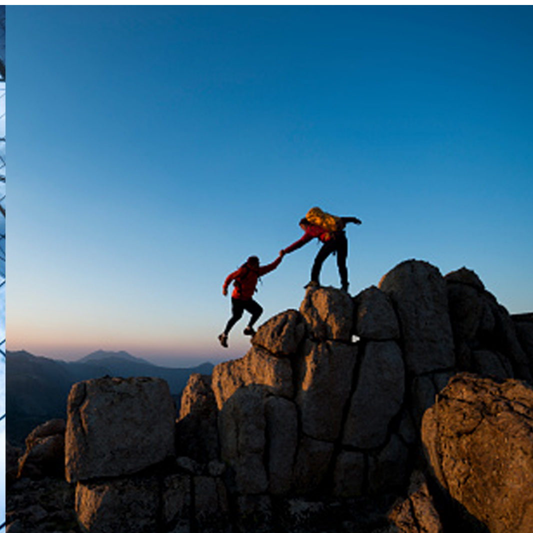
MORNINGSTAR | SUSTAINALYTICS

Material Risk Engagement

2024 Q3 Report



Material Risk Engagement promotes and protects long-term value by engaging with high-risk companies on financially-material ESG issues.

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Engagement Approach

Morningstar Sustainalytics' Material Risk/Strategy & Risk Engagement engages with high-risk companies on the material ESG issues with the greatest levels of unmanaged risks. The purpose is to protect and develop long-term value in our clients' portfolio companies. Material Risk/Strategy & Risk is an engagement overlay of Sustainalytics' flagship product, ESG Risk Ratings.

The Stewardship team will engage with companies in Morningstar Sustainalytics' Ratings universe, consisting of more than 4,500 investable issuers in developed and emerging markets, which have an ESG Risk Ratings score of 30 or more. The ESG Risk Ratings score reflects the unmanaged ESG risk, so the higher the score, the more risk the company is exposed to.

The engagement is driven by constructive dialogue. The research from the ESG Risk Ratings and the Controversies research are leveraged to encourage companies to cover gaps in Material ESG Issues risk management. Engagement Response, Progress, Positive Developments, and Milestones are consistently tracked to measure commitment and capability to change in addition to the engagement activities conducted. When a company improves by bringing the ESG Risk Ratings score to below 28, the Material Risk/Strategy & Risk Engagement case will be considered resolved.

Executive Summary

Paulina Segreto
Director, Stewardship
Morningstar Sustainalytics

We are delighted to report on the activities and results of the Material Risk/Strategy & Risk Engagement programme for Q3 2024. This quarterly report includes an article on rising climate litigation risks, a case study for an active engagement, as well as an overview of engagement activities from July through September 2024.

Highlights for the Quarter

As of 30 September 2024, we had 322 engagements, including 12 opened and 11 closed in Q3. Three engagements were successfully resolved, as we saw improvement the ESG Risk Rating score below 28, indicating a move into the Medium ESG Risk Rating category, and lower unmanaged ESG risk.

During Q3, the team has:

- Conducted 33 meetings;
- Exchanged 294 emails/phone calls;
- Achieved 61 Positive Developments and 29 Milestones.

Addressing Climate Risk

Companies across industries face varying degrees of physical and transition risks related to climate change. These risks include asset vulnerability to extreme weather, operating in an increasingly carbon-constrained regulatory environment, and market uncertainty around the pace of the energy transition. Failure to adequately address these risks—along with a lack of transparency regarding key actions and investments—can expose companies to financial risk, ultimately undermining long-term value creation and eroding investor trust.

Approximately 200 of our 322 active engagements relate to SDG 13 on Climate Action, with one-third of all engagements primarily focused on carbon in own operations and carbon in products and services. This highlights that climate-related risks are considered some of the most material ESG issues for the companies we engage with. Key issues in ongoing dialogues with companies include de-risking low-carbon and net-zero investments, aligning capital allocation with net zero goals, and fostering stakeholder engagement that drives climate action.

We have also observed an increase in climate-related liability risks, particularly for companies in the highest emitting sectors. If companies fail to disclose how they are mitigating climate-related risks, or if their activities continue to significantly contribute to climate change, they may become increasingly exposed to legal action. Ultimately, this can result in lawsuits from investors and civil society, non-compliance penalties, reputational damage, and loss of capital. The rising trend of climate litigation, its impact on corporations, and the financial implications of legal risks associated with the low-carbon transition are explored further in the article *"Rising Climate Litigation: Financial Implications of Increasing Legal Action".*

We also present a case study on **EWE AG**, a German company in the energy sector. EWE AG has been facing climate transition risks due to Germany's Energiewende goals, increased carbon pricing, and the broader market shift to renewable energy and grid modernization. Throughout our three-year engagement, the company has shifted from reactive to proactive ESG management, anticipating regulatory changes, evolving stakeholder expectations, and market trends identified.

Looking Ahead

In Q4, we anticipate resolving multiple engagements with companies who are entering the Medium ESG Risk Rating category as well as companies currently in progress of publishing their annual FY23 disclosures. This will also mean that we should be able to record a higher number of Positive Developments, which are verified by these annual disclosures.

Engagement Trip – 4 to 7 November 2024

As the energy transition unfolds, solving climate change has become both an engineering and financial challenge. We have organized a series of company visits to major European issuers from 4 to 7 November 2024. The programme includes a combination of site visits and corporate meetings, providing direct access to corporate leaders, engineers, and subject matter experts across multiple industries: utilities, chemicals, construction, steel, and industrial gases in Germany, France, and Spain. The aim of this series is to get firsthand insights into the unique challenges and opportunities faced by key players in driving the European and global energy transition.

