Quarter 4 2017

Global ESG Investment

Report of activities of Standard Life Investments

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Euan Stirling
Head of Stewardship & ESG Investment
Aberdeen Standard Investments

Foreword

This was another busy and productive year for the ESG team at Standard Life Investments, during which environmental issues remained firmly in focus. Our new colleagues from Aberdeen Asset Management attended COP23 in Bonn, which sought to build technical and practical measures around the 2015 groundbreaking agreement of COP21 in Paris. In particular, the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) drew strong support from participants, including our parent company, Standard Life Aberdeen plc. At a discussion chaired by Zero Waste Scotland, we continued to investigate how businesses can reduce their environmental intensity by supporting the circular economy. We also attended a Business Green Leaders' Summit, where high-profile speakers highlighted the challenges facing the investment community.

Climate considerations continue to grab most environmental headlines, but water stress also brings significant challenges to many communities. This quarter, we report on our involvement in a Principles for Responsible Investment (PRI) sponsored engagement initiative. Talking with the companies in which we invest our clients' capital is a key ingredient of our investment process, so engaging specifically on water risks feels like a natural step. At the end of this report, we explain the rationale behind a number of our recent company engagements, including any influence we had on the issues at hand.

Meanwhile, we are grateful to Simon Howard, the CEO of the UK Sustainable Investment and Finance Association (UKSIF), and Campbell Fleming, Aberdeen Standard Investments' Global Head of Distribution, who both contributed to this edition. Campbell highlights the value of environmental, social and governance (ESG) considerations to our clients and the importance of meeting or exceeding their expectations. Standard Life Investments was one of the initial signatories to UKSIF and is currently a member of its Advisory Board. We also remain a proud sponsor of Good Money Week, a UK-wide initiative run by Simon and his colleagues at UKSIF. In this report, Simon explains why ESG factors are increasingly important in the management of pension scheme assets.

I am pleased to report that the Standard Life Investments Global Equity Impact Fund, which we introduced to you last quarter, launched in October. Hot on its heels, our plans for another impact fund continue to advance. Having already received regulatory approval, we expect to launch the UK Equity Impact - Employment Opportunities Fund in the first quarter of 2018. This will be done in conjunction with Big Issue Invest.

As we have in previous years, we will produce an annual ESG report, covering a range of our 2017 activities. As the last ever 'Standard Life Investments review', it will mark the end of one era but also the beginning of a new and exciting stage in our business development. In 2018, we will report as Aberdeen Standard Investments, as we combine our ESG investment activities and AGM voting policies.

We hope you find this report informative and would welcome any views you may have at:
responsible_investment@standardlife.com

Unless otherwise indicated, this document refers only to the activities, views and engagements of Standard Life Investments.

About Aberdeen Standard Investments

Aberdeen Standard Investments is a leading global asset manager dedicated to creating long-term value for clients. To achieve this, we offer a comprehensive range of investment capabilities, as well as the highest levels of service.

Overall, Aberdeen Standard Investments manages £583 billion* on behalf of clients in 80 countries. In managing these assets, we employ over 1,000 investment professionals and provide client support from 50 client relationship offices globally.

The Aberdeen Standard Investments brand was created in connection with the merger of Aberdeen Asset Management PLC and Standard Life Plc on 14 August 2017 to form Standard Life Aberdeen plc.

*Standard Life AUM/AUA data as at 30 June 2017, Aberdeen Asset Management AUM data as at 31 March 2017, all other data as at 30 June 2017

Collaborative engagements and events

www goodmoneyweek.com

Invest for a better future – Good Money Week

The UK annual event to promote good money choices, Good Money Week, took place on 8-14 October 2017. This campaign is run by UKSIF. For the third consecutive year, Standard Life Investments was a lead sponsor of the event and ran a number of activities during the period.

Good Money Week's main goal is to highlight to consumers that they can choose to invest their money in a way that reflects their values. Standard Life Investments manages a number of funds that can help in this regard, including our ethical and SRI funds. We have also launched a Global Equity Impact Fund and have regulatory approval to launch a UK impact fund in Q1 2018. Understanding the ESG factors of the investments we hold is an important component of what we do across our funds. However, our expertise and insights also help build strategies that are more closely aligned with investors' environmental and social values.

This year, as part of our 'invest for a better future' marketing campaign, we spoke at length on the topic of impact investing. The world faces numerous challenges, such as poverty, rising inequalities, climate change and unsustainable production and consumption. We believe that asset managers can play a vital role in helping to address these issues. Impact investing involves investing in companies, organisations and funds where the underlying investment is attractive from a financial perspective but that also have the explicit intention of generating a positive environmental or social impact. This can be through their products, services and strategic business activities.

We produced various marketing materials, including a white paper on using the UN Sustainable Development Goals to build an equity impact strategy, videos, infographics and commentary. You can find these at: **www.standardlifeinvestments.com/good_money_week.**

In addition, we ran a social media campaign on twitter and published a Citywire advertorial.

We also held a number of events during Good Money Week. This included a press event, chaired by Campbell Fleming, Global Head of Distribution for Aberdeen Standard Investments. At the event, Euan Stirling, Global Head of ESG Investment and Stewardship, covered impact investing, while Simon Howard, CEO of UKSIF, discussed the merits of Good Money Week. In addition, Elizabeth Corley, Vice Chair of Allianz Global Investors, spoke about the work she is doing on behalf of the government, aimed at growing a culture of social impact investing in the UK. The event was supported by Ginerosity, the world's first social enterprise gin. Press coverage during the week was excellent and demonstrated a high degree of engagement from publications including The Sun, Metro, Evening Standard, Mirror, Independent, Guardian, Times, BBC and Big Issue.

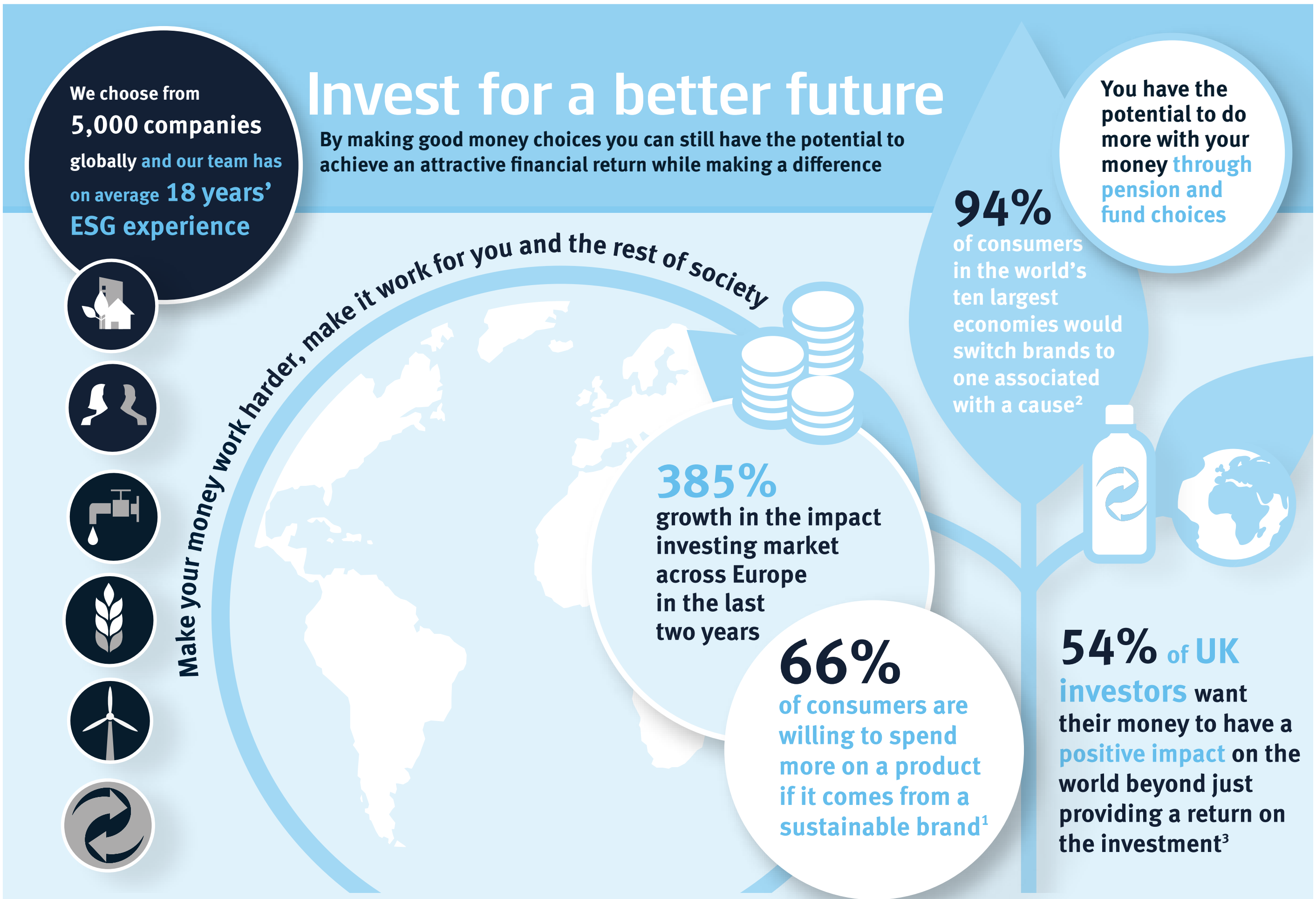
At our adviser event, we presented our two impact funds: the UK Equity Impact Fund – Employment Opportunities Fund and the Global Equity Impact Fund, which has since been launched. We outlined our broader approach to ethical investing, while external speakers provided views on the impact-investing market. These included representatives from Big Issue Invest, Big Society Capital, EQ Investors and an independent member of the Ethical Funds Advisory Group, which oversees the Standard Life Investments ethical fund range.

