Responsible Investment

Quarterly Report
Q4 2016

Standard Life Investments

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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 £269.0 billion (as at 30/06/2016). Our capabilities span equities, fixed income, real estate, private equity, multi-asset and absolute return solutions.

Headquartered in Edinburgh, Standard Life Investments employs over 1,700 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

It has been another challenging and eventful year. The success of the United Nations Climate Conference in Paris (COP21) at the end of 2015 created the momentum needed to reach a global agreement on climate change during 2016.

The Paris Agreement was adopted at COP21 and opened for signature in April. The Agreement seeks to limit the increase in the global average temperatures to 2°C above pre-industrial levels, with a higher aspirational ambition of limiting the increase to 1.5°C. Agreement from at least 55 Parties to the Convention, accounting for the production of an estimated 55% of total global greenhouse gas emissions, was needed to ratify the Agreement. This was achieved in October, and on 4 November the Paris Agreement came into force.

However, the Agreement still faces significant challenges. The Nationally Determined Contributions countries need to make are non-binding under international law; as such, it is not known how the obligations will be enforced. The election of Donald Trump also poses questions over the US's commitment to the Agreement. Despite this, investor momentum in addressing climate change continues. We saw an increasing numbers of shareholders supporting climate resolutions both in the UK and overseas, while scrutiny on corporate behaviour in relation to climate change has intensified.

Unfortunately, we also saw further evidence of rising inequality across the world. Global conflict has displaced large numbers of people, and migration has resulted in population discontentment. This has partly fuelled recent political events, such as the UK's vote to leave the EU and Donald Trump's US election win. This is manifesting itself for shareholders through increased scrutiny of corporate behaviour, by both society and governments.

Elsewhere, the ESG investment industry faced another wave of voting action against companies' remuneration plans, particularly in the UK. There were 21 major company meetings at which more than 20% of the votes were against remuneration resolutions. There was also a rise in the number of environmental and social resolutions that we voted on, from 49 in 2015 to 60 in 2016.

Finally, the UN Sustainable Development Goals grew in prominence during 2016 as investors increasingly looked for tools that can help them align their own activities/investments with the challenges facing society and the environment. We expect this trend to continue as 2017 unfolds.

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

The responsible investment team

Who are we?

The responsible investment team is dedicated to research and analysis of environmental and social issues that have a bearing on Standard Life Investments' client portfolios. We place specific focus on four key areas:

- employment issues
- human rights & community issues
- environmental matters
- anti-corruption.

The team works closely with investment colleagues and seeks to ensure that ESG considerations are embedded throughout our investment process. The team collectively has over 30 years' experience in responsible finance.

The team

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Analyst, Responsible Investment

Andrew Mason
Analyst, Responsible Investment

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Contact the responsible investment team at

esg_investment@standardlife.com

Five questions with Euan Stirling

Euan Stirling
Head of ESG Investment

What were your views of ESG issues prior to joining the team?

- It's more than just another acronym, that's for sure. I have been managing portfolios for some of the UK's more enlightened asset owners for the last 15 years and they have helped keep me on my ESG toes. As a portfolio manager, I have made use of our expertise in governance and responsible investment in my decisions to buy and sell stocks because it often informs on some of the most serious risks facing the companies in which we invest.

How has this view changed and/or developed?

- As our clients' thoughts have evolved on long-term investing, so have our own and I don't necessarily see an endpoint. For example, I think that the capital allocation implications of the COP21 Agreement to limit climate impact are only just beginning to be properly considered. Similarly, the shareholder disquiet expressed on executive remuneration in 2016 is likely to be amplified in 2017 as a reflection of broader concerns in society about fairness, inclusion and a company's licence to operate.

How much demand for ESG investment have you seen from institutional and retail customers?

- The picture so far has been one of steady growth, but the pipeline of client enquiries is definitely enjoying robust momentum. I strongly believe that we have a responsibility as asset managers to understand, as best we can, what our clients are looking for from their investments in both financial and non-financial terms, and then designing investment vehicles that will meet those requirements.

How do you see ESG investment developing in the future?

- The recent past has seen asset managers develop screening techniques to help their clients avoid some corporate risks that they view as harmful to society or the environment. What we are focusing on now is looking for positives to which we can apply our clients' capital, rather than negatives that they wish to avoid. We expect this approach to be significantly more impactful in a number of ways. Firstly, by focusing on companies that take a longer-term view of their own prospects, we can encourage such activities by helping reduce their cost of capital. We can then aspire to a virtuous circle where our clients' capital is being applied in support of a sustainable future, while also seeking to generate strong returns.

We understand that you are a bit of a 'petrol head'? Do you think you could ever become an electric/hybrid head?

- Without doubt! Some of the most exciting cars being produced use pure electric or hybrid propulsion. I'd love to drive a McLaren P1 or a Tesla Model S, but for a variety of financial and organisational reasons I haven't quite managed that yet. While I do like driving, I'm not alone in disliking traffic jams and motorways, especially when they combine. I'm also therefore looking forward to a future of self-driving electric cars. Plug your destination into the map, pick up a good book, and off you go.

Business, Energy and Industrial Strategy Select Committee

Mike Everett,
Governance and Stewardship Director

On 15 November, Mike Everett, Governance and Stewardship Director at Standard Life Investments, formally presented to the UK parliament's Business, Energy and Industrial Strategy (BEIS) Select Committee in relation to corporate governance.

Throughout the session, he answered questions on a host of topics, from directors' duties and executive pay, to board composition and diversity. Below is an executive summary of the meeting.

- We welcomed the Committee's interest in this important area and thanked it for the opportunity to contribute to this inquiry and the further consultation to be undertaken by the government.
- It was aknowldged that the UK has a highly developed and effective framework of legislation and corporate governance codes, and is viewed as a world leader by many other countries. However, it was noted that it is important that companies, investors and regulators such as the Financial Reporting Council continue to raise the standards of stewardship and engagement, thereby ensuring the UK retains this pre-eminent status.
- We highlighted that executive remuneration will continue to be high up the agenda for companies, shareholders and wider stakeholders, all of whom have a role to play in developing the structures, oversight and challenge that will help to align views on remuneration outcomes.
- We noted that there have been improvements in board composition, in particular gender diversity, and the benefits are widely acknowledged. Progress is still required to improve levels of diversity in executive management and this would best be done by providing further support to the various existing initiatives that continue to bring focus to this area.
- We agreed that company boards need to demonstrate they have given due regard to the opinions and concerns of employees, but we stated that we believe there are more effective mechanisms for achieving the desired outcomes than legislating for employee representation on boards. For example, boards could be required to hold formal sessions with employee representatives at least twice a year.

A full transcript can be found here **http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-energy-and-industrial-strategy-committee/corporate-governance/oral/43474.html**

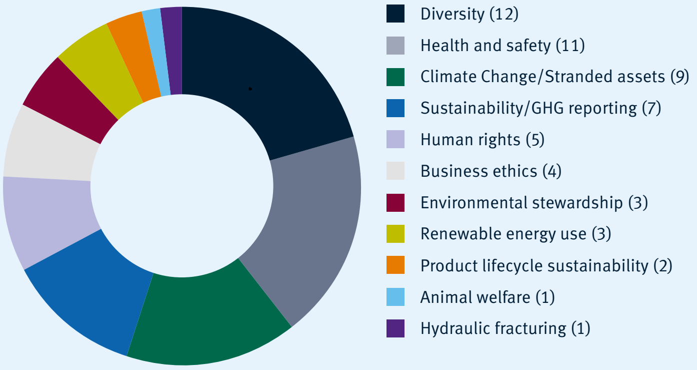
Voting during 2016

We have included statistics below on the number of resolutions in which we took part, specifically those focused on environmental and social issues. Year-on-year we have seen a growth in this area, with specific resolutions increasing from 49 in 2015 to 60 in 2016.

