Schroders

Sustainable Investment Report

Annual Report 2017

Marketing material

About Schroders

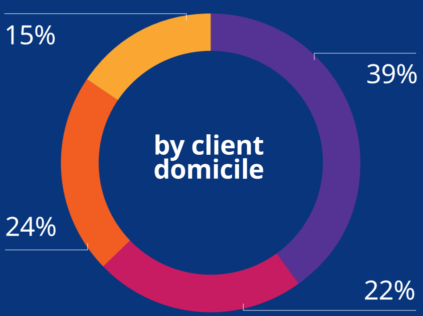
At Schroders, asset management is our only business and our goals are completely aligned with those of our clients: the creation of long-term value to assist them in meeting their future financial requirements. We have responsibility for £447.0 billion (€503.6 billion/$ 604.7 billion) on behalf of institutional and retail investors, financial institutions and high net worth clients from around the world, invested across equities, fixed income, multi-asset, alternatives and real estate.

As responsible investors and signatories to the UN's Principles for Responsible Investment (PRI) we consider the long-term risks and opportunities that will affect the resilience of the assets in which we invest. This approach is supported by our Environmental, Social and Governance (ESG) Policy for Listed Assets and our Schroder Real Estate Responsible Investment Policy.

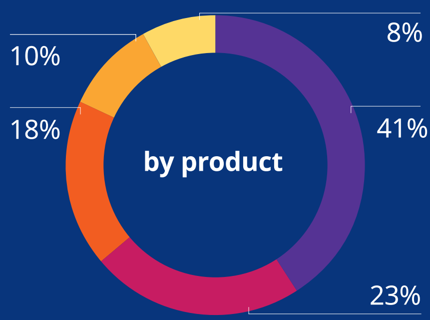
Presence in 29 countries

4,600+ employees

£447.0 billion assets under management and administration



- United Kingdom
- Continental Europe, Middle East and Africa
- Asia Pacific
- Americas



- Equities
- Wealth management
- Private assets and Alternatives
- Multi-asset
- Fixed income

Source: Schroders, as at 31 December 2017.

The companies and sectors mentioned herein are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

A message from our CEO

There is both a moral and a commercial imperative for asset managers to place environmental, social and governance issues at the heart of their investment business. These issues are of growing importance to our clients and an important source of good investment performance. Since joining Schroders I have made this my priority, building on a long history of constructive engagement.

Peter Harrison
Group Chief Executive,
Schroders plc

2017 has provided plenty of challenges to catch out less sustainable business models; catastrophic natural disasters from hurricanes, large scale cyber attacks and an opiate epidemic. The pace of change is accelerating and the landscape that businesses have to navigate is becoming increasingly demanding. Little wonder that at current churn rates 50% of the S&P 500 Index will be replaced over the next 10 years. Against this backdrop it is difficult for anyone to argue that sustainability isn't relevant.

This year we have again increased our resources. The team now stands at twelve members, enabling deep sector and regional specialisation. We have produced innovative thought leadership, sharing the tools that we have developed internally to assess the financial impacts of climate change with our Climate Progress Dashboard and Carbon Value at Risk models, as well as researching investors' thoughts on sustainability with our Global Investor Study. We have doubled the number of company engagements on two years ago to over 1,000.

Our commitment has been acknowledged externally. We have retained our A+ rating from the Principles for Responsible Investment (PRI) for our overall ESG approach. We were recognised by NGO ShareAction as the number one European fund manager for our responsible investment performance and transparency[1].

But challenges remain. As ESG integration becomes more mainstream, we should expect more scrutiny on the outcomes and impacts of all this activity.

Investors have rushed to coin new phrases relating to sustainable investing, before they have even fully agreed on definitions for existing terms like "green", "ESG", and "impact". Countries have developed accreditation schemes, which reflect local views on issues such as nuclear power, and are little more than an audit of holdings. It is small wonder that 41% of institutional investors who we surveyed in our global investor study identified lack of transparency and reported data as a barrier to sustainable investing.

Recognising that for the next stage of evolution in sustainable investment standard definitions and frameworks need to be agreed, both the EU and the UK have announced working groups examining the issue. However, inter-regional agreement may be difficult to achieve; we are moving forward with our own work accrediting investment processes in the areas of screening, integration and responsible investing where there is clear evidence of the role that sustainability plays.

1 Lifting the Lid: Responsible Investment Performance of European Asset Managers - The 2017 ShareAction Survey

Moving to emerging markets, corporate governance is a major area of focus for us as investors and we were delighted to host a discussion focused on identifying practical improvements that involved securities regulators, companies and investors during the quarter. Everyone agreed that strong corporate governance is key for attracting capital. This sentiment was echoed in another debate that took place at Schroders involving the "Focusing Capital on the Long Term" initiative. Again, we involved a number of stakeholders to come up with practical steps that everyone in the investment chain can take to create better long-term value.

Looking at research, an increasingly important but poorly quantified area of company investment is human capital. Previously, we have examined this through the lens of modern slavery and living wages. Our latest research shows the impact that integrating human capital considerations into profitability and asset measures can have on the measurement of profitability. Lastly, in August of this year, President Trump declared an opioid emergency in the US. We take a closer look at the investment implications likely to result from a problem of this scale.

As the breadth of topics analysed in this report demonstrates, companies continue to face a myriad of issues in today's world. As stewards of investor capital, we need to challenge companies to understand how they are dealing with big topics ranging from the structural shifts around the internet to the management of workforces in a knowledge-based economy and meeting the growing expectations of a wide range of stakeholders. Fact finding engagement is a key part of a meaningful dialogue with companies on how they will continue to enjoy success in years to come so we hope this quarter's report sheds some light on our fact finding approach at Schroders.

Schroders 2017 Sustainability Overview

Recognition

A+ UN PRI rating for overall approach to responsible investment

#1 in ShareAction Responsible Investment Survey of European asset managers

Top 5 in 2017 Asset Owners Disclosure Project (AODP) Global Climate 50 Asset Manager Index

Active engagement

1,000+ engagements across 50 countries

Top five engagement sectors

Consumer discretionary **20%**
Industrials **17%**
Financials **15%**
Consumer staples **11%**
Materials **8%**

Active governance

5,378 company meetings voted on

Instructed a vote against management at 42% of meetings

Source: UN PRI, ShareAction, AODP, Schroders as at 31 December 2017

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ESG and INtelligent Investing

Schroders has been incorporating ESG considerations into its fundamental research and stock selection process for 20 years. We published our first corporate governance policy in 1998, followed by our responsible investment policy in 2001. Since then, the information and tools available to us, our resources, the depth of our expertise and our approach to integrating responsible investment principles have evolved, but our commitment has remained the same: to be active owners of the companies in which we invest and to reflect ESG factors within our investment process.

Our world is changing faster than ever, environmental stresses are growing more acute and social pressures continue to surprise at every turn. Corporate fortunes rest on their ability to navigate that turbulent world. For investors, this changing picture creates challenges and opportunities. That's why we seek to put responsible investing at the heart of all we do. From choosing the right assets, to engaging with our investments, positive principles guide our actions. We believe this approach leads to better outcomes for clients and should be part of every investment process.

We call it INtelligent investing. The pillars of our discourse below are our core beliefs and how we conduct our approach.

INsight

To fully understand a company's potential you need to look beyond the annual report

INterpret

Knowing what to do with insights is the key that unlocks value foryou

INfluence

We've always seen ourselves as owners, not renters of the companies we invest in

INtegrity

We're committed to managing yourassets responsibly

Source: Schroders

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Integrated approach

At Schroders, we see ourselves as long-term stewards of our client's capital and this philosophy naturally leads us to focus on long-term prospects for companies in which we invest. That's why we seek to integrate ESG considerations into our research and overall investment decisions across investment desks and asset classes.

We recognise that different asset classes, portfolio strategies and investment universes require different lenses to most effectively strengthen decision-making. Our integration approach spans the breadth of the investment process, from identifying trends, analysing securities and constructing portfolios, through to engagement, voting and reporting.

This section includes case studies to clearly show how ESG factors are being considered and integrated in different parts of our business.

Source: Schroders

Integration in Equities

Sustainability from a global equity perspective

The Global and International Equity team has long assessed ESG factors as a central part of its stock analysis process, in fact long before the term "ESG" was broadly adopted. The appraisal of non-financial factors, now labeled "ESG", has served to inform the team's view of a companies' forward-looking growth, and the stability and associated risks of this growth, for more than a decade.

ESG integral to stock assessment

The team's investment philosophy is anchored on the belief that companies that deliver earnings growth above the level anticipated by market consensus will outperform the broader market. A significant focus area for the team's analysis is over the longer term, recognising the market's persistent failure to correctly appraise the long-term earnings power of companies. As long-term investors, we consider it vital to appraise both financial and non-financial factors when analysing a company and its stock in order to obtain a better understanding of a company's risk characteristics and return potential. Our assessment of ESG and other sustainability characteristics are an integral part of this analysis.

For example, one of our holdings has a growing portfolio of environmentally friendly products and dedicated research and development budget for this area of the business. There is low staff turnover and high employee satisfaction with an injury rate well below the industry average. The company is focused on long-term growth and there is a sensible compensation structure for senior management. These characteristics not only provide support to the structural drivers of growth for the business but add weight to our confidence that the growth potential can be realised by the company.

Proprietary risk framework

Given the importance of such considerations, the Global and International Equity team has developed a proprietary fundamental risk framework. The framework provides a systematic and forward-looking view of company risks (including ESG) and ensures that we capture, evaluate, and monitor factors relevant to the prospective risk and return potential for each stock.

Another recent example serves as a reminder that risks are dynamic and need to be continually reassessed in light of new information, additional analysis or further disclosures. One of our holdings had suffered a significant fall in share price following a report that questioned aspects of its accounting policies, amongst other issues. Although there was generally poor company disclosure, we had reflected this in our fundamental risk assessment.

In conjunction with our local research analyst, who had covered the stock for 19 years, we investigated the claims made and tested our thesis for the continued holding of the stock within our portfolios. While we recognised the need for greater transparency and improvement in elements of the firm's reporting, our assessment at the time was that concerns were exaggerated.

Our subsequent research and analysis, significantly around non-financial factors, provided the confidence to maintain our position. This was to the benefit of our client portfolios given the significant share price rally that ensued. We have continued to engage with the company on aspects of disclosure which are now having some bearing in the detail provided by the company.

It is our genuine belief that understanding ESG and sustainability issues better informs the risk and return potential of the stocks that we look at. We do not view this analysis as an overlay or screen for stocks and it certainly isn't an exercise in box ticking.

Engagement is key to philosophy

Our ownership of shares, however, extends beyond a simple acceptance of risk and return. We are active investors and engage regularly with the companies that we own. The Global and International Equity team monitors newsflow, data and disclosures and also engages in regular meetings with the companies in our portfolios.

We also work closely with Schroders' Sustainability team to highlight potential issues or material developments. Through a process of collaboration, engagement priorities are determined and a process with a clear action plan agreed. Engagement with companies will involve a combination of sustainability, corporate governance specialists and members of the Global and International Equity team as appropriate. Recent engagement priorities have included discussions with a number of Japanese companies on improving capital allocation, encouraging Swedish companies to abandon bundled director elections, and examining personnel and working practices at a large US e-commerce company.

Source: Schroders

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Fund Focus: Schroder ISF* Global Sustainable Growth

Our integration of ESG analysis over many years has demonstrated the importance of a company's culture and its relationship with its broader set of stakeholders to the company's ability to sustain its growth and returns over time.

Recognising the increasing client demand for a product with explicit ESG and sustainability characteristics, on 2 November 2017 the Global and International Equity team renamed Schroder ISF Global Demographic Opportunities to Schroder ISF Global Sustainable Growth and adapted the fund objectives to more-clearly reflect these characteristics.

This fund leverages the established process of ESG integration, fundamental risk and financial analysis but incorporates an explicit sustainability assessment for stocks being considered for the portfolio. This sustainability assessment provides a higher bar for inclusion in the fund ensuring that only those companies with positive sustainability characteristics are represented.

Sustainability Quotient assessment

To do this, the team have developed a systematic process for evaluating sustainability characteristics, embodied within what we call our Sustainability Quotient (SQ) assessment. This is a list of 20 detailed questions that are asked of each stock being analysed. As well as assessing a company's interaction with its stakeholders, it also examines areas that are important for the sustainability of the company's operations such as the prudent allocation of capital and the company's reporting and governance structure. This assessment provides a framework for the group's in-depth sustainability analysis, encompassing wide-ranging information from multiple sources, often significantly shaped by direct and detailed discussion with company management.

The aim is to capture those companies that exemplify sustainable investing. These are companies that are undeniably managed with a long-term time horizon and recognise the impact of their operations on various stakeholders. These companies will demonstrate a respect for the environment and natural resources; have a high regard for their employees/ suppliers and customers; will allocate capital prudently and value the interests of minority shareholders; and will be transparent and honest in their disclosures and actions. We believe these characteristics should be celebrated and encouraged, and will ultimately support strong operational performance and long-term structural growth.

Sustainable alpha with low volatility

We believe that the benefits of the fund's approach will be exhibited in its financial and non-financial performance. The fund is expected to return sustainable levels of alpha, with lower volatility characteristics although this cannot be guaranteed. Because the fund is designed to focus on companies whose actions take into account their impact on stakeholders, there is a reduced risk of impacts from controversial events or newsflow. With an expected holding of 30-50 names, along with the anticipation that stocks will be bought and held for the long term, we expect there to be a low turnover rate. The strategy is unconstrained in its approach which allows the fund managers to pursue attractive investment ideas wherever they are, across the globe and throughout the market capitalisation spectrum.

Schroder ISF Global Sustainable Growth – Risk Factors

The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. The capital is not guaranteed. Investments denominated in a currency other than that of the share-class may not be hedged. The market movements between those currencies will impact the share-class. The fund will not hedge its market risk in a down cycle. The value of the fund will move similarly to the markets. Emerging markets will generally be subject to greater political, legal, counterparty and operational risk. Changes in China's political, legal, economic or tax policies could cause losses or higher costs for the fund.

*Schroder ISF refers to Schroder International Selection Fund

Source: Schroders

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Integration in Fixed Income

A focus on Emerging Market Debt

Sustainability in credit fixed income is increasingly gaining traction, helped by the PRI's work, particularly its statement on ESG in credit rating that we have supported. It is our belief however, that integration in sovereign fixed income has been neglected. In 2017 we worked with our investment colleagues to build a better framework for incorporating medium-and longer-term ESG risks into our investment processes, drawing on both academic research and the experience of our investors. In June 2017 we published Sustainability and Sovereign Fixed Income.

To complement this work we are focusing, in our Annual Report, on how our emerging market debt (EMD) absolute return (AR) process practically incorporates ESG. The team firmly believes that in order to extract the best risk-adjusted returns from the asset class, a highly flexible strategy and a process designed specifically with risk control as a primary objective is required, and ESG analysis plays an important role in this.

Investment process based on country analysis

Our EMD universe encompasses over 50 countries across Asia, Eastern Europe and Latin America. Apart from the fund's liquidity-based diversification limits, there are no constraints regarding other metrics such as duration, minimum credit rating, or currency exposure. The team has developed a unique investment process, designed specifically for AR investing in the EMD universe.

In contrast to most other EMD products, we are permitted exposure to local currency debt, currencies and hard currency debt in one actively-managed portfolio. The strategy can have exposure to corporate debt but historically this has been limited. Country analysis forms the core of the investment process, with countries being compared over time and against each other. Major countries are reviewed at least once a year, minor ones less frequently. Analysis is based on four core assessment pillars: fundamental, quantitative, technical and sentiment. The fundamental analysis is by far the most important element; ESG is incorporated into both the fundamental and quantitative steps.

ESG factors: focus on social order and fairness

From an ESG perspective, areas of concern centre around potentially high levels of corruption, political stability, resource appropriation and poor infrastructure; institutions are generally weaker in emerging market countries. When analysing single countries, the team's extensive experience has proved that investments in countries exhibiting both sound fundamentals as well as evidence of clear social order and fairness make for the best opportunities. On that basis, the team tends to actively avoid countries where such conditions are not prevalent or significantly improving, even if factors such as high bond yields are available.

In the course of the country analysis, we actively monitor various social and political development indicators, such as the evolution of poverty head count ratios, literacy rates, rule of law and control of corruption. The team uses data provided by the World Bank and other multilateral organisations. Rating agencies, in our experience, are of little use in these markets, although at times they can be a good contrarian indicator.

On-the-ground analysis

It is important to conduct detailed, on-the-ground analysis and for that reason our EMD AR fund managers make frequent visits to the countries within their respective regions. The output from these trips results in detailed country reports that are focused on governance and politics, as well as social, economic and market developments. One aim of these trips is to form a well-rounded view of a country's outlook through engaging with a broad spectrum of contacts, rather than simply relying on official views on monetary or fiscal trends.

Trips are usually self-organised, and we have built up strong networks of contacts over a number of years. For example, locals are often inhibited in what they can say and we tend to rely more on foreigners who are embedded in countries and who can speak with a greater degree of freedom. This enables us to develop a deep understanding of the countries in which we invest, and also to track their evolution over the twenty-five years that we have been conducting visits.

Politics is inevitably the most qualitative element and focuses on risks and opportunities. The team meet with policymakers, politicians (both those in government and in opposition), think tanks, central banks, consultants, journalists, and companies. We evaluate the quality of the policymakers, the role of the law, the checks and balances on power and how democracy is actually operating. In our experience the trend is more important than absolute levels. Work by ratings agencies overlooks these factors; indeed our experience shows us that they can often be contrarian indicators when evaluating change in this area.

Source: Schroders

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Integration in Real Estate

Schroder Real Estate has managed real estate funds since 1971. Our real estate business is headquartered in London with 13 teams globally, and currently has £13.2 billion (€14.9 billion/US$17.9 billion) of gross real estate assets under management (at 31 December 2017) across direct real estate, real estate securities and real estate capital partners.

Direct real estate investment (the ownership and active management of buildings), provides scope for ESG considerations to be applied directly and for positive impacts to be realised. Schroder Real Estate's Responsible Investment Policy is embedded in our investment process. We believe this should help deliver improved long-term returns, contribute to tenants' business performance and create tangible benefits to the local communities and societies in which they operate.

We maintain an environmental management system aligned with ISO 14001 (the internationally agreed standard for such systems) to manage the deliverable actions derived from our Responsible Investment Policy. Our framework applies to all aspects of real estate investment including acquisition due diligence, asset management, property management provided by third parties, refurbishments and developments.

We also participate in the Global Real Estate Sustainability Benchmark "GRESB" which is the global standard for assessing the ESG performance of real estate funds and companies. Our approach can be best demonstrated by looking at our activity over 2017.

ESG for real estate securities and real estate capital partners is managed in alignment with Schroders' approach for indirect assets and Schroder Real Estate's Responsible Investment Policy.

Case study: Town regeneration at the Lexicon Shopping Centre, Bracknell, Berkshire, UK

In Bracknell, Berkshire (UK), we have developed a new town centre. We have been invested in the centre for over 15 years and the new 54,000 square metre Lexicon Bracknell scheme opened in September 2017. Unusually, and alongside the development partner, we have control over the majority of this post-war town centre. The scheme comprises new retail, leisure and 1,000 homes as well as the renovation of parts of the original retail and includes one of the largest green walls in Europe. The regeneration plan involved working closely with local government and the community to identify the needs of the centre and the town as a whole. This collaboration helped shape the design and amenity of the scheme, including infrastructure and accessibility, and informed public safety and wellbeing. Apprenticeship and recruitment services were also developed to support the construction project, workers and staffing for new occupiers with around 3,500 new job opportunities created. The regenerated centre will help the town develop its position as a retail centre in Berkshire and attract further investment from the wider area to continue Bracknell's economic development and prosperity. The Lexicon's success is marked by two 2017 Revo Gold Awards, Re:new Gold for projects that have positively impacted their surrounding environment and it was voted "Best of the Best" across all award categories.