Standard Life Wealth held two events for its charity clients, with a focus on climate change and fossil fuel disinvestment.

We also hosted an event on behalf of UKSIF, where Tracey Crouch (minister for sport and civil society), was invited to hear a range of views from the industry on the issues relating to Good Money Week.

Finally, we were part of a syndicate that sponsored research into consumer trends by the Wisdom Council, a UK-based customer research consultancy. The research showed there is a growing interest in products that reflect people's values. Eighty percent of respondents were interested in finding out more about ethical, green, impact and ESG-focused products. This rose to 90% among Millennials. This research supports the work we have done on Millennials, in which we have shown that younger investors are driving the demand for investing in a way that contributes positively towards society.

This year's activities to support Good Money Week were extensive and covered a broad range of Standard Life Investments' business, from the investment side, to wealth and direct pension and savings customers. This could not have been achieved without the fantastic commitment of those from around the business who sit on the Good Money Week steering committee, to which many thanks are due.



[1] Evidence: http://www.huffingtonpost.com/ryan-rudominer/corporate-social-responsi_9_b_9155670.html
[2] Evidence: https://www.forbes.com/sites/feeonlyplanner/2013/04/24/socially-responsible-investing-what-you-need-to-know/#1c994d583442)
[3] Evidence: http://uksif.org/wp-content/uploads/2015/10/Main-press-release_final1.pdf

Source: Standard Life Investments

COP23 (Special report from Aberdeen Asset Management)

In November, we attended the 23rd annual Conference of Parties (COP23) in Bonn, Germany, as part of the UK government's Department of Trade delegation in our capacity as a global asset manager. The annual conference under the UN Framework Convention on Climate Change was the second COP since the ground-breaking Paris Agreement was struck in 2015. After the fanfare of COP 21, this was always going to be more of a technical affair, as countries continued to negotiate the more specific details of how the Paris Agreement will function post-2020.

The significance of the event was elevated by US President Trump's decision in June 2017 to withdraw the US from the Paris agreement and with Syria's timely announcement two days into the conference that it would sign the Paris Agreement. This left the US as the only nation not to adhere to the milestone deal. Despite this distraction, there were a number of key outcomes and progress on many issues.

We also participated in a well-attended panel with other members of the financial services industry in the UK to discuss how private and public sector institutions can increase investment in order to accelerate the transition to a low carbon economy. Aberdeen Standard Investments became an inaugural signatory to Climate Action 100+, which will endeavour to push the world's largest greenhouse gas emitters to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures.

We believe that environmental issues will continue to rise among company and regulatory agendas and that as investors we have an important role to play in the transition to a low-carbon economy.

Business and human rights: manage risk, implement policy, and secure relationships

We attended Innovation Forum's business and human rights event in London, and spoke on one of the panels. The forum was hosted by UK-based multinational law firm Freshfields Bruckhaus Deringer, and the majority of attendees were from companies, non-government organisations and other stakeholders looking to share and develop best practices. The event covered a comprehensive range of issues, including the risks and drivers for companies to take action, assessing and mitigating supply chain risk, modern slavery, legislation and civil society expectations.

Focused workshops were also run on a number of specific topics and industries, including a workshop on reporting, where we joined Share Action on the panel to discuss investor expectations, and the launch of the Workforce

Key takeaways

- **The 2017 Global Carbon Budget** was released during the conference and highlighted that, in 2017, CO2 emissions from fossil fuels and industry are projected to grow by 2%. This follows three years of nearly no growth (2014-2016). These findings have amplified the need for a ramp-up of ambitions (captured by the 'Talanoa Dialogue').
- **The 'Talanoa Dialogue'** stipulates that there will be a stocktake of pre-2020 implementation and ambitions next year at COP24 and again at COP25. The strong demands for enhanced and more transparent pre-2020 action signal the shift in balance of global climate leadership towards the developing (and more vulnerable) countries.
- In response to the US's withdrawal from the Paris Agreement, Governors Andrew Cuomo, Jay Inslee, and Jerry Brown created the **US Climate Alliance.** This bi-partisan coalition of states is committed to reducing greenhouse gas emissions consistent with the goals of the Paris Agreement. America's Pledge highlighted the importance of non-state actors, with 15 states, 455 cities, 1,747 businesses and 325 universities representing 54% of the US GDP and 35% of US GHG emissions all signing up to the Pledge. These parties have declared their support for the Paris Agreement and have voluntarily adopted greenhouse gas reduction targets. This shows the US is still making an important contribution to climate action.
- A common theme across panels, geographies and public as well as private organisations was the adoption of **Task Force on Climate-related Financial Disclosures (TCFD)** recommendations for better consideration of climate risks and opportunities. This includes the standardised disclosure by industry allowing a more constructive engagement between parties. Some parties started talking about adopting a 'comply or explain' approach to their investments with regards to TCFD adoption. Shortly after the conference, Standard Life Aberdeen plc announced that it supports the recommendations of the TCFD, as it believes they will contribute to improving the quality and usefulness of climate change disclosures.

Disclosure Initiative. Discussions highlighted the strong link between disclosure and performance. They also suggested that, among the many differing reporting standards and demands for companies, human rights disclosures should always take their lead from the UN Guiding Principles on Business and Human Rights. They should also be written comprehensively enough so that they can be used for multiple purposes.

In order to encourage honest and in-depth discussions about the human rights challenges that businesses are facing, the event was run under the Chatham House rule. Working with legal teams was noted as one of the more common challenges. Emerging legislation increasingly aims to force better disclosures and to hold companies to account for their statements, e.g. the Duty of Vigilance in France, the California Transparency in Supply Chains Act, and the Responsible Business Initiative in Switzerland. As such, many in-house legal teams noted that aspirational or honest accounts of a company's progress in respecting human rights might expose the company to litigation. While in the short term this may prevent corporate disclosure, many noted that this would ultimately cut through some of the existing empty rhetoric and stimulate positive, tangible action. The ways in which bribery and corruption have been combatted was held up as an example of changing corporate behaviour through reporting and accountability legislation.

Co-ordinated action was also a key theme throughout the event. Human rights issues are often systemic and can be exacerbated by gaps or inconsistencies in a government's implementation of its duty to protect its citizens. In these situations, it is often difficult for a single company to solve the problem entirely. Conference attendees felt that, until the community itself takes action on the issue, companies are predominantly confined to remedial action, rather than preventative measures. To address this, many urged, and were eager to discuss, ways to stimulate pre-competitive collaboration. This could, for example, include establishing a minimum supply price across industry procurement contracts that ensures a living wage for employees in the supply chain. This type of collaboration does not come naturally to companies operating in highly competitive sectors, but could make a significant contribution to ensuring the livelihood of workers across supply chains.

Overall, the forum was a useful event to better understand some of the challenges and initiatives underway to ensure that companies respect human rights. It is encouraging to see companies taking action to set standards, share best practice, and recognise human rights as a material business issue.

Community and indigenous rights: the financial materiality of community consent

We attended a UKSIF event in London on community and indigenous rights. Throughout the afternoon, a number of speakers from academia, business and civil society spoke on numerous topics. While communities overall were discussed, particular attention was paid to the specific rights of indigenous people to Free, Prior and Informed Consent (FPIC), which is recognised in the UN Declaration on the Rights of Indigenous Peoples.

One of the main themes that emerged was the distinction between consultation and consent when engaging with communities. Often projects involving land development will consult the local community. In doing so, however, it becomes clear that plans are already in place, and these consultations are more to inform rather than gain consent. The Dakota Access Pipeline (DAPL) was offered as an example of poor community engagement, as the speakers claimed it was not aligned with FPIC, was too narrow in scope, poorly timed and served as notification rather than consent. Given the large expanses of land that pipelines cover, pipeline consent can be particularly challenging for companies to manage. In the case of the DAPL, protesting tribes wanted to be consulted on the whole of the project, rather than a smaller impact area defined by the developers. However, during the consultations, construction on other parts of the pipeline was already progressing.