Last quarter, we highlighted the Aiming for A initiative and the various environmental resolutions that we supported. Environmental issues remain an important subject for shareholders and this year we have seen a continued focus on environmental stewardship and sustainability/greenhouse gas reporting.

We have also seen a significant growth of interest in business ethics, mainly relating to companies lobbying activity and companies' health & safety standards. Meanwhile, as stewards of our investments, we recognise how important it is to vote at the various AGMs of our investee companies. We also believe that the change in resolution types and new voting topics raised offers insight to our investment process.

Summary of voting resolution subjects



Source: Standard Life Investments

Collaborative engagement and events

Church of Scotland and Islamic Finance Council

Amanda Young was invited to participate in a private event at the House of Lords, hosted by the Islamic Finance Council and the Church of Scotland. This was the second in a series of three events, at which key participants shared how they were developing their approach to ethical finance within their respective faiths.

In recent years, the Islamic Finance Council and the Church of Scotland have been engaged in a positive dialogue around this issue, with the aim of establishing an ethical financial solution that is financially sustainable, demonstrates social impact and is open to everyone in society regardless of race, religion or ethnic background. The solution is to be based on the shared values between faith traditions.

At the workshop, representatives from various faiths and leaders in the ethical investment space explored the current state of ethical finance and the obstacles facing investment institutions. The third of these workshops is set to be held in 2017.

Fifteenth anniversary of FTSE4Good Index

During the quarter, FTSE Russell celebrated the 15th anniversary of the FTSE4Good Index Series. Launched in 2001, the FTSE4Good Index was one of the first sustainability related indices. It is designed to measure and include the performance of those companies that have strong track records in managing ESG issues.

The FTSE4Good Index provided investors with tools for creating index-tracking investments focused on sustainable investment. When it was initially launched, the FTSE4Good Index was instrumental in encouraging a number of companies to improve their disclosure practices of how environmental and social matters were managed within their businesses. This was largely due to a number of high-profile companies being excluded from the index due to poor disclosure and a lack of accountability.

One of the key drivers of the series was the revision to the UK Pensions Act in 1999, which required trustees to disclose in their Statement of Investment Principles whether ethical, environmental or social considerations were taken into account as part of their investment strategies.

The launch of the UN Global Compact in 2000 also added to the demand for this type of index. This encourages business leaders to commit to adopting 10 principles on how environmental, labour, human rights and anti-corruption issues are managed within their businesses. The UN Global Compact's four key areas of focus form the foundations of the research undertaken by the responsible investment function at Standard Life Investments.

In 2001, the new index series generated substantial press coverage, as well as a degree of controversy. Over the past 15 years, around

1,000 companies have improved standards so that they can be included. Amanda Young sits on the FTSE Russell ESG Advisory Committee, which oversees a number of ESG-related products, including the FTSE4Good Index Series.

As part of the 15th anniversary celebrations, FTSE Russell hosted a market opening ceremony. The honours on the day were carried out by Sir Mark Moody-Stuart, Chair of the FTSE Russell ESG Advisory Committee, and Jenny Anderson, Investment Officer of TPT (formerly the Pensions Trust).

This was followed by a conference entitled "Past-Present-Future of Sustainable Investing". The conference provided an opportunity to reflect on how far the industry has come over the past 15 years, the health of ESG investment today and what the future holds for investors seeking to address ESG factors within their investment processes. The conference featured a roundtable (chaired by Amanda Young) with senior leaders from CalSTRS, Malaysian public pension fund KWAP and HSBC Pension Fund. These leading asset owners provided many interesting insights into the challenges they faced over the past 15 years and shared the many invaluable insights they had learned.

Women in Finance Charter

Our parent company, Standard Life, recently signed the HM Treasury Women in Finance Charter. With commitment from 72 leading financial firms, the charter is designed to improve gender diversity in senior positions within the sector.

The intent behind the Women in Finance Charter fits with Standard Life Group's undertaking to improve and promote all forms of diversity and, as part of Standard Life's wider approach, its commitment to tackling the specific challenges around gender equality.

As Keith Skeoch, CEO of Standard Life, said:

"In signing this Charter, we are taking another important step towards our goal of creating a diverse leadership population and talent pipeline. At Standard Life, we believe it is important to have a fully diverse workforce and we have been taking positive steps to breakdown barriers where they exist. That's why we're pleased to be joining other leading organisations in supporting the Women in Finance Charter. We're looking forward to working together to make a sustained difference."

Further information on the Charter and the extensive work Standard Life is doing to promote it can be found at: http://www.standardlife.com/sites/dotcom/sustainability/employment/women-in-finance.page

Gender equality

As a result of this focus, representation of women on Standard Life's talent pipeline has increased to 43%, and the company is focused on converting this into its senior leadership population. Last year, Standard Life was voted in The Times Top 50 Employers for Women and its award-winning Women's Development Network consistently report higher engagement levels for members than women and men elsewhere in the business.

We have also improved parental transition, have market-leading shared parental leave provisions and have received external accreditation for the support we have in place for working carers.

Our aim is to continue our focus in this area, and we have set progressive target ranges for our leadership population to represent the gender split of our workforce (currently 48.1% female) by end-2025.

Global Water Stewardship Forum

Andrew Mason presented our views on water stewardship at the first Global Water Stewardship Forum, hosted by the Alliance for Water Stewardship (AWS). The forum included representatives from a number of companies, governments and non-government agencies. The central feature of the Forum was to promote and discuss the implementation of the AWS Standard. This is a globally consistent framework for major water users to understand their water use and the impacts that has on the environment, as well as to work collaboratively and transparently for sustainable water management within a catchment context.

We have been taking part in collaborative engagement with fellow investors and the Principles for Responsible Investment (PRI) to assess how companies are managing water throughout the year. We believe that water stewardship continues to increase in importance and at the conference we highlighted the need for companies to take a holistic approach to stewardship on an asset by asset basis. We will continue to drive this agenda with investee companies during 2017.

GlaxoSmithKline site visit

GlaxoSmithKline's (GSK) Irvine site in North Ayrshire is a well-established producer of Amoxil and Augmentin. The site was established in 1973 and received £130 million of investment over the last five years, mainly focused on improving efficiency.

The operation of the plant represents an example of 'best in class'. Initiatives have included a £9 million investment in two wind turbines and £10 million in a biogas facility.

These have reduced the cost of energy consumption and improved waste disposal processes. The site aims to achieve carbon neutrality and currently operates under the key areas detailed below.

- Quality Improvement: integrates CAPA, RCA, Human Reliability, CIA Commitments and Remediation to deliver improved quality performance.
- Safety Improvement: maximise effectiveness of the EHS Blue-chip projects (Occupational Hygiene and Process Safety) through on-site ownership to deliver improved EHS performance.
- GSK Production System: promote zero accidents, defects and waste culture by standardising tools and ways of working to create consistency and excellence throughout GMS sites.
- Process Robustness: improve manufacturing capability by ensuring robust products and processes that meet patients' and regulators' expectations; and by addressing long-term, often hidden, factors associated with poor process robustness.

We were joined on the visit by representatives of the AMR UK government initiative designed to review antimicrobial resistance and led by Jim O'Neill, the former lead economist of Goldman Sachs. GSK is well positioned in this space, producing a wide range of vaccines and antibiotics. It also has close links to the various industry bodies looking to address these issues.

Standard Life Investments engaged with several companies and sector bodies regarding antimicrobial resistance throughout the year. The visit to GSK's plant offered additional knowledge and we will produce a report on the topic in 2017.

Good Money Week

Standard Life Investments was the lead sponsor of Good Money Week, run by the UK Sustainable Investment and Finance Association (UKSIF). Good Money Week is a chance for the industry to raise awareness of all aspects of 'good money'. Standard Life Investments' core message was that customers can invest their money to reflect their values, without foregoing returns. The Good Money Week launch page (uk.standardlifeinvestments.com/ifa/good_money_week) provided access to three short articles to supplement awareness of the campaign: Investing with Responsibility – Wake-up Call; Rise of the Millennials; Impact Investing – from Niche to Mainstream. These articles were supported with the launch of a white paper on impact investing.

