good board looks like. In truth, there is no fixed formula; some of the aforementioned corporate catastrophes happened on the watch of seemingly fit and proper boards. That's not to say, however, that investors shouldn't seek to establish what they believe constitutes best practice. Nor that they shouldn't engage with those companies where they believe board composition is sub-optimal and where changes would be in the best interests of shareholders.

"From Enron and WorldCom to Parmalat and Wirecard, recent history is littered with tawdry tales of boardroom dysfunction"

In that vein, we recently initiated several engagements with companies on the issue of board independence. Good governance demands that boards are composed of individuals with the necessary skills and external experience to bring support, and robust challenge to the boardroom. In our view, this requires strong independent representation. The objectivity and outsider perspective that suitably qualified, high-quality independent directors can bring are assets that can help to minimise the risk of mismanagement and its potential financial implications. Where we believe it to be in the best interests of shareholders, we will not hesitate to actively encourage companies to strike a better balance regarding independent representation.

Typically, we expect a minimum of 50% of directors on the board of non-controlled companies to be independent (we generally presume directors are not independent if they have served on the board for ten or more years). Furthermore, we generally prefer to see an independent chair and/or an independent lead director. Note, however, the presence of the words "typically" and "generally". As with many other ESG-related issues, we would rather avoid a cookie-cutter approach to board composition. Context is everything and, in some circumstances, levels of board independence may not align optically with acknowledged best practice for very good reasons.

A case in point is Costco, the leader in North American warehouse retailing. On first inspection, the Costco board falls short of our stated preferences on independence. We have, however, taken the decision not to engage with Costco on this issue, given we believe the composition of the board is an important ingredient in Costco's 'secret sauce' and that change would not be in the best interests of shareholders. We could, of course, be proven wrong and there is no

“Typically, we expect a minimum of 50% of directors on the board of non-controlled companies to be independent”

question that the stakes do feel higher when you step away from the standard view, but we put value in our judgement and our knowledge of the companies we invest in.

At the time we took the decision not to engage with Costco, seven of its twelve board members were 'non-independent' by our definition, short of our preferred 50% threshold. That split has since changed to six out of eleven following the death of legendary investor and long-term Costco director Charlie Munger. A self-confessed Costco “addict” Mr. Munger served as a director of the firm for more than 25 years, bringing not only seven-decades' worth of investment experience but also a deep understanding of business models and, importantly, Costco's culture.

Of the six remaining non-independent directors, three are executives and three are non-executives with tenures in excess of ten years. In our view, these non-executive directors not only boast invaluable experience and expertise but, due to their long tenure, they are steeped in Costco's culture and fully understand the benefits of doing business in the unique Costco way.

The Costco approach to business is built around the concept of delayed gratification – resisting the temptation of immediate rewards in anticipation of greater rewards later. This is a very rare trait in business. In practice, it means paying employees more than you need to, so they stay and perform better over the long term; treating your suppliers well and offering better payment terms than necessary, in order to build and maintain long-term business relationships; and sharing growing economies of scale with your customers, so as to offer better value for money and increase loyalty.

Costco's ways have not always been well understood or appreciated. In the early 2000s, the company was out of favour on Wall Street for 'disregarding shareholder interests'. For analysts, Costco's tortoise was no match for Walmart's hare with its ruthless approach to costs, employees and suppliers. Not for the first time, however, the tortoise has outperformed. Today, Costco is one of the most admired brands in the world and its stock has comfortably outpaced Walmart's.* On top of this, employee retention is amongst the highest in retail and the company ranks as one of the most efficient large retailers (including from a carbon perspective). In other words, the Costco way of doing business has benefited shareholders, the company and the wider community. It is Costco's people – from board members to in-store employees – who are tasked with preserving this rare but successful culture.

Jeff Raikes, for example, has been a board member since 2008. A well-known philanthropist, Mr. Raikes co-founded the Raikes Foundation and was previously CEO of the Bill & Melinda Gates Foundation – the second largest charitable foundation in the world. Attuned to Costco's community values, his experience makes him an ideal fit for the role of chair of Costco's nominations committee and to oversee diversity and sustainability initiatives at the firm, key factors in employee acquisition and retention.

Similarly, Sue Decker, a board member since 2004, brings invaluable insights in technology and internet business models at a time when Costco is in the early stages of developing its own e-commerce platform and team. CEO and founder of Raftr, a digital media platform used by unions and non-profit organisations, Ms. Decker was also CFO of Yahoo in the early 2000s. As was the case with Charlie Munger, she is a long-standing member of the Berkshire Hathaway board, a company with similar long-term values to Costco.

The final non-executive director is Hamilton James, a board member since 1988 and chairman since 2017. Highly experienced across many global industries, Mr. James was former president and COO of Blackstone, and one of the key individuals credited with growing the company from a small private-equity shop into a global investment giant with nearly US$1 trillion in assets. Importantly, Mr. James' “non-independence” provides better challenge than the combined chair and CEO role that is typical of non-independence in the US.

“The Costco approach to business is built around the concept of delayed gratification”

There are few executives with the quality to deliver that challenge more effectively than Mr. James.

Judged solely on the experience they bring to the board, it would be very difficult to advocate for the removal of any of the aforementioned directors. But add in their deep knowledge and understanding of Costco's unique approach to doing business and we think that to do so would be counter-productive for the company and shareholders.

Any of Costco's principles could be sacrificed in the hope of delivering a sugar rush for profits or the share price. To do so would be to prioritise short-lived gains over long-term success and it is vital to have people in place who understand this. Costco is a case study in business success and the current board plays an integral role in preserving the culture that makes it a special business. Best to leave the cookie cutter in the kitchen drawer.

> *“It is Costco's people…who are tasked with preserving its rare but successful culture”*

*Source: Factset, Costco +2050.4% vs Walmart 245.1% (total return from 31 December 1999 to 19 December 2023 in USD)

COLLABORATION

The consistent application of highly selective investment criteria, a long-term investment horizon and an approach that is agnostic to benchmarks, be that sector or geography, means that our scope to engage collaboratively is more limited than it might be for others. That said, we do recognise that there are instances where a collaborative effort is the most powerful way to try to effect change.

In 2023, we were lead signatory for three companies as part of CDP's non-disclosure campaign. Two of the companies, Cognex and United Urban, submitted responses, enabling us to close our engagements for change, and we continue to engage with the other, Bapcor. Unlike 2022, we did not act as co-signatories due to changes in CDP's strategy. We deemed a requirement to sign all letters regardless of ownership as incompatible with our engagement approach.

Industry Initiatives
We recognise that all investment firms must play a part in encouraging well-functioning markets and financial systems. Despite our size we do believe it is incumbent upon all to proactively collaborate to address challenges and improve standards where possible.

Through our membership of the Investment Association, we continue to participate in a number of industry initiatives and working groups in relation to sustainability and TCFD. We have also collaborated with our parent, BNY Mellon, to respond to consultations over the course of 2023.

FCA Consultation Paper 22/20 – Sustainability Disclosure Requirements and Investment Labels
Participated in discussions and review of the Consultation, providing feedback to BNY Mellon to enable coordination of a joint response on proposed final draft rules to the FCA.

FCA DP23/1 – Finance for Positive Sustainable Change
As part of BNY Mellon's response to the Discussion Paper, we shared our thoughts on a range of issues.

European Supervisory Authorities consultation on revision to technical standards under the Sustainable Finance Disclosure Regulation (SFDR)
Engaged to review and develop a non-public response from BNY Mellon.

Investment Association's TCFD Focus Group
Representation on the IA's TCFD Focus Group, which considers 'key themes seen from the first round of reporting against the FCA's rules on TCFD for asset managers.'

Investment Association Survey on Stewardship Reporting
Participated in a survey to capture the quantity, nature and frequency of both client and investment consultant voting and engagement requests received by members.

European Commission Consultation on Implementation of SFDR
We provided feedback to BNY Mellon, which in turn sent a coordinated response on behalf of all BNY Mellon investment boutiques.

MEMBERSHIPS

We are members of or signatories to several groups that we believe best represent client interests in pushing for meaningful change in matters of sustainability, including:

Principles for Responsible Investment
Signatory since 2017
Membership reflects our commitment to the PRI's six principles and we report annually on our activities.

CDP (Formerly Carbon Disclosure Project)
Member since 2017
CDP is a not-for-profit charity that runs the global disclosure system used to establish company environmental impact and disclosure assessments.

Council of Institutional Investors
Member since 2023
The Council of Institutional Investors is a non-profit association of US public, corporate and union employee benefit funds. Our membership allows us to keep up-to-date with US asset owner sentiment on investment-related issues in corporate governance.

UK Investment Association
Longstanding member
The IA is the trade body and industry voice for investment managers in the UK. Several Walter Scott representatives now participate in IA working groups. The aim of which is to agree/shape industry best practice and provide input into policy making and regulation.

ICGN (International Corporate Governance Network)
Member since 2019
Founded in 1995, the ICGN is a leading authority on global standards of corporate governance and investor stewardship.

We have also stated our commitment to the **UK Stewardship Code** and **Japan's Stewardship Code**.

COLLABORATIVE ENGAGEMENT

Our involvement in collaborative efforts around environmental reporting continued in 2023, with a particular focus on encouraging companies to respond to CDP's non-disclosure campaign for climate.

COGNEX
We were lead signatory on the letter requesting that Cognex respond to CDP's non-disclosure campaign and provide better climate-related disclosure. The company had already made significant progress with the publication of its inaugural sustainability report in the second half of 2022 and during subsequent engagements, we were assured that a response to the non-disclosure campaign would be forthcoming later in 2023. Confirmation of this duly arrived in October, enabling us to close our engagement for change.

BAPCOR
We were lead signatory on the letter requesting that Bapcor respond to CDP's non-disclosure campaign and provide better climate-related disclosure. We subsequently received a response from the company confirming that it will not be submitting a response to CDP this year but that an assessment of its approach to ESG is ongoing. The company confirmed it has been looking into various ESG-related indices and reporting frameworks, including CDP, and that a decision will be made once this process is complete.

We will continue to monitor progress and continue our engagement as appropriate.

VAT GROUP

We have been engaging on climate with VAT Group since 2021, encouraging disclosure of climate data in line with CDP or another initiative, such as TCFD. In that time, the company has made good progress, and last year we participated in an ESG materiality consultation, which helped the business to identify specific areas of focus, whilst it also carried out a CO2 accounting exercise which provided insights into scope one and two emissions. In September 2023, VAT group submitted a response to the 2023 CDP non-disclosure campaign for climate, enabling us to close our engagement for change.

SUPPLEMENTARY COMPANY ENGAGEMENT INFORMATION IN ACCORDANCE WITH THE UK STEWARDSHIP CODE

ENGAGEMENT OUTCOMES

Our investment process leads to long-term holdings in some of the world's most successful companies. The issues that we decide to pursue in terms of engaging for change may be challenging. These are highly unlikely to be issues that can be quickly fixed. As such, we do not expect engagements for change to move quickly from initiation to successful close. We continue to refine and evolve our approach to engagement to ensure the best possible outcomes for our clients.

The examples of engagement for change shared within this report are intended to give an insight to the range of topics we discuss with management teams and the varied approaches.