Case study: Sustainable office acquired in a new eco quartier Paris, France

The Résonance building is located in the new Victor Hugo eco quartier in Bagneux, southern Paris which is set to benefit from the extension of Metro Line 4 by 2020, connecting Bagneux to the heart of Paris in 15 minutes and the new Grand Paris Express Line 15 by 2022. The sustainable building design aims to deliver low energy consumption; the optimised building skin with high-performance insulation and airtightness should limit heat losses and gains, and heating and cooling techniques aim to ensure tenant comfort. Wellbeing is key with large windows, onsite gardens, an intercompany restaurant, fitness, concierge and wellness areas, and cycle facilities. The onsite property management team is focused on ensuring the building operates to its efficient design credentials. Résonance achieved a triple certification of HQE[2], BREEAM[3] Very Good and Thermal regulations -37% (French RT 2012) and a WIRED Score Platinum. The resulting environment provides an uplifting working experience and the service charges are materially lower than an equivalent building without such environmental initiatives.

2 High Environmental Quality certification - assesses the environmental quality of green buildings.
3 Building Research Establishment Environmental Assessment Methodology – an environmental assessment method and rating system for buildings.

Case study: Improving office energy efficiency in UK

Our direct real estate programme includes setting sustainability objectives for those assets where we as landlord have operational control. In the UK we set a 6% energy consumption reduction target for the two years to 2018 against a 2015/16 baseline, assessed on a like-for-like basis. We have been pursuing a number of initiatives to achieve this including a 12-month programme to improve building management system efficiency for a number of larger multi-tenanted office buildings. The results for the first year delivered an energy consumption reduction of -4% on a like-for-like basis. We hope to see continued improvement over the second year of the programme and the achievement of our target.

Source: Schroders

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Integration in Private Equity

Founded in 1997, Schroder Adveq is a leading global private equity asset manager. In mid 2017, the firm became a wholly-owned subsidiary of Schroders plc. Schroder Adveq focuses on specialised investment solutions that enable our institutional clients access to select private market segments through primary, secondary and direct/co-investments. Schroder Adveq is headquartered in Zurich and today manages more than USD 8 billion (at 31 December 2017) on behalf of its investors.

Responsible investment principles key to long-term success

Adherence to principles of responsible investing is particularly important for private equity investing given its long-term nature. Schroder Adveq has long recognised the importance of ESG and the positive impact it can have for its stakeholders across the investment chain. The firm's responsible investing policy was formally integrated into its working practices eight years ago when it signed up to the PRI.

A proactive approach to ESG integration

For Schroder Adveq, ESG is not simply about negative investment selection based on set criteria. The firm's proactive approach to ESG is core to our values and embedded throughout our operations. ESG plays a critical role in our comprehensive due diligence process when we are assessing a company or a fund prior to investment and also in the ongoing monitoring throughout the life of an investment. We actively work with our fund managers to improve their responsible investment approaches. We are convinced that adhering to responsible investing principles maximizes long-term value and benefits our clients, shareholders, employees, and the communities in which we operate.

Responsible Investment Committee driving our activities

Schroder Adveq's approach to responsible investing is directed by the Responsible Investment Committee, chaired by the Head of Risk Management and comprises several investment managers and marketing professionals. The Responsible Investing Committee develops and implements an organisation-wide approach to responsible investing that is actively embraced across all functional roles.

Committed to promoting ESG in private equity

Schroder Adveq continues to invest in its commitment to lead the market in the management of ESG issues. The firm is constantly striving to improve its ESG processes, systems, monitoring, evaluation and engagement. We actively encourage our General Partners to adopt ESG practices and values in their own investment practices, to disclose all relevant and material ESG risks and report on the impact ESG has on investment performance, in accordance with established and evolving international standards. Likewise, Schroder Adveq reports its own ESG performance in keeping with international standards and makes this report available to clients.

Case study

In 2017, the Schroder Adveq Investment Committee approved 39 primary fund commitments pursuing venture capital, growth, buyout or turnaround investment strategies in North America, Europe or Asia. Each firm was assessed for its adoption of responsible investing practices and ESG factors within the firm's overall operations and in particular its investment process. It is clear that there is a wide disparity among private equity firms in the adoption of responsible investing and ESG factors in accordance with internationally accepted frameworks. Thus, Schroder Adveq sets specific adoption goals with each fund manager in which we commit capital and monitor their implementation as part of our overall investment monitoring efforts. We are pleased to see the positive results of our efforts. As an example, at the end of 2017, one of our US-focused turnaround managers implemented an ESG policy covering the firm's investment practice. This was clearly a positive first step in what we believe will enhance the risk and return profile of our investment with this leading firm.

Case study

In January 2017, Schroder Adveq partnered with the Chartered Alternative Investment Analyst (CAIA) Association to conduct a global CAIA membership survey on responsible investing. The survey's findings were widely publicised globally as they reinforced what Schroder Adveq has been advocating for years. Specifically, asset owners, asset managers and consultants agreed that consistent industry standards and more education are needed for responsible investing, including the adoption of ESG and ethical principles. In addition, the survey supported the view that adoption of ESG factors in investment practices is of increasing global importance. The survey was completed by 647 CAIA members worldwide; respondents included asset owners such as endowments, insurance companies, pension funds etc. with assets under management of between USD1 billion and USD100 billion, as well as consultants. Schroder Adveq has used the results of the survey to better understand and educate others on the role of responsible investing in the alternative investment management industry.

Source: Schroders

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Integration within Wealth Management

A view from Cazenove Capital

Cazenove Capital is the wealth management and charity investment business of Schroders plc in the UK and Channel Islands. We offer personalised, discretionary investment services and wider wealth management services to a broad range of clients. Cléo Fitzsimons leads Cazenove Capital's Sustainability offering and works closely with Schroders' ESG specialists, allowing a pragmatic and flexible offering to Responsible Investment (RI).

2017 saw an increase in demand from clients, especially millennials, for the application of RI strategies within their portfolios. Furthermore, much of the interest has been for more flexible Sustainability strategies such as thematic investing or social impact as opposed to the more traditionally used negative screening strategy. A prominent theme this year has been Climate Change and many clients have enjoyed following Schroders' Climate Progress Dashboard which monitors 12 indicators to show the progress being made toward decarbonising the global economy.

Sustainability on the agenda

Cazenove held two investment seminars in the Channel Islands in 2017 and for the first time we dedicated part of the agenda to sustainability. We covered how Schroders and Cazenove practically integrate environmental, social and governance factors into the investment process as well as the spectrum of sustainability strategies available to clients. Pleasingly, we have seen an increase in the number of offshore clients requesting the application of a sustainability strategy to their portfolios and are happy to be able to cater to such requests in a bespoke fashion.

Philanthropy

We believe that clients should approach their philanthropy with the same stewardship they would their investments and we take our role in the professionalisation of philanthropic giving seriously. We work with clients to define their philanthropic ambitions and spending plans, and manage the assets of the charitable structure to deliver the income and capital required. We can create and implement a bespoke ethical investment mandate where required, including social impact investments.

We have a specialist within our wealth planning division who provides guidance to private clients regarding the various ways to formally structure charitable giving whether this be direct, via the use of a donor advised fund, charitable trust, foundation or charitable incorporated organisation. Where a donor advised fund is suitable we provide access to market leading solutions via the C Hoare & Co Master Charitable Trust and National Philanthropic Trust (UK), a US/UK dual qualified donor advised fund for clients of Schroder Wealth Management (US) Ltd.

We aim to help clients align the causes they care about with the right end-beneficiaries, giving them confidence to make larger and more impactful gifts over time. We do this by providing clients with access to a range of independent philanthropy consultants who will provide advice on strategic giving. These consultants are matched to the client by our team to ensure they receive the right advice at the right time on their philanthropic journey. Philanthropy is very important to the large families we work with and we provide introductions to philanthropy and training via our next-generation investment days and events throughout the year targeted to young adults between the ages of 16-25.

Charity update

At the end of 2017 our specialist charity team, Cazenove Charities, looked after £8.7 billion on behalf of 837 charities. Over the year the team has continued to generate positive returns to support our client's charitable purposes. In addition to the investment management service, the team offer support to trustees in the form of advice and education. Over the year we have run trustee training events reaching over 100 trustees. Partnering with chartered accountants Haysmacintyre and charity lawyers Farrer and Co, we have complemented our investment training with a series of events covering charity law and an introduction to charity finance and reporting as well as full and half day sessions on "What every trustee should know". Our flagship events attracted over 300 attendees, with the fourth annual charity investment lecture at the Royal Institution of Great Britain in May featuring Elroy Dimson and our full day charity investment forum in November at the Royal Institute of British Architects.

The team's commitment to the sector includes partnerships and collaborations with sector bodies to provide research and influence policy where appropriate. Over the year we have collaborated with the Association of Chairs on a briefing "Making board committees work" and sponsored the National Council for Voluntary Organisation's (NCVO) annual Civil Society Almanac – the key source of data on the UK voluntary sector. We were part of the Treasury working party on the implementation of the Common Reporting Standard for UK charities, and contributed to the Treasury report on "Growing a culture of social impact investing in the UK". We continue to work with both the Charity Commission and Financial Conduct Authority (FCA) on the Charity Authorised Investment Fund structure, and intend to launch our own funds in 2018.

Looking ahead to 2018

In 2018 we look forward to building on Cazenove's sustainability offering by fully integrating ESG considerations into the entire investment process both in the UK and internationally. We strive to continue offering our clients topical insights from the industry and reflect their bespoke sustainability requirements within their portfolios.

Source: Schroders

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INsight

Better investment insights come from creative and innovative research. At Schroders, we strive to be at the very forefront of thinking on existing and emerging sustainability topics. Our thematic research aims to enhance our understanding of the material ESG risks and opportunities that may impact a company's valuation and risk profile.

To fully understand a company's potential you need to look beyond the annual report. Analysis of how companies deal with all their stakeholders – such as customers, clients, and employees - are all vital clues to a company's long-term ability to grow and deliver consistent returns.

Schroders' Sustainable Investment team produces insightful multi-sector and multi-region research on a range of ESG issues. During 2017, we examined the following topics:

- Bribery and corruption in emerging markets
- The rise of founder-CEO firms
- Sugar, obesity and noncommunicable disease
- Corporate governance in Australia
- Trump: border adjustment tax vs carbon tax
- Corporate controversies: the role of ESG ratings
- Oligopolies
- Climate progress dashboard
- Human capital
- Labour standards at UK fulfilment centres
- Risk profile of consumer staples vs tobacco
- Implications of the US withdrawing from the Paris Agreement
- Investing in a time of political change
- Antimicrobial resistance: investment implications from farm to pharma
- The cost of opioid addiction
- Responsible lending in auto financing
- Carbon Value at Risk: how rising carbon prices could cut company profits
- It's not black and white for fossil fuels

We also publish papers to help educate clients and the broader public. During 2017, we published the following papers:

- Demystifying negative screens: the full implications of ESG exclusions
- ESG best practice: how some of the world's largest asset owners approach sustainable investment
- ESG and credit fixed income: integrating ESG analysis in practice
- ESG considerations for official institutions
- Sustainability and sovereign fixed income: our framework for ESG integration

In the following section we highlight three topics: how to invest in times of political change, how rising carbon prices could cut company profits and the current state of play with sugar.

Source: Schroders

Investing in a time of political change

The last few years have thrown up a series of political surprises. Rank outsiders overturning the odds have become so normal that equity markets have learnt to brace for impact and as a result, those impacts have become more muted.

The last few years have thrown up a series of political surprises. Rank outsiders overturning the odds have become so normal that equity markets have learnt to brace for impact and as a result, those impacts have become more muted.

Political leaders and commentators appear to have accepted that old rules may not hold even if there is little clarity on what the new rules are.

The changing political backdrop is a critical consideration for investors.

Governments are important stakeholders to companies in all sectors. Understanding how their priorities are changing and the implications for future profitability is an important part of our analysis of corporate sustainability.

Most commentary focuses on the immediate implications of each result. However, investors are better served by focusing on the structural lessons hiding beneath the headlines, sound bites and policy aspirations, rather than chasing news flow.

We have identified three key shifts in the political landscape that will outlast the next election cycle or today's political personalities:

1. Fragmented electorate concerns; political instability
The combination of increased voter discontent and the faster speed with which power moves between parties and leaders creates an increasingly fluid, unstable political environment.

Historically, one or two topics dominated the electorate's worries but the public's agenda is widening so that far more topics have a significant influence on a material share of the population.

The result is an increasingly fragmented political environment, spanning a wider range of issues, in which power can migrate quickly from one group to another.

2. Economic challenges continue to build
Balancing the public sector's books is a key part of government's job description. Doing so is becoming harder as growth slows, populations age, welfare burdens rise and tax planning becomes more creative.

Tax cuts and spending programs may play well in focus groups but in the long term we are likely to see less of either. Over time, a transfer of costs from public to private accounts appears inevitable.

3. Divergence in business vs. political interests
Since the financial crisis, a business-friendly political backdrop has given way to tensions as social priorities have changed.

Analysis of IPSOS Mori's historical surveys of social concerns in the UK highlights a shift from issues which broadly support businesses (like creating jobs) to those which present headwinds (like reducing immigration).

Implications for investing in a time of political change

The political shifts unfolding around the world will have significant ramifications for global companies and their investors. We outline four of those implications.

Currying political favour may become less rewarding
Political capital may become more of a liability as scepticism of the corporate sector grows, consumers' political views become more disparate and political leadership becomes more fluid.

Although lobbying spending is typically a small proportion of profits, some industries and companies have established strong relationships and influenced policies in their favour.

The tailwinds those efforts brought may become headwinds going forward. The chart (Figure 1) below plots the average levels of spending on lobbying and political contributions in each sector.

Figure 1: Intensity of lobbying and political contributions by sector

Source: Datastream, Schroders, last available financial data as at July 2017.

The companies and sectors mentioned herein are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

Adaptability will be key

A more fluid political backdrop raises the importance of adaptability over specific plans. Grounding strategic and investment goals in a specific vision of the world, however well thought-through, is less useful than ensuring business models are flexible to the changes that inevitably lie ahead.

To gauge corporate adaptability, the chart below (Figure 2) compares the proportions of sales companies generate from product segments which existed in their business five years earlier.

On average, companies in every industry generate more than three quarters of their sales from well-established business units, but there are sizeable differences across sectors.

Global business models under threat

Globalisation lies at the root of many of the issues that top voters' concerns.

Opening economies to global trade, capital and migration puts unskilled workers into competition with cheaper labour in emerging economies, cedes policy control to market forces and raises immigration pressures.

The net result for economic growth is invariably positive but with the benefits unevenly concentrated in a minority of the population, democratic politics create a brake to globalisation when too large a share of the population ceases to benefit.

Those industries whose customers are most global, or rely on global supply chains, are likely to be most threatened by moves toward more protectionist attitudes and policies (Figure 3).

Long term government spending and tax pressures

The need to balance their books eventually creates a constraint within which all governments need to operate.

Across major advanced economies, only Korea and Germany are running government surpluses while six of the G7 countries continue to operate with unsustainable deficits even after years of austerity measures.

A rise in taxation, cuts in government spending or a combination of both are an inevitable feature of future budgets, whatever political party is in power.

Those paying the lowest tax rates face the greatest risks of cost increases, whereas those most reliant on government spending are at the greatest risk of growth pressures (Figure 4).

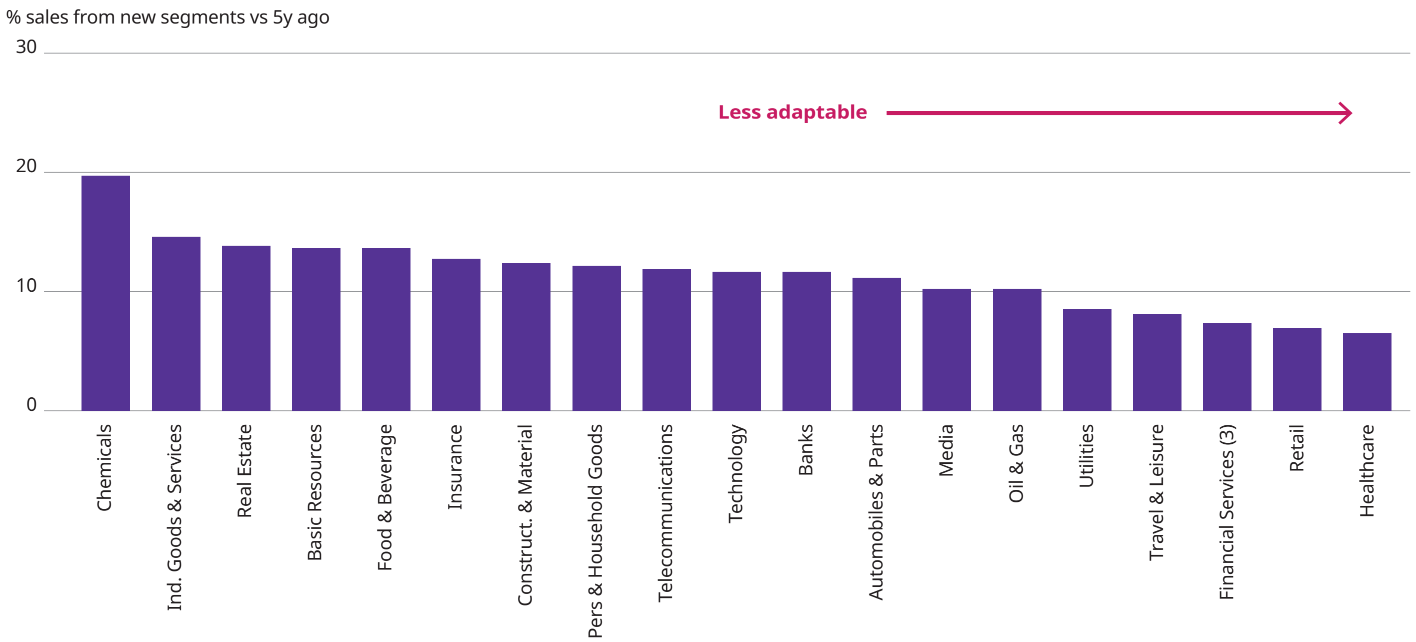
Conclusion

We have little to add to questions of how the UK's Brexit negotiations will be affected by the general election result, whether Macron will succeed in transforming France's political agenda or what excitement Trump's next announcement holds.

More important is the direction of political travel and the journey ahead for global industries and their financial prospects.

We have identified several trends we expect to feature on that journey. While the outlook may be getting more complicated, a roadmap that includes those hurdles is becoming more important.

Figure 2: Average share of revenues from divisions which existed 5 years ago



Source: Datastream, Schroders, last available financial data as at July 2017.

