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The majority of fund managers spend most of their time *talking* about their buying discipline rather than discussing the ownership process, and how they exercised their stewardship responsibilities. However, we believe that actions speak louder than words so rather than just talking about it, we show exactly how we exercise our stewardship responsibilities by sharing actual insights from our engagement and voting activity. These demonstrate how sustainability is embedded in the lifecycle of our investments.

An obvious manifestation is how we vote at annual general meetings (AGMs). Our Swiss equity team has written up a case study based on the engagement and voting that they conducted at the AGM of one of their holdings, GAM. This activity was spearheaded by fund managers, and involved collaboration with competitors aimed at getting the best outcome for clients.

We also take you through the highlights from the 2017 UK AGM season to date, where much of the focus remains on pay. Corporate governance reform was high on Prime Minister May’s agenda when she took office and the 2017 season was a chance for investors to show how seriously they take their responsibilities in this area.

Another topic that has been in the headlines is corporate culture. We are delighted to share the insights from an event that we hosted on “culture the intangible.” This is a nebulous subject and the insights shared by accountants, the Banking Standards Board and other investors were helpful in defining what shareholders should be focusing on to assess the cultural health of their investments.

Moving onto research, our work on antimicrobial resistance in the food chain shows the implications for a number of sectors while our analysis of the tobacco industry yielded some surprising results. Because many of our clients exclude the sector on the basis of ethical, religious or individual preferences, the sector is often overlooked when it comes to engagement and risk assessment. We compare the tobacco industry to the consumer staples sector and find that in short, neither tobacco nor sugar are good for your health!

Finally, climate change remains a major focus for us. In July we published our latest tool, the Climate Progress Dashboard. The news isn’t good. Our calculations are based on a number of indicators from political commitments to electric vehicle and oil and gas output, and forecast a 4 degree rise in temperatures - double what scientists have forecast to be “safe.” We will publish more over the next quarter and update the dashboard on a regular basis. Look out for our latest climate change work [here on our website](#).
Carbon Value at Risk: how rising carbon prices could cut company profits

The extent to which company profits and investor returns could be at risk from tougher climate policies and higher carbon prices has been set out by a new model developed by Schroders.

The “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.

Percentage of earnings at risk from rising carbon costs

Source: Schroders and DataStream. 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 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.
The cost of drug-resistant infections is potentially huge. Leading economists estimate resistance could contribute to 10 million deaths per year at a cost of $100 trillion by 2050 if no action is taken.

Yet the food and drug industries and investors do not yet factor in fully the implications and opportunities.

With a growing number of bacteria able to survive in the presence of antibiotics, it becomes increasingly difficult for doctors to cure patients with infections. Antimicrobial resistance (AMR) has been accelerated by the misuse and overuse of antibiotics in humans and animals.

For instance, globally, 480,000 people develop multi-drug resistant tuberculosis each year, and in 2016, news broke that bacteria were developing resistance to colistin, a ‘last-resort’ antibiotic.

AMR could fundamentally undermine the value of industries tied to conventional antimicrobials as lawmakers crack down on their excessive use and availability. Here, we briefly look at the implications for the healthcare and food industries and highlight potential risks and opportunities.

While the healthcare sector has not borne the blame for antibiotic resistance, this sector is the supplier of antibiotics for both human and animal use, and ultimately will face restrictions in how rapidly this product area can grow.

Even though access to antibiotics is growing in developing markets, indicating higher volumes, we believe this growth will be restricted, and the costs heavily controlled.

We find that incumbent manufacturers of antibiotics – particularly those that supply the farming industry – will face the biggest obstacles.

On the opportunity side, innovative drug companies could reap imminent financial rewards for inventing new classes of antibiotics - already scientifically challenging - but will likely face stricter marketing restrictions.

We see the greatest opportunities for companies providing either alternatives to antimicrobials (such as vaccines and probiotics) or peripheral services (such as diagnostic testing for infections, and cleaning services - given the role hygiene plays in spreading infection).
Sector implications: food industry

A large body of academic research highlights the farming and food industries’ roles in the AMR challenge, the increased regulatory pressure and heightened scrutiny from consumers will have an impact on company policy.

Those most likely to be affected include food producers that are reliant on antibiotics to control infection, as they could face additional costs to upgrade farming practices.

Companies providing additives to animal feed will be well placed to benefit however, as they take the opportunity to innovate and expand nutrients to reduce the reliance on antibiotics.

Retailers and restaurants are also being affected by rising consumer awareness and many are already strengthening supply chain policies restricting the use of antibiotics.

How Schroders is engaging on antibiotic stewardship

Given the substantial cross-industry investment impacts we have identified, we have sought to understand how companies are approaching and managing AMR risks and opportunities, and encouraging further data disclosure that will enable us to value the impacts in our models. This is vital: the resistance threat is not yet on corporate risk radars for 70% of the 10 companies with the largest US antibiotic sales.

Our engagement questions for healthcare companies centre on:

- Product areas affected by the AMR trend
- Sales, marketing and pricing disruptions
- Approach to R&D
- In-house knowledge of the latest policy developments
- Impact of the O’Neill review on risk discussions
- Assessment of the collateral impact of AMR on demand for other therapies, devices or treatments which are dependent on antibiotics

We have also supported collaborative engagement initiatives aimed at food companies in the antibiotic supply chain, led by non-profit programme Business Benchmark on Farm Animal Welfare (BBFAW).

