Responsible Investment

Quarterly Report
Q2 2016

Standard Life Investments

This document is intended for institutional investors and investment professionals only and should not be distributed to or relied upon by retail clients.

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Introduction

At Standard Life Investments, we are committed to being a responsible investor. We also believe it is important to be clear and informative on the major environmental, social and governance (ESG) issues surrounding our own business, our investee companies and the world in which we live.

As such, this quarterly report details the numerous thematic pieces we have written on the major environmental and social trends, as well as thought leadership and insight pieces from across the ESG spectrum.

The report details the many engagements we have undertaken with various companies specifically related to ESG issues. While not an exhaustive list, this is a comprehensive representation of the various steps taken by Standard Life Investments to help ensure it remains an active and responsible steward of our clients' assets.

Standard Life Investments is one of the world's leading investment companies, with global assets under management of £253.2 billion (as at 31/12/2015). Our capabilities span equities, fixed income, real estate, private equity, multi-asset and absolute return solutions.

Headquartered in Edinburgh, Standard Life Investments employs over 1,500 talented individuals. We have offices in a number of locations around the world including Boston, Hong Kong, London, Beijing, Sydney, Dublin, Paris and Seoul. In addition, we enjoy close relationships with leading domestic players in Asia, including HDFC Asset Management in India and Sumitomo Mitsui Trust Bank in Japan.

Foreword

Amanda Young
Head of Responsible Investment

As I write this quarter's foreword, we are facing up to the likelihood of the UK now leaving the European Union. For responsible investors, this creates huge uncertainty around the UK's stance on a number of key environmental and social issues.

Given the lack of clarity regarding how the government will approach issues like climate change, UK companies are left with much uncertainty over future regulation. It has raised questions about how the UK will approach human rights, environmental protection, employment law and carbon reduction. The EU standards in these fields are some of the strongest in the world. Likewise, uncertainty abounds for a number of non-UK listed companies operating in the UK that comply with EU requirements.

However, the implications of the UK's referendum for responsible investment markets will take some time to ascertain. As with the aftermath of the 2008 global financial crisis, it will be essential for both investors and corporates to continue to adopt the highest possible business standards. This is particularly true during a time when there is a pronounced flight to quality by investors.

The next few years will bring more uncertainty. Responsible investment research, analysis and engagement will be more essential than ever to understand the increasing societal risks facing the companies in which we invest. Our research will continue to follow the four pillars of the UN Global Compact. Our ESG investment team will continue to actively engage with our investee companies on a host of matters.

This quarter, we voted on a number of environmental and social shareholder resolutions linked to climate change. We also attended a number of key industry events and engaged with numerous companies. All of this and more will be detailed in the following report.

As ever, we welcome your feedback and invite comments to the team's mail box **esg_investment@standardlife.com**

The responsible investment team

Who are we?

The responsible investment team was sad to say goodbye to Rebecca Maclean and Alix Chosson during the quarter. We will miss them both. We would like to take this opportunity to thank them for their enormous contribution to responsible investment at Standard Life Investments over the past few years.

Rebecca Maclean has made an exciting move internally to take up a new position in the UK equities team, and we look forward to seeing how she integrates her environmental and social analytical skills into stock recommendations. We welcome two new responsible investment analysts to the team – Marc Brammer and Sophie Rahm.

Marc has significant experience in ESG research, having worked over an extended period with MSCI and Innovest. Sophie joins us from Schroders where she was an ESG analyst. We look forward to the contributions that Sophie and Marc will make to integrating environmental and social issues into our investment process.

The team

Marc Brammer
Analyst, Responsible Investment

Sophie Rahm
Analyst, Responsible Investment

Andrew Mason
Analyst, Responsible Investment

Katharina Lindmeier
Graduate, Responsible Investment

Contact the responsible investment team at

esg_investment@standardlife.com

Voting during the quarter

Mike Everett
Governance & Stewardship Director

The voting season in the UK has, once again, been characterised by significant disagreement between companies and shareholders on remuneration. We have noted 21 major company meetings at which more than 20% of the votes were against remuneration resolutions, a number of which received more than 50% of the vote.

The reasons for these adverse votes are not wholly consistent, but there appears to have been a focus on the quantum of overall remuneration at some companies, which has resulted in shareholder dissatisfaction.

Although we welcome shareholders holding companies and their boards to account, we do see votes against management as a failure of the engagement process. It had been our view last year that an apparent reduction in shareholder votes against management reflected improved engagement and better understanding of each other's views on some aspects of governance. Unfortunately, that view was perhaps premature, with this year being rather more challenging. It is apparent that additional work needs to be done by companies and shareholders to ensure clear communication of views and intentions.

Outside of the UK, however, our experience of voting this year has indicated a general increase in companies' willingness to engage with shareholders. This has been particularly true for European firms where many have been proactive in offering engagement and seeking views on proposed agenda items.

There appears to be a drive to help shareholders understand companies' intentions with certain resolutions. This has not always resulted in supportive voting, but it is a welcome trend.

One notable change in France was the impact of double voting rights introduced by the Florange Act. The influence of the French government in particular has increased significantly, as demonstrated by the outcome of certain remuneration votes. After being proposed by the government, the introduction of a binding vote on remuneration in France is currently being considered.

In the US, shareholders continued to pressurise companies into introducing proxy access arrangements. Through these resolutions, shareholders are endeavouring to obtain increased influence on the make-up of boards. They have requested the introduction of by-laws that allow shareholders with more than 3% of a company's shares, held for more than three years, to nominate directors. At Standard Life Investments, we are generally supportive of these proxy access resolutions, but we are also willing to support alternative proxy access standards proposed by companies if we deem them to be more appropriate in particular circumstances.

We also saw the introduction of shareholder resolutions in relation to carbon disclosure at Exxon Mobil and Chevron. We were supportive of the resolutions that encouraged increased disclosure on the impact of various policy change scenarios, as this will better allow us to assess a company's ability to remain successful over the longer term.

In Asia, we have seen improving trends in governance practice, engagement and disclosure. In Japan, the introduction of the Stewardship and Corporate Governance Code has created an environment of change and improvement. In addition, the work by shareholders over a number of years to influence the levels of independent directors has yielded some good results. This year we continued to vote against the re-election of certain directors if we felt the company had failed to make sufficient progress in this area.

In Korea, there have been some improvement in the timely publication of annual reports and audited financial statements in English. There has also been the introduction of an assessment mechanism to rank companies by the standards of their English disclosures. We hope that this will further encourage companies to improve their reporting standards. Such measures enable overseas investors to conduct more thorough analysis, thereby making Korea an increasingly attractive market for investment.

There are areas of disappointment. Disclosure standards need to improve in certain Asian markets, notably in Taiwan where there is very little information provided in English. We will continue to encourage companies in Asia to improve their English disclosures, in order to make the market more accessible to overseas investors.

We provide in-depth disclosures of our voting activity on the Standard Life Investments website. This gives details of all the companies and resolutions, as well as high-level data on the numbers of meetings and unsupportive votes. We also provide rationales for our votes in instances where we have voted against resolutions or in situations where we believe resolutions are contentious. This information can be found at the URL links below.

http://www.standardlifeinvestments.com/governance_and_stewardship/what_is_corporate_governance/voting_disclosure.html

http://www.standardlifeinvestments.com/governance_and_stewardship/what_is_corporate_governance/company_meetings.html

http://www.standardlifeinvestments.com/governance_and_stewardship/what_is_corporate_governance/our_voting_records.html

WPP AGM

Euan Stirling
Head of Stewardship and ESG Investment

In June, Head of Stewardship and ESG Investment Euan Stirling attended the AGM of WPP in order to represent Standard Life Investments. His attendance followed a similar escalation of engagement at the 2015 AGM, at which we voiced concerns about the potential for Sir Martin Sorrell to dominate board decision-making, given his long tenure, his role in shaping the group and his remuneration arrangements. We have engaged with the company several times since the AGM to discuss these topics further, and cast votes on behalf of our clients in line with our views.

At the 2016 AGM, Euan gave the following statement.

"Management succession has been a key risk for the company for a number of years. This has been all the more apparent as the group has expanded through acquisitions and organic growth, while maintaining a comparatively small corporate head office function, with only 400 of the 190,000 group employees at the corporate centre. On this issue, we believe that the company is making good progress, an assertion supported by the disclosures in its recently published annual report. As each year passes, however, and as the company continues to grow and evolve, we clearly move closer to the day that a new chief executive will need to be recruited. As a result, we believe that the board's work on succession to date will need to be augmented and regularly refreshed so that the group has the ability to continue to succeed with a new hand on the tiller.

