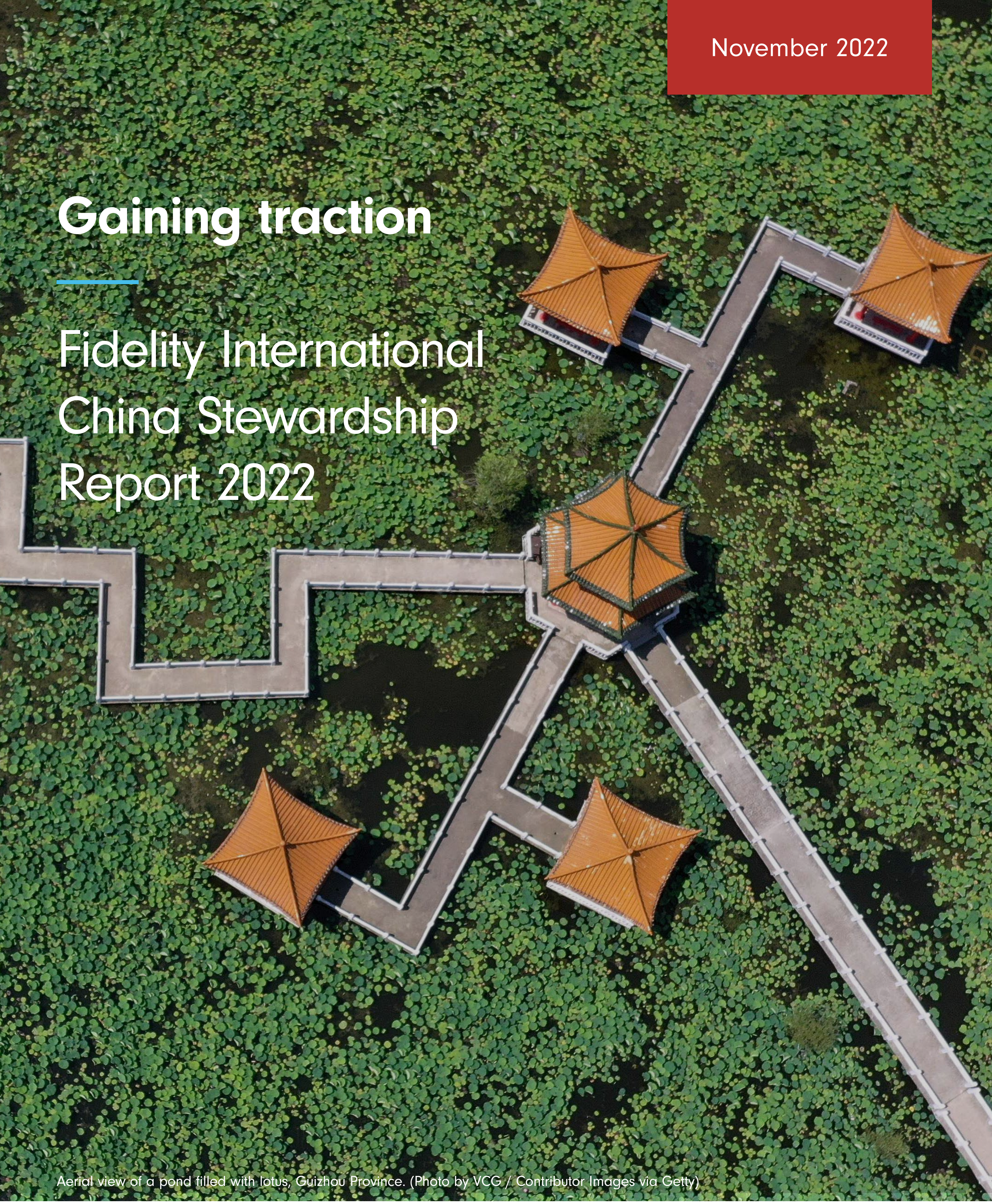
November 2022

Gaining traction

Fidelity International China Stewardship Report 2022



Aerial view of a pond filled with lotus, Guizhou Province. (Photo by VCG / Contributor Images via Getty)

Prepared in cooperation with ZD Proxy Shareholder Services

Fidelity INTERNATIONAL

About Fidelity International

Fidelity International offers investment solutions and services and retirement expertise to more than 2.8 million customers globally. As a privately held company with a heritage spanning half a century, we think generationally and invest for the long term. Operating in more than 25 locations and with $613.3 billion in total assets*, our clients range from central banks, sovereign wealth funds, large corporates, financial institutions, insurers and wealth managers, to private individuals.

Our Workplace & Personal Financial Health business provides individuals, advisers, and employers with access to world-class investment choices, third-party solutions, administration services and pension guidance. Together with our Investment Solutions & Services business, we invest $459.9 billion on behalf of our clients.

*Data as at 30 September 2022. Read more at fidelityinternational.com

About ZD Proxy Shareholder Services

Founded in 2016, ZD Proxy Shareholder Services is the first domestic proxy advisory firm in China. As a pioneer in the field, ZD has provided proxy advice covering over 800 A-share listed companies for a clientele of institutional investors that oversee a total of $20 trillion in assets globally.

Since its inception, ZD has been committed to building trust and safeguarding clients' long-term interests. Working closely with institutional investors, ZD strives to bring China's corporate governance and sustainable growth to a higher level.