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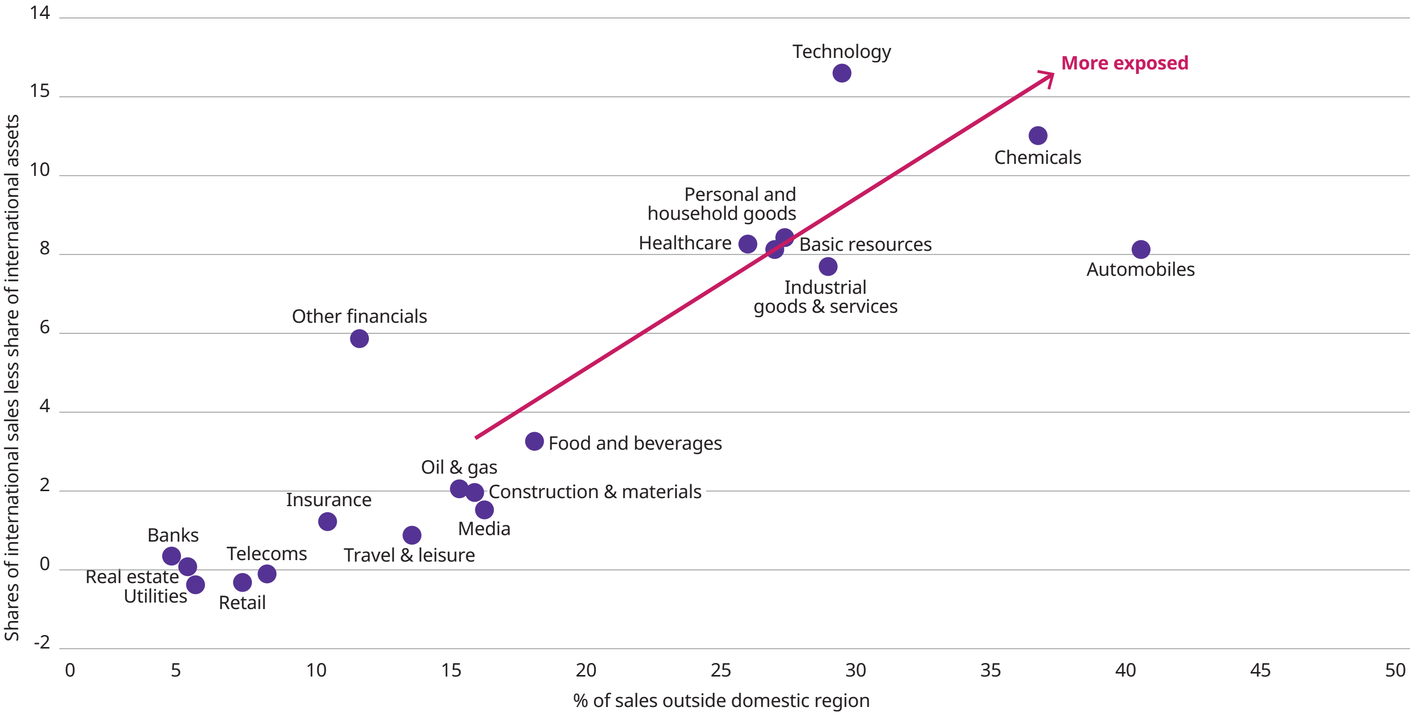
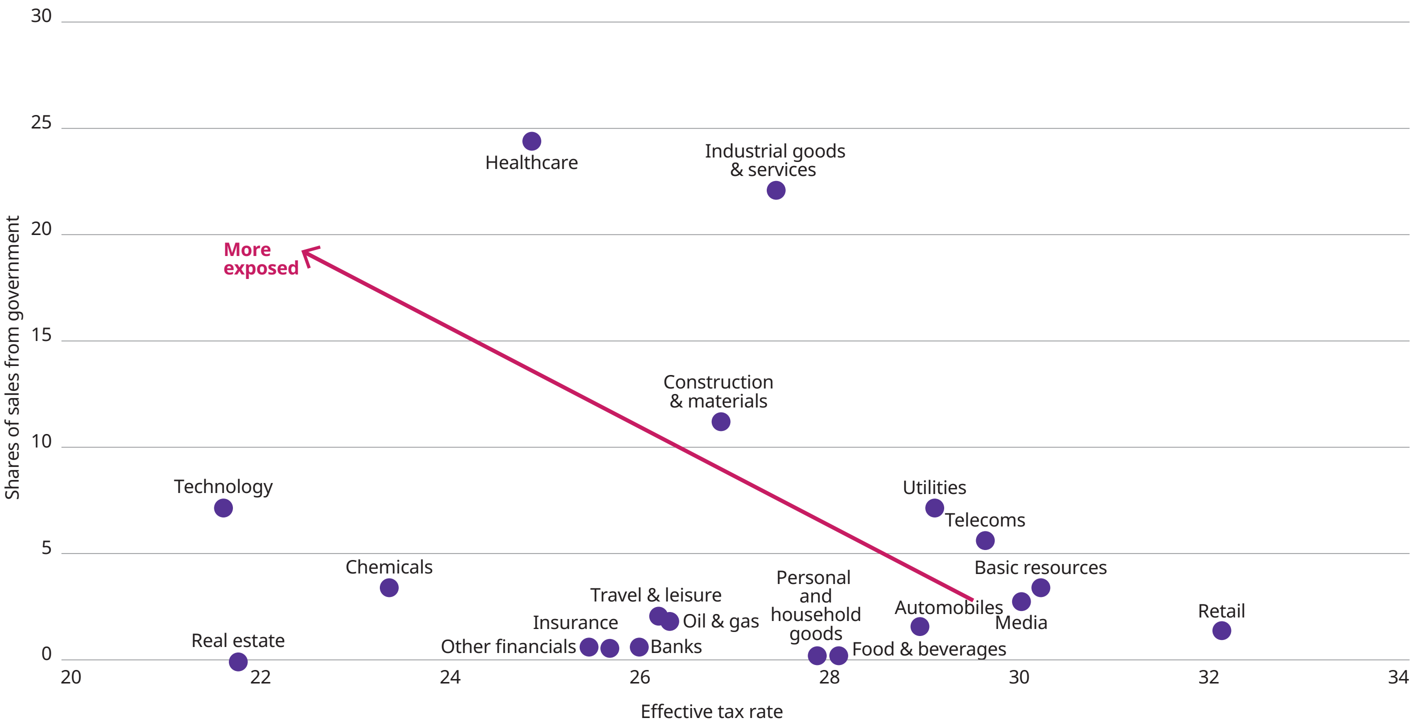
Figure 3: Global sales exposure vs. global cost exposure



Source: Government spending exposures from Morgan Stanley, Datastream, Schroders, last available financial data as at July 2017.

Figure 4: Government revenue vs tax exposures



Source: Government spending exposures from Morgan Stanley, Datastream, Schroders, last available financial data as at July 2017.

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How rising carbon prices could cut company profits

Schroders' "Carbon Value at Risk" (Carbon VaR) framework, developed by the Sustainable investment team, highlights the inadequacies of traditional measures of climate risk and the problems investors face evaluating the impact of climate change on company profits.

Carbon VaR shows almost half of listed global companies would face a rise or fall of more than 20% in earnings if carbon prices rose to $100 a tonne.

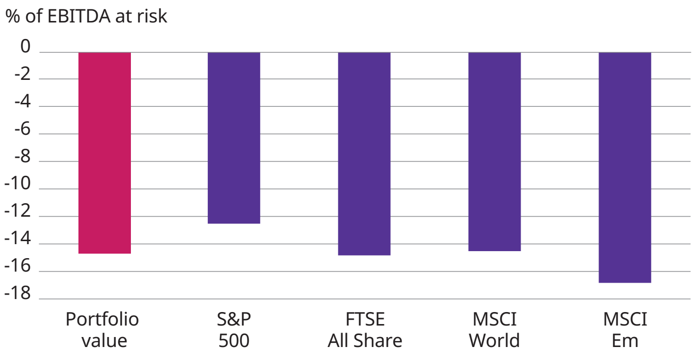
A carbon price is a cost applied to pollution to encourage companies and other organisations to reduce the amount of greenhouse gases they emit.

Unlike usual carbon footprint measures, Carbon VaR focuses on companies' business models and profit drivers rather than purely environmental measures.

The analysis shows carbon prices will have to be far higher than recent levels, reaching over $100 if the internationally agreed target of 2°C for global warming limit is to be met. (Visit our Climate Progress Dashboard to find out our latest prediction of where we stand on likely future warming.)

The effects on industries, companies and financial markets would be significant and widespread. Measuring and managing those risks is critical and requires the sort of innovative thinking Schroders is introducing today.

Figure 5: Percentage of earnings at risk from rising carbon costs



Source: Schroders and Datastream. Schroders portfolio value based on a hypothetical strategy comprising the five largest funds managed by Schroders. Calculated using constituents as of May 2017. For illustrative purposes only.

What is Carbon Value at Risk?

Carbon VaR measures the impact of rising carbon costs on a company's profitability more accurately than those provided by carbon footprint analyses.

The effects of rising carbon prices on companies will be both dynamic and complex:

- Companies' costs will rise in proportion to the total emissions generated by themselves and their suppliers
- Selling prices are likely to rise to offset cost increases at an industry level
- Demand should fall reflecting the sensitivity of customers to prices in each market affected, shrinking companies' sales and costs
- Carbon VaR takes these linkages into account to gauge the impact on industry profits, using an estimating process to capture the three key variables of emissions, price and changing demand.

It's also important to include all greenhouse gas emissions required to produce and sell a product, which conventional measures of carbon exposure do not.

The analysis also underlines the inadequacies of traditional measures of climate risk.

The problem with carbon footprints

Carbon footprints have become one of the most familiar ways for investors to gauge the impact of their investments on the environment.

A carbon footprint is a measure of the impact our activities have on the environment measured in units of carbon dioxide. So, if you drive a car to get to work or take a plane to go on holiday you leave a carbon footprint.

Businesses are the same. Everyday their operations create carbon emissions. A company's carbon footprint typically relates the emissions it generates to its revenue or market capitalisation.

Such measures of "carbon intensity", even if they are consistent, are often poor indicators of the effects of climate change on profitability or value. As a result, they provide little clue to the effect of carbon emissions on company earnings.

The curious case of Apple and Samsung

The example of Apple and Samsung is worth considering.

The two rivals sell fundamentally similar consumer electronics. Yet Samsung's carbon footprint is significantly higher than Apple's, because Apple outsources most of its manufacturing whereas Samsung manufactures more products itself.

In climate terms, this is an irrelevance: the emissions created by producing and selling both sets of products are in reality much the same.

To get an accurate picture, an investor clearly needs to get a handle not just on the company's own emissions, but also those emanating from its suppliers. Carbon footprints, as currently conceived, don't incorporate that information.

It follows that investors who rely on carbon footprints to guide their portfolios may face risks that they and their managers are not addressing.

Without innovative tools to help navigate a new environment of carbon reduction, investors will find it hard to reach their investment destinations, which is why the Carbon VaR model was created.

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Sugar: current state of play

More than two years on from our first research report exploring the idea that sugar could turn "Big Food" into "Big Tobacco", the staples industry has faced significant changes. We take a look at how the landscape for food and beverage companies has changed, the industry response and how we're factoring this into our investment decisions.

How sugar has changed the landscape for food and beverage companies

The figure below summarises the risks identified in 2015 and how they have evolved since then:

Figure 6: State of play in 2018

Risk
- Increased regulations
- Sugar tax
- Tobacco-like product warnings
- Lost sales
- Changing consumer trends

Catalysts:
1. Consumers and public health
2. Healthcare costs
3. Science

Outcome
- Lower sales
- Litigation costs
- Reputational damage
- Sector looks expensive
- Exposed to M&A and activist investors

=

Valuation

Current impact:
- Lower future growth rates
- Higher COGS*

Potential future impact:
- Litigation costs, liabilities and potential write downs = lower multiples due to lower growth and profitability

*Cost of Goods Sold

State of play in 2018

Risk	Outcome and valuation impact
Increased regulations Regulations around advertising and labelling have increased as well as voluntary sugar reduction guidelines. 35 countries now have mandatory restrictions on sugar-sweetened beverages in schools[4]. Singapore has set voluntary sugar reduction targets by 2020 and the UK has done the same for sugary food categories.	**Lower sales** Staples sector volume and price growth has declined from 5% in 2011 to below 2% in 2017[5].
Sugar tax While we thought that the industry lobby may be influential enough to continue with voluntary targets, the burden of healthcare costs was enough to convince governments and states to introduce sugar taxes. 17 new sugar taxes have been introduced since 2015, with more of the global population covered by a sugar tax than a carbon tax[6].	**Litigation costs** While we have not yet seen tobacco-like litigation, law suits around mis-marketing continue to rise. According to World LII legal database there are nearly 350 lawsuits that have been brought against the staples sector in the last three years. Only the banking and pharmaceutical industries have faced a higher level of litigation[7].
Tobacco-like product warnings Nutritional labelling and industry best practice is continuing to evolve. For example, changes to the nutritional facts label in the US and food labelling changes in Hong Kong. However, tobacco-like warnings have not materialised. The American Beverage Association successfully blocked San Francisco's tobacco-like warning on sugary soft drinks at the US Circuit Court of Appeals in late 2017[8].	**Reputational damage** While tobacco-like warnings have failed, the media attention and consumer awareness means that damage has been done. Brand Index shows that perceptions of value are declining; less than 10% of consumers have a positive perception of product quality across 5 of the top 8 carbonated soft drinks brands[9].

4 World Cancer Research Fund International, Schroders.
5 Global Consumer staples; 18 ideas for 2018, Societe Generale, SG Cross Asset Research.
6 WHO, Worldbank, Beverage Daily, Schroders.
7 World LII legal database, Schroders.
8 Lee, B., Forbes, Here Is What Sugar-Sweetened Drink Warning Labels May Do To Obesity, January 2018.
9 Brand Index, Schroders.

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Risk	Outcome and valuation impact
Lost sales Staples sector volume and price growth has declined from 5% in 2011 to below 2% in 2017[10].	**Sector looks expensive** Branded food product average P/E is still at 22.3 versus tobacco sector average of 16.5[11].
Changing consumer trends Healthier challenger brands and private labels are taking market share from Big Food companies. Examples include low sugar, high protein ice-cream Halo Top taking share and causing double digit sales declines for the world's largest ice-cream manufacturer, Unilever.	**Sector exposed to M&A and activist investors** Since our original note was published there has been a failed bid for Unilever and activist investors making demands of Nestle.

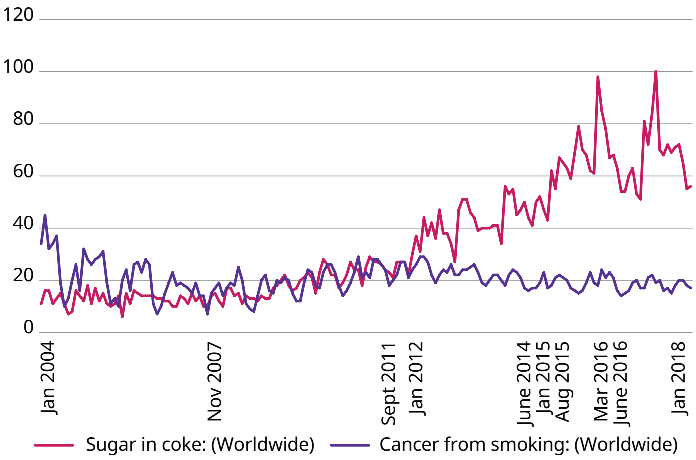
Key

Increasing and material risk	Emerging risk	Not a major risk

We think three catalysts highlighted in our original research can explain the current state of play.

Catalyst 1: Increased stakeholder awareness amongst consumers, public health bodies and regulators.
The media, consumers and regulators are all more focused on the role of sugar in our diets. The google trends graph below demonstrates the continued momentum in interest in sugar in soft drinks, which is compared to the "known" risk of cancer and smoking. There's no indication that this trend will reverse.

Figure 7: Google trends: sugar in Coke



Source: Google trends, Schroders

10 Global Consumer staples; 18 ideas for 2018, Societe Generale, SG Cross Asset Research.

Catalyst 2: Demographics and healthcare trends. The rise of obesity, diabetes and other non-communicable diseases put pressure on government healthcare budgets.
The continued rise of global obesity, diabetes and non-communicable diseases is undeniable. The World Health Organisation states that global obesity rates have doubled since 1980, at a time when global sugar consumption has also increased. Though we suggested that the strength of the lobby and the consumer industry's preference for self-regulation may limit the possibility of sugar taxes, we've seen 17 new sugar taxes introduced across the world since 2015.

Catalyst 3: Availability of independent scientific research increasing the possibility of large scale litigation
In 2015 we highlighted the parallels between the food industry today and the tobacco industry in the 1980s. One of the most frequent arguments we've heard against sugar being the next tobacco is that smoking can easily be isolated as the main cause of lung cancer. But unlike smoking, people consume multiple food and beverage brands every day and multiple causes for the non-communicable diseases have been identified. We believe that scientific research will continue to advance but as obesity rates continue to rise, we think litigation risk will follow the more recent tobacco litigations in Quebec and award damages based on the market share of high risk products[12]. We think Public Health England's (PHE) voluntary sugar reduction targets[13] which focus on higher risk categories such as soft drinks, breakfast cereals, confectionary, yoghurts and ice-cream provide an indication for product categories that face higher litigation risk. According to PHE, soft drinks (including fruit juice) are the single biggest contributor of sugar to children's diets at 28% of daily sugar intake. These higher risk food categories combined contribute a further 32% of sugar to children's diets.

11 Societe Generale, SG Cross Asset Research.

12 Tobacco giants vow to fight Canadian judgement handing C$15bn to smokers, The Guardian, 2 June 2015.

13 Sugar Reduction: Achieving the 20%, Public Health England, 30 March 2017.

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How the industry is responding

With sugar firmly on the radar of all stakeholder groups, food and beverage companies need to adapt to survive. The key trends we've identified are explained below:

Increased Mergers and Acquisitions

Increased stakeholder awareness is a double-edged sword; there is a rise of challenger brands meeting consumer demands for healthy products which offer a wide range of M&A opportunities for the food majors. But at the same time, it also changes investor expectations. Companies failing to adapt to these new trends fast enough have become the target of activist investors.

Reformulation and innovation

Food and beverage majors are reformulating existing product portfolios to respond to consumer demand and the threat of sugar taxes. But reformulation success is not guaranteed; it can be costly and can damage the brand if it doesn't meet consumer expectations. In the past two years we've seen mixed results. For example, the reduction of sugar in Nestle's Kit Kats, the first major recipe change since the Second World War and marketed as an increase in milk and cocoa, met negative media attention[14]. We've also seen product innovation from private label brands that are keen to benefit from the rising health and wellness trends.

Increase in ad spend

Another response method we've seen is an increase in advertising to help offset the move to healthier alternatives. The introduction of a sugar tax has also contributed to the "demonisation" of sugar, the perception of which advertising agencies are trying hard to fight. Advertising spend data from Societe Generale shows that 66% of the top 32 staples brands have increased their ad spend over the last five years[15].

Increase in company disclosure

There has been increasing pressure on companies from all stakeholders, including investors, to explain how companies are responding to this trend. The graph below shows how sugar taxes alone have received more attention in annual reports and company disclosures.

14 New "healthier" KitKat only contains four fewer calories than previous recipes", The Telegraph, 28 March 2017.

15 Global Staples and Global Media report, Societe Generale, November 2017.

Some corporates have introduced new nutritional targets, such as those launched at Mars, which breaks down its product portfolio into recommended frequency of consumption. This helps educate the consumer, demonstrates a proactive commitment to regulators and provides greater insight into higher risk categories to investors.

How we're considering sugar risk within our investment process

Engaging for better disclosure

In 2017, together with another investor, Rathbone Greenbank, we published "Sugar, obesity and noncommunicable disease: Investor Expectations". The document outlines why investors are looking at sugar, what disclosure they want from companies and how they will use it. It also provides an engagement framework for investors to use when engaging with the food and beverages sector. The final draft is available online and has now been communicated to over 40 global food and beverage companies[16].

