

Global ESG Investment

Q3 ESG Report 2019



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Andy Mason
Senior Manager, Stewardship,
Editor

Voting and engagement summary 2019

Company	Topics discussed
AVEVA Group	Board diversity & remuneration
Bayer AG	Board oversight & diligence
BHP Billiton	Lobbying practices
Cal-Maine	Environmental management
CRH	GHG emissions
GMR Hyderabad International Airport Ltd	Health and safety practices
John Laing Group	Gender diversity
Johnson & Johnson	Product stewardship
Recruit Holdings	Board oversight
Vale	Tailing dam management

“Our quarterly ESG report provides a summary of our research, company engagement and voting activities. The report’s objective is to inform, disclose and create discussion. We welcome comments and observations.”

Foreword



Euan Stirling
Head of Stewardship
and ESG Investment

I recently had the pleasure of visiting Paris. The purpose of the trip was to attend the annual conference of the United Nations-supported Principles for Responsible Investment (PRI). We are longstanding signatories to those principles and proud sponsors of the event, which brings together nearly 2,000 responsible investment specialists from around the world. The agenda for the conference was truly diverse but there was an understandable focus on climate change, given the sharp increase in adverse weather events around the world. More details of the conference can be found in this quarter’s report.

Corporate governance has long been a mainstay of our environmental, social and governance (ESG) research and engagement. Indeed, our efforts in this area were formalised as a result of the 1992 Cadbury Report on the ‘Financial Aspects of Corporate Governance’. Those with long memories will remember the collapse of Polly Peck, the Bank of Credit and Commerce International, and the Maxwell Group, which either inspired or highlighted the need for the report. The passing of 27 years since

“Corporate governance has long been a mainstay of our environmental, social and governance (ESG) research and engagement.”

publication might suggest that lessons would have been learned; however, more recent corporate failures have emphasised the need for continued focus in this area. Our third-quarter report illustrates the work we have been doing with companies such as mining group BHP, healthcare and agriculture group Bayer, and industrial software developer AVEVA. These are diverse businesses, drawn together in our thoughts by considerations over how they are governed.

As I mentioned, climate change was a focus of attention at the Paris conference. And, judging by their conversations with us, it also continues to be the number one area of environmental interest with our clients. This has started to permeate our voting analysis, as we find shareholder resolutions relating specifically to climate change, and companies’ related actions, appearing more frequently. However, resolutions are not limited to climate change and over the year we have voted on numerous areas – particularly board diversity, where we have increased our number of votes against management. We assess each resolution on its merits, although find ourselves supporting many of them.

At Aberdeen Standard Investments (ASI), we continue to engage with many of the companies in which we invest our clients’ capital. One of those engagements worth highlighting is with Brazilian mining group Vale, whose Brumadinho tailings dam collapsed earlier this year causing hundreds of deaths. We are working with other investors and industry groups to try to raise operating standards to minimise the chance of such tragedies happening in the future.

Events

Reflections on the PRI in Person conference

Paris, 10-12 September 2019



Bill Hartnett
Stewardship Director

ASI was once again proud to sponsor the annual “PRI in Person” conference on responsible investment. Co-ordinated and managed very effectively by the PRI itself, the event rightly claims to be the largest coming together of responsible investors globally.

The first thing that grabbed me about PRI in Person was the sheer size of the event – there were over 1,800 attendees (including 12 from ASI) representing over 830 organisations from 50 countries, with 190 speakers and 35 reporters from five media partners. The hashtag, #PRIinPerson, was applied on more than 9,000 tweets, which generated almost 40 million impressions, reaching over 6.4 million people!

Responsible investment is growing rapidly and this growth shows no signs of abating. To the contrary, as outlined in the opening video by French President Emmanuel Macron, governments and regulators as well as civil society and the general population increasingly recognise the finance sector’s key role in this area. This includes addressing the risks and opportunities from multiple ESG areas, as well as allocating capital more effectively to help meet UN Sustainable Development Goals (SDGs). A major responsibility also involves overcoming the short-term focus of the financial services industry and transforming it to the more long-term approach that is increasingly being called for by asset owner trustees.

The theme of the conference “Responsible investment in an age of urgent transition” was certainly appropriate given the heightened popular call globally for action on a wide range of ESG issues. These include climate change, social inequality, modern slavery, plastics pollution, tailings dam management and executive remuneration.

Another takeaway from the conference is just how the range of ESG issues keeps growing and risk areas for investors keep expanding. The breakout sessions covered issues such as: culture and diversity; Taskforce for Climate-Related Financial Disclosure

(TCFD) carbon reporting; the EU Taxonomy; sustainable global food systems; artificial intelligence; human rights; tailings dam management and the UN SDGs; ESG metrics in executive pay; plastics and the circular economy.

The breakout session on “Climate change and strategic asset allocation” featured some very promising methodological research from Craig Mackenzie, ASI’s Head of Strategic Asset Allocation. Craig continues to develop this methodology internally.

The sessions sought the perspectives of multiple stakeholder groups, including central banks and stock exchange regulators. Noting the maturity of responsible investment, there were topics across multiple asset classes, including fixed income; developed and emerging market sovereign debt; and private assets. Of particular relevance to our engagement activities were the multiple sessions on active ownership and collaboration. In the session “Active ownership 2.0”, the discussion centred on making engagement more demonstrable and outcomes-focused, with a greater willingness to broaden the threshold of issues considered ‘financially material’.

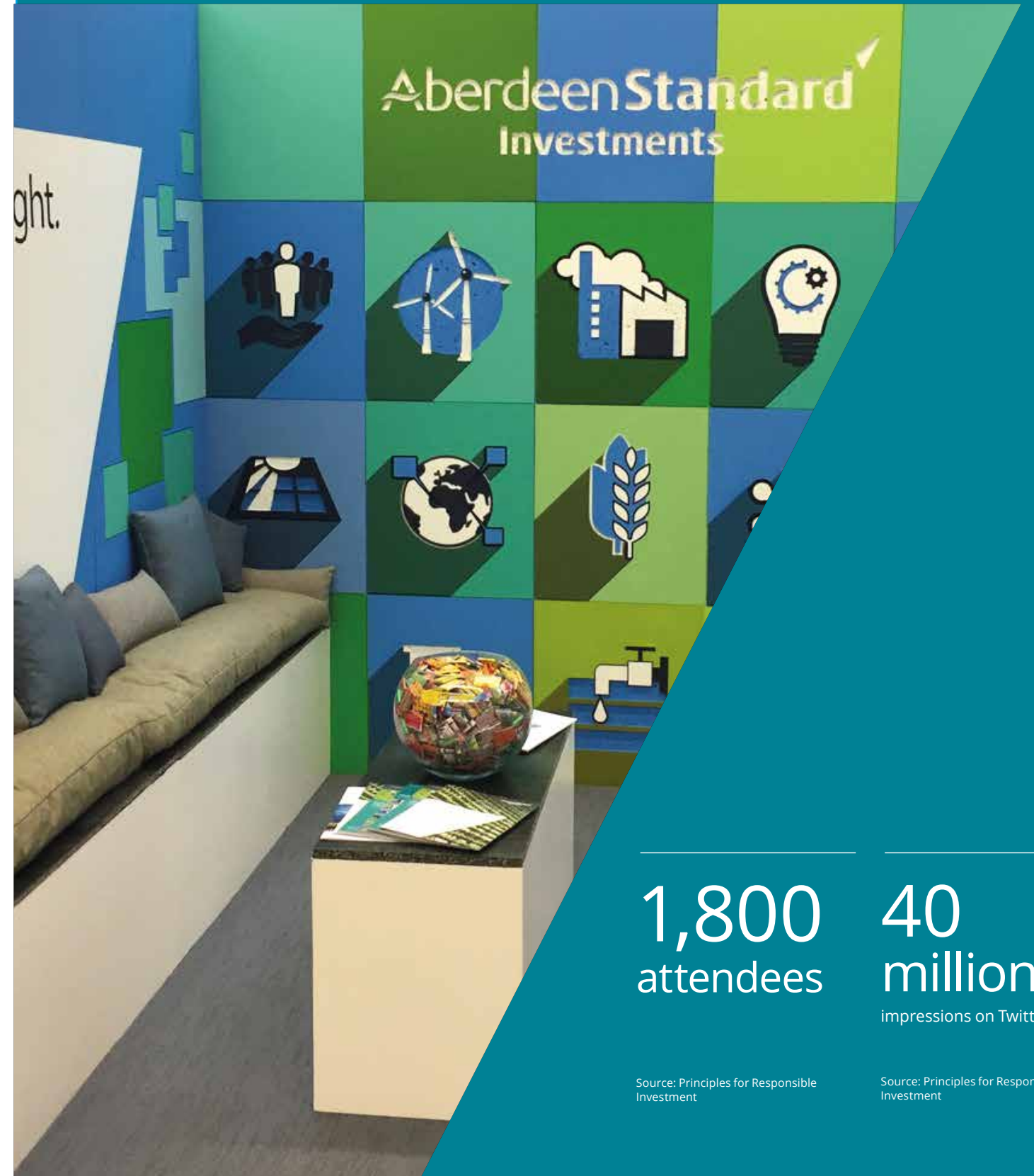
The plenaries were excellent. The meeting on “The transition to a net zero emissions economy” featured interviews with Climate Action 100+ leads and the CEO of Shell. The latter discussed the company’s approach to becoming net zero carbon by 2050. This also introduced one of the PRI’s most pioneering projects, “The Inevitable Policy Response”. Here, the PRI is working with Vivid Economics and Energy Transition Advisors to develop independent Forecast Policy Scenarios for the inevitable situation when governments are forced to provide a policy response to climate change. The PRI will publish modelling of the impact on factors, including the macro-economy; key sectors, regions and asset classes; and the world’s most valuable companies. The PRI believes this inevitable response will occur by 2025.