Engagement Overview

322
engagements as of 30 September 2024

12
new engagements

595
companies engaged since March 2020

SDG 13 Climate Action
linked to 61% active engagements

Asia / Pacific
region with the largest number of engagements

Oil & Gas Producers and Utilities
industries with the most engagements

Disclosure and Net-Zero/Decarbonization
top material ESG topics in engagement dialogues

Engagement Status

When we open an engagement, the status is Engage. We will then pursue engagement until we change status to:

Resolved The company has achieved the engagement objective.

Archived Engagement is concluded, the engagement objective has not been achieved.

Disengage Engagement is deemed unlikely to succeed.

322 engagements as of 01 July 2024

12 new Engage

3 Resolved

8 Archived

0 Disengage

322 engagements as of 30 September 2024

334 engagements during Q3 2024

On a regular basis, universes are rebalanced and issuers might therefore be removed from our data set. Corporate changes can also affect case status. In such circumstances, opening and closing engagement counts will not match. Impacted companies may or may not overlap with investor holdings.

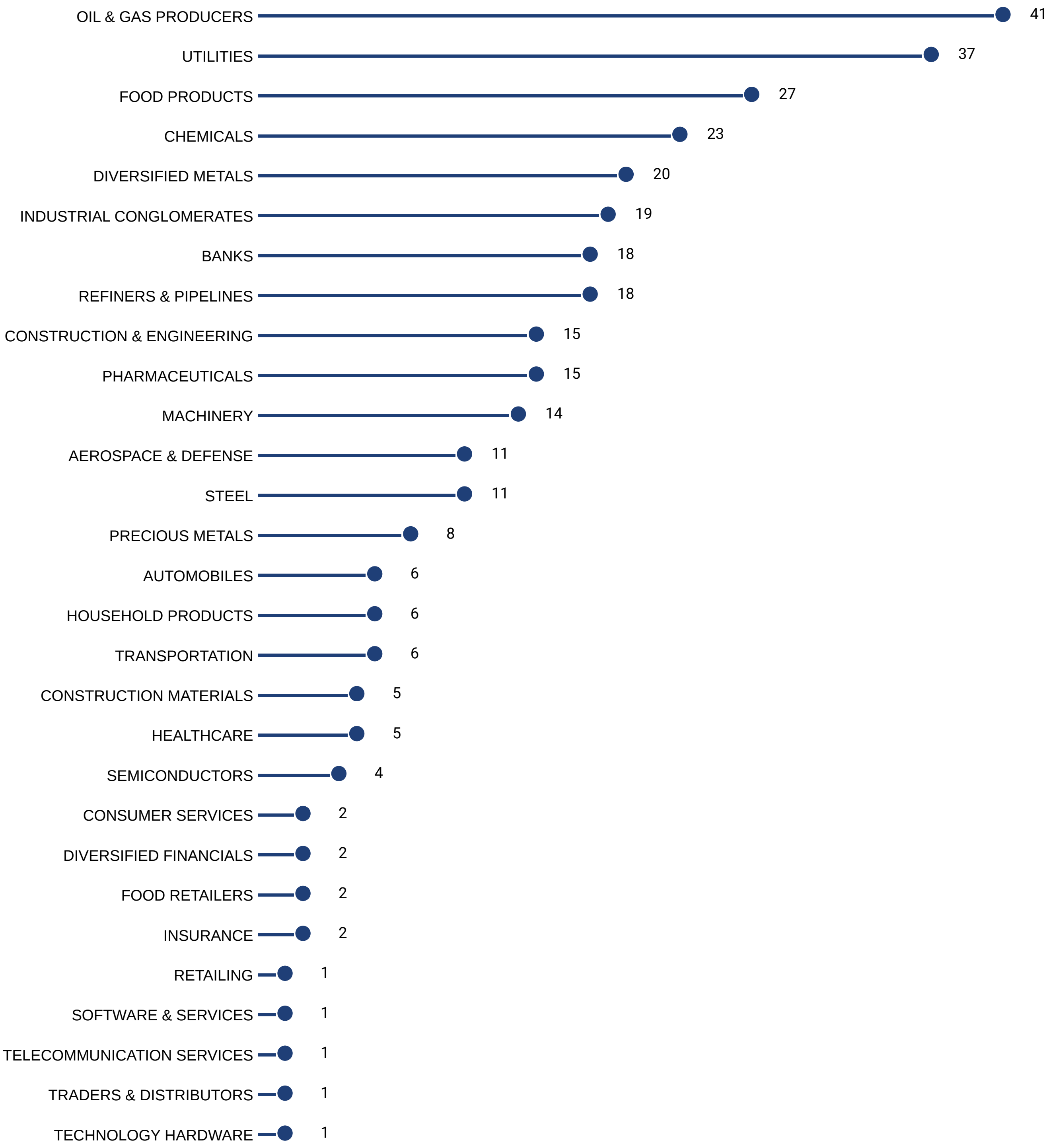
**Due to Morningstar Sustainalytis' universe update, the following case has lost its status: TSC Holding IPJSC - Focus on Risk Assessment and ESG Disclosure*