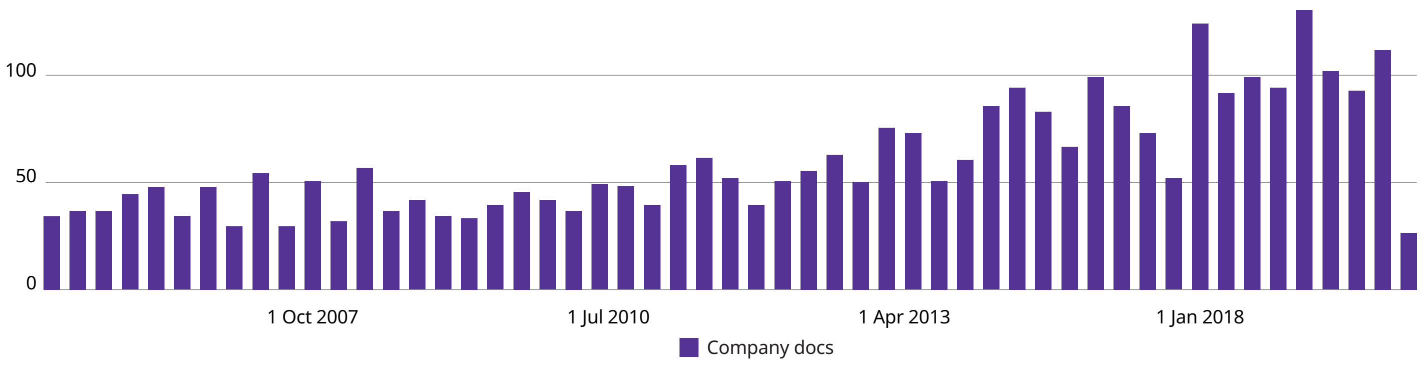
Company research and stock recommendations

How are we using this increased disclosure in our investment process? Our proprietary research platform at Schroders includes over 40 instances where analysts have factored the risk into their stock recommendations, sector research or discussed at company meetings.

This increased research focus has also influenced portfolio construction. For example, our credit teams consider a broad range of thematic trends when investing. The pan-European credit team started looking at diabetes in 2013, which was further enhanced by the wider obesity and non-communicable disease risks driven by sugar highlighted by the sustainability team. As a result of our research the team adjusted their sector exposure to mitigate potential balance sheet risk faced by European food and beverage corporate bond issuers.

16 Schroders, research notes written between November 2015 and January 2018.

Figure 8: Number of company documents referencing sugar tax (2004 – 2018)



Source: Alphasense.

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INterpret

Knowing what to do with insights is the key that unlocks value for clients. Our team of investors and analysts around the world have the experience and local knowledge to apply that understanding to specific situations.

In this section, we interpret the Sustainable Development Goals (SDGs), explore the full implications of negative screens and examine the results from the independently collected Schroders global investor studies.

Source: Schroders

Counting carbon: the Taskforce on Climate-related Financial Disclosure

A reflection of growing climate awareness

In June 2017, the Task Force on Climate-related Financial Disclosure (TCFD) published the conclusions of its 18-month review of ways the financial sector can better account for climate change[17]. That report met a willing audience among both corporates and investors, both of which increasingly recognise the risk climate change poses.

The TCFD report outlines disclosure principles that move past the standards already established. Those principles fall into four categories: governance, strategy, risk management and metrics & targets. The TCFD is not a standard-setting body and has no capacity to support reporters or to monitor implementation. However, other organisations – in particular CDP (formerly the Carbon Disclosure Project) – intend to incorporate the TCFD's conclusions into their reporting frameworks, ensuring its momentum will continue.

Greater focus on the TCFD's conclusions will mean three key changes, bringing welcome context and focus to reporting:

- Climate information should be reported in mainstream financial filings
- Reporting should include forward-looking information on companies' resilience and ability to adapt to different climate scenarios
- Reporting should focus on the most strategically or financially important areas of performance.

Continuing a long term trend toward transparency

Climate disclosure has expanded massively since CDP was established in 2000. Since its first report was published, the number of companies reporting to that organisation has risen more than ten-fold to 2,418 companies, representing over half of global market capitalisation[18]. That initiative provides the data that underpins most climate risk analyses today.

The TCFD promises to extend that trend into more forward-looking assessments. By focusing on companies' strategies to adapt to the risks and opportunities climate change poses, we hope that future reporting will allow investors to judge future strategic risks more effectively.

17 See the Final Report for full details of the TCFD's recommendations.

18 See https://www.cdp.net/en/scores-2017 for information on corporate responses to CDP's surveys.

Clearer risk measurement by financial companies

The reporting framework is as relevant to asset managers and other investors as it is to industrial sectors. After years of demanding transparency from other companies, investors are coming under increasing pressure to measure and manage the risks facing their own portfolios. While the TCFD principles are voluntary, several countries are considering or implementing regulations requiring investors to disclose how they address climate-related risks[19].

Reporting changes through the corporate and financial sectors should provide more – and more robust – information. That trend, in turn, should allow our industry to develop increasingly detailed, realistic and thoughtful models of climate risks than those the industry has relied on historically.

We are committed to measuring and managing material climate risks

At Schroders, we shared our insights with the TCFD working group and voiced our support for its recommendations when published[20]. We have long recognised the importance of climate change to investors and remain committed to strengthening our ability to measure and manage its risks and opportunities. Reflecting that view, we are currently completing the TCFD section of the Principles of Responsible Investment's (PRI) annual signatory assessment.

Our first corporate engagement on the issue was in 2002 and during the year we wrote to 125 companies explaining our views and requesting more information. We combine our voice with other investors through industry initiatives such as the Global Investor Statement on Climate Change, which aligns around 400 global investors[21], and have signed up to the Climate Action 100+ initiative pushing for more robust disclosure from the most exposed companies.

We have also invested in developing tools and analysis to help identify those companies at greatest risk from climate change. The Climate Progress Dashboard provides an objective measure of the speed and scale of transition toward a low carbon global economy. Risk analyses such as Carbon Value at Risk and our work on fossil fuels provide proprietary insight into the implications of one of the greatest disruptive challenges facing the global economy, industries and financial markets[22].

19 For example, France's Article 173 was the first such regulation (see here).

20 Our CEO Peter Harrison added his name to leading CEOs supporting the recommendations (see here).

21 See the Global Investor Statement on Climate Change for further details.

22 Our climate change research is available here.

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Sustainable Development Goals: An investor perspective

The United Nations Sustainable Development Goals (SDGs) have captured the finance industry's attention. We think it important investors recognise the challenges in applying them to investment analysis.

The Sustainable Development Goals are important

The UN Sustainable Development Goals (SDGs)[23] represent a comprehensive agenda for addressing the world's societal challenges. The 17 goals, developed by an Open Working Group of governments, academics and civil society members, were adopted by the UN General Assembly in 2014, giving them a prominent position in the global development agenda albeit without binding international or national commitments to adopt them.

The goals reflect the biggest challenges facing global societies, environments and economies today. If realised they will radically alter the shape of the planet in 2030 by helping to end poverty, build peaceful, just societies and enable sustainable resource use.

But they are not an investment framework or corporate strategy

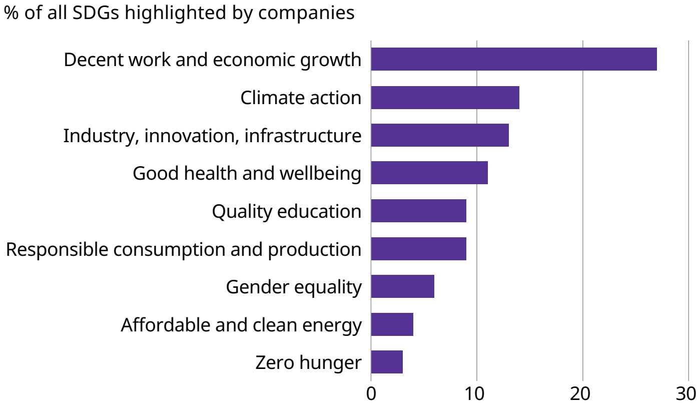
Although the goals are aimed more at policy makers than investors or companies, the private sector has responded enthusiastically. Large institutional asset owners have already made commitments[24], with the two largest Dutch pension funds targeting €80 billion in SDG investments by 2020[25]. The business case for corporate SDG alignment has also been discussed at length[26] and an analysis of 100 major companies by the Global Sustainability Index Institute (UNGSII) found that 82% reported some commitment to the SDGs in 2016[27].

The SDGs are popular in communication materials, but it is less clear that they influence strategy as much as they provide a lens through which to present it. PwC has looked at references to the goals in corporate sustainability reports, work we have used to identify areas receiving most attention. 80% of references are to the five most common SDGs, all of which are already established elements of CSR strategies (Figure 9). We see a similar focus on a few SDGs in investment products which reference the goals.

The challenge is understandable; the SDGs were not designed to provide the basis of an investment process or corporate strategy. Of the 17 goals, the UN has designed 169 indicators to measure progress. Most of these measures are directed at systemic challenges that investors and companies have no direct mechanism to address. We have estimated that only 15-20% of the 169 metrics could reasonably be measured at a company level and only 6-8% using data currently available (Figure 10).

23 The United Nations Sustainable Development Goals, UNDP, 2017.
24 "APG, PGGM set out investment routes to UN development goals", Susanna Rust, IPE, 2017.
25 "Asset owners push to satisfy U.N. goals", Sophie Baker, Pensions & Investments, 2017.
26 "The SDG Investment Case", UN PRI, 2017.
27 "SDG Commitment Report 100: Tracking companies' efforts to contribute to the Sustainable Development Goals", UNGSII, 2017.

Figure 9: SDGs highlighted most frequently in corporate CSR strategies



Source: PwC, Schroders, 2017.

Inappropriate use risks misleading investors

SDGs were not designed for investors. We are concerned they are being misappropriated and misused. Our own analysis, combined with broader research, suggests several issues.

Established CSR activities are being squeezed into ill-fitting SDG categories. Companies tend to report on obvious goals such as 'economic growth' or 'climate action' despite the indicators underpinning those goals lacking company-focus (Figure 9)[28] or materiality. As our research shows, only a minority can even be reported on by corporates, and the focus on businesses' exposure to and management of broader sustainability issues may suffer as a result.

28 "SDG Reporting Challenge 2017: Exploring business communication on the global goals", PwC, 2017.

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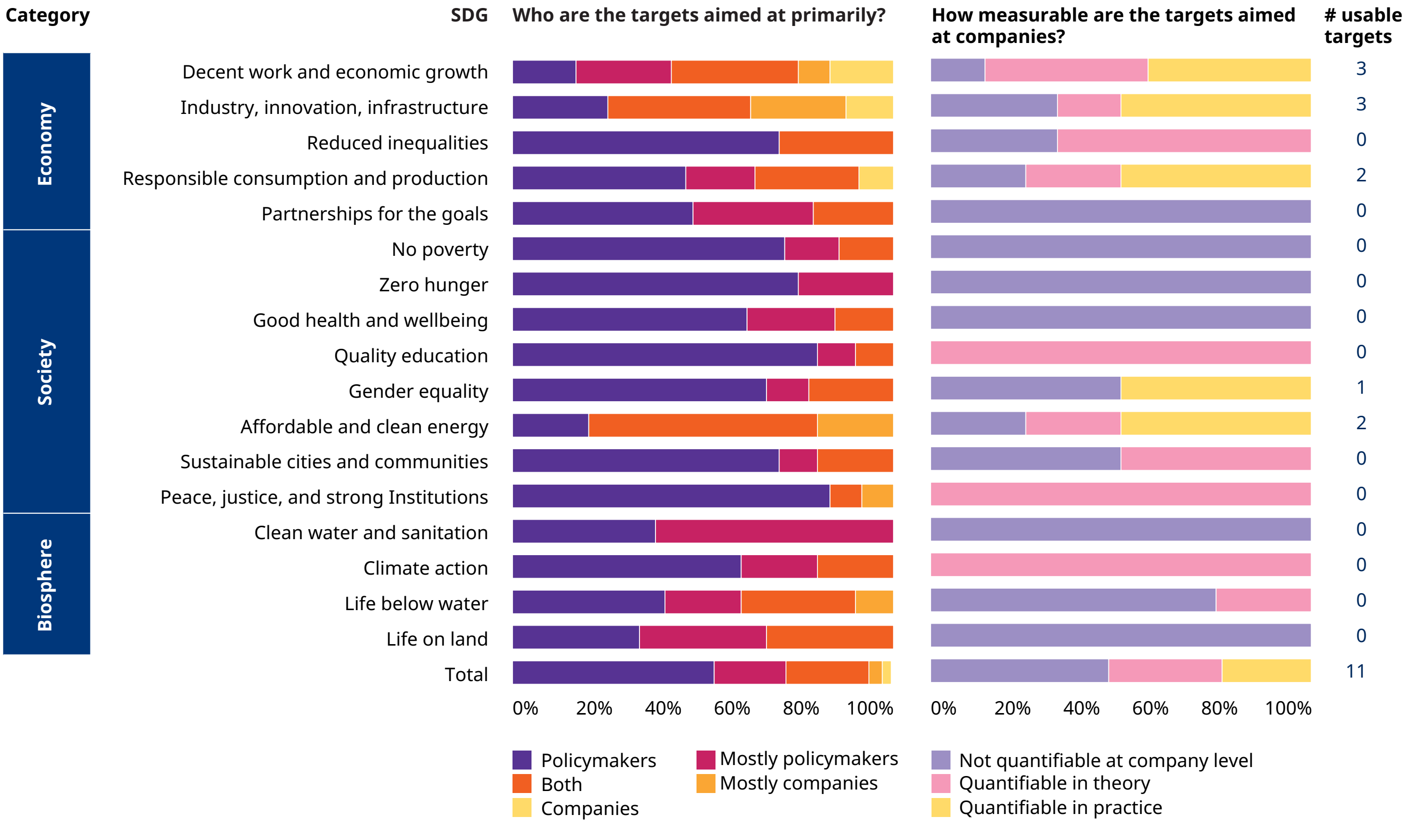
Figure 10: SDG metrics are badly aligned to corporate KPIs



Source: UNDP, Schroders, 2018.

Without a consistent reporting framework, companies and investors apply positive filters to their SDG efforts, demonstrating constructive activities without an objective assessment of the negative impacts their business may have. Historically we have seen similar patterns of behaviour with greenwashing of various projects on companies. Addressing the global challenges SDGs were designed for requires a comprehensive action plan for systematic change, rather than piecemeal efforts by a few companies. As large, active investors we use our voice with policymakers to support coordinated and holistic solutions to global challenges.

We take a pragmatic and objective view of companies

We are supportive of the aims of the SDGs. However, given the challenges associated with fitting the SDGs themes into a regular investment process, we regard the goals as a useful framework to articulate and organise impact measures, rather than as the sole basis for investment decisions. Our application of sustainability measures across investments – an approach that considers how companies are interacting with all their stakeholders and the contribution this might have (both negative and positive) to their long-term success – is a more holistic way of assessing companies, and leads to more relevant and material investment outcomes. While many of the topics involved in this assessment may overlap with certain SDGs, others do not. We make no apology for this.

We also feel that SDGs can provide a framework for some of our engagement actives. Our analysis shows 11 targets that are relevant for corporates including the proportion of corporates with CSR reports and the amount of women in senior management positions. These are areas that we have been committed to for some time and we will continue our efforts.

Although we do not base our firm-wide investment process on the SDGs, we recognise that some clients are interested in assessing impacts along the SDG dimensions and have tools to help them do so.

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Demystifying negative screens: the full implications of ESG exclusions

Negative screens that sieve investments on environmental, social and governance grounds remain critical to many investors. One-tenth of the assets we manage exclude companies based on their involvement in controversial products or services. Widely-used broader definitions put the share of screened investments closer to one-fifth of all professionally managed assets[29]. Screening continues to grow, with assets subject to screening having increased by 16% annually over the last four years[30].

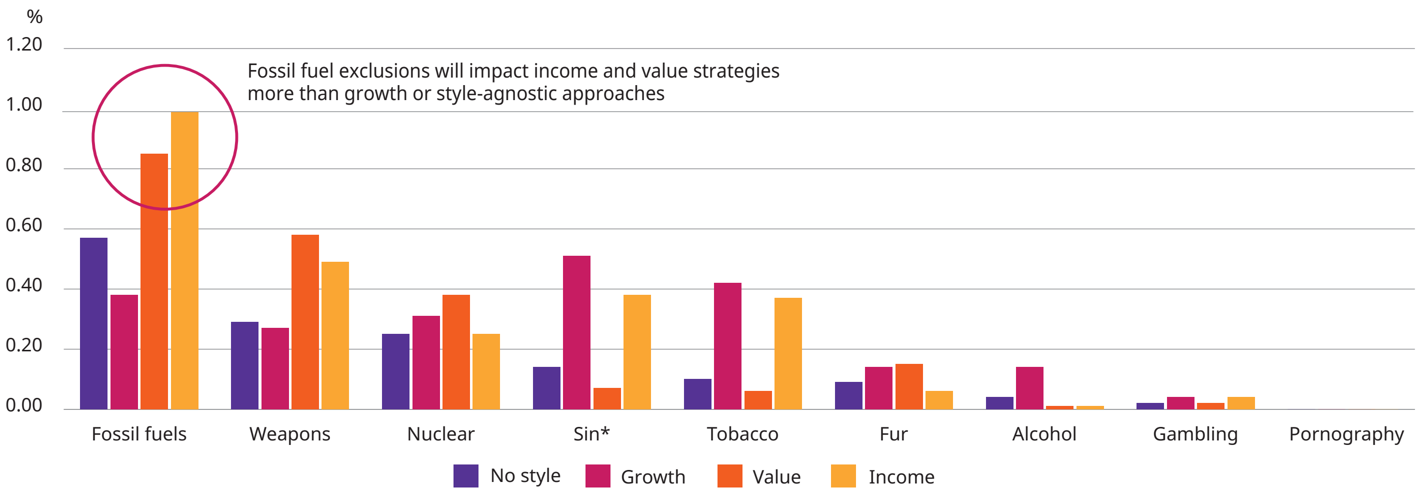
Negative screening deserves more attention

Of course, negative screening is only one aspect of sustainable investment, and serves a different purpose to activities such as integration and engagement. While the last two are designed to help investors reach better investment outcomes, exclusion policies reflect investors' choices to avoid activities they consider unpalatable. We firmly believe ESG integration and engagement, effectively implemented, can lead to better investment decisions. We recognise, however, that this is not the only concern for many investors, and so the practical considerations presented by screening almost certainly warrant more attention than they currently receive.

Even if decisions on screens are taken separately from investment analysis, it is vital to understand their effect on investment goals. Typically, this is discussed in terms of the impact of screening on historical performance, a rear-view focus that distracts from more important questions. History tells us there is no reason to expect exclusions to systematically reduce long-term returns. But by increasing volatility and inhibiting investment styles, choices over how exclusions are applied and defined can make it significantly harder for managers to execute certain strategies. The chart in Figure 11 shows the extent to which typical negative exclusions constrain managers. Implementing screens may be mechanical, but assessing their impact on portfolios is a complex task.

Figure 11: Different exclusions can have very different impacts on investment strategies

Impact of screened MSCI World style indices relative to the unconstrained MSCI World style indices over the last 20 years.



*Sin stocks include tobacco, alcohol, gambling and pornography.

Exclusions for fossil fuels and all sin stocks are based on a 10% revenue exposure, as defined by MSCI. Exclusions for weapons, fur and nuclear are based on business involvement, as defined by MSCI. Strategy execution impact is represented by tracking error, calculated as the standard deviation of the differences between screened and unconstrained index returns. Style index based on MSCI style criteria and constituents. The value and growth strategies considered only those stocks included in the MSCI Global Value or Growth indices, respectively, and the income strategy considered only those stocks with a dividend yield greater than 4%. Index returns calculated using quarterly rebalancing of the MSCI World Index over the last 20 years, resulting in slight differences from the true performance of the index.

