Aberdeen Standard Investments

Standard Life Investments Ethical Funds

2018 Annual Review

Contents

Foreword	03
Introduction	04
Thematic work	06
Engagement and voting	16
Collaborative engagements and events	20
Standard Life Investments (SLI) Ethical Funds Advisory Group and the ESG Investment Team	21

Foreword

Over the past six years, I have had the pleasure of chairing the Standard Life Investments (SLI) Ethical Funds Advisory Group. The time has come, though, to hand over the reins. I am pleased to announce that Barry O'Dwyer, who leads our UK business, will be taking over the role.

Colin Walkin
Chair of the Ethical Funds Advisory Group

"Ultimately, we seek to generate a good financial return for our investors in an ethical way. It is pleasing to see that our range of SLI UK ethical strategies remains popular with investors."

The SLI Ethical Funds Advisory Group brings together the investment management specialists responsible for running our ethical funds with our client-facing teams. Importantly, the Group also receives input and advice from three external advisors. Not only are they investors in the ethical funds, but they are also recognised experts in areas such as alternative energy, environmental pollution, ethical agriculture and dispute resolution.

I was persuaded to take on the role with a simple pitch: "this will make you look really cool to your children". That's as may be – but, I'm glad to say, that the role has been so much more. It has increased my understanding and appreciation of so many important subjects, from climate change and oil seed production, to standards of corporate governance in major companies. Over the years, I have also become fascinated by the juxtaposition of commercially driven investment decisions alongside huge ethical issues that affect the whole planet.

The Group conducts an annual survey to gauge our investors' opinions and priorities about ethical investing. It is interesting to see how ethical priorities have shifted over time. While areas like animal testing remain a high priority, other issues, such as the fair treatment of workers – in both the emerging and developed world – have gained ground. This is recognition that if a company cannot be trusted to treat its own employees well, then it can hardly be expected to respect the environment and the creatures that live within it.

Ultimately, we seek to generate a good financial return for our investors in an ethical way. It is pleasing to see that our range of SLI UK ethical strategies remains popular with investors. Net inflows into the funds are rising. This is in marked contrast to other areas of the investment management industry, which are experiencing structural outflows from traditional asset classes.

There is a lot of talk in the industry about the 'bifurcation of risk'. Investors are deserting traditional asset classes in favour of low-cost 'tracker'-type products and/or high-yielding 'alternatives'. The question is: where does this leave ethical investments?

In my view, there is another dynamic at work alongside the 'bifurcation of risk'. This lies in the changing demographic profile of investors and how they invest. In the past, individuals would entrust their financial decisions to investment professionals. Today, thanks to the rise of defined contribution pensions, peripatetic working styles and new technologies, people are increasingly making their own investment decisions. As issues like global warming and the unscrupulous exploitation of the world's natural resources become ever more apparent, I believe these new, younger investors will seek to invest a proportion of their long-term savings into ethical funds.

I think the future of ethical investment is bright – and it will only get brighter in the years to come. I have certainly moved on from trying to impress my children (generally a lost cause anyway), and become a strong supporter and advocate of this part of the investment industry. This will not change – and I will eagerly watch Barry as he makes the role his own.

Introduction

Welcome to the 2018 annual review of Standard Life Investments' ethical funds. We have been running ethical funds for over two decades. This year, we celebrated 20 years of the SLI UK Ethical Fund. Through our funds, we seek to consider our clients' ethical values, while also offering the potential to earn a competitive return. The Ethical Funds Advisory Group govern the ethical criteria. The Group meets twice a year and provides external oversight to the ethical investment criteria.

We recognise the subjective nature of personal ethics. As such, we aim to be as transparent as possible about our ethical investment process. In this review, we highlight:

- **all our activities relating to the ethical funds**
- **the results of our annual survey of investors**
- **our engagements with companies held in the ethical funds.**

Annual ethical survey results and policy changes

We want our ethical funds to reflect our clients' concerns and principles. To this end, we conduct an annual survey of clients to gather their views on which ethical considerations are most important to them.

The latest survey revealed that the top areas of concern for investors remain environmental issues and human rights abuses. Many of the queries received from investors related to fossil fuels. Investors and advisors were supportive of introducing an exclusion of oil & gas exploration and production companies. However, they were less supportive of excluding companies that serve this industry.

In 2018, we amended the Ethical Policy to exclude oil & gas exploration and production companies. We have also introduced a threshold of business activity involved in refining, extraction, distribution and pipelines to capture those companies that might fall outside sector exclusions. The screens do not formally capture the oil & gas services sector. There was no impact on current portfolio holdings as a result of the policy change. Many of these companies were already excluded under other criteria, such as climate change, environmental degradation and animal testing. We have also continued to measure the carbon footprint of the ethical funds, which we will present later in this report. Climate change is an important area of concern and we engage with all companies on how they manage this risk.

“Through our funds, we seek to consider our clients’ ethical values, while also offering the potential to earn a competitive return.”

