WALTER SCOTT

BNY MELLON | INVESTMENT MANAGEMENT

ANNUAL ESG REPORT

2019—2020

FOREWORD

It is hard to overestimate the global impact of the Covid-19 pandemic. As investors in companies around the world we must judge how businesses have coped and responded to the myriad of challenges they have faced. Those judgements certainly rest on financial analysis but that is only part of our work. We have always believed that, over the long term, strong environmental and social credentials alongside sound governance go hand-in-hand with financial success. As long-term, 'buy and hold' investors we must research, debate and judge all material factors that either support or undermine a company's long-term investment case. This report aims to share what that means in practice through the day-to-day work of our Investment team.

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2020 has tested the resilience of corporate finances, operating practices and cultures. The particular pressures faced, or opportunities exposed, will vary company to company. Likewise, the most appropriate response or action will differ. Just as companies with strong balance sheets have the ability to look forward and invest rather than become stuck shoring up the present, so companies with strong leadership and well-founded cultures don't waste time wondering how to react, what to do or how to behave. We have seen those companies adapt and move forward, doing so without sacrificing environmental or social values. Through our ongoing engagement with companies around the world, we have been able to challenge them on their actions and determine whether those actions meet the standards that we demand.

The behaviour of many retailers and apparel brands has been one of the highest profile issues this year. Despite much talk of strong partnerships along the supply chain and well-audited practices, we have all read reports of factories in the major supply chain hubs in Bangladesh and Vietnam, amongst other markets, being left with completed garments that won't be paid for and cancelled orders. As the pandemic has placed a duty of care on employers to provide a safe working environment, we have seen apparel factories in the UK exposed for failing to provide that environment, as well as allegedly failing to meet required minimum pay levels. Unfortunately, none of this has come as a surprise to us given our research over several years into supply chain practices and standards. That work is summarised in this report. It will certainly continue.

Environmental concerns have also continued to grow in recognition and importance. Some might have expected environmental targets to take a back seat on the road to economic recovery. Instead, Covid-19 seems to have brought a collective awareness of the fragility of our world. The need to protect the environment is now felt more keenly than ever. Investing in the energy sector, we have long sought to identify the very best oil producers, with the strongest reserve profiles, most efficient techniques and with ongoing investment to limit the unavoidable environmental footprint. Similarly, we have invested in market-leading energy service companies delivering expertise and technology to improve both the financial and environmental costs of extraction and production. Where we should set the bar in terms of environmental cost has been an increasingly regular debate amongst the team and so, last year, we embarked on a project to reconsider our approach to measuring and assessing carbon costs and determining how we judge energy investments. In this report, we share those initial plans, and look forward to reporting back once we complete this work later in the year.

Proxy voting is another area that continues to grow in prominence. Just as we always recognised the importance of talking to companies, so we have always devoted significant time and attention to proxy votes. Here, an individual vote often gives only part of the story, with engagement prior to annual general meetings an important part of the Research team's job. Stewardship is multi-faceted. As stewards of our clients' capital, we believe that research, engagement and proxy voting cannot be separated and should be considered collectively. Responsibility for all aspects of rests in the hands of our Research team.

That responsibility and critical lens must, of course, also extend to how we work and operate as a business. ESG topics are regularly included in the Research team's ongoing training programme. We have also added formality to our ESG Group to ensure that the firm's research continues to evolve and that we effectively report on that work. An ESG @ WS group has also been established to challenge management and ensure the firm moves forward in reducing its environmental footprint whilst strengthening its social credentials and support. Our work to ensure that we attract and retain a diverse group of individuals, and offer an environment that reflects and supports that diversity, has also continued this year.

This annual review can only hope to give you a glimpse of our activities. This is never a job done, nor should it be. This is not a tick-box exercise. We have long recognised the importance of integrating ESG issues into our investment approach. That commitment is longstanding and as relevant and important as ever.

Best wishes,

Jane Henderson

Jane Henderson, Managing Director

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ABOUT US

RESPONSIBLE

We are entrusted to invest on behalf of our clients around the world over a long-term investment horizon. In that context, it is inconceivable that we would not invest in a responsible way, in every sense. We look for companies that meet our defined investment criteria. This places as much importance on management talent, operational efficiency, rigour and best practice, governance and culture as it does financial metrics.

CONSIDERED

With a long-term investment horizon and a highly considered, and reflective, investment process, we take time to consider every company on its merits. We spend a great deal of time determining material issues and assessing company actions and reports through that lens. We don't apply broad-brush rules or impose a myriad of exclusions. Instead, we collectively consider the context and make informed, and collective, judgements.

INQUISITIVE

Our research is multi-faceted. From desk-based research to engagement with management, visits to factories or shops, discussions with, and analysis of, suppliers or competitors, we must build a comprehensive picture of any company, and then challenge it.

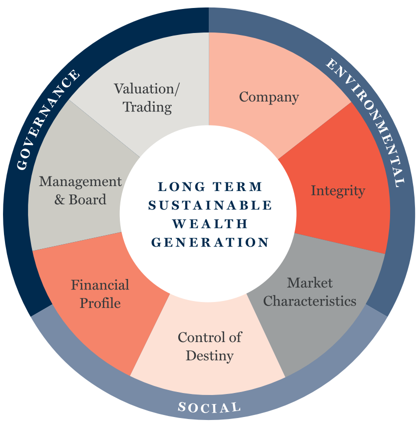
INTEGRATED

Every member of the Research team is responsible for understanding how companies' sustainability credentials stack up. There is no separate ESG team. This is deliberate. These factors are too important. They are integral to our investment analysis and decision-making, not an adjunct.