Active Engagements by ESG Risk Ratings Categories

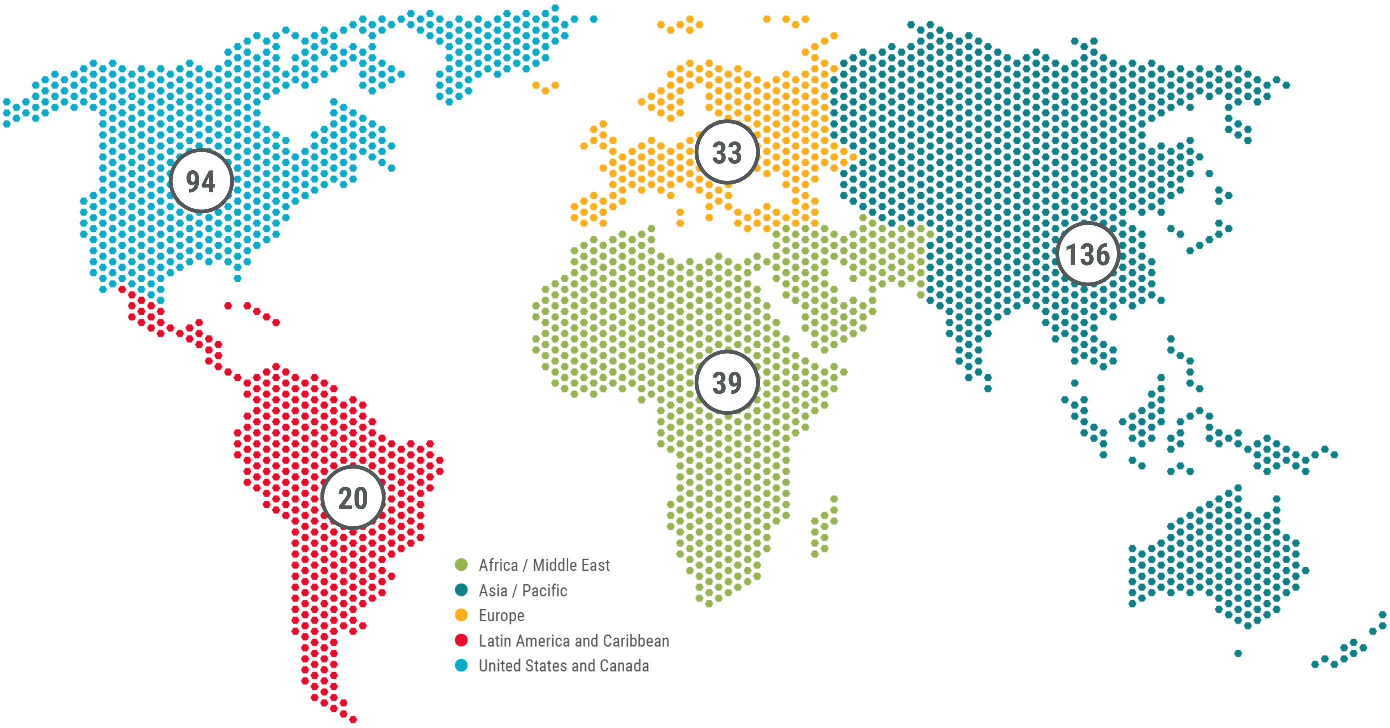
Active Engagements by ESG Risk Ratings Categories

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)
		19% (28-30)	67%	14%

Industry Distribution



Engagements by Headquarter Location

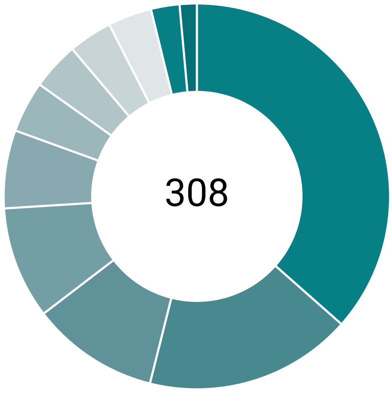


Engagement Topics

During the reporting period, our engagements addressed a number of topics across the environmental, social and governance pillars.

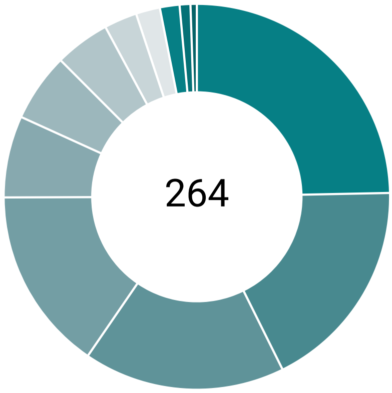
Environmental

- NET-ZERO/DECARBONIZATION (114)
- CLIMATE CHANGE (54)
- WATER SECURITY (33)
- WASTE MANAGEMENT (29)
- WATER QUALITY (20)
- BIODIVERSITY (13)
- LAND POLLUTION AND SPILLS (12)
- AIR POLLUTANT EMISSIONS (11)
- NATURAL RESOURCE USE (11)
- DEFORESTATION (7)
- CIRCULAR ECONOMY (4)



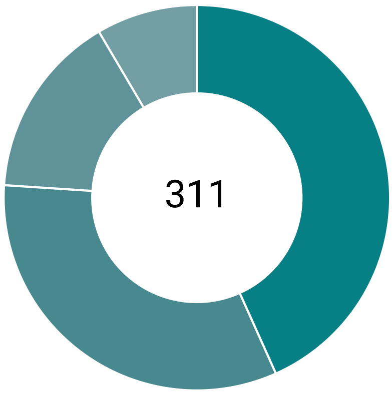
Social

- PRODUCT QUALITY AND SAFETY (66)
- HUMAN CAPITAL (48)
- COMMUNITY RELATIONS (45)
- OCCUPATIONAL HEALTH AND SAFETY (41)
- HUMAN RIGHTS (18)
- DIVERSITY, EQUITY AND INCLUSION (DEI) (15)
- DATA PRIVACY AND SECURITY (12)
- INDIGENOUS PEOPLE (7)
- MARKETING PRACTICES (5)
- LABOUR RIGHTS (4)
- HIGH-RISK TERRITORIES (2)
- JUST TRANSITION (1)



Governance

- DISCLOSURE (135)
- ESG GOVERNANCE (102)
- BUSINESS ETHICS, BRIBERY AND CORRUPTION (48)
- BOARD COMPOSITION (26)



Note : An engagement can cover one or more issues and objectives reflected in overlapping issue statistics.