Thematic work

During the year, the Ethical Funds Advisory Group discussed a number of our research papers. These included reports on climate change, plastics, labour practices, and artificial intelligence.

Climate change

Aberdeen Standard Investments' approach

Climate change risks and opportunities have a material impact on economies and the companies in which we invest. This includes the physical impacts of more extreme weather events. This also includes risks and opportunities in relation to the energy transition to a low-carbon economy. Our ESG research team has dedicated resources to look at climate change for all our investments.

We regularly produce research on climate change to provide quality insights and support investment decision-making.

We strongly support the recommendations of the Taskforce for Climate-related Financial Disclosures (TCFD), published in 2017. The TCFD provides a global framework for consistent company disclosures on the financial implications of climate change risks.

We believe the recommendations will improve the quality, comparability and usefulness of climate change disclosures. As a company, we have committed to reporting in line with TCFD. This will demonstrate how climate change analysis informs our approach to strategy, governance and risk management.

We engage with investee companies to understand how we manage climate-related risk and opportunities and to communicate our expectations. We think companies should apply the TCFD recommendations to their climate data reporting. This will help them to provide transparency on material climate-change risks and opportunities, as well as their potential financial impact.

We focus on six areas within our climate change approach.

Area of Focus	Objective
Research & Data	Provide high-quality climate change insights and thematic research across asset classes and regions at macro and micro level. We also collaborate with others within the business on this topic. Use climate-related data as input into the investment process. For example, carbon emissions, portfolio footprint, two-degree scenario analysis. We do so by using market leading data sources and methodologies.
Investment Integration	Understand current and emerging climate change risks and opportunities – and their potential financial impacts across regions and sectors. Integrate material physical and transition risks and opportunities into our investment decision-making, and understand the implications for our portfolios.
Client Solutions	Understand client needs in relation to climate change and low-carbon product demand. Develop innovative climate-related client solutions and products across all asset classes. This includes, equity, fixed income, real estate and private markets. Consider climate factors in a variety of solutions e.g. screening, impact, best-in-class.
Investee Engagement & Voting	Engage with investee companies on climate risks, climate solutions and scenario analysis. We also look to apply the TCFD framework when reporting on climate-related data. Influence via engagement (in-house and collaborative) and voting. Consider investment implications if there is limited progress in response to engagement.
Collaboration & Influence	Collaborate with industry associations and initiatives such as PRI, Climate Action 100+, TPI, IIGCC and CDP. Engage with peers and policymakers to drive industry developments and best practice. Influence through thought leadership and innovative solutions.
Disclosure	Disclose climate-change-related data using the TCFD reporting framework across the four pillars: governance, strategy, risk management, metrics and targets

“We regularly produce research on climate change to provide quality insights and support investment decision-making.”

Carbon footprinting

One of our primary areas of focus is carbon footprinting. In our view, it is a good starting point for understanding the impact portfolios can have on carbon emissions compared with the benchmark and other portfolios. It provides a baseline against which to measure companies. Carbon footprinting can also identify sectors and companies that are outliers and which could contribute significantly to the portfolio footprint.

However, carbon footprinting is a backward-looking measure. It does not provide a full picture of the company's contribution to the energy transition. A company involved in the production of clean energy technologies may have high carbon emissions themselves, but the products they make will contribute to a reduction in emissions. Alternatively, company emissions may be low, but the end products generate high emissions. The automotive industry is a good example. It is therefore important to understand the impact of emissions along the company's whole value chain.

Carbon emissions are categorised in the table below.

Scope 1	Direct emissions from sources owned/controlled by the reporting entity (generally reported by the company)
Scope 2	Indirect emissions from the consumption of purchased energy, such as electricity and heat (generally reported by the company)
Scope 3	Indirect emissions (not part of Scope 2) that occur in the value chain of the reporting company – upstream in the supply chain and downstream during the lifecycle of their products & services. This is more challenging to obtain and is often estimated using models that are still quite immature

We include Scope 1 and 2 emissions for portfolio level analysis. We consider Scope 3 emissions at company level. This provides us with a better understanding of a company's full impact through its value chain. It also shows how it compares with its peers.

Carbon footprinting results for Standard Life Investments' ethical funds

Based on Scope 1 and 2 emissions, we conducted carbon footprinting analysis for our three SLI ethical funds. The summary results are in the table below. All funds were significantly more carbon efficient (i.e. had a lower carbon intensity) than their benchmarks. The carbon data available covers over 95% of the equity funds, but the coverage for the corporate bond fund is only 60%.

		Carbon Intensity (tCO2e/mn revenue)			
Fund	Fund Data Coverage	Portfolio	Benchmark	Absolute Difference	Portfolio relative to BM
SLI UK Ethical Fund	95%	98.6	226.3	-127.7	44%
SLI Europe Ethical Fund	100%	142.9	297.2	-154.3	48%
SLI Ethical Corp Bond Fund	60%	159	296	-137	54%
Emissions included: Scope 1 & 2					

Source: Aberdeen Standard Investments and Trucost, 2018

"A company involved in the production of clean energy technologies may have high carbon emissions themselves, but the products they make will contribute to a reduction in emissions."