Read more at zdproxy.com

Preface

Small steps count in China stewardship evolution

Welcome to the second edition of the China Stewardship Report. Like the first report two years ago, the 2022 study was produced jointly by Fidelity International and ZD Proxy Shareholder Services. In the following pages we document and analyse the progress we are seeing on the ground in China - sometimes slow and faltering, sometimes quick and dramatic - when it comes to shareholder stewardship in the world's second-biggest economy. Globally, stewardship is playing an increasingly key part of sustainable corporate growth, with shareholders effecting changes through voting and engagement. It has become a consensus among institutional investors to develop systematic stewardship approaches.

As China's capital markets evolve, we are happy to see a rise in regulatory support for enhancing stewardship practices, as well as a pickup in voting rates at shareholder meetings.

While controlling shareholders with outsized sway remain a key risk to corporate governance at many Chinese firms, minority investors can still prevail - especially if they work together. In most companies, the combined stake of all non-controlling holders exceeds 50 per cent, leaving room for an engaged block of voters to influence corporate affairs. In addition, Chinese regulators require voting for a wider range of corporate decisions than in many other countries. This helps boost the case for investors' participation in governance through voting in China.

A firm advocate for ESG investing, Fidelity International has formulated its own sustainable investing principles and guidelines. Since mid-2021, we have been applying our votes systematically on company resolutions around the world. We can attest to the rising willingness among Chinese firms to heed investor calls for ESG improvement.

Every small step counts in China's stewardship development. Each responsible vote or sincere dialogue will add up over time to make a difference. We believe today's concerted efforts of investors, companies and regulators are paving the way for stewardship practices to flourish in China, adding to the healthy growth of the country's capital markets.

Flora Wang
Head of Stewardship, Asia, Fidelity International

Active shareholder votes impact corporate governance in China

It is our great honour to join hands with Fidelity International again to co-publish this 2022 China Stewardship Report and share our latest insights on the voting practices of shareholders in the Chinese A-share market over the past three years. As China's first proxy advisory firm, ZD Proxy is deeply rooted in this highly sophisticated market and is committed to providing in-depth, professional proxy voting advice for institutional investors abroad and at home. We have witnessed first hand the gradual change among institutional investors in China as they went from "voting with their feet" to "voting with their hands."

For a long time, A-share corporate governance was marked by 'one shareholder dominance,' with cases of controlling shareholders encroaching on minority interests occurring from time to time. However, after years dedicated to working on voting services, we are excited today to see institutional investors increasingly wielding their power of voting rights to make an impact. By actively engaging with companies and firmly voting against them, investors have successfully protected their shareholder interests. These stewardship practices have served to monitor and discipline listed companies against misconduct, and have significantly changed the corporate governance environment at large.

The Chinese government has been advocating and leading the way towards its stated goal of improving the quality of listed companies, which we believe can be enabled through responsibly exercising shareholders' rights to vote, question, and offer suggestions. Undeniably, alongside regulatory support, investors and other market participants all have their parts to play. At ZD Proxy, we hope to make our contribution as an independent voting advisory to help improve the quality of listed companies.

Ling Fang
CEO and Partner, ZD Proxy

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Introduction

Following years of localisation, 'stewardship' is no longer a strange concept to investors and listed firms in China. Participation in shareholder voting has been on the rise, and company managements are becoming more responsive to engagement by investors.

These positive developments go hand-in-hand with the rising awareness in China over environmental, social and governance (ESG) investing, which has gained traction in the wake of the Covid-19 pandemic. Moreover, in September 2020, the popularity of sustainable investing received a significant boost from China's announcement of a 2060 national target for reaching net zero greenhouse gas emissions.

Institutional participation in the A-share market continues to rise while the dominance of controlling shareholders is easing somewhat, creating more room for asset managers like Fidelity to deepen their stewardship practices.

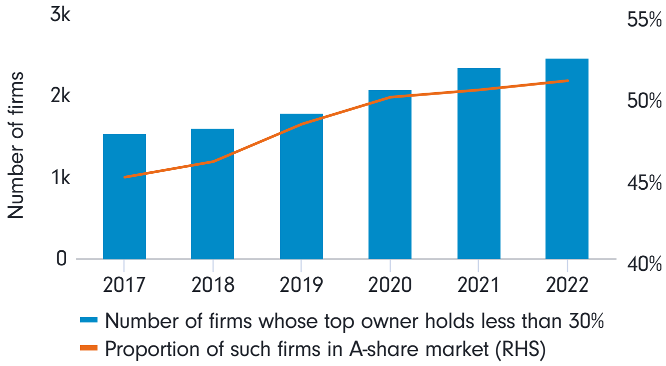
Investment stewardship refers to the fiduciary duty of professional money managers to provide responsible oversight of capital on behalf of clients. Voting at a company's shareholder meetings and directly engaging with its management are key tools for investors to encourage sustainable business behaviour and enhance client returns.

Policy support has played a key role in driving China's ESG and stewardship development over the last few years. The government has introduced a series of policies aimed at fostering high-quality disclosure and responsible investing. For instance, the Shenzhen Stock Exchange issued guidelines in January of this year requiring listed firms to disclose their ESG performance and making such disclosure a key focus of regulatory review. In June, the China Banking and Insurance Regulatory Commission (CBIRC) asked banks and insurers to incorporate ESG standards in their investment processes and to enhance their stewardship practices.