Resolutions filed by shareholders on AMR have also started to creep into food company AGM ballots this year. The resolutions request timeframes be set on removing non-therapeutic use of antibiotics in meat supply chains.

We supported the resolution filed at Sanderson Farms but voted against at McDonald’s given the company is already committed to phasing out antibiotics.
Stakeholder analysis: Smoking or obesity – which poses the greatest investment risk?

Tobacco industry: exclusion versus ESG integration

When discussing the tobacco sector within the context of sustainable investing, it is often in reference to clients’ preference for excluding the sector from their investment portfolios (an investment approach termed “screening” or “exclusion”). This decision may be taken to align with a charity’s mission, or to reflect ethical, religious or individual preferences. Schroders’ 2016 Global Investor Survey showed that 18% of investors would consider selling out of stocks associated with tobacco or alcohol.

However, we believe it is important to take a closer look at the sector through an integration lens given the prevalence of tobacco firms in global benchmarks and positions held across a range of client portfolios. Rather than simply exclude these stocks, we assess ESG issues and engage with tobacco companies on behalf of our clients that hold tobacco stocks in their portfolios.

Stakeholder analysis: surprising results

Using a stakeholder approach, we quantified a broad range of issues related to each individual stakeholder group in the tobacco industry including regulators, suppliers, employees and customers. We did this relative to the broader consumer staples sector, which includes food producers, beverage manufacturers and food retailers. By assessing each of these we thought we may be able to further explain why tobacco companies are valued at a discount to their consumer staples peers (part of the discount can be attributed to the material lawsuits and strict regulation facing tobacco firms).

However, the results surprised us. When assessing both risk exposure and risk management across the two industries, we found that:

1. **Tobacco: better established risk management**

   Tobacco companies have more established risk management systems in place resulting from past challenges. For example, they pay higher tax rates, higher wages and have more robust supply chain management. A summary of our analysis opposite shows that the risk profile for consumer companies is changing and we do not believe they have the adequate systems in place to adapt to these increasing risk.

   ![The rising risk profile of consumer staples companies versus tobacco firms](chart)

   **Stakeholder issue** | **Trend** | **Tobacco risk profile** | **Consumer staples risk profile**
   --- | --- | --- | ---
   **Human capital** | Wages are higher for tobacco as attracting talent is a challenge, but consumer staples could face similar pressures | ![Increasing risk](icon) | ![Risk stable](icon)
   **Supply chain management** | Tobacco has more stable costs through greater supply chain visibility and lower risk of disruption. The opposite is true of consumer staples | ![Increasing risk](icon) | ![Risk stable](icon)
   **Product liability litigation** | Continued but declining risk for tobacco, but a possibility of further litigation. Emerging risk for consumer staples | ![Increasing risk](icon) | ![Risk stable](icon)
   **Tax rates** | Tax rate for consumer staples companies looks unsustainably low | ![Increasing risk](icon) | ![Risk stable](icon)
   **Governance** | Lack of diversity on tobacco boards | ![Risk stable](icon) | ![Decreasing risk](icon)
   **Bribery risks** | Risk to operating licences from potential fines for tobacco companies | ![Risk stable](icon) | ![Increasing risk](icon)

1 In 2013, the number of GMB members was increased from 3 to 7.

2 This was a voluntary consultative (non-binding) vote which effectively has no impact.

3 This was a binding vote. According to GAM’s articles of incorporation, the Board must now submit a new compensation proposal for approval at a subsequent extraordinary shareholders’ meeting, or at the next ordinary shareholders’ meeting.
2. Exploring the parallels: Big Food and Big Tobacco

The parallels between the two sectors and the risk that food companies could become as unloved as tobacco firms may imply greater risk for consumer companies going forward. The risk profile for tobacco companies is well understood and is more stable in comparison.

Current regulatory pressure is clearly greater for tobacco companies but as highlighted in the graph below, obesity is almost equal in its negative economic impact. The World Health Organisation (WHO) estimates that smoking has an annual economic impact of $2.1 trillion, and obesity is only slightly lower at $2 trillion, as demonstrated by the graphic below.

As discussed in our 2015 ESG thematic note, “Is Sugar turning Big Food into the next Big Tobacco?” we believe that regulation across the consumer staples sector will increase over the next few years. This will be partly driven by the healthcare concerns highlighted previously, but also by rising consumer awareness and scientific scrutiny. This is already evident with the introduction of additional sugar taxes in the UK, Spain and South Africa since 2015. Our research also highlighted the potential for tobacco-like litigation against food and beverage companies for their role in contributing to the increasing healthcare burden faced by governments.

ESG risks are priced into tobacco, but not consumer staples

While the tobacco sector continues to face material risks, our analysis suggests that these are stable and well understood by the market. Consumer staples companies, which may become the “next tobacco”, face rising risks. As active owners we will continue to monitor these trends and actively engage with companies across both industries.