Consideration of the ESG opportunities and challenges relevant and material to any investment company must be integral to our research and decision-making. With our focus on 'bottom-up' research, our investment process is deliberately

"Consideration of the ESG opportunities and challenges relevant and material to any investment company must be integral to our research and decision-making."

structured to discard companies where ethical, governance, environmental or social standards are deemed to put the achievement of the long-term portfolio return targets at risk. In researching any company, regardless of geography or sector, we apply the same analytical framework. That framework forms an important part of the overall research process and is based on seven areas of investigation.



It may be appropriate to consider ESG factors across almost any aspect of a company's business and therefore all seven areas.

ENGAGED

Engagement is what we do every day. It might have a specific goal, but equally there need not be a discrete objective. We expect every company we invest in to engage on issues of sustainability. We focus on getting to know and understand every business and its industry in order to seek out the issues that matter most for the sustainability of those businesses and those industries. If a business is not well positioned, with our long-term investment horizon, it is un-investable. In this way, we take a bespoke approach for each company and industry in order to focus on the issues that matter most. We avoid box ticking; simply put, it wastes management teams' time, our time and does not fulfil our fiduciary duty to our clients.

"We focus on getting to know and understand every business and its industry in order to seek out the issues that matter most for the sustainability of those businesses and those industries."

ASSESSING ESG

THE CASE FOR INTEGRATED ESG INVESTMENT

We strongly believe that the integration of ESG factors applies to, and can add value at, all stages of our investment process. It not only helps us identify what to invest in and what to avoid, but it is also vital to our ongoing review of investments, and the stewardship and engagement activities we undertake with companies.

We believe that integrating ESG factors into our investment process benefits our clients' risk-adjusted returns in the following main ways:

—It allows us to identify companies with superior prospects, which stem, at least partially, from strong ESG credentials. This allows us to uncover and potentially invest in companies with better near-term and terminal growth prospects, if the price is right.

—It can help us avoid companies at risk from inferior ESG credentials. By owning a concentrated portfolio of ESG 'leaders' as opposed to a long list of names that includes 'laggards' we reduce exposure to fundamental risk.

—Companies with superior and improving ESG credentials (and therefore better fundamental opportunities and reduced risks) will, naturally, be afforded a lower cost of capital. This provides a supportive tailwind to shareholders' returns through rising multiples/falling discount rates. Given societal trends in consumption and investing, we consider this more likely to happen for companies with a strong ESG focus. Many of the consumer companies held in our portfolios exhibit elevated valuations relative to history, but we believe they also boast superior ESG credentials. Not only will this feed into better fundamental performance but, crucially, also support their multiples relative to their peer group. Conversely, our analysis can help us identify companies where the cost of capital is likely to increase due to inferior ESG factors. In the main, we have avoided stocks and whole sectors that many increasingly deem un-investable. While some of these companies have delivered strong fundamental performance, they have proved poor investments as the market's assessment of their ESG risks has fed into lower multiples.

FROM THE RESEARCH TEAM

One of the most important aspects of Walter Scott's research process is its consistent framework, applied over decades across all types of companies and market conditions. A framework that incorporates quantitative and qualitative factors, that focuses on materiality and that considers ESG factors alongside all others. That framework has led us to some of the most successful companies in the world. Companies with demonstrable success not only financially but also in environmental and social impact. We must scrutinise every company before it enters a portfolio. But the work does not stop there. We must continually monitor and test those companies. In doing so, we must consider evolving subjects and assess a company's performance against rising standards. We must determine how to judge complex and inconsistent data. When a company faces a particular challenge or when standards appear to be slipping, we must decide, how, and when, to engage, or to divest.

We hope that the examples that follow demonstrate our process and approach in action. We hope that these examples also show that issues and opportunities across the ESG spectrum aren't subjects that are casually picked up, researched and dropped. We welcome rising standards, just as we welcome more transparency. We hope that any new, negative issues within portfolio companies will be rare, but we recognise that our research must be ongoing and we must continue to challenge, consider and engage. We must trust the management teams of companies that we invest in. Indeed, we spend a great deal of time establishing that trust, which in turn is often the basis for effective dialogue and engagement.

EVIDENCING OUR APPROACH

We have selected three examples to demonstrate our approach to ESG research and consequent engagement. These examples seek to show what we mean by in-depth, and ongoing, research and considered engagement objectives. First, a project to consider carbon in its widest sense that began last year is an attempt to take stock, reassess existing views and past work, and set a path for future research. On a related subject, we are often asked how we set engagement objectives and measure engagement success. A summary of our recent engagement with CLP aims to answer that question, albeit as ever, the answer is one that demands both time and judgement. As a third example, retail supply chains have become a very contentious and high profile subject but our recent work is not a knee-jerk reaction to front-page news, instead it is part of ongoing research and dialogue dating back to 2013.

THE INVESTMENT PROCESS

ESG QUESTIONS & CONSIDERATIONS*

PROCEED

PROCEED

IDEAS

Does the company operate in an area where environmental and/or social impacts are often negative?

Is the company well-positioned to improve its environmental footprint, social impact and/or address any regulatory change?

Is there evidence of a healthy, supportive corporate culture?

Anything unusual in the ownership or governance structure?

Are the company's accounts qualified in any way?

IDEAS

TEAM DISCUSSION

RESEARCH

TEAM DISCUSSION

RESEARCH

TEAM DISCUSSION

DISCUSSION

We've heard the case for growth, but what are the risks to that case?