On the subject of executive pay, we have today voted against the Remuneration Report. The current policy could result in the chief executive receiving over 15 times his base salary of more than £1 million should all the performance conditions be met. We expect that is more than would be required to recruit, retain or motivate even someone with the redoubtable talents of Mr Sorrell.

Your annual report specifically acknowledges that businesses need permission from society to operate and that they need to exhibit a broad sense of responsibility to all stakeholders. As shareholders, we ask that these factors are reflected in future succession planning and remuneration policies. We commend the board on the progress that they have made in succession planning in the last 12 months and would ask that this effort continues in order to improve the risk profile of the group. Could I also ask, Mr Chairman, for your view of the likely impact from the improvement in succession planning, on the remuneration policy which will face a mandatory vote at next year's annual meeting?"

Commenting on the event afterwards, Euan said:

"While committing to continued succession planning efforts, WPP pointed out that historic remuneration arrangements had one more year to run. This may therefore result in significant payments to the CEO being reported in next year's annual report. We will continue to engage with the board on this matter."

Voting on environmental and social issues

We were involved with numerous resolutions focused on social and environmental issues. We continue to see year-on-year increases in these types of resolution and new initiatives, such as 'Aiming for A'. Below are details of the various votes we cast over the quarter and the rationale behind each.

'Aiming for A' is an investor coalition that is currently undertaking in-depth engagement with large extractives and utilities companies. The initiative places shareholder resolutions before stakeholders at company AGMs, using the Carbon Disclosure Project (CDP) performance bands and sector analysis as an initial benchmark for measuring company performance. Work-to-date has focused on "strategic resilience for 2035 and beyond". This seeks to test how robust each company's product and service portfolio is in the face of low-carbon scenarios.

'Aiming for A' Shareholder Resolutions
Glencore [FOR]: the 'Aiming for A' initiative tabled a shareholder resolution that the company's management supported. We also voted for the resolution and continue to encourage the company to be active in the debate over fossil fuel reserves. Given its knowledge and position in the marketplace, Glencore is well-placed to provide insights to inform the debate on key issues, such as the likelihood of carbon-heavy assets becoming stranded.

Rio Tinto [FOR]: the company was asked to annually assess what the impacts would be from a scenario in which policies were designed to meet the Paris Agreement (this was an accord signed by world leaders to limit temperature rises this century to below 2°C). We voted in favour of the resolution and would welcome more clarity and transparency to assess the resiliency of the company's portfolio of assets in light of climate change policy scenarios.

Other climate change-related resolutions

- **Amazon [FOR]:** the resolution requested that the company report further on sustainability, including greenhouse gas reduction goals. We voted in favour of the resolution as we believed the company had very limited disclosure along these lines while, at the same time, it had high-risk exposure and several controversies relating to sustainability.
- **Anadarko Petroleum [FOR]:** the company was asked to report how it planned to address stranded carbon asset risks. While the company has improved its disclosure of sustainability issues in the last year, it still remains somewhat behind the curve on climate issues. As such, we voted in favour of the resolution. We also said we would benefit from more information on how the company manages its climate change risks.
- **Chevron [FOR]:** the company was asked to annually assess what the impacts would be from a scenario in which policies were designed to meet the Paris Agreement. We voted in favour of the resolution because the company is not currently providing investors with enough information to allow them to assess how it integrates climate change risks into its portfolio and its capex allocation decision-making processes. In addition, investors could use more clarity and transparency to assess the resilience of the company's portfolio of assets to climate change policy scenarios.

- **Chevron [AGAINST]:** we voted against two additional resolutions, including one to adopt quantitative global greenhouse gas data for products and operations. We voted in line with management on these resolutions because we believed that they were not in the best interests of shareholders. The company already discloses greenhouse gas data and operational details to a good standard. As such, requesting additional data would be unnecessarily burdensome.
- **Chevron [AGAINST]:** the second resolution asked the company to increase the return on capital to shareholders in light of climate risks. We moved to vote against this proposal because it would restrict management's ability to determine where appropriate investments could be made to ensure the company's long-term viability in a changing energy environment.
- **Danske Bank [AGAINST]:** shareholders tabled a resolution that asked the bank to cease making new investments into non-renewable energy sectors. We voted against this resolution as we do not believe that the current energy market would support renewable-only investments.
- **Dominion Resources [AGAINST]:** there were three shareholders proposals regarding climate change issues at Dominion. The first included requiring finding a nominee director who had environmental experience. We voted against the resolution as the company is best-placed to decide which skills and experience directors should have and, as such, we thought this resolution would place too specific a restriction on the company's ability to recruit the best candidates.
- **Dominion Resources [AGAINST]:** the second related to reporting on the risks of climate change. We voted against this resolution because the company provides a medium-term outlook each year, as well as regulatory scenario-based analysis to shareholders. Given its level of risk exposure, we believe the company has satisfactory disclosure and management of climate change regulatory risks.
- **Dominion Resources [AGAINST]:** with the third resolution, the company was asked to begin reporting on its plans to adapt to distributed energy generation and energy efficiency. We voted against the resolution because most of the company's activities are regulated and it is already transitioning from coal-fired power to a more diverse gas and renewable-focused portfolio.
- **Exxon Mobile [FOR]:** as shareholders, we were asked to consider four shareholder resolutions at the meeting. In a similar proposal to Chevron, Exxon was asked to annually assess the impacts of a scenario in which it implemented policies designed to limit temperature increase in line with the Paris Agreement. We voted in favour of the resolution as we would welcome more clarity and transparency to assess the resiliency of the company's portfolio of assets in light of climate change policy scenarios.
- **Exxon Mobile [AGAINST]:** a second resolution requested Exxon find director nominees with environmental experience. As with similar proposals, we voted against the proposal because the company is best-placed to decide which skills and experience directors should have. Further, we thought this resolution would place too specific a restriction on the company's ability to recruit the best candidates.
- **Exxon Mobile [AGAINST]:** a third resolution asked Exxon to increase return on capital to shareholders in light of climate risks. In this case, we voted against the proposal as we thought this would restrict management's ability to determine where appropriate investments could be made to ensure the company's long-term viability in a changing energy environment.
- **Exxon Mobile [AGAINST]:** finally, shareholders tabled a proposal that the company should adopt a policy acknowledging the imperative to limiting global warming to 2oC. While this proposal was relevant in principle, especially given Exxon's denial of climate change risks, we thought the resolution was poorly phrased. The issue is not for the company to acknowledge the 2oC limit, but rather for it to integrate this scenario into its forecasts, as per the resolution for which we voted.

- **Royal Dutch Shell [AGAINST]:** Shell faced a shareholder resolution that asked the company to become a renewable energy firm by investing its fossil-fuel profits into renewable energy. We felt the resolution was not realistic and not in the best interests of shareholders.
- **Statoil [AGAINST]:** the company faced two shareholder resolutions on climate issues, including requesting it present a revised strategy reflecting its joint responsibility for meeting the current energy demand within the Framework of National and International Climate Targets. We voted against the first proposal because it is overly prescriptive and would require the company to shift all new investments into renewable energy rather than oil & gas. The company has already provided details on its climate change resilience strategy after last year's 'Aiming for A' resolution. Engagement on this matter would be our preferred approach.
- **Statoil [AGAINST]:** the second proposal asked the company to establish a risk management investigation committee on the board. We rejected the proposal as it would require a committee to investigate the "post-merger irregularities in corporate governance" with regards to the Statoil/NorskHydro merger. Statoil already has a safety, sustainability and ethics committee that has been reviewing this case, thereby making this proposal somewhat redundant.
- **Suncor Energy [FOR]:** shareholders asked the company to report on its climate change risks and strategic approaches. We voted in favour of the resolution because Suncor has significant investments in oil sands, which are among the highest-risk assets for stranding due to carbon regulation and low oil prices. We would welcome more information about the company's resilience to climate change risks.

In addition to the numerous environment-focused resolutions, there were also those relating to social issues. This included the gender pay gap in the technology sector.

Google and the gender pay gap

Alphabet (Google) faces a resolution requesting that the company produce a report detailing its policies and goals to reduce the gender pay gap. The proponent's statement highlighted that in the US median income for women is 78% that of their male counterparts and that women are under-represented in the technology industry. Alphabet highlighted that it has long-supported diversity and equality in the workplace. It also publicly shared its global gender diversity and ethnic diversity workforce data.

