“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.”

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In 2019, environmental, social and governance (ESG) moved to the fore across the investment community. Aberdeen Standard Investments (ASI) has a long pedigree in the application of ESG considerations in the investment process. This report details just some of our ESG activities during 2019.

During the year, climate change and its direct impacts on our environment and society dominated economic, political and commercial spheres. We attended the World Economic Forum in Davos, whose theme was ‘Stakeholders for a cohesive and sustainable world’. This is a reflection of how the world’s attention is now clearly focused on climate change and the challenges it presents. We have continued to engage with and set milestones for companies on their approach to climate change, exercised our voting rights to drive better performance in the area and influenced our investment decisions in relation to climate change factors. We published the paper ‘Climate change – our approach for investments’. This outlined six climate change areas of focus within our investment strategies. This was followed by a white paper in September 2019 – ‘Investing in a changing climate’. The paper highlights the risks and opportunities stemming from the low-carbon energy transition, as well as the physical risks related to climate change and the implications for investors. As a company, ASI has pledged to become carbon neutral by the end of 2020. Our CEO has taken on the role of executive climate change sponsor and climate change is now a standing agenda point at our Board’s Risk and Capital Committee.

Our focus is not limited to climate change. Over the year we also continued the work on our approach in the Social and Governance elements of ESG. Employment practices, the emergence of the gig economy, the need for a living wage and the management of social capital have influenced our fundamental analysis of investee companies. Empirical evidence demonstrates the long term sustainability of companies that engage with and develop their employees. As we move into the Fourth Industrial Revolution and technology becomes more integrated into ways of working, employment practices will continue to grow in importance.

The achievement of environmental and social goals is driven by robust corporate governance. As active stewards of our clients’ capital we have engaged with and, in some cases, chosen to vote against the boards of companies in which we invest. The role of asset managers allocating the capital of others brings with it important responsibilities to deliver the desired outcomes of those who appoint them. Their ability to do so is often assessed by their adherence to various codes, standards and regulations that have been developed during the past two decades. Numerous policies emerged, including the first revision of the UK Stewardship Code since 2012, encouraging asset managers to be active stewards of capital across asset classes. We welcome the revisions to the code, which are aligned with our investment approach.

“Environmental, social and governance considerations underpin all our investment activities, and will continue to do so as we invest today to change tomorrow.”
ASI was involved in a number of industry events this year. One of the most significant was the 72nd CFA annual conference, which took place in London. More than 1,900 investment management professionals gathered to learn how disruption is affecting the global investment profession. Amanda Young, our Global Head of Responsible Investment, was invited to lead a session on ‘ESG investment — from process to product’.

The PRI in Person conference in Paris was of a similar scale. A number of ASI representatives joined those in the responsible investment profession, representing 830 organisations from 50 countries. The theme of the conference, ‘Responsible investment in an age of urgent transition’, focused on the heightened global call for action on a wide range of ESG issues. These included climate change, social inequality, modern slavery, plastics pollution, tailings dam management and executive remuneration.

We also attended the International Corporate Governance Network conference in Amsterdam. One clear theme was the increasing shift from shareholder engagement to engagement with a broader group of stakeholders. There was a focus on ESG integration and the benefits this brings. It touched on the challenge of finding relevant, reliable and comprehensive data to help with this integration.

We also supported a number of Brooks MacDonald IFA events around the UK. Our focus was on the ‘social’ element of ESG. The sessions essentially provided an ‘ESG in practice’ session for the IFA community.

Our global team represented the firm as speakers, guest note presenters and panellists on conferences and events around the world. These included in Seoul, Singapore, Paris, Zurich, Milan, Stockholm, Holland and Australia, to name just a few. Our activities involved the opening keynote speeches at the annual International Corporate Government Summit in Taiwan, speaking about the active role of global institutional investors in strengthening the corporate governance ecosystem.

Meanwhile, Petra Daroczi, our fixed income ESG Investment Analyst, spoke about the active role of global institutional investors in strengthening the corporate governance ecosystem at the annual International Corporate Government Summit in Taipei. The key message was how long-term investors like ASI can help independent directors devise a more stakeholder-centric governance system. The next day, we presented on how investors can help companies implement better anti-bribery and corruption practices at the Global Corporate Sustainability Forum at the iconic Taipei Royal Hotel.
“The key message was how long-term investors like ASI can help independent directors devise a more stakeholder-centric governance system.”
Davos

In January 2020, I attended the 50th annual meeting of the World Economic Forum (WEF) in Davos with Keith Skeoch, our CEO. This year’s theme was: ‘Stakeholders for a Cohesive and Sustainable World’.

As a first-time attendee, I was somewhat sceptical about the value of the event, not least due to the air miles accumulated to discuss climate change. However, I was surprised at the tangible actions and outcomes from some of the meetings we attended.

There is no other event that brings together such a large group of global leaders from government, business and society. Only by doing this do we have a platform to forge the partnerships we need to build a sustainable world. It was clear to me that investors will have a crucial role to play in how we invest our capital, as this will determine the world we live in for the future.

The sustainability agenda has always featured at WEF. Historically, the issues sat at the fringes of the forum. However, this year was significant as sustainability took centre stage, particularly the topic of climate change.

A number of prominent individuals, such as the UK’s Prince Charles and Sweden’s Greta Thunberg, spoke about the need for change. They and others encouraged leaders to think about a different type of economic model and urged them to take immediate action. They also challenged business, governments and investors to think about the alternative forms of capital when building businesses for the future. These include natural capital, human capital and social capital, alongside economic capital. As investors, all of this will define how we think about both public and private capital allocation of the future.

The Global Risks Report, issued in the run up to the meeting, supported this focus on sustainability. For the first time, all top-five risks in terms of ‘likelihood’ were environmental. Additionally, three of the top five in terms of ‘impact’ were also environmental – rising sea levels, increased weather events and loss of habitat.

I attended a number of meetings that focused on encouraging governments and businesses to develop a different type of thinking. A major question was: how can they use business-as-usual practices to generate social outcomes? We hosted the launch of the United Nations Office for Project Services/Economist report. This outlines how governments can use their procurement policies and funds to generate positive social impacts. Such innovative thinking also means governments can help the UN achieve its Sustainable Development Goals (SDGs).

We also hosted a roundtable with leaders of academic institutes to explore some of the pressing issues for investors, including climate change, gender inequality and strong governance structures.

Outside of our own meetings, we attended a number of events focused on issues such as how we could measure the financial implications of climate change for future investment; how reporting can change to reflect a range of capitals; and how we only have 10 years left to deliver against the SDGs.

The shift in tone and focus at Davos this year was remarkable. It also generated some tension between certain leaders, businesses and governments as to what they could realistically achieve. What was clear, though, is that partnerships are going to be essential to drive the urgent change required to meet the future needs of our planet and its people in an equitable and sustainable way.

There remains a substantial gap between ambition and real action. As the WEF showed, investors have a unique role to play in driving the right type of allocation of capital that can support a just and fair transition to a cleaner society. Companies, however, will need to play their part too. Despite progress, convincing much of the corporate world that climate change and inequalities are urgent matters remains a challenge. So, in addition to how we allocate our clients’ capital, we must be the champions of driving change with the companies in which we invest. We must highlight the need for them to take immediate action. The time for talk is over. In doing so, we can protect the value of our investments, while ensuring that these investments are around for the long term.
“ESG issues have always been on the agenda at Davos, but historically these discussions have been held on the fringes. This year, they took centre stage.”

Amanda Young, Global Head of Responsible Investment
In 2019, we saw fracture lines in many parts of the world in which we operate. In some cases, these have reflected political divides; in others, issues such as climate change have been to the fore. This has emphasised the need to collaborate in order to address the issues and to begin to heal the divides.

We find ourselves interacting with asset management peers, asset-owning clients and potential clients, regulators, civil servants, politicians and non-government agencies on a scale that we did not anticipate, even as recently as 12 months ago.

This is an acceptance that, as well as generating an economic return, private sector capital allocation can be a force for positive change, sometimes in the absence of an adequate policy framework. The financial services industry is beginning to realise the influence it needs to exert in order to address environmental and societal issues. It is also recognising that the push can be so much stronger when individual parties join forces for a common good.