Plastics

The problem

Plastics are harming life on earth. Eight million tonnes enter the ocean each year and plastics may outweigh fish by 2050. Smaller pieces can be even more harmful, as they are easy to consume and are almost impossible to clean up. The health impacts of plastic pollution on humans are not fully known. A recent world-first pilot study[1] examined stool samples of eight people from around the world. It found that every sample contained micro plastics. This is hardly surprising when scientists have found plastic in a variety of foods ranging from fish, to shellfish, honey, and tap water.

What is changing?

The plastic problem was most famously brought to light by David Attenborough's *Blue Planet II*, which featured an episode on ocean plastics in October 2017. In January 2018, the Chinese government banned foreign waste imports. This was followed by other countries and soon drew attention to the sheer volume of plastics created in industrialised countries.

This led to increased pressure on governments and companies to act on single-use plastics. As a result, there has been a wave of regulations, policies, consultations and targets designed to reduce plastic use and increase plastic recycling. The most material government action is the European Parliament's Strategy on Plastics in the Circular Economy. In October 2018, the parliament approved a proposal to ban 10 single-use plastic items and certain other types of plastics, among other measures[2].

Governments are also applying or considering taxes to tackle the issue. The recent UK budget included a proposal to tax plastic packaging with less than 30% recycled content by 2022.

Our approach

Our research found an increase in the scientific evidence relating to the harmful effects of plastics. There is also a rapid rise in government and industry action on single-use plastics. We anticipated that, in certain industries, the demand for plastics would continue. We identified sectors at risk, while highlighting those with clear opportunities. We also explored the risks of the unintended consequences that could result from a move away from plastics. These included worse environmental outcomes, green-washing, black markets, and health risks.

As part of our research, we spoke to a dozen companies and industry experts. The goal was to increase our understanding of the problem and discover industry best practice. We also sought to identify what the companies considered to be the risks and opportunities in plastics.

Company insights

During our engagement, we found that not all plastics are targeted the same way. Construction and automobiles are not facing government or consumer pressure to move away from plastics. In these industries, plastics can contribute to more affordable homes and lighter cars. These plastics have been in use for decades, so the impact of disposal is not a high concern.

Meanwhile, microfibre pollution from washing polyester fabrics doesn't appear to be on the radar of regulations. However, the problem of microfibres being released into the environment persists.

Alternatives to traditional plastics are growing, but they still cost too much. These include bio-based plastics and biodegradable or compostable plastics. Many companies highlighted the problem of limited composting facilities to process biodegradable plastics. They also cited contamination issues.

The challenge is that traditional plastics are an incredibly efficient, low cost way to protect products and preserve food. Customers are also not willing to pay more for alternatives.

Consumer companies seem more focused on improving the current recycling paradigm through product recyclability and reusability, rather than pursuing biodegradable or compostable alternatives. Businesses also highlighted their efforts to move towards circular economic systems, to increase the value of products at the end-of-life, and partnerships with waste management organisations to 'close the loop'. Companies identified a worldwide shortage of food-grade recycled materials as a key risk in their supply chain.

It is clear that solutions need to involve all players – governments, companies, and consumers. With customers unwilling to pay more, many companies highlighted the difficulties of making changes to plastics without governments levelling the playing field. This could occur through penalties, incentives or other regulations.

According to most companies, addressing plastic pollution requires improved waste management. This is a challenge for global companies, as waste is usually regulated and managed at a regional or municipality level. Government action to incentivise recycling and reduce littering seems to vary in cost and structure. Companies argued that regulations need to be more standardised across and within countries.

Conclusion

Most companies we interviewed said the biggest misconception about plastics was that they were all bad. This is not a surprise given that our initial research highlighted the value of plastics across almost all applications. In our view, the challenge for companies is to:

- identify and eliminate unnecessary uses
- educate consumers
- take responsibility for ensuring they don't leak their products into the environment.

Our annual client survey revealed investors are concerned about plastics. We have shared the findings of our research and engagements with our investment teams and with the Ethical Funds Advisory Group. The goal of which is to improve understanding, while informing future engagements and investment decisions. The issue will be ongoing, and we will continue to monitor advancements and report our findings.

[1]Study conducted by Philipp Schwabl and presented at the 2018 United European Gastroenterology conference. Reported by Douglas Quenqua, "Microplastics Find Their Way Into Your Gut, a Pilot Study Finds", The New York Times, https://www.nytimes.com/2018/10/22/health/microplastics-human-stool.html
[2]For more information see: http://www.europarl.europa.eu/news/en/press-room/20181018IPR16524/plastic-oceans-meps-back-eu-ban-on-throwaway-plastics-by-2021.

"The challenge is that traditional plastics are an incredibly efficient, low cost way to protect products and preserve food. Despite companies having alternatives ready to go, many of which are scalable, customers and consumers are not always willing to pay more."