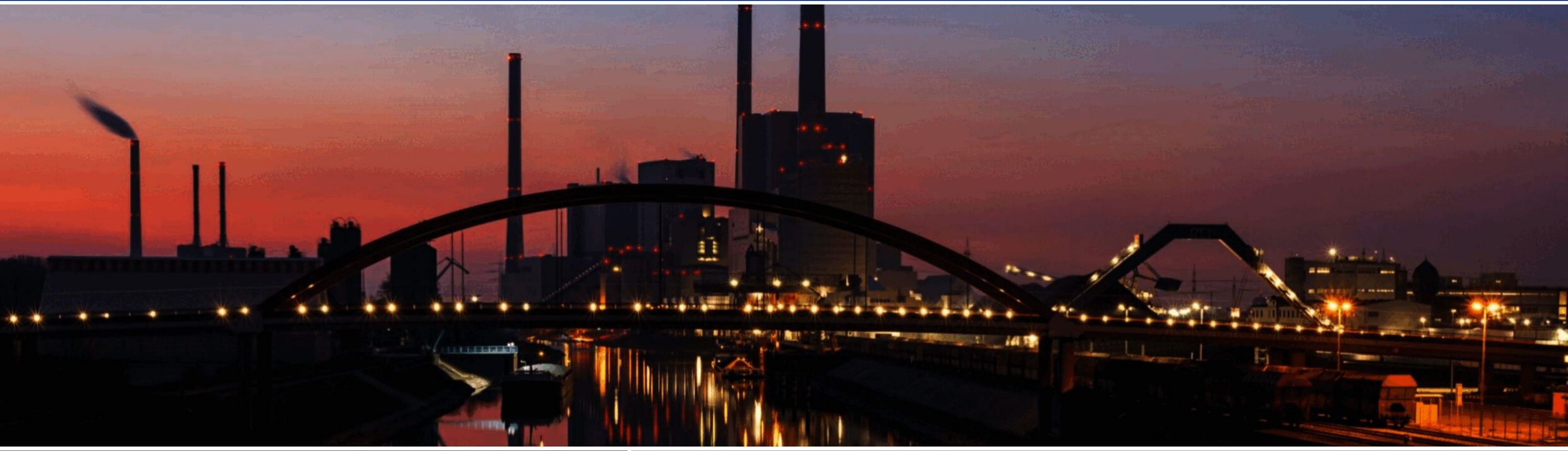
Sustainable Development Goals - Mapping Engagements

All engagements are mapped to the 17 UN Sustainable Development Goals (SDGs). The mapping is done by Morningstar Sustainalytics and refers to the focus and objective(s) of the engagement.

1 No Poverty	0%	10 Reduced Inequality	2%
2 Zero Hunger	1%	11 Sustainable Cities and Communities	20%
3 Good Health and Well-Being	12%	12 Responsible Consumption and Production	46%
4 Quality Education	1%	13 Climate Action	61%
5 Gender Equality	2%	14 Life Below Water	1%
6 Clean Water and Sanitation	7%	15 Life on Land	4%
7 Affordable and Clean Energy	20%	16 Peace and Justice, Strong Institutions	57%
8 Decent Work and Economic Growth	21%	17 Partnerships to Achieve the Goal	2%
9 Industry, Innovation and Infrastructure	15%		

Case Study: EWE AG

Material Risk Engagement — Engagement Since: 15 February 2021



Industry: **Utilities**
Base Location: **Germany**

EWE AG operates in the energy sector in Germany, providing electricity, natural gas, water management, and communication infrastructure.

Progress: **Excellent**
Response: **Good**
Latest Milestone Achieved: **3**

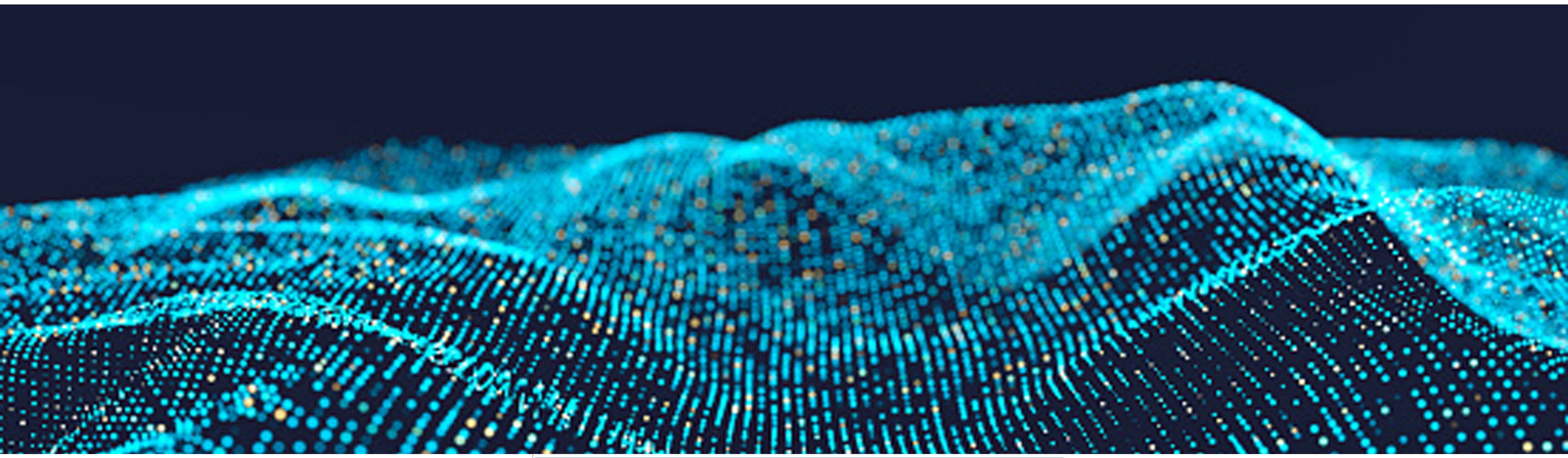
Engagement Update
Since 2021, Morningstar Sustainalytics have held four meetings with EWE, the latest in July 2024. EWE has been responsive and open to dialogue, actively seeking investor input. The timing of the engagement aligned well with EWE's efforts to strengthen its ESG governance, enhance reporting, and improve its ESG Risk Rating.