Are there identified weaknesses across E, S or G that might derail that growth?

What are the company's ESG priorities?

What is the day-to-day influence of the founder/majority shareholder?

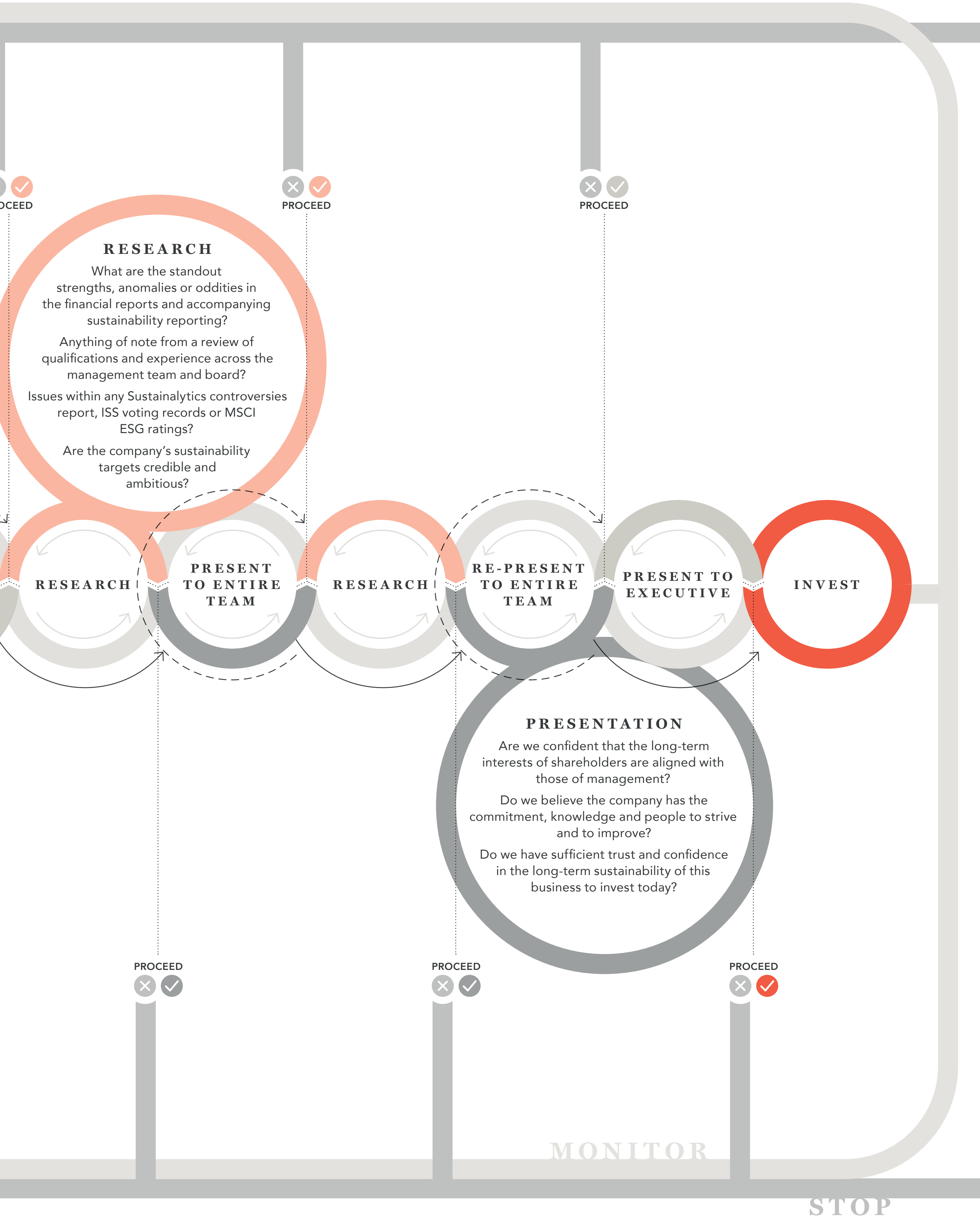
Has the company been forthcoming in providing information?

Can we meet the CEO?

PROCEED

PROCEED

PROCEED


PROCEED
PROCEED
PROCEED
RESEARCH
What are the standout strengths, anomalies or oddities in the financial reports and accompanying sustainability reporting?
Anything of note from a review of qualifications and experience across the management team and board?
Issues within any Sustainalytics controversies report, ISS voting records or MSCI ESG ratings?
Are the company's sustainability targets credible and ambitious?
RESEARCH
PRESENT TO ENTIRE TEAM
RESEARCH
RE-PRESENT TO ENTIRE TEAM
PRESENT TO EXECUTIVE
INVEST
PRESENTATION
Are we confident that the long-term interests of shareholders are aligned with those of management?
Do we believe the company has the commitment, knowledge and people to strive and to improve?
Do we have sufficient trust and confidence in the long-term sustainability of this business to invest today?
PROCEED
PROCEED
PROCEED
MONITOR
STOP

CONSIDERING CARBON

KEY QUESTIONS

—Can we distil and define our collective climate change beliefs?

—What is the appropriate strategy for our oil & gas investments?

—What is the appropriate strategy for our utility investments?

—What are the risks and opportunities for the portfolio more broadly?

—Are there more investment opportunities that we should be considering?