Garment supply chains

Background

In April 2013, 1,134 people were killed and 2,500 injured in the collapse of the eight-storey Rana Plaza building in Bangladesh. The building had housed garment factories producing clothes for international brands. Unsafe buildings resulting in accidents were common in Bangladesh and other garment manufacturing countries. However, Rana Plaza was unprecedented in its scale. It became a wake-up call to companies and consumers about working conditions in garment supply chains.

The incident led to the foundation of both the Accord on Fire and Building Safety in Bangladesh, and the Alliance for Bangladesh Worker Safety. The Accord was a five-year legally binding agreement between the global unions IndustriALL and UNI, eight Bangladeshi unions and global fashion brands. It focused on providing independent inspections of factories and bringing together existing audit frameworks.

What has changed in Bangladesh?

The five-year anniversary of the disaster marks the end of the original Accord. By some measures, it has been a success. By 2018, the Accord covered 220 brands and 1,600 factories. More than 600 factories had completed 90% of the renovations required. In early 2018, unions reached a landmark $2.3 million settlement with a multinational brand after claiming the company had not addressed the issues identified in the inspections of 150 factories. The Bangladesh government revised its Labour Act and increased the minimum wage.

However, issues remain. Working conditions have not improved at factories supplying Russian and Turkish firms, which are not covered by the Accord. And, while there has been progress in health & safety, low pay and harassment remain a big issue.

A new Accord came into effect on 31 May 2018. Called the Transition Accord, it has a three-year term and is intended to facilitate a transition to a national regulatory body in Bangladesh. While similar to the original Accord, it has a number of new elements. These include provisions for workers' severance payments in factory closures and relocation, and training on Freedom of Association protections.

What has changed in the rest of the world?

In recent decades, China has dominated the production of readymade garments. There were expectations that, as living standards rose in China, many garment supply chains would move to cheaper countries. Yet despite being relatively expensive, China continues to dominate the industry thanks to the efficiency of its factories. This, however, is driven by excessive working hours and garment factories moving inland. A number of challenges in working conditions remain, including a lack of collective bargaining and child labour.

Fast fashion

While China continues to dominate, the increased demand from fast fashion has brought garment production closer to Europe. This includes Turkey and Morocco, and even the UK. While the safety of buildings is not as big a concern in these countries, exploitation of workers is common. In Turkey, Syrian refugees, notably children, are at the forefront of production.

In the UK, the Environmental Audit Committee is currently investigating the sustainability of the domestic fashion industry. The results so far are concerning. However, the issues of worker violations and human trafficking plaguing the UK textile industry are not new. In 2010, a Channel 4 *Dispatches* programme found a number of companies were using factories in Leicester that were not paying workers the minimum wage. A University of Leicester report in January 2015 estimated that 75-90% of workers in the UK garment sector were paid £3 an hour. A later *Dispatches* programme in January 2017 reported that brands, such as New Look and River Island, were sourcing from factories paying workers £3 an hour. In 2018, the *Financial Times* ran a detailed report about the Leicester factories supplying the likes of boohoo and Missguided.

The implications for companies and our ethical funds

Our ethical funds hold a number of UK-based and international apparel and footwear manufacturers. In 2018, we amended the ethical policy to make explicit reference to avoid investing in companies where there is evidence of bad employment practices. We engage with companies on their supply chains and there are some common takeaways from our research.

- Collaboration is critical to success. While global brands may have exclusive suppliers, factories often produce for multiple brands. This makes it harder to implement lasting change without some degree of collaboration.
- Illegal subcontracting remains a huge issue and audits are only moderately effective. A number of companies have told us that traceability is one of their biggest challenges – whether in countries like Bangladesh or in the UK.
- While a weak rule of law leads to a higher risk of human rights violations, it does not mean the introduction of laws will stop them from occurring. Occasionally, factories are shut down after raids uncover illegal migrant workers – only to re-open again soon after.
- While consumer awareness is rising, consumer behaviour has not materially changed. In the aftermath of Rana Plaza, our engagement also found that companies had reacted to the increased supply chain risk, but had not seen an impact at point of sale.
- The direction of travel is difficult to assess. There is no shortage of reports predicting a shift in consumer behaviour. However, the rise in fast fashion is likely to put greater pressure on the readymade garment industry as it continues to push down prices.

The Accord successfully addressed some of these challenges. That said, it is limited to one issue and one geographic area. It is evident that more work needs to be done. While there is limited consumer pressure, investors have a role to play in holding investee companies to account over how they manage their supply chains. We will continue to engage with companies on how they are managing human rights risks in their supply chains.

"In the UK, the Environmental Audit Committee is currently investigating the sustainability of the domestic fashion industry. The results so far are concerning."

Artificial intelligence and automation

Introduction

Artificial intelligence and automation (AI&A) is a technology with broad scope and far-reaching applications. Artificial intelligence can refer to any technique that enables computers to mimic human intelligence, using logic, if-then rules, decision trees, and machine learning. AI&A is already used across numerous industries. These include financial services, insurance, information & communication, and scientific & technical. Healthcare also use AI. For example, the NHS uses it to:

- improve the early diagnosis of heart disease and lung cancer
- reduce the number of false positives
- better match patients to clinical trials
- support the planning of care patients.