Wisdom Council research

In the run up to Good Money Week, Standard Life Investments commissioned research from the Wisdom Council. This research provided insight into investors' attitudes towards ethical and values-based investing (SRI, green, sharia, etc.). In the survey, 80% of UK respondents believed human rights, equality and eradicating poverty are important considerations when investing. The same number of investors did not believe that performance is sacrificed when investing in values-based funds. The research also showed a greater uptake of values-based funds by investors under the age of 40, compared with those over 40. Of those who had not chosen a values-based investment product, 33% were unaware of these types of products and 24% said their pension scheme does not offer this option. This supported the findings detailed in the white paper we released last year, titled: The Rise of the Millennials.

Events

The week also provided an opportunity to hold and participate in several events, which were opened to a number of different audiences. This included an ethical breakfast seminar where topics such as deforestation, selecting positive impact stocks and the Standard Life Investments ethical funds' processes were discussed. Standard Life Investments also participated in the Good Money Week Talks event hosted by UKSIF the preceding week. The discussion was around key 'good money' themes and the real or perceived barriers and opportunities experienced by Millennials. One panel debate was titled "Millennials meet the finance sector: are Millennials changing investment values and needs being met by the finance sector?" The accompanying debate featured Millennials within the finance industry, as well as key professionals from Standard Life Investments, Aviva and Triodos Bank.

Innovation Forum conference on business and human rights

In October, we attended a two-day conference hosted by the Innovation Forum in London on how companies can better manage human rights risks. The event was well-attended by a range of multinational companies, including Nestle, Anglo American, Ikea and Thai Union.

The panel discussions covered topics including modern slavery, child labour, grievance mechanisms, risk mapping and reporting. There were also sessions addressing human rights risks for specific sectors, including agriculture and the fishing industry. Some panels looked at specific human rights concerns, such as Syrian migrants in the Turkish garment sector.

We also attended a session with legal experts on regulation and prosecution of human rights abuses. The legal landscape for human rights is changing gradually. Regulation around reporting requirements continues to tighten in different jurisdictions, including the Modern Slavery Act in the UK and the Trade Facilitation and Trade Enforcement Acts in the US. There is increasing scrutiny of global operations by both the media and the regulator. Companies are seen to have a responsibility for their actions in other jurisdictions, and legal avenues are being explored to hold companies to account in the UK for abuses committed in jurisdictions that have a weaker rule of law.

One of the key challenges for companies remains mapping supply chain risks to operations, especially indirect. A further challenge is engaging and monitoring their suppliers. Companies highlighted the need for collaboration in the pre-competitive space, supported by organisations like the Ethical Trading Initiative. There were also interesting discussions about audits and their limitations, and the emergence of new technologies like Blockchain to bring transparency into complex supply chains.

The conference was extremely insightful, as it showed which human rights issues companies believe are currently the most important and how they address them. It was encouraging to see participation from companies across such a broad range of sectors and that they are increasingly recognising human rights risks in their operations, as well as engaging in dialogue with each other.

Thematic commentary

An introduction to impact investing

While the practice is decades old, the term ‘impact investing’ was coined by the Rockefeller Institute in 2007. Traditionally, it involves investing in companies, organisations or funds with the intention to generate positive social and environmental impacts, alongside financial returns. It was developed, in part, as an acknowledgment that governments and philanthropy cannot solve all the world’s problems alone.

This type of impact investing could entail a charity or foundation building a health-centre or funding vaccination programmes in Africa. While noble, one drawback to this type of investment is that funding can be erratic, reliant on the financial stability and changeable attitudes of a few wealthy patrons.

Going mainstream

More recently, mainstream impact investing has grown in prominence. This involves channelling capital into listed entities that are attractive from a financial position, but that also have a business strategy that can deliver measurable social and environmental returns. Such an investment could include investing in companies operating a closed loop business model, delivering renewable energy solutions, or buying bonds with a specific environmental or social purpose.

Looking to the future

This is a rapidly growing industry: according to the Global Impact Investing Network, around $60 billion went into impact investing globally in 2015. This figure looks set to rise. Indeed, according to JP Morgan, impact investing will reach $1 trillion by 2020. This is likely to be driven by Millennials (18-34 year olds) – a generation increasingly looking for investment vehicles that make a difference to the world.

For asset managers that embrace impact investing and offer suitable products to cater for this market, the future looks bright.

For a more comprehensive look at impact investing, please go to: http://www.standardlifeinvestments.com/WP_Impact_Investing/getLatest.pdf

Authors

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Deforestation and the challenges it poses for companies

Deforestation is not a new issue. However, recent environmental disasters such as Indonesia's forest fires in the summer of 2015 have reignited public interest in the subject. While the net rate of annual forest loss has slowed, 10 million hectares of tropical forests alone are still destroyed annually, an area of the size of South Korea.[1] Deforestation accounts for around 12% of man-made greenhouse gas (GHG) emissions globally, roughly equivalent to the GHG emissions from the transport sector.[2] It is also linked to other issues including land grabs, community displacement and food security. Net forest loss is highest in the low-income group of countries and associated with increasingly rural populations.[3]

The implication for companies

Almost 80% of deforestation is linked to agriculture, with the four big forest commodities, cattle products, palm oil, timber products and soy, accounting for almost a third of global deforestation.[4] While responsibility for tackling deforestation has traditionally been placed on upstream producers, processors and traders, as well as small-scale farmers and local authorities, downstream manufacturers and retailers that rely on forest commodities in their supply chains also have a role to play. There has been increasing scrutiny on multinational companies. Several reports, including the CDP Global Forests Report and Supply Change Forest Trends Reports, track large multinational companies' commitments and actions.

Investors can be exposed to reputational or financial risk either from investing directly into producers or through investee companies' supply chains. When IOI Group, a Malaysian palm oil company, was suspended from the Roundtable on Sustainable Palm Oil (RSPO) for violating its policy on clearing forests earlier this year, its shares fell 18%. Forestry or agriculture assets could experience an unanticipated or premature writedown, devaluation or conversion to liability as a result of a variety of risks.[5]

The reputational risk faced by companies that fail to address deforestation in their supply chain is also high. Criticism and campaigns conducted can lead to consumer boycotts, and can even result in companies being denied finance. There are also operational risks. Twenty-six large corporates decided to suspend their contracts with IOI following its RSPO suspension, including Unilever, Nestle, Mars, Johnson & Johnson and Procter & Gamble. But switching suppliers may be costly and difficult to implement. Only 20% of palm oil is currently RSPO certified, and for timber only 11% of the global forest area is covered by a timber certification, such as the Forest Stewardship Council.[6]

1 World Resources institute Blog http://www.wri.org/blog/2015/09/satellites-uncover-5-surprising-hotspots- tree-cover-loss)
2 IPCC WG2, 2014
3 Food and Agriculture Organisation of the United Nations, State of the World's Forests 2016
4 Supply Change, Supply Change: Tracking Corporate Commitments to Deforestation-free Supply Chains 2016
5 Kepler Cheuvreux, Forest & land degradation 360 report
6 UNECE Forest Products Annual Market Review 2014-2015

The ratification of the Paris Agreement and the United Nation's Sustainable Development Goals are also supporting further initiatives and potential regulation on deforestation to mitigate climate change. The French government, for example, attempted to include a tax on Indonesian palm oil in its biodiversity law passed recently. While the so-called "Nutella tax" was watered down in the final draft of the law, it demonstrates the risk of further regulation.