The financial materiality of community resistance can be significant – 73% of oil project delays are due to non-technical issues. Persistent delays may ultimately lead to the company abandoning the project, accepting sunk costs and losing its associated production capacity and revenue. Many noted that, to date, companies are largely reactive to community concerns. However, a proactive and properly implemented approach to community consultation and consent could bring shorter project timelines and quicker permit approvals. A company's ability to easily operate within a potentially complex environment could quickly turn into a competitive advantage.

There is often a lack of corporate disclosure on community relations. We therefore believe an active engagement approach is the most effective ways to assess companies on this issue. We discussion community impact with companies, we look for accountability at the top of the organisation, evidence of effective engagement with communities, and examples of how companies overcome challenges. This level of detail provides assurance that the company will maintain both its social and legal licenses to operate.

Circular economy investment event

We attended a roundtable discussion, chaired by Zero Waste Scotland and hosted by the Edinburgh Centre for Carbon Innovation. The event aimed to explore opportunities and challenges of investment in companies advancing circular economy principles within their business models. Circularity Capital also presented its approach to investing and the ways in which businesses can integrate circular economy principles to maximise value. Other attendees included representatives from major banks, investment firms and social enterprise and investment partners. Lady Susan Rice, British banker and chair of Scottish Water, offered numerous insightful closing remarks.

While further discussion was primarily focused on enabling access to finance for small and mid-sized enterprises, some of the larger listed corporates were offered as examples of initiatives in, for example, clothing recycling and 'product as a service'. Some of the challenges noted were reverse logistics (i.e. getting the product back after use) and access to traditional finance. Because assets are traditionally used as collateral for lending, companies that decrease their total number of assets by increasing reuse may struggle to get financing in this way.

We followed up with Zero Waste Scotland after the event to suggest that the Power Up Scotland Programme may provide a route to funding for circular economy businesses. Pioneered by Big Issue Invest and funded by Aberdeen Standard Investments, Edinburgh University and the Scottish government, the initiative aims to help early-stage social ventures to access loan funding. More information on Power Up Scotland can be found at **https://bigissueinvest.com/powerup/**

The BusinessGreen Leaders' Summit

We attended BusinessGreen Leaders' inaugural one-day summit, which brought some of the world's leading thinkers together to discuss how the green economy has evolved over the past decade and where it will develop as it continues to gather pace. BusinessGreen is one of the UK's leading sources of research and news on environmental issues in the UK. Speakers included Alan Whitehead, MP, Jonathon Porritt Co-founder of Forum for the Future, and Dr Emily Shuckburgh, Climate Scientist and Deputy Head of the Polar Oceans Team British Antarctic Survey.

The event highlighted that 2017 marked a critical moment for green industries. The goals of the Paris Agreement require the urgent scaling up of low carbon infrastructure and business models. Falling clean-tech costs, innovative financing models, and effective policies all suggest mass deployment of these 'survival technologies' is both possible and desirable. At the same time, however, fresh headwinds have emerged in the changes to US policy, the growth of economic populism and the challenges presented by Brexit. What happens over the next decade is challenging business leaders, entrepreneurs, investors and policymakers the world over.

We found it slightly discouraging that some of the speakers believed that the investment community was slower than other sectors to address the challenges that climate change presents. As one of the leading ESG investment houses, we believe that our actions will not only serve our clients in tackling the areas above but also serve to improve the sector as whole.

Thematic commentary

Campbell Fleming
Global Head of Distribution
Aberdeen Standard Investments

ESG: the heart of the investment philosophy at Aberdeen Standard Investments

Standard Life Investments was the investment arm of Standard Life plc, a major UK-listed financial services company, which started life in 1825. Aberdeen Asset Management plc was formed in 1983 via a management buyout and has grown from a pioneer investor in Asian and emerging markets into a full-service, UK-listed investment house. The Aberdeen Standard Investments brand was created in connection with the merger of Aberdeen Asset Management PLC and Standard Life Plc on 14 August 2017 to form Standard Life Aberdeen plc.

At Aberdeen Standard Investments, the investment needs of our clients drive everything we do. We look to support investors with a full range of investment opportunities and solutions, and the highest level of service and support. As a major asset manager, we have the resources to transform new investment ideas into practical investment products and the scale to deliver real value for money to investors. Our focus on responsible investment reflects both our clients' needs and our approach.

As signatories to the PRI, the world's leading proponent of responsible investment, and to the UK Stewardship Code, both heritage Aberdeen Asset Management and Standard Life Investments have a long legacy as responsible investors. ESG has historically sat within each company's stewardship approach, which – along with engagement and proxy voting – outlines the fiduciary role that we play as guardians of our clients' money. We believe it is important to be clear and informative on the major ESG issues surrounding our own business, our investee companies and the world in which we live.

ESG integration focuses holistically on the intrinsic risks and opportunities of investments and thereby helps us to better understand the quality of an asset, along with its key concerns. An asset may have material risks with regards to governance, cybersecurity, labour standards, or even bribery and corruption issues. By considering all the risks and opportunities that an asset offers, we can better understand its true quality, how much we should pay for it, how much of it we should put in our portfolios, and where to focus our ongoing engagement. As a result, we consider ESG risks to be an integral part of financial risk – and not separate from it.

Aberdeen Standard Investments will continue to offer clients a variety of screened portfolios that help clients avoid investment in certain areas such as tobacco, alcohol and weapons. Thematic portfolios can be created that are tailored to clients' needs. For example, if an investor wishes to focus their investments on a specific theme, such as renewable energy or low carbon, then we can create bespoke products to meet these needs.

Stewardship and ESG will also remain fundamental components of our investment philosophy and process. Indeed, this is a synergy that supports the rationale for the merger and it will be a key strategic element of Aberdeen Standard Investments' future.

From climate change to the growth of artificial intelligence, the world faces an unprecedented array of opportunities but also a plethora of threats and uncertainties. Investing sustainably with consideration of ESG issues has rarely been more important. Damage to society and the environment have substantial long-term implications, and this realisation will remain a driving force for those seeking more responsible investment strategies.

Effective stewardship is critical, but clever algorithms do not make good stewards. As active, responsible investors, Aberdeen Standard Investments is committed to delivering strong sustainable returns for our clients. Our approach means we are in a unique position to influence wider change that can transform societies and the environment in the long term.

Simon Howard

Chief Executive
UK Sustainable Investment
and Finance Association

ESG developments in the UK and beyond

I'm very happy to be able to write a piece about the state of ESG in the UK and more widely. I see encouraging progress in many areas and it is great to be able to celebrate this at the end of the year. I'll start at the large institutional scale before considering how changes there are mirroring what UKSIF is seeing in the retail market and wider society. I'll close by considering international developments. There is a pleasing circularity to it all, which I think reflects real progress across the board.

I know previous issues of ESG Investment have covered fiduciary duty, and 2017 has seen two significant developments in this space. First, The Pensions Regulator (TPR) has said that trustees of defined benefit schemes are "required" to consider all financially material factors. In 2016, for a trust-based defined contribution schemes TPR had used the word "should", and this is a welcome strengthening of guidance. We argue that ESG is clearly financially material and so it should now be appearing explicitly on pensions scheme risk registers and trustee agendas. We were delighted when, in September, leading investment consultants joined our joint initiative with Association of Member Nominated Trustees and committed publicly to promoting the guidance to their clients.

The other fiduciary duty development was a report from the Law Commission recommending that the UK government change pension law to give statutory effect to TPR's interpretation on financial materiality. This is the second time in three years that the Law Commission has made this recommendation and rumours are that the government is minded to accept it this time. Importantly, the Law Commission also recommended that the FCA inject the same thinking into contract-based defined contribution (DC) pensions. This raises the very welcome possibility that the overwhelming majority of pension schemes in the UK will have to consider ESG if it is financially material.

DC is the growth area for pensions and places more of the burden on the saver. As such, it makes sense for providers to consider what the saver wants. Here, the trend is clear. In the polling for Good Money Week (which Standard Life Investments kindly sponsored) the number of people saying that they were "only motivated" by financial return fell to 39%*. Meanwhile, data on other questions suggest it is the young – the people most likely to be offered DC schemes – who are most concerned over issues such as climate change and stakeholder rights. I'm quite sure that employers offering pensions that reflect staff views will see better take-up and perhaps a boost to employee loyalty. I think we can hope that the ESG quality of pension schemes becomes a differentiator between employers in the future.

This interest among society at large is echoed by the financial advisers we work with, who report that clients welcome discussing ESG issues and that such client engagements tend to last longer. ESG is an opportunity for advisers to differentiate themselves and better retain clients.