Source: Datastream and Schroders, as at 30 June 2017.

29 Global Sustainable Investment Review 2016, Global Sustainable Investment Alliance.

30 Global Sustainable Investment Review 2016 as above.

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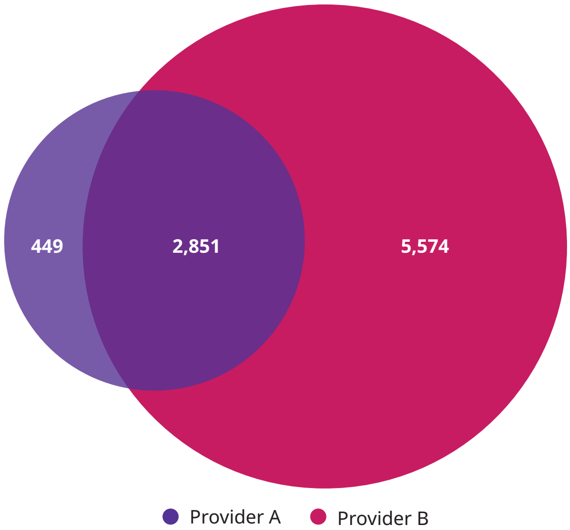
Navigating the complexities of screening

At the sharp end of implementing and maintaining screens it is clear that discrepancies in the specific criteria used for apparently similar exclusion policies can result in very different exclusion lists. A careful and thoughtful approach to screen definitions, and an understanding of their different implications, is vital, as is recognising the differences in exclusion assessments made by different independent firms. Figures 12 and 13 below show how, for a number of identical or closely related criteria, two widely-used ESG data providers offer very different exclusion lists due to differences in their company coverage and the different conclusions they reach about commonly covered companies.

Figure 12: Different data providers have very different company coverages...

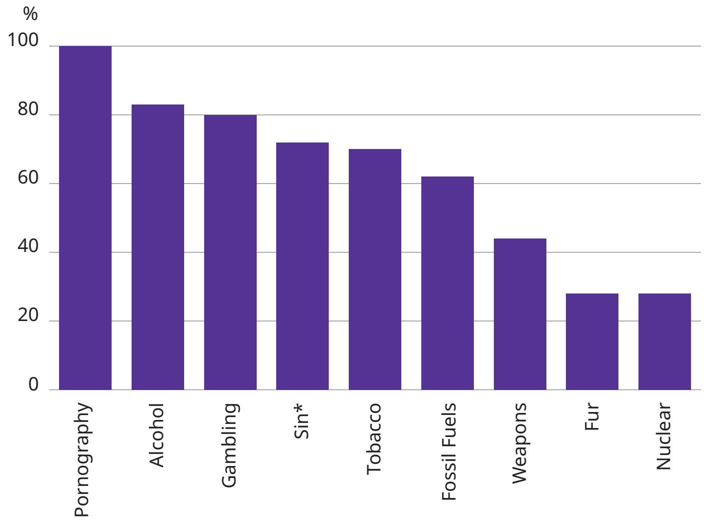
Total universe of companies covered by two different data providers



Source: anonymous data providers and Schroders, as at 17 November 2017.

Figure 13 ...and can reach very different conclusions about the companies they commonly cover

Percentage of commonly covered companies excluded by both providers for different screens



*Sin stocks include tobacco, alcohol, gambling and pornography. Exclusions for fossil fuels and all sin stocks are based on 10% revenue cut off. Exclusions for weapons, fur and nuclear are based on business involvement. Source: anonymous data providers and Schroders, as at 17 November 2017.

Screening is superficially simple, but actually fraught with practical challenges. Understanding the complexities and biases screens create before they are implemented and appropriately assessing performance afterwards is critical. A manager who can recognise the pitfalls and help the investor define the most appropriate screen is essential.

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Schroder Global Investor Survey: interpreting the results

Our society and environment are changing faster than ever, forcing companies to adapt or fall behind. With this comes a growing recognition of the importance of investing in sustainable businesses, as our research shows.

To gauge the latest investor attitudes, we surveyed more than 22,000 people from 30 countries with a minimum of €10,000 (or equivalent) invested. We also conducted a survey of 500 institutional investors, comprising pension funds, foundations, endowments and sovereign wealth funds, across 15 countries. We asked them about their views and actions in relation to sustainable investing, as well as some of the challenges they face.

In the following sections we highlight the key findings from both surveys.

Global Investor Study (end investors)

Understanding of sustainable investing has become more sophisticated
Generally the industry has been better at coining terms like sustainable, responsible and ethical without really defining them. We asked end investors about their understanding of sustainable investment. More than half (53%) linked sustainable investments to companies likely to be more profitable due to proactively preparing for environmental and social changes. Almost as many (46%) related the term to companies leading their industries in terms of environmental and social issues, even if they aren't the most attractive investments. Interestingly, less than a quarter (23%) associated the term with specific avoidance of controversial companies (such as alcohol, tobacco or weapons manufacturing).

Perceptions of sustainable investing are changing
More than three-quarters (78%) of end investors feel sustainable investing is more important to them now and almost two-thirds (64%) said they have increased their sustainable investments compared to five years ago. Our survey also indicated that they no longer see positive impact and financial returns as mutually exclusive. Whether it's a fund focusing on green technologies or improving diversity, they are looking for their sustainable investments to generate profits as well as drive positive societal and environmental change.

Sustainable investing lags sustainable behaviours
Globally, people exhibit sustainable behaviours in everyday life: 72% often reduce or recycle household waste and 54% often buy locally-produced goods. Yet only 42% of respondents choose sustainable investment funds over other types of funds as a way of contributing to a more sustainable society.

Regional differences: the Americas and Asia lead the way
A higher proportion of investors in the Americas and Asia (81% and 80% respectively) believe sustainable investing is more important than five years ago compared to their European counterparts (75%). This belief was mirrored in their actions, with 70% of investors in the Americas and 68% in Asia (particularly in Indonesia, India and China) stating they have increased their sustainable investments over the past five years, compared to 58% in Europe. The results are perhaps unsurprising given sustainable investing is more established in Europe.

Institutional Investor Study

Sustainable investing is on the rise
Institutional investors have increased their sustainable investments the world over. Globally, almost half (48%) say they've increased their allocation to this area over the past five years. European investors have been the strongest supporters, with 60% investing more sustainably compared to only 33% in Asia.

Looking ahead to the next five years, over two-thirds of respondents globally believe sustainable investment will become even more important.

Reflecting different investor preferences
Amongst institutional investors that already have sustainable investments, funds which apply sustainability to all their investment decisions are the most popular (27%), followed by those which focus on corporate governance and how companies are run (25%), and those which invest in green technologies (24%).

For those not currently allocating to sustainable investments, funds which focus on governance have the greatest appeal, with 57% saying they would invest in such vehicles. Interest is also high for funds investing in medical science and diversity (52%). Despite the fossil fuel divestment movement grabbing media headlines, funds which avoid oil, gas or coal hold the least appeal with 46% of investors saying they would not invest in such funds.

Regardless of the type of sustainable investment, the majority of institutional investors indicated their motivation for investing is equally for the potential profit and the potential positive impact.

Source: Schroders

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Importance extending beyond equities

Sustainability is often considered in the context of equities, but our research shows that 49% of institutional investors believe it is also important for infrastructure investments. Meanwhile, 44% believe fixed income investments should also factor in sustainability considerations and 40% feel the same about real estate.

Challenges remain

Despite the general consensus around the increasing importance of sustainability, globally, 77% of institutional investors find sustainable investment a challenge. Challenges were particularly extensive in Asia, with 82% of asset owners in the region reporting difficulties. This contrasted with 69% of investors in the US.

As Figure 14 shows, performance concerns (44%) were cited as the greatest obstacle to sustainable investing, followed by lack of transparency and reported data (41%).

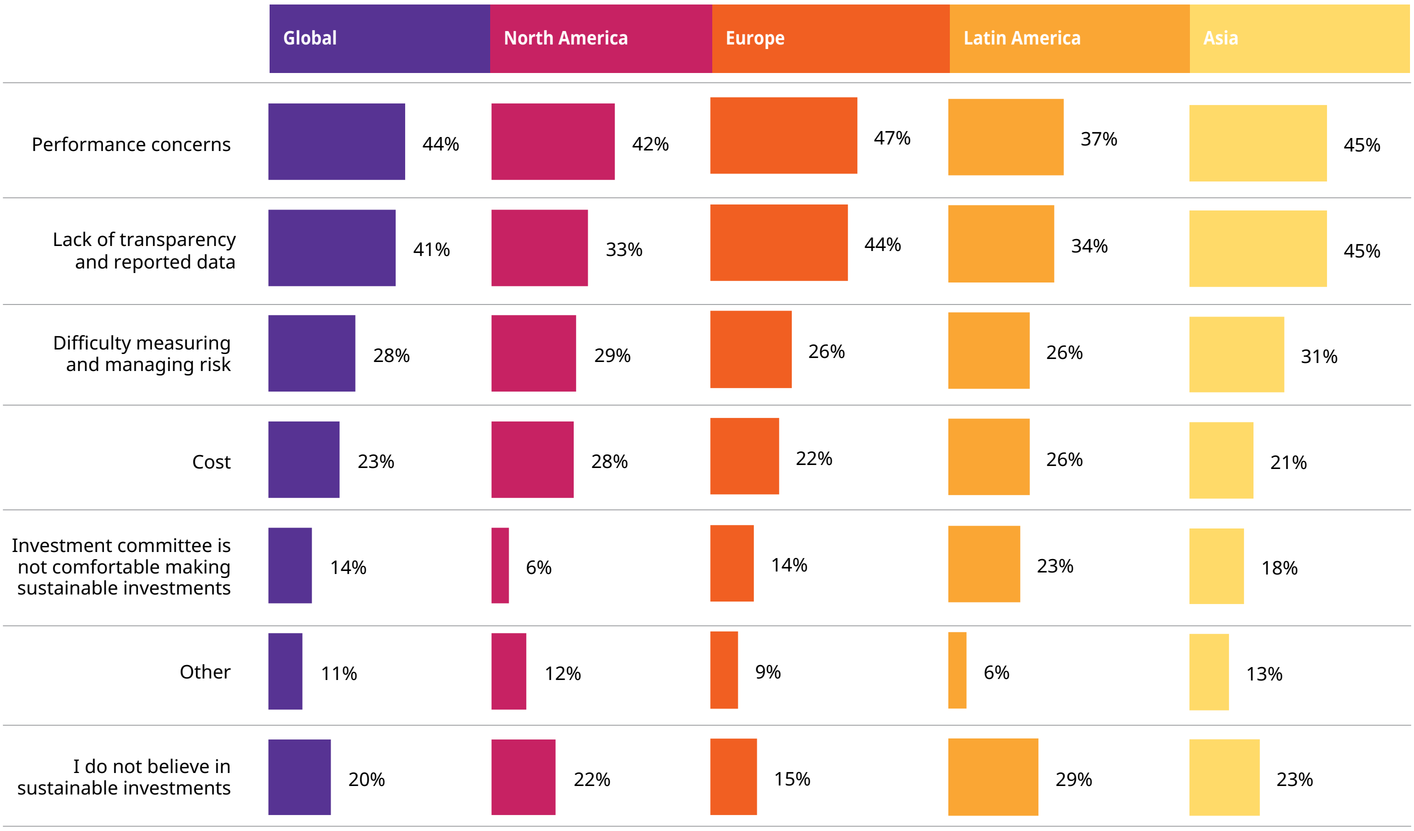
Conclusion: we need to do more to facilitate broader adoption

It is clear from our global investor studies that sustainability is becoming increasingly important for individual and institutional investors. Not only are they looking for sustainable investments to deliver financial returns, they also see it as a way to drive positive environmental and societal change.

Despite demonstrating a variety of sustainable behaviours, sustainable investing by individual investors appears to be less widely embraced. This suggests that there are some barriers holding back broader adoption. We think incorporating our findings on definitions will help us build solutions that work. For institutional investors, concerns about performance, transparency and risk are the main hurdles.

We are encouraged by the growing global interest in sustainable investing and the recognition of its importance, particularly in the Americas and Asia where it is less well established. However, our research suggests there is still some way to go for both individual and institutional investors to adopt a more sustainable investment approach. We need to do more as an industry to help them understand how they can achieve their desired financial and social outcomes through different investments.

Figure 14: Challenges to sustainable investing



Source: Schroders.

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INfluence

At Schroders, we believe that we are owners - rather than renters - of capital. Effective and responsible active ownership has long been part of our fundamental approach to investment.

We recognise that companies play a critical role in societies and the environment. It is essential to question and challenge companies about issues that we perceive may affect their value as appropriate. As such, we actively exercise voting powers and engage with companies on issues such as strategy, risk, performance and governance. Through our engagement, we can improve our understanding of the issues companies face, and influence improvements – and ultimately, protect or enhance the value of our investments.

The overriding principle governing our approach to voting is to act in the best interests of our clients. Where proposals are not consistent with the interests of shareholders and our clients, we are not afraid to vote against resolutions.

Engagement at Schroders does not occur in silos. Our engagement activities combine the perspectives of our portfolio managers, financial analysts and ESG specialists in order to form a rounded opinion of each company and the issues it faces. This section details our corporate engagement activities on ESG-specific issues and our proxy voting activities.

Source: Schroders

Engagement

Engagement approach

As an active manager, company engagement happens on a daily basis across Schroders. In 2017, our equities teams held over 9,600 meetings with companies, and our fixed income team held over 1,500. While these meetings tend to focus primarily on financial performance, they also provide a platform to discuss ESG topics. We track ESG conversations across some of these meetings, and are currently developing tools to better capture the data across Schroders.

In addition, our ESG team undertook 1,013 specialist ESG engagements with companies in 2017, interacting with a total of 781 companies (2016: 761) across 50 countries (2016: 34). Figure 15 below demonstrates the global outreach of our engagement.

Why do we engage?

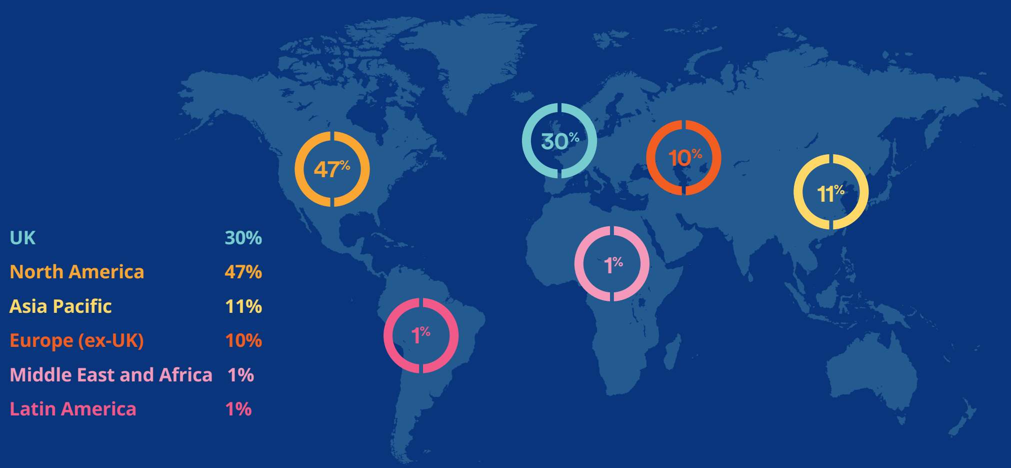
The aim of our engagement is threefold:

1. To encourage companies to adopt longer-term approaches to their stakeholder relationships;
2. To improve investment insights on emerging risks and opportunities; and
3. To generate better returns.

We divide our engagement into two categories: fact finding and change facilitation. Figure 16 below shows how this has been split over the past five years.

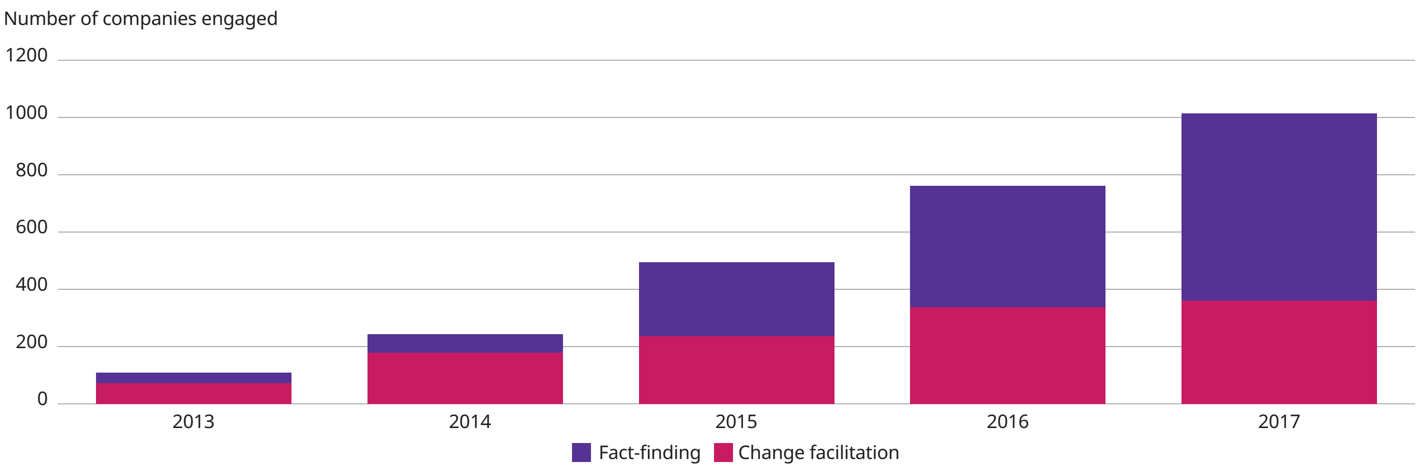
Given our decades of engagement experience, in 2017 our focus has been to better define the reasons behind why we engage, and importantly, the outcomes of our engagement.

Figure 15: Company engagement by region



Source: Schroders as at 31 December 2017.

Figure 16: Reasons for ESG engagement over the past five years



Source: Schroders as at 31 December 2017.

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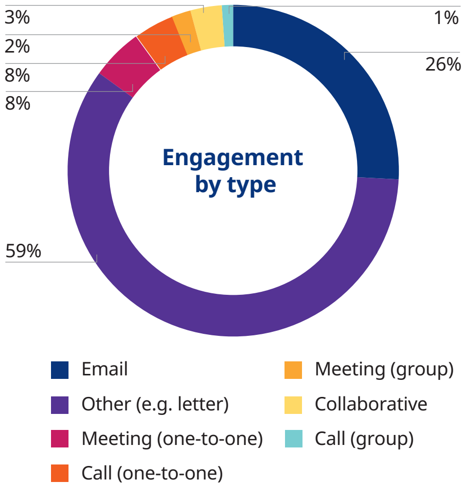
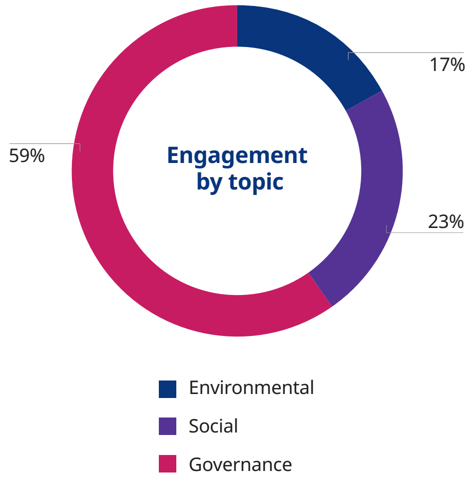
Figure 17: Company engagement by type in 2017



Source: Schroders as at 31 December 2017.