These guidelines followed a directive from the State Council, China's cabinet, in September 2020 calling for greater information transparency and more active institutional participation in corporate governance.

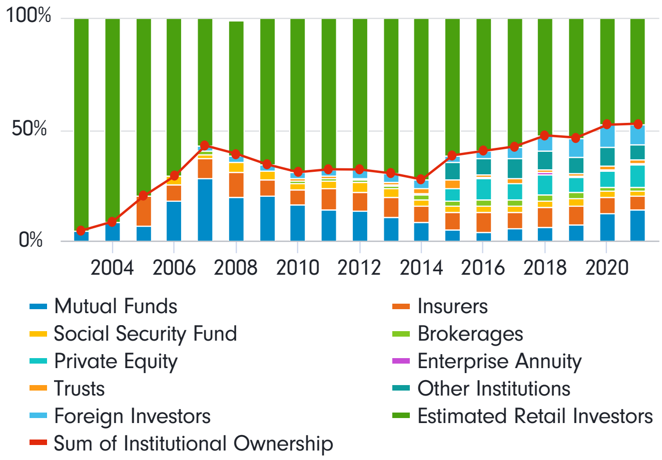
Institutional participation in the A-share market continues to rise while the dominance of controlling shareholders is easing somewhat, creating more room for asset managers like Fidelity to deepen their stewardship practices. At the same time, 2021 saw a significant increase in the number of onshore Chinese signatories for the United Nations Principals for Responsible Investing (PRI) programme, with 25 new asset managers joining last year versus 13 in 2020. And while many minority investors have yet to be convinced of the power of voting in shareholder meetings to challenge controlling interests, some are starting to at least express themselves through dissenting votes. The proportion of minority shareholders casting "against" ballots has jumped in recent years, albeit from a low base.

Chart 1: Ownership concentration declines in A-share market



Source: ZD Proxy, Fidelity International, Nov 2022. Only 1H data is used for 2022.

Chart 2: Institutional ownership climbs in A-share market



Source: CICC, Fidelity International, July 2022

On the other hand, companies have actively increased shareholder communication, with the proportion of listed companies in the A-share market discussing earnings results with investors rising from 55 per cent in 2020 to 94 per cent in the third quarter of this year. The number of firms within the study publishing ESG reports (excluding corporate social responsibility, or CSR, reports) has also increased dramatically, rising to 262 as of the first three quarters of 2022, a threefold increase from the same period a year earlier.

While we've seen incremental progress, there is still meaningful room for further improvement in active stewardship. At shareholder meetings, plans floated by minority investors remain insignificant in number, despite an overall increase in proposals. We need greater enthusiasm for voting among A-share investors; holders of Hong Kong-listed H-shares, led by foreign institutions, remain the more active group of voters. Moreover, proposals on environmental and social issues are conspicuously scarce, although governance-related initiatives have been rising steadily.

This paper consists of three main sections: 1) an overview of trends in shareholder resolutions and voting; 2) responsible voting case studies; and 3) engagement case studies.

An aerial view of skyscrapers in Shanghai's Lujiazui Financial District at night. (Photo by VCG/VCG via Getty Images)

Part 1: Shareholders lean into meetings and votes

Shareholders lean into meetings and votes

The number of shareholder meetings and the topics they cover offer a unique angle to understand the market environment under which stewardship activities are conducted in China.

Consider how trends in shareholder meetings can reflect the fortunes of a given sector. The property slump in mainland China reduced the need for shareholder approvals of financing plans. The number of refinancing resolutions from property companies dropped by more than half to 40 in 2021, from 96 in 2020. For example, China Fortune Land Development Co. held zero shareholder meetings on financing plans from 2021 to mid-2022, compared with four in 2020.

The average number of shareholder meetings per year at A-share companies remained consistent at around 3-4 meetings a year.

On the other hand, power equipment companies have seen a rise in shareholder meetings as the number of investment projects increase. Shenzhen Capchem Technology Co. held three meetings in 2021 on project investment, compared with none on this topic in 2019 and one in 2020.

Overall, the average number of shareholder meetings per year at A-share companies remained consistent at around 3-4 meetings a year.

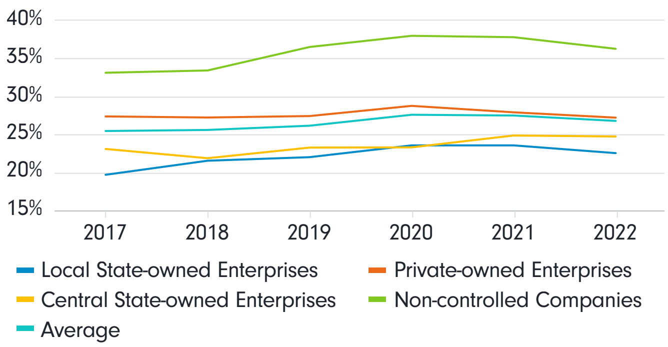
Our findings are based on a proprietary study conducted for Fidelity International by ZD Proxy Shareholder Services. The study encompassed 6,385 shareholder meetings and 49,642 resolutions made from 2020 to mid-2022 by 749 companies that were or have been constituents of the MSCI China A Onshore Index during this period (including 97 companies listed on both A- and H-share markets).