Take climate change. Four years ago in Paris, over 190 countries committed to making a difference to the way they acted. That was an astonishing development. However, progress since then has been painfully slow, despite mounting evidence that the real impacts are emerging at a much faster pace than expected. The investment industry is responding to that challenge by joining forces. A group of our clients established the Transition Pathway Initiative so that we could grade companies’ responses to the climate emergency. Climate Action 100+ is an industry-wide initiative to pressurise some of the world’s most carbon-intensive companies to change their ways. In the UK, the Prudential Regulation Authority and Financial Conduct Authority are advocating that the financial services industry considers climate risk as a near-term financial risk. These are all great examples of collaborative approaches to dealing with a critical issue. They are also changing the way that banks lend, insurers invest their funds and asset managers create investment solutions targeting a broader range of outcomes beyond a simple financial return.

This approach is not confined to climate change. We find common cause with many of our investment peers with respect to corporate governance concerns. Examples include excessive executive remuneration, operational considerations such as workers’ rights and treatment, and environmental issues like water stress, tailings dam standards and pollution. We find that in different parts of the world, different organisations have helped coordinate efforts in order to target specific problems.

In January 2019, a tailings dam collapsed in Brumadinho, Brazil, killing nearly 300 people. The investment industry, and particularly those closest to Vale, the company which operated the mine, responded promptly and collectively to try to establish significantly improved safety and maintenance standards. Their goal is to hopefully prevent such a disaster recurring. We continue to be involved in these efforts.

Everything that I have described so far is focused on making our industry outputs – the investment funds that we help to create and maintain – more sustainable. Recently, there have been significant policy developments to inspire us to do more. The UK Stewardship Code, in its first serious revision since 2012, now sets clear and high standards for the promotion of active stewardship across all investment types. The European Union has established a taxonomy, which defines specific activities as sustainable. It is hoped this will promote the allocation of capital to enterprises that will generate a strong financial outcome, as well as positive environmental results. We have consulted with the organisations producing these new standards and will work hard to support them with the help of our peers in the industry.

We believe that by acting together we can harness the power of private sector capital allocation to help address some of the biggest issues that our society faces. Our door is always open – in 2020 and beyond.
“The financial services industry is beginning to realise the influence it needs to exert in order to address environmental and societal issues.”

197 countries have signed the Paris Agreement

Source: as at 4 November 2016, United Nations Treaty Collection
Businesses and human rights – a new digital landscape

As investors, we have a duty to our clients to understand the ways in which human rights affect the value of investments. We also have a duty to respect human rights in our own activities. We do this by attempting to fully understand the ways in which investments positively or negatively affect the rights of others and by influencing positive changes where needed.

In 2019, we saw two key trends gather strength and momentum:

- the growth of mandatory human rights due diligence and disclosures
- heightened awareness of the corporate influence on digital human rights.

An evolving legal landscape

United Nations Revised Draft Treaty
In July 2019, a revised Draft Norms was published on the Responsibilities of Transnational Corporations and other Business Enterprises with Regard to Human Rights. The Draft Treaty essentially puts the onus on states to:

- ensure that domestic legislation requires anyone conducting business activities to respect human rights
- undertake human rights due diligence in its business activities and contractual relationships.

The state must also ensure that domestic law provides a “comprehensive and adequate system of legal liability for human rights violations or abuses in the context of business activities.” In implementing the Treaty, states are also to address the specific impacts on vulnerable groups, such as women, children, indigenous people, people with disabilities, refugees, migrants and internally displaced people.

The preamble to the Treaty also specifically references the ‘Protect, Respect, Remedy’ framework and UN Guiding Principles on Business and Human Rights, emphasising the complementarity of approach with established voluntary initiatives.

Due diligence and disclosure laws
Recent assessments have found the overall human rights reporting situation to be lacking. This has catalysed a call for mandatory reporting requirements, with a strong focus on demonstrating sufficient due diligence processes.

Enforcing legal obligations on companies in multiple regions has an important role to play in levelling the business playing field. Doing so ensures that no company is financially or competitively disadvantaged by adhering to these laws. A good example of this principle in action can be seen in the evolution of anti-bribery and corruption laws. While the Foreign Corrupt Practices Act (FCPA) was introduced in the US in 1977, it remained largely unenforced until the Organisation for Economic Co-operation and Development and the UN introduced conventions in 1997 and 2005. These acted as a catalyst for other countries to implement similar legislation.

A similar approach may prove effective in combating corporate human rights violations. Current, incoming and proposed human rights due diligence and disclosure laws are in play in North America, Europe, Asia and Australia, adding pressure to companies from multiple sides.

Digital human rights
Technological advances can act as a powerful support for enhancing human rights. For example, the rise of social media has

“As new technologies develop and come into use, unintended human rights consequences can arise.”

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facilitated coordinated local activism, enhanced freedom of expression and enabled global community building. However, as new technologies develop and come into use, unintended human rights consequences can arise. For social media, moderation of user-generated content is a significant challenge and has led to allegations of election interference, mass violence and genocide.

The growth of innovative technologies raises important questions about the strength of current policies, legal systems and corporate approaches to mitigating risks to human rights. As new technologies come into use, the potential human rights impacts should be strongly considered. The role of businesses in this context becomes increasingly important, given that many of these advancements are developed and commercialised by corporate entities for use by governments, individuals and/or other businesses.

Conclusion

Thorough assessments of salient human rights issues will mitigate risks, and allow companies and investors alike to capitalise on opportunities. Many challenges remain, even for those with the most advanced approaches to human rights. Regions of the world are at different stages of progress in their human rights approaches, but global corporate influence is clearly growing. The business case for using this influence to stimulate positive change is also crystallising, with clear benefits for corporate reputation, operations and regulatory risk mitigation. Those that take ownership of human rights issues now will be well positioned to support ongoing improvements.

“Many challenges remain, even for those with the most advanced approaches to human rights.”
Climate change and the environment – an area of exponentially growing importance

Katy Grant  
Senior Manager ESG Investments - Research

Eva Cairns  
Senior ESG Investment Analyst

Climate change was a very hot topic in 2019 – and one that is here to stay. Increasing severity and frequency of physical impacts were experienced across the globe; whether that is flooding in the UK, Venice and Mumbai, wildfires in California and Australia, or record temperatures across Europe. The Intergovernmental Panel on Climate Change produced two reports on the impact of climate change on land and oceans and these provided further compelling evidence for the urgency of action.

This has led to changes in public perception and a growing movement of climate activities. The world needs to aim for a net-zero emissions target by 2050 to achieve the goals of the Paris Agreement and increasing numbers of governments and companies are setting such targets. Another encouraging development is the drastic fall in prices for solar photovoltaics, wind tech and batteries. This is shifting capital flows into low carbon assets.

With this in mind, climate change is more material for investors. It was a key area of focus for us in 2019. As a company, ASI has pledged to become carbon neutral by the end of 2020. Our CEO has formally taken on the role of executive climate change sponsor and climate change is now a standing agenda point at our Risk and Capital Committee.

Integrating climate change research into our investment process

In May 2019, we published the paper ‘Climate Change – Our Approach for Investments’ which outlined six climate change areas of focus and was discussed in our Q2 ESG report. This was followed by a white paper in September 2019 – ‘Investing in a Changing Climate’. The paper highlights the risks and opportunities stemming from the low-carbon energy transition, as well as the physical risks related to climate change and the implications for investors.

The paper included a deep dive on hydrogen. This is part of a research series looking at fuels of the future and their role in decarbonising different industries. To obtain a better understanding of investment opportunities and the growth potential of hydrogen, we engaged with companies such as Air Liquide, one of the world’s largest hydrogen producers. While hydrogen can help decarbonise hard-to-electrify industries such as long-range transportation, heating and industrials, we believe the high cost and lack of infrastructure to produce green hydrogen today means it will still be some time before this plays a more important role in our energy system.

Our focus has not solely been on replacing fossil fuels. We also produced a research paper on climate change and land, and what it means for the food industry. A quarter of global emissions come from agriculture, forestry and land use, but these are areas we believe are not given enough attention. Tackling unsustainable levels of livestock, food waste (which contributes to 8-10% of global emissions) and innovation in sustainable farming are key areas to consider. We became signatories of the FAIRR (Farm Animal Investment Risk and Return) initiative. This provides extensive research on protein producers and collaborative engagement opportunities.

In our ESG sector series, we took a closer look at utilities and airlines and how they manage risks and opportunities related to climate change. Airlines are under particular pressure to reduce emissions, given (a) the growth that is expected in the industry; and (b) the difficulty in decarbonising long distance flights that cannot be electrified with current technologies. There is a strong focus on efficiency improvements and many are looking to offset emissions, including easyJet and British Airways. We believe that while useful as a short-term measure, this can only get the industry so far. Innovation into aircraft design and sustainable aviation fuels are needed to decarbonise the sector.