Figure 18: Company engagement by topic in 2017



Source: Schroders as at 31 December 2017.

How do we engage?
Our mechanism for engagement with company representatives varies but typically involves one of the following methods:

- One-to-one meetings with company representatives
  - E.g. members of the board, senior executives, investor relations, specialist managers such as sustainability or environmental managers
  - These meetings are either undertaken collaboratively with our financial analysts and investors, or are focused ESG engagements undertaken by our ESG specialists;
- Written correspondence or phone calls;
- Discussions with company advisers and stakeholders;
- Joint engagement with other investors (further information on our collaborative approach can be found on page 41).

Figure 17 illustrates the split of company engagement meetings by type during 2017.

How do we prioritise engagement?
Our engagement activities are prioritised based on several factors:

- The materiality of our exposure to the individual companies, either by the total size of assets invested on behalf of clients or by the percentage of shares held
- Whether there have been controversies or we know about poor stakeholder relationships
- Whether the firm is considered an ESG laggard.

Our equity research, fixed income research, ESG and data teams frequently work together to identify areas that warrant discussion with companies. Engagement can be proactive or reactive.

What issues do we engage on?
Our engagement activity covers numerous companies, sectors and regions across a range of issues. Figure 18 breaks down our engagements by overall topic and Figure 19 provides an indicative list of the specific issues we engaged on during 2017, with the top ten issues in blue. During the year, we focused on a number of governance topics, with corporate access issues resulting from regulatory scrutiny featuring heavily in our work. We also engaged with a number of companies on climate change strategy and a range of social issues. The appendix on pages 43-54 provides a full list of the companies we engaged with in 2017.

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Figure 19: Indicative list of ESG topics engaged during 2017

Environmental	Social	Governance
Biodiversity	**Customers**	Accounting practices
Climate change	Data security	Auditors
Environmental policy/strategy	Health and safety	Board committees
Environmental products and services	**Human capital management**	Board structure
Environmental supply chain	Human rights	Business integrity
Forests	Labour standards	Corporate strategy
Pollution	**Nutrition and obesity**	**ESG governance and sustainability strategy**
Waste management	**Product safety**	**Governance oversight**
Water	Social policy / strategy	**Remuneration**
	Supply chain management	Shareholder rights
		Succession planning
		Transparency and disclosure
		Voting

Source: Schroders as at 31 December 2017.

What are the outcomes of our engagement?

We log all instances where we have requested change at companies on ESG-specific issues. We review company progress on an annual basis (Figure 20). We categorise progress in five ways:

1 Achieved
2 Almost
3 Some change
4 No change;
5 No further change required[31].

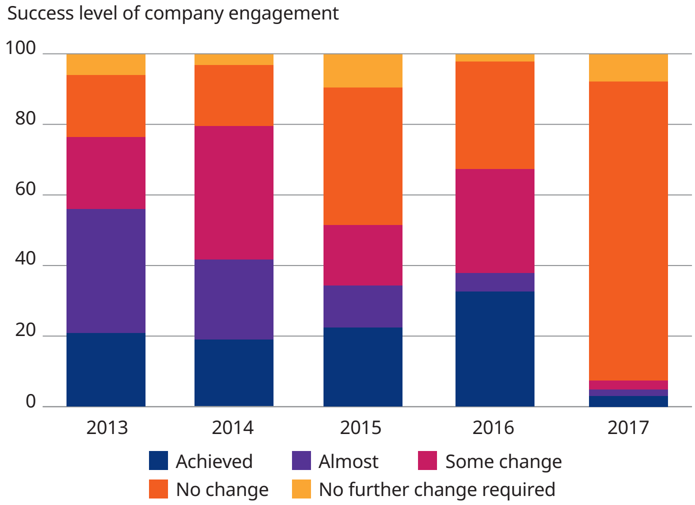
We recognise that these success factors may be subjective, and that Schroders' influence may not have been the sole driving force for this change. However, we believe it is important to track companies' progress and measure the outcomes of our engagement.

We review requests for change a year after they have been made, and subsequently on an ongoing basis, recognising that key strategic changes will take time to implement into a company's business process.

We realise that effective engagement requires continuous monitoring and ongoing dialogue. It is interesting to note that, of the companies we engaged with five years ago in 2013, 56% of our change requests to date have been "achieved" or "almost achieved", reflecting good progress. Due to this lengthy process and the inherent nature of these engagements, we anticipate more current engagements success to be of a higher percentage in the future.

31 This category is used if, for example, a company has divested the business in question, or if the company has provided a valid reason for not implementing the change requested.

Figure 20: Effectiveness of requests for change (by company engaged)



Source: Schroders as at 31 December 2017.

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Proxy voting

Why do we vote?

As stewards of our clients' capital, we believe that making full use of our voting rights is part of our fiduciary duty. It is about holding management and boards to account to ensure that they are managing the business for the long term. In order to create, sustain and protect the value of our investments, we encourage companies to follow corporate governance best practice. Put simply, as equity holders we have a responsibility to act like owners of companies.

Engagement with companies is also a critical part of our process. We ensure that there is an ongoing dialogue, and form long-term relationships that reflect an in-depth understanding of companies. Corporate governance best practice is an evolving area and we want to encourage rather than mandate improvements. We take a proactive approach in engaging with our significant holdings to convey our reasoning and policies prior to voting at general meetings.

It is our policy to vote on all resolutions at all AGMs/EGMs (extraordinary general meeting) globally except where there are restrictions that make it onerous or expensive to vote compared with the benefits of doing so. For example, shareblocking practice whereby restrictions are placed on the trading of shares which are to be voted upon.

Further information on our voting policy and monthly disclosure of our global voting can be found on our website. This includes a short reasoning behind situations where we have voted against management, which we hope provides helpful clarity.

In 2017, we voted on approximately 95% of total resolutions, and instructed a vote against management at 42% of meetings. In total, we voted on 5,378 meetings.

Where do we vote?

As a global investor, Schroders votes across all regions in which we invest. The majority of voting is conducted from our London office; however our offices in Australia, Japan, Taiwan and Indonesia make their own voting decisions. We try to ensure a consistent house view is given to companies, but in order to maintain the necessary flexibility to meet client needs, these local offices may determine a voting policy regarding the securities for which they are responsible. Japan and Australia have their own voting policy, both of which are publically available. Figure 22 represents our regional voting activity in 2017.

We submit electronic votes for all meetings, however, on occasion we may attend annual or extraordinary meetings to submit our vote in person.

What issues do we vote on?

Schroders will engage and vote on any issue affecting the long-term sustainable value of a company in which we are invested. Overleaf, Figure 23 shows the resolution breakdown of topics that we vote on. The majority are targeted around issues required by local stock exchange listing requirements (e.g. director elections, acceptance of reports and the allocation of income, approval of remuneration policies and reports). We also actively engage and vote on shareholder resolutions and have dedicated Sustainable Investment analysts who use their sector specific knowledge to make these voting decisions.

Why do we vote against company management?

As long-term, active investors we hope to support management on all resolutions, but our pragmatic approach means that we will oppose management if we believe that it is in the best interests of our clients to do so.

For example, we will vote against management if we believe a proposal diminishes shareholder rights or if remuneration incentives are not aligned with the company's long-term performance and creation of shareholder value. Such votes against will typically follow an engagement and we will inform management of our intention to vote against them before the meeting, along with our rationale.

In recent years we have been increasingly voting against individual directors. For example where we have had ongoing concerns about remuneration we may vote against the chair or other members of the remuneration committee. Also, where there have been ongoing and significant areas of concerns with a company's performance we have chosen to vote against individuals on the board who have served long tenures. We still support the principle of collective board responsibility, but believe that there should also be some individual accountability.

Source: Schroders

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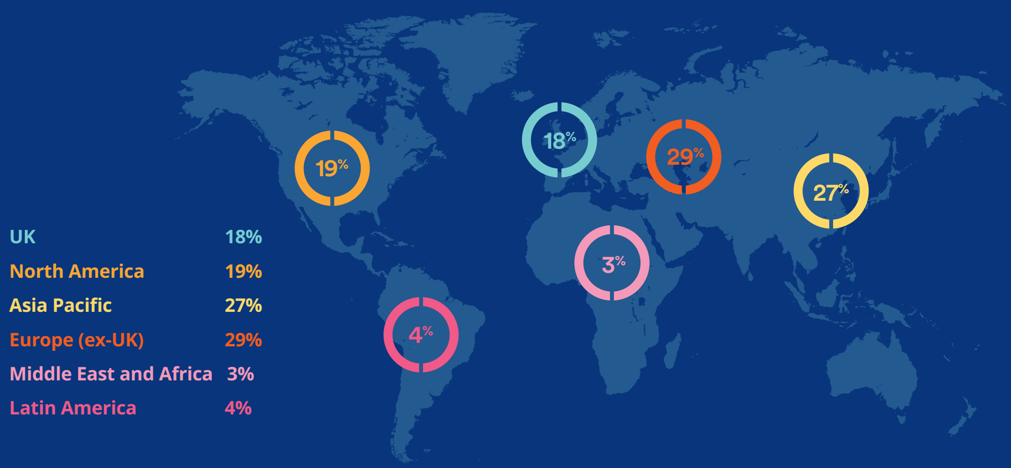
Figure 21: Voting Activity 2013-2017

Year	Meetings	Resolutions	With management	Against
2017	5,378	62,058	82%	18%
2016	5,168	61,114	84%	16%
2015	5,151	57,942	85%	15%
2014	5,616	60,330	91%	9%
2013	6,489	63,422	93%	7%

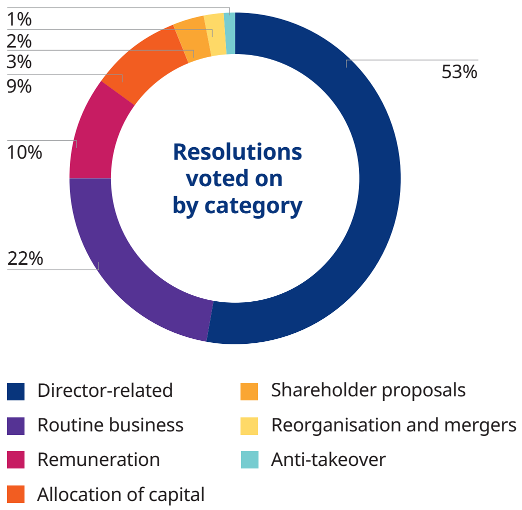
Source: Schroders as at 31 December 2017.

Figure 22: Global voting



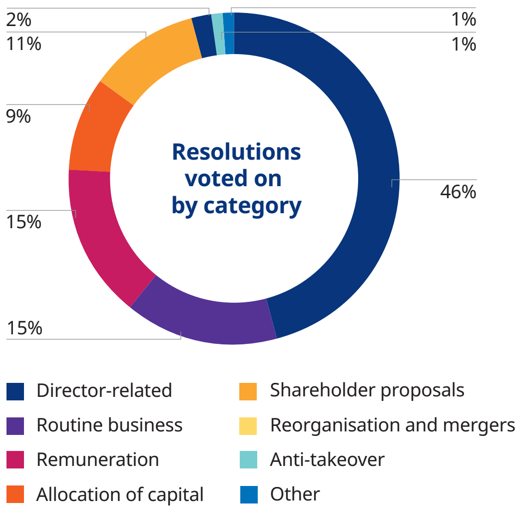
Source: Schroders as at 31 December 2017.

Figure 23: 2017 breakdown of resolutions voted on by category



Source: Schroders as at 31 December 2017.

Figure 24: Reason for "against" votes 2017



Source: Schroders as at 31 December 2017.

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2017 Stewardship review

We have already reviewed the AGM season in our Q3 report, but stewardship is much more than voting, 2017 was another active year for us and our activities covered a range of issues. We voiced our concerns in a number of high profile cases such as the Tesco/Booker deal and the accounting fraud at BT, as well as helping Pets At Home improve its pay structure. Stewardship remains integral to our investment processes and we remain as committed as ever to encouraging good governance and accountability from our holdings.

Going public on M&A

We have been invested in Tesco for some time and have been supportive of the recovery led by Dave Lewis in focusing the business back to basics. In January 2017 Tesco plc and Booker Group plc announced they had reached an agreement of a share and cash merger to create the UK's leading food business. Their well respected non-executive director, Richard Cousins, who has now sadly died, resigned as a result of concerns over the deal.

We contacted the company for a discussion expressing concerns about the price being paid for Booker and the increasing operational risk. Our meetings failed to resolve these concerns.

We wrote a formal letter to the company laying out our position, that we also went public with. Ideally engagement is best conducted out of the limelight, but when a clear difference of opinion cannot be bridged, going public is one of the ways that we will escalate our concerns. We outline our approach to escalation in Principle 4 of our Stewardship Code statement. In line with this we also voted against some directors at the 2017 annual general meeting (AGM).

Post-controversy engagement

It's been a difficult year for BT Group plc with the uncovering of fraud at the group's Italian business; a whistleblower disclosed wrongdoings related to the inflation of profits. This was followed by the discovery of improper sales, purchase, factoring and leasing transactions. The result was a change of CEO and CFO at BT Italy and the tender process for the auditor was accelerated with KPMG replacing PwC.

To approve the accounts, we needed comfort that relevant changes had been implemented and lessons had been learnt, and engaged with the company. BT accepted there had been a failure of internal control. They demonstrated that they had implemented a number of remedial and compensating actions and made all necessary adjustments in its consolidated financial statements. We voted for the accounts but against auditors, PwC, who had been in place for a considerable length of time.

We continue to engage with the company, in particular the new chair. There are wider issues with the regulators and customers around network quality, and we feel that meeting the expectations of these stakeholders is key for long-term value creation. We encouraged the new chair to try a collective engagement approach so that the concerns of shareholders could be effectively gathered.

Collective engagement

Collaboration between investors is an important stewardship tool. It enables companies to receive clear and consistent messages on shortfalls and remedies relating to governance.

We have been involved with the Investor Forum, the UK body set up to facilitate collective engagement. As well as sitting on the board and providing funding, this year we worked with the Forum on a number of issues ranging from working practices at UK fulfilment centres, to specific engagements such as chairman succession at Rio Tinto, and involvement in strategy and stewardship meetings. The Forum has been instrumental in helping us deliver clear messages to companies and we look forward to working with in the future.

We are keen to do more collaborative engagement, where regulation permits, around the world. We have had a long standing involvement with the Asian Corporate Governance Association (ACGA), which allows us to interact with investors in Asia. This year we have become members of the Dutch and Italian Investor Associations with a view to having more impact in other markets.

Source: Schroders

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Progress on pay

Both commentators and stakeholders have expressed concern over executive pay levels for some time now. Despite this there has been little innovation in the area.

Conventional long-term plans incentivise management to hit financial targets, such as earning per share (EPS) growth, giving rise to the concern that executives become overly focused on short-term results over long-term value creation. The schemes are complex; some management teams have said that they don't fully understand them.

In 2016 the Investment Association (IA) set up an Executive Remuneration Working Group to examine the issues around the current system. It suggested greater use of restricted shares. These plans grants shares to the executive but place certain restrictions to ensure long-term alignment. In essence, the individual receives a pre-determined amount of shares without having to hit specific business targets.

While shareholders acknowledge the need for change, they are divided on the use of restricted shares. Some are concerned about rewards for failure, while others support their simplicity. Recognising the issues with the current system, we are keen to support change.

As a specific example, Pets at Home contacted us in February to discuss a review of its remuneration policy. The company felt EPS and relative total shareholder return (TSR) were too complex and wanted the ability for management to build a meaningful shareholding over the long-term, so proposed restricted shares.

On the positive side, the plan enabled a 50% reduction of the maximum payments. However, their proposal vested over three years, which in our view was too short, and was underpinned by a dividend cover target, which we felt was at risk of being manipulate. We encouraged the company to adopt a TSR underpin, a five year vesting period, and engaged our peers to gauge support for such a move. The company took our views on board and the plan passed with a 78% approval.

Engagement campaigns

When we feel strongly about an issue we often write to all of our investments explaining our thoughts on a topic. We did this in 2015 in the UK, asking companies to consider stepping away from quarterly earnings reporting, in favour of more strategic discussions. As well as seeing more companies adopt this approach, we have been delighted that in 2017 the IA endorsed this approach. Meanwhile in the US, some commentators are advocating that companies step away from providing quarterly guidance.

In 2016 we raised the issue of viability reporting. Our analysis had shown a clear preference for companies assessing viability over a three-year time frame, with many adopting a standard "boiler plate" approach rather than linking the assessment back to their business model or even risk reporting. We fed in to the Financial Reporting Council's (FRC) Financial Reporting Lab project on the issue in 2017, and welcome the report. In the wake of the Carillion failure, viability and going concern will become an increasing area of focus.

On 3 January 2018, the MiFID II directive, European-wide regulation for financial services, came into effect. One of the areas which will be affected is corporate access, as investment banks cannot be paid for arranging company meetings. Ahead of this we wrote to our pan-European investments reaffirming our commitment to engagement, and asking for more direct contact, and have been encouraged by the responses that we have received so far.

Source: Schroders

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INtegrity

We're committed to managing clients' assets responsibly. That's why we're dedicated to promoting sustainable business practices that help businesses reach their full potential.

Our responsible approach isn't a new attempt to follow market trends, nor is it separate from our mainstream investment processes. Responsible principles drive our investment decisions and the way we manage funds. While Schroders has always considered the impact of responsible investment issues, over the past 20 years we have formalised how we responsibly engage and manage our investments.

We see ourselves as long-term stewards of our clients' capital and this means looking beyond the numbers. Our approach involves engaging with companies about their activities and helping them manage risks to drive better performance. Our investment experience and academic research show that companies with good ESG management often perform better and deliver superior returns over time, both for investors and society.

Source: Schroders

Screening and ethical exclusions

Ethical exclusions (or negative screening) refers to a strategy that involves the removal of specific companies or sectors from the investible universe of a portfolio based on a client's ethical criteria.

This remains an important area for our clients. We have continued to see a steady increase in the value of assets under management (AUM) to which some form of ethical exclusion is applied. As of 31 December 2017, Schroders managed £ 46.6 billion in ethically screened assets, representing 10.7% of our total AUM.

Year	Ethical AUM (GBP million)	% of Group AUM
2017	46.6	10.7
2016	33.2	8.6
2015	29.9	9.6
2014	27.8	9.3
2013	25.3	9.6

Source: Schroders as at 31 December 2017.

Of the £46.6 billion of AUM with ethical constraints in 2017, approximately £3.2 billion was managed by Schroders' Wealth Management business (including charities).

These ethical mandates vary from excluding stocks on a single issue to incorporating a variety of ethical issues. In addition, they often define a degree of materiality (e.g. percentage of revenues) a stock derives from its exposure to a particular issue. Tobacco, gambling and alcohol remain the most commonly applied screens.

Cluster munitions

Schroders fully supports the international conventions on cluster munitions and anti-personnel mines (APM). Consistent with this support, and in line with our commitment to responsible investment, we will not knowingly hold any security that derives revenue from, or provides funding for, cluster munitions or APMs.

Schroders will apply this policy to all funds that we directly manage. On occasion, there may be additional securities recognised by clients or local governments; these will be added to the Schroders Group exclusion list for those relevant jurisdictions or specific mandates.