Our research found that Alphabet had taken positive steps to disclose the gender and ethnic make-up of its workforce. They were: overall women (W) 30% men (M) 70%; tech W18% M82%; non-tech W47% M53%; leadership W22% M78%. We also appreciate that the company does not apply the same uniform definitions and reviewed its equal employment opportunity filing, which highlights the difficulties this can create. However, we believe that the technology sector as a whole has issues regarding the gender pay gap and while Alphabet has already taken some positive steps, it would be favourable for it to produce greater detail on its approach in this area. As a result, we voted in favour of the resolution and will continue our review of gender issues within the technology sector.

Collaborative engagement and events

UK Sustainable Investment and Finance Association

The UK Sustainable Investment and Finance Association (UKSIF) recently held its annual conference in Edinburgh. This was well-attended by the industry and focused on a large number of topics. Standard Life Investments contributed to the 'Hot Topics for 2016' session, which opened the conference. In our view, the hot topics facing the responsible investment industry fall into three categories: disruptors, trends and intervention. We view Millennials as the key disruptor of our times. This emerging generation will be the investors of the future. They will also be the customers of the companies in which we invest. They have a heightened sense of society and the environmental challenges we face. Technology has enabled greater access to information than previous generations and is shaping how Millennials view the world.

One continuing trend that will be significant for 2016 is climate change. While the Paris Agreement was a success in many ways, the changing political landscape provides questions as to how the commitments made by world governments will be implemented. Finally, more and more regulation is being introduced around the world which places greater onus on companies to deliver environmental and social solutions. This shifting responsibility will create both challenges and opportunities for the corporate sector. Investors will need to ensure that wider stakeholder views are considered in investment decisions, as these often have an impact on future government legislation. The UKSIF conference covered a number of interesting ESG areas, including executive remuneration and pay gaps, ESG ratings, the auto industry's emission challenges, operating in world heritage sites and fiduciary duty.

European Commission

At the European Commission DG Environment, Standard Life Investments met with representatives to provide an investor's perspective on the significance of integrating environmental, social and governance matters into the investment process. We also asked EU representatives to consider regulation that will be useful for investors, as well as easy to adhere to by companies. Standard Life Investments is keen to reduce the reporting burden on companies, but also wishes to ensure that market relevant data is provided on ESG matters by the companies in which we invest. We believe the right regulation will be key.

Responsible Business Summit

Standard Life Investments participated in a panel session at this year's annual Responsible Business Summit in London. The session, entitled 'Investor Clinic: build a transparent relationship with the investor community to deliver bottom line value', allowed us to provide an investor's perspective on what we seek from the companies in which we invest. We looked at how we were searching for innovative companies that could deliver solutions to the world's problems in a profitable manner. We encouraged relevant reporting, rather than reporting for reportings sake. This would allow investors to distinguish whether corporate responsibility commitments were truly at the heart of a business, or just lip service. In addition, we called for strategic business-orientated sustainability outcomes. Companies will no longer be able to justify their existence by their bottom line. Forward-thinking companies are already beginning to disclose the broader value to the environment and society they bring. This will need to be reflected through a company's mission and strategy statements, in order to ensure they maintain their licence to operate.

Presentation at BIER Conference

The Beverage Industry Environmental Roundtable is a technical coalition of leading global beverage companies focused on advancing sustainability within the sector. The group works as a technical knowledge base, a conduit for transparency in the supply chain and an engagement vehicle with stakeholders. Its members are made up of 23 leading global beverage companies, with $2,620 billion in combined annual revenue and over 2,100 facilities in 170 countries.

We spoke at the group's bi-annual conference detailing the challenges that we see for the sector and the types of disclosures we expect from companies. A recurring theme among attendees was the large number of requests for data and a lack of understanding of how this information was actually used by investors. This is an issue we are witnessing across sectors and our views are highlighted in an article within this report.

Ethical Corporation Responsible Business Summit

During the quarter, a number of people from Standard Life Investments attended the 10th anniversary PRI event in London: 'Shaping the Future of Responsible Investment'. The conference assessed a number of industry trends, with time to reflect on the past decade of responsible investment growth and developments. As a new focus, it looked at the risks and challenges to a sustainable financial system. Several leading figures from within, and outside of, the industry provided input into the discussion. This included talks on considering wider stakeholder views, active ownership, aligning senior management incentives with shareholders and continued discussions about the importance of climate change. Standard Life Investments would like to congratulate the PRI on the past 10 years and what it has achieved during this time. Looking forward, the PRI has started to undertake a wider consultation on what is in store for the next decade, and we will be contributing our thoughts to this.

Innovation Forum: Sustainable Extractives

We presented our views at an event hosted by the Innovation Forum exploring how to manage risk and negative uncertainty within the extractive sector. The forum explored a number of areas, including local content, reducing non-technical risk and future standards of human rights and business.

We offered our view on the stranded assets debate. This explores how the challenges of reducing emissions, as well as the potential mechanisms to achieve this goal (such as increasing the cost of carbon), can make many extractive activities commercially unviable. We highlighted that certain extractive activities will face economic headwinds, although warned against a 'broad brush' approach to the topic. A detailed assessment is required to fully assess the potential of stranded assets. This includes site-specific reviews and an assessment of the markets on which products are sold. We have produced a report offering further insights on stranded assets, which is available on our website.

Sector and asset class reports

Andrew Mason
Analyst, Responsible Investment

Standard Life Investments is a founding member of the Investment Leaders Group (ILG). The aim of the ILG is to examine ways to generate long-term investment returns within a sustainable economic, social and environmental framework.

Lower risk

In January 2013, the ILG, a global network of pension funds, insurers, asset managers and academics from the University of Cambridge, started to develop an intellectual model to demonstrate how responsible investment creates value in the real economy, with a view to strengthening its application within markets. Following extensive research, the group produced a report highlighting the key facets of responsible investment including its definitions and purposes, the moral and investment case, and the potential actions that can bolster its application. Importantly, it also found that good environmental, social and governance (ESG) practices can serve to reduce the risk within investment portfolios. In addition, it was revealed that investee companies with sound ESG practices often enjoyed lower firm-level risk and lower cost of capital.

Building upon this work, the ILG focused on social and environmental risk factors affecting financial markets. The first area of enquiry pertained to the future risks posed by climate change, notably in creating economic shocks. This project was conducted by three Cambridge research groups in conjunction with various ILG members. The group produced its findings in a report called "Unhedgeable Risk". This details the potential economic shocks that could adversely affect investors and the annual growth rates required to achieve long-term growth in the face of these risks.

Moving from concept to implementation

The ILG subsequently moved from concept to implementation, with a focus upon three key areas: the issues arising from short-termism in financial markets, the development of a model to measure the impact of climate regulation on companies and portfolios, and the creation of a framework which calculates and communicates the social and environmental impacts of portfolios.

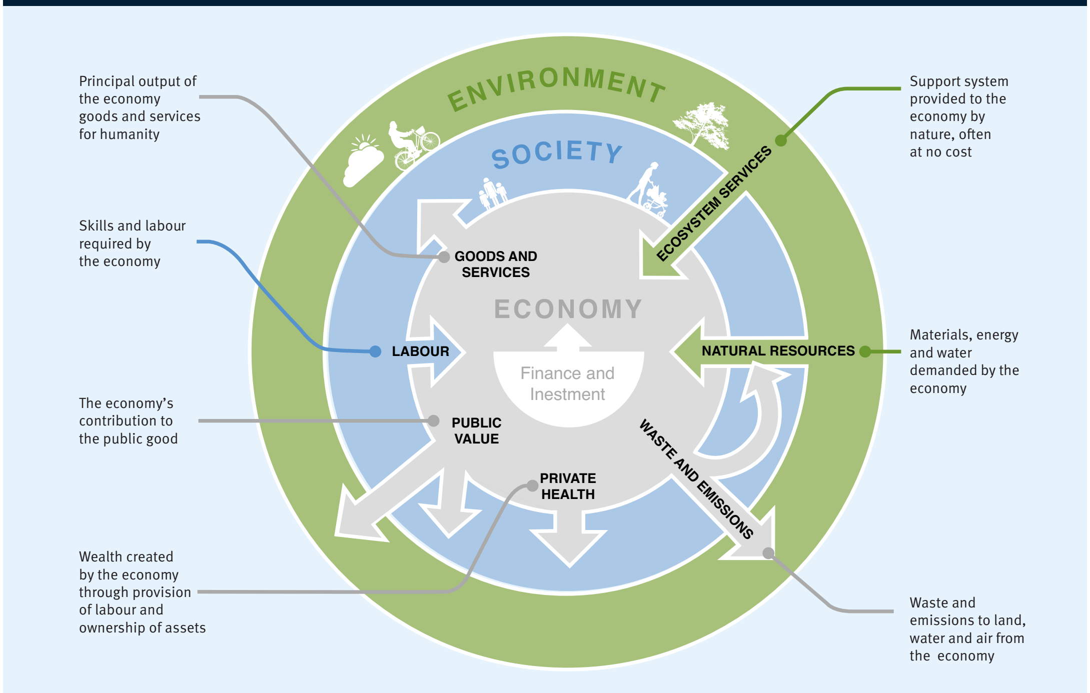
Short-termism has been identified as a cause for economic instability. To address this, the group created a toolkit of investment strategies which could be used to help create long-term responsible and sustainable investment. This was defined as investments that promote long-term value creation within companies and the economy as a whole. The toolkit offers 10 design features, which can be adjusted and applied by asset owners to suit investment time horizons. This work also contributed to new guidance issued by the US Department of Labor on economically targeted investment practices and the benefits they create for society.