Our climate change research led us to engage with a number of companies to better understand their exposure to, and management of, related risks and opportunities. By doing this, we aim to influence them towards credible Paris-aligned targets. This included attending the BP AGM, leading the engagement with E.On as part of Climate Action 100+ and discussing decarbonisation pathways with Arcelor Mittal.
“Tackling unsustainable levels of livestock, food waste (which contributes to 8-10% of global emissions) and innovation in sustainable farming are key areas to consider.”

**Carbon footprinting our funds**

To understand potential exposure to carbon risk, we have developed capabilities to carbon footprint our funds across equities and corporate bonds. This helps provide an understanding of the carbon-related risks embedded in our portfolios and highlights the most carbon-intensive companies. It also gives us an estimate of emissions from our data provider Trucost, rather than disclosed by the company. We have engaged with companies to encourage emissions disclosure in alignment with TCFD (Taskforce on Climate-related Financial Disclosures). While carbon footprinting is backward-looking and needs to be complemented with more forward-looking data, it is a useful baseline for carbon analysis.

**Looking beyond climate change...**

Our research focus goes beyond climate change, as we strive to consider all material environmental risks and opportunities. For example, we analysed how a circular economy may represent a new system for the future. With the world’s consumption of raw materials set to double by 2050 without intervention, we examined the effects of moving towards a circular economy.
We looked at it both in terms of reducing costs and creating competitive advantage, as well as transforming the exploitation of natural resources and reducing greenhouse gas emissions. We considered how circular economy principles are being written into political frameworks and where opportunities might lie, from the point of view of waste as a resource and also business model re-evaluation.

We believe we have the opportunity to assist in the development and implementation of policies. Furthermore, companies that are cognisant of the benefits of supporting a circular economy are likely to perform better in the long term than those that are not.

We also continued our research on plastics, examining different types of plastics and their most significant environmental impacts. Our latest research considered which plastics are the worst offenders over the product lifecycle. We examined regulatory trends as well as the opportunities that exist across industries and sectors.

Countries, cities and companies are banning the worst single-use disposal plastics products. These legislations are effective in reducing the most visible forms of plastic pollution, but do not provide a systematic solution. Governments are beginning to think more holistically. EPR (extended producer responsibility) mandates are likely to force companies to increase their collection rates and improve the recyclability of their products. For investors, significant opportunities may arise within the circular-plastic economy. However, we need to be cautious of innovative types of bioplastics/biodegradable plastics and claims made about them.

A further topical issue has been deforestation, particularly in light of the forest fires in the Amazon that made headlines earlier this year. In September 2019, we signed the PRI’s investor statement on deforestation and forest fires in the Amazon. We also published a thematic research report on deforestation and its impacts for investors. Our report focused on the growing global demand for four commodities: palm oil, cattle, soy and paper/timber products, which together drive the bulk of deforestation in the Amazon. We concluded that the risks from deforestation are significant. Exposure of illegal practices in the supply chain and shifts in consumer demand are likely to hit companies’ reputations and profitability.

At the same time, we believe investors are uniquely positioned to advocate a harmonised policy response and encourage companies to increase transparency and set time-bound targets.

Deforestation affects numerous global companies, via both direct operations and through supply chains. This has been reflected in our wide-ranging engagement with companies on this vital environmental issue.

External collaboration – influencing others and sharing best practice

We joined the Climate Financial Risk Forum established by the PRA (Prudential Regulation Authority) and the IIGCC (Institutional Investors Group on Climate Change), working closely with the TPI (Transition Pathway Initiative). This gave us the opportunity to shape best practice by discussing key climate change topics such as scenario analysis, physical risks and 2-degree aligned portfolios with other asset managers and asset owners.

In October, we took part in ‘The Future of Plastics’ conference in Amsterdam, organised by the Innovation Forum. We participated in a plenary session in which we discussed our approach to the plastics issue and how this is incorporated into our investment processes and decision-making.

What’s next in 2020?

We expect climate change to be of exponentially growing importance to our clients, regulators and our industry. Our priority is to continue progress across the six areas identified in our approach. Our specific focus is on applying climate change scenario analysis to a range of asset classes and understanding the financial impact of different climate scenarios. This will feed into our first climate change-related milestone – the publication of our TCFD report in Q1 2020.

And, finally, COP26 (the UN climate change summit) will be held on our doorstep in Glasgow in November 2020. We see this as an opportunity to highlight the urgency of climate action and the critical role of investors in making the low-carbon transition happen.
“We expect climate change to be of exponentially growing importance to our clients, regulators and our industry.”
Living wage & fair pay

Ziggy You
ESG Investment Analyst

The ‘living wage’, as a concept, has been around for some time. The ancient Greek philosophers, Plato and Aristotle, argued for an income that is based on needs for the sake of the common good.

The Global Living Wage Coalition (GLWC) defines a living wage as:

the remuneration received for a standard workweek by a worker in a particular place sufficient to afford a decent standard of living for the worker and her or his family. Elements of a decent standard of living include food, water, housing, education, health care, transportation, clothing, and other essential needs including provision for unexpected events.

Studies have attempted to calculate a living wage. For example, the charts below show how the constituent components of a living wage relate to one another.

Why is the living wage important now?

The issue of a living wage has attracted renewed attention as income inequality around the world causes social and political upheaval.

Real wage growth has stagnated over the last few decades\(^1\). Meanwhile, labour’s share of national income has declined since 1980, particularly within developed countries.

Technology has displaced jobs, and many workers struggle to realise a living wage in casual employment. Wage discrimination is still widespread. For many millions, employment is no longer a route out of poverty.

Goal 8 of the UN’s Sustainable Development Goals calls for the creation of ‘decent work’. This requires wages that cover basic needs and afford workers a modest level of economic security. Indeed, the right to a living wage is considered a human right.

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\(^1\) World Employment Social Outlook – Trends 2019, ILO, p17
“The issue of a living wage has attracted renewed attention as income inequality around the world causes social and political upheaval.”


Source: ILO estimates based on official figures from 84 low- and middle-income countries and 5 high-income countries as recorded in the ILOSTAT database and the ILO Global Wage Database

Beyond a living wage – fair pay practices

However, simply stipulating a higher wage threshold is not enough. Also crucial is the notion of fair pay. Besides wage levels, this requires pay practices that ensure equal pay for work of equal value, and pay systems that are transparent and enable sustainable wage development.

Why should investors care?

**Good for businesses and shareholders**

Empirical research demonstrates that fair wages motivate employees to be more productive which, in turn, boosts profitability. They reduce attrition and its associated costs. They also help attract talent, and improve product and customer services, as well as employee relations.

**Good for workers and the Sustainable Development Agenda**

Asset owners and asset managers allocating capital to companies that implement fair pay practices are helping to achieve SDG 5 (gender equality), SDG 8 (decent work for all) and SDG 10 (inequality reduction) of the UN SDGs. Many investors have signalled an ambition to play a greater role in supporting these goals.

**Risks of not caring**

Companies that fail to pay a living wage and implement fair pay practices face risks of operational disruption from strained labour relations, additional cost associated with high employee turnover and reputational damage, which further limits companies’ ability to attract talent. Furthermore, in jurisdictions where there are regulations in place regarding fair wages, companies’ wages levels and pay practices can expose them to legal risks.

**Challenges, choices**

How a living wage is determined varies by geography and different definitions of a ‘basic but decent’ life. The variations make it difficult for investors to gauge if companies, especially those operating in multiple jurisdictions, are paying a living wage. Currently, there is no legal framework or methodology to drive the implementation of living wage policies and thus no incentive for companies to address this issue.

A more fundamental challenge is that, with the pressure to deliver short-term profits, many companies retain the mind-set that views worker returns versus shareholder returns as a zero-sum game, i.e., wages are a cost that need to be kept as low as possible.

However, with empirical evidence demonstrating the benefits of fair wages, long-term sustainable investors do have choices. They can, for example, choose to better understand the cost and benefit of a living wage. Investors can engage with companies to encourage fair pay practices. Another option is to allocate capital to companies where a living wage and fair pay form part of a sustainable business strategy.
Allocating capital to bring about change

Mike Everett
Stewardship Director, Policy & Voting

It has been recognised for some time that financial services firms have a major influence on the organisations to which they provide capital, through bonds, equity, loans or other vehicles. However, the stakes are rising as both policymakers and the ultimate owners of capital, such as individuals, charities or pension schemes, hold asset managers to account. Financial services firms are reacting to this heightened focus by seeking to demonstrate their consideration of ESG factors, and where necessary show their ability to influence companies to change.