Focus Area
EWE faces climate transition risks due to Germany's *Energiewende* goals, rising carbon prices, and the broader shift toward renewable energy and grid modernization, which challenged its traditional power generation assets. Initially, the engagement focused on establishing ESG governance and risk controls, but as EWE's ESG practices matured, we shifted the discussions to implementing a climate transition roadmap and ensuring transparent disclosure of key actions and investments.

Engagement Outcomes
EWE has made meaningful ESG progress through a series of adaptation efforts and portfolio changes. In 2022, the company established an ESG governance structure, integrated ESG risks into overall risk management, and published SBTi-verified 2030 targets. EWE also created a high-level roadmap and committed to invest EUR 10 billion, including issuing a green bond, to achieve its science-based targets and reach operational net zero by 2035. In 2024, EWE shut down its last coal-fired plant, marking a key milestone in its climate transition strategy.

Insights & Outlook
The engagement highlights EWE’s shift from reactive to proactive ESG management, anticipating regulatory changes, evolving stakeholder expectations, and market trends. In July 2024, EWE reaffirmed its commitment to publish a detailed climate transition plan and disclose climate risk analysis in its first CSRD-aligned report in 2025.

Engagement Results



33
meetings

294
emails and phone calls exchanged

3
engagements Resolved

29
Milestones achieved

61
Positive Developments

54%
of engagements with Good or Excellent Response

47%
of engagements with Standard Progress

Engagement Progress

Progress reflects the pace and scope of changes towards the engagement objective that the company is making, assessed on a five-point scale.

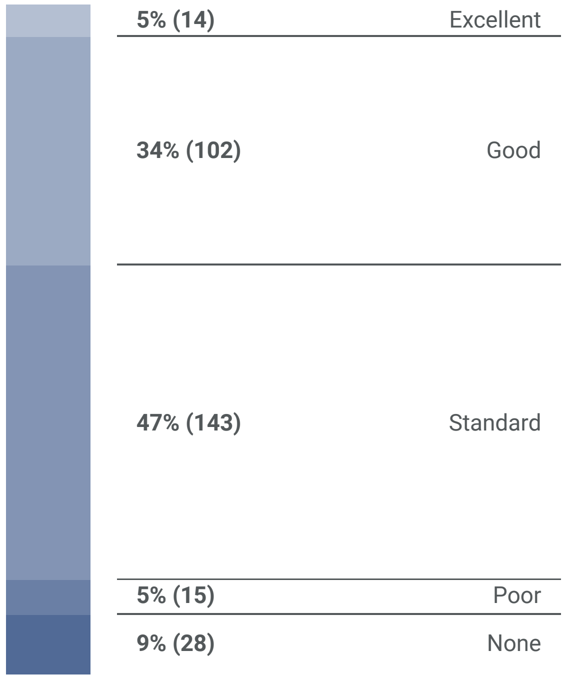
Excellent The company has adopted a proactive approach and addressed the issues related to the change objective.

Good The company has taken sufficient measures to address the issues related to the change objective.

Standard The company has undertaken a number of measures to address the issues related to the change objective.

Poor The company has indicated willingness to addressing the issues related to the change objective, but no measures have been taken yet.

None The company has not made any progress against the engagement objective.



Engagement Response

Response reflects the company's willingness to engagement diaolgue with investors, assessed on a five-point scale.

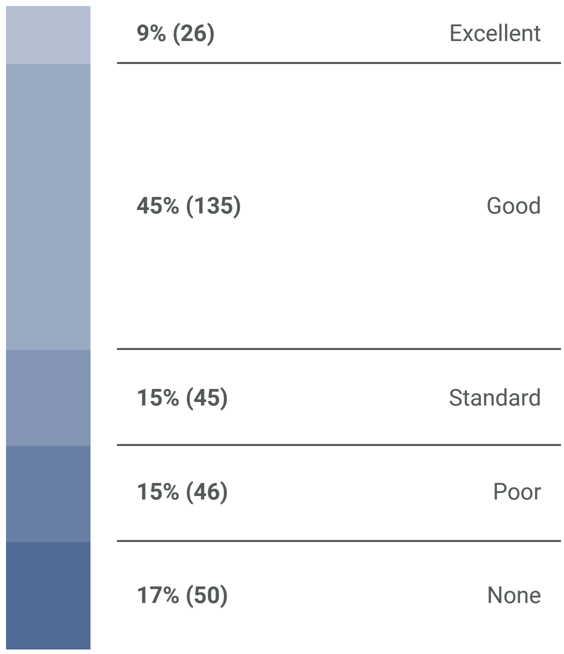
Excellent The company is proactive in communicating around the issues related to the change objective.

Good The company addresses all the issues related to the change objective.