**Estimated global social burden of smoking compared to obesity (2012)**

<table>
<thead>
<tr>
<th>Selected global social burdens</th>
<th>GDP, $ trillion</th>
<th>Share of global GDP %</th>
<th>Historical trend</th>
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<tbody>
<tr>
<td>Smoking</td>
<td>2.1</td>
<td>2.9</td>
<td></td>
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<tr>
<td>Armed violence, war, and terrorism</td>
<td>2.1</td>
<td>2.8</td>
<td></td>
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<tr>
<td>Obesity</td>
<td>2.0</td>
<td>2.8</td>
<td></td>
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<tr>
<td>Alcoholism</td>
<td>1.4</td>
<td>2.0</td>
<td></td>
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<tr>
<td>Illiteracy</td>
<td>1.3</td>
<td>1.7</td>
<td></td>
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<tr>
<td>Climate change</td>
<td>1.0</td>
<td>1.3</td>
<td></td>
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<tr>
<td>Outdoor air pollution</td>
<td>0.9</td>
<td>1.3</td>
<td></td>
</tr>
<tr>
<td>Drug use</td>
<td>0.7</td>
<td>1.0</td>
<td></td>
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<tr>
<td>Road accidents</td>
<td>0.7</td>
<td>1.0</td>
<td></td>
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<tr>
<td>Workplace risks</td>
<td>0.4</td>
<td>0.6</td>
<td></td>
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<tr>
<td>Household air pollution</td>
<td>0.4</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>Child and maternal undernutrition</td>
<td>0.3</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>Unsafe sex</td>
<td>0.3</td>
<td>0.4</td>
<td></td>
</tr>
<tr>
<td>Poor water and sanitation</td>
<td>0.1</td>
<td>0.1</td>
<td></td>
</tr>
</tbody>
</table>

Source: Overcoming obesity: An initial economic Analysis, McKinsey Global Institute, November 2014
As part of Governance Week 2017, Schroders organised an event on culture for female shareholders. The goal was to delve into the research, focus on tangible culture indicators, and come up with some practical strategies for engagement on the issue. We are grateful to the audience and to Aviva Investors, the Banking Standards Board, EY, the Financial Reporting Council (FRC), Morgan Stanley, Nuveen and Value Act who participated in the talks and panels for so generously sharing their insights.

Does culture really matter?
The evidence from shareholders was that culture is a key part of both financial analysis and engagement. Increasingly, an assessment of the cultural health of an organisation is explicitly made before investing. Investors can get “lost in spreadsheets” and fail to ask the right questions as to how numbers are being achieved. Examples were cited from the technology sector, where companies had pursued a growth agenda at all costs but have “crashed and burned.” Culture eats strategy for breakfast, and no sector is immune.

The focus is not on identifying a single right culture, but on establishing how culture is being used to help businesses achieve their objectives. The best companies identify the cultural shifts needed to help them achieve their goals and explicitly monitor them.

Furthermore, there is a difference between culture and values. Articulated values are often “bought” and look remarkably similar across companies. According to the Banking Standards Board’s 2016 survey, 81% of respondents agree that their firm’s values and purpose are meaningful to them as an individual. However, only 65% say there is no conflict between their firm’s stated values and how they do business. Investors clearly need to look behind the platitudes.

Can you measure culture?
Culture is most often measured by surveys. However, there was widespread agreement that the construction and framing of a firm’s own employee surveys can encourage positive answers and therefore lead to less-than-accurate results. In contrast, the Banking Standards Board’s survey consists of a mixture of 36 positive and negatively worded questions, to minimise bias. Other surveys ask for more spontaneous answers, mapping the words given against the firm’s aspirations.

It is important to have a meaningful framework to assess culture against; for example, mapping purpose, strategy and values to a cultural hierarchy to assess an overall contribution to society. Having established an ideal, it is then possible to assess an organisation’s health.

A firm’s culture is also a key input into any audit. Data analytics can be used to help identify areas of vulnerability, highlighting where deeper analysis is needed. This has the potential to shift audit priority away from a size to a risk focus.

We need to talk about culture
The CEO is still viewed as a key component of any firm’s culture and without unfettered access to the board room, an assessment of culture from the outside can therefore be difficult. However a number of practical suggestions were made, with the most important message being “ask and validate”.

- A diverse board is often a good sign. This does not necessarily have to be just in terms of gender or nationality, but in terms of diversity of experience, ethnicity and age.
- Board turnover, both high and low should be challenged.
- Is the CEO happy for other board members to meet with shareholders without him/her being present?
- What is on the board agenda?
- What are the Key Performance Indicators (KPIs)?
- Is there a well articulated succession plan and culture? Can the firm promote from within?
- Remuneration structures are insightful; the best incentivise people on firm performance first, team performance second and finally individual performance. And it isn’t just CEO pay - how are people incentivised throughout the organisation?
- Can management provide examples of a healthy culture, but also discuss things that have gone wrong and what was done about it?

Regulatory scrutiny coming
As well as becoming more important for investors, culture is on the regulatory radar too. Given the FRC’s pioneering work in the area, it could feature in upcoming revisions of the UK Corporate Governance and Stewardship Code. In the future investors may be asked to articulate the work that they have done in this area. Participants in the investment chain should also be willing to provide transparency on their own cultures and behaviours.

Trust then verify
Culture is a relatively new arrival on the governance agenda. However as this event demonstrated, it shows no signs of going away, especially now that regulators have the issue firmly in their sights. The anecdotal link between culture and performance has clearly been made and with the new tools under development we will have a more data-driven approach for the future. The united view of contributors was that a strong commitment from the top to a healthy culture, and a willingness to drive it down into the organisation, is essential. Investors need to be able to delve past things like employee surveys and mission statements to verify if this is really happening.
The Corporate Governance team at Schroders branded 2016 “The year of the shareholder revolt on pay”. 2017 was supposed to be uncomplicated. The UK government had released its Green Paper on corporate governance reform towards the end of 2016 and we had engaged with companies and remuneration consultants on the need to lower quantum. We believed that they’d received the message. We’ve now learnt this wasn’t necessarily the case.