The conference programme closed with a panel of experts from the Financial Sector Commission, who discussed “Modern slavery and human trafficking”. The sessions featured testimonies of two survivors of modern slavery. They shared their reflections on the role of the financial sector in combating this egregious social issue, with reporting now mandatory in many jurisdictions around the world.

Among the stalls in the venues, ASI’s offering was often complimented for its aesthetic appeal, but also because it was made from plastic recovered from the oceans.

Overall, the 2019 PRI in Person conference was a great success and the embodiment of the extraordinary growth and success that responsible investment continues to enjoy.

“The range of ESG issues keeps growing and risk areas for investors keep expanding.”



1,800
attendees

Source: Principles for Responsible Investment

40
million
impressions on Twitter

Source: Principles for Responsible Investment

Thematic commentary

Building more resilient portfolios by integrating ESG in long-term asset allocation



Craig Mackenzie

Head of Strategic Asset Allocation

We are developing robust methods to include ESG issues such as climate change, demographic shifts in the labour force, economic inequality and corporate governance into our long-term return forecasts. The strategic asset allocation (SAA) we perform for clients and our multi-asset portfolios is materially different as a result of taking these issues into account.

These days, most investors think it makes sense to consider ESG risks when evaluating securities in equity and bond portfolios. But very few investors consider ESG in their SAA. This is a big missed opportunity. The point of SAA is to consider the long-term structural factors that affect investment returns across asset classes, sectors and regions; and to build resilient portfolios that deliver returns irrespective of the many uncertainties the future holds. In today's world, ESG factors are among the most important long-term structural elements there are.

Climate change as a long-term investment risk

Global warming poses both long-term physical risks as the climate changes, as well as nearer-term risks as the energy sector shifts from fossil fuels to low-carbon alternatives. The worst of the physical risks are in the distant future, but the energy transition is already well underway. Ten years ago, the UK generated 30% of its electricity from coal. In the last 12 months, it is less than 5%.

But, as chart 1 shows, this energy transition is only just beginning. As it gathers pace, it will likely have material negative effects on the long-term investment returns of sectors, regions and asset classes with heavy fossil fuel exposures. At the same time, it will benefit those strongest in renewable energy and other parts of the low-carbon economy.

There is still considerable uncertainty about how fast the transition will occur and what shape it will take. But the outline is becoming clearer. We are developing robust methods to include realistic climate-transition scenarios into our long-term return forecasts, and to reshape our strategic portfolios accordingly.

Aging populations, inequality and interest rates

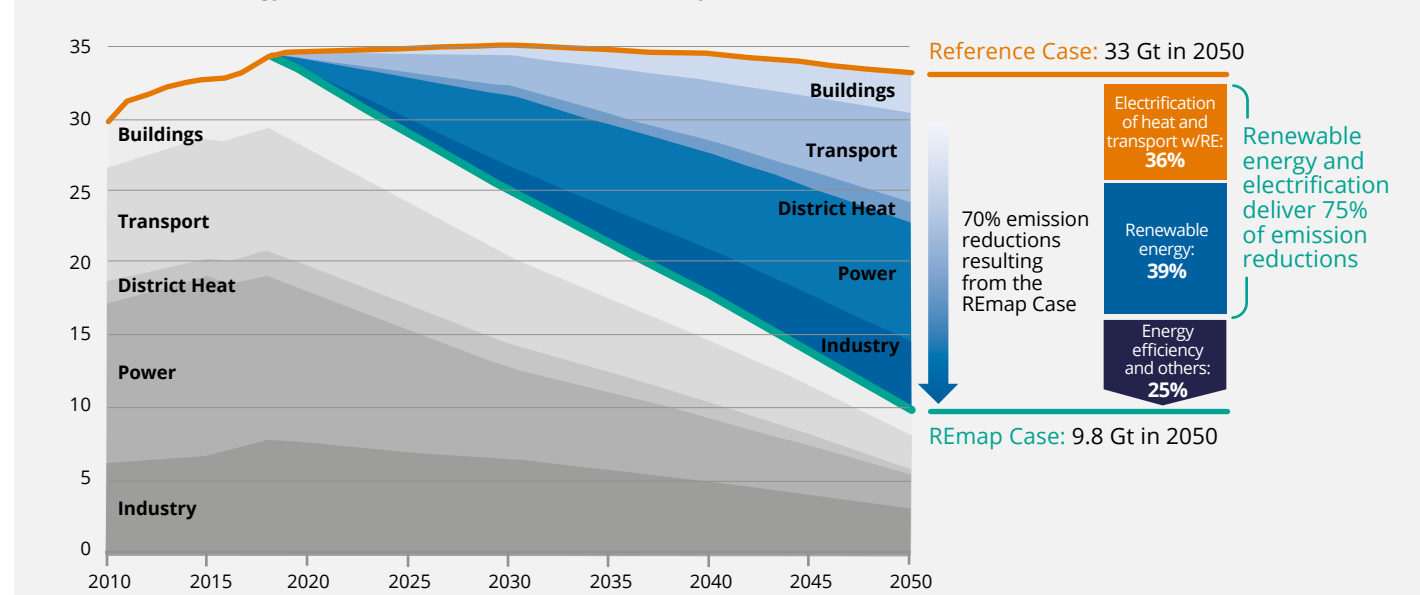
While climate change is the most visible issue, there are even more important ESG factors for asset allocators. Perhaps the single most vital challenge is the fact that interest rates remain stubbornly low.

What does this have to do with ESG? Many economists argue that interest rates are low because of a chronic 'savings glut'.¹ Essentially, there is too much global saving and too little desire to invest. This pushes down interest rates. The savings glut is caused by various factors but, according to some influential studies,² among the most important are two factors associated with the 'S' in ESG – namely, aging populations and income inequality.

"The savings glut is caused by various factors but, according to some influential studies, among the most important are two factors associated with the 'S' in ESG – namely, aging populations and income inequality."

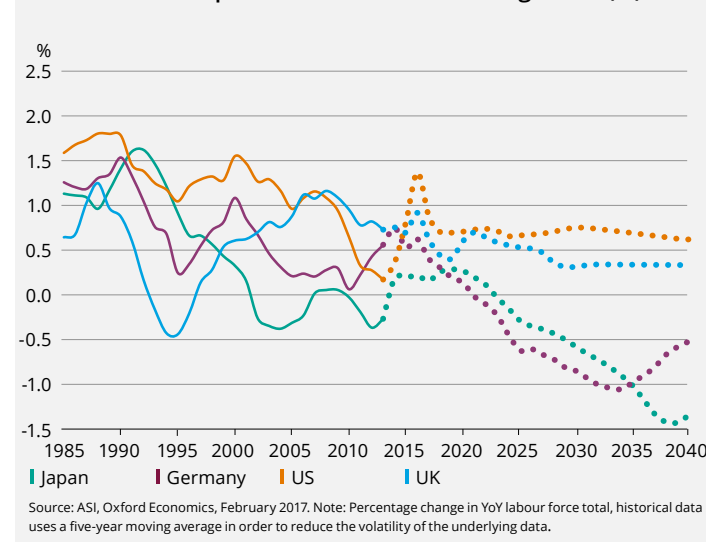
Changes required for 2°C transition scenario

Chart 1 – Annual energy-related CO₂ emissions, 2010-2050 (Gt/yr)



Source: Irena, 2018

Chart 2 – Developed markets' labour-force growth (%)



Put simply, the large baby-boomer generation has reached peak savings at the same time that sluggish global growth deters investment. In addition, income inequality means a greater share of income goes to the rich, who tend to save a larger percentage of their incomes.