Impact on number of jobs

Estimates for the impact of AI&A on jobs vary. A landmark study in 2013 suggested that 47% of US jobs are at high risk of automation.[3] Recent studies have challenged this figure. The OECD argues the numbers are closer to 10% for the US, 12% for the UK, and 14% on average for OECD countries,[4] In addition, 32% of jobs face substantial changes to how they are performed.[5] However, vendors have said that many companies are buying AI&A technology with a primary mandate to reduce employee numbers.

Conversely, a recent PwC report found that AI&A will create as many jobs as it replaces, with winners and losers divided by sector. In the UK, AI&A is expected to displace about 7 million jobs between 2017 and 2037. However, it forecasts that 7.2 million new jobs will be created across healthcare, science and education.[6] AI&A is already used across the sectors expected to experience job creation. This demonstrates that widespread use of the technology does not always lead to displaced jobs.

AI&A has already resulted in a rapid change in the workforce in certain sectors. A 2011 survey showed that 44% of firms that had reduced their headcount since the 2008 financial crisis had done so using automation. Similar technology step-changes have occurred throughout history. For example, in the 1900s agriculture employed 40% of the workforce. This compares to 2% today. In the 1950s, the introduction of automation led to significant shifts within the car industry.

There is also a belief that automation will replace lower-skilled workers, with the technology programmed by higher-skilled workers. However, many vendor companies, such as Blue Prism, dispute this claim. It said the AI&A systems do not require strong technology skills; rather, they rely on the user understanding the processes.

Nonetheless, unions suggest there is consensus that lower-paid jobs are more at risk from AI&A. Unison has identified this tendency may have a geographic impact. Indeed, studies showed that the North East and Northern Ireland are more vulnerable than London and the South East. Similarly, a disproportionate number of female, ethnic minority and disabled workers fill the jobs among those most at risk. The threat of automation is also highest among teenage workers and may result in increased youth unemployment.

Impact on job quality

Many applications of AI&A are not about replacing entire roles. Instead, they attempt to improve processes, reduce mundanity and provide new data that was previously unavailable. The NHS highlights how AI&A can enhance research and reduce human error. AI&A in financial services is helping to identify fraud and reduce the risk of financial crime. AI&A will also increase productivity. However, the TUC has called for a fair distribution of these benefits. This includes the potential for reduced working hours and even moving to a four-day working week.

Companies implementing AI&A systems report increased customer satisfaction, as complaints are handled quicker and insurance decisions processed faster. A YouGov survey found 40% of workers agreed that new technologies will lead to better working conditions and job satisfaction. Only 24% disagreed.

Conclusion

The applications of AI&A are broad and varied. The outcomes for employment will depend on the intentions of the users. Government policy and regulations will be key to ensuring strong standards of corporate behaviour.

Our ethical customers have long had concerns about ensuring good employment practices in the companies in which we invest. AI&A will have implications for the future of employment. We will continue to monitor the positive and negative impacts of technology on workforces to ensure ethical practices are adopted by companies.

[3] Carl Benedikt Frey and Michael A Osborne, 2013, "The Future of Employment: How Susceptible are Jobs to Computerisation?", https://www.oxfordmartin.ox.ac.uk/downloads/academic/The_Future_of_Employment.pdf.
[4] Ljubica Nedelkoska and Glenda Quintini, OECD, 2018, "Automation, skills use and training", https://www.oecd-ilibrary.org/fr/employment/automation-skills-use-and-training_2e2f4eea-en.
[5] OECD, 2018, "Putting faces to the jobs at risk of automation", https://www.oecd.org/employment/Automation-policy-brief-2018.pdf.
[6] PWC, 2018, "UK Economic Outlook", https://www.pwc.co.uk/economic-services/ukeo/ukeo-july18-net-impact-ai-uk-jobs.pdf.

"Many applications of AI&A are not about replacing entire roles. Instead, they attempt to improve processes, reduce mundanity and provide new data that was previously unavailable."

Engagement and voting

We are serious about our role as stewards of our clients' capital, and seek to illustrate how we hold companies and boards accountable on behalf of our clients and beneficiaries.

We do this through active engagement, voting, attending and speaking at annual general meetings (AGMs). We provide a more detailed account of our engagement and voting activities in our ESG investment quarterly reports, which can be found on our website.

Engagement

The ESG investment and regional teams engage with investee companies on ESG and ethical issues. During the year, a number of themes stood out, including labour issues, gender selection, and plastics. Cyber security and data privacy were also major themes in light of the General Data Protection Regulation, which came into force in the EU in May 2018.

As shareholders, we believe it is important to use our voice to encourage stronger corporate behaviour. In most cases, we will seek to engage with the company and escalate our concerns to the board. However, we will consider divesting a company from the ethical funds if it is not doing enough to address our concerns.