The need to consider the impact of fossil fuels is probably only eclipsed by the complexity in measuring that impact and comparing the multitude of targets the companies now set. It is easy to cast oil companies as villains and divest. But why divest in the very best oil companies that might be making impressive and innovative steps forward in both meeting the world's energy needs today whilst investing to meet those needs in the future in a much more environmentally appropriate way? Why punish an oil company but ignore a company in another sector where the environmental footprint is equally troubling? Does divestment risk driving ownership into the hands of unscrupulous investors?

Without exclusion lists or divestments comes the need to properly assess and judge company rhetoric and data. Company statements must be tested against others and against the available science. We must also understand future technologies and understand what is reasonable and realistic today, not what a company might aspire to do in an ill-defined way over a vague timescale.

To add to that complexity, this is a fast-changing field. There is an abundance of data and a range of scientific views. There have been significant technological steps forward. With that comes opportunities for established companies to do more and leapfrog their peers as well as new investment opportunities. Of course, this subject has been under our scrutiny and analytical watch for many years. So, in autumn of 2019, two members of the team decided to reconsider carbon and to begin a 12-18 month project to challenge our existing views, look at current academic and industry thinking, consider available and emerging technologies, and assess opportunities. This subject is not limited by geographical barriers, nor sector classifications. As generalists, the team are accustomed to looking across borders and sectors. In addition, the benefit of a team-based approach in tackling this kind of project is that it can be divided amongst the whole group. Reporting back, challenging ideas and sharing knowledge and research is what the team does every day.

PROJECT SCOPE

Whether a project or company analysis, our research incorporates a range of views and a variety of sources. Over the course of this project we are speaking to experts, attending conferences, visiting companies, reading a great deal, doing our own financial analysis to then discuss, and debate, all of that amongst the team. This project is no different. Below some of the activities within this project plan.

Academic insight – Early in the project we met with academics from Edinburgh University's Edinburgh Centre for Carbon Innovation. There have been consequent conversations with members of its faculty which will continue throughout this project, and beyond.

Emerging technologies – A member of the team attended the Web Summit conference in Lisbon in November 2019 to find out more about carbon storage technologies. Billed by Forbes magazine as the world's largest technology conferences, it brings together all those at the forefront of technological advance so a great starting point in assessing available and emerging technologies in this area. In February, attendance at the Sustainable Innovation Forum, which ran parallel to the UN COP25 summit in Madrid, offered another chance to hear from a range of voices on carbon reduction.

Other perspectives – Having met with Ørsted, the global leader in offshore wind farms and visited one of its facilities in Liverpool Bay, a member of the team also met with an RSPB (Royal Society for the Protection of Birds) conservation planner. The purpose of this meeting was to understand the persistently high-profile objections around offshore windfarms.

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RESEARCHING CLIMATE CHANGE

Reconsidering, researching and defining climate change analysis within the research process, assessing risks across industry, policy and technologies whilst looking for opportunities

PROJECT PLANNING
Defining project scope & structure

RECAPPING ON EXISTING RESEARCH
Initial information gathering

GREEN & SUSTAINABLE FINANCE EVENT
University of Edinburgh

WEB SUMMIT LIBSON
(Environmental technology track)

SUSTAINABLE INNOVATION FORUM
Madrid

2019

MEETING WITH ALFEN
The Netherlands

PRESENTATION INITIAL FINDINGS AND PROJECT PLAN TO ADDRESS 9 AREAS
1) Data & Science (2) Investment Risks (3) Power Generation (4) Transportation (5) Measurement & Target Setting (6) Corporate Progress (7) Geographical Differences (8) Game Changers (9) Other

PROJECTS ALLOCATED TO MEMBERS OF TEAM
(1) Oil Market Dynamics (2) Energy Generation (3) Carbon Pricing (4) Electric Vehicles (5) Nuclear (6) Circular Economy (7) Battery Storage (8) Hydrogen (9) Carbon Capture & Storage (10) Methane (11) Buildings

GUEST SPEAKER
Jamie Butterworth, Investment Manager, Circularity Capital & Former CEO, Ellen MacArthur Foundation

Expert · Engagement · Research · Site Visits · Discussion · Training

2020

CATCH-UP MEETING
Orsted, Global Leader in Construction & Operation of offshore windfarms

MEETING WITH AALBERTS INDUSTRIES
Technologies bringing energy efficiency to buildings & other industrial applications

TELEPHONE MEETING
RWE, offshore & onshore wind farms and amongst largest producer of renewable energy, globally

TELEPHONE MEETING
VP Hydrogen at Air Liquide & board member of World Hydrogen Council

PRESENTATION
Initial findings to team of projects to begin

REVIEW
Of all work to date and reassessment of project plan

POSSIBLE ALLOCATION OF ADDITIONAL PROJECTS
(1) Hard to abate emissions (2) Measurement & target setting (2) Best-in-class corporate progress (3) Gas/lng

PROJECT PRESENTATIONS
To research team and collective debate

CONCLUSIONS, RECOMMENDATIONS AND NEXT STEPS

Team effort – The initial list of subjects shared amongst the team included oil market dynamics, electricity generation, carbon pricing, electric vehicles, nuclear, battery storage, hydrogen, carbon capture and storage, methane, hard to abate emissions including air travel, steel, cement and gas/LNG.

WHAT NEXT?

This work will underpin our assessment of the risks and opportunities from climate change not only for energy companies but also across all sectors. That assessment will embrace technological development, the policy responses and attitudes of governments. We will use our findings to stress test all holdings, to identify weaknesses and opportunities. This work may lead to divestments. It may lead to new investments. It will almost certainly lead to new investment ideas. However, even if there is no evident activity, our analysis will have been strengthened. We will be alert to future red flags or opaque reporting as well as emerging technologies. Of course, whilst this particular project will have an end date, this work will not end. As climate change presents one of the most significant risks facing the world today, so it will present opportunity. Our task is to ensure we have the knowledge and the understanding to find that opportunity within much change, hyperbole and inevitable failure.