Modelling the impacts of climate regulation on portfolios broke from traditional measures of climate risk and sought to measure the short-term impact of environmental change. The group recognised that while investors have access to top-down macroeconomic research on the likely impacts of climate change, there has been a lack of bottom-up company-level tools that could support improved stock-picking. The model was applied across three high-risk sectors (electric utilities, oil refining and natural gas) in five key countries, namely the UK, Spain, Germany, Canada (Alberta province) and the US (California). The findings reveal that carbon and energy regulation can impact companies' margins; companies' risk mitigation activities are significant; and energy and carbon risk assessments can facilitate stock-picking.

The ILG considered the influence investments have upon social and environmental structures. Understanding these impacts and encoding their characteristics into mandates could deliver investment opportunities that have positive social and environmental effects in addition to offering strong returns. A framework was developed which clustered and prioritised the United Nations Sustainable Development Goals into a set of six impact metrics. These metrics can be applied to any portfolio to assess how portfolios impact social and environmental systems. The aim of the work is to enable and facilitate consumer choice and to allow asset owners to understand both the financial and societal benefits of their assets.

We believe that to ensure long-term prosperity, financial, social and environmental systems need to work in unison (see Chart 1). The belief that stable economies often rely upon stable social and environmental systems informs our investment philosophy – and our work with the ILG has served to develop and inform our approach.

Chart 1: Inflows and outflows from an economy



Company disclosure - the need for quality over quantity

Sir Arthur Conan Doyle once said that "any truth is better than indefinite doubt". As investors, we base our decision-making on the most up-to-date and accurate information possible. This means we also demand ever greater disclosure from our investee companies.

Sustainability reporting has certainly evolved over the years. Initially, a report would be a simple description of the company's philanthropic activities accompanied by a flattering picture of the CEO. However, reporting standards have improved immeasurably. Now, reports are far more comprehensive, detailing how companies are addressing their numerous ESG risks and opportunities. This can include everything from detailing levels of greenhouse gas emissions from company travel to the investment made in employee training and retention. Demand from the investment community has not been the only driver of increased investment reporting: companies can leverage such reports as a way of creating positive external recognition. In addition, society as whole expects great transparency from corporations and demands ever more information from them.

Setting standards

The Sustainability Accounting Standards Board (SASB), a US based non-profit organisation, has recognised the need for companies to disclose issues linked to ESG practices. It acknowledges that current standardised financial reporting is largely focused on the ability to access financial capital.

It is SASB's mission, through a series of guidance initiatives, to allow companies to report on ESG considerations through SEC Form 10-K or 20-F filings. In order to achieve this goal, the group has produced a number of standards for different sectors.

The Global Reporting Initiative (GRI) was one of the first initiatives to offer guidance on sustainability reporting, transforming from a niche organisation in the 1990s to a standard now applied by many large organisations. This reflects the GRI's hard work and the increasing relevance of ESG consideration among companies, investors and society as a whole. During this quarter, the initiative discussed the latest evolution of its 'Guidance from GRI: G4 Guidelines to GRI Standards' to a global audience of companies from across sectors at its annual conference.

Finally, the International Integrated Reporting Council (IIRC) is a global coalition which seeks to integrate financial stability and sustainability in both reporting, behaviours and decision-making. Although already well-established, the IIRC has designated 2014–2017 as its breakthrough phase, with an aim of generating a large-scale shift that will see its principles become the international standard.

These standards do not operate in isolation and individual companies have produced reporting practices which are both complementary and more robust to the standards listed above. For example, SSE's integrated reporting has come to be viewed as a benchmark for other companies to follow. Meanwhile, LafargeHolcim's IP&L (integrated profit & loss) report has set a target for new ways of reporting.

However, this broad spectrum of reporting can present a problem for both investors and companies. For the former, it can be difficult to compare companies applying different standards as each framework has its own view on how materiality should be determined, reported and assured. For some companies, there is a risk that reporting standards start to lead an individual company's strategy. For example, a policy might suddenly be produced for an immaterial part of the company's strategy, in order to ensure that the standard's guidance is met.

A recent report by the UN Environment Programme and others found a significant increase in the number of sustainability reporting trends applied globally. The table on the next page highlights this growth in both mandatory and voluntary reporting instruments over a ten-year period from 2006.

Index inclusion versus onerous demands

Reporting does not stop here. Companies must also complete numerous questionnaires and submit information to be used in indices. There are plusses and minuses to this process. On the one hand, they can help companies gain recognition, allow them to test and improve strategies, and communicate more easily with investors. On the other, the process can be time-consuming and financially arduous. Indeed, the questionnaire for the Dow Jones Sustainability Index runs to several hundred pages; similar questionnaires are required for the MSCI, FTSE4Good, EIRIS/Vigeo, London Benchmark Group and many more. Companies that fail to complete these reports may run the risk of being excluded from passive fund products.

While the goal of standardisation is to be welcomed, there are caveats. For one thing, this endless stream of reporting in the name of transparency can result in companies suffering so-called 'reporting fatigue'. Indeed, one of our investee companies stated that it requires a full-time employee, backed by additional support, to meet its reporting demands. Adding, "we are asked hundreds of things in a hundred different ways and can't do what is being asked of us as we are too busy reporting". As for investors, this huge volume of reporting can lead to information overload and a lack of clarity.

Next steps

As investors we do not believe that this is the best use of resource. However, investors and companies are not entirely blameless for this 'opaque transparency'. Companies, for example, have add to the magnitude of reporting as they seek to gain recognition and commercial advantage via their sustainability initiatives.

For example, the Principles for Responsible Investment (PRI) currently has over 100 separate ongoing engagements, ranging from requests for sectors to sign-up to certain pledges to specific requests for companies to disclose details of, or adopt, certain practices. Investors also increasingly seek ever more detailed information, adding to the burden.

While these engagements can be beneficial for both investors and investee companies – and Standard Life Investments has taken part in a number of PRI engagements – the continued expansion of engagement initiatives is becoming unnecessarily burdensome for companies.
Not only that, the sheer deluge of information ultimately diminishes its significance.

So, what can be done? First, we must assess the types of information available and how they are put to use. Standard Life Investments recently applied a number of data points to understand climate risks within portfolios and, separately, to measure the social and environmental impact of portfolios. Even with the significant amount of disclosure detailed above, it proved difficult to find reliable quantitative data to fully measure portfolios. To avoid a lack of clarity for investors and ever-increasing demands on companies, it is therefore important that investors and investee companies collaborate. Progress has been good in this regard, with the SEC about to begin a public consultation on sustainability disclosure within filings, which could act as a hub to bring views together. Further, organisations such as the Global Initiative for Sustainability Ratings are working to bring clarity to the various ESG disclosures. Ultimately, investors, companies and reporting standards must work together to condense and provide one version of the truth, if the production and application of ESG information is to develop.

Trends in sustainability reporting instruments		2006		2010		2013		2016	
Reporting Instruments	Mandatory	35	58%	94	62%	130	72%	248	65%
	Voluntary	25	42%	57	38%	50	28%	135	35%
	Total	**60**		**151**		**180**		**383**	
Countries & Regions		19		32		44		71*	

Source: Carrots and Sticks: Global trends in sustainability reporting regulation and policy.
*64 with instruments.

Engaging on anti-bribery & corruption

Corruption is a major impediment to sustainable economic, political and social development. It can impact across all sectors and geographies, and increases the cost of doing business, restricts cross-border investment and trade, leads to the inefficient use of public resources and erodes public trust in both business and the state.