Engagement case studies

A.P. Moller-Maersk

A.P. Moller-Maersk A/S is an integrated transport and logistics company. It operates a fleet of vehicles, including container vessels, tankers, supply ships, special vessels and terminals. The company is held in our European Ethical Equity Fund.

We held two calls with AP Moller-Maersk to discuss its management of key ESG risks. We were updated on the progress it was making on cyber security controls and IT infrastructure. This follows the significant NotPetya breach last year. We discussed the group's approach to shipbreaking, an environmental concern in Asia, and also its management of labour issues.

The group sits in an industry exposed to a high level of ESG risk. Against its peers, however, it performs well in all areas. Perhaps the biggest risk to the company and sector is the IMO 2020 regulation on sulphur emissions. We will continue to follow-up on this topic to ascertain how the company intends to meet these regulatory requirements and what the costs might be.

Dixons Carphone

Dixons Carphone is an electrical and telecommunications retailer and services company. It offers a wide range of electrical and mobile products, as well as connectivity and after-sales services. Dixons Carphone is held in our UK Ethical Equity Fund.

Following Dixons' merger with Carphone Warehouse, we followed-up on how the board and executive restructuring had been progressing. We also wanted to see whether any further changes were expected.

In 2017, the company had been hit by a cyber attack, which resulted in the loss of customer data. Dixons reassured us that it is making significant efforts to make the IT infrastructure far more robust. It also sought to assure us that the lost data had not resulted in any reported fraud incidents. This occurred pre-GDPR implementation; as such, the financial impact had been limited.

We were pleased to hear about the company's new Corporate Sustainability Programme. This focusses on the high level pillars of people, environment and the circular economy. While this programme is still in its infancy, it should be well received by investors – especially as the business continues to improve its ESG values across the supply chain.

Clinigen Group

Clinigen Group is a global pharmaceuticals and pharmaceutical services business. It is dedicated to serving patients, the medical community and the healthcare industry. The company is held in our UK Ethical Equity Fund. In March 2018, we had two meetings with Clinigen to discuss its workforce and pricing strategy.

Since the company's inception, it has grown significantly through acquisition. However, this has not led to significant restructuring and employee engagement. Clinigen recently started to introduce apprenticeship schemes. It is also looking to trial a formalised internship programme in the next few years. There is a good range of training and development opportunities available to employees, not just for leadership teams.

Clinigen has a strong approach to fair pricing. A significant number of products in its Managed Access business are provided to the patient free of charge. Its own product lines strive to maintain a narrow pricing corridor. The company also demonstrates its ability to balance affordable access in difficult markets with its financial requirements.

Counterfeit medicine is a significant problem. One of Clinigen's primary aims is putting healthcare professionals back in front of the patient, instead of patients buying products on the internet. This presents a strong business opportunity, assuming physicians understand that they can access treatments in a safe and legitimate way from Clinigen. The company confirmed that it is not involved in animal testing, making it an acceptable investment for the ethical funds.

Both our meetings with the company were positive. However, it would be good to see more detailed reporting on its workforce in future reports.

Adidas

Adidas manufactures sports shoes and sports equipment. The company produces products that include footwear, sports apparel, golf clubs and balls. We hold it in the European Ethical Equity Fund. We engaged with the company to discuss exposure to deforestation via its leather supply chain and its commitment to using 100% recycled polyester by 2024.

We were comfortable with the group's approach to managing deforestation risk, although we encouraged it to update its policies on the matter. We also encouraged increased evaluation of how its suppliers adhered to the Leather Working Group. Adidas assesses how tanneries ensure they do not use hides linked to deforestation. It also calculates how these tanneries manage chemical and other environmental risks.

On plastics, Adidas is a leader through its Parley Ocean Plastic Program. It also recently pledged to only use recycled polyester by 2024. The company acknowledged the problem of microfibre pollution from washing. It is working with academics, scientific institutions, the European Commission and others to combat this issue.

The engagement demonstrated that the company is working to significantly reduce its environmental footprint, particularly its exposure to deforestation. We will continue to monitor the company's ESG risks in deforestation and progress in mitigating microfibre pollution.

Engagement and voting

Below is an overview of our engagement with companies held in the SLI ethical funds during 2018.

Company	Topics Discussed
A.P. Moller-Maersk**	Cyber security, shipbreaking, environment
Adidas	Labour issues, deforestation, plastics, bribery
Allianz	Environment, sustainability strategy
AT&T	Labour issues, data security
Aveva	Merger, labour
Bellway	Sustainability strategy
Blue Prism	Governance, artificial intelligence
Clinigen Group	Labour relations, access to healthcare
Danske Bank	Money laundering
Dixons Carphone	Governance, board structure, cyber security
Greggs	Labour relations, health & nutrition
HSBC	Sustainability strategy, green bonds, SDGs and TCFD
Inditex**	Human rights in supply chain, raw material sourcing
ING Groep**	Bribery settlement, sustainable finance, cyber security
Inmarsat	Remuneration
International Personal Finance**	Regulations, governance, tax
Interpump	ESG risks and opportunities
John Laing Group	Governance, diversity
Kesko	Governance
Lloyds Banking Group	PPI, cyber security, remuneration
Mitie	Labour issues
NMC Healthcare	Governance, geography, reporting, animal testing, IVF
Nostrum*,**	Investor communications, board composition
McDonald's**	Labour issues
Phoenix Group	Governance
Polypipe	Plastics
Ricardo	Military exposure, labour, environment
Rightmove	Governance
Royal Bank of Scotland	Sustainability strategy, diversity
SAP**	Bribery & corruption, cyber security
Severn Trent	Capital markets day
Standard Chartered	Stewardship and Strategy roundtable: financial crime, cyber security, board, diversity
Vodafone	Attended AGM
Wilmington	Governance
Wirecard	Governance