What companies can do to address deforestation

Companies have made a lot of progress introducing commitments, especially around palm oil and timber. Seventy percent of the companies that responded to the CDP forest questionnaire have a commitment to reduce or remove deforestation and forest degradation, many of them looking to the year 2020 to achieve a level of raw material certification.[7]

The attention companies give to different commodities also varies. For instance, cattle products cause approximately 2.7 million hectares of annual tropical forest loss alone, 10 times more than palm oil, yet only 15% of those with exposure to cattle-driven deforestation have made a commitment to address this.[8] But companies often struggle to implement these commitments. The lack of transparency makes traceability in the supply chain difficult. In addition, any costs of changing to certified raw materials have to be leveraged elsewhere in the company or passed onto consumers. This can act as a barrier, especially for smaller companies.

Multi-stakeholder groups such as the RSPO for palm oil, the Forest Stewardship Council (FSC) for timber, and the Rainforest Alliance, are key to helping improve sourcing standards. Their certification programmes allow companies to better track where their raw materials come from. However, certifications are standardised and will not fit all companies equally well. They are a good basis but should be supplemented by additional commitments. In addition, some certifications have been subject to criticism. An interesting development is that of jurisdictional certification schemes, where local governments make a commitment to produce only certified commodities in their jurisdiction. This system, which relies on local monitoring, is better at addressing region-specific issues such as community displacement. It is currently being trialled in several countries including Malaysia, Indonesia and Brazil.

by Katharina Lindmeier

How our investee companies are addressing deforestation

Bellway is a major UK housebuilder with a well-established and highly regarded management team. As one of the UK's largest housebuilders, Bellway plays an important role in addressing the growing national housing shortage while delivering returns to shareholders in a way that protects and enhances the environment and the economy. Industry fundamentals are currently favourable for the housebuilding sector, supported by a benign land market and continual undersupply of good-quality homes.

Through its chain of custody, Bellway ensures that timber from the forest to the final point of purchase is certified. Bellway will aim to ensure that all wood products used by the company in its housebuilding process originate from verified, well-managed forests. The cornerstone of Bellway's policy means the timber used to build a house is sourced from managed stewardship forests accredited to PEFC (programme for the endorsement of Forest Certification) or FSC. This allows Bellway to have high levels of transparency and traceability to guarantee compliance for its timber supplies.

Bellway has a robust approach for its supply chain management, which enables it to develop long-term relationships with its suppliers. Procurement is controlled using a centralised approach selecting suppliers, products and services that meet the quality and value-for-money requirements of the business, while at the same time minimising any negative social and environmental impacts. Bellway's wood procurement policy is communicated to all its timber suppliers. The company has to balance many different stakeholders when it constructs a new home, but still has managed to deliver impressive financial returns, growing its profits before tax from £246 million to £354.2 million over 2014 to 2015 (source: Bellway 2016).

7 CDP Global Forests report 2015 https://www.cdp.net/en/research/global-reports/global-forests-report-2015
8 Supply Change, Supply Change: Tracking Corporate Commitments to Deforestation-free Supply Chains 2016

Thematic commentary (continued)

Mondi is an international integrated paper and packaging company that has exposure across the whole value chain, from managing forests and producing pulp, paper and compound plastics to developing effective and innovative industrial and consumer packaging solutions.

The paper and packaging industry faces many global challenges around ongoing climate change, biodiversity loss, deforestation and degradation of land, as well as freshwater ecosystems and resource scarcity. These global megatrends and international collective action are increasingly calling for Mondi to drive sustainability and transparency across its business.

Wood is one of Mondi's most important raw materials. The company's challenge is to meet the increasing demand for paper and packaging products, while still adhering to its sustainable forestry policy. Mondi's sustainable forestry policies considers the productive capability, biological integrity and community needs of the forests that it owns, manages and sources material from.

There is increasing demand from Mondi's customers for sustainable fibre usage. In order to address this, Mondi has a policy of 100% FSC certification and promotes sustainable management of its owned and leased forests. From forests Mondi does not own, there is a minimum of 70% FSC certification.

In collaboration with its suppliers, Mondi is taking steps to encourage greater transparency and promote fair working conditions by developing a responsible, inclusive and sustainable supply chain.

Mondi has developed a successful global partnership with the World Wildlife Fund. This partnership is enabling shared learning and collaborative action to promote ecosystems, manufacturing and product stewardship. Projects in Russia in the Boreal and Silver Taiga have explored effective ways of balancing increased commercial yields while protecting high conservation value areas and benefiting the local communities.

Despite these many challenges, Mondi delivered profit growth of 24% in 2015. The key driver of Mondi's profit growth in 2015 was attributable to the return from self-help capex initiatives. Many of these initiatives and much of the return is directly attributable to lowering energy requirements and gaining green energy credits.

As an investment, Mondi is on top of these issues and Standard Life Investments is reassured that the company is not linked to any illegal deforestation and does not use illegal wood in its production process.

by Lesley Duncan

Sophie Rahm
Analyst, Responsible Investment

Climate change after Paris: COP22 in Marrakech

The international community reached a landmark agreement on climate change at the 21st Conference of Parties (COP21), held in Paris in December 2015. Countries recognised the necessity to curb greenhouse gas emissions in order to keep global temperatures within 2°C of pre-industrial levels.

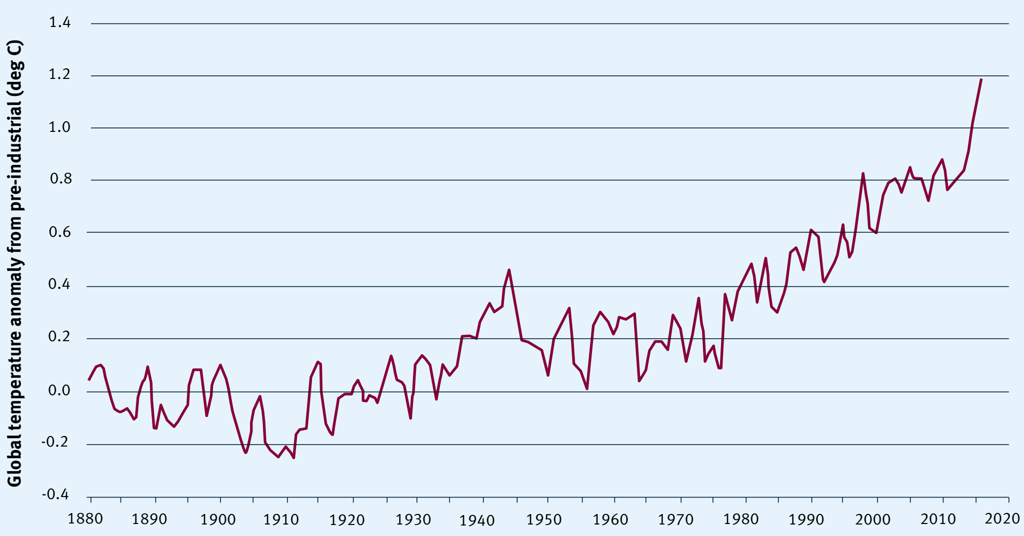
One year later, the international community reconvened in Marrakech in November 2016, at the 22nd Conference of Parties (COP22). The context of the Marrakech meeting was particularly favourable: it started the day after the COP21 Agreement entered into force, having reached the necessary ratification thresholds. The meeting in Marrakech offered the opportunity to discuss the implementation of the Paris decision.

This international agreement came into force in record time, demonstrating both strong consensus and commitment on tackling climate change. Although the outcomes of the 2016 meeting were relatively modest in comparison to the Paris achievements, the Marrakech Action Proclamation for Our Climate and Sustainable Development reaffirmed the alarming rate of climate change and the necessity for all countries to take action, while also supporting the most vulnerable countries for which financial resources are limited. It called "for the highest political commitment to combat climate change, as a matter of urgent priority", recognising that we are lagging behind. Particularly, the proclamation stresses the need to:

- translate the Nationally Determined Contributions (NDC) into investment-ready vehicles
- ensure adequate adaptation to the current and expected impacts of climate change
- strengthen resilience through scaling up support and investment in climate solutions
- increase investment in infrastructure
- support voluntary efforts, initiatives and coalitions for climate action.