The following companies are on our Group exclusion list (February 2018):

- Aerojet Rocketdyne
- Aryt Industries
- Ashot Ashkelon
- China Aerospace Science and Technology
- China Aerospace Science and Industry
- China North Industries Group Corporation (Norinco)
- Hanwha
- Motovilikha Plants JSC
- Israel Military Industries
- Poongsan Corporation
- Poongsan Holdings Corporation
- Roketsan
- Sichuan Academy of Aerospace Technology
- Splav State Research

Terrorist financing

As a result of the Patriot Act and the Anti-Money Laundering and Counter Terrorism Financing law in the US, many US state pension funds request that their fund managers divest from any companies that could be undertaking business within countries that the US government considers terrorist states.

Schroders meets its US clients' requests to screen out these companies. As of 31 December 2017 we estimate that £5.3 billion of AUM was screened based on client-defined criteria.

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Collaboration, industry involvement and public policy

We support, and collaborate with, several industry groups, organisations and initiatives. These are important in improving sustainability standards across sectors, establishing a consistent dialogue with companies, and in promoting the ongoing development and recognition of ESG within the investment industry. We also work with organisations that we are members of, and with national and regional trade associations, to develop their submissions on various regulatory issues around the world.

We believe that working with peers and policymakers on ESG issues is an important activity and regularly respond to public consultations both as a firm and working with investor groups.

Advocacy and public policy

- **Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD):** Following our submission in May 2016, we responded to this public consultation in February 2017. We argued that given the systematic risks climate change poses and the scale of the challenge to mitigate its effects, every sector will be impacted. We agree with the call for more standardised data in an audited setting, but feel that the report could have gone further than endorsing many of the disclosure projects currently underway. We also advocated and encouraged the development of stronger models and analytical tools to be developed in tandem with increased reporting.
- **UK Government Green Paper on Corporate Governance Reform:** We called for stronger consequences for losing an advisory vote on a company' remuneration report and the supermajority requirement. We supported the idea of increased pay ratio disclosure and argued that a principles-based approach is preferable to mandatory regulation, so that remuneration structures can be tailored to the circumstances of the company. We also argued that a focus on pay should not "crowd out" shareholder engagement on other issues, particularly strategic direction or quality of management which are significantly more important for long-term value creation.
- **UK Green Finance Taskforce:** The regulatory and legal position on fiduciary responsibilities to consider material ESG issues has become much clearer in recent years and in our experience rarely represents a barrier to the integration of climate (or other important environmental and social) factors into investment decisions. Most recently in September 2016, the Pensions Regulator warned trustees against complacency when assessing ESG issues within portfolios. If this is happening, there should be little additional need for specific encouragement for green investment.
- **Dutch Ministry of Economic Affairs:** We wrote to express our concern on the proposed introduction of a law that allows a Dutch target company a one-year "time-out period" during which shareholder rights will be suspended. We believe it is in effect a country-wide takeover defence, despite it being for one year. We do not think this circumstance should warrant the suspension of shareholder rights.
- **Financial Reporting Council (FRC):** We responded to a consultation on auditors and preliminary announcements. We agreed that audits should be complete and the auditor's report on the underpinning statutory financial statements signed before results are released. We did not support additional audit disclosure with preliminary announcements. We voiced our concern with alternative performance measures and asked for more regulatory guidance around them. We also responded to some of the recommendations from the UK Select Committee inquiry on corporate governance reform, and provided feedback on risk and viability statements for the Financial Reporting Lab.
- **EU High Level Expert Group:** We responded to the group's questionnaire and argued that sustainable finance is used to describe a range of investment strategies and goals, often vaguely articulated. Institutions seeking involvement should describe (i) the intended goal in specific terms, (ii) the role financial services and capital markets can play in achieving that goal, (iii) the way their products and services are designed to play that role and (iv) how they measure and communicate progress. Without clarity, a consistent strategy is very difficult. Furthermore, with competing or vague goals, strategies are likely to be compromised
- **FTSE Russell, MSCI and S&P:** We responded to a consultation on non-voting shares being included in an index. We do not support the notion that companies with no voting rights can be eligible for inclusion in an index. In our view, voting rights are a fundamental attribute of equity capital. Unlike other forms of capital, equity is permanent risk capital. Voting rights reflect the unique role that equity plays in a company's funding. They are how ownership rights are exercised, how directors are made accountable and they underpin investor stewardship. We think that a 25% threshold for voting rights in the hands of non-restricted shareholders could be appropriate. This should be calculated as the number of voting rights as a percentage of total outstanding shares (of all classes).
- **Investor Forum and the Department for Business, Energy & Industrial Strategy (BEIS):** The Investor Forum arranged a meeting between the BEIS and investors to discuss views on the labour standards enforcement strategy review. This was an opportunity for Schroders to explain how it uses data on human capital and supplier labour standards in its investment process. It also provided insight into future regulation trends.

Source: Schroders

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Committees or initiatives promoting responsible investment

- **Trade associations:**
  - **Investment Association (IA):**
    - Our CEO chairs the IA
    - We also sit on the IA's Corporate Governance and Engagement Committee and the Investment Committee. The committees engage actively with policymakers and other stakeholders in the UK on how the investment management industry and capital markets can best serve their needs. In 2017 we helped form responses to the BEIS Green Paper: Corporate Governance Reform and the Financial Conduct Authority's (FCA) consultation on premium listing, supported the formation of the IA public register on shareholder voting, and formed positions on virtual AGMs.
  - **European Funds and Asset Management Association (EFAMA):**
    - We serve on the board of EFAMA. This is the representative association for the European investment management industry.
    - We make ongoing contributions to EFAMA's responsible investment consultations and reports. In 2017 we helped shape the response on the European Commission Consultation on investor's sustainability duties.
- **UK Sustainable Investment and Finance Association (UKSIF):** We are a member of the UKSIF Markets Committee, which seeks to promote responsible investment and raise awareness among different stakeholder groups through initiatives and events, including Ownership Day and Good Money Week.
- **Principles for Responsible Investment (PRI):** We are a member of the UN PRI Integration Sub-Committee. We facilitated a joint workshop run by the PRI and CFA UK. The workshop provided a forum for non-ESG specialist fund managers to discuss the increased demand for ESG from clients and the challenges of integrating ESG into their investment processes, and offered opportunities to discuss solutions. We spoke on a panel about emerging ESG trends, highlighting sugar as a material risk. We also participated in a roundtable discussion on the relevance of human rights in company valuations, providing examples of our experiences. The roundtable was organised by the PRI to help out with a study by the University of Manchester. Our key message was to not concentrate on human rights as a terminology, but instead to focus on particular areas of human rights such as workforce relations, community relations, etc. There is not a one-size-fits-all approach. Additionally, we responded to the PRI's consultation on signatory accountability, providing feedback on the proposed policy for serious violations of the integrity of the PRI initiative.
- **Financial Reporting Council (FRC):** We participated in a roundtable on corporate governance reform, discussing whether the UK Corporate Governance Code does enough to account for stakeholder interests. We also participated in an investor workshop discussing human capital reporting, providing our views on how investors use the annual report. Schroders was keen to highlight that human capital is a key asset but current reporting requirements are limited to full-time-equivalent employees and wages. We requested more information on workforce structure (full / part-time, use of contractors) and more data to demonstrate how effective a company's human capital management is.
- **International Corporate Governance Network (ICGN):** During 2017, we contributed to the ICGN's yearbook, spoke at and attended their conferences and dialled into various webinars. We also indicated our intentions to endorse their Global Stewardship Principles which will be detailed on their website in February 2018.
- **Asian Corporate Governance Association (ACGA):** We collectively engaged with companies and regulators through this body. During 2017, we contributed to the consultation on amendments to the Hong Kong Corporate Governance Code and responded to the investor survey on audit committees. We also participated in several conference calls with our peers.
- **BankingFutures:** We have been involved with the BankingFutures project since 2015. A group of banks, investors and civil society facilitated by two non-governmental organisations (NGOs) came together to conduct an engagement with over 200 stakeholders on the future of banking in light of the Global Financial Crisis. We participated in two work streams; one focused on more effectively addressing the needs of small-and-medium enterprises (SME), and the other on improving communication between banks, investors and other stakeholders to enhance banks' ability to deliver long-term value. The full reports can be found here.
- **Investor Forum:** We are currently members and serve on the board. This group seeks to contribute to long-term investment performance by promoting cultural change and enhancing shareholder stewardship through collective engagement. During the year we spoke on a panel about the importance of culture and provided feedback on the group's strategy.
- **Focusing Capital on the Long Term (FCLT):** FCLT is an NGO dedicated to encouraging long-term behaviours in business and investment decision-making. During the year we hosted a debate on how to improve long-termism in investment.
- **CDP (formerly known as Carbon Disclosure Project):** In 2017 we engaged with 125 companies which had not responded to the CDP survey. We outlined the importance of transparency and the value of disclosures addressing their exposures to climate risks and opportunities. We also spoke on carbon disclosure at a CDP event in Japan and participated in a mining roundtable with companies and other investors.

Source: Schroders

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- **ShareAction Workforce Disclosure Initiative:** We are one of the founding signatories to the Workforce Disclosure Project, which was developed by ShareAction, in collaboration with investors. The initiative seeks to gain more data on human capital practices and promote greater transparency. We participated in several roundtables and provided detailed feedback on the pilot survey. We are supportive of the initiative which aims to be the CDP for human capital but we were concerned that the initial survey draft was too ambitious which may prevent some companies from participating. We also encouraged ShareAction to highlight the investment relevance of their questions so that the survey results are helpful for investors trying to integrate this key issue into their investment decisions.
- **Coalition for Inclusive Capitalism:** We are a member of this not-for-profit organisation dedicated to promoting the Inclusive Capitalism movement. We are involved in The Embankment Project for Inclusive Capitalism, launched in June 2017, a project to develop and test a new framework to better reflect the full value companies create through human, physical, financial and intellectual capital deployment.
- **Institute of Business Ethics (IBE):** The institute has done work on responsible financial reporting, acknowledging that accounting issues often feature in corporate crises. We supported this by appearing on a panel the discussed what directors should be focusing on when it comes to financial accounts.
- **Investment Association (IA):** We participated in a roundtable seeking feedback on proposed guidance to board members on the value of stakeholders. We advised that the guidance should not be too prescriptive and that boards should report on how they have taken stakeholder views into account (and what impact they have had). We advised against having a chief stakeholder officer.
- **Access to Medicines Index:** We provided feedback on the new access to antibiotics index methodology, emphasising the need for material data, and we were on a panel of select investors to help corporates convey their "access to medicines" approach in a context that is relevant for investors.
- **CFA:** We spoke at a CFA seminar in Philadelphia on the benefits of a sustainable investment approach, including ESG integration and engagement.
- **Sustainable Oceans:** We attended an event with investors, NGOs and industry experts to discuss a range of industry initiatives around sustainable fishing and ocean plastics.
- **Investor Relations Society:** We joined the panel of judges to help select the best sustainability reporting examples across the UK large cap, international large cap and UK small cap categories. We shared our views on best practice sustainability reporting, alignment with risks and opportunities in a company's annual report and stakeholder engagement.

Collaborative engagement with companies on specific ESG issues

- **Climate Action 100+:** In 2017, we became a founding signatory to the Climate Action 100+ initiative, a five-year collaborative engagement project to engage over 100 of the world's largest corporate greenhouse gas emitters to improve governance on climate change, curb emissions consistent with a 2 degree scenario and strengthen climate-related financial disclosures in line with TCFD recommendations. We will be leading engagement for two companies in the materials and energy sectors.
- **Animal Welfare – Business Benchmark on Farm Animal Welfare:** following our collective engagement in 2015 and 2016 encouraging companies ranking poorly on the benchmark to improve their disclosure around animal welfare standards, we participated in a webinar to discuss the progress of the engagements and the 2016 index rankings. Schroders contributed some suggestions to the engagement approach and provided feedback on the engagement letters. Schroders believes that good animal welfare practice is a useful proxy for supply chain management. It has been encouraging to see significant improvements at several companies that had previously ranked in the bottom tiers of the index.
- **Investor Forum:** We participated in a collective engagement with UK apparel and online retailers, visiting several UK fulfilment centres to observe labour conditions and what the companies were doing to retain and attract staff for future growth. This collective engagement allowed us to better understand how our investee companies were managing labour issues across their distribution networks and work with our peers to better understand supply chain best practice across a broader range of companies where Schroders does not have a holding. As a result of the collective engagement we have written a research note which we have shared with investors across Schroders, as well as our clients and peers to help raise awareness of this ESG trend.
- **Sustainability Accounting Standards Board (SASB):** We supported a request (spearheaded by the Access to Medicines foundation) for SASB to include more meaningful reference to access to medicines within its reporting framework for the biotechnology and pharmaceutical sectors. Access is an increasingly material area for healthcare companies and standardised reporting measures would give investors access to comparable data.

Source: Schroders

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Compliance with UN PRI

This section demonstrates our compliance with the UN PRI, and highlights the relevant pages within this report where evidence of this compliance is demonstrated, in addition to other sources not included in this report.

Investor outcomes	Investment technique	Page
P1: We will incorporate ESG issues into investment analysis and decision-making processes	– Dedicated Sustainable Investment team comprising 12 ESG specialists focused on integrating ESG considerations across investment desks	pg 55-56
	– Long-standing ESG training programme for financial analysts and portfolio managers	pg 56
	– Sector focus allows close working relationship between ESG and financial analysts	pg 56
	– Joint company meetings between ESG, credit and equity analysts	pg 30-31
	– Multi-sector and multi-region thematic research produced on key sustainability trends to educate investors	pg 13
	– Proprietary investment-driven ESG analysis tools for our investors	pg 56
	– All research shared on our proprietary global research platform	pg 20, 56
P2: We will be active owners and incorporate ESG issues into our ownership policies and practices	– Engaging with companies and actively voting at AGMs since 1998	pg 29-36
	– ESG policies for listed assets, real estate and private equity	pg 1, 10-11
	– Global voting strategy	pg 29, 33
	– Active engagement with companies in which we invest and monitoring of success	pg 30-32, 43-54
P3: We will seek appropriate disclosure on ESG issues by the entities in which we invest	– Active engagement with companies to encourage greater transparency	pg 30-32, 43-54
	– Participation in collaborative disclosure initiatives to improve disclosure standards	pg 35, 39-41
P4: We will promote acceptance and implementation of the principles within the investment industry	– Members, leaders and participants of various forums and networks – Collaboration with other investors to promote and develop responsible investment principles and practices – Sponsorship and support of responsible investment initiatives, including hosting conferences, seminars and workshops – Submissions to regulators, trade associations, legislators and other bodies – Participation on speaker panels at conferences such as the PRI in Person Conference 2017 – Working with clients who are considering becoming members of the PRI to help them understand the benefits and practicalities of membership – Publicising responsible investment events to clients and encouraging attendance – Trustee training and ongoing client education on responsible investment and ESG trends	pg 39-41
P5: We will work together to enhance our effectiveness in implementing the principles	– Collaboration with other investors, sharing information and exchanging our views – Active participation in industry networks such as the PRI, Asian Corporate Governance Association and the International Corporate Governance Network	pg 39-41
P6: We will each report on our activities and progress towards implementing the principles	– Responsible investment activities detailed in our publicly available quarterly and annual reports – Best practice case studies included in our reports and publications such as Schroders Investment Horizons – Thematic and special ESG reports published on our website	Throughout this report

Source: Schroders

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Appendix

Figure 25: Companies specifically engaged with on ESG topics during 2017

Company	E	S	G
Consumer Discretionary			
Accor			✓
Alibaba Group	✓		✓
Alsea		✓	
Amazon	✓	✓	✓
American Eagle	✓		
Antena 3 de TV			✓
ASOS		✓	
Astra International	✓	✓	
Autoliv			✓
Bajaj Auto			✓
Bed Bath and Beyond	✓	✓	
Belle International	✓		
Bellway			✓
Berkeley Group			✓
BMW		✓	✓
boohoo.com		✓	
Bosch	✓		
Bovis Homes			✓
Breadtalk Group		✓	
Brembo			✓
Brilliance Auto	✓		
Brinker International		✓	
Burberry Group			✓
Cafe De Coral		✓	
Cairo Communicationations			✓
Carter's	✓	✓	
Cheesecake Factory		✓	
Coats Group			✓
Comcast		✓	
Compass Group		✓	✓
Continental			✓
Cooper Tires	✓		
Daily Mail and General Trust			✓
Daimler		✓	✓
Dalata Hotel Group			✓
Darden Restaurants		✓	
Debenhams			✓
DFS Furniture			✓
Dixons Carphone			✓
Dometic Group			✓
Domino's Pizza		✓	
Dongfeng Motor	✓		
Dufry			✓
Enterprise Inns			✓
Fairwood Holdings		✓	
Famous Brands		✓	
Faurecia			✓
Ferrari	✓		✓
Fiat Chrysler		✓	✓
Flight Centre		✓	✓
Ford Motor		✓	
Galaxy Entertainment Group	✓		
Game Digital			✓
Garmin	✓		
General Motors		✓	
Genting Singapore	✓		
Genuine Parts		✓	
GKN			✓
Granada Group			✓
Greene King			✓
Haier Electronics			✓
Halfords Group			✓
Harley-Davidson	✓		
Haseko			✓
Headlam			✓

Source: Schroders, 31 December 2017

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Company	E	S	G
Hollywood Bowl			✓
Home Depot		✓	
Honda Motor Co		✓	
Howden Joinery			✓
Husqvarna			✓
Hyundai Motor		✓	
IMA			✓
Inchcape		✓	
Inditex		✓	
Informa			✓
Intercontinental Hotels Group			✓
ITV			✓
Jack in the Box		✓	
Jaguar Land Rover		✓	
JD Sports Fashion		✓	
JD.Com	✓	✓	
John Wiley	✓	✓	
Jollibee		✓	
Kia Motors Corp	✓	✓	
Ladbrokes			✓
Lagardere			✓
Lookers		✓	✓
LVMH			✓
Marks and Spencer		✓	✓
Maruti	✓		
McDonalds		✓	
Merlin Entertainments			✓
Michael Kors	✓		✓
Millennium & Copthorne Hotels			✓
Mitchells and Butlers		✓	✓
Modern Times Group			✓
Moncler	✓		✓
Mothercare			✓
Motherson Sumi Systems	✓		

Company	E	S	G
Mvideo			✓
N. Brown Group		✓	
Naspers			✓
NEXT			✓
NH Hotels			✓
Nike		✓	
Nissan Motor		✓	
Nokian			✓
OPAP			✓
O'Reilly Auto		✓	
OVS			✓
Pandora			✓
Pearson			✓
Pendragon		✓	
Persimmon			✓
Pets at Home			✓
Photo-Me International			✓
Porsche	✓		✓
Publicis Groupe			✓
Redrow			✓
Reed Elsevier			✓
RELX Group			✓
Renault		✓	
Restaurant Group			✓
Richemont			✓
Salvatore Ferragamo			✓
Samsonite	✓		
Sands China	✓		
Shanghai Auto	✓		
Shenzhou International	✓		
Sky		✓	
Sportech			✓
Sports Direct		✓	✓
Starbucks	✓	✓	

Source: Schroders, 31 December 2017

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Company	E	S	G
SuperGroup			✓
Swatch			✓
Target		✓	
Tata Motors		✓	
Taylor Wimpey			✓
Technicolor			✓
Technogym			✓
Television Francaise			✓
Thomas Cook			✓
Toyota Motor		✓	
Trinity Mirror			✓
Valeo			✓
Vivendi Universal			✓
Volkswagen		✓	✓
Whitbread		✓	
William Hill			✓
Wolters Kluwer			✓
XXL			✓
Yoox			✓
YUM! Brands		✓	
Consumer Staples			
AG Barr		✓	
Ahold Delhaize			✓
Alicorp		✓	
Ambev	✓		
Anheuser-Busch InBev			✓
Arca Continental		✓	
Archer Daniels Midland		✓	
Aryzta			✓
Associated British Foods		✓	
AVI		✓	
Barry Callebaut		✓	
Beiersdorf			✓
Bimbo		✓	