Standard The company provides responses to some of the issues related to the change objective.

Poor The company has initially responded but not properly addressed the issues related to the change objective and is unwilling to engage further with us.

None The company has not responded to the inquiries.



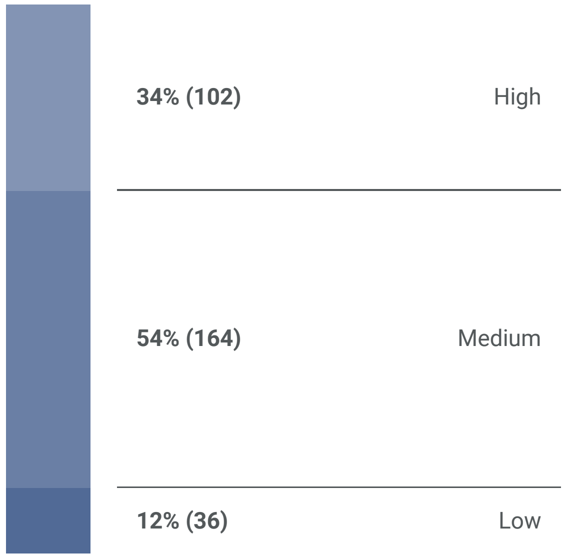
Engagement Performance

Performance describes the combined company Progress and Response.

High Good or Excellent Progress in combination with Good or Excellent Response.

Medium Standard level of Progress and Response.

Poor Poor or None Progress in combination with Poor or None Response.



Engagement Milestones

Milestones are our five-stage tracking of progress in achieving the engagement objective.

29
Milestones achieved in
Q3 2024

Milestone Framework Structure

Milestone 5 Change objective is considered fulfilled.

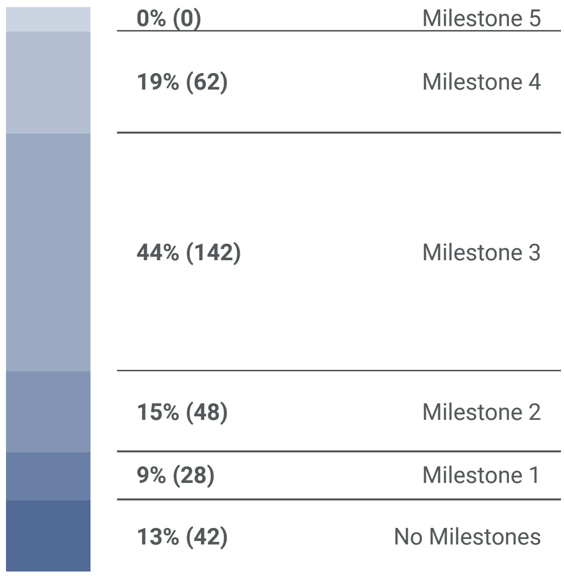
Milestone 4 Implementation of strategy has advanced meaningfully, and related issuer disclosure maturing.

Milestone 3 Strategy is well formed and has moved into early stages of implementation.

Milestone 2 Issuer establishes a strategy to address the issue.

Milestone 1 Acknowledge of issue(s) and commitment to mitigation.

Engagements by Highest Milestone Achieved



Engagements Resolved

COMPANY	COUNTRY	INDUSTRY	ISSUE	QUARTER
Charoen Pokphand Foods Public Co. Ltd.	Thailand	Food Products	Focus on Corporate Governance	Q3
Elders Ltd.	Australia	Retailing	Focus on Risk Assessment and ESG Disclosure	Q3
LONGi Green Energy Technology Co., Ltd.	China	Semiconductors	Focus on Corporate Governance and Human Capital	Q3

Resolved - LONGi Green Energy Technology Co., Ltd.

ESG Risk Ratings Score

Negligible (0-10)	Low (10-20)	Medium (20-30)	High (30-40)	Severe (40+)

24.8

INDUSTRY:
Semiconductors

BASE LOCATION:
China

ENGAGEMENT FOCUS:
Human Capital
Business Ethics
Corporate Governance

RATIONALE FOR RESOLVED STATUS:
LONGi Green Energy Technology Co., Ltd. has improved its ESG Risk Rating score to below 28.

Positive Development Highlights:

- LONGi's 2023 Sustainability Report is prepared in accordance with well-recognized international reporting standards (e.g. Global Reporting Initiative) and covers comprehensively all material ESG issues, as well as initiatives in all areas to mitigate the material ESG issues.
- The company has expanded the board-level Strategy Committee to become the Strategy and Sustainable Development Committee, which oversees the full scale of ESG issues within the company.
- It has obtained the ISO 37001 certification for Anti-Bribery Management Systems and the ISO 37301 certification for Compliance Management Systems.
- In June 2023, LONGi introduced its first Human Rights Policy. It has established a screening system for suppliers with environmental as well as social criteria.
- In 2023, LONGi was recognized by the Science Based Target initiative (SBTi) for its emission reduction targets, which align with the 1.5°C target in the Paris Agreement.

In the latest update of the ESG Risk Rating, LONGi has achieved a significant improvement that brings the score to below 28 and comfortably within the medium risk category.