Similarly positive trends can be seen globally. Not only is there widespread support for initiatives such as the Task Force on Climate-related Financial Disclosures and the Sustainable Development Goals, with UKSIF members moving to implement these and develop appropriate products, but there is buoyant activity in the other international 'SIFs'. In the US, that SIF is supporting the many non-Federal bodies refusing to let President Trump's attitude on COP 21 change their commitment to fighting climate change. In Europe, the national SIFs through Eurosif are all supporting the work of the EU's High-Level Expert Group on Sustainable Finance (HLEG), which was covered in the last edition of this report.

We expect the HLEG to promote the use of labels for ESG-style investment funds and that leads on to the very buoyant Australasian SIF, RIAA. RIAA runs its own labels for funds and it seems that the market has passed the tipping point, with pension providers now keen to secure the label and private citizens contacting the SIF to use it in selecting their funds. This is fascinating since it might show how the UK market could develop: as DC becomes the norm, pension providers and employers will want to meet the ESG criteria of savers, and labels that flag the funds attitude to ESG may begin to appear thanks to HLEG. This may be too optimistic but it is not entirely fanciful, which I suspect it would have appeared a mere five years ago.

*UKSIF's "Public Polling 2017" can be found at http://uksif.org/wp-content/uploads/2017/10/FAITH-AND-INVESTMENT-COME-TOGETHER.pdf

Thematic commentary

Gair Brisbane
Senior Client Portfolio Manager, Standard Life Wealth

Principles-based investing

We may think of principles-based investing as being a recent trend. Not so. Ethical considerations have been evident as far back as 1758 when the Quakers in Philadelphia[1] stated that members were prohibited from having an association with the slave trade for ethical reasons. In the UK, the first ethical fund to be made available to retail investors launched in 1984.

Undoubtedly though, restricting an investment portfolio on ethical grounds has risen in prominence over the last decade. During this period, managing an investment portfolio in line with ethical criteria has moved from being a niche interest, pursued largely by philanthropist investors and organisations such as religious or health organisations, to become a far more mainstream proposition.

Avoiding reputational damage

The motivating factors that lead an organisation to limit their investment universe on ethical grounds may stem from concerns about damage to reputation should a contentious investment be made public. One such example is the case of major UK charity Comic Relief, when the BBC Panorama documentary claimed that the charity, which lists among its charitable purposes helping those affected by conflict and reducing alcohol-related harm, held shares in BAE Systems and Diageo between 2007 and 2009.

Traditionally, a principles-based approach to screening investments has centred on excluding 'sin' stocks, such as alcohol, tobacco, gambling, armaments and pornography; or avoiding specific companies, such as Dow Chemical Company following the use of Agent Orange in Vietnam. One of the best known controversies related to Nestle after the 1974 report entitled 'The Baby Killer'[2] which highlighted the company's practice of encouraging formula milk and discouraging breastfeeding in Africa. These examples of ethical restrictions are implemented through negative screening of a company, or excluding the relevant industrial sector. Over time, however, principles-based organisations have become more interested in the positive impact that their investment assets can have, while also being more specific in their exclusions.

Targeted screening

Today, an investor may wish to prevent investment in companies associated with child labour, but not child employment, where that employment is not considered dangerous and does not negatively impact the child's education.[3] They may also want to see their assets used to influence positive behaviour. This is work the ESG team at Standard Life Investments supports through attendance at shareholder meetings and throughout the year in less formal engagements. Each quarter, this report highlights Standard Life Investments' engagement with companies and catalogues how we, as asset managers, have voted.

The importance of charities

'The third sector' (charities) is, unsurprisingly, where we find many principles-based investors. In England and Wales, the charities regulator, the Charity Commission, requires that charitable organisations must include an 'investment policy statement' as part of their formal documentation. This would normally outline the charity's view on investment restrictions, if they are considered necessary. In Scotland, the regulator (the Office of the Scottish Charities Regulator) does not make a similar demand. Despite this, many Scottish charities consider it to be 'best practice' and the Standard Life Wealth Charity team has conducted workshops with several clients over the last year to assist discussions relating to writing an investment policy statement for the first time. The charities with which we work have found the time allocated for deeper discussion to be a very worthwhile exercise. Board members have been forced to challenge whether they are approaching principles from the perspective of the charity's purposes or allowing personal ethics to influence their view.

Principles-based investing may have taken many years to rise in prominence and, while it may not yet be mainstream, it is certainly no longer a niche proposition. Just as smartphone technology progressed over a 15-year period from being a luxury item to a necessity in our lives, it is not hard to imagine that aligning personal standards and beliefs with investments will continue to develop until it becomes an extension of the brands that we buy or the companies for which we work. There are already encouraging signs in that regard, most notably the work of the UK's Good Money Week, which we detailed earlier in this report.

[1] http://www.ilo.org/ipec/facts/lang--en/index.htm

[2] https://www.theguardian.com/sustainable-business/nestle-baby-milk-scandal-food-industry-standards

[3] http://ethicalfutures.co.uk/assets/templates/ef/images/ef/whitepaper/Whitepaper-The%20Growth%20of%20Ethical%20Investment-0516.pdf

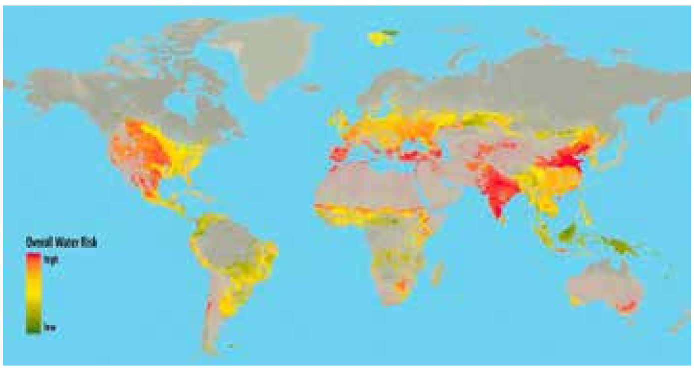
Sophie Rahm
Responsible Investment Analyst

PRI collaborative engagement on water risks in agricultural supply chains

The PRI Secretariat co-ordinates a number of collective engagements, including one on Water Risk in Agricultural Supply Chains, which Standard Life Investments joined in 2015. Population growth, changes in climate conditions and business activities are jeopardising the world's water resource. Demand for freshwater is increasing while supply is growing scarcer. Agriculture is the biggest user of freshwater, responsible for approximately 70% of the world's consumption.[1] However, there is little visibility for water in agricultural supply chains, and the level of water dependency in sectors like food, beverage or retail is still extremely difficult to gauge.

One of the difficulties with water assessments is the regional nature of the risk. While climate change and greenhouse gas emissions are essentially global in nature (despite wide discrepancies in terms of point of origin), water stress is usually felt on the basis of a region or a basin. Certain types of crops are also more water intensive. For example, growing wheat in India requires 10 times more water than in China.

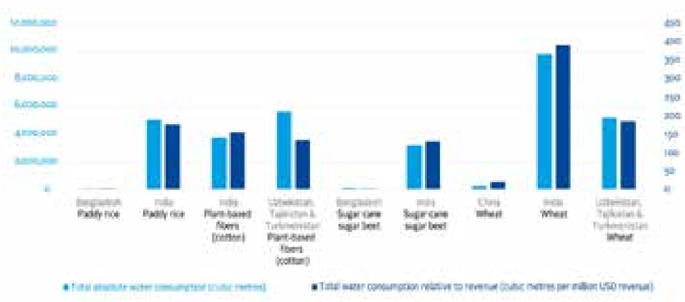
Figure 1: Global irrigated land facing water risk



Source: WWF, 2017

[1] United Nations World Water Assessment Programme, 2014. The United Nations World Water Development Report 2014

Figure 2: Total water consumption in identified crop-country combinations



With help from the World Wildlife Fund (WWF) and PwC, PRI developed an engagement framework and established a collaborative engagement strategy targeting over 30 companies. A number of global investors were then tasked with talking to companies and reporting their findings back to the investor group. Asking the same questions and exploring similar issues helped to benchmark companies against peers and identify 'best practice'.

A public disclosure benchmark was conducted in 2015 and 2017 using a series of indicators developed by the PRI Water Risk Advisory Committee. The results show that:

- 84% of the 32 companies benchmarked improved their disclosure of water risks in agricultural supply chains in 2017
- the company that made the most progress boosted its disclosure score by 44%
- retailers were the biggest laggards in terms of disclosure.

Since 2015, Standard Life Investments has engaged with Diageo, Kering and Orkla in order to understand how the companies deal with water risks in their agricultural supply chains, and what measures they are putting in place to mitigate some of these risks. We found Kering and Diageo on the better end of the spectrum with regards to water risk management, and are generally encouraged by Orkla's appetite to take its existing initiatives further.