These factors help explain why our forecasts for long-term returns from government bonds are significantly lower than in the past. As a result, we have significantly reduced our use of government bonds in our growth portfolios.

¹ Bernanke, B (2005) The global savings glut and the US current account deficit

² For example, Rachel and Smith (2015), Secular drivers of the global real interest rate.

>30%

UK electricity generated from coal in 2008

Source: Ofgem, 2019

<5%

UK electricity generated from coal in 2018

Source: Ofgem, 2019

Demographics and long-term equity returns

Demographics also impact returns on growth assets. Working-age populations are shrinking in Europe, Japan and much of East Asia. Standard supply-side models of economic growth tell us that the potential growth of an economy is a function of the growth in its labour force and in productivity. A poor demographic outlook and weak labour productivity growth make for a sluggish growth outlook, with knock-on implications for equity earnings growth and returns.

ESG risk and SAA

The discussion above is not intended to provide a comprehensive survey, but merely to indicate the relevance of ESG factors to SAA. We have a more detailed evaluation of the relationship in our forthcoming 2019 *Long Term Investment Outlook*³ report. The SAA we perform for clients and our multi-asset portfolios is materially different as a result of taking these issues into account.

³ Available at www.aberdeenstandardforecaster.com

Voting trends and observations 2019



Mike Everett
ESG Stewardship Director

Andy Mason
Senior Manager, Stewardship

Rachel Rotheram
ESG Investment Analyst

During the third quarter, the peak voting season for most markets reached its end for another year. The intensity and effort of the season never diminishes.

Gender diversity

In fact, it noticeably increased in 2019 as more companies sought dialogue prior to their AGMs and as we implemented new and strengthened voting policies to underpin our engagement and emphasise our views. Some key areas of focus have included gender diversity, auditor tenure, director tenure & over-boarding, and the increasing number of environmental & social resolutions. From January to the end of September 2019, we voted at 4,478 meetings, with 2,298 having at least one vote against.

A significant change in 2019 was the implementation of voting policies related to gender diversity in the UK, Western Europe and North America. While we are seeing a broad trend of improvement in gender balance on boards, we took voting action where gender diversity did not meet our expectations and where companies couldn't demonstrate commitment to improve. In the UK, the Hampton-Alexander review sets a target for FTSE 350 company boards of one-third (33%) representation of women by the end of 2020. In order to reflect our support for this target, our policy for 2019 was to vote against the nomination committee chair (NMC) of any FTSE 350 company with less than 25% representation of women on the board. For smaller companies, we took voting action against companies that had no female representation on the board. This reflected the fact that such boards tend to be smaller, with less director turnover than large companies. In Europe, we adopted the same approach to that which we followed in the UK. In the US, meanwhile, we voted against the NMC where there was less than 20% female representation on a board. Thus far in 2019, we have voted against the NMC at 30 UK, four European and 75 US companies.

Auditor tenure

We are strongly of the view that auditor independence is a crucial factor in maintaining audit quality, and consider that a long tenure could compromise independence. We therefore decided to strengthen our policy on auditor tenure, and apply this globally. Mindful of the EU audit regulations limiting auditor tenure, we

voted against the re-election of auditors if their tenure exceeded 20 years and there was no commitment to an audit tender in the near term. As there is no regulation around auditor tenure in the US, this policy resulted in a significant increase in votes against auditors during the season. Most significantly, we voted against the appointment of auditors at 300 US companies as a result of this policy.

Board terms

In Europe, there was an increase in the level of dissent on the discharge of directors and management. Several resolutions received significant dissent, including Bayer, ING and Deutsche Bank. A vote on the discharge of the board is seen as a vote of confidence and is market practice in several countries such as Germany, Spain and the Netherlands. In these markets, it is common for director terms to be greater than three years. We actively encourage our investee companies to limit board terms to a maximum of three years, with a preference that they introduce annual re-elections. The absence of regular votes on director re-elections makes the vote on discharge a useful tool to hold boards to account. However, the (usually) bundled nature of the resolution, coupled with uncertainty over the implications of an adverse outcome, does mean that we have generally preferred to take action on individual elections where appropriate. We review these proposals on a case-by-case basis.

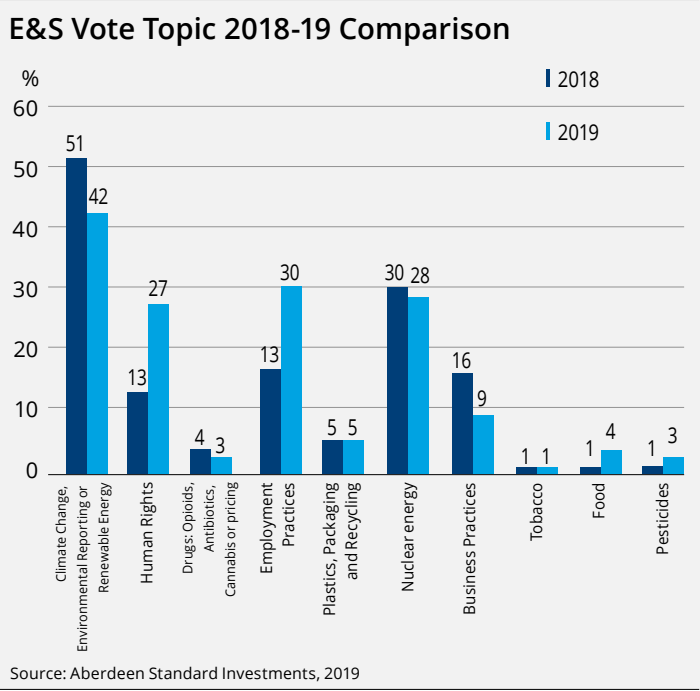
Ahead to 2020

As we prepare for the 2020 voting season, we are looking ahead to the impact of changes to best practice and regulation – particularly the implementation of amendments to the Shareholder Rights Directive (SRD II). While several markets are yet to transpose the regulations into local law, we nevertheless expect an increase in the number of resolutions as more countries require companies to present remuneration reports, remuneration policies and related-party transactions for shareholder approval. We expect increased engagement on remuneration in the lead up to the season, as companies consult on our views. We welcome the opportunity to have a 'say on pay' in markets where it has not previously been required – notably the Netherlands and Germany.

Specifically in the UK, changes to the Corporate Governance Code required that new directors' pension contributions be aligned with those of the workforce as a whole. We have voted against relevant resolutions at a number of companies in 2019 where this was not factored into new remuneration policies. Next year, as defined in new Investment Association guidelines, companies will be expected to put in place plans to move the pension contributions of incumbent executive directors to the level of the workforce by the end of 2022. In our voting analysis next year, we will assess these plans in detail.

Environmental and social (E&S) issues

In addition to the voting issues we have addressed around corporate governance, we have also seen a growing number of votes focused specifically on E&S issues. Over the year, the number of E&S proposals reviewed grew by more than 12h% on the

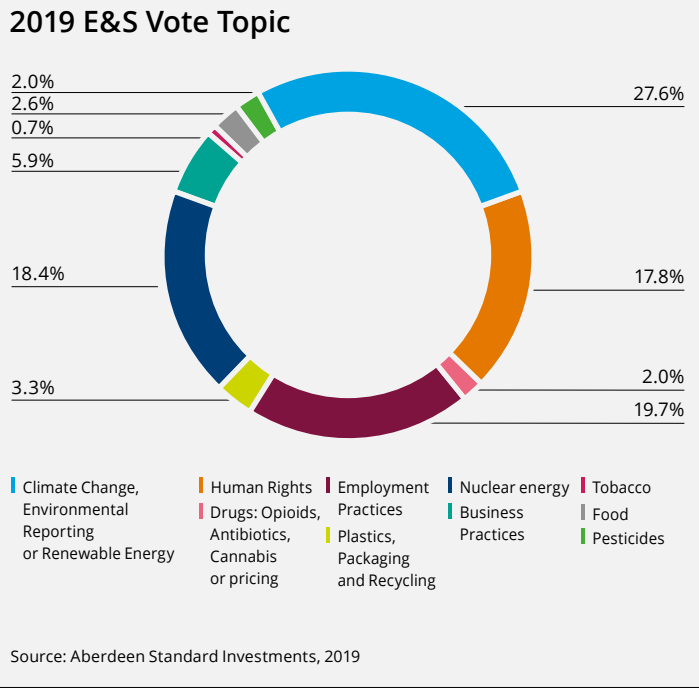


previous year. We observed some of the largest increases within human rights and employment practices categories. In addition to the growth in the number and frequency of these votes, we are also seeing improvements in their proficiency.