Company	E	S	G
BRF		✓	
Britannia Industries	✓	✓	
British American Tobacco			✓
Britvic		✓	
Campbell Soup		✓	
Carrefour			✓
China Mengniu Dairy	✓		
China Resources Beer	✓		
Coca Cola		✓	
Colgate Palmolive		✓	
Conagra Inc		✓	
Costco		✓	
Dairy Crest Group			✓
Danone		✓	✓
Diageo			✓
Emart	✓		
Flowers Foods		✓	
General Mills		✓	
Glanbia	✓		
Greencore			✓
Greggs		✓	
Gruma	✓		✓
Henkel			✓
Hershey Foods		✓	
Hormel Foods		✓	
Imperial Tobacco			✓
Indofood	✓	✓	✓
JBS		✓	
Kellogg		✓	
Kerry Group		✓	
KOF		✓	
Kraft Heinz Foods		✓	✓
Lindt		✓	
M. Dias Branco		✓	

Source: Schroders, 31 December 2017

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Company	E	S	G
MARR			✓
McCormick & Company		✓	
Mondelez International		✓	
Monster Beverage Corporation	✓		
Nestle	✓	✓	✓
Nu Skin Enterprises	✓	✓	
Ontex Group			✓
Pepsico		✓	
Pernod Ricard			✓
Philip Morris			✓
President Chain Store	✓	✓	
Raia Drogasil	✓	✓	✓
Reckitt Benckiser			✓
RFM Corporation		✓	
Sainsbury		✓	✓
Sapporo Breweries		✓	
SCA			✓
Smucker		✓	
SSP Group		✓	
Suntory Beverage & Food		✓	
Tate & Lyle		✓	
Tesco		✓	✓
Thai Beverage	✓		
Treatt			✓
Tsuruha	✓		
Unilever		✓	✓
Universal			✓
Walmart		✓	✓
Wesfarmers		✓	
Wm. Morrison		✓	✓
Woolworths		✓	
Wuliangye	✓		
X5	✓		
Yili Group	✓		

Company	E	S	G
Energy			
Adaro Energy	✓		
Amec Foster Wheeler			✓
Anadarko Petroleum	✓		
Apache	✓	✓	✓
BP	✓		✓
Cabot Oil & Gas	✓		
Cairn Energy			✓
Canadian Natural Resources	✓		
Chevron Texaco	✓		
China Shenhua Energy	✓		
Cimarex Energy	✓		
CNOOC			✓
Devon Energy	✓		✓
ENI	✓		✓
EOG Resources	✓		
Exxaro	✓		
Exxon Mobil	✓		
Galp			✓
Gazprom			✓
Hargreaves Services			✓
Helmerich & Payne	✓		
IHC Caland			✓
Lukoil			✓
Lundin Petroleum			✓
Marathon Petroleum	✓		
National Oilwell Varco	✓	✓	
Newfield Exploration	✓		
Occidental Petroleum	✓		
Petro Geo-Services			✓
Phillips 66	✓		
Pioneer Natural Resources	✓		
PKN	✓		
Premier Oil	✓		✓

Source: Schroders, 31 December 2017

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Company	E	S	G
Romgaz			✓
Royal Dutch Shell	✓		✓
SARAS			✓
Sasol			✓
Schlumberger	✓	✓	
SK Innovation	✓		
Soco International			✓
Statoil			✓
Tambang Batubara Bukit Asam	✓		
Tatneft	✓		✓
TechnipFMC	✓		
Tenaris			✓
TGS			✓
Total			✓
Tupras	✓		
Valero	✓		
Wood Group			✓
YPF	✓		
Financials			
3i Group			✓
Aberdeen Asset Management			✓
ABN AMRO			✓
Ageas			✓
AIA Group		✓	
Allianz			✓
Alpha Bank			✓
Amundi			✓
Anima			✓
Aroundtown			✓
Ashmore Group			✓
Assicurazioni Generali			✓
Assura			✓
Atrium European Real Estate			✓
Aurelius			✓

Company	E	S	G
Aviva			✓
AXA			✓
Banca Farmafactoring			✓
Banca Generali			✓
Banca IFIS			✓
Banca Mediolanum			✓
Banca Sistema			✓
Banche Popolari Unite			✓
Banco Santander			✓
Bankinter			✓
Barclays			✓
BBVA		✓	✓
BNP Paribas			✓
British Land			✓
Catalana Occidente			✓
Cerved Information Solutions			✓
CK Hutchison Holdings	✓		
Close Brothers		✓	✓
Coface			✓
Collins Stewart			✓
Credicorp		✓	
Credit Suisse			✓
Credito Emiliano			✓
Derwent London			✓
Deutsche Bank			✓
Deutsche Boerse			✓
Direct Line			✓
DNB Nor			✓
Erste Bank			✓
Essent	✓		
Euler Hermes			✓
Everest Re	✓	✓	
FinecoBank			✓
Fondul Proprietatea			✓

Source: Schroders, 31 December 2017

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Company	E	S	G
GAM			✓
Grainger			✓
Grand City Properties			✓
Hastings Group			✓
HCI Group		✓	
HDFC Bank		✓	
Hellenic Exchanges			✓
Hispania Activos			✓
HSBC			✓
Industrivarden			✓
ING Groep	✓		✓
Intermediate Capital Group			✓
Intesa Sanpaolo			✓
Jafco			✓
JLT Group			✓
Jupiter Fund Management			✓
Just Retirement			✓
KBC			✓
Klépierre			✓
Lancashire			✓
LEG Immobilien			✓
Legal & General Group			✓
Liberbank			✓
Lloyds Banking Group			✓
London Stock Exchange			✓
Man Group			✓
Mediobanca			✓
Merlin Properties			✓
Mitsubishi UFJ			
MLP			✓
Morses Club			✓
NASDAQ		✓	
Nets			✓
NewRiver			✓

Company	E	S	G
NEX Group		✓	✓
Nexity			✓
Nordea			✓
Old Mutual			✓
Orix		✓	✓
OTP			✓
Phoenix			✓
Provident Financial			✓
Prudential Corporation			✓
Rathbone Brothers			✓
Royal Bank of Scotland			✓
RSA Insurance Group			✓
Safestore			✓
Saga			✓
Sampo	✓	✓	✓
SEB			✓
Secure Trust Bank			✓
SGS			✓
SMFG			✓
St James Place Capital			✓
Standard Chartered			✓
Swedbank			✓
Swiss Re			✓
Tinkoff Credit System			✓
TP ICAP			✓
Turkiye Garanti Bankasi	✓	✓	✓
UBM Development			✓
UBS			✓
Unibail-Rodamco	✓		✓
Unicredit			✓
Unite Group			✓
Universal Insurance	✓		
Vienna Insurance Group			✓
Virgin Money			✓

Source: Schroders, 31 December 2017

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Company	E	S	G
Vonovia			✓
Wells Fargo		✓	
Wendel Investissem			✓
Wharf	✓		
Workspace Group			✓
Worldpay			✓
Zurich Financial Services			✓
Health care			
Allergan		✓	✓
AstraZeneca		✓	✓
Basilea Pharmaceutica			✓
Bayer		✓	✓
Biogen			✓
BTG	✓	✓	✓
CSL		✓	
Danaher			✓
Dechra Pharma		✓	✓
DiaSorin			✓
Elekta			✓
Endo		✓	
Essilor			✓
Fresenius			✓
Genus			✓
Georgia Healthcare Group			✓
GlaxoSmithKline		✓	✓
Hikma		✓	
Indivior		✓	✓
Lilly, Eli & Co		✓	
Lonza		✓	✓
Lundbeck			✓
Merck & Co		✓	
Meridian Bioscience			✓
MorphoSys			✓
Novartis		✓	✓

Company	E	S	G
Novo Nordisk		✓	✓
Orpea			✓
Otsuka Holdings		✓	
Pfizer		✓	✓
Recordati			✓
Roche		✓	✓
Sanofi-Aventis		✓	✓
Santen	✓	✓	✓
Shire		✓	✓
Sino Biopharm		✓	
Smith & Nephew			✓
Spire Healthcare			✓
STERIS	✓	✓	✓
Sun Pharama		✓	
Teva		✓	
UCB			✓
United Health		✓	✓
Valeant		✓	
West Pharmaceutical Services			✓
Zoetis		✓	
Industrials			
Aalberts Industries			✓
ABB			✓
Acuity Brands	✓		
Aena			✓
Aerojet Rocketdyne Holdings			✓
AGCO	✓		
Aggreko			✓
Ahlsell			✓
Air France-KLM			✓
Alstom			✓
Ashtead			✓
Assa Abloy			✓
Atlas Copco			✓

Source: Schroders, 31 December 2017

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Company	E	S	G
Babcock International Group			✓
BAe Systems	✓	✓	✓
Balfour Beatty			✓
Beijing Enterprises	✓		
Berendsen			✓
Bilfinger Berger			✓
Bodycote			✓
Bpost			✓
Brenntag			✓
Bunzl		✓	✓
Canadian Pacific Railway	✓	✓	✓
Cape			✓
Capita			✓
Chemring Group			✓
China Communications Construction			✓
China Gezhouba Group	✓		
China International Marine Containers	✓		
China Railway Construction			✓
China State Construction Engineering	✓		✓
Cobham			✓
D/S Norden			✓
Danieli			✓
Dart Group			✓
De La Rue			✓
DMCI	✓		
Doosan			✓
DP World			✓
DSV			✓
EasyJet			✓
Eicher Motors	✓		
Elis Services			✓
ENAV			✓
Experian			✓
Fanuc		✓	✓

Company	E	S	G
Finmeccanica			✓
FirstGroup			✓
Fortive	✓		
Fortune Brands Home & Security	✓		
G4S		✓	✓
GEA Group			✓
Go-Ahead			✓
Haitian	✓		
IMI	✓		✓
Interpump Group			✓
Intertrust			✓
James Fisher and Sons			✓
John Laing			✓
Johnson Electric			✓
Kaman			✓
Kardex			✓
Keller			✓
Keppel Corporation		✓	✓
KION Group	✓		✓
Kone			✓
Korea Aerospace Industries	✓		
Kratos Defense & Security Solutions			✓
Krones			✓
Kubota		✓	✓
Kuroda Electric			✓
L-3 Communications			✓
Larsen & Toubro			✓
Legrand			✓
Leonardo			✓
Leoni			✓
Lockheed Martin		✓	
Maeda Road Construction	✓	✓	✓
Maersk	✓		✓
Maire Tecnimont			✓

Source: Schroders, 31 December 2017

The companies and sectors mentioned herein are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

Company	E	S	G
Mears Group			✓
Melrose Industries		✓	✓
Munters			✓
National Express	✓		✓
Nippon Densetsu Kogyo Co			✓
Northrop Grumman		✓	
NWS Holdings	✓		✓
Philips			✓
Porr			✓
Prysmian			✓
Qinetiq Group			✓
Rentokil Initial			✓
Reunert		✓	
Rheinmetall		✓	
Rieter Holding			✓
Rockwell Collins		✓	
Rolls-Royce			✓
Roper Technologies	✓		
Royal Mail		✓	✓
RPS Group			✓
Safran		✓	
Saint-Gobain			✓
Sankyu			✓
Schindler			✓
Senior			✓
Serco			✓
Shanghai Electric			✓
Siemens			✓
Sig			✓
Singapore Technologies Engineering		✓	
SKF	✓		
SMC Corp	✓		✓
Smiths Group			✓
Spirax-Sarco Engineering			✓

Company	E	S	G
Stabilus			✓
Stericycle	✓		
Teleperformance			✓
Travis Perkins			✓
Trelleborg			✓
United Technologies		✓	
United Tractors	✓		
Vallourec			✓
VAT			✓
Vestas Wind Systems			✓
Vinci			✓
Volvo		✓	✓
Waste Connections	✓		
Weg			✓
Weichai Power	✓		
Weir		✓	✓
Wienerberger			✓
Wolseley			✓
Zodiac Aerospace			✓
Information Technology			
Alfa Financial Software			✓
Altran			✓
Amadeus			✓
Apple		✓	
ASM International			✓
ASML			✓
Canon	✓		
carsales.com.au			✓
Catcher		✓	
Checkpoint Software Technologies		✓	
Computacenter			✓
Criteo			✓
Dassault Systemes			✓
DMT			✓

Source: Schroders, 31 December 2017

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Company	E	S	G
Electrocomponents			✓
Fidessa			✓
Gocompare.Com			✓
Halma			
Hexagon			✓
Imagination Technologies		✓	✓
Indra Sistemas			✓
Infineon			✓
Iomart			✓
IQE			✓
Keyence	✓		✓
Laird	✓	✓	✓
Lam Research	✓		
Largan Precision	✓		
Linear Technology		✓	
Logitech			✓
Merkantildat			✓
Micro Focus			✓
MoneySupermarket.com			✓
Naver	✓		
NCC Group			
Netease.com	✓		
Nokia			✓
Novatek Microelectronics			
Otsuka	✓		
Redcentric			✓
RIB Software			✓
Sabre	✓		
Sage			✓
SAP			✓
SDL			✓
ServiceNow	✓		
Siltronic			✓
Soitec			✓

Company	E	S	G
Sophos			✓
Sopra Steria			✓
Spectris		✓	✓
STMicroelectronics			✓
Tencent	✓	✓	✓
TKH Group			✓
u-blox			✓
United Internet			✓
YY		✓	
Materials			
Albemarle	✓		
Anglo American		✓	✓
Anhui Conch Cement	✓		
Antofagasta	✓	✓	
Arcelor			✓
Asian Paints	✓		
Ball			✓
BASF			✓
BHP Billiton	✓	✓	✓
BillerudKorsnas			✓
Canfor Corporation		✓	
Clariant			✓
CRH			✓
Croda International	✓	✓	✓
Dow Chemical		✓	
DSM			✓
Ecolab	✓	✓	✓
Elementis			✓
Ems-Chemie	✓		
Essentra			✓
Evonik Industries			✓
Ferrexpo			✓
Forterra			✓
Gerdau			✓

Source: Schroders, 31 December 2017

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Company	E	S	G
Glencore	✓		✓
Hexpol			✓
Ibstock			✓
Imerys			✓
Johnson Matthey		✓	✓
JSR	✓	✓	
K+S	✓		
KGHM Polska Miedz	✓		
Korea Zinc	✓		
Lenzing			✓
Linde			✓
Lonmin		✓	
Metsa Board			✓
Mitsuboshi Belting			✓
Norilsk Nickel	✓		
Norsk Hydro	✓		✓
Packaging America	✓	✓	
PETRONAS Chemicals			✓
Philips Lighting			✓
Pidilite Industries	✓		
Polyus	✓		
PotashCorp		✓	
Rayonier Advanced Materials	✓	✓	
Reliance Steel & Aluminum Co	✓		
Rio Tinto	✓	✓	✓
Sesa Goa	✓		
Sika			✓
Sinofert			✓
Smurfit Kappa			✓
Steel Dynamics	✓		
Symrise			✓
T & K Toka			✓
Thyssen Krupp			✓
Tosoh	✓	✓	

Company	E	S	G
Umicore			✓
Vicat			✓
Zotefoams			✓
Telecommunication Services			
AT&T		✓	
BT			✓
Cellnex Telecom			✓
China Mobile			✓
China Unicom	✓		
Com Hem			✓
Deutsche Telekom			✓
France Telecom			✓
Hellenic Telecommunications			✓
HKT Trust	✓		
Hrvatski Telekom			✓
Iliad			✓
Inmarsat		✓	✓
Intouch	✓		
INWIT			✓
KDDI			✓
KPN			✓
Mobistar			✓
Orange			✓
Qatar Telecom	✓		
Sistema			✓
Swisscom		✓	
Talktalk			✓
TDC			✓
Telecom Italia			✓
Telefonica			✓
Telefonica Brasil			✓
Telkom		✓	
Telkom Indonesia	✓		
T-Mobile		✓	

Source: Schroders, 31 December 2017

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Company	E	S	G
Turk Telecom			✓
Vodafone			✓
Utilities			
AEM			✓
Ameren	✓		
Beijing Datang Power	✓		
Centrica			✓
CGN	✓		
China Longyuan Power	✓		
China Resources Power	✓		
CLP	✓		
CMS Energy			✓
Dominion Resources	✓		
Drax			✓
Duke Energy	✓		
E.ON			✓
Edison International	✓		
Endesa			✓
Enel	✓		✓
Engie			✓
ENN Energy	✓		
EYDAP			✓
First Energy	✓		

Company	E	S	G
Fortum			✓
Gas Natural			✓
Hera			✓
Meralco	✓		
National Grid		✓	✓
National Thermal Power	✓		
NHPC	✓		
NW Natural		✓	
Pennon Group			✓
Perusahaan Gas			✓
PGE	✓		✓
Power Assets Holdings	✓		
Power Grid Corporation of India	✓		
Qatar Electricity & Water	✓		
Red Electrica			✓
RWE			✓
Severn Trent			✓
Southern Company	✓		
Tenaris			✓
United Utilities			✓
Veolia Environnement			✓
Westar Energy	✓		

Source: Schroders as at 31 December 2017.

Source: Schroders, 31 December 2017

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Our Sustainable Investment team profiles

Schroders has a long-serving and well-resourced Sustainable Investment team. It is comprised of ESG specialists who are responsible for analysis, engagement, voting and facilitating ESG integration into investment processes across teams and asset classes. We also employ a dedicated product and client resource.

Jessica Ground
Global Head of Stewardship

- Team head responsible for sustainability strategy and global corporate governance
- 20 years in investment.

Andrew Howard
Head of Sustainable Research

- Thought leadership and integration, climate change
- 20 years in investment.

Elly Irving
Sustainable Investment Analyst

- Consumer goods and services
- 10 years in investment.

Douglas Smith
Sustainable Investment Analyst (Graduate)

- Energy, financials
- 1 year in investment.

Seema Suchak
Sustainable Investment Analyst

- Healthcare and materials
- 14 years in investment.

Ovidiu Patrascu
Sustainable Investment Analyst

- Industrials and IT
- 6 years in investment.

Source: Schroders

The team provides ESG training to all existing and new investment analysts to ensure that all investment desks are aligned in their efforts to integrate ESG considerations into their analysis. The programme includes general ESG training as well as sector-specific and tailored training for individual investment teams. As a result of a collaborative effort with our ESG specialists, analysts and portfolio managers are also able to draw on a proprietary ESG guidance document which identifies the key ESG risks and opportunities, along with relevant data points and metrics, specific to more than 170 GICS[32] sub-industries. This ensures that our analysts and investors keep abreast of the latest ESG trends and how they can impact a company's valuation and risk profile.

32 Global Industry Classification Standard

Our specialists also produce regular multi-sector and multi-region thematic research (please see the "Insights" section on page 13 for examples). This research is published on our centralised research platform, presented at investment team meetings and is easily accessible to all of our analysts and portfolio managers across all investment teams.

Alex Monk
Sustainable Investment Analyst (Graduate)

- Utilities and telecommunications
- 1 year in investment.

Marc Hassler
Sustainable Investment Anlyst

- Climate change
- 1 year in investment.

Daniel Veazey
Corporate Governance Analyst

- Corporate Governance
- 16 years in investment.

Pippa O'Riley
Corporate Governance Analyst

- Corporate Governance
- 2 years in investment.

Sophie Keatley
Corporate Governance Analyst

- Corporate Governance
- 2 years in investment.

Belinda Gan
Associate Product Manager

- Reporting, client communications and product management
- 13 years in investment.

Source: Schroders

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