**Large votes against pay**
We witnessed a significant percentage of “against” votes at some large companies this year.

**Large votes against remuneration resolutions**
- In the biggest vote against this year, Pearson’s investors rejected the pay report in which the CEO received a 20% pay rise.
- AstraZeneca suffered another shareholder revolt as the CEO’s compensation rose 68% to £13.4 million.
- Safestore pulled their initial remuneration resolution and presented a revised plan at an extraordinary general meeting (EGM), which just scraped through. This could see share awards worth up to 1.6% of the company’s market value.

**Behind the headlines**
Safestore’s move is part of a growing trend that has seen numerous companies withdrawing pay resolutions ahead of their annual general meetings (AGMs) following pressure from shareholders. The following plans were pulled by management prior to their AGM:
- Imperial Brands planned to increase the maximum bonus payable to the CEO by 100% to 450% of salary.
- Chemring’s new incentive plan was originally based on single year targets.
- Aveva’s Restricted Share Plan allowed directors to be granted share awards irrespective of performance.

Source - Company websites
**Director accountability**

Schroders is holding individuals more accountable than ever for poor governance practices. Since 2016 our policy has been to vote against the remuneration committee’s chair when there are repeated pay concerns. We executed this at:

- British American Tobacco
- AstraZeneca
- Standard Chartered
- Centrica

Of 410 UK meetings in 2017, Schroders voted against 53 directors at 34 companies. Although Schroders’ policy is to encourage board diversity, many of these negative votes were, unfortunately, against female directors. This is partly because over 40% of FTSE 350 remuneration chairpersons are currently women - a disproportionately high percentage considering the low percentage of women versus men on boards.

**Schroder votes against remuneration 2016 vs 2017**

Glimmers of hope

There have, however, been some signs of progress in 2016. For example, BP was dealt a blow as 60% of shareholders voted against its pay report. After extensive engagement with investors, the firm slashed the CEO’s pay package by around 40%. Quantum and complexity were both reduced and more than 97% of shareholders were in favour of the rejigged policy. We also saw an improvement in the banking sector. UK banks received universal approval of their revised pay plans, quantum was down and votes had over 95% approval rates.

A better way forward?

The one thing investors agree on is that the current pay structure is flawed and disliked. Restricted share awards have been proposed as an alternative to long-term incentives. These awards would not involve performance criteria, but executives would be motivated by a long-term increase in the company’s share price. The majority of companies we met with had discussed alternatives at board level but still appear to support conventional long-term incentives.

That said, one of the companies we met with, Pets at Home, received 85% support for their proposed alternative incentive plan. Their approach was down to simplicity.

- The maximum potential of earnings was halved from 150% of salary to 75%.
- Insertion of a financial underpin with zero shares vesting in the event of negative total shareholder return (TSR)
- Staggered vesting over three to five years
- The incentive plan is subject to both Malus and Clawback clauses

More work to do on pay

With some large votes against pay reports and policies, investors are signalling that companies have more work to do on pay. Furthermore, shareholders are holding boards and individual directors more accountable for pay. It appears long-term incentive plans aren’t going away. Although we are likely to see more and more companies discuss alternative incentive plans, the majority of pay policies are locked in for three years, so there will not be overnight change. 2018 may be just as interesting.
When GAM Holding (GAM), a mid-sized Swiss asset manager with a history dating back to 1983, released its 2016 annual report, our local equity team in Zurich promptly picked up on the issue of executive compensation. A thorough review of GAM’s pay practices against history and peers revealed major concerns:

- **Pay for performance**: Despite poor performance, compensation was growing:

  | Growth in underlying profit before taxes |
  | 5 Years | 3 Years | 1 Year |
  | -43.9%  | -48.5%  | -39.3% |

  | Group Management Board (GMB) compensation growth¹ |
  | 5 Years | 3 Years | 1 Year |
  | 248.6%  | 10.7%   | 7.1%   |

  | CEO compensation growth |
  | 5 Years | 3 Years | 1 Year |
  | 156.5%  | 71.5%   | 22.8%  |

- **Excessive transfer of wealth**: Total compensation for the GMB stood at 15% of underlying profit before taxes and 1% of market cap, which we deem excessive irrespective of industry or company size. It was also more than double what we observed at peers, and the highest level in GAM’s own history.

- **Poor communication**: Tables and comments in the 2016 annual report and a pre-AGM (annual general meeting) presentation appeared misleading to us, particularly given the exclusion of long-term incentives (LTIP) from total compensation. The comparison with previous years’ figures was not properly adjusted to reflect prior one-off payments to management.

Under Swiss law shareholders vote on a series of resolutions around pay at an AGM. Our fiduciary duty towards our clients, the ultimate shareholders of GAM, demanded that we take action. We met with company management twice to voice our concerns. Unfortunately, the company did not change the 2017 AGM agenda, although the chief executive officer made voluntary concessions regarding his remuneration for 2017.

### Collaborative engagement

Together with Schroders’ sustainability team we contacted other GAM shareholders to share our analysis and concerns, which resulted in constructive conversations with other shareholders around the world. We also raised these with ISS, the proxy voting advisor.