Firms are also responding, as they undertake additional ESG analysis, sourcing additional data and developing transparent reporting systems. Policymakers are putting significant efforts into the development of regulations and codes of conduct. The ultimate objective is to harness the influence of capital flows in order to deliver important changes. Most significant among these is the transition to a low-carbon global economy.

Codes of conduct

The role of asset managers allocating the capital of others brings with it important responsibilities to deliver the desired outcomes of those who appoint them. Their ability to do so is often assessed by their adherence to various codes, standards and regulations that have been developed during the past two decades.

Jurisdictions around the world have recognised the power of such policies and codes to drive change. Indeed, those attracting the most signatories tend to be the ones developed for global use such as the UN supported PRI. One problem, however, is that individual countries have often put in place their own versions. These may be based on those already in place in other markets or on standards proposed by global actors such as the OECD.

The recognition that the allocation of capital can potentially drive significant economic change has also led policymakers to create policies that apply to more stakeholders within the overall investment chain. Such activity stands alongside consumer concerns about the impact of companies on the environment and wider society, driving significant change along the investment chain.

Together these trends are creating a broader framework of accountability. Asset managers aim to demonstrate their responsible allocation of capital via a high standard of engagement with the companies or organisations in which they invest or allocate capital. As a result, investment managers are creating more clearly defined investment policies and processes in order to integrate the consideration of ESG factors into their decision-making. Engagement and disclosures are quickly developing to better demonstrate the inclusion of ESG factors within both portfolios and products.

It is noticeable that many of these developments are occurring on a global basis. An example is the implementation of global frameworks such as the standards developed by the TCFD and the assessment of impact investing funds on the UN’s SDGs. The increasing use of such frameworks across the investment chain and by policymakers is creating more standardisation, albeit we are at a relatively early stage with a small number of players at the forefront of such change.

A combination of roles

More and more investors are accepting that they have an important role in helping address some significant global environmental and social issues. Such a commitment means they must take responsibility for encouraging positive changes in the businesses in which they invest to achieve the desired outcomes. It is also important for policymakers to continue to develop the necessary policies to influence more players along the investment chain. However, there are risks to consider: both investors and policymakers must maintain an awareness of the actions of each other to ensure that the necessary outcomes are delivered. Rather than developing even more codes and standards, it would be preferable for policymakers, standard setters, asset managers and key investors to work together to use the existing frameworks. A successful conclusion would help align long-term capital allocation with the outcomes desired by those who provide the capital and which are needed by society as a whole.
“Engagement and disclosures are quickly developing to better demonstrate the inclusion of ESG factors within both portfolios and products.”
Investors are eager to know about the ESG issues affecting their investments and the stewardship activities of those overseeing them.

Firms are also responding, as they undertake ESG activities. From ASI's position, we are cognisant of this through endeavouring to be students of our clients. We have observed a large increase in the frequency and types of ESG-related questions in requests for proposals (RFPs), due diligence documentation and general inquiries over the last three years.

In 2018, approximately 10% of RFPs at ASI were either directly related to responsible investment solutions or were explicitly shaped around general ESG concerns. Meanwhile, around 45% of RFPs contained at least one ESG-related question. Fast forward and, as of Q3 2019, the proportion of targeted responsible investment solution RFPs increased to 15%. Further, more than 75% of these requests now include at least one or more questions related to ESG considerations.

Drivers
While there may not be a single explanation for the drivers of this upsurge, there are undoubtedly a few key forces behind the growing interest and commitment of investments to this space.

Associations and affiliations
The growth in the PRI membership is helping with the understanding around responsible investment and how to integrate ESG considerations into traditional investment analysis across multiple asset classes. Its reach is spanning further, with signatories now at 2,515, in spite of them gently raising the bar for signatory status. Approximately 18% of these signatories are asset owners and this helpfully applies pressure and influence on corporate behaviour either directly or indirectly through asset managers.

The Sustainability Accounting Standards Board framework is also making significant inroads, while the Global Reporting Initiative standards are long established. There is also increased adoption of specific country stewardship codes, as well as climate change-focused reporting initiatives like the Task Force on Climate Related Financial Disclosure.

Work with clients
The PRI membership and others are some of the many conduits for more collaborative action. In 2019, one of our investors, the Brunel Pension Partnership, raised the issue of human rights in relation to the products and activities of BAE Systems in the Kingdom of Saudi Arabia. We arranged a collaborative client meeting with the chair of the company's board. The company explained the nature of the government-to-government contract, to which it was aligned, and clearly outlined the scope of its responsibilities. Following the meeting, BAE Systems agreed to review its assessment of human rights as part of its risk management framework.

Regulation
The rise in ESG considerations is either being followed by or pushed by (depending where you are on the maturity curve) increasing ESG requirements and standards insistent on transparency around disclosures. One global example is the Singapore Exchange. In 2016, it introduced sustainability reporting for listed companies; while, in the same year, the province of Ontario made it a legal requirement for pension plans to disclose whether ESG-related factors are part of investment policy statements. Meanwhile, France has been at the epicentre of climate change legislation. In 2015, the country passed an Energy Transition Law, which requires institutional investors to report on both the physical and transition risks faced by their assets.

Investor preferences
Much has already been made of the growth drivers from millennials and women, pushing the need for not only better articulation of ESG integration, but a greater choice of responsible investment products. However, this growth transcends both generation and gender. While these areas may have lit the fuse, demand has quickly caught fire and is attracting interest from all generations, genders, geographies and demographics.
The future landscape

Client preferences are becoming more pronounced and varied. It is clear there is demand for greater investment choices that are aligned with these preferences. This rise in client predilection is perhaps also driven by the increasing ease of access to investing globally.

As has happened over time with accounting standards (GAAP and IFRS), the global investment landscape needs harmonisation of ESG-related standards and guidelines. It is hoped that legislation like the Shareholder Rights Directive II, which came into effect in June 2019, the European Commission’s Sustainable Finance Plan and guidelines akin to the updated UK Stewardship Code 2020 will provide greater consensus and clarity around categorisation of appropriate funds and solutions for clients.

75% of RFP requests include at least one ESG question

2,515 PRI members

“As of Q3 2019, the proportion of targeted responsible investment solution RFPs has increased to 15%.”
Over the year, ASI has worked in collaboration with various investors on a range of topics. We provide more detail of two initiatives below.

**WDI**

We have continued our involvement in the Workforce Disclosure Initiative (WDI), an investor collaborative designed to help companies improve the standard of reporting on workforce metrics. As well as being signatories of the WDI since it was established, we are members of the WDI Advocate Group, which means that we have committed to engage with a number of companies to encourage their participation in the WDI survey. This year we have engaged with numerous companies, including St. James Place, Stagecoach, Go-ahead and Barratt Developments in this regard.

Additionally, we attended the first WDI annual conference earlier this year and subsequently a roundtable that brought together investors and companies to discuss the importance of workforce transparency. WDI is currently developing a performance score that measures participating companies’ labour practices based on the data they disclose. We have provided comments on the assessment framework, which will be adopted into the next iteration of the methodology design.

**Deforestation**

During 2019, deforestation was brought to the forefront of the global media as reports of fires in the Amazon once again highlighted the precarious state of our world’s rainforests. Deforestation and the associated impacts on biodiversity and climate change present systemic risks to our investment portfolios. By contrast, well-managed renewable forests can bring vital social, environmental and economic benefits; contributing to an efficient and sustainable financial market. As investors, we are uniquely placed to advocate harmonised policy responses and engage with companies to increase transparency. In Q3 2019, ASI signed the ‘Investor statement on deforestation and forest fires in the Amazon’, launched by the PRI. This demonstrates our commitment to putting pressure on companies to improve their actions and commitments towards eliminating deforestation from their operations and supply chain.

**Investors for Opioid Accountability**

We have continued our support and membership of the Investors for Opioid Accountability (IOA) coalition. The group is made up of 57 investors with around $4 trillion in assets under management. Since its inception in 2017, the group has continued its work to improve accountability within the pharmaceutical sector and to address the opioid epidemic and public health crisis in the US. The group has sought to engage with companies and has tabled 52 shareholder resolutions on the corporate governance requirements to fully address the opioid crisis. Of these, 26 were settled prior to the vote, 21 went to a vote and eight were not settled. The key areas of focus for the group are:

- independent chair of the board of directors
- board-level responsibility for opioid business risk oversight
- misconduct clawback policies including disclosure of the use of the clawback
- avoiding excluding legal costs related to opioids from incentive pay
- expanded reporting on corporate political and lobbying expenditures.

The group’s successes have included numerous companies committing to the creation of board-level committees dedicated to overseeing opioid sales and/or distribution, 12 companies issuing board risk reports and 10 companies adopting misconduct drawback policies.