As a result of its clandestine nature, it is difficult to measure the cost of bribery & corruption globally. The best approximation comes from the World Bank, which estimates some $1 trillion each year is paid in bribes globally.

The majority of bribery & corruption cases brought by regulators result in fines levied on businesses, rather than criminal convictions against individuals. These fines can therefore affect the company's long-term profitability and, in some cases, lead to declining share prices. As such, it is investors that ultimately pay the cost. The table below highlights the reported losses from large company corruption scandals.

Company	Estimated Losses (US$)	Date	Scandal	Impact
WorldCom	107 billion	2002	Accounting fraud	- the biggest bankruptcy in US corporate history - 20,000 workers lost their jobs
Volkswagen	87 billion	2015	11 million cars worldwide fitted with a so-called 'defeat device' that ran the car below normal power and performance when an emission test was occurring	- impact of corruption scandal still unfolding - significant damage to Volkswagen's brand and the wider automotive sector
Enron	74 billion	2001	Accounting fraud	- largest corporate bankruptcy in US history until WorldCom's bankruptcy - 5,000 workers lost both their jobs and the majority of their pensions, which were invested in Enron stock
Petrobras	21 billion	2015	Alleged diversion of billions of dollars from company accounts for their executives use, or to pay off officials	- impact of this corruption scandal is still unfolding - significant damage to Petrobras's brand and to Brazil's image as a destination for investment. - service providers have downgraded the company's credit rating

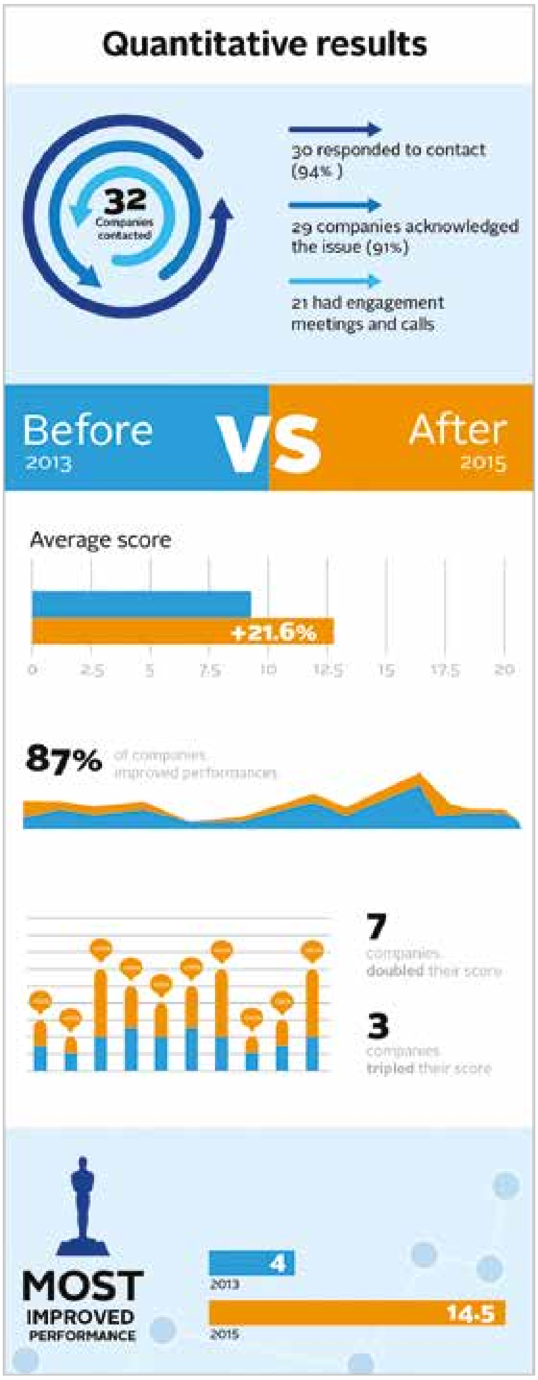
Company	Estimated Losses (US$)	Date	Scandal	Impact
Various International Banks	9 billion (in fines)	2012	Manipulation of LIBOR interest rate benchmark	- fines and other prosecutions - public loss of confidence may drive down the wider finance industry profits for years
AIG	3.6 billion	2005	Accounting fraud	- largest quarterly loss in 2008 - bailed out by US taxpayers
Siemens	3 billion	2008	Payment of bribes for contracts	- significant loss of trust - focus on improvements appear to have helped rebuild the company's reputation
Olympus	1.7 billion	2011	Accounting fraud	- cut 2,700 jobs - scrapped around 40% of its 30 manufacturing plants globally (It is unclear how much of this restructuring was as a direct result of the corruption scandal)

Source: PRI report "Engaging on anti-bribery and corruption" 2016

At Standard Life Investments, we regularly engage with investee companies to assess the steps being taken to manage the risks posed by bribery & corruption. This includes ascertaining the policies that companies have in place to tackle the problem. To facilitate this – and with support of the Principles of Responsible Investment and other asset managers – we engaged with number of companies between 2013 and 2015 in order to:

- gauge their ability to manage the risks presented by bribery & corruption
- ascertain how they achieve enhanced transparency on these measures
- assess how they meet regulatory demands
- understand the risks to invested capital as a result of their ability to manage bribery & corruption.

To support our understanding, the group commissioned Transparency International to evaluate the public disclosure of 45 selected companies relating to their approach to bribery & corruption. Businesses were measured against 13 indicators, set out by Transparency International's "transparency in corporate reporting methodology", and five additional indicators produced by the investor group carrying out the engagement. Following the results, 32 of the companies were selected for direct engagement. We carried out a second assessment of these businesses in 2015. At that time, we found that average scores had increased and a number of companies had actually doubled their score. The graphic below shows the quantitative results of the engagement.



During this process, we found that companies had improved disclosure on the policies they had in place. However, it was clear that the majority of companies found it difficult to detail how the policies were actually applied. It was also noted that reporting on whistle-blowing hotlines was inadequate or unavailable. As such, we stressed to companies that data on the application of policies and the use and monitoring of hotlines was important to investors and encouraged companies to make this information publicly available.

As with the improving practices among businesses, regulators have upped their game. For example, the UK's Bribery Act and the US's Foreign Corrupt Practices Act mean regulators can apply domestic laws to miscreant companies operating in other geographies. Globally, there have been positive steps to tackle bribery & corruption.

This year heralded the landmark International Anti-corruption Summit, hosted by UK Prime Minister David Cameron and attended by business leaders, politicians and civil servants. During the conference, numerous heads of state signed a global declaration against corruption. Signatories have committed to expose corruption, pursue the corrupt and support victims of crime wherever they see it. This replicates and supports Sustainable Development Goal Sixteen, which seeks to reduce bribery & corruption in all its forms.

We will continue to engage with companies on bribery & corruption. Recently, we supported a joint publication by the PRI and the United Nations Global Compact (UNGC), which offers a guide to investors on all the major facets of this important issue. We believe this is an excellent example of cross-collaboration between individual investors, the PRI and UNGC.

Sustainable real estate investment update

Graham Baxter
Real Estate Sustainability Manager

In the second quarter of 2016, the focus of our sustainable real estate investment (SREI) work has been in two key areas: stakeholder engagement and our 2016 submission to the Global Real Estate Sustainability Benchmark (GRESB) Assessment.

Stakeholder engagement

Following the publication of our 2015 annual report and updated SREI policy framework earlier this year, we are engaging with our stakeholders to embed our strategic priorities. In May, we held a sustainability workshop in London for 50 of our principal external suppliers, including our managing agents and external surveyors. Sessions were structured around the three strategic priorities – occupier satisfaction, resource scarcity and climate change – and the discussion of opportunities in different contexts was extremely productive. We will be holding a similar session over the summer in our Paris office to engage with our overseas suppliers.

An additional key area of focus is engagement with our tenants and, specifically, the development and roll-out of sustainable fit-out guides. These are being produced for each of our three main real estate sectors – retail, office and industrial – and aim to provide practical guidance to tenants on how to consider sustainability during fit-out works to maximise the benefit from our strategic priorities.

Global Real Estate Sustainability Benchmark Assessment 2016

We are currently preparing our fund submissions to the GRESB Assessment, which closes on 1 July. In 2015, 16 of our funds were ranked as Green Stars. This year, we will again submit all of our direct real estate funds to the Real Estate Assessment and will, for the first time, submit our real estate debt funds to the GRESB Debt Assessment. Results are due to be published in September.