During the conference, the World Meteorological Organization (WMO) and the United Nations Environment Programme (UNEP) both released data highlighting the scale of the challenge. The WMO announced that 2016 was likely to become the hottest year on record, further confirming the upward trend of global annual temperatures (see Figure 1). In its 2016 Emissions Gap report, UNEP further showed that current NDC pledges fall well short of both the 1.5°C and 2°C targets.

Figure 1: Global temperature change from pre-industrial levels (1880-2016)



Source: World Meteorological Organization, 2016

Thematic commentary (continued)

Another concern at the time of the conference was the results of the US presidential election. During his campaign, now-President Donald Trump said he would pull out of the Paris agreement and limit funding for climate change action. This has been a concern for the international community. More will become clear as Trump's presidency unfolds. However, the momentum around climate change now seems to be such that a US withdrawal from the Paris Agreement would not dampen global political efforts. There is a consensus that the US would lose international leadership on climate change, but other countries such as India or China could fill its shoes and become climate change leaders instead.

In the wake of COP22, 48 countries (including Morocco, Bangladesh and Ethiopia) committed to source 100% of their electricity needs from renewable sources, while 200 global companies committed to emissions reduction targets consistent with a 2°C threshold effort as part of the Science-Based Targets Initiative. More recently, a number of capital cities (Paris, Madrid, Athens and Mexico City) announced a ban of diesel vehicles by 2025 at the 2016 Mayors Summit.

The signals from governments, cities, civil society and businesses are now so prevalent that the trend of a low carbon transition now appears irreversible.

Ruairi Revell
Sustainability Advisor, Real Estate

The role of real estate investment in health, wellbeing and productivity

Over the last few years, we have seen rapid growth in the 'wellness economy' – industries that help consumers incorporate wellness into every facet of their lives. This economy is now estimated to be worth $3.7 trillion globally[1].

The built environment has a crucial role in determining people's health and wellbeing; on average we spend 90% of our time indoors, with much of that spent at our place of work. It is therefore no surprise that there is an increasing body of evidence linking the design of the built environment, not only with health and wellbeing outcomes, but with workplace effectiveness and productivity.

There are several key characteristics of buildings that directly influence the health, wellbeing and productivity of the people in them. Poor indoor air quality can depress productivity by 8-11%[2], while distracting noise can reduce performance by 66%. Similarly, feeling too hot or too cold can reduce performance by 6%. Focus at work increases by 15% for those with window views. Additional factors such as daylight and lighting, internal planting, layout, active design and nearby amenities also have a significant influence. These principles apply not just to office buildings, but also to industrial units and retail spaces where there are further implications for the customer experience.

When we consider that staff generally account for 90% of business operating costs, it is clear that even a modest improvement in health and productivity can have a significant financial benefit for employers.

As one of Europe's largest real estate investors, Standard Life Investments is actively working with our stakeholders to help realise these benefits. Having defined health, wellbeing and productivity as one of our strategic priorities for sustainable real estate investment earlier this year, we now have several workstreams underway.

We are currently participating in the UK Green Building Council's Wellbeing Lab for offices, which aims to move the industry forward on the topic. The work involves undertaking detailed acoustic and air quality monitoring of one of our buildings alongside occupier surveys using the Leesman Index – the largest global benchmark of workplace effectiveness. Findings will inform the design of an upcoming refurbishment to ensure the building positively influences health and wellbeing. Once complete, we plan to apply the learning from this project to our wider real estate investment portfolio.

Many of the factors affecting the health and wellbeing of building users are determined by the occupier's fit-out. With this in mind, we are currently refreshing our sustainable fit-out guides for retail, office and industrial sectors to reflect these topics. This will ensure that occupiers are equipped with the evidence and information necessary to incorporate health and wellbeing into their fit-out design.

As interest in this agenda continues to grow, we look forward to reporting back on our progress in the near future.

1 Global Well Institute: https://www.globalwellnessinstitute.org/press-room/statistics-and-facts/
2 All statistics taken from World Green Building Council, Health, Wellbeing and Productivity in Offices: http://www.worldgbc.org/activities/health-wellbeing-productivity-offices/

Thematic commentary (continued)

Sarah Norris
Investment Director,
European Equities

UN Sustainable Development Goals: influence on investment

Designed to transform our world, the United Nation's 2030 Agenda for Sustainable Development Goals (SDGs) is a plan of action that calls on all nations and governments to act in a collaborative partnership to promote economic, social and environmental development.

We believe the SDGs set out in the agenda will guide government behaviour and investment in the coming years, with corporates set to follow suit. As companies purposefully address global issues and set themselves measurable targets to effect change, they will achieve a lasting positive impact.

Ethical investing is not solely a method of investing designed to avoid certain activities and industries, but offers the potential to identify companies that have a positive impact. As such, we seek to identify 'preferred' companies whose actions, products and services actively benefit society and the environment.

Consumer tastes are also changing, and companies are uniquely positioned to capitalise on this, thereby reinforcing the UN's goals. By focusing on the UN's agenda for change, we can identify companies that meet our ethical criteria and offer positive impact and financial return.

The diabetes 'epidemic'

One example of opportunity in ethical investing is the chance to address the growing prevalence of diabetes. Currently, diabetes is one of the World Health Organisation's (WHO) most deadly non-communicable diseases. In recent years, the prevalence of diabetes increased most dramatically in emerging markets, the Pacific Island nations, the Middle East and North Africa, which now have the highest diabetes levels in the world.

The WHO estimates the majority of people with the disease around the world suffer from type 2 diabetes. This is primarily the result of excess body weight and physical inactivity, and largely preventable. Global diabetes care costs an estimated $864 billion, an economic burden on national healthcare systems around the world; the WHO and other organisations have even gone so far as to call diabetes an 'epidemic'.

To contain an epidemic requires global preparation. The UN's SDGs two and three explicitly focus on health and wellness. Through specific performance indicators, these two goals seek to address nutritional needs, encourage sustainable food production systems, help farmers adapt to climate change and, encouragingly, reduce premature mortality from non-communicable diseases through prevention and treatment.

Corporates to lend a hand

Just as one country cannot achieve all of this in isolation, neither can the political world achieve it without the support of consumer giants. Fortunately, advancing the UN's agenda on health and wellness while generating a financial return are not mutually exclusive.

Consumer tastes are evolving as quickly as the global agenda: from what we put in our bodies, to what we put on our bodies.

We count calories; we shop organic or local; and we wear athletic clothes to run every day errands. Our shift toward more active, health-conscious lifestyles is driving corporate investment in nutritious, sustainable products.

However, simply reducing the sugar or salt content of products will not go far enough to meet the UN's 2030 objectives. To have a positive impact, thereby advancing goals two and three, a company must intentionally address issues around nutrition, sustainability and health through its products and services.

For example, Wessanen is a Dutch company that focuses on developing food that is good for people and for the planet. Defining its mission as "Healthier food, healthier people, healthier planet", Wessanen's intent is to promote healthier and more sustainable diets, and in the process have a positive environmental impact.

Over the last decade, Wessanen consciously reduced its turnover from around €2 billion to €400 million to focus solely on vegetarian, organic and fair trade. This is because it saw change was needed and an opportunity to focus on a different part of the food universe.

Growth of organic

Consumer tastes are evolving and many believe that the world needs to increasingly move towards producing more organic food. There is a long way to go: in most countries, organic food only accounts for 3-6% of total food. However, this figuring is growing, with organic increasingly moving out of its niche and into the mainstream.

There are a number of factors why organic food does not have a larger share of the market, top of which is sheer lack of awareness and understanding. As such, a big part of what Wessanen (and others) is doing is to educate consumers through brands and marketing.

Another reason is accessibility: stores simply do not carry enough produce or are unable to source healthy goods with which to stack their shelves. Aspects of animal welfare are also coming to the fore, including a WHO report on the potential carcinogenic properties of meat.