Our efforts seem to have contributed to the voting results at the 2017 AGM:

- The 2016 compensation report was strongly rejected, with only 17.6% of votes in its favour.³
- The 2017 GMB variable pay proposal was overwhelmingly dismissed, with a meagre 7.1% support.⁴
- The chairman of the compensation committee was not re-elected to this position.

Both proxy voting specialists ISS and Glass Lewis suggested voting against compensation, which played a significant role in the above results.

We are often asked by our clients about collective engagement, and this case shows how collaboration and knowledge sharing can play a powerful part in supporting shareholder rights.

### Engaging to protect the interests of our clients

Since the AGM the company has approached us and other shareholders to conduct a full review of pay practices at GAM. We view this as a very positive step. In early June, we met with the newly elected chairman and a new member of the compensation committee to share our views not only on remuneration and other governance aspects, but also on capital allocation, target setting and cost culture. At the time of writing, our engagement is ongoing and we aim to better align strategy and management with the interests of long-term shareholders.

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³ In 2013, the number of GMB members was increased from 3 to 7.

⁴ This was a binding vote. According to GAM’s articles of incorporation, the Board must now submit a new compensation proposal for approval at a subsequent extraordinary shareholders’ meeting, or at the next ordinary shareholders’ meeting.
### Total company engagement

Our ESG team had 683 engagements this quarter with the 619 companies listed below, on a broad range of topics categorised under “environmental”, “social” and “governance”. They included one-to-one meetings, joint investor meetings, conferences, teleconferences, written correspondence and collaborative engagements.

For further details about the issues discussed and company responses, please contact your Client Director.

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The companies and sectors mentioned herein are for illustrative purposes only and are not to be considered a recommendation to buy or sell.
## Third quarter 2017

**Total company engagement (continued)**

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The companies and sectors mentioned herein are for illustrative purposes only and are not to be considered a recommendation to buy or sell.
### Third quarter 2017

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<td>AEM Torino</td>
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<td>ATHEN WATER SUPPLY</td>
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<td>Beijing Datang Power</td>
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<td>Centrica</td>
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<td>CGN Power Co</td>
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<td>China Longyuan Power</td>
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<td>China Resources Power</td>
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<td>E.ON</td>
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<td>Edison International</td>
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<td>Enel Americas</td>
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</table>
## Third quarter 2017

### Total company engagement (continued)

<table>
<thead>
<tr>
<th>Company</th>
<th>E</th>
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<tbody>
<tr>
<td>Enel Chile</td>
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<td>First Energy Corp</td>
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<td>Fortum</td>
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<td>Gas Natural</td>
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<td>Hera</td>
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<tr>
<td>IN National Thermal Power</td>
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<tr>
<td>Meralco</td>
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<tr>
<td>National Grid</td>
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<td>NHPC</td>
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<tr>
<td>Pennon Group</td>
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<td>PGE</td>
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<td>Power Assets Holdings</td>
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<td>Power Grid Corporation of India</td>
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<tr>
<td>Qatar Electricity &amp; Water Co</td>
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<tr>
<td>RWE</td>
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<td>Severn Trent</td>
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<tr>
<td>Southern Co</td>
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<tr>
<td>United Utilities</td>
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<tr>
<td>Veolia Environnement</td>
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<tr>
<td>Westar Energy Inc</td>
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</tr>
</tbody>
</table>

**Key**

- **E** – Environment
- **S** – Social
- **G** – Governance

*Source: Schroders as at 30 September 2017.*

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The companies and sectors mentioned herein are for illustrative purposes only and are not to be considered a recommendation to buy or sell.
Third quarter 2017

Engagement in numbers

Regional engagement

<table>
<thead>
<tr>
<th>Region</th>
<th>Engagement Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>209</td>
</tr>
<tr>
<td>North America</td>
<td>72</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>97</td>
</tr>
<tr>
<td>Europe (ex-UK)</td>
<td>289</td>
</tr>
<tr>
<td>Middle East and Africa</td>
<td>7</td>
</tr>
<tr>
<td>Latin America</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: Schroders as at 30 September 2017.

Engagement type

- Collaborative engagement (e.g. joint investor letter) 11%
- One-to-one meeting 1%
- One to one call 1%
- Other (e.g. letter) 85%

Source: Schroders as at 30 September 2017.

Engagement by sector

- Consumer Discretionary 19%
- Information Technology 15%
- Consumer Staples 7%
- Materials 8%
- Energy 7%
- Real Estate 17%
- Financials 7%
- Telecommunication Services 5%
- Health Care 1%
- Utilities 1%
- Industrials 1%

Source: Schroders as at 30 September 2017.
We believe we have a responsibility to exercise our voting rights. We therefore evaluate voting issues on our investments and vote on them in line with our fiduciary responsibilities to clients. We vote on all resolutions unless we are restricted from doing so (e.g. as a result of shareblocking).

This quarter we voted on 486 companies and approximately 96% of all our holdings. We voted on 14 ESG-related shareholder resolutions, voting with management on 12.

The charts below provide a breakdown of our voting activity from this quarter. Our UK voting decisions are all available on our website at www.schroders.com/responsibleinvestment under ‘Voting’.
This section reviews any progress on suggestions for change we made a year ago, in this case the third quarter of 2016. There are four possible results: “Achieved”, “Almost”, “Some Change” and “No Change”. Of a total number of 80 “change facilitation” requests made, we recorded 22 as Achieved, 5 as Almost, 6 as Some Change and 47 as No Change.