Company engagement

During the second quarter of 2016, we engaged with a wide variety of companies regarding environmental and social issues. Below is a snapshot of this engagement.

Engagement snapshot

Company	Topics discussed
Alliance Data Systems	Approaches to data privacy and security
Anadarko	Human rights
BHP Billiton	Focus on the group’s exposure to coal
Electricity de France	Changes to senior management and approach to renewable energy
Glencore	Annual SRI analyst meeting
Great Portland Estates	Sustainable building practices and environmental impact
Joules	Approach to animal welfare and human rights
JP Morgan	Corporate culture and support to local economies
Pearson	Challenges with educational testing
Royal Dutch Shell	Annual SRI analyst meeting

Further details of these interactions, in addition to a summary of all company meetings, can be found below. We use a matrix approach to identify the companies with which we engage. This approach considers a number of criteria, including: internal mandates, specific client mandates and company performance.

The key below offers details of the drivers for engagement with individual companies. Additionally, further information on our approach to engagement can be found at :

http://www.standardlifeinvestments.com/sustainable_and_responsible_investing/engagement.html

Key

- Internal mandate
- Client mandate
- Performance based engagement

Alliance Data Systems

Engagement driver	
Engagement driver: Client mandate Engagement topic: ► Labour ► Ethics	Alliance Data Systems (ADS) provides data-driven and transaction-based marketing and customer loyalty solutions, predominantly in North America. The company offers a portfolio of integrated outsourced marketing solutions, including customer loyalty programmes, database marketing services, consulting, analytics and creative services, email marketing and private label and co-branded retail credit cards. We met with the Head of Investor Relations at ADS in April to talk about the company's approach to data protection and data privacy for its customers. The company had a major data breach at its Epsilon subsidiary in 2011. In addition, the sector in general is under regulatory pressure in the US and the EU as a result of the lack of transparency industry and structural vulnerabilities around data privacy and security. We inquired about the company's risk exposure in these areas and what policies and procedures it has implemented. The company stated that it now has a robust approach to data security, partly in response to the experience with the Epsilon breach. This includes appointing a Chief Information Security Officer at Epsilon, conducting regular data security inspections, providing training and adopting key data security management practices. While determining the depth and details on data security transparency is challenging, we are pleased to note that the company appears to be in a good position vis-à-vis upcoming legislation on data security. The company also stated that it believes the impact of these regulations will be minimal. In addition, ADS also demonstrates best practice with respect to marketing with its 'opt-in' approach for loyalty card programmes, while regulation only requires an 'opt-out' option for clients. Given the overall lack of transparency on data protection and privacy, and therefore the subsequent structural risk for increased regulation for this area, we will monitor the situation in the sector and at the company to determine if ADS warrants revisiting for engagement.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Anadarko

Engagement driver:

- Internal mandate
- Client mandate
- Performance based engagement

Engagement topic:

- Human Rights

Anadarko Petroleum Corporation is an independent oil & gas exploration and production company with international operations. In the US, the company operates in Texas and surrounding states, the Rocky Mountain region, Alaska and the Gulf of Mexico. Internationally, Anadarko has exploration and/or production operations in Africa, Asia, South America and the Caribbean.

In March, we met with representatives from Anadarko, including the VP of Corp Communication, the General Counsel and the VP of Environment, Health & Safety. In addition, we were joined by other institutional investors in Anadarko through the Principles for Responsible Investment network.

We met to discuss the company's progress and policies on human rights, particularly with respect to Mozambique, which has been identified as the region where the company has the highest levels of risk. We also discussed the governance of human rights in general at the company, such as its enterprise risk management system and how it was embedded in day-to-day operations. Important to this discussion is Anadarko's consideration of membership in the UN's Guiding Principles on Human Rights (UNGP) and its move towards potential certification of its operating procedures and processes.

We questioned the company about how it is currently evaluating ways to enhance awareness and disclosure of its human rights policies and procedures externally. It has been evaluating the UNGP for some time and it stated that the approach it has taken is consistent with the Principles. However, the company has not formally signed-up to the Principles because it wanted to develop an approach that was robust enough before moving in that direction.

We pressed Anadarko regarding its plans to develop assessment and monitoring in line with the UNGP. The company stated that human rights are considered within the Environmental, Social, and Health Impact Assessment (ESHIA) process that it has developed. In Mozambique, the company is also meeting IFC standards to ensure that outside funding, which is part of the project financing, remains uninterrupted. Anadarko also stated that it is following the same processes globally but that in Mozambique there has been a strong focus on relations with local communities, grievance mechanisms and the resettlement process. Colorado was also a region where strong community interface systems have been an asset.

We inquired about the company's involvement and impression of IPIECA, the global oil & gas industry association for environmental and social issues, of which it has now been a member for two years. Anadarko said it gained value from the association because it is a good forum to share knowledge and learn about best practice from competitors. Finally, we pressed the company on how the governance of human rights is organised from the top down to the kind of training systems it had in place to ensure effective implementation of its policies and procedures.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Anadarko (continued)

Engagement driver:

- Internal mandate
- Client mandate
- Performance based engagement

Engagement topic:

- Human Rights

In response, Anadarko provided details of its enterprise risk management system. In Mozambique, it has established a stakeholder engagement group with a strong focus on community engagement. A large number of community meetings have taken place, which is critical as the project requires voluntary resettlement; as such, community involvement is essential.

Looking ahead, we aim to follow up with Anadarko on stakeholder engagement and grievance mechanisms, as well as the possibility of the company becoming a signatory to the Voluntary Principles on Business and Human Rights. We are looking to see further development and involvement by the company in key human rights initiatives that will help improve its policies, procedures and therefore its overall risk profile.

BHP Billiton

Engagement driver:

- Internal mandate
- Performance based engagement

Engagement topic:

- Environment

BHP Billiton is a UK-listed metals and mining firm with operations around the world. The company's diversified minerals portfolio includes iron ore, copper, coal, nickel, gold and oil & gas.

We met with BHP during the last quarter to discuss the dam failure at Samarco. On 5 November 2015, the Fundão tailings dam failed at an iron ore mine operated by Samarco in Minas Gerais, Brazil. BHP has a joint venture in the dam. We are continuing to monitor BHP's progress with its remediation and compensation programmes following the accident.

Last quarter's meeting was focused upon BHP's exposure to coal, its current coal assets and what place it believes coal will have in a future energy mix. BHP highlighted that it agrees with the findings of the IPCC (Intergovernmental Panel on Climate Change) that climate warming was influenced by human activities and that it would have an impact on the planet. The company explained that it had a diverse portfolio which is resilient to the transition to a climate where global average temperature rises are limited to 2°C.

BHP recognised the demand for, and cost of, coal has decreased and stated that by focusing on its operations, maintenance and supply it had reduced costs significantly enough to ensure the business remains successful. It also highlighted the longer-term coal market outlook remains positive thanks to demand from countries like India. The group has been creating synergies with other parts of its business, such as replicating some of the operations applied in the production of iron ore, which is reducing the cost of production.

We recognise the negative impact that the burning of coal has on the environment and that a number of asset owners and managers have chosen to reduce exposure to, or completely divest from, companies that produce coal. We also recognise the increasing demand in regions such as India and South Asia. We are supportive of green energy production in these regions and understand that the current energy mix and GDP growth requires the continued use of coal at this stage of the energy transition.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Électricité de France (EDF)

Engagement driver:

Performance based engagement

Engagement topic:

- Labour
- Environment

EDF produces, transmits, distributes, imports and exports electricity. The company, using nuclear power, coal and gas, provides electricity for French and other European energy consumers.
We engaged with EDF in April regarding changes to leadership and strategy. We met with investor relations representatives and the Vice President for Sustainability Development Eric Maucort. We asked them to outline current developments regarding the new CEO, the projections for renewables growth, development of the energy management services business developments in the nuclear power systems, as well as related UK market developments.

The company revealed a new strategy last November with the arrival of the incoming CEO Jean-Bernard Levy. The company announced a move to decrease exposure to France and nuclear power generation with strong renewables growth and foreign market projects. In addition, we discussed the extension of the executive committee to five new members and reviewed the new responsibility breakdown and creation of a unified international division of EDF. The company stated that the new organisation would be structured with thermal and nuclear generation grouped together, while hydroelectric power would be included in with the renewable energy generation division. The unified international division would consist of nuclear, thermal and hydro. Further details of this strategy, titled 'Cap2030', will be made available to stakeholders in the summer of 2016.