Resolutions regarding climate change and associated environmental reporting continue to dominate, as companies consider alignment with the aims of the Paris Agreement and are encouraged to improve their reporting on this area. Over the year, 28% of the E&S resolutions we voted on related to climate change, environmental reporting and renewable energy. This year we also saw increased levels of voting with regard to the use of plastics, especially in relation to packaging and recycling. We have published several reports on our investment strategy relating to plastic, including an article in our Q2 ESG report. We believe that this and other specific environment-related resolutions will continue to increase.

"Resolutions regarding climate change and associated environmental reporting continue to dominate, as companies consider alignment with the aims of the Paris Agreement."

A report published by Majority Action in October 2019 detailed how asset managers' votes on climate-related proposals displayed a significant disparity across asset managers on the number of proposals supported. Some asset managers voted against the majority of climate-related resolutions, despite public commitments to support the transition to a low-carbon economy. The report found that ASI voted in favour of the majority of 'climate-critical' resolutions tabled. It is important to note that the number of environmental resolutions voted for or against is not a true representation of a voting approach. ASI's voting decisions are an integral part of our investment strategy and we apply a nuanced analysis before reaching a conclusion. In certain cases, voting in favour of a climate-related resolution may be onerous



upon the company, unwarranted or against the interests of a transition to a low-carbon economy. A voting strategy which is heavily tilted towards voting in favour of or against all climate resolutions could represent a strategy which applies a less focused and more passive approach.

Human rights and employee practices made up circa 40% of the resolutions voted on, accounting for 18% and 20% respectively. Resolutions regarding employment practices have increased substantially; these include those covering diversity issues and the gender pay gap, as discussed above. Human rights proposals also increased and this year included resolutions attributed to advances in new technologies such as facial recognition software, and online risks, such as content governance, hate speech and child exploitation. Resolutions were tabled at some of the largest names in tech, such as Amazon and Alphabet. In Amazon's case, we voted in favour of a resolution relating to reducing hate speech and against a resolution limiting the sale of facial recognition technologies.

In addition to the thematic areas, we voted on a range of specific issues including the management of nuclear facilities by Japanese utility companies, the prevention of animal cruelty and the sale of tobacco.

Voting represents a key aspect of active asset management. It is one of ASI's most important duties as an active steward of our clients' capital. Unlike certain passive investment strategies, where research may be limited in a bid to maintain low fees, ASI reviews proposed resolutions and in some cases engages with stakeholders, including proxy advisors, investee companies and the proponents of resolutions, before reaching a decision. While we may often reach the same conclusion as our proxy voting services, rather than outsource decisions and simply follow their recommendations, we conduct independent internal research to ensure we are comfortable with our position.

Within the report we offer further detail on our voting decisions on AVEVA, the information technology company, pharmaceuticals group Bayer, and miner BHP Billiton. We are committed to disclosing our voting decisions and report the outcomes on our website and within this report.

The extended auditor's report: an underappreciated information source for investors



Alison Kennedy
Stewardship Director

The extended, or enhanced, auditor's report is a financial reporting innovation that first appeared in the UK in 2013. The UK's Financial Reporting Council led the way globally in requiring that the auditors of listed companies produce an extended audit report that provided better transparency around the audit process and outcomes. This was a move that we, and other investors, welcomed.

The International Audit and Assurance Standards Board issued its standards on extended audit reports in 2015 and the US Public Company Accounting Oversight Board followed suit in 2017. The EU has also gone down a similar path with its 2017 audit reform legislation. The key aim of all of these initiatives is to improve communication around audit issues with investors and other readers of annual reports.

Now, several years later, it's worth asking if the extended auditor's report has lived up to expectations. From our perspective, the answer is a resounding 'yes'. We now have a much clearer idea of the scope of the audit and the level of materiality applied. The report outlines the key audit matters which have most significance to the audit and hence receive the greatest focus. However, it is also fair to say that these reports can appear to consist of 'boilerplate' content and that they are not very user friendly. This provides an opportunity for investors who are prepared to spend time reading them to, on occasions, discover some interesting information which is not generally appreciated by the market and may provide insights into business risk or prompt questions for management and the board to answer. On key audit matters, reviewing how these have changed since the previous year and

how they align with the key risks outlined elsewhere in the annual report can provide useful insights. Similarly, what is the scope of the audit and, if this looks low, why is that? If certain parts of the business are not subject to a full audit, investors should ask what the board and audit committee are doing to ensure that there is sufficient oversight for financial reporting and internal control purposes. Investors should also look carefully at the language used in the auditor's report and what message this conveys.

The 2017 and 2018 Thomas Cook annual reports provide a topical and interesting example of some of these points. In the 2017 auditor's report, the classification of some 'separately disclosed' items was challenged and the change of auditor resulted in a significant increase in the scope of the audit. These are all things that should prompt questions of management and the board. The 2018 auditor's report noted that the classification of a number of 'separately disclosed' items was again challenged but this year, the auditors also requested a number of adjustments be made and 'strongly recommended' that management strengthen the process for identification and approval of these items. This is highly unusual and again should prompt questions of management.

Another example is provided by the GlaxoSmithKline 2018 annual report. The auditor's report outlines that the IT systems which impact on financial reporting were considered a key audit matter and identified that IT control deficiencies were noted around user access management. It went on to say that the company put a remediation plan in place and that the audit & risk committee had also commented on this elsewhere in the annual report. This demonstrates a willingness to be open about control deficiencies and provides reassurance that the audit & risk committee is aware of its responsibility for monitoring material controls. In Glaxo's case, this is reinforced by its US listing which, under the Sarbanes-Oxley framework, requires that a company's audit committee oversees key IT systems and material controls.

There is an ongoing debate about the role of audit, audit quality and the degree of competition in the audit market. There are a number of reviews taking place in the UK and some sort of regulatory intervention seems inevitable. Although the extended audit report is not a focus of this debate, there is certainly scope to continue to evolve and improve the information contained in this report and this is something that we will look to encourage over time.

"It's worth asking if the extended auditor's report has lived up to expectations. From our perspective, the answer is a resounding 'yes'."



2013

first year the enhanced
auditor's report
appeared in the UK

Source: UK Financial Reporting Council

Water as an unpriced risk



Andy Mason
Senior Manager,
Stewardship

The need to manage water dates back to the earliest civilisations. Today, the management of this resource has never been more important as the global population continues to grow, with ever increasing demands for water-intensive resources and services. If global steps are not taken to manage water quality, efficiently allocate across uses and users, and to adjust for the risk of climate change, this largely unpriced resource could represent the ultimate ‘tragedy of the commons’.

- According to the United Nations, roughly 1.2 billion people currently live in areas of physical water scarcity, with this number potentially increasing to 3.5 billion by 2025. This risk is particularly prevalent in Asian markets. A recent report published by China Water Risk highlighted the following.
- Asia has limited water resources to develop. Neither China nor India have sufficient water to ensure food and energy security. They will also be unable to develop under the current export-led economic growth model.
 - Significant systemic risk is caused by the clustering of 280 large cities in 10 major Asian river basins.
 - Climate change threatens already scarce water resources. For example, rivers draining from the Himalayan glaciers are expected to decline over the next 50 years.

Despite these risks, the report goes on to identify the lack of focus among financial institutions in the region on water risk, particularly the risks presented by assets clustered in areas that currently or could face water risk in the future. A recent report by the Leadership Group on Water Security in Asia exemplifies the scale of the challenge. Asia is home to half of the world’s population but has the least fresh water per person of any continent, excluding Antarctica. Its population is expected to increase by almost 500

million in the next 10 years, with 60% of this growth among urban populations – the very people who are clustered around water risks.

Governments and investors have been taking steps to address these risks. China’s economic stimulus package continues to invest in ecological projects, including reducing water use and water pollution. It has also taken more punitive measures with the Ministries of Environmental Protection and Finance to prevent the worst water polluters from accessing finance. The UN announced its Water Action Decade in 2018, launching a number of projects, while the UN’s Sustainable Development Goal Six targets clean water and sanitation for all people.

Through industry initiatives such as the Principles for Responsible Investment (to which ASI has been a long-term contributor), and investor network Ceres, the investment community has sought to address the challenges posed by water. The Investor Water Toolkit produced by Ceres deserves special note as a resource available to all investors seeking to act on water risk. Research providers are also supporting this drive and highlighting areas requiring action. For example, the Carbon Disclosure Project reported that, of 783 companies it assessed in 2018, only 29% had set water targets or goals.

Measurement of water by companies and investors still lags behind the well-established mechanisms that are in place to measure greenhouse gas (GHG) emissions in efforts to address climate change and global warming. This is driven by a number of factors. First, GHG present a global impact – an emission in Delhi can ultimately have an impact in Dublin. The same cannot be said for a lack of rainfall in Delhi compared to a rainy Dublin. Unlike climate-focused initiatives such as the Paris Agreement, this regional emphasis affects the ability to create a global consensus on tackling the issue. Regional variations also impact the ability to aggregate total impacts. A company can combine its total emissions in Delhi and Dublin to represent its total global emissions. A business that aggregates its water use cannot represent its regional impacts. Nor does it represent the water intensity of individual assets versus areas of operations.