ESCALATION

We have a formal process to guide the agreement of objectives, agree the route most likely to achieve those aims and then provide approval to proceed. An important aspect of that process is periodic review and the related decision to change approach or further escalate the engagement. Whilst engagement for change is likely to remain less common relative to many of our peers, given our selective investment approach and focus on high quality, market-leading companies, over time this more formal and documented process is enabling us to report on success and common themes. There were no formal escalations in 2023.

JUDGING PROGRESS

Progress on engagement is judged on a case-by-case basis and is reviewed periodically. We acknowledge that engagements for change can take time and we are supportive of management teams that wish to take an iterative approach on the issue under discussion, providing a clear pathway to improvement is in place.

PROXY VOTING

As long-term investors, we have always considered proxy voting an important part of equity ownership. Considered proxy voting helps us ensure effective corporate governance and protect long-term shareholder value. It allows us to protect and promote the interests of our clients by expressing our views and initiating or contributing to change where required.

OUR APPROACH

Reflecting that commitment, the member of the Research team responsible for an individual portfolio holding – the stock champion – is also responsible for proxy votes regarding that holding just as they are responsible for research and engagement. It has always been considered important that the person with day-to-day responsibility for monitoring a particular company and leading engagement with management, should also take the lead on determining voting decisions.

Additional supplementary information relating to our approach to proxy voting is provided in Appendix A of this report and in our Proxy Voting Policy available on our website. To ensure that we have all the necessary information on an Annual General Meeting or Extraordinary General Meeting, we receive documentation on forthcoming votes from custodians and receive meeting analysis from an external proxy voting advisory service.

We consider third-party recommendations for information purposes but arrive at voting decisions independently, based on company meeting materials and, where required, engagement with the company for additional information.

We vote every proxy in a manner we believe consistent with our clients' best interests. While we carefully consider management's views when determining how to vote, final decisions are always subject to our assessment of the likely client impact. There is of course oversight and support. Given the rising complexity and breadth of items on AGM agendas today, the extent of the support provided to stock champions has increased in recent years. The firm's Proxy Voting Policy offers a robust starting point in ensuring consistent voting decisions.

The Stewardship and Sustainability team within Research Operations is responsible for managing the day-to-day proxy voting process. This includes managing deadlines, highlighting relevant issues, providing annotated materials and reports, and where useful joining calls with company management or board members ahead of an AGM. The team works with stock champions to ensure voting is consistent and aligned with our approach. Voting is overseen by the Proxy Voting & Engagement Group (PVEG), a subgroup of the Investment Stewardship and Sustainability Committee (ISSC).

POLICY

Walter Scott's Proxy Voting Policy, which is available publicly within the Sustainability section of the Walter Scott website, has evolved over the years and is prepared by us independently. We take ICGN guidance into consideration and are confident that the policy is aligned with industry best practice.

The Proxy Voting Policy was updated on two occasions in 2023, providing greater clarity with respect to our expectations on board composition and independence, auditor tenure and fees, and political donations. Regarding the latter, we generally oppose proposals asking for permission to make political donations. For certain markets (such as the UK), where it is a legal requirement to seek pre-approval for such donations, we amended our policy giving us the flexibility to support proportionate requests that are merely designed to protect the company against inadvertent or unauthorised political donations.

> *"We vote every proxy in a manner consistent with our clients' best interests"*

Our Proxy Voting Policy applies across all investments, regardless of geography or strategy. It does, however, take into account the fact that corporate governance standards and expectations can vary between regions. It also applies across all clients for whom we are mandated to vote. Other clients make their own decisions on whether to vote, and how to vote.

We vote all proxies in line with our voting policy. If a client for whom we have voting authority instructed us to vote differently to our policy on a specific item then we are able to facilitate this given sufficient notice and on the understanding that such requests are relatively rare. There was one example of this in 2023, when a client requested that we abstain from voting their shares on a specific shareholder proposal. Clients in pooled funds or investors in funds managed by our distribution partners are not able to set their own voting polices.

100% of votes were submitted where we had the authority to do so in 2023. Shareholder proposals continued to play a growing part in our discussions around proxy voting decisions, and in our engagement with companies. In the second quarter of 2023, traditionally the busiest quarter of the year, we voted on 78 shareholder proposals, ten more than in the same quarter last year.

We evaluate each proposal individually and take due consideration of materiality and management's guidance. Certainly, if the proposal is in the long-term interests of shareholders, we will vote in favour, but it is often the case that after further discussion with management as to what is in the best interests of shareholders in the long-term, we will vote against shareholder proposals that might otherwise appear relatively uncontentious. Equally, we find these same management teams will typically embrace constructive recommendations from long-term investors, reflecting our view that ongoing engagement rather than shareholder activism is more often the most effective tool for achieving positive change.

As was the case in 2022, this year saw a continuation of the politicisation of the environmental, social and governance landscape, a fact reflected in many shareholder proposals. Remuneration was also a contentious area, with several US holdings requesting excessive executive pay packages.

We disclose on our website full voting records on a quarterly basis including a rationale for any votes against management recommendations. We remain of the view that the voting rationale can be as important as the vote cast and so we continue to review the best way to develop our public disclosure in an open, informative, and useful way. Our Shareholder Rights Directive II (SRD II) disclosures also provides detail regarding significant votes. The examples below are just a few of the many decisions made in 2023 with associated engagement and collective deliberation.

“Our Proxy Voting Policy applies across all investments, regardless of geography or strategy”

Netflix

There has been a resurgence in organised labour activity in the US in recent years, with the Writers Guild of America strike from May to September 2023 amongst the most high profile examples. The strike halted production across much of Hollywood, impacting programming at, amongst others, Netflix. Reflecting the renewed interest in labour relations, a shareholder proposal at Netflix's 2023 AGM asked the streaming giant's board of directors to “adopt and publicly disclose a policy on its commitment to respect the rights to freedom of association and collective bargaining in its operations, as reflected in the International Labour Organization (ILO) Declaration on Fundamental Principles and Rights at Work”. According to the proponent, the adoption of such a policy would not only demonstrate Netflix's respect for labour rights, it would also “protect long-term shareholder value” whilst providing shareholders with “greater transparency on these fundamental practices”. Many of Netflix's peers, including Amazon, the Walt Disney Company and Paramount, already have related policies/statements in place.

In recommending that shareholders vote against the proposal, Netflix emphasised that it complies with all laws concerning freedom of association and collective bargaining. In the US, this includes complying with the National Labor Relations Act, which forbids employers from interfering with employees in the exercise of rights relating to organising for collective-bargaining purposes. Management also highlighted that Netflix is party to over 40 collective-bargaining agreements with various unions and guilds, and that there were no repercussions for employees who staged a walkout in 2021. Furthermore, the company works hard to protect employee rights and maintain a healthy workplace culture. As such, management believes the proposal would “not create additional benefits to our employees or value for our shareholders”.

Weighing these arguments, we took the decision to vote for the proposal and against management's

recommendation. Labour relations is a pertinent issue for Netflix given the recent writers' strike and previous staff walkouts. By implementing the requested policy, Netflix would benefit both itself and shareholders in terms of management of labour-related risks, as well bringing the company more in line those other streaming firms with similar policies in place.

Compass
Proxy voting adviser ISS recommended voting against Compass Group's remuneration report in advance of the company's 2023 AGM. The basis for the recommendation was a perceived failure on the part of Compass to address the significant shareholder dissent recorded at the 2022 AGM, when 32.5% voted against the company's remuneration policy. The dissent was in response to the decision to increase the quantum of the company's long-term incentive plan (LTIP), which Compass argued would enhance the motivation and retention of executive talent.

Based on a range of considerations, however, we took the decision to vote in line with management's recommendation and for the remuneration report. Not only do we not consider executive remuneration at Compass to be excessive (CEO remuneration is positioned at around the median of the company's comparator group) we noted also that the LTIP granted in 2019 lapsed in full due to missed targets, the third successive LTIP to do so. The targets for the 2019 award were set shortly prior to the onset of the Covid-19 pandemic, rendering their achievement unrealistic despite the very strong performance of the business in the circumstances.

In a letter received by us prior to the recommendation from ISS, the Chair of the Remuneration Committee stated that whilst the best-in-sector performance of the company during the pandemic might have "justified a modest level of vesting", consideration had been given to "shareholder and proxy agency views as well as the current broader and economic environment". For us, this decision not to exercise any positive discretion shows a healthy level of restraint. We also noted the decision to cap salary increases for executive directors at below 5%, whilst awarding UK employees an 8% increase.

Universal Music Group
Executive remuneration can be a balancing act. Remuneration committees must ascertain a level of compensation that can recruit, retain and incentivise key executives, whilst being proportionate and aligned with the interests of long-term shareholders. That challenge becomes even more acute when it involves a high-profile, transformative CEO with a deep knowledge of the business and industry that, if lost, would be extremely difficult to replace. Such is the case with Lucian Grainge, CEO of Universal Music Group (UMG).

Since taking the helm in 2010, Grainge has built UMG into the world's biggest record label with a roster of artists that reads like a who's who of popular music. In that time, he has become the industry's pre-eminent executive. Given Grainge's status and track record, it came as little surprise when UMG announced in March that it was extending his contract for another five years. Announcing the deal, UMG's board emphasised Grainge's contribution to the success of the business and the vital role he would play in securing future opportunities and "maximizing shareholder value for the long term".

Under the terms of extension, UMG moved Grainge from an all-cash compensation package to one that is a combination of equity and cash. According to UMG, the majority of compensation would be paid in UMG equity and UMG performance-based stock options "to assure the compensation program is aligned with shareholders' interest". The new package was made subject to shareholder approval at the company's AGM in June. From our perspective, we welcomed certain elements of the new compensation package, including a ~two-thirds reduction in base salary and a more appropriate annual bonus structure. Overall, it represents a more sensible and better-aligned long-term structure than its predecessor. However, we were concerned by the inclusion in the long-term incentive plan of a one-time "transition" equity award, which will see Grainge receive a potential total of US$100 million (50% restricted stock units and 50% performance stock options) should UMG's share price surpass certain targets by the time his contract ends in May 2028.

In our view, the potential quantum of the award was excessive and we therefore chose to vote against the proposal at the AGM. Whilst the proposal was adopted, dissent was considerable, with 41% of shareholders voting against. The chair of UMG's remuneration committee has since resigned as a director, in part because of push back against the pay package. We will continue to monitor this issue.

CASE STUDY: BOOKING HOLDINGS – INTEGRATED ENGAGEMENT AND PROXY VOTING

The Covid-19 pandemic had a significant impact on executive compensation packages, with targets set prior to the onset of the pandemic often rendered unachievable by the ensuing economic disruption. Attempts by remuneration committees to recalibrate compensation plans to reflect the disruption did not always result in remuneration structures that were appropriate or proportionate. As we detail in our Proxy Voting policy, we typically prefer executive remuneration structures that align the interests of management and directors with long-term shareholders and durable value creation. We also have a strong preference for compensation plans that are clear, robust and proportionate.

Reflecting these preferences, we took the decision to vote against management in the 'say on pay' vote on 2021's executive remuneration package at Booking Holdings' 2022 AGM. In our view, the structure of the online travel company's remuneration package was both overly complex and poorly disclosed in places. We also had misgivings about the extent to which the structure aligned with the interests of shareholders, as well as the size of the proposed increase in total compensation. Whilst Booking's management team had admittedly performed well during the Covid-19 pandemic, we did not believe the proposed increase reflected the total return experienced by shareholders in recent years. The 'say on pay' vote failed, receiving only 31.7% of votes for.