We are pleased to see the company commit to an increase in renewable energy generating capacity from 28 to 50 gigawatts (including hydroelectric) by 2030, which would imply a growth rate of 1.5 gigawatts per year. The initial objective would be to grow the portfolio by 10 gigawatts by 2025 globally with a focus on mature markets (US and Europe) and some additional development in emerging markets such as South Africa, India and Chile. Currently, renewables make up 5% of the company's generation assets (9,063MW). EDF also outlined the development of energy management services in France, mainly through its Dalkia subsidiary. The company will work with large industrial customers and local authorities, which it hopes will help it retain those customers who are concerned about tariffs. For smaller clients, the focus will be on providing technical expertise as well as financing solutions.

In addition, EDF discussed the challenges and headwinds around nuclear – a complex situation with future government's decision-making playing a big role in the outcomes. The company outlined a large capital expenditure programme around its nuclear facilities, including €55 billion to be spent by 2025 with €500 million average per reactor. This capital expenditure includes €3.3 billion spent on maintenance, and the remainder on safety and extension of the nuclear generation portfolio. In July, the French government announced the merger of the Areva and EDF nuclear operations, which EDF stated would require an additional €4-5 billion in capital. Of particular interest has been the delays to the Flamanville plant, with an estimated delivery date of 2017. The company also has expansion plans for China, France and the UK for nuclear facilities.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Glencore

Engagement driver:

- Internal mandate
- Client mandate
- Performance based engagement

Engagement topic:

- Human Rights
- Labour
- Ethics
- Environment

Glencore held its annual SRI analyst meeting on 13 June. The meeting was chaired by Chairman Tony Haywood, with CEO Ivan Glasenberg providing the key performance highlights and next steps. The company has made significant progress over the past few years in managing its sustainability strategy, and made some positive changes to management systems since it purchased Xstrata. Glencore continues to face key risks given the regions where it operates (where many other multi-nationals refuse to go) and the markets in which it operates (particularly coal). In our view, the company is exposed to three key risks: its health & safety performance, climate change and risks of asset stranding, and business ethics (including bribery & corruption).

While the company had a significant health & safety incident earlier this year, we believe this was an isolated occurrence. This is because it happened at a newly acquired mine, which has yet to implement Glencore's strengthened health & safety systems that were rolled out a couple of years ago. Overall health & safety statistics have improved, with a 62% reduction in fatalities since 2013. The Kazakhstan mining industry has a notoriously poor health & safety record, although this has improved of late. The company stands out as a leader in this region and supports the view that the past few years have seen a cultural shift in health & safety attitudes. We were encouraged Glencore has committed to undertake a special review of its tailings dams in 2016.

While the group did not see any significant environmental incidents over the past year, and has worked to reduce direct environmental impacts (such as SO_2 emissions), its exposure to the thermal coal market raises the company's profile among climate change activists. It is exposed to the stranded assets debate, although it should be noted that fossil fuel activities represented just 5% of revenues and 26% of EBITDA in 2015. The company remains very bullish on coal. That said, it has recently mothballed a number of its coal mines, believing there is no reason to take the asset out of the ground if it is not needed. Glencore is using the opportunity to upgrade these facilities to bring them back on line when the coal environment improves. The company is also actively seeking to increase its exposure to coal assets through acquisitions.

While climate change remains a risk, we were encouraged to see the company produce a report on climate considerations for its business. However, we do not believe Glencore has considered sufficient scenario planning for the business over the longer term. The group remains exposed to a move away from coal-fired power, but it remains bullish on the market.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Glencore (continued)

Engagement driver:

- Internal mandate
- Client mandate
- Performance based engagement

Engagement topic:

- Human Rights
- Labour
- Ethics
- Environment

The company operates in countries with a high risk of corruption. In addition, through its trading operations, Glencore faces additional business ethics risks. It is exposed to price-fixing allegations (zinc), for instance. While high-level improvements have been made and reporting has increased, we remain concerned that the company runs an internal, rather than independent, whistleblowing mechanism. We would also like to see risk-focused training for different areas of the company, given the myriad of business risks in its operations. These range from bribery & corruption in its mining through to price-fixing through its trading.

We have encouraged the company to be more vocal in the debate around stranded assets and the risks of coal stranding, given its coal exposure. While we welcome its climate change report, we also encouraged Glencore to contemplate more detailed scenario planning on climate considerations for its business. We think the company should think how its business would look through exposure to other minerals and metals. We also promoted better disclosure of how it manages its business ethics risks, including reporting on incidents, follow-up and action in detail.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Great Portland Estates

Engagement driver:

Performance based engagement

Engagement topic:

- Labour
- Environment

Great Portland Estates (GPE) invests and develops freehold and leasehold properties, focused on the central London office market.

We previously met with GPE during the second quarter of 2015. During the meeting, we were encouraged by the steps taken by the group to limit environmental and social impacts within its operations. We did question GPE as to how it incentivised employees, highlighting that certain areas of its business required a highly skilled workforce.

The group highlighted that it had lost some key employees since our last meeting and that its approach was to reward employees based on company not individual performance. GPE could therefore lose employees to competitors that reward individual achievement; however, we favour GPE's approach, which we believe is more likely to ensure the best use of resource and reward.

This was a positive meeting and GPE appeared well-positioned to take advantage of growth opportunities in London's property market. We highlighted the continuing rise in London house prices at the time of the meeting and questioned what the group was doing to support affordable housing and if it had a large percentage of property lying vacant.

GPE has a low single-digit percentage of property that is vacant, which is due to operations as opposed to profiteering from fallow land. BNP Paribas Real Estate estimates housing prices have risen by 56% since 2012, which is creating significant stress on individuals (particularly low/mid income) trying to establish themselves on the London property market. GPE is aware of the current demands for affordable housing in London and currently provides a percentage of affordable housing to reflect the new private developments in production.

GPE's approach to the environment is robust. All new builds have achieved a BREEAM (building research establishment environmental assessment method) rating of excellent, and very good or excellent on refurbishments. It is currently exploring the application of 'The WELL building Standard', a US model that takes a holistic view of a building.

Overall, we were encouraged by the meeting and believe that GPE has positive practices. The portfolio is entirely London-based and the current affordable housing shortage, increasing population and recently elected new mayor could have varying impacts. We will continue to monitor these areas.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Joules

Engagement driver	Details
Engagement driver: Performance based engagement Engagement topic: Ethics	Joules Group is a UK-based apparel retailer. This was our first engagement with the company following its recent IPO. Our ethical funds seek to invest in companies that support solutions to the significant environmental and social challenges we face, and uphold the highest standards of corporate responsibility. The Ethical Funds Investment Policy sets out a range of criteria, both positive and negative, for assessing companies, which are reviewed regularly based on surveys and consultations. The funds also follow an active engagement policy to challenge and encourage companies to improve their environmental and social performance and practices. The meeting was set up primarily to address concerns about the company's use of Angora fur in its products, which is in conflict with the Policy. The company reassured us that it had completely phased out the use of Angora fur across its product range. We also discussed Joules's approach to sourcing more generally. The company explained the policies and controls it has in place both to ensure animal welfare and human rights in its supply chain. We welcomed this information and encouraged the company to publish more details on its approach to responsible sourcing on its corporate website, which currently has limited disclosure.

Key

- Internal mandate
- Client mandate
- Performance based engagement

JP Morgan

Engagement driver:

Client mandate

Engagement topic:

- Human Rights
- Labour
- Ethics

JPMorgan Chase & Co. (JPM) provides global financial services and retail banking. This includes investment banking, treasury and securities services, asset management, private banking, card member services, commercial banking and home finance. JPM also serves business enterprises, institutions and individuals.

This is the first engagement we have had with the group and it was driven by concerns raised regarding the size and number of fines it has received.

We questioned the company regarding the size of its losses since the financial crisis in 2008. The company highlighted that its own practices had not been as exposed to the significant losses linked to mortgage-backed securities as those of the companies it had purchased, Bear Sterns and Washington Mutual. JPM highlighted that this was largely a legacy issue and that if it had not made these acquisitions, the impact on the US economy following 2008 could have been more severe.

We commended JPM's 'How we do Business – The Report' document that it produced in 2014. This detailed the progress that the company had made to generate a positive culture within the group, setting the appropriate risk controls and considering the steps it needed to take to support economies. We questioned if the group was going to produce an updated version of the report; JPM advised that it would not.

We questioned what oversight there is of sustainability issues within the group and the steps it is taking to attract and retain employees. JPM has a board-level Public Responsibility Committee (PRC) which meets and reports to the main board on a quarterly basis. The PRC has oversight and responsibility for the company's responsibility charter. JPM does not disclose its employee opinion scores. We believe that this can offer valuable insight to both the culture and employee practices within an organisation and have suggested that the group disclose these scores.