READING LIST*

Research note: On the Road – Talking ESG in Texas (2019)

Research Journal 10 *— Carbon Confusion:* Companies across multiple geographies and sectors are striving to reduce their carbon footprint and bold targets have become almost commonplace. But judging those targets and interpreting those efforts remains a challenge.

Research Journal 10 *— The Zeitz Way:* Jochen Zeitz, former CEO of PUMA, is an environmental trailblazer. He believes companies have a key role to play in the fight against global warming.

Research Journal 10 — On the Road, EOG & ESG, Des Armstrong, Investment Manager

Research Journal 9 *— Fossil Fuel Challenge:* The energy industry faces multiple challenges, amid rising demand and a growing need to find more sustainable alternatives to fossil fuels. We discuss the outlook for both traditional and new forms of energy.

Research Journal 9 *— Living the Dream:* The urgent need to address climate change tends to inspire fear, even panic. Dr Gabrielle Walker, a recognised expert on the topic, argues that a more positive approach is required.

Research Journal 4 — *A Crude Awakening:* Conflicting perspectives have raised confusion in investors' minds about their allocation to oil. Paul Loudon, Investment Analyst, and Alan Lander, Investment Manager, deliver the Walter Scott perspective.

Research Journal 2 — *Hit the Gas:* Aggregated supplies, more flexible contracts for customers and growing demand for gas-powered marine and road transport are radically altering the dynamic of the market for liquefied natural gas (LNG). Could we see the emergence of gas as a global commodity? If so, when? We ask Andrew Walker, BG Group's Vice President of Global LNG, and Walter Scott's Tom Miedema for their insights.

Research Journal 1 — *The Great Energy Debate:* Shale gas, which is extracted by hydraulic fracking, has helped transform the US's energy outlook, with the country set to become self-sufficient in natural gas by 2030, according to some experts. But the process – more commonly known as fracking – has become the subject of huge controversy. Bjorn Lomborg, author of The Skeptical Environmentalist, and Nick Molho, head of energy policy at conservation body WWF-UK, present both sides of the argument.

Research Journal 1 — The Furore behind Fracking, Des Armstrong, Investment Manager

Lecture Series 2019 — Presentation by Dr Gabrielle Walker, A Climate for Change

Investment Conference 2018 — Presentation by Bjorn Lomborg, How to Fix the World Smartly

Investment Conference 2018 — Presentation by Pierre-Etienne Franc, Vice President of Hydrogen Energy, Air Liquide

Investment Conference 2016 — Transcript of discussion between Mark Papa, former Chairman & CEO of EOG Resources and Bassam Fattouh, Director of the Oxford Institute for Energy Studies, The End of Fossil Fuels?

Canadian Investment Conference 2013 — Presentation by Dr Wenran Jiang, founding director of the China Institute at the University of Alberta, Power Shifts in the Global Energy Market

Investment Conference 2012 — Transcript of discussion between Mark Papa, then CEO of EOG Resources and Bjorn Lomborg, An Insatiable Appetite for Energy

**Please refer to page 47 regarding access to our research reports.*

ENGAGEMENT FOR CHANGE WITH CLP

Founded in Hong Kong in 1901, China Light & Power, now CLP Holdings, is primarily an electricity utility business in Hong Kong, serving over 2.4 million accounts. Earnings and cash flow from the core Hong Kong business help finance investments in overseas markets including China, Australia and India. CLP has become one of the world's most efficient utilities and the company's objective is to transfer its substantial expertise in its domestic market into long-term overseas investments. The Hong Kong government's plans to generate more "green" electricity also presents CLP with opportunities at home.

In 2007, the company issued its inaugural environmental plan and that plan has been tightened at numerous points subsequently. The targets have always been considered valid, and appropriate. More broadly, CLP has always shown a willingness to engage. However, as the bar of expectation around emission targets continues to rise, we felt that CLP could do more. Specifically, we felt the company could accelerate the disposal or decommission of its coal-fired assets. These assets have limited contribution to profits but are a significant contributor to the company's overall emissions.

In late 2019 we spoke to CLP about accelerating its decarbonisation strategy. We then outlined our views in writing and spoke with the company at length in March. During that call, management updated us on the latest iteration of its carbon emission reduction plan as it actively manages its portfolio towards zero or low-carbon technologies.

Management was keen to stress that CLP's decarbonisation targets have received very positive feedback from most stakeholders. The current plan tracks reasonably closely to science-based targets under a two-degree warming scenario. Management also stressed its commitment to science-based targets, which we applaud. Unlike other companies, CLP's targets are based on a detailed roadmap of investments and closure timetables for specific assets based on currently available technologies and costs. The plans are not contingent on unproven technologies or assumptions about lowered costs.

In regard to our particular area of concern, the company's coal assets, there had been tangible updates since our last formal conversation with management. Its portfolio of coal generation assets is under strategic review with a further announcement that there would be no new investments in coal projects. Instead, the company announced that its entire capex budget would be directed towards low or zero-carbon assets, across gas, nuclear, transmission and renewables.