For investors and their investee companies to fully understand the use of this resource, volumetric water benefit accounting must be applied. This is based on three key areas:

- identify shared water challenges in a local context
- define water stewardship project activities
- gather data and calculated volumetric water benefits.

Building upon these cornerstones, companies can create a representative, replicable standardised approach to water that can be used to reflect water stewardship or the lack thereof. Many companies have started to apply these types of indicators and I would highlight BHP’s inaugural water report, published in 2018, as

an example of best practice. In addition to the key areas already identified, the company details areas such as tailing dams, which could ultimately impact its operations, and water sanitation hygiene (WaSH).

ASI continues to engage with investee companies to understand how they are managing these risks, and what opportunities exist in

this space. This includes technologies that improve water usage or improved methods to desalinate water. At a portfolio level, we are exploring means to measure water resilience and, as part of industry groups, we will continue to seek greater disclosure from investee companies. Although largely unpriced to date, we do not believe that this will or should be the case over the longer term.

Table 1: Contributions to Water Stewardship Outcomes, Shared Water Challenges, and SDG Targets per Water Stewardship Activity Category

Water Stewardship Outcomes ^a		(1) Sustainable Water Balance	(2) Good Water Quality Status	(3) Good Water Governance	(4) Important Water-Related Areas (IWRAs)	(5) Safe Water, Sanitation, and Hygiene for All (WaSH)	N/A
Shared Water Challenge		Water quality	Water quality	Water governance	Important water-related ecosystems	Water, sanitation and hygiene (WaSH)	Extreme weather events
SDG Target(s) ^b		6.1,6.4	6.2,6.3	6.5,6A,6B	6.6,1.3	6.1,6.2	11.5,13.1
WS Activity Category	Land conservation and restoration	✓	✓		✓		✓
	Water supply reliability	✓		✓			✓
	Water access	✓	✓	✓		✓	
	Water quality		✓		✓	✓	✓
	Aquatic habitat restoration	✓	✓		✓		
	Water governance	✓	✓	✓	✓	✓	✓
	Catalytic activities	✓	✓	✓	✓	✓	✓

Sources: World Research Institute, 2019, Valuing Nature, LimnoTech, and Quantis.
Notes: Categories as defined in the VWBA water stewardship activity classification.
(a) Alliance for Water Stewardship (2019)
(b) United Nations (2015)

“Measurement of water by companies and investors still lags behind the well-established mechanisms that are in place to measure greenhouse gas (GHG) emissions in efforts to address climate change and global warming.”



1.2 billion

people living in areas of water scarcity

Source: United Nations

3.5 billion by 2025

Source: United Nations

Examples of engagement

Throughout the quarter, we have engaged on a range of issues across multiple geographies. The following section of the report offers further detail on the companies that we have engaged with and the topics discussed.

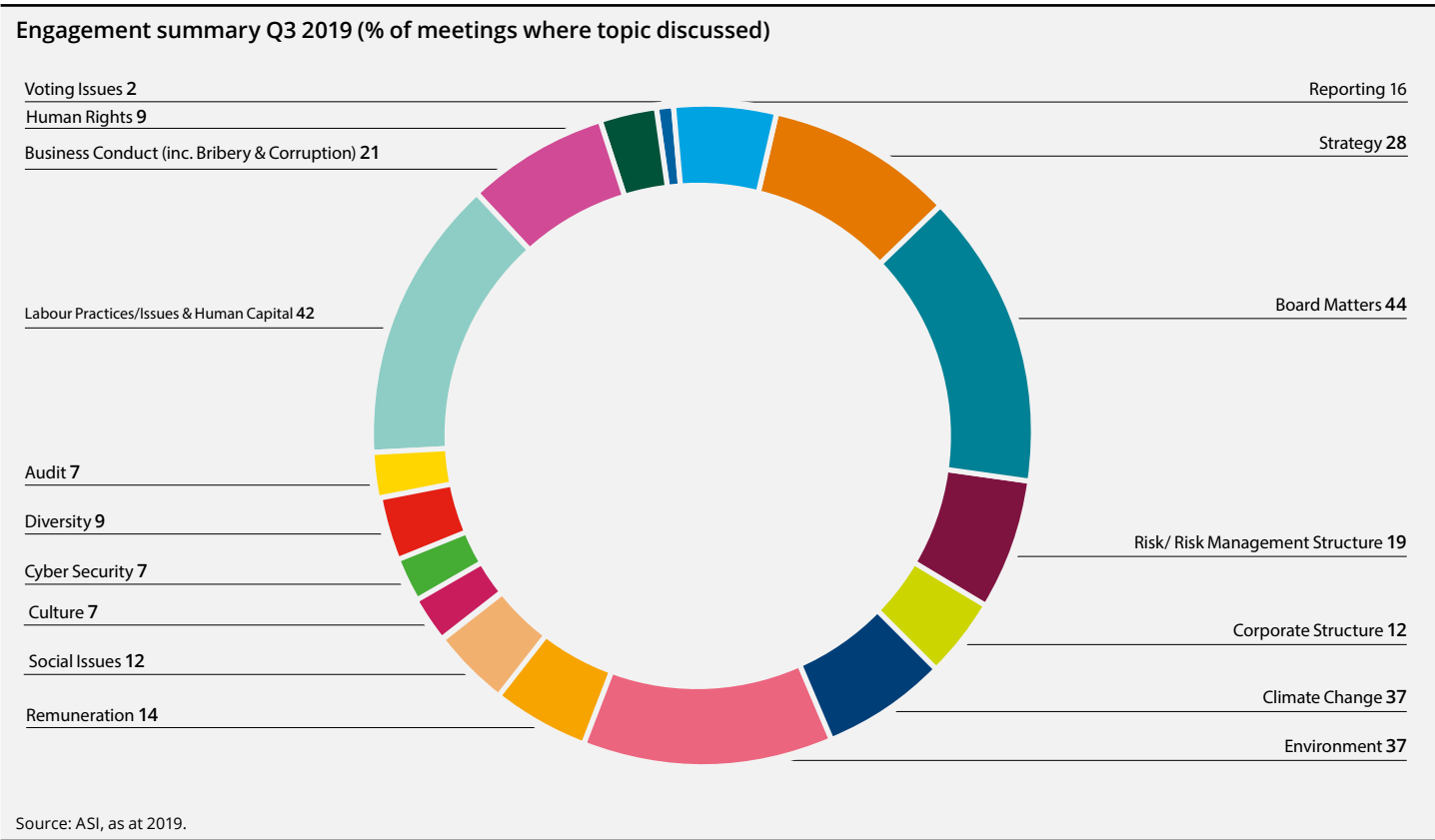


ESG voting and engagement summary

Voting summary Q3 2019

	Total
Shareholder meetings at which our clients' shares were voted	666
Percentage of meetings with at least one vote against or abstention	34.99%
Number of resolutions voted	6,344
Percentage of resolutions voted with management recommendations	88.11%
Percentage of resolutions voted against management recommendations	6.64%
Percentage of abstentions	1.04%

During the quarter, we met with and discussed ESG issues with over 100 companies. The chart below and table opposite offer examples of companies that we engaged with and the specific ESG topics discussed.