Rising Climate Litigation: Financial Implications of Increasing Legal Action

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Material Risk/Strategy & Risk Engagement
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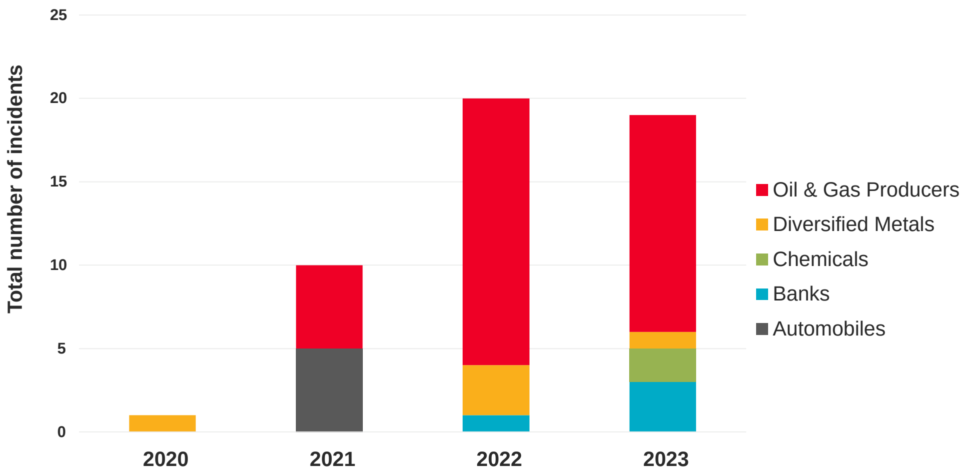
Introduction

Growing evidence suggests that traditional climate risk analysis may not fully account for legal risks.[1] The increasing prevalence of climate litigation and enforcement actions amplifies financial risks related to climate change, extending beyond the scope of transition risks articulated by the Task Force on Climate-Related Financial Disclosures (TCFD). This article examines the trends in rising climate litigation, its impact on corporations, and the financial implications of legal risks associated with the low-carbon transition.

Litigation is an Emerging Element of Climate Risk

The number of climate litigation cases has surged significantly over the past decade, with claimants increasingly achieving successful outcomes.[2] While governments were once the primary targets of such legal action, the 2015 Paris Agreement provided a strong framework to compel corporate climate action through the courts. Since the Paris Agreement, around 70% of climate litigation cases have been brought against corporations, reflecting a shift in how stakeholders hold companies accountable. Similarly, an analysis of Morningstar Sustainalytics data comparing the number of climate-related probes and litigation incidents between 2020 and 2023 across five heavy-emitting industries indicates an upward trend. Additionally, it shows that the degree of exposure varies by industry, with Oil & Gas Producers being the most affected (see Figure 1).

Figure 1. Industry Comparison of Probes and Litigation Incidents Related to the Carbon Impact of Products and GHG Emissions (2020–2023)



Source: Morningstar Sustainalytics. The data for this analysis was retrieved on September 10, 2024, from Sustainalytics Ratings Universe. For informational purposes only.

Note: Probes and litigation incidents refer to the status of allegations assessed under Sustainalytics' Controversies Research Event indicators:

1. **Carbon Impact of Products:** This assesses incidents related to the harmful environmental impacts of carbon dioxide emissions associated with the use of a company's products. For financial institutions, this may include the financing of projects or companies whose products result in significant carbon dioxide emissions.
2. **Energy Use and GHG Emissions:** This assesses incidents related to poor management or excessive release of greenhouse gas (GHG) emissions from a company's business activities.

A landmark case that may shape future litigation is *Milieudefensie et al. v. Royal Dutch Shell*, where a Dutch court ruled that **Shell** must reduce its global emissions by 45% by 2030, based on the Paris Agreement.[3] [4] While Shell's management is appealing the decision, recent court orders in the Netherlands to reduce emissions beyond the company's targets introduce additional risks in Shell's valuation associated with the energy transition. Shell has identified climate change and the energy transition as material risks based on societal concerns and developments related to climate change.[5] To achieve its emissions reduction targets, Shell proactively manages all climate-related risk components, including societal and litigation risks. The company acknowledges that evolving societal expectations may impact its license to operate, reputation, and competitive position and that litigation is perceived to be an increasing risk for the oil and gas industry. Shell notes that legal action may result in forced strategic changes, hydrocarbon divestment, regulatory permit denials, or paying fines and compensation to plaintiffs. While Shell believes these lawsuits lack merit, the company recognizes that unfavourable outcomes may have a material impact on earnings, cash flows, and financial condition.[6]

Climate Legal Action in Reverse

In line with the global trend of increasing climate litigation against corporations, **ExxonMobil** is facing numerous lawsuits related to its historical emissions and climate change impact.[7] [8] The company acknowledges regulatory and litigation risks related to changes in environmental laws, which may increase compliance costs or delay business opportunities.[9] ExxonMobil further notes it could be adversely impacted by litigation outcomes, particularly in the US, where large and unpredictable penalties or lawsuits pushing policy changes or seeking financial gains may occur.[10]

In a surprising move, ExxonMobil has also taken legal action against activist investors challenging its climate strategy and mitigation efforts.[11] In January 2024, ExxonMobil filed a Texas federal lawsuit attempting to prevent activist shareholders from submitting future climate change proposals after they called for emissions reductions across its value chain. The lawsuit set a precedent, and some believe it could trigger a wave of corporate litigation in the reverse direction—targeting climate activists and environmentally focused investors. Despite the withdrawal of the proposal and the lawsuit's eventual dismissal, ExxonMobil faced reputational damage and financial risks, including the loss of support from the California Public Employees' Retirement System.[12]

Climate Litigation Exposes Corporates to Financial Risk

Climate litigation poses direct threats to companies through successful lawsuits, but it may also carry broader financial implications. Exposure to litigation can lead to higher borrowing costs, subsidy cuts, stricter climate regulation with added compliance costs, and new disclosure requirements. Legal outcomes may further add complexity to mitigation and adaptation efforts of well-understood physical and transition risks. Additionally, reputational damage resulting from legal actions may exacerbate exposure to financial impacts, including reduced access to capital.[13]

Yet, little is known about the full financial impact of climate litigation on corporate value. While still a developing field, some evidence suggests that unfavorable rulings can negatively affect company valuations, with the largest emitters being the most vulnerable.[14] Such findings imply that lenders, insurers, and financial regulators should treat climate litigation risk as a material financial issue.