More voter turnout

In the past two years, Chinese investors had to contend with outbreaks of Covid-19 and related travel restrictions. Despite this difficult backdrop, voter turnout among minority shareholders remained steady and even slightly increased to 27.5 per cent in 2021, compared to 26.2 per cent in 2019 before the pandemic. Most likely this was due to the quick and successful migration of shareholder meetings to virtual platforms, with the Shanghai and Shenzhen stock exchanges having allowed online voting since 2004. Nevertheless, given the very modest gains, we see much room for improvement in the turnout rates.

Diving into the numbers, minority shareholders participated most actively at non-controlled companies, with 37.8 per cent of minority shareholders attending general meetings at such firms in 2021. Minority participation was seen as rising slowly for SOEs, where the turnout ratio for meetings of local SOEs rose to 23.6 per cent in 2021, compared with 22.0 per cent in 2019, and central SOEs increased to 24.9 per cent in 2021, versus 23.3 per cent in 2019.

Chart 3: Voter turnout rate for minority shareholders at meetings



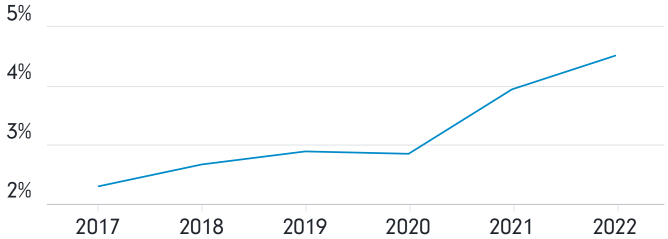
Source: Fidelity International, ZD Proxy, November 2022. Note: 2022 data is through June 30.

Analysed by meeting type, minority shareholders were more interested in attending annual general meetings (AGMs) than extraordinary general meetings (EGMs). There was a gap of about 5 per cent in participation rate between the two meeting types over the past 2 years, as AGMs receive more market attention, and listed companies communicate more about them.

Shareholders just say "No"

Shareholders are increasingly expressing their opposition against resolutions they dislike. The number of resolutions where more than 10 per cent of all shareholders cast "against" or "abstain" votes surged to 1,831 (or 3.7 per cent of all resolutions) from 2020 to mid-2022, compared with 1,070 in 2017-2019 (or 2.5 per cent of all resolutions).

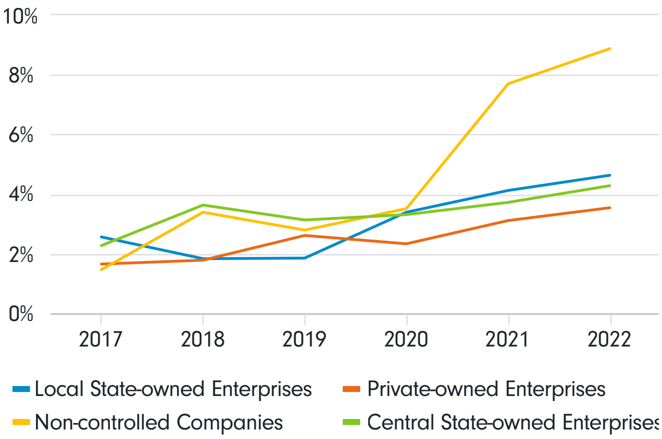
Chart 4: Percentage of all resolutions facing significant votes against



Source: Fidelity International, ZD Proxy, November 2022. Note: 2022 data is through June 30. Significant vote against: more than 10% against" or "abstain" votes.

Notably, the number of resolutions facing such levels of opposition accounted for 8.9 per cent of all resolutions at non-controlled companies in the first half of 2022, a sharp increase from 3.5 per cent in 2020.

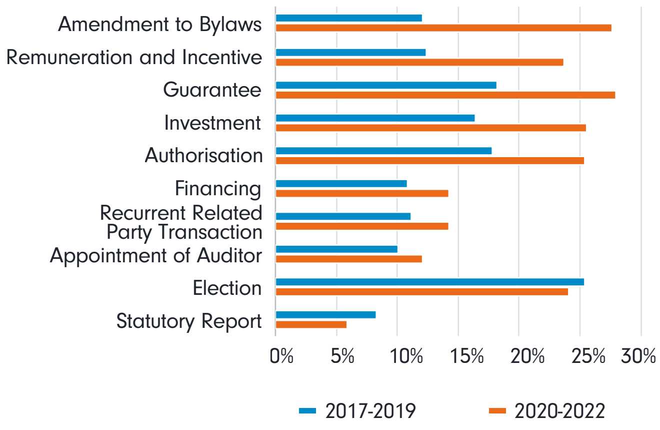
Chart 5: Percentage of significant votes against by company type



Source: Fidelity International, ZD Proxy, November 2022. Note: 2022 data is through June 30. Significant vote against: more than 10% "against" or "abstain" votes.

Among the types of resolutions facing minority opposition, amendments to bylaws, guarantees, or remuneration and incentive plans had substantial increases in 2020-2022H1 compared to the 2017-2019 period. Resolutions in these three categories receiving more than 10 per cent "against" or "abstain" votes from minority shareholders accounted for 29.1 per cent, 28.3 per cent and 23.7 per cent, respectively, of all the resolutions in 2021. In contrast, the ratios were only 11.2 per cent, 23.5 per cent, 13.9 per cent, respectively, in 2019.