Engagement summary Q3 2019

	Reporting	Strategy	Board Matters	Risk/Risk Management Structure	Corporate Structure	Climate Change	Environment	Remuneration	Social Issues	Culture	Cyber Security	Diversity	Audit	Labour Practices/Issues & Human Capital	Business Conduct (inc. Bribery & Corruption)	Human Rights	Voting Issues
Name																	
Aub Group Ltd	•		•					•							•		
Boohoo Group Plc					•		•		•				•	•			
Bradespar Sa		•	•														
Brf Sa									•	•							
Cal-Maine Foods Inc			•		•		•										
Caterpillar Inc							•			•			•				
Centrica Plc		•				•	•							•			
Cimsa Cimento Sanayi Ve Tic	•					•	•										
Cognizant Tech Solutions														•			•
Comcast Corp			•				•							•			
DS Smith Plc		•					•							•			
Energean Oil & Gas Plc				•			•	•						•			
E.on Se		•				•											
Equifax Inc				•							•						
HSBC Holdings Plc	•		•	•		•									•		
Imperial Brands Plc							•	•	•					•			•
Indivior Plc			•												•		
Johnson & Johnson				•											•		
Jumbo Interactive Ltd			•					•				•					
JPMorgan Chase & Co	•			•										•			
Kainos Group Plc		•	•									•					•
Kingfisher Plc		•					•				•			•			
Korean Air Lines Co Ltd			•			•								•	•		
Maximus Inc			•					•						•			•
Merck & Co. Inc.									•						•		
National Express Group Plc			•		•												
Nmc Health Plc		•												•			•
Petrobras - Petroleo Bras				•		•	•										
Provident Financial Plc			•		•									•	•		
Rightmove Plc														•			
Ryanair Holdings Plc		•	•			•		•						•			
Sats Ltd		•		•	•					•			•				
Swedbank Ab		•	•												•		
Swedish Match Ab		•	•						•								
Tesco Plc			•				•							•			
Treasury Wine Estates Ltd			•				•										
Turk Telekomunikasyon As			•				•				•	•		•			
Vesuvius Plc	•						•					•		•			
Yum China Holdings Inc	•			•			•					•					
Yoma Strategic Hldgs Ltd															•		
Zhongsheng Group Holdings	•	•	•														

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Our voting is disclosed on our website each month
<https://www.aberdeenstandard.com/en/what-we-do/esg-investment/proxy-voting>

ESG Voting Statistics:
Source: Senior Global Voting Administrator, Middle Office & Data Department, ASI as at 2019

ESG Engagement Statistics:
Source: Quarterly ESG Engagement Report, ASI as at 2019

AVEVA Group

Mike Everett
Stewardship Director





AVEVA Group PLC is a holding company that develops and markets computer software and services for engineering and related solutions. During 2017, the company merged with Schneider Electric’s industrial software business. The combination of these businesses resulted in Schneider Electric having a 60% shareholding in AVEVA. ASI owns 4.5% of the issued shares.

We have had concerns regarding the company’s remuneration arrangements over a number of years. In 2018, we voted against two resolutions awarding the CEO and CFO one-off retention awards. In 2017, we voted against the resolutions to approve the remuneration policy and the remuneration report, and also voted against all of the members of the remuneration committee.

At the AGM in 2018, 27% of shareholders voted against the retention payment resolutions. That represents almost 70% of the independent shareholders. The only apparent action that the company has taken to address this dissent is to add a further independent director to the remuneration committee. One third of the retention awards, which we voted against in 2018, vested in 2019 and were disclosed in the remuneration report put to the 2019 AGM for approval. As we voted against the retention arrangements at the 2018 AGM, we voted against the results of their implementation at the 2019 AGM.

In addition to our concerns about pay, the board does not currently meet our guideline of having at least 25% female members. As a 60% shareholder, Schneider Electric has two representatives on the board. This means that the Chair does not currently have full

Key Driver	Key Outcome
 Internal mandate	 Escalation candidate

control over the board nominations process. Under the shareholder agreement with Schneider, he will himself be replaced by a Schneider Electric nominee by 2021. In advance of the AGM, we engaged with the Chair to discuss these issues and have asked him to share our views and expectations with his board for future reference. We have seen some improvement to the gender balance through recent appointments and so we did not take voting action on the board’s diversity at the 2019 AGM. However, we have indicated to the company that we do expect it to meet the levels of board diversity stipulated by the Hampton-Alexander review. This will require it to have one-third female members of the board by the end of 2020.

AVEVA is premium-listed in the UK and in the FTSE 250 Index. We expect it to meet the standards required of such a company. However, at this time, its board structure and remuneration arrangements do not meet these standards. Despite the presence of Schneider Electric as a majority shareholder, the company should work to address the expectations of all shareholders. Our voting decisions and engagement will continue to seek improvements in board diversity and remuneration arrangements.

“In addition to our concerns about pay, the board does not currently meet our guideline of having at least 25% female members.”

Bayer AG



Mike Everett
Stewardship Director



Bayer AG produces and markets healthcare and agricultural products. The company manufactures products that include aspirin, antibiotics, anti-infectives, cardiovascular, oncology, central nervous system drugs, over-the-counter medications, diagnostics and animal health products, as well as crop-protection products, plastics and polyurethanes.

As part of its stated strategy to be leaders in its core business segments, Bayer acquired its US-based competitor Monsanto in June 2018 for US\$63 billion. We engaged with the company over the period of the acquisition, although there was no shareholder vote to approve the deal. Subsequent to the acquisition, the company faced litigation from plaintiffs in the US alleging that glyphosate, a Monsanto product that has been sold for over 40 years, was carcinogenic. Thus far, the US courts have awarded punitive damages of US\$290 million against Monsanto, although an appeal is ongoing. We have engaged with the company on these matters and have provided details of this engagement in our Q4 2018 Global ESG Investment Report.

At the AGM in 2019, shareholders were asked to approve resolutions to discharge the Management and Supervisory Boards for the fiscal year 2018. Such resolutions seek shareholders’ approval of the actions taken by the boards during the year and, as such, are seen as a vote of confidence. Although support of these resolutions does not prevent future shareholder action against the company or boards, it may make such action more difficult. In the run-up to the AGM, two proxy advisors recommended votes against these resolutions, prompting the company to write to shareholders to explain its position. We therefore undertook further engagement with the company to fully understand the due diligence it had taken when acquiring Monsanto – particularly in relation to its assessment of the litigation risks inherent in Monsanto’s past business.

Key Driver	Key Outcome
 Performance-based engagement	 Escalation candidate

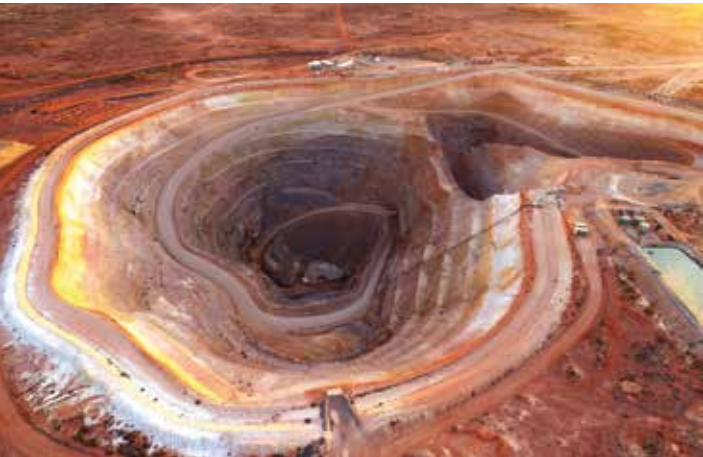
Our engagement with the company provided sufficient information regarding the actions of the boards during the diligence process to vote supportively on the resolutions to discharge them for fiscal-year 2018. However, we did reflect significant disappointment about the destruction of value caused by the acquisition of Monsanto, particularly regarding the execution issues that have arisen. We highlighted to the company that we hold management responsible for the successful integration of the two businesses and for delivering the required improvements for the good of all stakeholders.

We will continue to monitor the outcome of the legal actions against the company and also the synergies it expected to deliver through the acquisition of Monsanto. If necessary, we will undertake further engagement and voting action in order to hold management and the board accountable for their decisions.

“Our engagement with the company provided sufficient information regarding the actions of the boards during the diligence process to vote supportively on the resolutions to discharge them for fiscal-year 2018.”

BHP



Bill Hartnett
ESG Investment Director



In October 2019, we publicly announced, prior to the AGM of BHP (the world’s largest miner), that we would be supporting a shareholder resolution. At the time of voting, we held a significant 3.3% equity holding in the company. The substance of this advisory resolution asked the BHP board to suspend memberships of industry associations that they evaluated as undertaking lobbying or advocacy activities that were inconsistent with the Paris Agreement goals and therefore not aligned with BHP’s own climate strategy.

Anti-climate change lobbying activities by corporates and industry associations is rife globally and across sectors. We have long been monitoring climate change lobbying activities because they are so insidious. They do not hit investors’ typical ESG materiality threshold because, for a literal drop in the ocean in their annual budget, corporates and industries can be extremely effective at undermining the political will needed to address climate change. For this reason, we view proper oversight of companies’ lobbying activities as a significant climate issue for investors’ stewardship efforts. Unfortunately, anti-climate change advocacy activities are getting worse globally.

Investors had been focusing on BHP’s industry group oversight for some time, due to concerns over climate lobbying activities in its home country, Australia. Engagement from investors had resulted in BHP’s initial Industry Association Review being released in January 2018. Disappointingly, as the resolution pointed out, since that time, and despite BHP’s introduced governance measures, anti-climate change lobbying activities from industry associations where BHP is a major funder arguably had deteriorated. One of many examples being the 950 press releases (420 related to coal) made by the six Australian trade bodies of which BHP is a major

Key Driver	Key Outcome
 Performance-based engagement	 Escalation candidate

member. This runs counter to the promised ‘technology neutral’ approach to climate lobbying and undermines the company’s commitment to align with the Paris Agreement. Additionally, coal assets comprise less than 5% of BHP’s portfolio.