Whilst these steps are encouraging any restructuring of its portfolio assets is complex and will take time to achieve. Management pointed to its commitment to make no further investment in coal fired assets, which meant the cancellation of a

"Unlike other companies, CLP's targets are based on a detailed roadmap of investments and closure timetables for specific assets based on currently available technologies and costs."

long-planned investment in Vietnam. With concern that this cancelled investment might negatively affect the company's relationship with the Vietnamese government, time was invested in discussing and agreeing a diplomatic exit and announcement. Those conversations took almost a year.

Whilst on one hand we would like to see more rapid action in disposing of these assets, we do also have a lot of sympathy with management's case. These are complex actions. Where it has coal assets, CLP is often a major employer with plant closures having a potentially devastating impact on local communities. Closure is also contingent on available, alternative power. Dialogue with management with CLP dates back to an initial investment in the 1980s and the company has met our expectations both financially and across ESG metrics and standards. Where we believe more can be done, in this instance environmentally, we have to decide whether the issue is of such materiality that we should divest or we should engage. If we decide to engage, we must then determine the most effective route. We might begin with a conversation, or a more formal letter laying out our case, which in turn can often form the basis for a more directed conversation in the future. We might consider a collaborative approach if we feel our direct, and discrete, engagement isn't working. Patience is often required, but if we have decided not to divest and to engage, we will often continue to engage, and prompt, over years.

In the case of CLP, we will continue to put the case for more rapid divestment and may well consider collaboration through organisations like Climate Action 100+ if we still feel a sense of urgency is lacking. A decarbonisation strategy is of course appropriate in and of itself, but the company's positive progress and investment in renewables is certainly being clouded by its coal-fired assets, which unavoidably impacts its ESG ratings and its acceptability to many investors.

However, this example also shows that engagement, and more particularly engagement objectives, rarely fits into a neat equation of asks and results. Perhaps, because of the rigours of our investment process, we won't invest in companies with egregious ESG practices or indeed, obvious, 'easy' wins on an ESG scorecard. With CLP, we have been discussing environmental issues with them for many years. So whilst our decision to formalise those environmental discussions and hold divestment of certain assets as our objective might seem a wasted effort at this juncture we take a longer term view. We continue to urge the company to divest of its coal assets and in doing so we will also continue to put forward our view that CLP has the opportunity to the lead the utility industry, particularly from an Asian perspective. We firmly believe that the company has the opportunity to accelerate its growth through decarbonisation, without dilution to returns of profitability, while doing the right thing for the planet.

GARMENT SUPPLY CHAIN RESEARCH

In 2018, an Oxfam report stated that on average it would take four days for the CEO of a major fashion retailer to make what a female garment worker in Bangladesh earns in her whole lifetime. We have all become accustomed to the all-too-frequent reports of scandalous conditions in factories producing garments for well-known retailers and brands. These reports have always stood at odds with slick public relations efforts as well as often-categorical denials of inappropriate practices anywhere in the supply chain. We had considered this subject but back in 2013, we met Rosey Hurst, founder of ethical trade consultancy, Impactt and decided to look into this area in more depth. The work has been ongoing ever since.

Child labour was a subject we had spoken to a number of global retailers about prior to meeting Ms Hurst. Bluntly, she told us, that any global retailer that said they didn't use child labour anywhere in their supply chain was lying, as simply, there was no way they could say that with categorical certainty. Those remarks led us to both question our approach to engagement on this subject, and others, and left us keen to understand how we might form our own views to incorporate in our company research and guide our engagement.
In 2014, a member of the team joined Impactt on a research trip to Bangladesh and Myanmar to visit garment factories contracted by global brands and retail chains, to meet factory owners, trade unions and workers. That same investment manager returned to Bangladesh in late 2019 to again visit factories and meet trade representatives and workers to discuss change and progress. These conversations then feed into future conversations with the management of investments in retail and apparel brands.

Specifically, that recent trip was a reminder that audits are far from straightforward. Audits have become the default answer on questions around conditions at the end of the supply chain. We heard from factory owners trying to absorb the costs of audit findings whilst also speaking to the representatives of global retailers, in this instance, in Bangladesh and Vietnam responsible for these audits. Unsurprisingly perhaps, there are often a small number of auditors covering many factories often across numerous countries.

Contrary perhaps to glossy CSR brochures and the assurance of impressive-sounding audits, the Covid-19 pandemic has

"We heard from factory owners trying to absorb the costs of audit findings whilst also speaking to the representatives of global retailers, in this instance, in Bangladesh and Vietnam responsible for these audits."

reminded us of the perilous state of factory workers, with many global retailers refusing to take delivery of manufactured garments, and thereby refusing to pay as well as cancelling all future orders with no recompense whatsoever. There have been various initiatives to address this situation, including by Impactt, but those knee-jerk reactions stand in contrast to the claims of important and long-standing relationships with suppliers that we hear so often.

"Our investment approach leads us away from those who operate with questionable practices, propelled by insecure finances or excessively tight margins."

Covid-19 has also reminded us of questionable conditions in garment factories much closer to home. Again, this is a subject that we have looked into in the past. On return from Bangladesh and Vietnam in November, the team felt it was important to understand the difference between those factories and some closer to home. So in February this year, we visited one of Inditex's key suppliers in Portugal. We were assured and impressed by what we saw.

There have been other site visits and many conversations but our engagement with Inditex has been amongst the most constructive. In the wake of the Rana Plaza, Inditex took a lead in industry collaboration. Through our much more recent conversations with the company, we know it has tried to take a lead as Covid-19 puts such pressure on garment factories particularly in emerging markets.