<table>
<thead>
<tr>
<th>Company</th>
<th>Suggestion for change</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Consumer Discretionary</strong></td>
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</tbody>
</table>
| Berkeley Group       | Asked for more transparency around how the company is working towards its “net biodiversity gain” target. | Achieved – The latest annual report provides more detail about the company’s net biodiversity gain target and the progress made to date. For example, building in an ecology assessment to all pre-planning for new developments, commitments to install living roofs on all new apartment developments, rainwater harvesting and green infrastructure.  
Achieved – The company has published a commitment to have a net biodiversity gain on all new developments. |
| Burberry Group       | Asked the company again to provide Key Performance Indicators (KPIs) for Human Capital Management (HCM). | Some Change – The company has started to provide more HCM disclosure on its website. It reports on some HCM data including diversity and employee training but has not yet developed any KPIs. |
| Taylor Wimpey        | Asked company to build on the 2016 target of “reviewing biodiversity practices and focus on green infrastructure” to provide more granularity and measurable outcomes. | Achieved – The company’s 2016 Sustainability report provides evidence of an increased focus on biodiversity. The company provides examples of working alongside the Wildlife Trust on development level projects to creating a group-wide Guide to Green Infrastructure, which will be launched later in 2017. The company also provides more disclosure about how it manages potential impacts on biodiversity during the construction process through a Site Specific Environmental Action Plan. 
Achieved – The company now provides more disclosure around how it manages the potential impacts on biodiversity during the construction process, with a Site Specific Environmental Action Plan. |
|                      | Asked for a publicly available statement on company’s approach to avoiding, minimising, and mitigating the biodiversity impacts from construction activities |                                     |
|                      | Asked the company to provide more disclosure on how it manages environmental risk along the supply chain, specifically the risks around cotton. | Achieved – The CFO responded to our queries and provided more context on cotton sourcing. The company is aware of the environmental risks along the supply chain and has strategies in place to mitigate risks.  
The company’s 2016 CDP response provides more detail about managing climate-related risks across its procurement and logistics activities, including sourcing cotton. |
|                      | Asked the company whether it will take steps to ensure compliance with the UK Modern Slavery Act given the recent acquisition of UK shoe retailer, Office | Achieved – The company provided re-assurance that it has a committee in place to monitor all legislative compliance, including the Modern Slavery Act via the newly acquired Office UK business.  
The Office subsidiary now discloses a modern slavery statement on its website. |
<table>
<thead>
<tr>
<th>Company</th>
<th>Suggestion for change</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Truworth</td>
<td>Asked the company whether it assesses ESG issues as part of its supplier selection process.</td>
<td>Some Change – The company includes compliance to the supplier code of conduct for new existing suppliers and is expanding this to new suppliers. The latest annual report acknowledges the need to integrate the company’s supplier code of conduct into the supplier selection process.</td>
</tr>
<tr>
<td></td>
<td>Asked the company to explain how it communicates and monitors compliance with its supplier code of conduct.</td>
<td>Some Change – The company is developing new systems to monitor compliance as it does not currently conduct supplier audits. However it does have quality control staff in supplier factories who can report code breaches.</td>
</tr>
<tr>
<td></td>
<td>Asked the company to disclose carbon emission targets.</td>
<td>Achieved – The latest annual report shows that the company has introduced a 5% annual CO2 reduction target against a 2014 base line and is looking to set a longer term target in future.</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td></td>
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</tr>
<tr>
<td>Coca Cola</td>
<td>Asked for the company to report on its progress against commitments made to the World Health Organisation.</td>
<td>Achieved – The 2016 Sustainability report and disclosure on the website does provide more detail about sugar reductions in reference to the WHO target, responsible marketing, funding scientific research and product labelling.</td>
</tr>
<tr>
<td>Imperial Tobacco</td>
<td>Asked the company to provide more context on its supply chain disclosure explaining its indirect sourcing strategy.</td>
<td>Achieved – Partly driven by the Modern Slavery Act, the company now discloses much greater transparency on its supplier base and dependence on third party leaf suppliers and what standards apply to these suppliers. The company also provides more detail about its monitoring, training and performance review processes.</td>
</tr>
<tr>
<td></td>
<td>Asked for more disclosure around deforestation risk.</td>
<td>Achieved – In 2017 the company responded to the CDP Forest survey for the first time.</td>
</tr>
<tr>
<td>Tesco</td>
<td>Asked for health and nutrition performance stats to better understand the company’s progress on sugar reduction and product reformulation.</td>
<td>Achieved – In 2017 the company responded to the CDP Forest survey for the first time.</td>
</tr>
<tr>
<td>Energy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LUKOIL</td>
<td>Requested Health and Safety and process safety performance data.</td>
<td>Achieved – Lukoil reports data on injury rates and share of company employees working in harmful environments, both of which have been falling in recent years.</td>
</tr>
<tr>
<td></td>
<td>Requested more details on GHG emissions and targets.</td>
<td>Almost – Lukoil has been carrying out an assessment of GHG emissions of all production entities in Russia. This will now feed into CDP enhancing their carbon disclosure to them. The company reports specific air emissions (in terms of kg/ton of products produced/sold), broken down by sector (e.g. oil &amp; gas production, petrochemicals). The company, however, does not report GHG targets.</td>
</tr>
<tr>
<td>Wood Group</td>
<td>Asked for water management and performance data.</td>
<td>Almost – Wood Group submitted to CDP Water in 2016, as discussed in its 2016 Annual Report, to improve its sustainable water use. Because Wood Group’s disclosure to CDP Water in 2016 was its first year of doing so, its disclosure is not yet public, with the aim to develop its water strategy over the coming years.</td>
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<tr>
<td>Company</td>
<td>Suggestion for change</td>
<td>Result</td>
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<tr>
<td><strong>Financials</strong></td>
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<tr>
<td><strong>Admiral</strong></td>
<td>Asked for employee data disclosure</td>
<td>Achieved – Employee data is freely available in the company’s CSR report. Admiral has a team of over 100 learning and development professionals across the group, and 5,800 training slots were taken up by employees in 2016. The company also reports on gender diversity and staff satisfaction metrics.</td>
</tr>
<tr>
<td><strong>Assura</strong></td>
<td>Asked for more transparency and measurable targets regarding minimising and mitigating biodiversity and waste impacts</td>
<td>Some Change – Assura released a brief environmental policy in February 2017, which includes the commitment to reduce waste but did not mention biodiversity. The policy references annual environmental objectives and targets but does not go into further detail; disclosure of such targets would be a further step.</td>
</tr>
<tr>
<td><strong>Bank of America</strong></td>
<td>Asked for disclosure of customer complaints data</td>
<td>Some Change – The company discloses complaints data to the Consumer Financial Protection Bureau but there is no discussion of complaints management systems in place.</td>
</tr>
<tr>
<td></td>
<td>Requested transparency in systems to engage customers in difficulty</td>
<td>Almost – In late 2016, the company introduced the Spending &amp; Budgeting tool on mobile and online platforms; used by 600,000 users. Some initiatives to prevent excessive borrowing e.g. ‘Safe Balance Banking’ and debit card clients cannot overdraw at the point of sale. These are improvements but seem voluntary - there is no discussion of when the bank might step in, and there is no definition of customers in persistent debt.</td>
</tr>
<tr>
<td><strong>Citigroup</strong></td>
<td>Asked for details on financial consumer protection practices.</td>
<td>Almost – The company’s 2016 Citizenship Report includes a ‘Consumer and client protection’ section. In 2016, Citibank established a ‘Listening command centre’ that proactively identifies emerging issues through data analytics using social media, phone, chat and email; disclosing this data would be a further step. Annual training of the ‘Treating Customers Fairly (TCF)’ Program is compulsory for employees of the Global Consumer Bank, and over 119,000 employees completed this course in 2016. Whilst the report does not discuss the simplification of product ranges, Citibank launched personalised marketing videos in 2016 to improve consumers’ understanding of existing products; 89% of new customers and 83% of existing customers who responded to a survey said they better understood their card’s benefits as a result. More information and disclosure of responsible lending practices and management of customers in difficulty would be welcomed.</td>
</tr>
<tr>
<td><strong>Unicredit</strong></td>
<td>Asked company to improve disclosure on how environmental and social risk management is incorporated in the framework and impacts on business decisions.</td>
<td>Achieved – Unicredit have dramatically improved the way in which they present the environmental and social risks and drivers as part of their business model realisation. This is evidenced in their most recent integrated report.</td>
</tr>
<tr>
<td></td>
<td>Asked company what they are doing to improve the culture of compliance and sustainability.</td>
<td>Almost – The company now has an Integrity Charter, a Code of Conduct and a Code of Ethics. The Integrity Charter states ethical principles that should be observed, but does not discuss compliance mechanisms with this Charter, whilst the Code of Conduct aims to promote the firms compliance culture and commitment to sustainability.</td>
</tr>
</tbody>
</table>