Following the AGM and having written to the company explaining the rationale for our vote, we initiated an engagement for change with Booking, encouraging it to put in place a simpler remuneration structure with better disclosure and shareholder alignment. We elaborated further on our thinking in a subsequent meeting with the company, detailing where we thought the business could improve its remuneration practices. This culminated in a meeting in May 2023, where Booking outlined its proposed changes.

Encouragingly, the revised remuneration structure was both simpler and better aligned with the long-term interests of shareholders. Amongst the proposed changes were a better balance between time-based restricted stock units and performance-based units, and a welcome return to three-year targets for performance share units. Also included was a total shareholder return modifier, aimed at better aligning the payout of performance-based units with the experience of shareholders. Given these changes and our positive experience of Booking's openness to constructive engagement, we were comfortable supporting management on this issue at the 2023 AGM.

TIMELINE

November 2020 – May 2021 – Meetings to discuss executive remuneration changes in response to pandemic

May 2022 – pre-AGM call – Discussed executive remuneration for 2021

June 2022 – AGM – Voted against management's recommendation. Vote failed, receiving only 31.7% votes for

July 2022 – Letter – Wrote to Booking outlining rationale for vote

July 2022 – Engagement for Change initiated – Focus on simplification, alignment, disclosure

November 2022 – Governance call – Discussed potential improvements to remuneration

May 2023 – pre-AGM call – Discussed proposed new remuneration structure

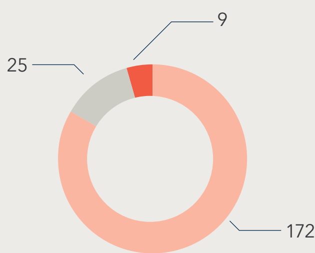
June 2023 – AGM – Voted with management's recommendation

PROXY VOTING & ENGAGEMENT GROUP

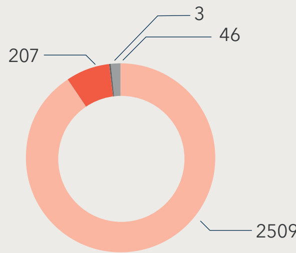
Extract from Walter Scott's Proxy Voting Policy: "Voting is overseen by the Proxy Voting & Engagement Group (PVEG), a subgroup of the Investment Stewardship and Sustainability Committee (ISSC). All votes are signed off by one of the Co-Chairs of the ISSC, the Head of Research, the Head of Research Operations or in their absence a Director of Walter Scott. The PVEG reviews proxy voting decisions on a periodic basis.

The PVEG will determine our approach to voting on contentious or sensitive issues, or items that are not expressly covered in our policy or where further guidance has been requested by a member of the Research Team. In the event that there is not agreement between the PVEG and the relevant stock champion on our proposed approach to voting, or where there is a particularly material or contentious issue, or a recommendation to vote in a manner that is contrary to our Proxy Voting Policy, the final decision will be escalated to the ISSC."

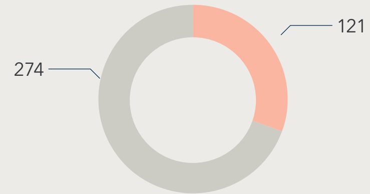
PROXY VOTING OVERVIEW



- Total Voted AGMs
- Total Voted Special Meetings
- Total Mix Meetings



- Total proposals voted 'For'
- Total proposals voted 'Abstain' (0)
- Total proposals voted 'Against'
- Total proposals voted 'Withhold'
- Total proposals voted 'One Year'



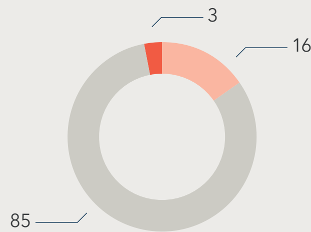
- Total votes against Management recommendation
- Total votes against ISS recommendation

VOTES AGAINST MANAGEMENT RECOMMENDATION RATIONALE

66	Due to potential dilution >10%
2	Political Donations
13	"Ad hoc" items – Potential proposals not known prior to meeting
3	Poison Pills
6	Corporate Governance issue
10	Compensation and stock option plans
3	Remuneration related
1	Persistent failure to attend Board meetings
1	Preference for a one-vote-per-share structure
8	Vague/Poorly-defined proposal
1	Only able to support one slate
7	Shareholder proposal – In long-term financial interest of shareholders

This voting summary for the full year 2023 reflects the votes cast by Walter Scott & Partners Limited during the period on behalf of our clients for whom we have full voting discretion.

SHAREHOLDER PROPOSALS



All 3 'Withhold' votes relate to the Illumina proxy contest in which the only voting option for nominees was 'For' or 'Withhold'. Walter Scott supported the management nominees and voted 'Withhold' for the 3 nominees proposed by the shareholder.

SUPPLEMENTARY PROXY VOTING INFORMATION IN ACCORDANCE WITH THE UK STEWARDSHIP CODE

REMUNERATION

Executive compensation is often the highest profile and most contentious subject in proxy voting. The need to attract, retain and motivate management is important, but equally so is aligning reward to long-term targets that are measurable, comparable, sufficiently demanding and that support a company's culture and ethos.

In 2023, we saw requests from several US companies for very large remuneration packages, some of which were subject to discussion by the ISSC (at the time still referred to as the ISC). The ISSC also continued to discuss and debate what we might collectively view as best practice, as well as what we would prefer not to see. For example, we amended our proxy voting policy to reflect our preference for 100% independent remuneration committees. We continued to deepen our understanding of the current remuneration landscape during 2023, with the Research team receiving training on executive remuneration, as well as US-specific executive remuneration from an external consultant.

VOTING PROCESS

We subscribe to ISS' services as an effective means to receive proxy voting ballots and then to action the vote informing applicable custodians. But the voting decision rests solely with Walter Scott without any reliance on ISS recommendations.

Voting follows a two-step process. One person within the Client Operations team places the instruction on the ISS platform and another checks that instruction matches, as well as checking the voting information is entered correctly into our investment accounting system. If there is an instruction on a proxy vote that is client-specific then a manager in our Client Operations team also checks the instruction to make sure it has been submitted correctly. After submitting the proxy voting instruction, we do a 'ballot check' to ensure the accounts, and positions, that we have voted on through ISS match our investment accounting system information. This allows us to identify any issues straight away and to contact ISS or the custodian to promptly resolve them. We also receive a daily email from ISS that details any rejections, which also allows prompt resolution where needed.

The Client Operations team also carries out another layer of checks between our systems and the clients' custodians, to double check how many shares we expect to be voting on, incorporating whether the client has given us proxy voting authority. Votes are submitted through ISS and we check that our instructions have been successfully received. We also often inform the

company of our voting recommendation where there has been engagement on an issue or where there has been a vote against management and we want to re-iterate our case or concern.

100% of votes were submitted where we had the authority to do so in 2023. Instances where we do not have the authority to do so can include when the client has directed stock lending, power of attorney is not in place, we do not receive the ballot from the custodian, or it is a restricted market. We continue to work as closely as possible with other providers, notably the custodians, to ensure that all proxies can be voted in a timely manner.

VOTING OUTCOMES

Where any individual proposal receives less than 85% votes in favour, the stock champion is notified. Where votes fail, in addition to notifying the stock champion, the Research Operations team also notifies the PVEG so that those votes can be formally reviewed in the context of our voting decision and possible engagement.

STOCK LENDING

Walter Scott does not undertake stock lending. Any such arrangement rests solely with clients and their appointed custodian. Walter Scott generally does not ask clients to recall stock on loan in order to vote with the exception of material votes.

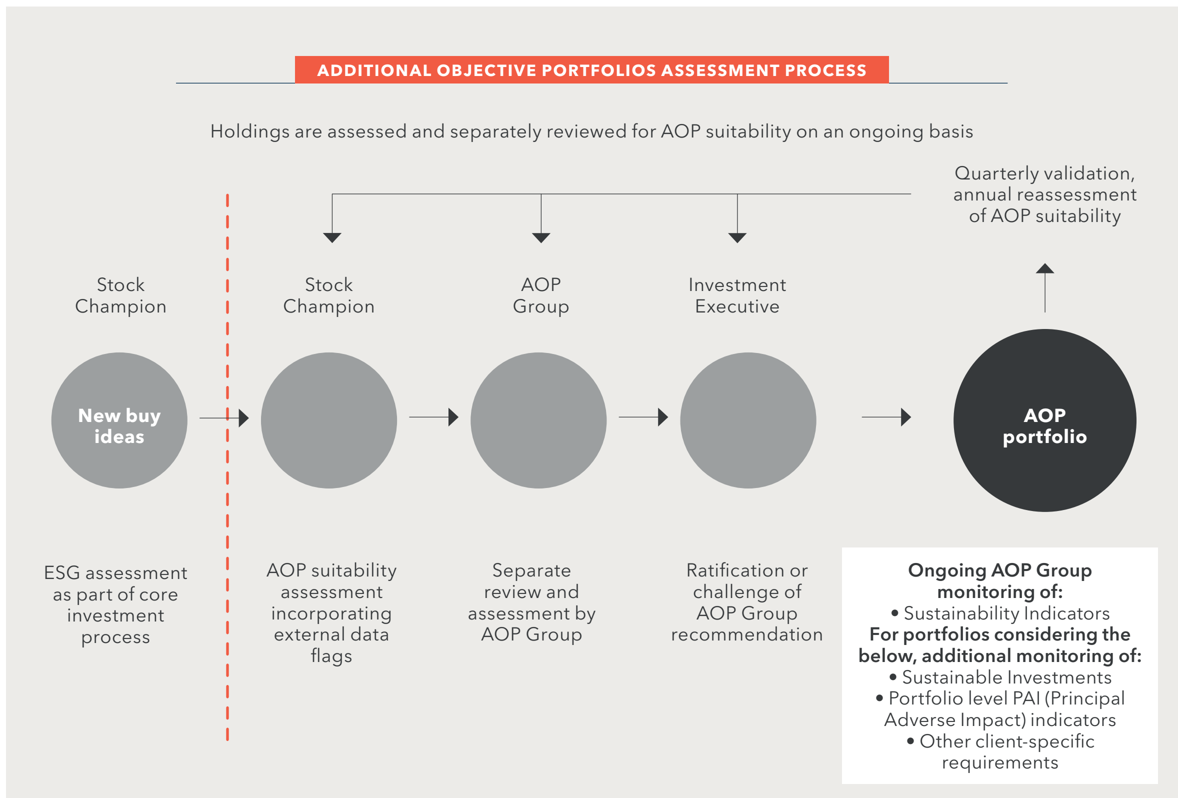
Where the firm believes a resolution is material, in that the outcome could significantly affect the long-term investment return, on a best efforts basis Walter Scott will generally seek to ask clients who lend stock to recall any stock on loan.

ADDITIONAL OBJECTIVES PORTFOLIOS

As highlighted in last year's Sustainability Report, we launched an additional process in 2022 to meet evolving client needs for portfolios that are managed in line with additional sustainability requirements, such as the 'Article 8' fund framework for "holistic analysis of environmental and social characteristics" set out in the EU's SFDR. In addition to alignment with the SFDR framework, we can offer clients a range of different sustainable investment requirements.