In addition to working with the group, ASI also engaged separately with pharmaceutical companies and distributors on their approach to opioids. Although this issue has not received significant focus from European asset managers, it is an area that ASI has worked on for some time. The US Centre for Disease Control and Prevention estimated more than 47,000 deaths in the US from opioids in 2017. The social and economic effects of opioid misuse are staggering and ASI will continue to engage with companies to ensure that the appropriate steps are taken to meet the challenge.
Dams

Following the 2019 collapse of mining company Vale’s tailings dam, the Church of England and the Swedish Council of Ethics of the AP Funds founded the Investor Mining and Tailings Safety Initiative. It has been good to take part in this initiative, which seeks to address the potential risk of tailings dams. It brought the investor community together with mining companies and the International Council of Mining and Metals to improve safety levels. The initiative has led to calls for an international standard for tailings dams based upon the consequences of failure.

The group has also sought public disclosure from over 700 companies on ownership and safety levels of tailing dams. Response rates have been positive to date, with 73% of the industry by market capitalisation providing responses. However, a number of companies have failed to respond. In collaboration with other investors, ASI will seek to engage with these companies to encourage disclosure or offer an explanation as to why it is not necessary. This initiative has been an example of how the investment community can come together with industry to tackle an issue of such significance. We will continue to work with the group and commend the Church of England and the Swedish Council of Ethics of the AP for its creation.

“Deforestation and the associated impacts on biodiversity and climate change present systemic risks to our investment portfolios.”

57 investors*

$4 trillion assets under management*

*Investors for Opioid Accountability coalition
ESG trends across asset classes

We have seen the continued growth of ESG across asset classes. Here are some insights from our heads of research on the fixed income and equity desks.

Last year, we saw an acceleration in both client and market awareness of ESG and its importance in bond investing. During 2019, we witnessed a significant increase both in the number of investment products/solutions and ESG fixed income indices. This is primarily in response to increasing client interest. This shift in demand is driven from a multitude of different factors: many regulatory bodies that oversee large fixed income institutional investors (e.g. insurance, pension schemes) are increasing the need for these asset owners to be more aware of ESG risks in their portfolios; many investors are more informed on environmental or social risks and are looking for ethical/sustainable or thematic products to help them express their views via their bond investments. Investors are recognising that integrating ESG risk analysis into fixed income investment decisions should help support enhanced risk-adjusted returns over the longer term.

The fixed income ‘toolbox’ to support this trend is also expanding. Green bond issuance in 2019 was up nearly 60% versus 2018, already exceeding US$180 billion year-to-date at the time of writing. To help assess and rate these bonds, we have also seen more investment from the credit rating agencies (and, indeed, buy-side investors). Not only has this included new analytical approaches for their credit assessments, but also corporate investment to build out their databases and capabilities. In Europe, in September, we also saw a new type of bond issued – the Italian utility Enel issued four Sustainable Development Goals (SDG) bonds. The coupon of these instruments increases if environmental targets are not met. Elsewhere, we also saw growing discussion around the issuance of ‘transition’ bonds.

Finally – and some may argue most importantly – the significant shift of capital from public to private markets means that bond investors will likely play a more significant role in driving improved ESG practices. This is discussed in more detail in our recent publication: “Bondholders’ unique access to private companies and use of covenants gives them a pivotal role in the transition to a more sustainable economy.”

Outside of bonds, we have also seen an increasing growth of ESG across our equity desks. A common thread is the increase in ESG reporting among companies. In emerging markets (EM), there is increasing disclosure, although it still lags that in developed markets, with a noticeable gap between certain EM companies. Disclosure is an even more nascent consideration in frontier markets. Where companies have taken an active interest in ESG, we are beginning to see the disclosure of impact information. European ESG disclosure is in line with investor requirements and regulatory requirements – companies are disclosing much more on their ESG strategies and activities. With this comes increasing concern over ‘greenwashing’. Similar trends to Continental Europe are found in the UK, with the addition of more companies including ESG information in their financial results. Across all regions, companies have highlighted the issue of reporting fatigue and a lack of clear guidance on the vast amount of ESG metrics, ratings, and reporting standards, including which ones are favoured.

Additional factors we are experiencing are detailed below.

- **Collaboration** – industry groups/investors/asset owners are coming together to establish best practice in the wake of tragic events. These include collaborative work among investors on tailings dams and engagement on deforestation following the Amazon fires.

- **Sustainable finance regulation** – a real push from the EU for sustainable finance, driven by its sustainable finance action plan. This includes increasing requirements for companies to disclose non-financial and climate change risks; asset managers to assess ESG risks and opportunities for investments and portfolios; the development of a sustainable taxonomy defining clean and dirty industries/activities; and the integration of ESG risk management into the capital requirements for banks and insurers.

- **Climate change** – particularly relevant for many European companies given: the EU emissions trading systems (ETS) scheme and increasing carbon price; EU carbon emissions regulation for autos; and the introduction of a regional policy on aviation in France. Net-zero carbon emissions are seen as a market-leading ambition for Europe by 2050, with several companies targeting this date ahead of the Paris Agreement 2070 target.

In the coming years, we expect ESG considerations that were previously ignored to become more of a feature in company valuations and to form a clearer part of company strategies. This is a welcome step and marries with our investment philosophy of integrating ESG across all of our asset classes and investment considerations.
“Last year, we saw an acceleration in both client and market awareness of ESG and its importance in bond investing.”

60% increase in green bond issuance between 2018 and 2019
Results of the 2019 Global Real Estate Sustainability Benchmark’s (GRESB) real estate assessment were published in September. GRESB is the global ESG benchmark for real estate and infrastructure investments covering over $4.1 trillion of assets worldwide. It measures the ESG performance of funds, awarding ‘green stars’ to those reaching an absolute level of performance and a score out-of-five for performance relative to other participants.

We were awarded 33 ‘green stars’ for strong ESG performance across the real estate funds we manage. This is the highest number awarded to any participant this year and seven more than we achieved last year. Four of the funds we manage were awarded ‘five-star’ status, placing them in the top 20% of the GRESB universe. Additionally, three of our funds were placed at the top of their GRESB peer groups.

The ESG ‘impact dial’

GRESB is one important part of how we measure and benchmark the ESG performance of real estate portfolios. Recognising that ESG strategies should reflect the complexities and differences of real estate portfolios, we have recently launched a new ESG ‘impact dial’ tool. This allows our approach to ESG to be tailored to a fund’s specific requirements and characteristics. It also gives us the ability to engage with our clients on a wide range of specific ESG topics in relation to their portfolios and to calibrate our approach to their priorities and aspirations. ESG in real estate is a complex and diverse world. Our innovative approach means that one size no longer has to fit all.


The path to net-zero emissions

As members of the Better Building Partnership (BBP), we recently made a commitment to tackle climate change through the delivery of net-zero carbon real estate portfolios by 2050. The BBP Climate Change Commitment has also been signed by 22 other commercial real estate managers. In summary this will involve:

- publishing a pathway to achieve net-zero carbon emissions from our global portfolio by the end of 2020. This will cover new and existing buildings and address both operational and embodied emissions
- annual disclosure of energy performance and progress towards net-zero carbon emissions
- developing comprehensive climate resilience strategies for our portfolios by 2022.

The commitment is a statement of intent and leadership by BBP members. We don’t yet have all of the answers as to how net-zero emissions will be achieved across our portfolios, but this sets the direction of travel. We believe this is essential to ensure our portfolios are positioned well for the future and that they deliver long-term value for our clients.

Indeed, our Airport Industrial Property Unit Trust (AIPUT) has already committed to working towards carbon neutrality by 2025. AIPUT is a specialist owner and manager of industrial property on and near major UK airports. The occupier base includes airlines, cargo handlers, freight forwarders, airline catering and specialist airport-related services.

The current carbon footprint of AIPUT is comprised of emissions associated with energy consumption (both landlord and tenant), business travel and embodied carbon from new construction projects. In order to future-proof the portfolio, there is a commitment to reduce emissions from the portfolio and associated activity as much as possible over the next five years. An internal carbon price has been set and the resulting Carbon Innovation Fund will be reinvested in the portfolio to deliver further savings.
Key actions to date include significantly tightening the specification for new buildings and refurbishments, undertaking detailed embodied carbon assessments of development projects and establishing the feasibility for solar photovoltaic installations. Residual emissions in 2025 will be offset through ‘Gold Standard’ carbon credits and the journey towards achieving zero emissions from the portfolio will continue thereafter.