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<table>
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<tr>
<th>Company</th>
<th>Suggestion for change</th>
<th>Result</th>
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</thead>
<tbody>
<tr>
<td><strong>Health Care</strong></td>
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</tr>
<tr>
<td>Celgene</td>
<td>Asked company to disclose results of employee survey.</td>
<td>Achieved – The company has disclosed the results of its employee survey, with a 95% response rate and good feedback overall.</td>
</tr>
<tr>
<td>ESSLOR</td>
<td>Asked company to disclose position on climate change and meeting 2 degree target.</td>
<td>Achieved – The company has renewed its commitment to decreasing emissions and has acknowledged both the Paris Agreement and also the impact that climate change can have along its value chain, and is addressing this through operational risk functions.</td>
</tr>
<tr>
<td><strong>Industrials</strong></td>
<td></td>
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</tr>
<tr>
<td>Cobham</td>
<td>Asked for more engagement with shareholders following recent poor performance.</td>
<td>Achieved – The company has been plagued by profit warnings, which have led to rights issues and dividend cuts. We engaged collectively with the Investor Forum asking the board to open up a dialogue with shareholders to explain how oversight historically operated. The board was initially reluctant to talk. However, there is now a new CEO, CFO and Chair in place. We are hopeful that this new leadership will adopt a better dialogue with its shareholders.</td>
</tr>
<tr>
<td>Rolls-Royce</td>
<td>Pushed for Total Shareholder Return (TSR) and cash flow to be considered in the metrics.</td>
<td>Achieved – 20% of the Long Term Incentive Plan will be based on Total Shareholder Return in 2017.</td>
</tr>
<tr>
<td>RPS</td>
<td>Asked for CEO succession planning to take place.</td>
<td>Some Change – The CEO will be retiring. Head-hunters have been appointed and the company has agreed a remuneration policy that will allow for a successor to be hired.</td>
</tr>
<tr>
<td></td>
<td>Asked for the appointment of new independent directors.</td>
<td>Achieved – A new Chairman has been appointed. We have met with him and are reassured.</td>
</tr>
<tr>
<td>Sig</td>
<td>Asked for a better articulation of the strategy from the management team.</td>
<td>Achieved – The CFO has been replaced.</td>
</tr>
<tr>
<td><strong>Materials</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GOLDCORP</td>
<td>Asked company to disclose information about management of Penasquito tailings leak.</td>
<td>Achieved – Goldcorp has addressed this issue in its latest sustainability report, with an emphasis on the ongoing remedial work and its commitment to safe tailings. We continue to monitor the effectiveness of its tailings management system.</td>
</tr>
<tr>
<td>Synthomer</td>
<td>The company consulted shareholders on proposed changes for its upcoming policy vote. We were not supportive of targets being kept at current levels or an increase in the proportion of earnings per share (EPS) with the company's continued focus being on M&amp;A opportunities. We wanted to see shareholding requirements pushed to 200% which is now common practice.</td>
<td>Achieved – Following shareholder consultation the company will be introducing bonus deferral, increasing the stretch of annual bonus targets and increasing shareholding guidelines to 200%. In addition, following our feedback the company will not be changing their LTIP measures for 2017.</td>
</tr>
</tbody>
</table>