OVERVIEW

The 'Additional Objectives Portfolios' (AOP) methodology was developed by a dedicated project team in response to the EU SFDR and other sustainable investment regulations and client-specific ESG preferences. Our aim was to develop a process for sustainable investment funds that built on our longstanding work on ESG Integration, Stewardship and Sustainability. In addition to requiring the development of a framework for assessing the suitability of existing holdings for these portfolios, we developed a separate governance framework to ensure that there was a separate review of all proposed holdings. The AOP Group (referenced in the Governance chart on page 9) performs this function, making recommendations to our Investment Executive about the suitability of holdings. It is important to note that the AOP Group does not have a 'veto' over holdings in AOP funds or recommend new ideas, nor does



it have responsibility for portfolio construction – decision-making responsibility continues to sit with the Investment Executive, supported by the Research team and the appropriate stock champion.

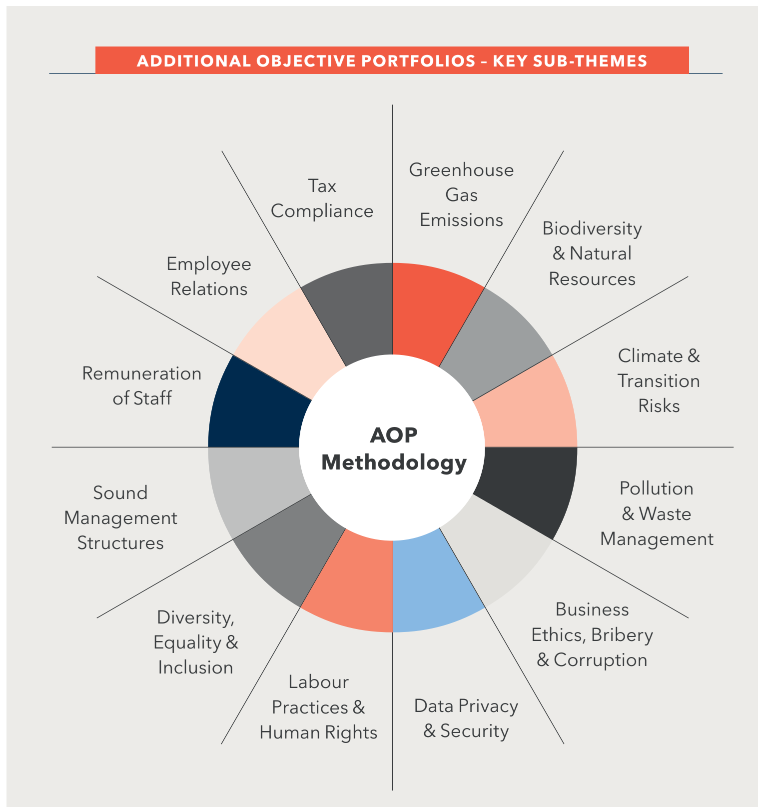
AOP PROCESS

Our suitability assessment process aims to combine the best available external data with the fundamental analysis and company-specific knowledge of our stock champions.

In developing our approach, we have been careful to ensure that the conclusions from the AOP assessment do not have any bearing on our willingness to hold companies in 'non-AOP' portfolios, although we do of course ensure that any financially material insights gained from the process that have broader relevance to all holders are shared with relevant colleagues in the Research team. The AOP Group is comprised of members of the Research and Research Operations teams. The diagram on the previous page sets out the AOP process.

The suitability assessment incorporates 12 ESG sub-themes (see diagram below) that we determine to be important in deciding whether a company meets the appropriate portfolio sustainability requirements. This uses carefully selected external vendor data to augment the typically more qualitative fundamental analysis from stock champions of company performance on material ESG factors using an additional structured assessment template to capture insights and conclusions. If a company 'flags' against the monitoring thresholds that we have set for each of the external data points, the appropriate stock champion will undertake additional analysis to determine the accuracy of the data and the materiality of the issues identified. Analysis is then reviewed by the AOP Group, including an overall suitability recommendation from the stock champion. As part of its review, if the AOP Group has any outstanding concerns it will arrange a meeting with the stock champion to discuss the matter in detail before a final recommendation is made to the Investment Executive with respect to suitability for respective portfolios. In addition to this core suitability assessment process, relevant data pertaining to additional SFDR considerations such as 'Sustainable Investment' classification (incorporating 'do no significant harm' checks) and portfolio level 'Principal Adverse Impact' indicators are also reviewed quarterly by the AOP Group and we have the capability to provide oversight and monitoring to a range of additional client sustainability requirements through this model.

The AOP Group meets on a quarterly basis to review any material changes in the selected external data points (with appropriate stock champion analysis) which might have an impact on the suitability of AOP holdings. This includes a review of any holdings that have previously been deemed to be unsuitable for AOP clients to determine whether an issue has been satisfactorily addressed. The AOP Group is also involved in the production of periodic reporting requirements for SFDR clients and can undertake additional research into key sustainability themes and issues arising relating to AOP holdings.



CLIMATE

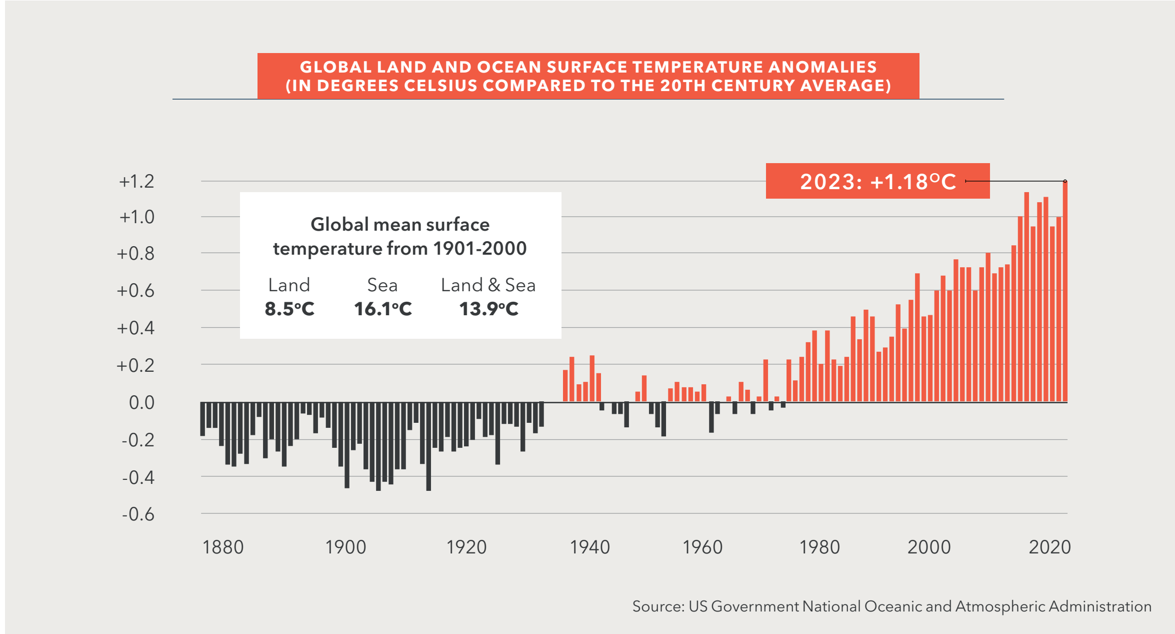
It is part of our broader fiduciary duty to identify and address to the best of our ability systemic risks to our clients' portfolios. There is a broad consensus that climate change is a growing systemic risk to the global economy, and for this reason the investment management industry's approach to managing climate risks and opportunities is also the subject of regulatory focus. The Board of Walter Scott has delegated responsibility for climate change strategy to the Managing Director in her role as chair of the Executive Management Committee. The climate change strategy is subject to periodic review and challenge by the Board of Directors. We published our first entity level TCFD-aligned report in June 2023, significantly enhancing our disclosure in this important area of our business. We are due to publish an updated version of this comprehensive annual disclosure in the second quarter of 2024. We would direct interested clients and other stakeholders towards these detailed reports, and this section of our Sustainability Report therefore provides a summary overview of key developments and metrics relevant to our ongoing commitment to understanding and managing climate-related risks and opportunities.

CONTEXT

As we have stated before, we are now in a world that is rapidly moving from climate risks to climate impacts. 2023 was the warmest year since global records began in 1850, and the 10 warmest years in the 174-year record books have all occurred during the last few decades.

Whilst there continues to be some debate on the causality and impact of climate change, and the importance (or otherwise) of taking concerted action to reduce emissions, the temperature records above are generally accepted as empirical fact and are supported by scientific data from international agencies and national government departments. The transition challenges arising from regulation and changing customer expectations are also clear and present risks to unprepared businesses.

Despite low expectations all round in the run-up to the December 2023 COP28 meeting, the talks concluded



Source: US Government National Oceanic and Atmospheric Administration

with a milestone agreement to 'begin the global transition away from fossil fuels', the first time that this had made the text of an international treaty of this kind.

It is for these reasons that we continue to believe that it is of material financial importance for our holdings to have the ability to successfully operate and grow in climate scenarios where there are more concerted policy efforts to curtail emissions, such as a Paris-aligned economic trajectory.

It is important to note that not all physical and transition risks arising from climate change will be intuitively predictable, and certainly not without company specific nuance. For these reasons, 'bottom up' fundamental analysis of investee companies is critical.

DEVELOPING OUR APPROACH TO UNDERSTANDING AND MANAGING CLIMATE-RELATED INVESTMENT RISKS

For a number of years we have been analysing climate risks and opportunities wherever material to our investments, and we have included an element of structured climate scenario analysis in our Integrity document since 2021. However in 2023 we enhanced our existing approach in a number of ways.

To facilitate this, we set up a new research group with an initial focus on climate risk, reporting into the Investment Stewardship and Sustainability Committee to provide oversight and guidance to our investment-related research in this area. With representation from both Research and Stewardship and Sustainability specialists in Research Operations, this group has overseen the development of several innovations which are now established as ongoing elements of our climate risk management process, complementing our existing 'bottom up' fundamental analysis of climate risks contained within the Integrity document.

Over the course of 2023, we implemented the following:

- We undertook climate scenario analysis on our holdings for the first time at an aggregate firmwide level, presenting the findings to our Investment Management Committee (IMC). This assessment reviewed 'Climate Value at Risk' data pertaining to both policy related and physical impact related risks. This review will now be updated on an annual basis, with the findings presented to the IMC for consideration.
- We enhanced our framework for undertaking ongoing climate scenario analysis for all holdings as part of our Integrity document, adding a third scenario (NGFS Disorderly – Delayed Transition) to our existing two scenarios. This means that from 1st January 2024 all holdings and (proposed new buys) are being reviewed against three NGFS climate scenarios (NGFS Orderly – Net Zero 2050; NGFS Disorderly – Delayed Transition; NGFS Hothouse – Nationally Determined Contributions). We anticipate that our approach in this area will continue to evolve, and we may make further changes to the type and range of scenarios that we utilise in the future.
- In addition to the core analysis outlined above, we also developed a new 'Enhanced Climate Assessment' (ECA) process for analysing climate risks and opportunities pertaining to higher emissions / potentially higher risk holdings, and undertook an initial 20 assessments (c.10% of WSPL holdings) in the latter part of 2023. The findings were presented to the ISSC and the Investment Management Committee. The ECA for relevant holdings will now be included in the core research material for company reviews, and ECAs will be updated annually for qualifying holdings. An ECA assessment will also be introduced as a step in the investment process for all new buys that meet the qualifying criteria[2].