* Letter sent to company
** No longer held in ethical funds at the end of 2018

Voting

The ESG investment team votes at general meetings of the companies held in the ethical funds.

During 2018, we voted against remuneration-related resolutions at a number of annual general meetings (AGMs). We cast these votes where we did not feel remuneration practices and policies were fully aligned with our guidelines and shareholders' interests. These included an increase in the ability to make and retain one-off awards, and performance targets that we did not consider to be stretching. There was also insufficient disclosure of these issues.

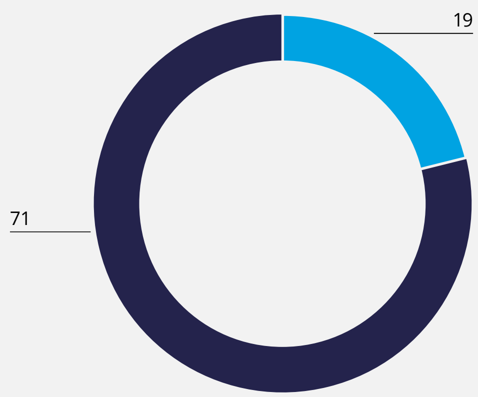
We voted against the re-election of directors where we had concerns about board composition, independence, and 'overboarding'. For example, at Kone's AGM, we voted against director re-elections because we did not consider there to be sufficient independent representation on the board. We also had concerns about executive directors sitting on the remuneration and audit committees. In addition, we voted against the auditors, PwC, as it has held this role for 60 years. In our view, excessive tenure impedes independence. We voted against auditor appointments at a number of other companies for the same reason.

At TUI's AGM, we again voted against the formal discharge of responsibility of the supervisory board chair. We welcomed the introduction of a vote on remuneration arrangements at the company. However, we believe further movement is required to bring the company's governance arrangements in line with UK practice. This was the stated intention when TUI AG and TUI Travel PLC merged.

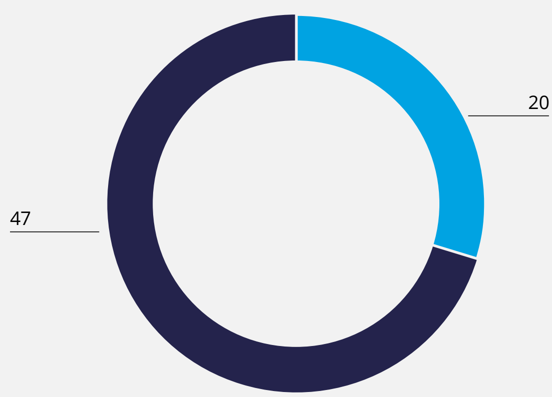
At John Laing Group's AGM, we abstained from voting to approve the annual report and accounts. This was due to the lack of gender diversity on the board and the absence of any substantive reporting on diversity in the annual report. The chief executive had also publically committed to this issue. We have engaged with the company to discuss diversity and it has since improved its board gender balance.

We also did not support a number of share issuance resolutions at companies where the terms of the requested authorities exceeded our guideline limits on share issuances without pre-emption rights.

SLI UK Ethical Equity Fund



SLI European Ethical Equity Fund



Number of meetings with at least one vote against or abstention
Number of meetings voted all in favour

Source: Aberdeen Standard Investments, December 2018

Collaborative engagement and events

Aberdeen Standard Investments was once again co-lead sponsor of Good Money Week 2018.

Good Money Week is a UK campaign to raise awareness of sustainable, responsible and ethical finance – helping people to make good money choices. To promote our sponsorship, raise awareness of our ESG capabilities and support the UKSIF 'empowering women' theme, we ran an 'Invest for a Better Future' marketing campaign. This highlighted our work on diversity, while reinforcing our belief that investors can make good money investments. Activities included events for the press, UK advisors and Aberdeen Standard Investments staff. Standard Life Wealth also hosted two events for charity trustees, CEOs and financial directors of higher education, and faith-based charities.

In the run-up to Good Money Week, we commissioned research from YouGov to find out how 8,000 individuals understand ESG and how they access products. The research discovered that the majority of investors, particularly women, do care about where their money is invested. It also found that awareness of the UN Sustainable Development Goals (SDGs) is greatest among 18-24 year olds.