BHP is certainly not the sole culprit on lobbying activities – the practice is rife. However, it serves to undermine the integrity of BHP’s climate leadership aspirations which, as a shareholder, we have long encouraged (and often witnessed) as we believe it is in our mutual best long-term interests.

Outcomes on this engagement can be measured in a couple of ways. First, following our move to publically support a resolution, several other leading asset managers voted in favour. Despite neither of the major proxy advisors supporting this advisory resolution, it gained a significant 22.16% support from investors, with a further 7.72% abstaining, taking it close to 30% in total. This is a significant result and demonstrates that anti-climate change lobbying activities are clearly a major and growing concern for institutional investors.



The more important outcome will therefore be evidence of companies having stronger governance over their internal and external lobbying activities to ensure that they are fully aligned and integrated with their corporate climate change strategies. We will continue to engage with companies and investors to address this most stubborn obstacle in the transition to low-carbon economies.

“BHP is certainly not the sole culprit on lobbying activities – the practice is rife. However, it serves to undermine the integrity of BHP’s climate leadership aspirations which, as a shareholder, we have long encouraged (and often witnessed) as we believe it is in our mutual best long-term interests.”

Cal-Maine

Peter Psallidas
Graduate Business Analyst



Key Driver	Key Outcome
 Internal mandate	 Escalation candidate

around how it manages the composition and responsibilities of its sub-committees to enhance the checks and balances within its governance structure. This was marginally encouraging. There was also mention of internal discussions to add more independent board members. Despite these ESG positives, it did emphasise that it felt being a control company is a positive during a challenging point of the egg cycle. The company did not indicate that it might consider changing that.

An additional concern that arose during the meeting was that, at the moment, Fred Adams’s shares are currently held through Adolphus Baker, CEO, and Jean Adams, as his co-conservators. As of the most recent annual general meeting, Mr Baker will have full control of Mr Adams’s shares upon his passing.

Given the external challenges that Cal-Maine faces, as well as the severe environmental impact of many of its facilities, we encouraged the company to take measurable actions to improve its governance and environmental policies. We raised the issue with its executive leadership and will continue to monitor improvements in its disclosure of, and attention to, ESG-related matters.

“We encouraged the company to take measurable actions to improve its governance and environmental policies.”

Cal-Maine Foods is the largest US producer and marketer of specialty and non-specialty shell eggs. The company operates 42 production facilities in 29 states, selling over one billion dozen shell eggs in fiscal 2019. This accounted for roughly 19% of domestic shell egg consumption.

Our initial concerns with Cal-Maine stemmed from the fact that it is a family controlled company, with founder and Chairman Emeritus Fred Adams owning 64.5% of the firm’s shares. We were also able to identify that more than half of its facilities are in either high-risk or medium-high risk water-stressed regions.

We engaged with the company both to better understand checks and balances in place to manage and control risk, as well as to encourage changes in governance matters and the aforementioned environmental issues. As this is an active holding across several US funds, we wanted to better assess the inherent risk associated with Cal-Maine’s various ESG shortfalls.

We asked the company what processes it has in place to mitigate the impact of its water-intensive operations on the regions in which it operates. It was unable to provide a substantive answer. Its response was focused around cost impacts, rather than environmental impacts. Cal-Maine explained that when it enters significantly water-stressed areas, it will acquire enough land and resources so as to maximise its access to water and minimise incremental cost. There was no mention of incorporating environmental considerations into site selection or implementing water efficiency measures at existing locations.

On governance, we highlighted our concerns over a board that was only half-independent, the founder’s power concentration, and the company’s dual-class share system. It provided us with details

CRH

Rosie French
ESG Investment Analyst





CRH is a global building materials company that supplies aggregates, lime, cement, concrete and asphalt for a wide range of construction applications. These include major public roads and infrastructure projects, commercial buildings and residential communities.

ASI is a signatory of Climate Action 100+, an investor initiative targeting engagement with the world’s largest corporate greenhouse gas emitters. As part of the CA100+ initiative, a report was published by the Institutional Investors Group on Climate Change on the construction materials sector, which informed and drove our decision to engage with CRH on its climate change approach. As a large shareholder in CRH, we have closely engaged with it in the past on corporate governance. This marked our first climate change-focused engagement.

Following a letter sent to the chairman in June, we participated in a meeting with the head of sustainability. This meeting focused on CRH’s alignment with the TCFD and its participation in the Construction Preparer Forum; the group’s CO² emissions reduction targets and plan; governance of climate change and other ESG matters; and, finally, its public policy approach and involvement in industry associations.

In many ways, we see CRH as a global leader in its approach to climate change. Climate change sits both as a core part of the group’s risk management framework, as well as an integral part of its long-term strategy and potential business opportunities. The group is participating in a TCFD preparer forum which should lead to full disclosure in line with this framework – seen as best market

Key Driver	Key Outcome
 Internal mandate	 Escalation candidate

practice – by January 2020. We also saw CRH introduce a new Safety, Environment & Social Responsibility Committee in 2018.

What is perhaps most impressive is the group and management’s involvement in multiple cross-sector initiatives to develop solutions to reduce the lifecycle carbon emissions of cement. While there are many leading elements to the group’s climate change strategy, we offered several recommendations that we believe could help further strengthen and solidify a leading approach.

- CRH will publish its carbon emissions roadmap later this year. We encouraged it to set ambitious, science based targets for 2030 and 2050, which would support a 1.5 degree warming scenario. We also look for a clear plan on how to meet these targets.
- We recommended that its carbon emissions targets be linked to executive remuneration to ensure alignment of incentives.
- Finally, we encouraged CRH to carry out an exercise to ensure the alignment of its membership association policies with its own climate change policies and ambitions.



The engagement with CRH was largely positive, with open and constructive dialogue. Many elements of the group’s governance, risk management and strategy on climate change are strong. However, we will remain engaged to ensure the introduction of ambitious, market-leading carbon emissions targets. We have requested a meeting with the new chairman once he takes up the role from January 2020 to continue engagement on this topic.

“We will remain engaged to ensure the introduction of ambitious, market-leading carbon emissions targets.”

GMR Hyderabad International Airport Ltd

Petra Daroczi
Investment Analyst - ESG, Fixed Income



Key Driver	Key Outcome
 Client mandate	 On track to meet objectives

GMR Hyderabad International Airport is an Indian infrastructure construction company. It constructs and develops airports, roads, metros, and other transportation projects. It owns and operates the airport in Hyderabad, which currently handles around 18.3 million passengers annually and has two runways.

This was our first engagement on ESG with the company. The main drivers behind the engagement were twofold. First, GMR Hyderabad is a subsidiary of the GMR Group, which has faced several controversies in the past. These include local community opposition to its construction of a hydroelectric power plant in Nepal, and allegations of illegally over-invoicing coal imports.

As fixed-income investors, we often invest in subsidiaries rather than the parent group. It is therefore important for us to understand to what extent the parent company has influence over the ESG policies implemented at the affiliate. If the parent is a controversial entity, should we automatically assume that the subsidiary is the same?

GMR Hyderabad responded positively to our request for an ESG discussion. We asked it about the parent company’s oversight on how environmental policies and health & safety standards are implemented. The company adopts all of the parent group’s ESG policies but has a standalone oversight over these. Specifically, as GMR Hyderabad is planning a substantial expansion of the airport (with a target to handle some 34 million passengers), we asked it to elaborate on the environmental impact with regards to pollution and waste, as well as on the impact on the local communities. It has its own internal Environmental Management System and guidelines, and does not see any major challenges in applying these because it has been operating the airport for 13 years. It

further explained that while noise pollution can be a major issue for airports, it had its noise abatement procedures in place from “Day 1”.

Another area where we sought clarification was employee health & safety. The company shared details around the comprehensive training & certification procedure that is overseen by HR when a new employee is hired to ensure that they have the adequate skills for the job. Furthermore, the company puts in place an automated incident reporting system. It also monitors the number of accidents and injuries, categorising them based on severity (ranging from ‘near-miss’ to ‘fatality’). In addition, it has targets in place to reduce its environmental impact and to improve its health & safety record. All of this data is monitored and verified by an external third party.

As a result of the engagement, we felt comforted that the subsidiary is sufficiently independent from the parent company to devise and follow through its own ESG policies and targets. We felt that GMR Hyderabad is proactive on managing its environmental impact and has taken positive steps to ensure that its employees work in a safe environment. We asked the company to publicly disclose its efforts on the environmental and social fronts.

We will continue to monitor the disclosures in next year’s financial reports.

“As a result of the engagement, we felt comforted that the subsidiary is sufficiently independent from the parent company to devise and follow through its own ESG policies and targets.”