To support the above developments, in 2023 we provided externally facilitated climate scenario analysis training for our Research team and included a 'future climate pathways' workshop discussion on the agenda of our Research team away day, as well as an investor-led session on transition-related investment opportunities. The team also receive regular insights from a specialist energy transition focussed research provider, and we have arranged further climate-related external training in 2024.

We will shortly be issuing an updated annual TCFD Report for the firm, following the publication of the firm's first comprehensive TCFD Report in June 2023. We will be continuing to develop and refine our work in this area during 2024.

OUR PORTFOLIOS

As was the case last year, a relatively small number of companies represent a large share of global corporate carbon emissions. The same is true of our portfolios.

Looking across our portfolios, there continues to be limited exposure to more carbon intensive industries, such as utilities and fossil fuels, where the transition

SCOPE 1 & 2 EMISSIONS

Most recent financial year available at time of calculation (26 February 2024)

	Walter Scott Representative Holdings	MSCI ACWI
Carbon Footprint (tCO_2e / USDm invested)	24	53
Total Financed Carbon Emissions (million tCO_2e)	1.92	4.29
Total Financed Carbon Intensity (tCO_2e / USDm Sales)	94	147
Weighted Average Carbon Intensity (tCO_2e / USDm Sales)	87	123

See explanatory notes. All data relates to scope 1 and 2 emissions.

risks are more pronounced. Our portfolios continue to typically have greater exposure to industries, such as healthcare and information technology, where transition risks, while still applicable, are likely to be less pronounced. A number of our holdings are also in a position to support and enable a low-carbon transition through the provision of their core products and services.

We expect all our investee companies to disclose emissions data to the CDP and report according to TCFD recommendations, in order to provide financially relevant climate information and data, although we recognise that in many markets there is still considerable work to be done to meet this standard. It is important to re-emphasise that our objective with the above monitoring and engagement work is about creating value for our clients over the long term. Unaddressed climate change is a systemic risk to long-term performance for all companies, hence our analysis and focus on all holdings.

Explanatory Notes for Table:

1) Data are for 'Walter Scott Representative Holdings', which is an aggregation of Walter Scott composites active as at 31 December 2023. The proportionate weights of this aggregation are combined with the firm's total discretionary AUM to calculate an implied market value for each company holding.
2) Scope 1 & 2 emissions associated with the investments managed by Walter Scott on behalf of clients are reported using the investment-specific method according to the GHG Protocol. This method involves collecting Scope 1 and 2 emissions from the investee company and allocating the emissions based upon the share of investment. While the reporting guidelines for investment emissions in the GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard emissions are mostly clear, accurately capturing investment emissions is complex and for this reason emissions reported should be considered as an estimate.
3) Holdings data for Walter Scott Representative Holdings and MSCI ACWI are as at 31 December 2023.
4) Source: Walter Scott & MSCI – MSCI's emissions data has been aggregated by Walter Scott to a portfolio/benchmark-level using TCFD guidance. MSCI's emissions data is based on the most recent financial year available at time of calculation (26 February 2024).
5) Enterprise Value Including Cash (EVIC) has been used as an attribution factor to determine ownership of emissions.
6) An indicative Total Financed Emissions figure has been calculated for MSCI ACWI. This assumes an investment market value equal to Walter Scott's discretionary AUM, to allow for direct comparison to Walter Scott Representative Holdings' Total Financed Emissions.
7) Scope 1 and 2 emissions are based on reported emissions or, where reported emissions are unavailable, using MSCI estimated emissions. Walter Scott did not make any assumptions or use proxies.
8) Cash has been excluded and the holdings reweighted for the Weighted Average Carbon Intensity metric. For other metrics, cash is assumed to have zero emissions attributed to it.
9) Where data is missing for any input value needed for the calculation on a company level, whether a constituent of the portfolio or benchmark, the company has been excluded from that calculation entirely. Coverage for both portfolio and benchmark is >99%.

[1]The Network for Greening the Financial System is a network of 114 central banks and financial supervisors that aims to accelerate the scaling up of green finance and develop recommendations for central banks' role for climate change. The NGFS was created in 2017 and its secretariat is hosted by the Banque de France.
[2]Further details on our ECA selection criteria will be provided in our TCFD Report.

SUSTAINABILITY AT WALTER SCOTT

OUR ENVIRONMENTAL IMPACT

This year marked the first full year free of pandemic-related restrictions since 2019. Despite the inevitable challenges this posed from a carbon-emissions perspective, we continued to make progress in managing our environmental impact.

Overall, the company's carbon emissions for 2023 (using the location-based method), excluding emissions associated with the investments managed by the company, were 35% greater than 2022, but 14% less than our 2019 baseline emissions (when comparing like-for-like emissions sources).

Aiming to ensure that our operations and business model are resilient to climate and transition-related risks, this year we undertook our first physical climate and transitional risk scenario analysis in regard to our operations. We also continued to invest in technology to improve the resilience of our operations in the event of disruption from extreme weather events. Other operational risks considered include regulatory changes and rising energy prices.

In 2023, Walter Scott attained ISO 14001 certification, the international standard for environmental management systems (EMS), as part of parent company BNY Mellon's certification process. This has helped us to assess our ability to operate an EMS and mitigate the environmental impact of our Edinburgh offices, as well as ensuring we comply with all necessary laws and regulations.

During the year, we organised an employee tree-planting day in the Scottish Borders, during which staff planted native species trees in a remote upland site in the Tweedsmuir Hills. This volunteering exercise has contributed to protecting and expanding remnants of ancient woodland, as well as helping to improve biodiversity in the area.

OUR ENVIRONMENTAL TARGETS

We have set the following 2024 targets relating to our operations and sustainability to be tracked versus our baseline year of 2019:

- **Maintain an average annual recycling rate of 70% of total Edinburgh office waste**
  Walter Scott's recycling rate, which was an average of 72% for 2023, compared to 74% in 2022 and 72% in 2019, continued to exceed the Scottish government's 2025 target of 70%. We will continue to identify strategies to help further reduce overall waste going forward.

- **Reduce total office waste by 5% by the end of 2024**
  The total waste generated in 2023 was 22.8 tonnes, representing a reduction of 1% versus the 23.1 tonnes generated in 2019. General waste has fallen by 5% and we expect this to reduce further in 2024. New bins will be introduced to help improve the recycling ratio and a more detailed waste audit will be conducted.

- **Reduce office printing by 80%**
  Print volumes were down 87% relative to 2019. There was also a 2% decrease in print volumes compared to 2022, suggesting that reduced printing has become embedded within our post-pandemic work practices.

- **Reduce business travel-related emissions by 5%**
  Excluding emissions associated with the investments managed by Walter Scott, business travel is the single largest contributor to the firm's climate impact. Given 2023 was the first full year of post-pandemic travel, business travel emissions increased 71% compared to 2022. Compared to the base year 2019, business travel-related emissions fell by 12%. The ability to travel without restrictions allowed representatives of Walter Scott to meet clients and prospective clients in person, and to visit companies across the world.

  Meeting clients and companies is an important part of what we do. We have, however, worked hard to travel more efficiently. Careful trip planning has helped to ensure that, where possible, client meetings in North America are undertaken by resources based locally and where possible and when required, supported by Edinburgh-based resources via virtual conferencing facilities.

- **Reduce Scope 1 and 2 emissions by 5%**

In 2023, gas consumption (329,277 kWh) was in line with 2022 (331,610 kWh) with a 14% reduction in scope 1 emissions compared to the base year 2019. Office electricity consumption in 2023 (244,944 kWh) decreased by 5% versus 2022 (257,283 kWh) with a 31% reduction in location-based scope 2 emissions compared to the base year 2019.

Looking ahead, Walter Scott's primary focus is on emission-reduction efforts, although we do purchase certified carbon offsets as a contribution towards mitigating our impact. There continues to be significant debate about the efficacy of carbon offsets as a means of reducing the carbon intensity of business operations, and permanent carbon removal technologies are at an early stage of development. Therefore, as a firm, we have not subscribed to any 'Net Zero' frameworks and do not make any claims with respect to the 'Carbon Neutrality' of our operations.

Further details of our approach and rationale will be available in our 2023 TCFD report.