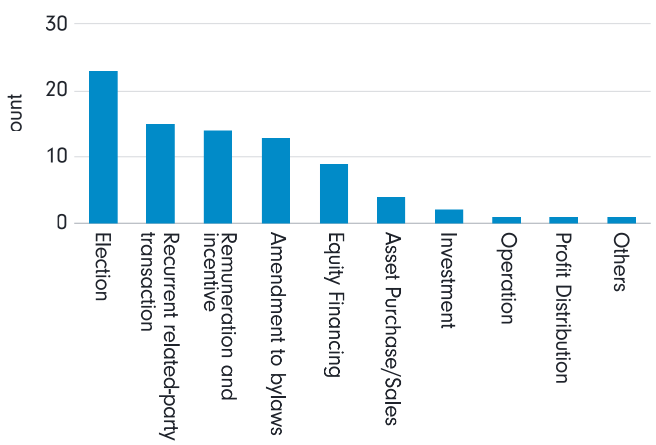
Chart 6: Percentage of significant votes against from minority shareholders by resolution type



Source: Fidelity International, ZD Proxy, November 2022. Note: 2022 data is through June 30. Significant vote against: more than 10% "against" or "abstain" votes.

The number of rejected resolutions jumped to 83 during 2020-2022H1, from 65 in 2017-2019. Apart from board elections and recurrent related-party transactions, which both continued to receive higher numbers of votes against, investors voted down 14 resolutions on remuneration and incentive plans, 13 on amendments to bylaws, and 9 on equity financing, a sharp increase from 4, 2 and 3 resolutions, respectively, of these types in 2017-2019.

Chart 7: Defeated resolutions by type (2020-2022H1)



Source: Fidelity International, ZD Proxy, November 2020. Note: 2022 data is through June 30.

Accountability rising

For their part, Chinese companies have stepped up their efforts to improve internal policies and communication with shareholders. This is largely a response to efforts by regulators to promote corporate governance.

In the first half of 2022, the number of corporate resolutions focusing on amendments to bylaws increased significantly after China's stock market regulators upgraded and adjusted rules in this area.

For their part, Chinese companies have stepped up their efforts to improve internal policies and communication with shareholders. This is largely a response to efforts by regulators to promote corporate governance.

Furthermore, a high-profile financial fraud case in 2021 at Kangmei Pharmaceutical Co highlighted the importance of directors' responsibility and how they can be held accountable in court and face significant financial loss. Following this case, in January 2022, the China Securities Regulatory Commission (CSRC) published the new rules for independent directors of listed companies, which consolidated guidelines for independent directors and included a new clause regarding setting up directors & officers (D&O) insurance. Since then, more than 200 listed companies raised remuneration for independent directors and more than 100 firms submitted proposals on D&O insurance for shareholder meetings.

Companies are also becoming more shareholder-friendly about disclosure. In 2021, 57.3 per cent of firms' disclosures on shareholder meetings were published through a consolidated circular, compared to 51.7 per cent in 2019. Consolidated circulars are highly welcomed by shareholders as they allow investors to assess meeting resolutions efficiently without wasting time combing through separate company disclosures for each voting resolution.

Lastly, more and more Chinese companies have started releasing ESG reports since the Shanghai and Shenzhen stock exchanges in 2020 encouraged locally-listed firms to voluntarily disclose ESG information. In the first three quarters of 2022, 262 firms published ESG reports in the A-share market, while four firms voluntarily submitted their ESG reports for shareholder review and approval. While it's a small number, it is significant once you consider that prior to 2020, no Chinese firm had submitted an ESG report for shareholder approval.

Chart 8: Encouraging signs of ESG reports being submitted for shareholder vote

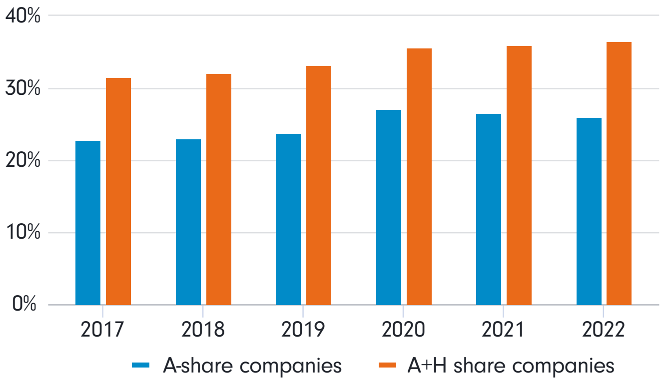
Source: Fidelity International, ZD Proxy, November 2022. Note: 2022 data is through June 30.

Room for improvement

Mainland investors still lag far behind their Hong Kong counterparts in terms of voting on corporate governance matters.

Our sample includes 97 Chinese companies that are dual listed with A-shares trading on mainland China's bourses and H-shares in Hong Kong. Minority shareholders' average participation at meetings of these A+H companies exceeded that of onshore-only firms by more than 10 per cent in 2022H1.