Diageo

As a spirits and beer maker, water is essential to Diageo's business. The company demonstrates 'best practice' in terms of water management. It has published a Water Blueprint Strategy and is actively managing its direct operational impacts on the water resource. It puts a strong emphasis on communities, capacity-building and a holistic approach to the issue (looking at energy use, transport, treatment and discharge of water). This helps the company understand payback time and return on investment.

It has mapped its production locations against water-scarce regions as per the World Resources Institute Aqueduct tool and is involved in a number of industry initiatives in order to refine its approach. It estimates that one-third of its total production is located in water-stressed areas, with around 70% of the raw material supply sourced from local farmers in Africa.

In 2017, Diageo started using standards developed by the Alliance of Water Stewardship and piloted assessments at a couple of sites. It is also involved in the Sustainable Agriculture Initiative, and will roll out its Excel-based farm water assessment to its local suppliers.

A few challenges remain. Having acquired a number of facilities in the last five years, some of them located in areas of high water stress (Tanzania, Ethiopia, Turkey), it takes time to bring them up to speed with the company's approach. In addition, engaging and creating an appropriate toolkit for third-party operators is difficult. Food and beverage producers, as well as retailers, are now putting more pressures on traders and brokers to improve their 'source of origin' disclosure.

Kering

The company, which owns a number of luxury brands, has conducted extensive analysis to identify water hotspots and quantify the impact in the supply chain beyond the first tier. Water risk is integrated into its Smart Supplier and Smart Sourcing programmes for procurement and raw material sourcing. Further, the company is innovating in raw materials, fabric processes and product design to improve water efficiency.

Its innovative Environment P&L approach provides a detailed analysis of water risk in the supply chain. However, more information is needed regarding the policies in place to manage the risk across subsidiaries.

Despite its leadership position, Kering recognises progress has been difficult. It believes that the apparel industry has been slower to respond to sourcing challenges than the food and beverage sector. However, momentum to tackle these issues is growing. Kering is very active in its management of environmental risks, both direct and indirect, and we believe it will be able to capitalise on previous initiatives and apply its savoir-faire to these challenges.

Orkla

Orkla is a leading supplier of branded consumer goods and concept solutions to the grocery sector, specialist retailers, out-of-home sectors and the bakery market. The Nordic and Baltic regions are Orkla's main markets. Orkla-branded consumer goods represent about 96% of sales, with its investment division accounting for the rest. Packaged food accounts for 41% of sales, ingredients 24%, while confectionary and home care account for 18% each.

The company's involvement in multiple supply chains makes risk identification difficult, but it is an area where Orkla has high ambitions. The approach is to develop cross-functional programmes on group-wide strategy, with a particular focus on certification. The priority commodities are fish, cocoa, palm oil, animal products and vegetables. The goal is to have important raw food material produced sustainably by 2020, with a first focus on cocoa, fish and palm oil.

We will continue our work with the PRI on this issue and believe that the stewardship of water by multiple stakeholders including companies, will increase in significance.

Katharina Lindmeier
Responsible Investment Analyst

Amanda Young
Head of Responsible Investment

The changing nature of employment

At Standard Life Investments, we evaluate investee companies in accordance with the four pillars of the UN Global Compact: human rights, labour relations, bribery & corruption and the environment. We regularly publish and update white papers on these topics. Following the publication of the updated environment white paper last quarter, we have recently published our latest paper on labour issues. It highlights the key issues companies are facing, and gives guidance on how labour issues should be taken into consideration by investors.

Recent exposés into retailers including Sports Direct, JD Sports and ASOS have identified that the demand for 'fast fashion', internet shopping and online purchasing has changed the nature of employment in some industries. In particular, the gig economy has emerged, where employees are not paid an hourly wage, but rather paid based on the number of 'gigs' they do, such as delivery drivers and couriers. The number of agency workers has also risen considerably.

In 2016, there were an estimated 865,000 agency workers in the UK. This number could reach one million over the next few years, with full-time agency workers earning around £430 less than an identical employee in the same role.[1] Contract workers are not often entitled to sick pay or parental leave pay and there is little recourse in the event of dismissal. The most significant sectors for agency work include health and social work, manufacturing and business. Forty percent of agency workers are non-UK nationals (double the overall workforce of 20%).

While labour issues differ quite significantly across sectors, what they have in common is that they are often poorly reported on and, as a result, insufficiently understood by companies and investors. Engagement with companies is crucial for investors to get a better picture of the labour-related risks and opportunities. During the year, we have engaged with a number of companies on labour issues, across a range of sectors.

Forum – collaborative engagement initiative on distribution centres

Following the workforce treatment at Sports Direct, it became clear that adopting poor employment practices can be detrimental to a company's share price. We approached the UK's Investor Forum to initiate a collaborative engagement project focusing on the business practices in the apparel sector. This involved site visits to a number of UK distribution centres. We examined employment practices that inform the use of staff agencies, zero hours contracts and consideration of the voluntary living wage.

One particular trend noted was the rise in automation within these warehouses. Historically, large numbers of staff were needed to manually select and pack the individual orders. This required staff to walk a considerable distance (often many miles) around the warehouses within a single shift. Recently, a number of new automated systems have been introduced to improve the nature of the work. While this is positive, the impact on job opportunities was a concern. Companies assured investors that the impact on job numbers would be limited, with more opportunity to build new skills and take on new roles to oversee the automation. We will continue to monitor the impact of automation on job numbers.

Setting the scene

Prior to the visits, investors held a meeting with the Association of Labour Providers (ALP), Debenhams and the Institute of Human Rights and Business (IHRB). The ALP is a UK trade association promoting 'best practice' in the supply of workers and is developing a global labour provider certification scheme to drive responsible practices. Given the issue over the use of contractors, it was encouraging to learn what was being done to improve conditions. UK-based multi-national retailer Debenhams provided its views as a founding member of the Fast Forward initiative (founded by ALP), which aims to promote compliance with ethical labour standards within supply chains. The IHRB, whose mission is to shape policy and improve business practices on the issue of human rights, shared its views.

Modern slavery and bonded labour

In addition, we met with a number of companies, including a store visit to Burberry. While Burberry operates in a very different environment from many other retailers, investors gained an insight into the issues retailers face on managing supply chains. We also met with M&S, ASOS and Staffline. M&S

[1] The Resolution Foundation, an independent think tank

provided an overview of its new state-of-the-art distribution centre. ASOS covered its approach to modern slavery, with investors agreeing that ASOS's statement was one of the better documents published.

Operating in the UK, Staffline is involved in providing contractor staff for a number of different industries and faces significant reputational risks around how its contractors are treated. Staffline outlined its proactive approach to fighting modern slavery, which makes it a partner of choice for its customers. The company provided insight into the extent of illegal working practices in the UK.

Staffline works closely with the UK's Gangmasters and Labour Abuse Authority (GLAA). The GLAA was created following the Morecambe Bay cockling disaster, where 21 Chinese illegal immigrant bonded labourers were drowned by an incoming tide.

The GLAA shared the regulator's perspective of combating modern slavery and its powers to investigate modern slavery across UK labour markets.

Modern slavery is a global crime that exists in all supply chains, affecting millions of people. Human trafficking and bonded labour have overtaken drugs as the global crime of choice. The GLAA estimates there are 50,000 people involved in labour exploitation in the UK. A number of contract workers have been held in bonded labour, which exposes many industries to this problem.

Distribution centre site visits

Visits to distribution centres included ASOS (whose warehouse is run by XPO), JD Sports, N Brown and Boohoo. It was useful to see how the different warehouses operate and their levels of automation vary. It is clear that these warehouses offer significant job opportunities. However, the focus needs to be on the quality of jobs offered. More recently, it was encouraging to note a number of improvements have been made in working conditions within warehouses. This has largely been down to investor and other stakeholder pressures. We witnessed at first-hand how some of the poorer practices that were uncovered have been remediated and improved.

However, the nature of the work is low-skilled, low-paid and often involves long hours, creating challenges in attracting workers. The companies all spoke about labour shortages and competition for workers in the market place. We could see the benefits of a business adopting good working conditions in attracting and retaining workforces. This could lead to cost efficiencies. Companies are slowly recognising the challenge and this is driving them to automate as many of these distribution processes as possible.

Through active engagement, we will continue to integrate labour issues into our investment process. This includes those companies with warehouse operations in the UK, as well those operating in the gig economy.

Ruairi Revell
Sustainability Advisor, Real Estate

Avoiding obsolescence: getting to grips with Minimum Energy Efficiency Standards in commercial real estate

The Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 come into effect on 1 April 2018. While this might sound like a dry piece of legislation, it has significant implications for owners of commercial real estate in England and Wales. It sets a minimum energy efficiency standard (MEES) based on Energy Performance Certificates (EPCs), with mandatory ratings on an A to G scale indicating the efficiency of a building's fabric and fixed services.