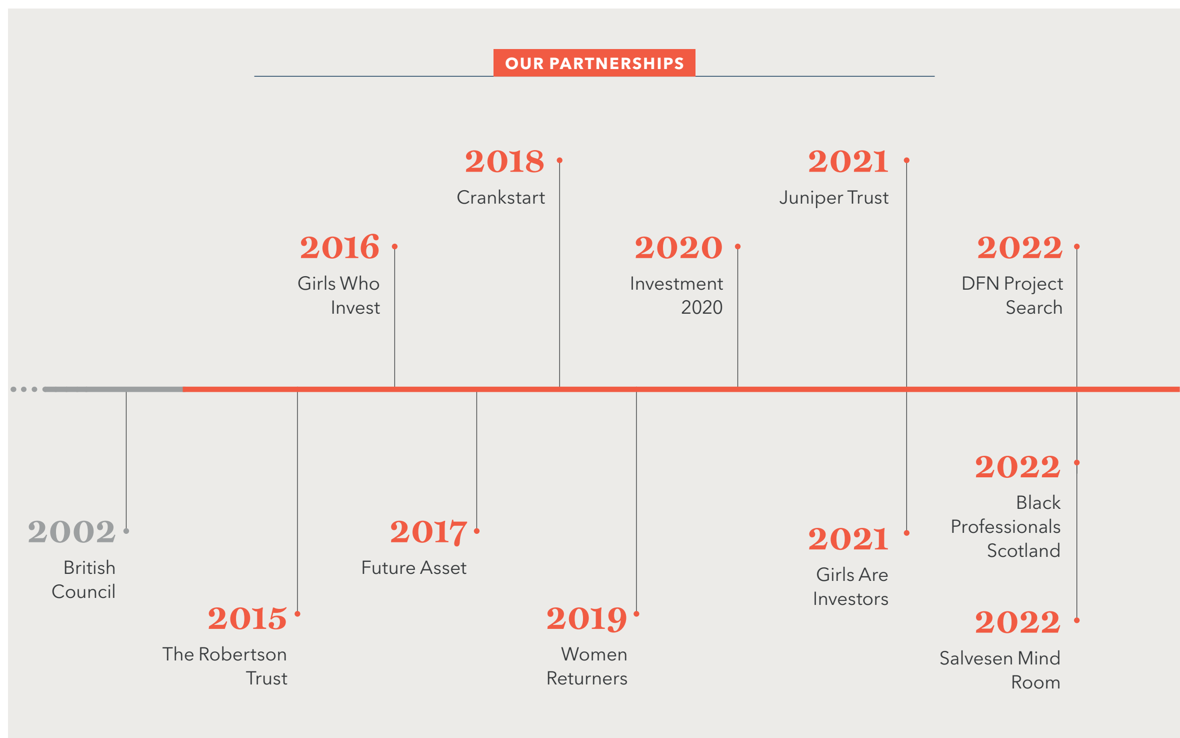
PEOPLE & CULTURE

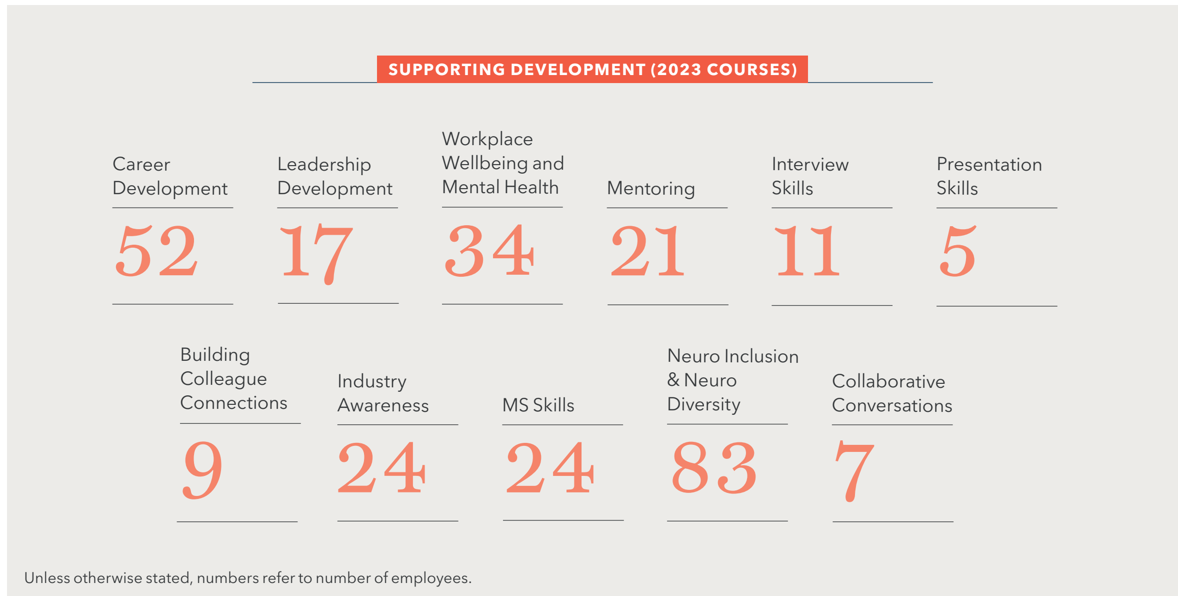
With a view to preserving and building on Walter Scott's unique culture, we introduced several new initiatives over the course of the year, strengthening and extending our existing work in areas such as career development, leadership, and performance management.

DIVERSITY, EQUITY & INCLUSION

Our 2023 Diversity, Equity and Inclusion (DEI) plan was drafted with the assistance of the DEI Working Group and subsequently ratified by the Executive Management Committee. Aligned with the key principles of Walter Scott's DEI Policy, one of the plan's key deliverables is the deepening of our relationships with our diversity partners, with a view to highlighting roles and careers to people who may not have considered Walter Scott as a potential employer. Further detail is outlined in the Attracting New Talent section below.

We hosted meetings with several diversity partners during 2023, including Black Professionals Scotland, Juniper Trust, Salvesen Mindroom and Future Asset. Not only do these partnerships improve our talent pipeline but they allow us to learn more about the challenges facing sections of society. For example, our partnership with Salvesen Mindroom, which began in 2022, improved our understanding of neurodiversity and helped us develop a more neuro-inclusive approach. In 2023, Salvesen Mindroom delivered a firm-wide





neuro-diversity session, attended by over 80 members of staff.

Other DEI initiatives in 2023 included our mentoring programme, with over 40 mentors working with new employees to ensure they are included and motivated. Furthermore, a new leadership development programme contains modules focused on inclusive leadership.

ATTRACTING NEW TALENT

The annual intern intake is always an important moment in the Walter Scott calendar. Every summer, ten individuals join us for a six-week internship programme, with opportunities available in our Investment and Operations functions. We encourage applications from inquisitive and motivated individuals regardless of degree subject and background, with experienced mentors on hand to offer support and guidance. We were delighted to welcome two interns as permanent employees in 2023.

Last year, the number of UK universities promoting our internship programme increased to 20, whilst diversity partners such as Black Professionals Scotland, Girls Are Investors, The Robertson Trust and Crankstart also promoted the programme and provided applicants.

FUTURE INITIATIVES

Our next People Plan will be agreed by the Executive Management Committee in the first quarter of 2024. As ever, its primary aim will be to strengthen further Walter Scott's existing culture. The plan will include many long-term initiatives that will continue into the following year and beyond.

GIVING GROUP

In 2023, the Giving Group supported 69 charities across Scotland and in Boston, covering a range of activities in areas such as young people, education, homelessness and the community. 2023 also saw Walter Scott employees vote for Richmond's Hope, which offers support to bereaved children and young people, as the firm's first charity of the year. To double the impact of the money raised by employees throughout the year, the Giving Group matched all donations.

ENGAGEMENT AND ASSESSMENT

Reflecting our commitment to forming long-term partnerships with charities, 47% of the 2023 budget was allocated to multi-year programmes. Charities often rely on annual funding, so these multi-year commitments can help provide valuable financial security.

One of the pillars of the Giving Group's approach has long been a focus on specific projects where the project outline, budget, expected outcomes and evaluation are clear. This provides us with clear accountability for the efficiency and impact of the donations and the evaluation component is a key aspect of our assessment. This offers not only the ability to assess whether the outcomes have been delivered, but also the opportunity for further improvement to the programme in the future.

As always, we maintained a close relationship with our supported charities through the course of the year. At each monthly meeting of the Giving Group, an invited charity provides an update on its work and the impact of our donation. These meetings also serve as a forum to discuss the charity's strategic outlook and challenges.

2023 ACTIVITY

2023 saw an increase in donations to community-focused activities, primarily due to our support for a number of new charities.

Soccer Unity Project
By operating a city-wide programme of free soccer in Boston, the Soccer Unity Project looks to achieve positive social change by strengthening the community through sport. The Giving Group is supporting the piloting of the Adaptive Soccer programme, which offers people with additional support needs the opportunity to participate.

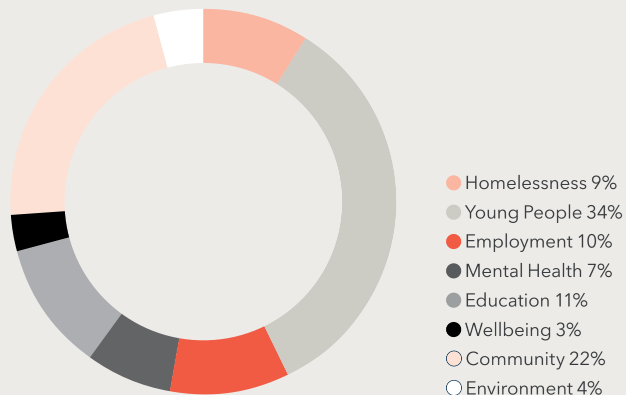
Pilton Community Health Project
This charity works with local people in a deprived area of north Edinburgh to take steps towards better health. The Giving Group supported the 'Women Supporting Women' programme, which helps women to feel more confident about parenting and supporting their child's learning.

National Galleries of Scotland
Leveraging its vast art collection, National Galleries of Scotland offers activities which allow a broader section of the local community to access art. The community programme provides workshops and aims to make the galleries more accessible and enjoyable for visiting community groups from deprived areas.

PURPOSE AND AMBITION

Through the Walter Scott Giving Group, the Board of Walter Scott hopes to share some of the firm's success with those in need across the local community. The purpose of the Walter Scott Giving Group is to agree on funding and ensure that such giving is impactful as well as efficient and transparent. The Group's ambition is to support local charities that focus on community, education and health. Through multi-year commitments to a number of charities, it is hoped a meaningful difference can be made. The Group has eight members from across the firm's operations and of deliberately varied levels of seniority.

2023 BUDGET SPEND BY AREA OF NEED AND FOCUS



We continued to provide volunteering opportunities for colleagues throughout the year. In collaboration with The Scottish Borders Forest Trust, 20 employees planted around 1000 trees in the Scottish Borders. For the fourth consecutive year, volunteers selected and packed Christmas presents for children and young people who otherwise wouldn't be opening presents on Christmas Day as part of the charity Cash for Kids' Mission Christmas campaign.

"2023 saw an increase in donations to community-focused activities"

FUTURE PLANS

The Giving Group's focus for 2024 will be to further strengthen relationships with our existing charitable partners, while engaging with potential new charities to support. We will remain committed to raising awareness internally of the important work being funded by the Giving Group, and to offering volunteering opportunities for individuals and teams across the firm.

APPENDIX A

UK Stewardship Code – Supplementary Information

OVERSIGHT GROUPS AND STEWARDSHIP RESOURCES

Investment Stewardship & Sustainability Committee
The Investment Stewardship & Sustainability Committee (ISSC) oversees the implementation of the firm's investment-related stewardship and sustainability activities and compliance with the firm's related policies. Its responsibilities include:

- overseeing the Firm's stewardship and sustainability, ESG Integration and Climate strategy, escalating any relevant issues or concerns where required.
- ensuring compliance with relevant stewardship and sustainability regulations
- overseeing the approach, quality and consistency of the Firm's policy and regulatory interactions in relation to stewardship and sustainability
- overseeing the selection criteria, quality and consistency of the Firm's engagement with investee companies
- approving company disclosures and responses to industry codes as required
- overseeing the approach to climate analysis and transition risk for portfolios.

The ISSC provides oversight of the Sustainability Policy and Regulations Group; Proxy Voting and Engagement Group; Sustainability Communications and Reporting Group, ESG Research Group and Additional Objectives Portfolios Group.

The Committee has representation from Investment Research, Research Operations, Client Service and Compliance. The Committee meets quarterly with ad hoc meetings when required.

Investment Team
The core Investment team comprises the Investment Executive and the Research team. The Research team consists of investment managers and investment analysts who work collectively across all portfolios managed by the firm.

Each stock held is championed by a member of the Research team. Typically, the champion will be the person that first proposed the idea and who is then responsible for monitoring thereafter.

The Research team is structured into three regional groups, with a combined group specifically tasked with looking at emerging market opportunities across regions, and as befits a global equity investment manager, individuals rotate amongst those teams. However, stocks are not reallocated as individuals move between regions. Those with long careers at the firm will have spent time in all the teams and will thereby champion stocks across all regions, as well as across industries. Our investment approach is centred on finding global leading companies irrespective of geographical boundaries and industry classifications. It is important that our Research team have that same perspective. In the search for the best, they must be able to contrast and compare companies across the world.

The stock champion is responsible not only for analysis and research but also engagement and proxy voting. Furthermore, they are responsible for assessing, analysing and monitoring material ESG risks and opportunities that make up an investment case. Whilst the firm believes that an integrated approach to ESG is more powerful and effective, the Research team is supported by Research Operations in a number of areas of ESG Integration, Stewardship and Sustainability. We have been increasing our resources in this area, with a number of Stewardship and Sustainability staff now based in our Research Operations team.

Remuneration at Walter Scott
Remuneration is an important part of the retention and motivation of staff and Walter Scott's approach to remuneration very much reflects its culture and its investment approach.