Outstanding building sustainability performance

Rounding off this year’s awards, we are happy to report that Hammarby Gård 13, a Swedish asset in the Aberdeen Property Nordic 1 Fund, has achieved an ‘Outstanding’ Building Research Establishment Environmental Assessment Method (BREEAM) In-Use rating. BREEAM is a global sustainability certification scheme that measures a wide range of topics – from operational energy efficiency to occupier health. The asset – a mixed-use building in the business district of Stockholm – boasts 100% LED lighting, district heating, cooling and electricity from local renewable sources, and very low water consumption. Hammarby Gård 13 is one of only six buildings globally this year to achieve a top rating.

As you can see, it has been a busy – but highly successful – year for our real estate team. We look forward to building on these achievements as we move into 2020 and beyond.

“We were awarded 33 ‘green stars’ for strong ESG performance across the real estate funds we manage.”

33
‘green stars’
from GRESB

2020
net-zero emissions from our global portfolio
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 Q4 2019

<table>
<thead>
<tr>
<th>Description</th>
<th>Total</th>
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<tbody>
<tr>
<td>Shareholder meetings at which our clients’ shares were voted</td>
<td>538</td>
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<tr>
<td>Percentage of meetings with at least one vote against or abstention</td>
<td>34.9%</td>
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<tr>
<td>Number of resolutions voted</td>
<td>3,840</td>
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<tr>
<td>Percentage of resolutions voted with management recommendations</td>
<td>90.3%</td>
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<tr>
<td>Percentage of resolutions voted against management recommendations</td>
<td>9.1%</td>
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<tr>
<td>Percentage of abstentions</td>
<td>0.5%</td>
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</table>

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 Q4 2019 (% of meetings where topic discussed)

<table>
<thead>
<tr>
<th>Topic</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Reporting</td>
<td>3.4%</td>
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<tr>
<td>Strategy</td>
<td>9.1%</td>
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<tr>
<td>Voting Issues</td>
<td>2.2%</td>
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<td>Human Rights</td>
<td>2.6%</td>
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<td>Business Conduct (inc. Bribery &amp; Corruption)</td>
<td>6.9%</td>
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<td>Labour Practices/Issues &amp; Human Capital</td>
<td>8.6%</td>
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<td>Audit</td>
<td>1.7%</td>
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<td>Diversity</td>
<td>3.9%</td>
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<td>Cyber Security</td>
<td>3.9%</td>
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<td>Culture</td>
<td>4.3%</td>
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<td>Social Issues</td>
<td>3.0%</td>
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<td>Remuneration</td>
<td>7.8%</td>
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<td>Risk/Risk Management Structure</td>
<td>6.0%</td>
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<td>Corporate Structure</td>
<td>1.7%</td>
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<td>Climate Change</td>
<td>12.1%</td>
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<tr>
<td>Environment</td>
<td>7.8%</td>
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Source: ASI, as at 31 December 2019
## Engagement summary Q4 2019

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Our voting is disclosed on our website each month

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
Boohoo

Peter Silver
ESG Analyst

Boohoo is an online value fashion retailer with a core target market of 16-30 year olds. The company offers women and men's clothing through its websites boohoo.com, prettylittlething.com and nastygal.com. It has also recently acquired the online offering of Karen Millen and Coast to appeal to a wider demographic and to extend the overall customer lifetime journey.

We have had continued engagement with the company, as it remains one of the core holdings within our UK Ethical and Impact funds. We also discussed the impacts of fast-fashion and the increasing environmental scrutiny in the wider sector.

We met with the management twice in six months. This included a repeat visit to its head office in Manchester, as well as a chance to see the new semi-automated distribution centre in Burnley, which is now live. This significant investment has provided much improved facilities for its employees and the more labour-intensive work had been replaced by automation. We have also been given more reassurance around the level of auditing within its Leicester factories, which had faced a significant amount of scrutiny following negative press reports. Boohoo has invited us to visit these factories in the new year and we look forward to seeing the operations.

Boohoo has also been working on improving its environmental impact. Although the company does operate as a fast-fashion business, it has put more focus into its textile recycling offering, with incentives for consumers in the form of shopping vouchers.

It has also developed a new sustainable range from secondhand clothes, which is being rolled out across all Boohoo brands. Finally, given Boohoo's significant reliance on social media to promote its ranges, it has implemented a marketing campaign to suggest new ways to wear its clothes. This has the intention of reducing the throwaway culture that has gained notoriety in the sector.

Finally, we learnt that the company has created a new head of sustainability role. It is also in the process of pulling together a wider sustainability strategy across a number of core areas. One key aspect will be end-to-end transparency of its supply chain, as well as improved monitoring and auditing processes. This is something we will continue to discuss with Boohoo as the strategy evolves.

We have been encouraged by the progress Boohoo has made during our continued engagement process. We believe that it will be rewarded in the long run by delivering on its aspirations of being a leader in sustainability. As active shareholders, we will continue to work closely with Boohoo to ensure it is able to provide more transparent reporting and mitigate the risks associated across the sector.

“We have had continued engagement with the company given its involvement in fast-fashion and the increasing environmental scrutiny in the wider sector.”
Fever-Tree is a premium tonic producer. It has disrupted the soft drinks market over the past decade to become the leading brand in premium mixers internationally. The company is held in both our UK Ethical Fund and UK Employment Opportunities Impact Fund. Clients have queried the company’s inclusion, due to a poor ESG rating by external data providers. However, this appeared to be due to lack of disclosure, so we arranged a meeting with the company to talk through its approach to sustainability in more detail.

One of the main risks faced by Fever-Tree is its sourcing of key ingredients from countries deemed high risk. These include the Democratic Republic of Congo, where it sources quinine, and the Ivory Coast, a source of ginger. We learned about the company’s focus on ‘Sourcing with Integrity’. It is committed to continuing to source from these regions due to the strength of the relationships which, in turn, have improved the level of audit and led to higher standards. We also discussed supplier contracts, and whether each had specific social and ethical clauses factored in, such as working conditions, health & safety, environmental impact, and anti-bribery and corruption. Fever-Tree is also a member of SEDEX, which provides additional third-party oversight of its suppliers. The company also hopes to become signatories to both the Ethical Trading Initiative and the International Labour Organisation, given that current company practices are already in alignment.

With regards to Fever-Tree’s wider environmental impact, being a global producer and distributor means this is a significant risk to the business if not actively managed. Respecting the environment has been engrained since the company was founded, with the choice of glass, rather than plastic, bottling. The next focus will be around monitoring its carbon footprint, and Fever-Tree is undertaking a project to map both Scope 1 &2, as well as Scope 3 emissions. We also learned that its supply chain contracts are being updated to ensure alignment with the company’s wider plan to reduce carbon emissions. Additionally, we discussed water stress risks, particularly in the US given the expansion and growth in this region, and how these were being managed.

We also discussed Fever-Tree’s approach to labour management. Its workforce is still relatively small (c. 150 people) with the majority based in its London office, with an increasing presence in the US. An entrepreneurial culture rings throughout the business and we were advised that through hard work, anyone is able to progress up the ladder, with a wide range of opportunities around the world. Fever-Tree has created a new head of talent role, to provide a more strategic vision for its staff, with a focus on internal development, improved communications, and will look towards greater graduate recruitment. Staff retention remains high and a number of people working for the company have been with it since it was founded.

Overall, we were comfortable with the measures adopted by Fever-Tree to mitigate some of the more material risks. At this stage, the company is still looking for the most effective way to disclose more information around its approach to sustainability. However, it is clear that a lot of positive work is being carried out behind the scenes. We look forward to seeing greater disclosure at the next reporting period and, as an active shareholder, we will work closely with Fever-Tree to improve upon this going forward.

“One of the main risks faced by Fever-Tree is its sourcing of key ingredients.”
Airbus is a multinational company that designs, produces and delivers innovative solutions for commercial aircraft, helicopter, space and defence sectors.

Following our first ESG engagement with the company last year, a meeting with the vice president of air transport & environmental affairs marked our second ESG-specific engagement with Airbus. We wanted to follow up on the management change and cultural evolution that has been taking place in the group since our last meeting. We also wanted to discuss its controls to prevent bribery & corruption worldwide, and, on an increasingly material topic, its strategy and approach to decarbonising the aviation sector.

From a management and cultural perspective, it appears that real change is happening. Led by the new CEO, Airbus is demonstrating an increased focus on ESG topics as part of its core business strategy. Specific areas on which it is concentrating include ethics & compliance, product safety, supply-chain management and due diligence – the last of which we had encouraged greater oversight during last year’s meeting. We also wanted to discuss its controls to prevent bribery & corruption worldwide, and, on an increasingly material topic, its strategy and approach to decarbonising the aviation sector.