Looking at the retail industry as a whole, there is still much to do. There are still retailers claiming to be on the path to 100% sustainable, which simply isn't possible. Our investment approach leads us away from those who operate with questionable practices, propelled by insecure finances or excessively tight margins. But we must continue to engage with the retailers and brands that meet our investment criteria to make sure they are demonstrating best practices today, and striving for improvement. We must have the knowledge and awareness to be alert to companies hiding behind questionable audits or making claims that just don't ring true. We hope to visit more factories in Europe to understand the economics and realities of those operations. We will continue to engage and continue to question all relevant management teams. Whilst we aren't investigative journalists or undercover operatives, we will continue to learn and listen so that through our engagement we can endeavour to ask the right questions and make some judgment on the veracity of the answers.

APPAREL DUE DILIGENCE

2013

POST RANA PLAZA DISASTER
Specific engagement with retail companies to understand their next steps, commitments to improved standards and more robust auditing

MEETING WITH ROSEY HURST, FOUNDER OF IMPACTT
EDINBURGH

MEETING WITH ROSEY HURST
HONG KONG

2014

IMPACTT INDUSTRY CONFERENCE LONDON
Restarting Ethical Trade

RESEARCH TRIP TO BANGLADESH AND MYANMAR
Visit factories and meet with factory owners, industry bodies and workers

2016

MEETING WITH ROSEY HURST, FOUNDER OF IMPACTT
EDINBURGH

Expert Engagement Research Site Visits Conference

2018

RESEARCH TRIP TO CHINA
Factory visit that supplies TJX amongst other global retailers

2019

RESEARCH TRIP TO FRANCE
Visit to a LVMH prototype workshop and a luggage workshop/factory

RESEARCH TRIP TO VIETNAM AND BANGLADESH

SOUTH EAST ASIA MEETING
Meeting with Head of Sustainability at Adidas focused on sourcing in South East Asia

2020

RESEARCH TRIP TO PORTUGAL
Research trip to apparel factory in Portugal, meeting management of factory, which is an important part of Inditex's supply chain

CALL WITH ROSEY HURST
Call regarding impact of Covid-19 restrictions on retailing in Europe and US, in turn on garment factories in Asia

CALL WITH ROSEY HURST
Call regarding specific due diligence on Malaysian rubber gloves factories

ONGOING
Calls with retail and apparel brands to understand their actions and future plans regarding outsourced manufacturing suppliers, especially in emerging markets

READING LIST*

Research report and video from Research Trip to Vietnam and Bangladesh 2019

Research report from Research Trip to Bangladesh and Myanmar 2014

Research Journal 8 — *Forced Labour:* Forced labour is widely reviled, but it is both common and increasing

Research Journal 8 — *Not Paying by the Rules:* Talk of forced labour might conjure up images of squalid sweatshops in emerging nations. But instances of worker exploitation are increasingly common in the developed world. This trend has adverse implications for both companies and broader economic growth.

Research Journal 2 — *You can't buy respect:* Industrial disasters and the exposure to workers' rights abuses have led some of the world's biggest brands to increase their scrutiny of suppliers' labour practices. Rosey Hurst of Impactt says we need to stop measuring the problem and start solving it.

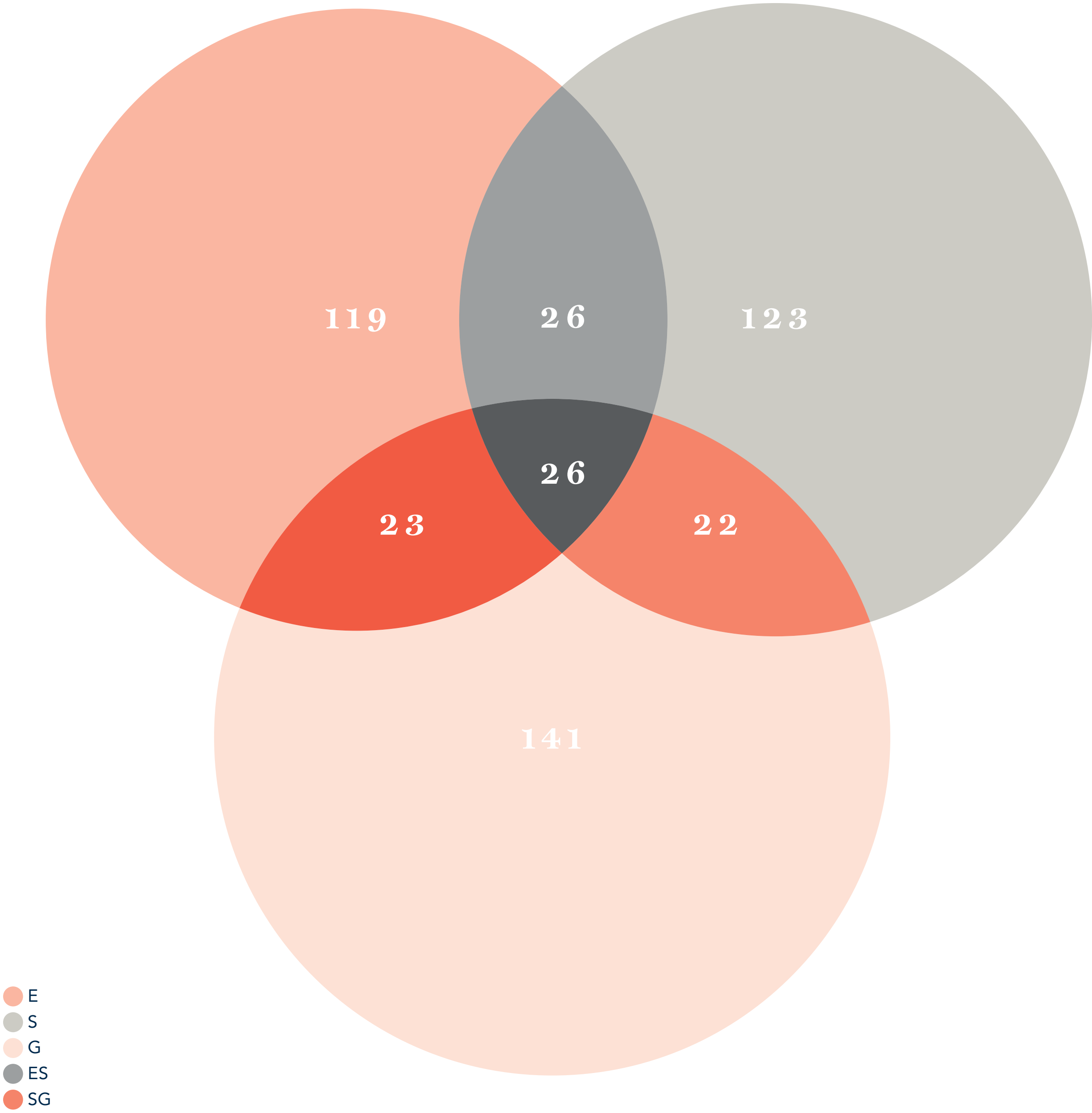
Investment Conference 2016 — Transcript of discussion with Rosey Hurst, Impactt