Global goals

This sentiment echoes the UN's own observations that: "food is a fundamental connection between people and the planet, and the path to inclusive economic growth" (UN Sustainable Development Knowledge Platform, 2015). The UN's SDGs focus on sustainable practices and conservation of our forests, waters, land and soil as a way to address poverty and hunger. Wessanen's strategy specifically mentions soil degradation and seeks to drive positive impact through sustainable and organic farming methods such as crop rotation, intercropping and the use of symbiotic associations.

In addition to an awareness of the UN's goals and objectives, Wessanen's strategy of promoting healthier, organic and vegetarian options is meeting consumer demand.

No longer reserved for a special shelf, healthier options are now commonplace in consumer's baskets – to the benefit of Wessanen.

Wessanen is not reacting to a shift in consumer taste, but a leader in innovation, with some of its brands – including Tartex, Allos and Bjorg – the first in their markets to introduce products such as vegetarian pâtés and tofu.

Healthier eating and better nutrition are Wessanen's passion, to use its own words. This level of intentionality and engagement is true impact investing: namely, having a positive effect on society and the environment, while delivering a financial return.

Sustainability engagement

During the fourth 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
AkzoNobel	Labour practices/environment
BHP Billiton	Environment
BP	Environment/ethics
Heineken	Labour practices/environment
Swiss Re	Human rights/business ethics/environment
Rio Tinto	Environment/ethics
Royal Dutch Shell	Ethics
Retail Next JD Sports SuperGroup	Labour practices

Sustainability engagement summary

Key

- Internal mandate
- Client mandate
- Performance based engagement

AkzoNobel

Engagement driver:

Internal mandate

Key topic:

- Labour practices
- Environment

It has been a year since our last meeting with AkzoNobel, at which we discussed the progression of its eco premium solutions, a suite of products with positive environmental impacts. There have been no major strategic changes since this meeting; however, some eco premium targets have not been met. Eco premium solutions have the following goals targeted to 2020:

- 20% of revenue from products that are more sustainable than those of peers
- 25%-30% more efficient resource and energy use across the value chain (measured by carbon)
- establish a new indicator (Resources Efficiency Index) measuring efficiency of products expressed as gross margin/cradle-to-grave carbon footprint.

To date, under the eco remit the company had produced a number of green products, including easy-care paint for the consumer market. Greater demand and opportunity from business customers includes:

- shipping (paints that reduce the drag on vessels)
- airlines (paints that manage extreme temperature changes and last longer than alternatives)
- automotive (paints that dry more quickly, resulting in less power being used in the painting process)
- furniture (‘green’ paints offer marketing advantage)
- construction (paints that respond to temperature and reduce the need for heating or cooling systems).

AkzoNobel produces and markets chemicals, coatings and paints. The company’s products include surfactants, polymer chemicals, pulp and paper chemicals, as well as lacquers and varnishes. It has operations in more than 80 countries, employing some 50,000 people.

We questioned what steps the company was taking to ensure product stewardship and to reduce the use of harmful substances within its products. It highlighted that on chemicals it was ahead of the regulatory curve, is developing alternatives and is continually reviewing all substances. We noted positive steps taken by the company, including the phase out of substances such as BPA and steps to remove VOCs. It is also moving away from oil-based paints & solvents towards water-based paints.

We noted that the company has faced issues around employee turnover and componentisation and that its targets for the number of female executives have not been achieved. This is an area which we will continue to monitor.

This was a positive meeting and the company’s reporting on and actions taken to tackle emission levels, produce sustainable products and tackle macro sustainability challenges are ‘best in class’. We are going to re-engage with the company to gain its view on impact investing and carbon reporting.

Key

- Internal mandate
- Client mandate
- Performance based engagement

BHP Billiton

Engagement driver:

Internal mandate

Key topic:

- Environment

BHP Billiton is an Anglo-Australian multinational mining, metals and petroleum company. We attended the launch event of its second report on Carbon Portfolio Analysis. The company became a clear sector leader when it published its scenario planning report for the first time in September 2015. In the current exercise, BHP Billiton is testing the resilience of its portfolio and strategy, demonstrating that it keeps an eye on climate-related events and advocating its "integrated approach to climate change". The Paris Agreement, the launch of the FSB's Task Force on Climate-related Financial Disclosures (BHP Billiton is a participant), as well as the wider acceleration of the global energy transition and the strengthening of domestic policies, have led BHP to update its views with this second report.

BHP re-tested its portfolio and corporate strategy in light of these developments.

The board concluded that all the commodities in the existing portfolio, including oil (12%), gas (10%) and thermal coal (4%), have strong future margins given that they are high-quality, low-cost assets.

We commend BHP for both its transparency and strategic consideration for climate change risk. This positions the company well ahead of its peers. However, some additional elements would make the analysis much more robust and helpful to investors. This could include a demonstration of how its 'integrated approach' is implemented across BHP's divisions and a granular, asset-based view of the risks posed by climate change.

Key

- Internal mandate
- Client mandate
- Performance based engagement

BP

Engagement driver:

Internal mandate

Key topics:

- Environment
- Ethics

BP is a British multinational oil and gas company. We attended BP's annual socially responsible investing meeting in London, at which the company outlined its progress on sustainability management. The session, hosted by Dev Sanyal (CEO Alternative Energy division), brought together a series of executives from various areas of the business, highlighting some of its 2016 activities and investments.

BP, just like Shell a few days before, mentioned that these were dynamic times, requiring the company to manage risk and uncertainty at unprecedented levels. It has closed its special Gulf of Mexico committee and is refocusing board activities on building portfolio resilience to a low carbon world. Natural gas is an essential component of this effort: it will account for 60% of BP's portfolio by 2020 (currently 50%). Its base case consumption fuel scenario has oil demand peak in 2035; its faster transition outlook sees oil demand peak much earlier, around 2020.

In 2016, BP joined nine other majors, representing 20% of global oil & gas production, in supporting the Oil and Gas Climate Initiative. This is a $1 billion investment fund looking to promote R&D efforts related to climate mitigation research. Research areas include technologies to reduce methane emissions, carbon capture and storage solutions, industrial energy efficiency and transportation efficiency. The individual financial effort of participants seems relatively modest, but BP reiterated the view that this was only R&D effort at this stage. Solutions deployment is not the priority.

BP's view on megatrends has not evolved much over the past year. In a challenging oil price environment, low cost oil remains a priority for 2017. This means getting more out of existing fields, increasingly relying on infrastructure-led operations and deepening positions in existing assets (from 50% to 70% ownership). It is about putting more volume on the books. Nevertheless, there seems to be greater recognition that renewable energy is now cost-competitive and that demographic changes could disrupt the demand for oil & gas products much more than currently anticipated. BP's chief economist recently

Key

Internal mandate

Client mandate

Performance based engagement

BP (continued)

stated that electric vehicles (from pure players like Tesla or traditional original equipment manufacturers) could grow much more rapidly than expected if customers buy in order to make a statement, 'liking what the car says about them'. BP will release an updated scenario analysis as part of its 2017 Energy Outlook. We expect it will include a scenario where natural gas demand does not take off, squeezed between oil and renewables.

Safety is another priority for BP. There has been steady progress in the reduction of process safety events and injury frequency rates. For example, it is trialling subsea vehicles to inspect pipelines and has recently established a new Response Information Centre, using sophisticated algorithms to track social media news. The latter allows for early identification of events and provides real-time support for critical decision making. One of the areas of focus has been methane emissions and leaks. Leaks are approximately 1.6% of natural gas production, better than the peer average (3%).

The trend is towards greater penetration of technological solutions to address operational problems: data analytics and other tools (such as Blockchain) will help BP achieve system efficiencies and further cost reductions.