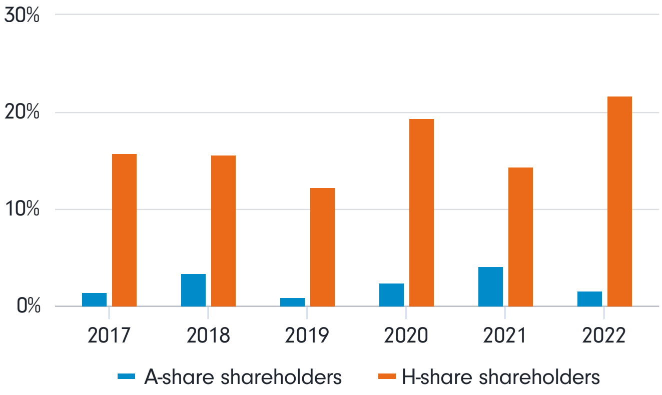
Chart 9: Minority shareholders' voter turnout at dual-listed A+H companies vs. A-share only companies



Source: Fidelity International, ZD Proxy, November 2022. Note: 2022 data is through June 30.

The gap is also reflected in expressions of dissent. A comparative look shows about 4 per cent of all resolutions at dual-listed firms in 2021 saw "against" or "abstain" votes from onshore shareholders amounting to 10 per cent or more. That was up from 2.3 per cent in 2020, but was a far cry from the 14.4 per cent of resolutions that faced against or abstain votes from offshore shareholders in 2021.

Chart 10: Lower dissent rates among onshore shareholders at dual-listed A+H companies



Source: Fidelity International, ZD Proxy, November 2022. Note: 2022 data is through June 30.

In the onshore market, controlling shareholders still play the dominant role in introducing shareholder proposals. Minority shareholders submitted only 38 proposals from 2020 to mid-2022, accounting for 6.5 per cent of the total shareholder proposals.

Moreover, proposals focusing on environmental and social factors are lacking in the onshore market. A small number of proposals related to the environment, such as green project investments or green bond sales, were raised in shareholder meetings, but they mostly stemmed from the companies' core businesses and weren't the typical environmental resolutions we observe in other markets. In overseas markets, ESG proposals are more often submitted by minority shareholders, and we have yet to see this development in China's onshore markets.

Shareholders look across the Central Business District, Beijing. Credit: Cancan Chu / Staff, Getty Images.

Part 2: Four case studies of active voting

Four case studies of active voting

A lopsided stock incentive plan

A maker of home appliances proposed a significant employee stock ownership plan (ESOP) in June 2021. Such plans can be a good way to align the interests of senior staff and shareholders. But in this instance, the plan involved, a lot of rewards going directly to the company's chairperson, who was about to retire. In all, he would receive nearly 800 million renminbi (around $875 million), or about 30 per cent of the total benefits. The plan was announced and added to other shareholder proposals only 10 days before the AGM, leaving insufficient time for shareholders to scrutinise the details. While the plan appeared to fit the definition of a 'restrictive stock incentive scheme' that would need a two-thirds majority approval, the company presented it as an ESOP requiring only a simple majority.

ZD advised its clients to vote against it, citing an overconcentration of benefits for the outgoing chairperson. The plan lacked incentives for the company's new senior executives, who would be instrumental for its future growth.

Despite the objection of minority shareholders, the plan was approved at the AGM and took effect in December 2021. Moreover, the company floated another proposal this year to lower the profit thresholds for unlocking the plan's benefits. Despite opposition from independent minority shareholders, this revision was also approved.

Taking aim at all-male boards

Fidelity often engages investees with regard to their internal policies related to gender diversity, and we reinforce this in our approach to shareholder votes. Our commitment to gender diversity is further reflected by our membership in the 30% Club Hong Kong Investor Group, a group of asset owners and managers working together to promote board gender diversity among companies, including many from mainland China, that are listed in Hong Kong. The group's 15 members oversee a combined $16 trillion of assets globally and are committed to the belief that boardroom gender balance enhances corporate performance.

When it comes to how Fidelity employs stewardship to promote gender diversity at investees, our key focus areas include the nomination process for board directors, criteria for replacing board members, and measurable gender objectives. We ask investees to regularly review their hiring and promotion practices to remove gender biases. We may encourage management teams of companies found to be falling short of sector best practices to adopt objectives for improvement and to demonstrate progress over time.

In promoting gender diversity, we favour an active stewardship approach that combines dialogue with clear voting policies. Sometimes this means that we vote against management when our initial engagement efforts fall flat. One example of this came in early 2021, when we started a dialogue with a large Chinese food and beverage company whose all-male board had been in place for years, despite women making up a significant portion of its customer base. In our talks, we highlighted the need for higher female representation while engaging the company on board-structure issues. Although the company made a verbal commitment to bringing women on board, it had taken no action by the end of May 2021, when it held an AGM with proposals on director re-elections.

We made the decision then to vote against re-election of the company's directors, citing the lack of progress on gender diversity, as well as the low board attendance by one director who had offered no satisfactory explanation for his absence.

A few months later, the company started to take small but encouraging steps. For the first time in its 20-plus year history, it appointed a female director to its board in December 2021. While this is only one example, we believe it provides an encouraging indication of the changes that engaged and active investment stewardship can bring to help promote gender diversity in China.