Key

- Internal mandate
- Client mandate
- Performance based engagement

JP Morgan (continued)

Engagement driver:

Client mandate

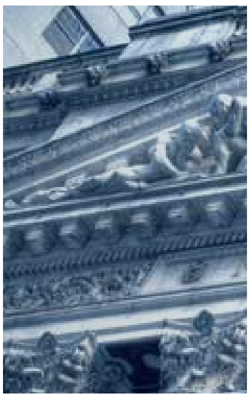
Engagement topic:

- Human Rights
- Labour
- Ethics

We were encouraged by the group's work through its 'Financial Solutions Lab'. JPM seeks to support economic growth and highlights that the income of middle-class America has declined by 4% since 2000, with lower income declining by 9%. JPM will deploy $1 billion on programmes focused on financial data and research. Its 'Financial Solutions Lab' has the following programmes:

- using big data to map economic progress and social impacts
- detailing impact of income fluctuations on households and use of technology to help people manage budgets
- provide funds to support financial inclusion on a global scale
- combat predatory lending
- match employees to employers to avoid a 'train and pray approach' to job creation
- support employment in Latin America
- support CDFI (community development financial institutions) to support local SMEs.

We were comfortable with the response that JPM provided regarding the number of fines received; however, conduct costs have had a significant impact across the sector and we will continue to monitor this area. JPM's 'Financial Solutions Lab' is a positive step and offers a useful example of how the financial sector can have a positive impact on the 'real economy'.



Key

- Internal mandate
- Client mandate
- Performance based engagement

Pearson

Engagement driver:

Client mandate

Engagement topic:

- Labour
- Ethics

Pearson is the world's largest education company, with 40,000 employees in more than 70 countries providing a range of educational products and services to institutions, governments and directly to individual learners.

We had our inaugural meeting with Pearson to talk about its long-term strategy and ongoing restructuring. We met with the Head of Investor Relations and the Head of Sustainability to discuss the challenges related to educational testing, the response the company had to a recent shareholder resolution filed by the American Federation of Teachers, as well as overall strategy delivery and structural changes to the business. The company has sold its UK Financial Times and The Economist, and moved fully into educational services.

Pearson has faced several headwinds regarding its educational testing business, with some negative press surrounding incidents with testing products in the US that involved various issues such as lost test results, incorrect answers on tests and similar events. The business has had some setbacks as a result, with a few high-profile contract losses. However, the company maintains that it is not alone in having difficulty with test delivery. Pearson communicated on its next stage of test delivery, which it believes will be more competitive as it will incorporate more elements of critical thinking and creativity. This is especially the case for US 'Common Core' testing, where the inability to track learning outcomes outside of hard knowledge has been a criticism of the system as a whole.

We also spoke to the company regarding strategic challenges and changes as it responds to competitive threats in the move to online content and direct competition from non-profits, as well as Google entering the educational marketplace. Pearson has announced a restructuring with about a 10% reduction in headcount, which is due to be completed by the end of 2016.

We were encouraged by its strategic plan to adapt to new trends in education, with a focus on digital, high-quality content and adaptive learning. We believe Pearson has already started a strategic shift, which will address many of the concerns raised in the shareholder proposal and refocus the company on value-added online educational systems. We will look to re-engage with the company in early 2017 to discuss the delivery of its overall strategy and restructuring, as well as improvements to test delivery.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Royal Dutch Shell

Engagement driver:

- Internal mandate
- Performance based engagement

Engagement topic:

- Human Rights
- Labour
- Ethics
- Environment

Through subsidiaries, Royal Dutch Shell explores for, produces and refines petroleum. The company produces fuels, chemicals and lubricants. Shell owns and operates gasoline filling stations worldwide.

We engaged with Shell in May 2016 as part of its 'SRI Day', which the company has conducted annually for several years. The meeting was attended by the CEO, Head of Operations and other senior executives, as well as many ESG investors across the financial sector. The agenda included a number of key issues relating to global operations, including the company's adaption to climate change and production portfolio resilience to low carbon scenarios. We also sought details on the management of the worsening security situation in Nigeria and the integration of BG Group, which shareholders accepted in January 2016. We previously spoke to Shell in April 2015.

A year after the 'Aiming for A' shareholder resolution, Shell has published a reported entitled 'Shell - Energy Transitions and Portfolio Resilience' in which it addresses a number of business risks relating to climate change and energy transition. The key points that Shell made for shareholders is that fossil fuels account for most of the energy mix in 2050 in all scenarios given growing energy needs stemming from population growth. This conclusion underpins the strategic direction for managing Shell's portfolio. In addressing questions about the resilience of the portfolio, the company explained that coal will be the most stranded asset and that a shift away from coal to gas is the key for energy transition. Renewables have grown fast but are not enough to replace fossil fuel capacity any time soon. The company stated that it supports a shift from coal to gas, implementation of carbon pricing and the use of carbon capture and storage. In response, we have some outstanding questions as to whether the company is making clear enough links between the scenarios laid out in the report and its strategic decision-making and capital expenditures.

The focus of our discussion with Shell also touched on the situation in Nigeria where the company has been involved for many years and is facing a deteriorating security situation. Shell reported that it has been significantly reducing its exposure to onshore activities via the sales of assets. Following the increase in security threats, Shell has evacuated most of its on-the-ground personnel. Seven staff members and contractors died working for Shell in 2015 and most of these incidents occurred in Nigeria. Major operations in Nigeria now consist of off-shore exploration, which the company views as lower risk.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Royal Dutch Shell (continued)

Engagement driver:

- Internal mandate
- Performance based engagement

Engagement topic:

- Human Rights
- Labour
- Ethics
- Environment

In addition, we spoke about the BG integration. However, many of the details have been delayed for discussion till later in the year when there will be greater clarity. Company executives did explain that BG's health & safety standards were now largely aligned with Shell's standards and that, in general, good progress had been made.

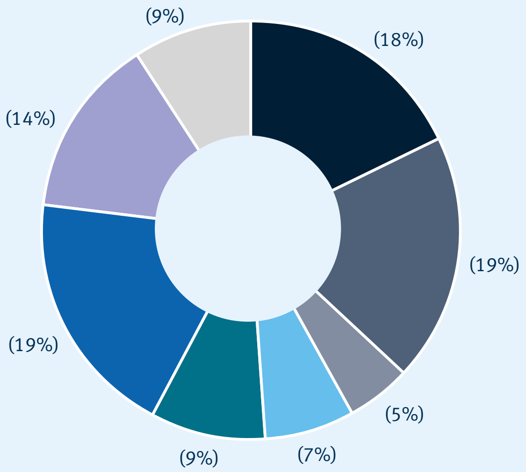
Looking ahead, we will continue to engage with Shell on its strategy with respect to its resilience in the face of low carbon scenarios, as well as getting updates on the BG integration. We will also seek to diversify the agenda of the SRI Day to include more social and human rights risks that were overshadowed this year, partly due to the recent COP21 decisions on the national plans for responding to climate change and the clear relevance to the company's core businesses.

Company engagement summary

	Human Rights		Labour				Environment			Corruption
Company	Principle 1: Support and protection	Principle 2: Non-complicity in violations	Principle 3: Right to collective bargaining	Principle 4: Forced & compulsory labour	Principle 5: Abolishing child labour	Principle 6: Discriminatory practices	Principle 7: Precautionary principle	Principle 8: Environmental responsibility	Principle 9: Diffusion of green technology	Principle 10: Addressing corruption issues
Alliance Data Systems	•	•								
BHP Billiton							•	•	•	
China Overseas Land			•				•	•		
EDF								•	•	
Glencore							•	•	•	
Great Portland Estates	•					•		•		
Johnson & Johnson		•								•
Joules	•									
JP Morgan	•	•								•
Pearson	•	•								
Royal Dutch Shell	•	•					•	•	•	
Santander		•								•
Sports Direct*	•	•	•			•				
Umicore								•	•	
Vedanta	•	•				•		•	•	•
Total	8	8	2	0	0	3	4	8	6	4

*Letter to company

Engagement summary Q2 2016



Principle 1: Support and protection
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Principle 6: Discriminatory practices
Principle 7: Precautionary principle
Principle 8: Environmental responsibility
Principle 9: Diffusion of green technology
Principle 10: Addressing corruption issues

Contact the responsible investment team at

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Important Information

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