The meeting was also an occasion for BP to showcase its community work at the Tangguh facility in Indonesia. As BP's only operated LNG business, it covers the full value chain of natural gas (wells, reception facility, plant and export) and will start production in 2020. Located in a remote area of Indonesia, it has been an environmentally and socially complex project. BP consulted with local populations, applying international standards of the International Finance Corporation, and the Asian Development Bank. It initiated a number of social programmes in 2003, and has tracked progress over time. Data shows significant improvements in the delivery of social benefits since then, such as greater local contractor involvement, increased mean years of schooling and steady income growth. This is a very positive development and will ensure BP's social license to operate in the region. However, we believe this framework is difficult to scale up, particularly to existing sites where similar metrics may not have been tracked over the project's life.

We will continue to monitor the evolution of BP's view on the energy transition and what this means for the business. Its technology investments and innovation initiatives should support positive improvements in operational performance, as well as inform a more holistic approach to project management.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Heineken

Engagement driver:

Internal mandate

Key topics:

- Labour practices
- Environment

Heineken is a global brewer, with operations in over 70 countries and over 85,000 employees.

We last met with Heineken in Q1 2015 when the focus of our discussion was responsible marketing and 'drink aware' messaging. We are encouraged by the steps that Heineken has taken in this area. The focus of this engagement was in relation to water scarcity, particularly assets in Africa.

Water stress is a significant risk to the company and in 2011 it launched various water stewardship programmes focused on the sustainability of water sources by asset. We believe that an asset-by-asset approach is best practice when dealing with water stewardship.

Heineken's most recent focus is on recycling water, including the use of waste water for non-essential operations such as cleaning bottles. Upstream agriculture has the greatest impact on water reserves and Heineken is working with local farmers to reduce water usage and improve agricultural production.

Heineken has a well-established progressive approach to sustainability and its openness to the challenges it faces reflects that it is a strategic priority for the business. Heineken's "brewing a better world" (BaBW) initiative is making positive progress and to date it has significantly reduced both its carbon and water footprint across its supply chain. Water and energy savings were around US$9.5 million between 2009 and 2015, while cost savings were also up.

As referenced earlier in the report, we believe that the ongoing challenges presented by water scarcity will magnify in 2017 and it is important that companies and other actors take steps to ensure appropriate water stewardship measures. We believe Heineken is well placed in this area.

However, we continue to have concerns regarding the number of employee fatalities recorded by the company. Health & safety remains an issue with 22 fatalities in 2015 versus 15 in 2014. Heineken recognises the issue and highlighted that road traffic fatalities continue to pose a challenge. The group is taking numerous steps to improve its health & safety standards, which we will continue to monitor.

We are supportive of Heineken's BaBW programme, which continues to reduce the company's environmental impacts and offer significant operational savings. We will continue to monitor the programme as it progresses toward its 2020 targets and the steps taken by the company to improve health & safety standards.

Key

- Internal mandate
- Client mandate
- Performance based engagement

Swiss Re

Engagement driver:

- Performance based engagement

Key topic:

- Human rights
- Business ethics
- Environment

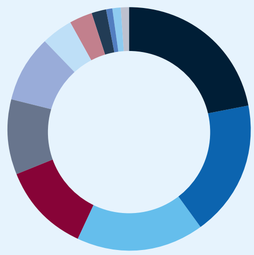
Swiss Re offers reinsurance, insurance and insurance-linked financial market products. The company also offers automobile, liability, accident, engineering, marine, aviation, life and health insurance. In addition, the company manages fixed income and equity investments for itself and other insurance companies.

We last met with Swiss Re in 2015 to discuss its risk mechanisms, the risks presented by reinsurance and the steps that it takes to ensure the sustainable allocation of its services. Swiss Re detailed its risk framework, for which we encouraged it to produce further detail.

Since the meeting, the company has disclosed details of its Sustainable Risk Framework (a social and environmental risk screen). The Framework identifies sustainability risk on a case-by-case assessment, offers additional due diligence on sensitive sectors and in some cases excludes the provision of services to certain companies or sectors.

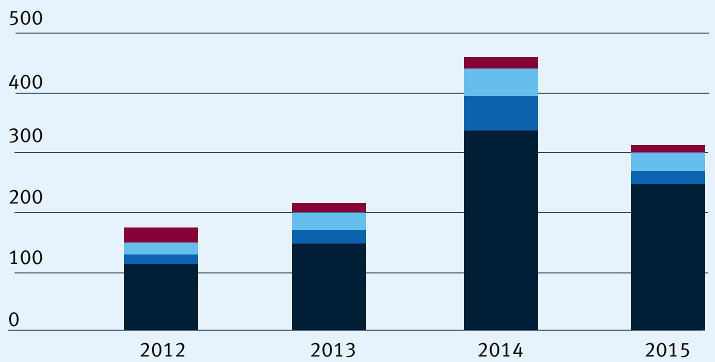
The chart below offers an overview of the Framework's application.

Sensitive Business Risks referred to our expert team in 2015



- 22% Mining
- 18% Excluded/critical country
- 17% Oil and gas
- 12% Dams
- 10% Other Industry/issue
- 9% Defence
- 4% Human rights
- 3% Forestry, pulp & paper and oil palm
- 2% Animal testing
- 1% Environmental degradation
- 1% Multi-issue
- 1% Nuclear weapons

Number of Sensitive Business Risk referrals



- Proceed
- Proceed with conditions
- Abstain
- Not materialised

Source: Swiss Re (pg 29 CR Report : http://media.swissre.com/documents/2015_corporate_responsibility_report_swissre_crr15.pdf

Key

- Internal mandate
- Client mandate
- Performance based engagement

Swiss Re (continued)

We questioned the company as to how it was developing products to meet increasing social and environmental challenges. Swiss Re detailed that its products continue to evolve and its growing portfolio now ranges from reinsured micro-insurance options for small livestock farmers in Kenya to hurricane, earthquake and excess rainfall risk in the Caribbean.

Its climate change research is led by the 4 IPCC (International Panel on Climate Change) emission scenarios and is supporting the pricing and the production of new products. It continues to evolve modelling and recently added new flood indicators, data on hurricane frequency and bushfire impacts in Canada and Australia.

We noted that across the sector the use of big data offers several opportunities to identify risk and trend within the life business. However, it also carries ethical concerns, including the risk of data breaches, invasion of privacy and homogenised risk pools excluding large groups. We have asked the company to consider these areas and produce an external statement on how it intends to use big data.

Employee turnover rates – especially in emerging markets – and a lack of actuarial talent remain a challenge across the sector. Swiss Re is taking positive steps in the area and its in-house training and compensation appears positive. However, turnover rates continue to rise – from 8.3% full-year 2013 to 10.6% full-year 2015. This is an area we will continue to monitor.

This was a very positive meeting and Swiss Re's product range is continuing to develop to meet the challenges of climate change. Since our 2015 meeting, the company has disclosed further information on its risk assessment procedures. We have sought further detail from the company about its approach to reporting on its use big data.

Rio Tinto

Engagement driver:

Internal mandate

Engagement topic:

- Environment
- Ethics

We attended Rio Tinto's Sustainable Development workshop in London, where the company provided an update on its sustainability management approach, with a particular focus on safety, greenhouse gas emissions and human rights.

In our view, Rio manages its spectrum of risks adequately, even if some underlying – and perhaps structural – issues may jeopardise its efforts and social license to operate.

Safety is a clear focus for the company. Its injury rate has never been particularly low. However, Rio is still to achieve a fatality-free year, and it will not be 2016. It has been liaising with DuPont Nemours and Shell in order to improve its process safety approach wherever possible. The company stated, however, that further performance gains could be difficult to achieve across the board, despite pockets of good progress locally.

In the wake of the Samarco disaster, miners are being encouraged, most notably through the International Council on Mining and Metals (ICMM), to conduct global reviews of their tailing dams. Rio has conducted such an audit and concluded that there was no cause for alarm. Tailings management and water storage risks were elevated in the company's safety standards framework. However, contractors' performance is still weighing most indicators down, while it is difficult to enforce Rio standards at non-managed sites.