In addition to our campaign for Good Money Week, we took part in a number of industry initiatives and events throughout 2018. At a conference convened by the Global Reporting Initiative, Principles for Responsible Investment and UN Global Compact, we presented on the ways in which the UN SDGs inform our ESG research. We attended the International Corporate Governance Network (ICGN) Annual Conference in Milan and participated in a panel discussion on governance at private companies. We also took part in the Scottish Government's roundtable discussion on establishing Scotland's Just Transition Commission, hosted by the University of Edinburgh's Centre for Climate Innovation.

Through her role as co-chair of the 30% Club's UK Investor Group, Deborah Gilshan, one of our ESG Investment Directors, led and participated in a number of collective company engagements to promote better gender balance in FTSE350 companies. This topic now features regularly in the ESG investment team's individual engagement meetings with investee companies. Deborah also spoke at various industry forums to explain the investment case for improving diversity on boards and in company leadership. She also sought to promote the stewardship work of investors in this area. Deborah also wrote a research note for our Global Outlook series on the importance of gender diversity as an economic and strategic imperative. As at end of 2018, the 30% Club had 66 FTSE 350 CEOs (including Standard Life Aberdeen Plc's co-CEOs) publicly committed to achieving 30% women in senior management teams by the end of 2020. Forty-four chairs of FTSE 350 companies (including Standard Life Aberdeen's chair) also publicly committed to achieving 30% women on boards by the end of 2020.

More information on our participation in industry events can be found in our ESG quarterly reports on our website.

Ethical Funds Advisory Group

The Ethical Funds Advisory Group oversees the ethical criteria of Standard Life Investments' ethical funds range. It is chaired by Standard Life Aberdeen's Head of UK and includes three independent members. The Group brings together the informed opinions of investors in the funds and external experts with those people from Aberdeen Standard Investments that manage, oversee and distribute the funds. The Group meets twice a year to ensure the correct application of policies and procedures and that they reflect the views of those invested. The Group also monitors ethical issues through reports and presentations from our ESG investment team and organisations involved in issues of concern.

Independent members

Francis Blake
After obtaining a degree in agricultural and forest sciences from Oxford University, Francis set up and ran his own organic farm in Somerset (where he still lives). He then used this experience to write a book, 'Organic Farming and Growing – a 'Guide to Management', which is still in print. In 1986, he joined the Soil Association, first as managing director of Soil Association Certification Ltd until 2000, then as Soil Association Standards director for a further 10 years, and finally policy advisor (part-time). During this time, he was also president of the IFOAM EU Regional Group (ifoam-eu.org) for nine years, and chair of the COSMOS-standard AISBL (cosmos-standard.org) for seven years. Now semi-retired, he is working as a consultant and chairs the Somerset-based Green Scythe Fair committee (greenfair.org.uk) and is a board member of IOAS (ioas.org).

Carey Haslam
Carey has been a conflict consultant for 25 years, specialising in process design, training and coaching for public and third-sector organisations. She currently focuses on mediation and alternative dispute resolution; developing the potential and resilience of senior management and staff teams; and diversity, equity and inclusion, in particular unconscious bias. She is a non-executive director of the Office of the Independent Adjudicator for Higher Education and held a senior management position with Leap Confronting Conflict, a national youth and conflict charity. She has worked as an environmental facilitator on projects including nuclear fuel, traffic and waste; has studied and provided training in human rights; has co-authored training manuals; has been a visiting university lecturer; and was originally an authorised financial planner. Carey has been investing ethically for the past 20 years. She has a degree in biology from Exeter University and a diploma in applied finance and investment from the Securities Institute of Australia.

Mike Segal
Mike has a PhD in chemistry from the University of Cambridge and spent the first 13 years of his working life in research and development. He is the author of over 70 papers in the scientific and technical literature field. In 1988 he joined the civil service, where he held a variety of posts in MAFF (Ministry of Agriculture, Fisheries and Food), the Food Standards Agency and DEFRA (Department for Environment, Food & Rural Affairs). During his career in government, he has had high-level responsibilities for policy issues relating to agriculture; environmental protection; human nutrition; UK and global food security; animal welfare; and protection of workers and the public. He was a director in DEFRA from 2004 to 2011. Mike has been happily retired since February 2011. When not travelling the world with his wife, he enjoys spending time with his grandchildren.

The ESG Investment team

The ESG investment team is dedicated to the research and analysis of the environmental, social and governance issues that have a bearing on Aberdeen Standard Investments' client portfolios. The team has responsibility for implementing the Ethical Funds Investment Policy and screening companies for inclusion in the ethical funds. It also engages actively and regularly with companies in which we are, or may become, a shareholder.

Amanda Young, Head of Global ESG Research, is Secretary to the Ethical Funds Advisory Group.

Standard Life Investments Limited is registered in Scotland (SC123321) at
1 George Street, Edinburgh EH2 2LL.

Standard Life Investments Limited is authorised and regulated in the UK by the Financial Conduct Authority.

Aberdeen Standard Investments

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ASI_1251_Ethical_Funds_annual_Review 0119 GB-150119-80512-1