Climate-related litigation and its impact on the financial sector in Europe has been discussed for several years, and it was identified as an emerging source of risk for the financial sector as early as 2021.[15] [16] However, others contest that despite the rapid rise in climate-related lawsuits, uncertainty surrounding court rulings and potential costs means these lawsuits have yet to significantly affect credit quality.[17]

Conclusion

Policymakers, investors, and companies are increasingly recognizing the need to understand climate risk exposures. However, addressing these risks effectively requires a holistic approach that integrates legal reasoning with financial analysis and climate science. The growing attention from regulators, shareholders, and investors on climate litigation underscores the importance of developing proactive strategies to minimize vulnerabilities and mitigate future exposure to climate-related legal risks.

Case Study: Greenpeace Canada vs. Pathways Alliance

A current application by the nongovernmental organization (NGO) Greenpeace Canada to the Canadian Competition Bureau alleges that the claims made by **Pathways Alliance** (a consortium of the six largest oil sands producers in Canada) of, "actively reducing emissions and helping Canada achieve its climate targets," are false and misleading. Greenpeace Canada has asked the Competition Bureau to have Pathways remove all the representations about reducing emissions, achieving net zero, cleaning air, and combatting climate change as well as issue a public retraction of these statements and pay a fine that is the greater of $10 million or 3% of worldwide gross revenues to organizations for the rehabilitation and clean-up of oil sands production.[18]

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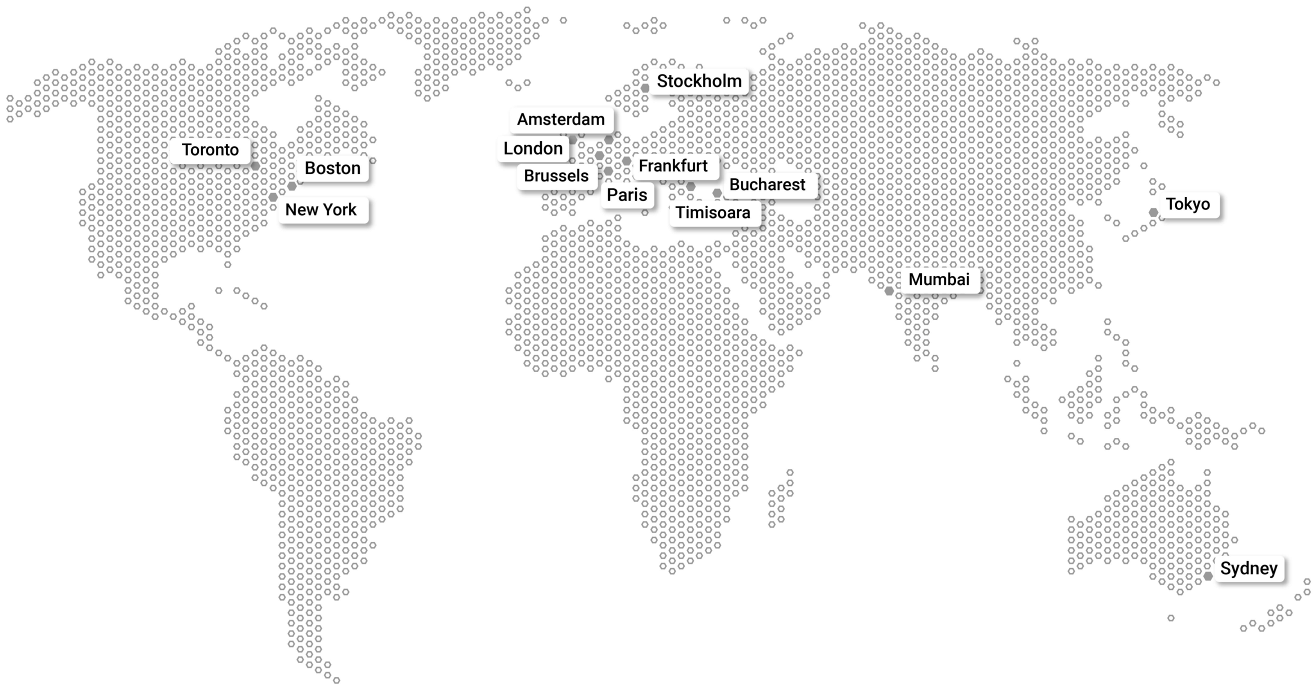
18 - To read more about the interplay and actions of stakeholders on greenwashing in Canada's oil and gas sector, please see the Morningstar Sustainalytics Blog's webiste. https://www.sustainalytics.com/esg-research/resource/investors-esg-blog/clearing-the-air-with-canada-s-oil---gas-sector--the-interplay-and-actions-of-stakeholders-on-greenwashing

About Morningstar Sustainalytics and Contacts

Morningstar Sustainalytics is a leading ESG data, research, and ratings firm that supports investors around the world with the development and implementation of responsible investment strategies. For more than 30 years, the firm has been at the forefront of developing high-quality, innovative solutions to meet the evolving needs of global investors. Today, Morningstar Sustainalytics works with hundreds of the world's leading asset managers and pension funds who incorporate ESG information and assessments into their investment processes. The firm also works with hundreds of companies and their financial intermediaries to help them consider material sustainability factors in policies, practices, and capital projects. Morningstar Sustainalytics has analysts around the world with varied multidisciplinary expertise across more than 40 industry groups. For more information, visit www.sustainalytics.com.



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