On the environmental front, Rio's focus so far has been on greenhouse gas emission intensity. By the end of 2015, it achieved a 21% reduction in emissions (2008 baseline), due to the closure and divestment of old smelters, as well as the start of lower intensity operations. By 2020, Rio aims to achieve a 24% reduction compared to 2008.

Key
Internal mandate
Client mandate
Performance based engagement

Rio Tinto (continued)

The focus in future will be on managing energy, not emissions. For this reason, Rio did not calibrate its emissions intensity to the 2oC science-based targets. Of most interest to investors were Rio's views on the climate change resilience of its portfolio. Having backed the 'Aiming for A' resolution at the 2016 AGM, Rio will produce this analysis in March 2017.

Rio demonstrates an active consideration for human rights risk, but as with safety, joint ventures and supply chains still present significant challenges because oversight and enforcement can be lacking. More importantly, we believe the closure and rehabilitation of mines may cause tensions with local communities, thereby putting a sometimes-tenuous social license to operate at risk. In Australia's Hunter Valley, communities are starting to question the quality of miners' intervention following mine closures, likely spurring further scrutiny by the Australian regulator. Another emblematic example is the Bougainville copper mine: Rio donated its majority shareholding to the government of Papua New Guinea, which is now responsible for the site's rehabilitation. Gifting shares or selling assets to juniors are controversial ways to pass on liabilities. We expect increased tensions and regulatory intervention on the back of such practices.

Looking ahead, we will encourage Rio to disclose the results of its dam review, as well as share with investors how it adjusted policies and practices after the Samarco disaster. We will also continue to monitor developments in relation to climate change resilience, human rights management and mine rehabilitation.

Royal Dutch Shell

Engagement driver:

Internal mandate

Engagement topic:

- Ethics

We attended Shell's first Board Engagement day, following on a tradition of executive engagement on sustainability. The direct access to the company's board members is a very positive development and supports Shell's investor engagement aspirations.

Each committee chair (nomination, remuneration, audit, CSR) gave a comprehensive overview of its 2016 achievements, in the context of the BG acquisition and a wider board governance review.

The board seems very engaged with executive management and frequently discusses the strategic orientation of the company. We are, however, cautious of its desire and ability to challenge management. One of its key themes for 2017 will be energy transition. However, we found that Shell's non-executives had adopted a relatively timid position on energy transition in comparison to Shell's well-publicised commitments (climate risk transparency, portfolio diversification, carbon capture and storage, biofuel investments).

Regarding performance measurement, there is a general lack of visibility on operational aspirations and targets, with a preference for year-on-year improvements over long-term goals. The environmental component of the annual bonus scorecard now exclusively considers greenhouse gas emissions management, replacing water use, oil spill volumes and energy intensity. This could signal a lack of commitment to these areas and there is a risk that performance may slip.

Finally, we find this first board engagement session has exclusively focused on 2016 achievements. We will encourage the company to keep holding such an event while at the same time providing more insight into processes. This should reassure investors that the board fulfils its role. We will also continue to assess Shell's response to energy transition challenges and monitor safety management, particularly in Brazil (where Shell has gained greater exposure through the BG merger) and Nigeria.

Key

- Internal mandate
- Client mandate
- Performance based engagement

UK Retail

Engagement driver:

Internal mandate

Key topic:

- Labour relations

Next
In October, we took part in an investor tour of the new Next store at Straiton Retail Park outside Edinburgh, led by the chief financial officer. Next sells ladies wear, mens wear, children wear and housewares in its stores across the UK.

The purpose of the tour was to gain an understanding of how retailers can successfully manage their workforce. Next uses an online system that allows staff to log their availability three weeks in advance, and then allocates shifts based on previous patterns and expectations of footfall. Shifts can be traded on a platform called the online marketplace, which employees can access from their mobile phones. Around 90% of shifts that are advertised are allocated. This system is much more cost-effective than traditional rotas and allows greater flexibility, which is appreciated by employees.

We also discussed the nature of contracts and incentivising employees for good customer service.

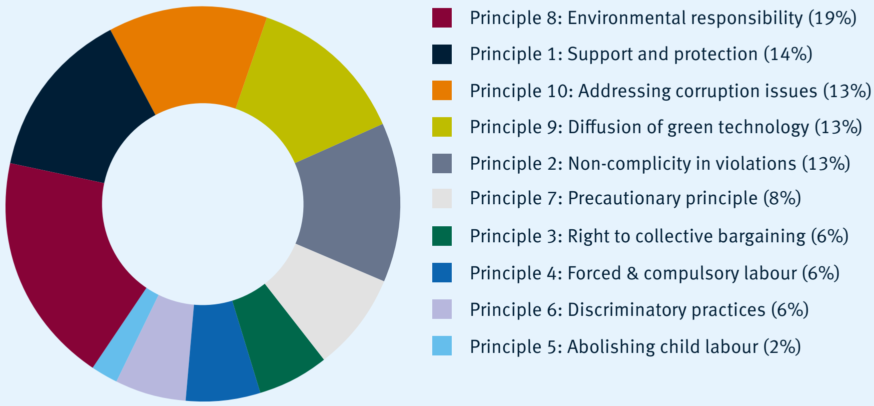
JD Sports
JD Sports is a UK-based apparel retailer selling brand-name sports and leisure wear. It employs around 12,000 people in the UK across its retail estate, warehouse and head office. This was the first time we met with the company. We spoke to the Head of HR to find out more about how JD Sports manages its workforce, as there is very little reporting. We were encouraged to hear about some of the good employee practices at JD Sports, including a commitment to no zero-hours contracts and a high proportion of direct employees in its warehouse. However, the company does not disclose this publicly. We highlighted that we believe the lack of disclosure could present a reputational risk to the company and offered recommendations for reporting.

SuperGroup
SuperGroup is the company behind the Superdry brand. It operates a chain of retail stores and wholesale activities in the UK, as well as an expanding overseas and internet business. We had previously engaged with the company about sourcing garments from Bangladesh. SuperGroup has been highlighted in the media for its exposure to Turkey and the resulting risk of human rights violations in its supply chain. The company outlined the steps it is taking to manage challenges in its sourcing activities. This includes local sourcing managers who visit factories, in addition to regular audits. The company also highlighted its work with the Ethical Trading Initiative. We were reassured by these steps and believe SuperGroup is aware of the risks and manages them well.

We also discussed SuperGroup’s approach to human capital management. SuperGroup employs around 2,200 people in the UK. Seventy-five percent of its workforce is under the age of 25. SuperGroup seems to have strong practices in place to manage its employees. It does not use zero-hours contracts and goes beyond the government’s living wage requirements by paying the national living wage to all staff, including those under the age of 25. We asked the company whether it would consider becoming an accredited living wage employer (the Living Wage Foundation rate is higher than that set by the government). SuperGroup explained its views that retailers were unlikely to sign-up because they do not want to be beholden to the Foundation’s view on living wage levels.

We encouraged the company to be more open in its reporting about the good practices it uses.

Engagement Summary Q4 2016



Source: Standard Life Investments

	Human Rights		Labour				Environment			Corruption
UN Global Compact Principles	**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**
AB Inbev		●		●				●		
ACS	●									
AkzoNobel						●	●	●	●	
Bank of Ireland	●		●							●
BP	●	●						●	●	
Britvic						●	●	●	●	
Daimler						●	●	●	●	
GlaxoSmithKline		●						●		●
Heineken		●		●				●		
JD Sports						●				
Novo Nordisk	●	●								●
Rio Tinto	●	●						●		●
Roche	●	●								●
Royal Bank of Scotland			●					●		●
Shell	●							●	●	
Shire	●		●							●
SuperGroup	●	●		●	●	●				
Swiss Re							●	●	●	
Taylor Wimpey			●	●			●	●	●	
Umicore								●	●	

Important Information

All information, opinions and estimates in this document are those of Standard Life Investments, and constitute our best judgement as of the date indicated and may be superseded by subsequent market events or other reasons.

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