Teamwork, contribution to team discussions and working with others to ensure the best client service, are all central to performance reviews. Beyond competitive base salaries, everyone in the firm shares an additional pool that is a percentage of the firm's annual profits. For the Research team, an individual's share of that pool is determined by a range of factors, and not solely, or indeed predominately, investment performance. Instead, that division will reflect an individual's own

research and analysis, contribution to team discussions, responsibility for ESG research and stewardship with integration of sustainability risks, pursuit of innovative research, sharing of expertise and experience with other team members, as well as an evident commitment to ensuring that all aspects of the investment process meet the highest standards. In short, the proportion allocated to an individual will reflect the efforts that will underpin the long-term success of the firm, not individual pursuits or any short-term target.

The relative weights of base salary and profit share move according to performance. The components of compensation will also vary from year-to-year depending on the level of operating profit. There is, however, no cap on profit share as a percentage of base salary. For directors and some senior staff, the majority of annual compensation comprises a share of the firm's profits. An element of this is deferred via a long-term incentive plan. This is primarily invested in a global equity fund of which Walter Scott is the investment adviser with the balance in BNY Mellon stock. Both have a deferral period which vests on a pro rata basis over three or four years. Walter Scott's compensation structure is designed to promote fair and equal treatment of all staff. The Board's Remuneration and Nominations Committee reviews and approves the annual salary and profitshare allocations based on the overall performance of the firm.

Reflecting our commitment to integrating stewardship, from 2023 every employee now has non-financial criteria requirements included as part of their annual review. These include a firm-wide ESG goal. Regardless of role, employees are expected to:

- Participate in Walter Scott's ESG updates, training and relevant industry training
- Understand the impact of Walter Scott's ESG approach on own role and implement changes to responsibilities where appropriate

ADDRESSING CONFLICTS OF INTEREST

Our approach to conflicts of interest remains unchanged and well understood. Conflicts of interest are inherent throughout the investment management business, therefore from the outset we have organised activities to ensure the interests of our clients are always placed first and avoids material conflicts of interest that cannot be managed in the best interests of clients. Our Conflicts of Interest Policy, available on our website, sets out our approach where conflicts are unavoidable.

As an equities-only manager with all members of the Investment team working collectively to manage all portfolios, the potential conflicts that might face more diversified investment firms or where strategies are managed separately by different individuals do not apply to Walter Scott. With regards to potential conflicts emanating from ownership or outside interests, the firm is 100% owned by BNY Mellon and there are strict compliance and review processes around any individual within Walter Scott taking on any external role, whether it is remunerated or not. With regard to personal trading, again Walter Scott's rules are robust, with investment discretion in single stocks prohibited. Where individual company shares have been bought prior to employment at Walter Scott any trading must be undertaken via a prescribed list of authorised brokers who in turn are required to report any trading activity to Walter Scott's compliance department. By assuming this strict position on personal trading, potential conflicts in this regard are significantly minimised.

Proxy Voting
For us, potential conflicts mainly occur with regard to proxy voting. For every proxy, we check whether the company is also a client. Where there are shareholder proposals, we also check whether the proponents are clients of the firm. During 2023, there were four potential conflict of interest situations with voting undertaken either with regard to a company that is also a client or where a client placed a shareholder proposal on the agenda. The Investment Stewardship & Sustainability Committee considered all instances and agreed that the proposed voting was in line with Walter Scott's Proxy Voting Policy.

Material Non-Public Information (MNPI)
In the course of shareholder engagement, Walter Scott may receive Material Non-Public Information (MNPI), although our approach and process is such that receipt of such information should be infrequent.

Our process, which is communicated to all investee companies and their representatives, requires companies to send any material which is not in the public domain, and may therefore be MNPI, to Walter Scott's Risk & Compliance's electronic mailbox. This mailbox is only accessible by Risk & Compliance. On receipt of any such material, the Chief Compliance Officer, or alternate within Risk & Compliance, will review the information. If it is considered possible that the material contains MNPI, it will be passed to a "Ring Fenced Team (RFT)" for further analysis. The RFT will be considered insiders while the information is being analysed. The RFT's analysis will determine whether the information is considered MNPI.

In the case of materials which are not considered to be MNPI, the material is passed to the relevant stock

champion within the Research team and the RFT ceases to be considered as insiders.

If the information is considered MNPI, the RFT will continue to be an insider until Risk & Compliance determine that the information has become public or immaterial. Until such time the material will remain confidential and ring-fenced within the RFT. At that stage, Walter Scott as a firm will not be considered an insider, and will continue to trade as normal in all stocks. While considered insiders, members of the RFT will not attend any research-related meetings and will not discuss the investment of the relevant stock with any other Walter Scott employee, whether formal or informal. That will include the stock champions if they were in receipt of the information. In addition, members of the RFT who attend the weekly Investment Management Group meeting or the more formal quarterly meeting of the Investment Management Committee should excuse themselves from the meeting if a stock is to be discussed for which they are in possession of MNPI.

SUPPORT OF WELL-FUNCTIONING MARKETS

Recognising our Role
We recognise that all investment firms must play a part in encouraging well-functioning markets and financial systems. Despite our size we do believe it is incumbent upon all to proactively collaborate to address challenges and improve standards where possible. Through our membership of the Investment Association, we continue to participate in a number of industry initiatives and working groups in relation to responsible investing, sustainability and TCFD. We have also collaborated with our parent, BNY Mellon, to respond to consultations over the course of 2023.

Addressing Market-wide Risks
Whilst Walter Scott's investment approach is resolutely focused on company fundamentals, we do take macroeconomic and geopolitical considerations into account at both company and portfolio level. For example, we have assessed the exposure of our investee companies to Russia and Ukraine in light of the ongoing conflict between the two countries. This analysis showed that of the companies that had exposure to these countries, the vast majority of them had only a relatively modest direct exposure. The indirect exposure to Russia and Ukraine was not material at a portfolio level. Similarly, we looked at the impact on our investee companies from higher interest rates and inflation. We also receive regular updates from an independent advisory firm on the potential impact on capital markets from geopolitical developments.

Despite macroeconomic and geopolitical vicissitudes, our approach is to remain focused on investing in world-leading companies with excellent management teams, robust business franchises and strong balance sheets. Events such as those in Ukraine emphasise the need to focus on the long-term fundamentals of companies, investing in businesses that are able to lever on growth trends that will endure beyond periodic challenges.

ONGOING REVIEW & ASSURANCE

Overview
The terms of reference for all board committees include the need to regularly review applicable policies to ensure not only effectiveness but that they remain in line with best practice. Our ESG Integration, Engagement and Proxy Voting policies are reviewed annually, and were last updated on January 1st 2024

Review and Audit
We continue to believe that our own process for review and challenge, and our parent BNY Mellon's internal audit mechanisms are sufficient at this point. With regard to our broader assurance and audit, in the second quarter of 2022, BNY Mellon Internal Audit reviewed our processes in relation to stewardship activities, including our 2021 response to the Code, as part of its periodic Investment Management Audit. This Annual Sustainability Report, incorporating our response to the UK Stewardship Code, has been reviewed and signed off by Walter Scott's Managing Director and the Investment Stewardship & Sustainability Committee.

We have held initial discussions with providers of external assurance services. We will continue to consider this issue further through 2024.

Feedback from Clients
Client feedback is primarily gathered through conversations with clients in regular meetings over time. Whilst we believe that is the most effective way of anticipating and reacting to client needs particularly given the tenure of many clients, we do also on occasion ask for formal feedback.

In 2023, we held our first post-pandemic in-person client conference in Edinburgh. Feedback from the event was collated and will be used to inform the structure and content of future events. Some examples of feedback received:

"An impressive and thought provoking event"

"Great topics with so much relevance today. Interesting and diverse perspectives"

"As always the calibre of speakers was explosive and quite thought-provoking"

"Really enjoyed the conference. Very interesting content, will definitely reference in the future"

Custom Client Requirements
A number of our segregated clients have specific investment restrictions laid out in their formal investment management agreement with us. Those restrictions often relate to religious or ethical views on alcohol or tobacco, with environmentally linked restrictions also increasingly demanded. Any restriction of that nature is coded into our trade management and processing system, Charles River (CRIMS), and manual oversight checks are also undertaken. Breaches of investment guidelines are infrequent, with robust policies and procedures in place.

All portfolios are subject to a daily automated compliance check within CRIMS against measurable client guidelines to detect potential alerts or warnings. This report is reviewed daily by the Portfolio & Cash Management team and the status electronically recorded. Thereafter, exceptions are annotated with any action required or explaining why there has been a status change. This process allows the team to review all accounts daily and take any required remedial action at the earliest opportunity. Technical or passive breaches of investment guidelines can occur because of market movements or unexpected cash flows. In such instances, remedial action is taken to ensure portfolios are brought back within guidelines as soon as practicable.

We also have a governance process and methodology for assessing the suitability of holdings for SFDR Article 8 mandates. We consider these as a collection of restrictions and challenge ourselves to ensure process and oversight is as robust and appropriate given the expectation that these requirements and restrictions will continue to increase in scope and number.

Client Communication
We consider effective client communication critical to what we do. With a relatively small number of clients and an institutional-only client base, our client service and client management teams are structured and resourced to allow regular conversations with our clients, sharing information and views whilst also soliciting feedback.

Within those conversations, interest in our stewardship activities continues to increase and we certainly now often devote more time to these subjects. Reporting on our stewardship activities has also been enhanced through the publication of our response to the UK Stewardship Code and SRD II disclosures, providing more detail around proxy voting records and significant votes. In 2023, all clients were issued with our updated Proxy Voting Policy and our TCFD Entity Report.

A quarterly stewardship commentary continues to be shared with clients and is also posted on our website.

Our reporting on engagement extends to our quarterly management reports that are prepared for each client.

In addition to timetabled communications, we continue to share our research and thoughts across the spectrum of sustainable issues in several additional ways. Our Research Journal combines contributions and interviews with our Research team with those of external experts. Client events mirror our Research Journal, combining contributions from our Research team and external academics or industry experts, alongside contributions from companies around the world. Reflecting our integrated approach to ESG, and the importance of issues of sustainability and stewardship in the context of our long-term approach, sessions on environmental and social issues are very often part of the agenda. At our 2023 client conference in Edinburgh, guest speakers covered topics relating to decarbonisation and the energy transition.

Shareholder Rights Directive II
The Shareholder Rights Directive II (SRD II) aims to promote shareholder engagement and improve transparency and stewardship practices across the European Union. SRD II requires asset owners and asset managers to make disclosures about their longterm investment strategies, their arrangements with each other and their engagement with the companies in which they invest. Walter Scott fully supports the goals of SRD II.

Under SRD II, asset managers must publicly disclose their Engagement Policy and, on an annual basis, outline how that policy has been implemented over the period. Walter Scott's Engagement Policy can be found on our website and the engagement case studies and company meeting information provided throughout this report show how Walter Scott implemented its Engagement Policy over the course of 2023.

Proxy voting is an integral part of our approach to Stewardship, and it is also an important part of SRD II. Our approach to proxy voting is summarised in our SRD II Report which is available on our website. That report also outlines our approach in determining significant votes as required by SRD II. Information is available on our website with updated information added quarterly.

MONITORING SERVICE PROVIDERS

Vendor Review & Monitoring
In 2023, we undertook an ESG data governance review, interrogating data from several platforms for integrity and consistency. The review found no major concerns regarding the overall data, although we did note some discrepancies in data from MSCI, which we are now actively investigating with assistance from MSCI. These discrepancies included minor issues such as time-lag and/or miscategorisation in a number of data points.