Questioning donations

In early 2022, China's securities regulator encouraged listed companies to strengthen their internal rules on how they approve donations. As a result, many firms revised their policies this year to give shareholders a bigger say on major donations.

A clinic operator with a questionable track record of approving donations, however, ignored investors' calls to revise its policy. The company had been donating an average of 15 per cent of its net profit over each of the last three years, with most of its charitable money going to a foundation connected with one of its senior executives. It had never sought shareholder approval for the donations.

At its AGM this year, the company floated a proposal to revise its corporate charter with no adjustment to its donation policy. At ZD's advice, many minority shareholders voted against the proposal. Nevertheless, it was approved, helped by a highly concentrated shareholding structure.

Small investors matter

Ahead of an EGM this year, a tech company that provides automotive diagnostics proposed an employee stock ownership plan for one of its subsidiaries. The company's controlling shareholder initially planned to join the scheme and receive an undisclosed additional stake in the subsidiary. Overall, the ESOP shares would be priced at book value and account for 40 per cent of the total shares of the subsidiary, which is strategically important to the listed firm.

ZD advised the company's shareholders to vote against the employee share plan, citing its large scale, low pricing, and a potential conflict of interest arising from the participation of the controlling shareholder. In addition, ZD joined some institutional shareholders in lobbying the company to reconsider.

The stance of minority investors was important in this case because the resolution constituted a connected transaction where the controlling shareholder had to abstain from voting. In the event, the company ended up heeding calls from minority shareholders, by downsizing the scheme and excluding its controlling shareholder, before putting it to a vote.

Part 3: Three case studies where investor engagement made all the difference

Three case studies where investor engagement made all the difference

Fostering better emissions disclosure in the cement industry

Cement is among the most pollutive sectors globally, and China pours more concrete each year than the rest of the world combined. Cutting emissions in the cement industry is crucial to China's national drive towards net zero by 2060. In line with these priorities, Fidelity International has been engaging Anhui Conch Cement, the country's second-largest producer by output, advising it on how to improve across ESG factors.

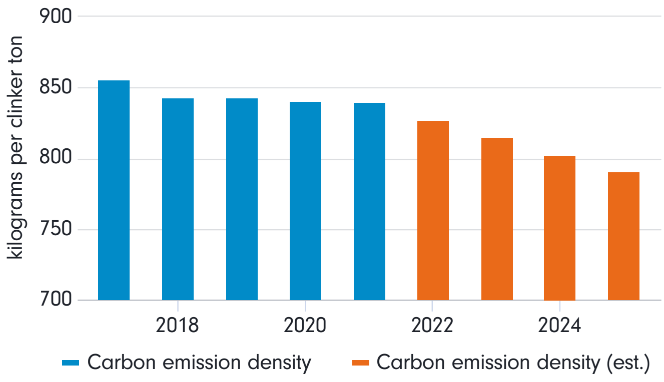
> We suggested to Conch that it communicate this clearly to external sustainability ratings agencies, so that they might re-evaluate the company's efforts - and the upgrades of Conch's ESG ratings then followed.

Fidelity's equity research and sustainable investing teams started speaking to Conch's management about emissions targets in late 2020. Even before our engagement started, Conch's management had shown a strong desire to improve the company's ESG practices, and progress has become even more tangible over the last two years. Reflecting some of the improvements the company made in response to advice from Fidelity, an external third-party ratings provider raised Conch's sustainability score in 2021 and recently upgraded it again in 2022, demonstrating a continuous improvement.

As Fidelity's analysts drilled into the details, they realised that Conch was selling its efforts short based on how it was disclosing and benchmarking its emissions data, and that some global sustainability rating agencies had been judging the company based on emissions per million dollars of revenue. This ignores one of the basic dynamics of the global cement industry: prices, production and consumption are highly localised because of the high costs of shipping. The result is that cement is in China typically 40 to 50 per cent cheaper than in the West. We realised that applying revenue-based emissions metrics would by nature severely disadvantage the Chinese company when compared with its global peers, and volume-based metrics that reflect emissions per unit of actual cement production would provide more accurate cross-border comparisons and a better picture of the company's efforts to reduce its carbon footprint. We suggested to Conch that it communicate this clearly to external sustainability ratings agencies, so that they might re-evaluate the company's efforts, and Conch's ESG ratings were subsequently upgraded.

While Fidelity has provided advice and encouragement, Conch has also been proactive in limiting the use of coal and electricity per tonne of cement, as well as boosting its overall operating efficiency. Following our suggestion to establish mid-term carbon reduction goals, the company set a more stringent target aiming to achieve 6 per cent total reduction in emission density by 2025 (domestically, Conch has already achieved the lowest emission density among large cement producers when measured by unit of output).

Chart 11: Anhui Conch plans steady emission cuts



Source: Company filings, Anhui Conch, Fidelity International, June 2022. Post-2021 numbers are company targets.

Moreover, the company has taken it upon itself to find new ways to reduce its emissions of carbon and other harmful greenhouse gases. For example, it has developed an efficient system to curb nitrogen oxide emissions, which in many cases could cause more global warming than carbon emissions.

There are signs that other large cement makers in China are starting to follow Conch's lead in ESG commitments, as the government pushes ahead with nationwide decarbonisation targets. We believe the drive toward net zero, combined with serious engagement by investors, will help eventually firm up a greener path for China's cement industry.