While it is still early days for the aviation sector with regards to decarbonisation, we are comfortable that Airbus has a strong understanding of the importance of this topic and how it will affect its business. Management clearly recognises the potential long-term risk to consumer demand for air transport if the carbon intensity of air travel is not addressed. We will remain engaged to ensure that ambitious Paris Agreement-aligned targets are set.

"While it is still early days for the aviation sector with regards to decarbonisation, we are comfortable that Airbus has a strong understanding of the importance of this topic and how it will affect its business."
SAP is Europe’s leading tech company in enterprise resource planning (ERP). Its software integrates back-office functions, and can be applied on-premises and in cloud-linked forms. SAP launched its cloud-based HANA database technology in 2010, which put it firmly in competition with Oracle. However, the complexities involved in transferring to a cloud-based approach have slowed the uptake, as customers have generally been satisfied with their existing on-premises ERP software solutions.

The founders of SAP (the Plattner, Hopp and Tschira families) together own 15.4% of the shares. SAP is governed by the German two-tier board structure, consisting of the supervisory board and management board. The former appoints, supervises and advises the latter. In the past couple of years, the company has improved board independence and increased diversity. Board terms in Germany are five years, which we think is a long time. The new German governance code recommended an appointment of three years. However, due to some opposition during the consultation, the government commission has decided to remove the recommendation. Nonetheless, we are engaging with the company to see if it will consider the three-year model. A lot of change has happened this year, with new employee reps elected and shareholder reps having seen a decrease in tenure. With all this change, the company is taking the three years tenure on board. This means long-standing and new directors will be on a three-year term, with those in the middle on five years. The audit committee also has a new chairperson.

The next significant governance event will be chairperson succession. Hasso Plattner, the current chair and one of the founders, has announced that this will be his last three-year term. The company will communicate its succession intentions a year before Plattner steps down. It is likely that a successor will come from the software industry. We believe it would be good for the next chair to be independent.

The CEO, Bill McDermott, announced his departure in October this year, after nearly 10 years as head. He has been replaced by two co-chief executives, Jennifer Morgan and Christian Klein. This arrangement has been used on a number of occasions since the company was founded. Indeed, the initial founders were co-chief execs. SAP believes this arrangement is helpful, given the global scale of its operations. While we are comfortable with the arrangement, we will closely monitor to see if it works as intended.

SAP has not disclosed an official tax policy. We encouraged it to do so and shared some examples of good disclosure. We are also engaging on the company’s remuneration policy, and have conveyed our views on annual bonus payments, performance targets and inclusion of non-financial targets.

We will continue to engage with SAP and are encouraged by the positive steps it has taken, especially its willingness to continue to adapt good governance practices.

“In the past couple of years, the company has improved board independence and increased diversity.”
DP World

Petra Daroczi
Investment Analyst - ESG, Fixed Income

DP World is an operator of ports and marine terminals. Headquartered in Dubai, its global footprint of assets consists of 78 locations across 40 countries, ranging from the west coast of the US through Africa to emerging Asia.

It was the first time we sought to engage with the issuer on ESG matters. Our concerns related to strategy and geographical exposure. DP World outlined an ambitious expansion plan focusing on growing cargo handling capacity, acquiring new customer segments in underserved markets, and investing in new digital opportunities, while improving the safety record for its roughly 45,000 employees. Translating this into 'ESG language', we questioned the company on key risks such as the environmental impact of the expansion, anti-bribery procedures in highly-exposed countries, cybersecurity of the new digital strategy, and worker health & safety given the heavy workload and machinery that is characteristic in port operations.

On the environmental front, the company has taken positive steps, such as using solar power in buildings, leading to cost reduction and energy-efficiency. It has begun to replace diesel-fuelled cars with electric and hybrid vehicles. We encouraged the company to collect and disclose data on the cost savings, as well as on its Scope 1 & 2 emissions.

DP World acknowledged that certain geographical areas present a challenge for bribery. The company has established processes to mitigate this risk, such as implementing an escalation and independent whistleblowing mechanism. It also employs consultancy or legal firms instead of local agents when bidding for new concessions. Additionally, it aims to partner with multilateral institutions such as the IFC (International Finance Corporation) in geographies that are prone to corruption. We welcomed the company's response that anti-bribery and corruption policies can slow down the 'go-to-market' strategy.

On cybersecurity, it sees cyber threats as a future issue, and is currently focusing on integrating the many different IT systems into a cloud solution. As the business evolves, we would like to see that the company adds relevant expertise in this area at board level.

The culture of health & safety stems from the top: the company explained that the CEO "did not want to lose a single person" to work-related accidents. The target is to have zero fatalities, which the company admits is an ambitious goal. While automation can be beneficial in developed markets to reduce injury and accident rates, this remains a challenge in developing markets as automation is less cost beneficial due to low labour costs. We welcomed the fact that employees and contractors undergo the same training for health & safety. We asked the company to be more granular when disclosing health & safety metrics and accident severity for employees and contractors.

As a result of the engagement, we determined that the company is on a positive ESG journey. We will continue to monitor its expansion strategy in high-risk countries and its trend for cost benefits from more efficient energy use, as well as for improved worker health & safety.

“The culture of health & safety stems from the top: the company explained that the CEO “did not want to lose a single person” to work-related accidents.”
Israel Electric Corporation

Petra Daroczi
Investment Analyst - ESG, Fixed Income

The Israel Electric Corporation (IE) is a state-owned energy company involved in electricity generation, transmission, and distribution to residential and industrial users in Israel. It currently operates 10 coal-fired power plants, and imports all of its coal supplies from South Africa, Colombia, and Russia. In 2018, the share of coal and gas in its electricity generation stood at 43% and 56.5% respectively. IE has an ambitious low-carbon transition plan, which has been influenced by:

• regulation (the introduction of the “Clean Air Law” in 2016 for reducing air pollution)
• the availability of alternative and cleaner fuel sources (Israel possesses abundant gas reserves)
• the national agenda (as a signatory to the Paris Agreement, Israel targets zero coal usage in electricity generation by 2025).

It was the first time we engaged with the company on ESG matters. Our objective was to understand the specific milestones and the cost and capital expenditure implications of the transition plan. We also sought to understand the role of renewable energy sources in its future business strategy.

In order to meet stringent pollution standards, IE has been retrofitting its coal plants with emission reduction technologies such as sulphur scrubbers. It has spent approximately $1.7 billion on such technology to date. Its target is to have all units retrofitted by 2020.

As a way to reduce its coal use, it will mothball and convert existing coal-fired plants. Mothballing refers to a temporary shutdown or hibernation of existing plants that are no longer in continuous operational use. IE aims to mothball four coal-fired units by 2022, and either convert the remaining six units from coal to natural gas by 2025 or mothball them by 2030. We wanted to understand if there are potential cost or supply availability issues that could derail the switch from coal to gas. IE outlined that natural gas would be supplied by three domestic gas reservoirs.

The company has a long-term development plan that addresses the use of renewable energy. It set a target to produce 10% of total electricity from renewables by 2020. It has also disclosed the budget it has invested in the grid infrastructure to be able to handle new sources of power generation. The government’s national target is to have 25-30% of electricity supplied by renewable energy by 2030.

Overall, we were satisfied with Israel Electric’s commitments to reduce its coal exposure and the viability of its low-carbon energy transition plans. We will continue to monitor the milestones and targets the company has set over the coming years.

“Overall, we were satisfied with Israel Electric’s commitments to reduce its coal exposure and the viability of its low-carbon energy transition plans.”
Kerry Logistics Network Limited

David Smith
Head of Corporate Governance, Asian Equities

Kerry Logistics is one of the largest third-party logistics (3PL) companies in Asia and Greater China, based in Hong Kong. It operates across two primary businesses – Integrated Logistics Operations and International Freight Forwarding. The company also owns and operates a portfolio of warehouses in Hong Kong.

Given the carbon intensity and environmental impact of the company’s business, we wanted to discuss in more detail its approach to sustainability. While we have discussed these issues with the company in the past, we wanted to spend more time with senior management to more fully understand their processes and practices, as well as their views on disclosure.

We spent time discussing the company’s governance of sustainability issues, and the ways in which the strategy and oversight of these topics is developed. It was evident to us that the company has a well-defined and clearly articulated structure around these issues, with oversight by various board committees, combined with operational leadership and implementation by management teams. Given the involvement of the managing director, we were comforted that these issues were being discussed at senior levels.