Under MEES in England and Wales, if a building (or building unit) has an EPC rating of F or G, it will become unlawful to grant a new lease or renewal from April 2018. From April 2023, this will apply to all existing leases. With an estimated 18% of commercial properties rated F or G nationally, there is a lot of work for landlords to do. Unless ratings are improved in time, landlords (and their investors) could be left with unlettable units and consequent reductions in income and asset value.

MEES raises a number of interesting questions about the relationship between landlords and occupiers when it comes to energy performance. Responsibility for compliance with MEES sits squarely with the landlord. Yet, in many commercial properties, a significant driver of the EPC rating is the occupier's fit-out. This is especially the case in retail and industrial units where lighting decisions alone can affect an EPC rating by several bands. Proactive landlords are of course working closely with occupiers in affected units and there is plenty of scope for win-win outcomes.

At Standard Life Investments, we embarked on a comprehensive review of EPC ratings to fully understand and mitigate exposure to MEES risk. We have re-drafted hundreds of EPCs and our exposure to F/G rated units is a fraction of the national average. For each of the few remaining F/G units, we have developed a tailored strategy to ensure ratings are improved.

This legislation stems ultimately from the EU Energy Performance of Buildings Directive 2010. This is being implemented differently in each member state and, indeed, differently within member states where building regulations are devolved. For example, the approach in Scotland requires an energy action plan alongside an EPC for qualifying building units, with the landlord given a limited period to implement improvements.

While it may be a wake-up call for many, MEES (and its equivalents in other countries) is also proving a useful catalyst for engagement between landlords and occupiers in order to improve the energy efficiency of commercial buildings.

ESG voting and engagement

Voting and engagement snapshot

Company	Topics discussed
888 Holdings	Board composition needs improvement
Allison Transmission	Positive governance changes
AP Moeller-Maersk	Strategic change is an opportunity for governance improvement
BT Group	Governance oversight and management of cybersecurity
Devon Energy	More disclosure in the pipeline
Ladbrokes Coral	Responsible gaming and regulatory compliance
Rio Tinto	Chairman succession process concluded
UnitedHealth Group	Access to health care and opioid addiction in the US
WPP	Continuing dialogue on succession planning

ESG voting and engagement summary

Key

Key driver

- Internal mandate
- Client mandate
- Performance-based engagement

Key outcome

- Influential in achieving change
- On track to meet objectives
- Escalation candidate

888 Holdings

Engagement driver:

Internal mandate

Performance-based engagement

Engagement outcome:

On track to meet objectives

888 Holdings is an online gaming and gambling business focused on bingo, poker, casino games and sports betting. It operates business-to-consumer (B2C) in the UK, Spain, Italy, Denmark, Ireland, Romania and the US. It also operates business-to-business (B2B) with its Dragonfish platform.

We discussed the current board composition and stated that having only five board members was not good governance practice, as it means that there are only two independent directors from which to fill the board committees. The chairman was aware of the issue and mentioned that the recruitment process has started the recruitment process for a new non-executive director in May 2017.

The chairman noted that the board is currently planning for the succession of the CEO, CFO and the chairman. The two executives are not thought to be looking to leave, but they are held in high regard in the industry and there is always the chance they could be tempted away by a larger company with more money. The chairman has been on the board for 11 years so will probably look to step down in the next two years.

The company operates in a number of different jurisdictions, all of which have their own unique regulatory environment and ways of doing business. China and Poland are the main countries that pose a risk. In these markets, there is no legal status for online gambling, so either country could close the market or regulate it. If a country is looking to open up its market and regulate, then 888 will initially pull out of that market, wait until the regulations are formalised, then re-submit its application. This is to avoid being placed on a 'blacklist', which could impact its chances of doing business in this jurisdiction in the future. The company is confident that there is no risk of criminal proceedings in any of the markets in which it operates. It pulled out of Australia this year.

The company was fined £7.8 million by the UK's Gambling Commission. The action followed the discovery of significant flaws in 888 UK Limited's social responsibility processes, which aims to protect consumers from gambling-related harm. The first issue was around customers' self-exclusion, where customers could still get access to some of their accounts after asking to be locked out for a specific period. This was because the IT system only searched for the customer's name once, and might miss multiple sites on which the same customer was registered. The system also could not cope with slightly different spellings of a customer's name. Additionally, 888 failed to recognise visible signs of problem gambling behaviour displayed by an individual customer. This was so significant as to result in criminal activity, with one customer staking over £1.3million, including £55,000 stolen from their employer. As a result, 888 has improved its algorithms, and now views its observer system as the best in the business. It would appear that the regulatory breach was due to a technical fault with its IT systems and not a problem with the overall business culture.

Key

Key driver

- Internal mandate
- Client mandate
- Performance-based engagement

Key outcome

- Influential in achieving change
- On track to meet objectives
- Escalation candidate

Allison Transmission

Engagement driver:

Internal mandate

Engagement outcome:

On track to meet objectives

Until it was spun out in 2007, Allison Transmission was an operating unit of General Motors. It listed on the NYSE in 2012. It is the world's largest manufacturer of fully automatic transmissions for medium and heavy-duty commercial trucks, as well as US tactical defence vehicles.

Since last year, the company has made some positive changes on the corporate governance front. It has declassified its board, implemented majority voting for director elections and also allowed proxy access.

The CEO/chairman previously highlighted that he would be stepping down in May 2018. We were therefore keen to get more detail on the succession planning process. The company mentioned that after a process that has lasted two years, President and Chief Financial Officer David S. Graziosi will assume the role of CEO from June 2018. We mentioned that we would prefer an independent chairman to head the board, but if it remained a combined role then we would continue to expect a strong lead independent director (LID) on the board.

The board's high turnover in recent years was due to the move from controlled company status. The nominations committee use a skills matrix to find the skillsets and experience that are missing from the board. We mentioned that while the board has a diversity of experience and ethnic make-up, there are no female members. The company still has room to add another director as it said the optimal size of a board is 10-11 members (the company currently has 10). The skillsets that could be considered for the future would be regulatory experience or international experience growing a business.

When discussing remuneration, we also asked the company to consider adding a financial underpin to the current LTIP, which only uses a single relative total shareholder return (TSR) metric. A financial underpin ensures that the LTIP only pays out when the financial performance of the business reaches a suitable target level, instead of relying solely on stock market returns. We also mentioned that the TSR performance criteria for the performance share units, which would start to payout at a threshold level for 25th percentile performance, would be too generous, given it that pays out 50% of the total award for threshold performance. We recommended lowering the payout percentage at the threshold level or increasing the percentile performance level at which the TSR metric would start to payout.

Key

Key driver

- Internal mandate
- Client mandate
- Performance-based engagement

Key outcome

- Influential in achieving change
- On track to meet objectives
- Escalation candidate

AP Moeller-Maersk

Engagement driver:

Internal mandate

Engagement outcome:

On track to meet objectives

AP Moeller Maersk is an integrated transport and logistics company and is a global leader in container shipping and ports.

Last year, AP Moeller Maersk announced a significant shift in strategy as it aimed to dispose of its oil & gas businesses and focus on transport and logistics. In line with this strategy, a new CEO was appointed and then, in February 2017, Jim Hagemann Snabe was appointed chairman. Snabe is former CEO of software company SAP. As Maersk is a family-controlled company, we viewed the appointment of a new independent chairman as a positive development and, as a result, contacted the company to have a wider discussion on governance. Our analysis had identified some areas of potential governance improvement and we felt that this period of change was a good time to engage on these issues.

We spoke to the group chief financial officer and discussed board composition and succession planning, board oversight of strategy and the importance of maintaining the company culture. We learned that the new chairman, with his IT experience and strategic perspective, was already having an impact. He has reorganised the work of the board committees and changed the balance of discussion between performance monitoring and strategy.

In addition, we discussed the cyber-security incident that hit the company in June and had a significant business impact. However, the company was pleased with how the workforce responded to this crisis, which demonstrated its ability to move quickly to address problems as they arise. More broadly, they put in place a 90-day plan to address the issues that arose from the attack.

During our discussions, we suggested a number of structural improvements to governance arrangements. We encouraged the company to review director terms of election. It currently has two-year director terms versus the one year 'best practice' in Denmark. We also encouraged it to consider a formal board evaluation and disclose director attendance at board meetings. These are all measures that improve board accountability and potentially board effectiveness. We feel there is scope to consider increasing the geographic diversity of the board and suggested that the company consider this as part of board succession planning. We will monitor developments.