Strength in numbers when engaging China's power sector

In recent years, collaborative engagement has emerged as a powerful form of stewardship, especially for dealing with investees that happen to be influential corporate giants. In a typical collaborative effort, Fidelity teams up with other asset managers, policymakers, or industry bodies to drive corporate change on critical sustainability issues. By working together instead of acting separately, we can amplify our collective impact on the way industries are regulated and companies operate.

Last year, Fidelity kicked off one such collaborative engagement with China Resources Power (CR Power), one of the country's leading independent power producers. Fidelity is the lead investor among five asset managers in this effort, which is being carried out as part of the Asian Utilities Engagement Program under the Asia Investor Group on Climate Change, whose members own or manage assets of over $36 trillion.

Our collaborative dialogue with CR Power has revolved around cutting carbon emissions, strengthening disclosures, boosting corporate governance, and controlling climate-related risks. In our multiple conversations, the company has shown a strong willingness to pursue sustainable growth, and shared details about its decarbonisation progress. CR Power has also actively sought advice from the investor group on how to advance its ESG disclosure, as the company prepared for its new sustainable development report.

CR Power has set a target of peaking carbon emissions by 2025, while planning to phase out all but one of its coal mines. The company already devoted 70-80 per cent of its total capital expenditure to renewable energy and plans to increase this further. Meanwhile, it's working towards a goal of adding 40 gigawatts of renewable capacity by 2025.

The company has acted responsibly in winding down coal mines, working towards a just transition: it has been reallocating human resources to renewable power units rather than laying off workers from stranded plants. We were also delighted to see that CR Power started linking the remuneration of its executives to ESG metrics, including renewable energy capacity, coal consumption, carbon emissions, and work safety.

The collaborative engagement is already showing signs of paying off. In a recent dedicated engagement call on disclosure, we recommended CR Power consolidates all ESG information into a single report, and officially adopts the recommendations of the Task Force on Climate-related Financial Disclosures in its future reporting. The company responded favourably and improved its disclosures accordingly in this year's new report.

> While stewardship typically revolves around equity investments, Fidelity's ESG integration is carried out across all asset classes.

Through these engagements, Fidelity and the other asset managers have reached agreement with CR Power to continue to hold regular dialogues going forward, as well as for the company to provide updates on its decarbonisation progress.

New steps forward in engaging with bond issuers

While stewardship typically revolves around equity investments, Fidelity's ESG integration is carried out across all asset classes. For instance, we have been in dialogue with Chinese debt issuers about sustainability practices. To this end, we have become one of the first asset managers in China to pursue ESG engagements with local government financing vehicles (LGFVs), whose debt issuance is key to the success of infrastructure projects at county to provincial levels across the country. Last year, LGFVs made up a quarter of China's corporate debt fundraising, issuing a total of $28 billion in offshore debt.

Early this year, members of our sustainable investing and credit research teams spoke to an LGFV based in eastern Zhejiang province. It was the first time this county-level LGFV had spoken with investors specifically on ESG issues, and we spent most of the time on fact finding and clarifying key ESG concepts. Since most LGFVs are unlisted, they face less regulatory oversight than public firms, and tend to take a passive, compliance-driven approach to ESG practices. Furthermore, the level of ESG awareness and integration of LGFVs is often constrained by the geographical region and administrative ranking of the issuer. For example, because it is not located in a provincial capital or other metropolis but a county-level city in Zhejiang, the LGFV we engaged with is limited in its ability to work with large and more ESG-aware construction firms to design green buildings that conform to national standards. Management also mentioned that because of the top-down governance structure that requires LGFVs to implement higher-level instructions, the firm had yet to receive specific guidance from the municipal or provincial government on implementing ESG-related policies and thus was unable to introduce initiatives beyond its mandate. We suggested to this LGFV that it should act early and start preparing for future ESG development.

This early progress was hard won after years of collective effort from institutional investors, regulators, proxy advisors, and other market participants, who worked hard to build a solid foundation for the long-term development of responsible investing.

While starting from a somewhat basic level, we see meetings like this as an encouraging sign that some LGFVs are warming to the idea of working with asset managers on sustainability. As China opens a greater part of its financial market to foreign capital, the stewardship of global investors like Fidelity will become increasingly important in shaping sustainable growth, especially for unlisted debt issuers that generally lack quality ESG disclosure. Such engagement can help familiarise LGFVs with industry best practices and investor expectations while allowing investors to have more insight into their operations.

Conclusion

Good stewardship isn't an outcome so much as it is a process, and we have seen how it is starting to gain solid footing in China in recent years. This early progress was hard won after years of collective effort from institutional investors, regulators, proxy advisors, and other market participants, who worked hard to build a solid foundation for the long-term development of responsible investing.

But like any process, the advancement of good stewardship won't always be steady or free from setbacks. There have been times in recent months where we have seen how macro headwinds and volatile markets can put additional strain on the managers of Chinese companies, limiting the attention and resources they are able to commit to improving sustainability. In the near term, investors should brace for occasional disappointments. We hope these prove to be few and short lived. Encouragingly, policymakers are offering much needed support through reform of rules on disclosure and corporate governance. But future improvements to good stewardship in China, including to voting and engagement by investors with investees, will depend on the continued efforts of all stakeholders.

Important Information

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