Source: Schroders as at 30 September 2017.
## Third quarter 2017

### Engagement progress

We have also reviewed engagement progress with the following 26 companies that we engaged with in the third quarter of 2016, but where no progress has been made. We will continue to review progress periodically.

<table>
<thead>
<tr>
<th>Company</th>
<th>Engagement Issue</th>
<th>Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Informa</td>
<td>Acquisition of Penton Business Media Holdings</td>
<td>Consumer Discretionary</td>
</tr>
<tr>
<td>John Wiley</td>
<td>Paper sourcing KPIs</td>
<td>Consumer Discretionary</td>
</tr>
<tr>
<td>Associated British Foods</td>
<td>Suppliers</td>
<td>Consumer Staples</td>
</tr>
<tr>
<td>Hengan International</td>
<td>Paper sourcing policy</td>
<td>Consumer Staples</td>
</tr>
<tr>
<td>Imperial Tobacco</td>
<td>ESG materiality matrix</td>
<td>Consumer Staples</td>
</tr>
<tr>
<td>LUKOIL</td>
<td>Oil spill data</td>
<td>Energy</td>
</tr>
<tr>
<td>Statoil</td>
<td>Low carbon strategy</td>
<td>Energy</td>
</tr>
<tr>
<td>Wood Group</td>
<td>Environmental impacts in the supply chain, mitigating impacts on biodiversity,</td>
<td>Energy</td>
</tr>
<tr>
<td></td>
<td>waste management and performance data</td>
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<tr>
<td>Admiral Group</td>
<td>ESG and responsible investment management, data security management</td>
<td>Financials</td>
</tr>
<tr>
<td>Assura</td>
<td>Code of ethics, biodiversity management, employee data disclosure</td>
<td>Financials</td>
</tr>
<tr>
<td>Bank of America</td>
<td>Transparency in marketing and selling practices, simplification of financial</td>
<td>Financials</td>
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<tr>
<td></td>
<td>product range</td>
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<tr>
<td>ICAP</td>
<td>Framework for capital allocation</td>
<td>Financials</td>
</tr>
<tr>
<td>JP Morgan Chase</td>
<td>Financial consumer protection</td>
<td>Financials</td>
</tr>
<tr>
<td>Paragon</td>
<td>Responsible lending, code of ethics</td>
<td>Financials</td>
</tr>
<tr>
<td>US Bancorp</td>
<td>Financial consumer protection</td>
<td>Financials</td>
</tr>
<tr>
<td>Amgen</td>
<td>Product safety and quality standard, whistleblowing systems</td>
<td>Health Care</td>
</tr>
<tr>
<td>Celgene</td>
<td>Animal welfare</td>
<td>Health Care</td>
</tr>
<tr>
<td>ESSILOR</td>
<td>Whistleblowing details, employee data</td>
<td>Health Care</td>
</tr>
<tr>
<td>GlaxoSmithKline</td>
<td>Governance</td>
<td>Health Care</td>
</tr>
<tr>
<td>Teva</td>
<td>Emissions data and targets for air pollution, FDA warnings, inspection data</td>
<td>Health Care</td>
</tr>
<tr>
<td>De La Rue</td>
<td>Governance</td>
<td>Industrials</td>
</tr>
<tr>
<td>Galliford</td>
<td>Mitigation of water risk, biodiversity</td>
<td>Industrials</td>
</tr>
<tr>
<td>Speedy Hire</td>
<td>Governance</td>
<td>Industrials</td>
</tr>
<tr>
<td>FISERV</td>
<td>Supply chain and human rights, HCM programmes and policy, environmental</td>
<td>Information Technology</td>
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<td></td>
<td>management programmes</td>
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<tr>
<td>LyondellBasell</td>
<td>Carbon targets</td>
<td>Materials</td>
</tr>
<tr>
<td>South32</td>
<td>Process safety</td>
<td>Materials</td>
</tr>
</tbody>
</table>

Source: Schroders as at 30 September 2017.

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