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We also spoke about Kerry’s approach to sustainability as part of its merger and acquisition process, and notably the integration process, and it was reassuring that it is a focus for the company as it integrates the businesses it acquires.

Given the carbon intensity of the logistics industry, strategies for carbon intensity reduction was a core part of our discussion. While the company’s disclosure on these issues is modest, it was very useful to hear about its areas of focus – the company has trialed the use of electric vehicles, has deployed a number of hybrid trucks, and has a clear focus on energy efficiency in company operations. On the last point, Kerry has focused on procuring energy efficiency equipment, including LED lamps, and these initiatives have contributed to the reduction in Scope 2 emissions that the company reports. We were similarly encouraged by the fact that the company is focusing on Leadership in Energy and Environmental Design (LEED) certification (two new logistics facilities in Hong Kong and Singapore have LEED Gold recognition), and we encouraged the company to continue to focus on the environmental impact and energy efficiency of properties, including existing properties.

However, while we were heartened to hear the company’s views on these issues, we also encouraged it to disclose more information so as to better communicate its initiatives to investors. The company is making very good progress on sustainability issues, and operates in a high impact industry. Investors are asking, and will increasingly ask, questions around not just performance but also targets and strategies for achieving targets, and these are areas where we feel the company could further enhance disclosure. As is common with engagements of this nature, our discussion with the company was very constructive, and we were very keen to stress our role as supportive and engaged owners. We agreed to continue the dialogue.

“The company has trialled the use of electric vehicles, has deployed a number of hybrid trucks, and has a clear focus on energy efficiency in company operations.”

Company is chosen for illustrative purposes only to demonstrate our ESG Investment process and is not intended to be an indication of performance, investment recommendation or solicitation.
Linx

Fraser Harle
ESG Investment Analyst

Linx has evolved from a company selling point-of-sale software for physical stores to an end-to-end platform enabling e-commerce, omni-channel and payments capabilities. Fostering an entrepreneurial culture, the company has grown a notable presence in the Brazilian market. A 2019 International Data Corporation survey places its market share in retail management software (enterprise-resource-planning + point-of-sale) at around 41%, nearly three times larger than its closest competitor.

As is common globally with technology companies, corporate governance practices can at times lag behind similar-sized peers in different sectors. Shareholder guidance plays an important role in the transition required from disruptor towards incumbency.

Our engagement with Linx covered ESG and traditional risk management, alongside corporate governance practice. Our aim was to gain an understanding of how formalised its processes are and the future direction of travel.

The company has adopted a centralised approach to risk management. The internal auditing department undertakes oversight, reporting in turn to the board of directors. Upcoming changes to this structure are slated for 2020, with the segregation of duties to a distinct ‘Internal Control’ department. This development points to an entrenchment of a robust risk framework at Linx, and is a positive development.

Linx factors principal environmental and social (E&S) considerations into the company’s strategic business risks. This highlights a maturity in E&S consideration and, as such, we are not concerned about the company’s practices. A third-party performs data-security audits on a weekly basis, while the company has a stringent due-diligence process in place for all external cloud-based services. Linx’s comparatively attractive brand in Brazil helps to spur recruitment and drives its low circa 9% employee turnover figure. Management fosters a strong corporate culture, typified by the CEO, who has spent his whole career at Linx.

We do, however, feel there are shortcomings in the company’s corporate governance practices. On the Board, and throughout the various committee-strata, the presence of executives erodes the independence of management oversight. We view change here as a vital catalyst for governance enhancement.

Alongside structural governance shortcomings, communication on changes to remuneration has been suboptimal. This makes it difficult for the market to make an accurate assessment on whether remuneration packages are deserved and if changes are aligned with shareholder wealth creation. This opacity on remuneration has resulted in significant votes against proposals at shareholder meetings. However, communication in recent times has improved.

Subsequent to our meeting, we have written to the company requesting improved independence on the board, alongside increased disclosure and engagement with third-parties. We believe these augmentations would provide tangible mutual benefits by improving the perception of governance. Linx welcomed our views.

Linx has made marked improvements from its entrepreneurial beginnings, and is in the process of strengthening its ESG credentials further. We have confidence in the ongoing potential of the business and will continue to push for positive change on corporate governance.

“We have confidence in the ongoing potential of the business and will continue to push for positive change on corporate governance.”
Kaiser Aluminum

Nick Duncan
Senior Manager - Stewardship

Kaiser Aluminum is an American aluminium producer. Legendary American industrialist, Henry J Kaiser, founded the company in 1946 with the lease and eventual purchase of three aluminium facilities from the US government. By way of background, the company emerged from bankruptcy in 2006 with the United Steelworkers Union (USW) one of its largest creditors. The company has had issues with asbestos, debt, and retiree medical and pension liabilities.

ASI had a call with Jack Hokema, chairman & CEO, to discuss the recent changes in its corporate governance. We were keen to better understand the current composition of its board, especially the influence that the USW had on board appointments. Part of Kaiser’s negotiated bankruptcy in 2006 was that the USW can designate 40% of the board directors, providing they are not current USW members or directors. Our concern is that the USW designated directors may not be the most qualified or best suited for the position. However, the company was quick to point out that the USW nominated directors have all been highly qualified and have contributed greatly to board proceedings. The company is now also able to vet any of the candidates before they are appointed to the board, thereby improving oversight of the USW candidates. To ensure effective succession planning, the nominations committee liaises with the USW to ensure the board composition and directors’ skillsets are in line with the company’s strategic direction.

We were also keen to understand the succession plans for when the current chairman & CEO retires from the board in three years. The company explained that Keith Harvey, the current COO, has been primed to take over the CEO position. In preparation, Harvey has effectively been running the company for the last few years. It looks almost certain that the company will also split the CEO/chair roles in future, with the new chair likely to appointed from the current board line-up. We believe that splitting the roles of the CEO and chair is best from a corporate governance perspective as it does not concentrate too much power and influence in one person.

Unfortunately, Kaiser still maintains a classified board system, so non-executive directors are not re-elected annually. We believe that all directors should face annual re-election, as having a classified board system can entrench management. It can also deny shareholders the ability to enforce change. According to the company, this board system came from the creditor committee during the previous bankruptcy proceedings. We encouraged the company to reconsider this structure; however, this is unlikely to happen in the near term.

The company is cognisant of the benefits of diversity. It has three female board members and 40% of the board comprises minorities. Diversity is encouraged throughout the organisation. However, the company did acknowledge the difficulty of appointing women into some of the operational roles, due to the nature of some of the work.

“We believe that splitting the roles of the CEO and chair is best from a corporate governance perspective as it does not concentrate too much power and influence in one person.”
Verizon Communications is an integrated telecommunications company. It provides wire line voice and data services, wireless services, internet services and published directory information. The driver for our meeting was to gain an understanding of its employee engagement and how its Verizon 2.0 strategy is evolving. We questioned the group on the diversity of its board and how it oversees its ESG approach. Verizon highlighted that 30% of its board is currently female. It also explained that its Verizon 2.0 strategy included an ESG focus, which the board oversees. Its ESG strategy focuses on being:

• transformative – issues that could significantly change the impact of the business
• strategic – issues that represent risk or opportunity to the business
• fundamental – issues managed as part of its responsible business practice.

Within the strategy, the company focuses on SDG 4 (providing young people with relevant technology skills). To date, it has reached 1.7 million students through its Verizon Innovation programme. It also aligns with SDG 8 (reducing environmental impacts). From 2016 to 2017, Verizon achieved a 28% reduction in its carbon intensity.

We are supportive of the company’s Verizon 2.0 strategy and its commitment to ESG goals and targets. We have encouraged the group to be more explicit on how ESG strategic aims link to remuneration.

The group’s labour practices have received negative attention, including press allegations that it took part in ‘union busting’. From 2016 to 2017, Verizon achieved a 28% reduction in its carbon intensity. The sector is subject to an increasing regulatory curve in relation to the use of data and data privacy. The group provides detailed disclosure on the number of data requests it receives from different governments in its global operations - a step we welcome. It also appears to be well positioned to manage emerging regulation; in particular, the California Consumer Privacy law, which aims to improve the privacy rights and protection of California residents. This should also position the company favourably if similar federal legislation develops in the US. We questioned what cyber security challenges the company faces. It advised that as its 5G wireless network expands it may be open to new cyber security threats. However, the group appears to have a robust approach to this risk, including extensive training for employees.

This was a positive meeting with Verizon. In addition to these previous points, we have also asked the company about its environmental targets. We will reassess the company at a later date to measure progress on the areas raised.

“From 2016 to 2017, Verizon achieved a 28% reduction in its carbon intensity.”
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