John Laing Group

Euan Stirling
Head of Stewardship and ESG Investment





We met recently with Olivier Brousse, chief executive of John Laing Group. He was accompanied by the group’s new CFO, Luciana Germinario. In 2018, we had engaged extensively with the company, inspired by our intention to vote against the report and accounts because of a lack of diversity on the board. This was exacerbated by meagre disclosures in the company’s annual report.

When we engaged with the company’s management team we found a very different picture to the one suggested by the headline statistics and the weak disclosure. The group had recently floated on the London Stock Exchange and was undergoing a transition. This involved moving from its focus on UK public partnership projects to becoming an international business looking to develop a broad range of infrastructure assets.

It became apparent from our interaction with the company that there were clear plans in place to improve diversity on its board, including the appointment of more women. It also had policies and plans in place to ensure a diverse workforce through its infrastructure development activities. The management team pointed out that the majority of graduate employees were female and that 45% of new joiners across the group were female. The company was also adapting from a construction industry heritage to one with a longer-term investment ethos and was now offering flexible working for all employees.

At this investment review meeting, more than 50% of our time was spent reviewing the recent progress on diversity and examining how the group plans to use its future approach to diversity and inclusion as a competitive advantage in the recruitment and retention of talent.

Key Driver	Key Outcome
 Internal mandate	 Influential in achieving change

The company now has three women on the board, from one previously, and actively monitors a broad range of diversity data from across its business in the belief that it will be a more successful builder and owner of infrastructure assets by doing so.

The chief executive pointed out that we had been the only investor to raise diversity as an issue with the company, and because we were their largest supporter in terms of ownership proportion, that this served as a wake-up call. This was reinforced by the discussion at the meeting around what best practice looks like across a number of other ESG issues. We have since provided details to the CFO of how we make impact assessments of companies’ activities with respect to the UN’s Sustainable Development Goals.

The company’s disclosure of its activities in pursuit of a diverse and inclusive culture has also improved substantially. This gives us confidence that its approach will be maintained to the benefit of future returns from the business.

“It became apparent from our interaction with the company that there were clear plans in place to improve diversity on its board, including the appointment of more women.”

Johnson & Johnson

Katy Grant
Senior ESG Investment Analyst





Johnson & Johnson (JNJ) is a US manufacturer of healthcare products. It also provides related services for the consumer, pharmaceutical, and medical devices and diagnostics markets.

Following on from our engagement with JNJ in the second quarter, when we drilled down into the group’s approach to quality and safety, and building on the numerous conversations that we have had with the company in recent years, we took part in a group ESG shareholder engagement meeting. There was a particular focus on JNJ’s role in the opioid epidemic, a widely-reported public health issue with which the company has become embroiled.

JNJ no longer actively markets any opioid products but continues to sell them where obligated. The two opioid products associated with JNJ, through its Janssen subsidiary, are Duragesic, a patch containing fentanyl which is applied to the skin, and Nucynta, an extended-release form of tapentadol in the form of an uncrushable pill. Marketing ceased on Duragesic in 2008 and Nucynta was divested in 2015. According to JNJ, both products were designed from the outset to reduce addiction and both had a ‘black box’ warning outlining the risk of addiction. Both also had to be prescribed by a physician. In addition to these two opioid products, JNJ supplied the active ingredient.

Despite the two named products above having constituted less than 1% of the opioids prescribed in the US, it is clear that their impact has had much wider-reaching consequences from a social risk perspective.

The group outlined its intentions to appeal the \$572 million civil judgement entered in the State of Oklahoma’s lawsuit against opioid manufacturers. It believes that the judgement is a

Key Driver	Key Outcome
 Internal mandate	 Escalation candidate

misapplication of public nuisance law. The use of this type of law against the company is in stark contrast to the talc litigation and other areas of litigation with which the company has been associated in the past. It marks new, more complicated territory in terms of potential litigation in the future.

More positively, the group ESG shareholder engagement meeting format signalled a new, more open approach to ESG engagement from JNJ. We hope this will continue. We will use the meeting as a platform for further one-on-one engagement with the group to fully understand the impacts of the opioid epidemic as it develops further. This represents a very serious social issue and could have a material impact on JNJ from both a reputational and financial perspective.

On the back of JNJ’s involvement in the opioid epidemic and reflecting our ESG assessment of the company, we, in conjunction with the other investors present, encouraged JNJ to improve its communication with investors on key ESG issues and to consider the use of the Sustainability Accounting Standards Board framework in its reporting.

“Despite JNJ’s products having constituted less than 1% of the opioids prescribed in the US, it is clear that their impact has had much wider-reaching consequences from a social risk perspective”

Recruit Holdings



Jerry Goh
Investment Manager



Founded in 1960, Recruit Holdings is a Japan-based technology company specialising in the provision of human resources-related services. It hosts its proprietary software and delivers the service through the internet for its current and prospective customers. Recruit’s business has widened into the life events field such as education, housing, automobiles, bridal, and the lifestyle field such as travel, dining, and beauty. Over the years, Recruit continued to maintain its dominance in the domestic economy. Its strong business model has allowed it to reinvest into new opportunities in the HR technology domain to pursue its next phase of growth.

However, part of the continued success of the company will depend on the ability of the board and its members to identify and exploit upcoming industry trends. Recruit understood the urgency of the matter, and initiated a call to understand our opinion on board composition, skillset diversification, and management pay.

We discussed remuneration extensively in order to ensure greater alignment to minority shareholders. Compared to before, stock-based compensation is now a majority part of remuneration, constituting about 55% of the total remuneration package. The exercise price of the stock options is also referenced to the market

Key Driver	Key Outcome
 Internal mandate	 On track to meet objectives

share price on the day of issuance of the options. That said, we noted the lack of a robust clawback policy, which may encourage management to game the accounting earnings. As such, we encouraged Recruit Holdings to consider implementing a clawback policy, and suggested the parameters of the policy.

Apart from remuneration, we praised the company’s progress in appointing new independent directors to the board. We took the opportunity to recommend that the board prioritise skills diversification to ensure that it is properly equipped with the necessary expertise to manoeuvre around the volatile business environment.



While noting that the company has performed well both financially and in terms of share price appreciation, we encourage it to continue to make improvements to its corporate governance structure. We believe the company could be leaders in the Japan market, and remain cautiously optimistic of its progress on ESG.

“We believe the company could be leaders in the Japan market, and remain cautiously optimistic of its progress on ESG.”

Vale

Fraser Harle
ESG Investment Analyst



Key Driver	Key Outcome
 Performance-based engagement	 On track to meet objectives

Nine months on from the Feijao dam collapse in the city of Brumadinho, we are still awaiting the ultimate judgement of the Extraordinary Independent Consulting Committees. Since our initial engagement report regarding the incident in the first quarter of the year, we have met and engaged with various stakeholders at Vale. These meetings have ranged from conversations with the new Safety & Operational Excellence department, to visiting the site at Brumadinho to examine the work being undertaken.

Alongside trying to gain greater insight into the operational changes made, we have met with those in Vale’s top management including Sandra Guerra, an independent director of Vale. Separate to our individual engagement efforts, ASI has been involved in the PRI collaborative engagement with Vale, and with the Church of England initiative, conducted with the International Council on Mining and Metals, to produce a global disclosure standard for tailings dam safety.

During our engagements, we have prompted Vale to adopt more prudent margins for safety than the minimum required under Brazilian regulation. We have learned that Vale’s prior position was to apply Brazilian standards and it had not planned to exceed what was mandated locally. Recently, we have been pleased to hear, following our conversations, that Vale is now beginning to benchmark against Australian and Canadian standards.

Vale has approved an investment programme to increase the ‘factor of safety’ across geotechnical structures from 1.5 to 2.0. Following the completion of the program, Vale’s factor of safety will exceed Brazilian standards, demonstrating the new conservatism being applied by company management. We believe this will help to bring the company more closely aligned to the best practice against which it aims to benchmark itself.

From a governance perspective, following the tragedy Vale has adopted a ‘three lines of defence’ model. The newly-created Safety & Operational Excellence office sits within the second line, overseeing the application of technical standards and driving best practice within the company. The area reports directly to the CEO, sits independently from operations and has the authority to halt operations. We welcome these changes to create robust oversight and help to minimise potential conflicts of interests.

As responsible stewards of our clients’ capital, we strive to ensure that the companies in which we invest implement and maintain best practice. The impact of Brumadinho emphasised the need for robust standards to be adopted, and emphasised the role active engagement can play to drive the adoption of these standards at our holdings. We will continue our ongoing engagements with Vale and seek to drive positive momentum at the company.

“The impact of Brumadinho emphasised the need for robust standards to be adopted.”

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