Key

Key driver

- Internal mandate
- Client mandate
- Performance-based engagement

Key outcome

- Influential in achieving change
- On track to meet objectives
- Escalation candidate

BT Group

Engagement driver:

Performance based engagement

Engagement outcome:

On track to meet objectives

BT Group is a multinational telecommunications company headquartered in London. In October, we met with incoming Chairman Jan du Plessis. At the company's AGM we had voted against the re-election of CEO Gavin Patterson and BT's Audit & Risk Committee Chairman Nick Rose. The appointment of the new chairman gave us an opportunity to explain the rationale behind our votes.

In our opinion, the failures in Italy, the deteriorated relationship with Ofcom (the UK communications regulator) and the general business underperformance raised questions as to whether the CEO was the right person to take the company forward. In addition, its Audit & Risk Committee, in our view, failed to apply adequate oversight of the Italian business and the performance of the external auditor. We also opposed the reappointment of PwC as auditor because, in our opinion, PwC did not sufficiently protect shareholder interests in respect of its audit of BT's Italian division.

We briefed du Plessis on these matters, so that he was fully aware of them as he began the role.

We also met with BT to discuss cybersecurity and human capital management. This formed part of two wider strands of our engagement work in 2017, on labour practices in the UK and on companies' readiness for the European General Data Protection Regulation, which will come into force in 2018.

BT's own security approach combines both physical and information security. The company has spent a lot of time assessing the criticality of data and deploying security controls. This allows BT to quickly identify potential incidents and escalate them to the right channels. The company provides security services to customers through its BT Security business, primarily to big multinationals. Although it does not focus on developing its own privacy products, it markets its internal expertise to customers.

We discussed the current landscape of cyber threats. Most of these threats still emanate from individual or small groups of hackers, some of whom disrupt services or deface public portals for ideological reasons, and an increasing number of cybercriminals motivated by financial gain.

BT acknowledged that in response to the growing demand for security services, recruiting and retaining skilled employees is a challenge. As a result, the company focuses on early careers with a large cohort of apprentices and graduates. In other areas of the business, BT is also creating jobs in the UK by moving back customer service roles that had been outsourced to other countries. This is a direct response to customer service suffering as a result of offshoring. While these changes are recent, BT is confident that in the long term they will have a positive effect on employee retention, engagement and net promoter scores.

Key

Key driver

- Internal mandate
- Client mandate
- Performance-based engagement

Key outcome

- Influential in achieving change
- On track to meet objectives
- Escalation candidate

Devon Energy

Engagement driver:

Internal mandate

Engagement outcome:

Escalation candidate

Devon Energy is an independent oil and gas exploration company operating in the US and Canada. It has assets in the STACK play in Oklahoma, the Eagle Ford area in Texas and the Delaware Basin. Its fracking operations have put Devon Energy in the centre of controversies around wastewater disposal. The current political environment in the US seems overall positive for the company, particularly with changes to land-leasing programmes whereby more federal land may be opened to oil and gas companies.

This was the first time we spoke to Devon Energy, and all relevant functions of the business (legal, health and safety, environment, governance) were represented at the meeting. The company's disclosure of environmental and social information has thus far been poor. It acknowledged that it is seeing increasing investor interest in sustainability issues and will improve its ESG data disclosure in the following months. We were assured it would be put to the board for discussion at its next meeting in November.

For now, the overall approach is very much compliance-driven. We remain concerned that this could make increased data disclosure difficult, although we welcome its willingness to engage with investors on these matters. Devon Energy is confident it has a good story to tell and that it should be more open and transparent about these operational achievements. There has been considerable investment directed towards energy efficiency, health and safety as well as water management, including fracking wastewater. For example, for one of its locations, Devon Energy has struck an arrangement with a local utilities company to use its wastewater for injection purposes. Over time, drilling activities have become more advanced and the technology now allows for lesser-quality water to be used. Unfortunately, the dollar amount of these investments remains a mystery. We encouraged this type of disclosure as it would help investors gauge the level of financial efforts needed to optimise operations year-on-year. Similarly, we would like to see the results of water risk assessments. For example, when a location is problematic, we want to know why; where are the hotspots; what can the company do to mitigate the impacts etc. At the moment, we are being told the story but missing the evidence.

One area of concern is Devon Energy's lobbying activity. The company is a member of industry associations, which tend to advocate against climate change action and further regulation of environmental emissions in the oil and gas sector (American Petroleum Institute, American Exploration and Production Council, Independent Producers Association of America, Canadian Association of Petroleum Producers). Scott Pruitt, former attorney general of Oklahoma and head of the US Environment Protection Agency, put his name to a letter written by Devon Energy, revealing close ties with the oil and gas sector. If and when Devon Energy publishes more information on its climate change risk approach, particularly oil price and demand assumptions, what it means for the business, how it may affect its strategy etc., it will be necessary to examine with even greater scrutiny how the company behaves in the political arena and where it spends its lobbying money.

In summary, current ESG disclosure remains very limited. We are confident that Devon Energy is committed to discuss its most material ESG risks and opportunities, showcasing some of its initiatives and demonstrating that both risk assessment and management are in place. Still, we remain sceptical on the strategic approach to climate change risk. We believe resilience planning and scenario analysis are a long way ahead, particularly in light of a regulatory context in the US, which may not be conducive to this process. Global investors are likely to continue to put pressure on Devon Energy and we should see better disclosure in the next few months.

Key

Key driver

- Internal mandate
- Client mandate
- Performance-based engagement

Key outcome

- Influential in achieving change
- On track to meet objectives
- Escalation candidate

Ladbrokes Coral

Engagement driver:

Internal mandate

Engagement outcome:

On track to meet objectives

Ladbrokes Coral (LC) is a betting and gaming business based in the UK. The company operates betting shops and call centres in the UK, Ireland and Belgium.

This was our first ESG meeting with LC in over two years. We recognise the growth of the gaming industry within the UK and believe it is important that all companies within the sector promote responsible gaming. Prior to our meeting, the UK Gambling Commission laid out its 2018-2021 strategy. This includes measures to protect the interest of consumers, raise standard for the gaming market and improve the Commission's engagement with the public.

We questioned LC on the Commission's report and the company highlighted it was supportive of the work undertaken. LC has a board-level social responsibility committee, which oversees the group's corporate responsibility strategy. It is chaired by a senior independent director and its main focus is responsible gaming. The committee is currently reviewing a number of its policies to ensure they reflect 'best practice' from both groups. LC was one of the founding members of the industry body senate group, which has limited gaming TV advertising before 9pm local time, dedicated 20% of gaming shop window advertising to responsible gambling and delivered a national responsible gambling advertising campaign.

We questioned what the company was doing to prevent customers from becoming addicted to gambling or gambling too much. LC highlighted that responsible gambling is one of its top priorities and it had put a number of measures in place to reduce risk. These included the use of algorithms to carry out behavioural data analysis to detect and deter problem gambling. It is also creating a player awareness system to minimise harm caused by gaming machines. In relation to fixed-odds betting terminals, the company advised it has taken steps to reduce harm and that there may be future regulation that would limit the returns and amounts spent on these machines.

We also questioned LC on its tax approach and ongoing court appeal against the UK tax authority regarding £71 million it had paid. LC was unable to elaborate on the case; however, it stated the case had been ongoing over a significant amount of time and that it fully disclosed the tax it paid in the UK, which totalled £583 million in 2016.

We will continue to engage with LC on the issues raised, particularly its promotion of responsible gaming.

Key

Key driver

- Internal mandate
- Client mandate
- Performance-based engagement

Key outcome

- Influential in achieving change
- On track to meet objectives
- Escalation candidate

Rio Tinto Group (which comprises Rio Tinto plc and Rio Tinto Limited)

Engagement driver:

Internal mandate

Engagement outcome:

On track to meet objectives

Rio Tinto Group is an international resources company with a dual-listing in the UK and Australia. The company employs over 50,000 people in 35 countries around the world. Major products include aluminium, diamond, gold, industrial minerals, iron ore, coal and uranium.

In March, the company announced that Chairman Jan du Plessis would stand down by the 2018 AGM (at the latest) and a process was underway to find a successor. This process was being led by Senior Independent Director (SID) John Varley. In June, however, Rio Tinto announced that Varley would be stepping down from the board to fight fraud charges related to his time as CEO of Barclays Bank. Rio Tinto then appointed Ann Godbehere as SID and she took over the succession process. She is an experienced non-executive director and joined the board in 2010.

We subsequently asked for a meeting with her and the company secretary to discuss this process. We were concerned the change in SID may have disrupted the process and were keen to understand their plans and provide our perspective on the profile of the new chairman. We were reassured the process was still on track and that a robust process was being followed. We provided some thoughts on the skills required of the new chairman, particularly experience in managing broader stakeholder relations - an issue that is increasingly important for the resources sector.