Overall, we believe we have procedures in place to monitor the data and service providers used within our investment process. Utilising the systems and processes of our parent company, BNY Mellon, we have extensive vendor management procedures. These procedures and checks do not only cover the take on or cessation of a vendor but they also require ongoing monitoring. This includes a formal, documented annual review. Whilst dialogue must be ongoing, that annual review is structured to include consideration of any previous issues as well as possible improvements. Where the relationship or service being provided is material to the business, a meeting, rather than just an exchange of correspondence, with documented notes, is required within the review.

Because investment decisions do not rest upon a single data point or input from an external research or service provider, there is no need to use any particular source or provider of external research. However, there is of course value in gathering data to help build a long-term investment case for a particular company, and the Research team is given the resources it needs to undertake that work, be that through very general and broad services, such as Bloomberg, or very specific inputs on environmental data, for example.

Proxy Voting Materials
We currently receive proxy voting materials from ISS and use its platform to submit all votes. We also gather materials directly from the company. Engagement with the investee company, as well as a 'common-sense' check by the stock champion also helps to highlight any errors in the materials being provided. We do not provide ISS with our Proxy Voting Policy nor do we ask them to follow it. We reach our own decision on how to vote: we do not rely on ISS to determine that decision and we instruct them on our final decision. ISS process votes for us and in doing so we ask them to confirm to us that those votes have been processed and submitted. We rely on ISS' own checks to ensure that processes and submitted votes are then counted.

Ongoing Review
We continue to consider additional data providers but whilst the number of approaches we have from providers, particularly across environmental and social metrics, continues to increase, none of those that we have investigated would add materially or specifically to our existing sources. With so many new providers, as well as new technologies, we will keep this under regular review.

APPENDIX B

Streamline energy and carbon reporting (SECR)

The Walter Scott SECR table is disclosed below. Whilst the table represents the company's best efforts in capturing the data, it is worth highlighting that methodologies may change or there may be different ways of capturing and presenting the data in the future. The annual reporting period, 1st of January to the 31st of December, is aligned with the financial year. The conversion factors applied, specific to the year reported for 2019 to 2023, have been published by the UK Government: Department for Energy Security and Net Zero.

	Units (kWh)			
Energy usage	**2023**	**2022**	**2021**	**2019 Baseline**
Gas combustion	329,277	331,610	344,627	381,758
Grid electricity consumed	244,944	257,283	241,353	296,111

	GHG Emission (metric tonnes CO_2e)				
Emissions Source	**2023**	**2022**	**2021**	**2019 Baseline**	**Note**
Scope 1: GHG Emissions	67	68	70	78	1
Scope 2: GHG Emissions (location-based)	51	50	51	74	2
Scope 2: GHG Emissions (market-based)	0	0	0	26	3
Scope 3: GHG Emissions	938	1,765,076	2,086,944	2,394,996	
1. Purchased Goods and Services[a]	111	125	160	n/a	4
5. Waste generated in operations	0.5	0.4	0.3	0.5	5
6. Business Travel	615	359	44	698	6
7. Employee Commuting[a]	211	177	205	n/a	7
(a) of which commuting	100	60	17	n/a	
(b) of which working from home	111	117	188	n/a	
15. Investments[b]	n/a	1,764,414	2,086,534	2,394,297	8
Total Gross GHG Emissions	1,056	1,765,193	2,087,065	2,395,148	

	GHG Emission (metric tonnes CO_2e)			
Intensity Metrics (Per Person Employed unless stated)	**2023**	**2022**	**2021**	**2019 Baseline**
Scope 1: GHG Emissions[c]	0.37	0.39	1.84	0.50
Scope 2: GHG Emissions (market-based)[c]	0.00	0.00	0.00	0.17
Scope 3: Purchased Goods and Services[a]	0.62	0.72	0.94	n/a
Scope 3: Business Travel per person travelling[d]	7.41	5.89	2.32	10.91

[a] Emissions not provided for 2019 due to a lack of available data.
[b] Emissions associated with the investments managed by Walter Scott on behalf of clients for 2023 are not reported to due a lack of available data.
[c] Persons Employed (PE) figure for 2023 based on average headcount for the year reported.
[d] Persons travelling figure represents the number of individuals for whom the business booked travel for during the year.

In accordance with the Companies Regulations 2018, the company reports its energy use and associated greenhouse ("GHG") emissions resulting from energy use in its UK buildings and employees' business travel. Due to the nature of the business' primary business activity and location of clients, business travel emissions reported include international travel and is not restricted to travel that both starts and ends in the UK.

The company has voluntarily reported additional emission types, where applicable utilising the calculation methodologies set out per the Greenhouse Gas Protocol, A Corporate Accounting and Reporting Standard Revised Edition, defined by the World Resource Institute/World Business Council for Sustainable Development.

Per the GHG Protocol Scope 2 Guidance, Scope 2 emissions using both the location based and market based methods have been reported. The market based method reflects emissions from electricity arising from a renewable energy supply contractual arrangement whereas the location based method does not.

METHODOLOGY NOTES

1. Walter Scott's Scope 1 emissions includes emissions from the tracked use of natural gas in occupied facilities. Natural gas usage is tracked using meter readings at each of the buildings occupied in Edinburgh, UK.

2. Location-based Scope 2 grid electricity emissions are estimated based on recorded consumption in kWh which are then converted using UK government emissions conversion factors for each applicable year.

3. Grid electricity usage is recorded through meter readings in each of the buildings occupied in Edinburgh. Our energy provider supplies our Edinburgh offices with 100% renewable electricity. The supplier buys electricity on the wholesale market and for every unit purchased a Renewable Energy Guarantees of Origin (REGO) certificate is bought to match. From 2020 onwards, electricity has been supplied in this manner, meaning that the firm can report a reduced emission figure under the market-based method.

4. Purchased goods and services includes upstream emissions from production of products and services acquired. This includes both tangible and intangible items and has been calculated using the hybrid method according to the GHG Protocol. This involves the use of a combination of supplier provided emissions data and the use of secondary data. Emissions reported are calculated using the most current Scope 1 and 2 emissions data specific to the vendor and where data is not available no estimate has been made. Figures are not provided for 2019 due to a lack of available data.

5. Waste generated in operations has been reported as the total mass of waste recorded by the waste management companies that service our offices. Reported emissions relate to those emitted in the end-of-life disposal process, in accordance with the GHG Protocol waste-type-specific-method and have been calculated using the weight of waste materials multiplied by the relevant annual UK government emissions conversion factors.

6. Business travel emissions include international travel due to the nature of the business' primary business activity and location of clients. Our travel provider calculates the average estimated carbon emissions associated with each business trip and as such the calculated emissions will vary depending on the route of travel. Emissions associated with hotel accommodation required for business travel have been included in the 2022 and 2023 figures, however, this was not reported in 2019 due to lack of available data.

7. Employee commuting includes emissions from the transportation of employees between their homes and the workplace. Additionally, emissions from teleworking (i.e. employees working from home) have been included within this category per the GHG Protocol.

   Transportation emissions associated with employee commuting have been calculated in accordance with the GHG Protocol distance-based-method. The calculations were supplemented with the results of a staff survey conducted in 2023, which gathered information at a respondent level to improve overall accuracy. Details including, mode of transport used; distance from the office; and frequency of travel were collected.

   Emissions associated with employee home working have been reported using the results of the staff survey conducted in 2023, in accordance with the GHG Protocol average data-method, as an estimate was required to determine the average energy consumption of an individual when working from home. The survey gathered information at a respondent level including the type of energy tariff the member of staff held at home; the number of electrical devices used; and whether they used additional heating or cooling equipment to enhance the accuracy of the average data-method calculation.

8. Emissions associated with the investments managed by Walter Scott on behalf of clients are reported

using the investment-specific method according to the GHG Protocol. This method involves collecting Scope 1 and 2 emissions from the investee company and allocating the emissions based upon the share of investment on the 31 December for the year reported. While the reporting guidelines for investment emissions in the GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard emissions are mostly clear, accurately capturing investment emissions is complex and for this reason emissions reported should be considered as an estimate. Due to a lack of available Scope 1 and 2 investee company data for 2023, emissions have not been reported.

All emissions reported have been calculated as at 26 February 2024. The calculation methodology has changed compared to prior years and now uses 'market value divided by a company's Enterprise Value Including Cash (EVIC) as an indication of ownership of emissions. In previous years, the calculation methodology used 'number of shares held divided by shares outstanding' as an indication of ownership of emissions. The updated calculation methodology has been used to restate the 2019 and 2021 emissions and the restated values are presented in the table below. Financed emissions have decreased, partly as a result of this change in methodology.

The following information is relevant to further explain the calculation approach that has been taken.

(a) Primary Sources: Walter Scott and MSCI – MSCI's emissions data has been aggregated by Walter Scott to a portfolio-level.

(b) Secondary Source: Factset – where EVIC data was unavailable via MSCI, FactSet was used as a secondary source for EVIC values.

(c) Cash is assumed to have zero emissions attributed to it.

(d) Ownership of emissions is determined by the proportionate weight of all companies within Walter Scott's Composites (as at 31 December of each calendar year), combined with the firm's total discretionary AUM as at 31 December of each calendar year to calculate an implied market value for each company holding. These company market values are then divided by each companies' Enterprise Value Including Cash (EVIC) to determine ownership of the companies' total emissions. This should be considered representative of the firm's exposure.

COVERAGE OF EMISSIONS ASSOCIATED WITH INVESTMENTS MANAGED BY WALTER SCOTT

	2023	2022	2021	2020	2019 (baseline)
15. Investments	n/a	1,764,414	2,086,534	2,256,602	2,394,297
% Reported Values	n/a	91%	92%	90%	88%
% Estimated Values	n/a	9%	8%	10%	12%
% No Coverage	n/a	0%	0%	0%	0%

(e) Emissions data for each company included has been sourced for the relevant financial year, where available at time of calculation (26 February 2024), as indicated by the coverage table below. For 2022, where financial year emissions have not yet been reported or estimated for investee companies, 2021 emissions data has been used as the most recent available.

Percentages indicate weight of market values in each category. Estimated emissions values are sourced from MSCI. Walter Scott did not make any assumptions or use proxies. Within the 'No Coverage' category, there may be companies held at a low weight that rounds to zero.

2022 emissions calculations use the most recently reported data available at time of calculation. Of the 91% reported value for 2022, 9.7 percentage points uses 2021 data since this is the most recently reported available.

Comprehensive details in relation to Walter Scott's climate impact from investment activities are detailed in its Task Force on Climate Related Financial Disclosures Entity Report which is published on the company's website.

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Beach on Canna

Walter Scott has been supporting emerging Scottish talent since 1988. In the same way that we believe that different perspectives within the team generate the best investment ideas, so we believe that our art collection should incorporate a wide range of work from an eclectic group of contemporary artists.

Our commitment to that community is reflected in our longstanding partnership with the Royal Scottish Academy and in particular our support of its annual 'New Contemporaries' exhibition that showcases the work of emerging artists from across Scotland's five main colleges of art and of architecture.

WALTER SCOTT & PARTNERS LIMITED,
ONE CHARLOTTE SQUARE
EDINBURGH EH2 4DR
TEL: +44 (0)131 225 1357
FAX: +44 (0)131 225 7997

WWW.WALTERSCOTT.COM

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Authorised and regulated by the
Financial Conduct Authority.
FCA Head Office: 12 Endeavour Square,
London E20 1JN · www.fca.org.uk