Shortly after our meeting, Rio Tinto announced the US Securities and Exchange Commission had filed a complaint in relation to the disclosure and timing of the impairment of Rio Tinto Coal Mozambique in 2011 and 2012. At the same time, the company also announced it had reached a settlement with the UK Financial Conduct Authority in relation to the timing of the impairment of these same assets, that is, the FCA determined that Rio Tinto should have carried out an impairment review earlier than it did, and the company was fined over £27 million as a result. Less than a month later, there was press speculation over the identity of the new chairman. With these developments, we then spoke separately to the chairman and the company secretary. We wished to discuss the board's response to the allegations relating to the impairment of assets in Mozambique and to provide our views on the press speculation.

The search for a new chairman was concluded on 4 December, when Rio Tinto announced that non-executive director Simon Thompson would take over as chairman in March 2018. He has strong industry expertise and previous experience as a company chairman, including stakeholder and shareholder engagement. We are therefore likely to support this appointment at the 2018 AGM.

Key

Key driver

- Internal mandate
- Client mandate
- Performance-based engagement

Key outcome

- Influential in achieving change
- On track to meet objectives
- Escalation candidate

UnitedHealth Group

Engagement driver:

Internal mandate

Engagement outcome:

On track to meet objectives

UnitedHealth Group owns and manages organised health systems in the US and around the world. The company provides employers products and resources to plan and administer employee benefit programmes. UnitedHealth also serves the health needs of elderly Americans, provides specialised care services and offers healthcare information and research to providers and payers.

This is the first time that we have spoken with the company regarding ESG issues and we were particularly interested in its approach to providing access to medicine in the US. The group offered details of its Center for Health Reform and Modernisation, which seeks to improve affordability, modernise healthcare systems and tackle key issues, such as children's health and chronic diseases. We believe a focus on the provision of care, especially delivering care outside a hospital setting, offers both a growth opportunity for the business and the potential of more affordable access to healthcare for US citizens.

As part of our ongoing engagement on opioid addiction, we asked how the group's subsidiary OptumRx was managing potential opioid risks and supporting penitents with addiction problems. UnitedHealth said that OptumRx had taken a number of steps, including educating practitioners and users on the appropriate doses, limiting the amounts of opioids prescribed, reducing inappropriate supply and supporting patients at chronic risk. These are encouraging steps; however, we recognise that this is an ongoing issue and the group may face challenges in the future as a result of legacy issues.

UnitedHealth's mission to improve the health system for all users has the potential for positive impacts across the US care system. We will continue to track its progress and have asked the company to communicate progress against these goals more clearly.

Key

Key driver

- Internal mandate
- Client mandate
- Performance-based engagement

Key outcome

- Influential in achieving change
- On track to meet objectives
- Escalation candidate

WPP

Engagement driver:

Internal mandate

Engagement outcome:

Escalation candidate

WPP is the world's largest communications services group, employing 200,000 people in 3,000 offices across 113 countries. It is a global leader in marketing communication services. WPP is made up of a family of smaller advertising agencies, which provide its global clients with a range of services, including advertising, media and data investment management, public relations and public affairs, e-commerce marketing and specialist communications.

Standard Life Investments has been a long-term investor in WPP and has attended the AGM of the company for the last three years to raise concerns around succession planning for Sir Martin Sorrell as CEO. Succession planning is arguably the most important role that a board undertakes and it is often more challenging when there is an entrepreneurial founder-CEO. That is because the individual is often synonymous with the organisation they have created. Our statement at the 2017 AGM sought to embolden further the chairman and the board to address this concern. The statement was in addition to an ongoing programme of private engagement and collaboration with other shareholders we have undertaken on this specific issue.

We requested publicly at the 2017 AGM that the board commit to discussing with the CEO the lead time required to ensure an orderly succession, as his service contract may be terminated by either the company or Sir Martin without any notice. We asked the board come to an agreement with him that, all things being equal, Sir Martin would provide sufficient warning to meet this timeframe. In our opinion, this increases the likelihood of a seamless succession as it would allow the board to execute their succession plans effectively and would reduce further the risk profile of the company. Unfortunately, no firm commitment was forthcoming from the board at the AGM.

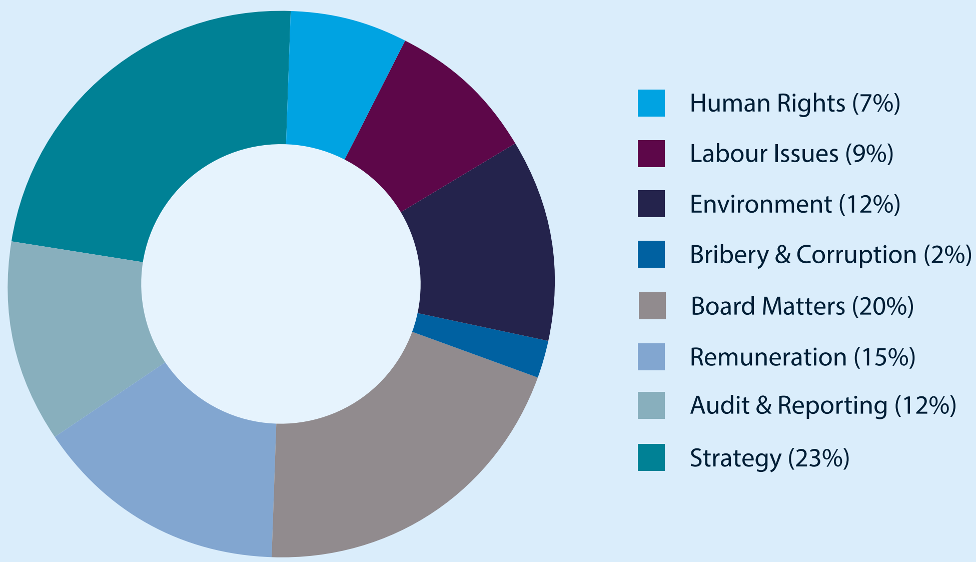
In November 2017, we led a collaborative meeting of shareholders with Chairman Roberto Quarta and Senior Independent Director Nicole Seligman to further discuss the board's progress on succession planning for senior executives, including the CEO. In our view, the board continues to make slow progress in addressing these issues, although it is encouraging that their disclosures have improved and it remains an area of focus area for the board. We again sought a commitment that the board puts in place an agreed timeframe of the CEO's departure. Again, no firm commitment was forthcoming and, while the chairman was able to give other assurances as to how the board is dealing with the issue, this was disappointing. We will continue to monitor the situation.

ESG voting and engagement

Voting summary Q4 2017	
Shareholder meetings at which our clients' shares were voted	182
Number of resolutions voted	1,646
Shareholder meetings at which our clients' shares were voted against management*	38
Number of resolutions voted against management	81
Shareholder meetings at which our clients' shares abstained*	7
Number of resolutions abstained	31

*On one or more resolutions

Engagement summary Q4 2017



Source: Standard Life Investments

Engagement summary Q4 2017

Company	Human Rights	Labour Issues	Environment	Bribery & Corruption	Board Matters	Remuneration	Audit & Reporting	Strategy
888 Holdings					●	●	●	
Accesso Technology Group					●	●	●	●
Alimentation Couche-Tard		●			●		●	●
Allianz			●					●
Allison Transmission					●	●		●
Allstate Corporation					●			●
ASOS	●	●						
AstraZeneca	●							
Atos		●						
Banco Santander		●						
BASF			●					●
BB&T					●	●		
Borregaard			●					
BT Group		●		●	●		●	●
Commonwealth Bank of Australia					●	●		
Costa Group	●	●	●					
Cranswick		●	●					
Devon Energy			●					
DFS Furniture					●	●	●	●
DS Smith					●		●	●
Essity Aktiebolag								●
First Republic Bank					●	●		
GlaxoSmithKline								●
Gooch & Housego					●	●	●	●
Goodyear Tire & Rubber					●	●		●
Greggs		●			●	●	●	●
Hilton Food Group					●		●	●
Keller Group					●	●	●	●
Kerry Group	●		●					●
Kier Group					●	●		●
Ladbrokes Coral Group	●							
Luxottica		●	●		●			
Mitchells & Butlers					●	●		●
National Grid		●	●					●
Nestle	●							●
Nextera Energy			●					
NMC Health					●	●	●	●
Novo Nordisk	●							●
Orsted		●	●					●
Philips Lighting					●		●	●
Premier Foods					●	●		●
Prologis					●	●		
RWE		●	●					●
Sage Group					●	●	●	●
SAP			●	●				
Swiss Re	●		●					●
Temenos Group					●	●	●	
Torchmark					●	●	●	●
UnitedHealth Group	●							
Valeo			●					
Total	**9**	**12**	**15**	**2**	**26**	**19**	**15**	**30**

Our voting is disclosed on our website on a monthly basis:-
http://www.standardlifeinvestments.com/governance_and_stewardship/what_is_corporate_governance/our_voting_records.html

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