Lecture Series 2015 — Presentation by Alan Lander, Red Tape and Factory Standards

Please refer to page 47 regarding access to our research reports.

COMPANY MEETINGS*

383 conversations (12 months to 30 June 2020)



**383 conversations were had across meetings in Edinburgh, on research trips and on calls.*

ENGAGEMENT

Engagement and ongoing dialogue with companies has always been considered an important part of our investment approach. It is the Research team's responsibility to identify salient ESG issues, communicate with the company, monitor progress and outcomes and feed this back to the team.

We benefit from excellent access to company management teams and boards. We seek to use that to make better investment decisions but also, sometimes, to express our views on how best to create value sustainably over the long term. That often includes discussion of specific E, S or G agenda items. Those meetings are led by a member of the Research team, with other colleagues also in the attendance as befits our team approach.

We take a tailored approach to company engagement. We do not have a standardised starting point for engagement across sectors, geographies and capitalisations but typically, material issues or those that are a cause of concern to the team are prioritised. As decision-making is team-based, all members of the team are familiar with all stocks in the portfolio. Because of this familiarity, issues and questions are raised at Research team meetings (occurring three times weekly) and then form part of our regular discussions with management.

We meet at least 70% of the companies we own face-to-face at least once annually. We host companies at our offices in Edinburgh throughout the year as well as arranging research trips overseas. Additionally, regular calls and written correspondence augment these face-to-face meetings.

Regular dialogue with companies affords the opportunity to discuss events or concerns as they arise. Where there is a particular concern or where issues are particularly contentious or important, the team will often organise a separate call or meeting with the individual or team specifically responsible for that issue within the company in question.

The outcome of an engagement always influences an investment decision but not necessarily a change in position size. We take a holistic and collegiate approach to assessing companies' prospects, including their sustainability in light of ESG. More material issues and/or adverse engagements are more likely to trigger a sale than a minor issue with undertakings to change.

"Engagement objectives and therefore, their effectiveness, are not standardised, they are tailored to each individual company."

Engagement objectives and therefore, their effectiveness, are not standardised, they are tailored to each individual company. Goals are dependent on the materiality of the issue and our objective for the company in question. For example, the goals with a company that we do not invest in are more likely to involve information gathering and explaining why we do not invest today. For an existing investment, the objective may be to encourage a change in approach but, depending on the materiality of the issue, goals will be different. In meetings and through regular dialogue with companies, management teams are encouraged to disclose and discuss all notable risks facing the company and therefore with a potential impact on the investment rationale. Dialogue is centred upon the long-term direction, opportunities and challenges for a company. Given that ESG-related issues are typically also long term in nature, to a greater or lesser extent engagement or dialogue on these issues will form part of all meetings.

CALENDAR OF ENGAGEMENT

The extracts below represent just a small sample of the engagements undertaken by the Research team over the past 12 months. However, we hope they demonstrate the breadth of those conversations. The extracts are from the meeting notes circulated to all members of the investment team following any meeting or call.

"The extracts below represent just a small sample of the engagements undertaken by the Research team over the past 12 months."

Q2 2020

KONE

E S G

A call with KONE's CEO offered an encouraging reminder of the environmental health considerations now integral to the elevator and escalator manufacturer's offer. In conversation around the financial impact of Covid-19, the CEO spoke of encouraging progress in China as the country moves out of lockdown. More specifically, the company's recently launched health and well-being solutions are gaining traction, which bodes well for similar success in other markets. One solution is an air purifier operated without buttons that need to be touched, and therefore cleaned. Its DX elevator which was launched in November is also now well positioned. The system, which can be run digitally and 'hands-off', includes anti-microbial surfaces. KONE can also now retrofit older elevators to incorporate some of this highly pertinent functionality.

"Like so many companies, moves into remote communication and enabled devices have accelerated."

LVMH

E S **G**

In advance of the AGM of any holding, the Investment Operations team gathers a range of AGM-related papers and reports, flagging contentious or unclear issues for the stock champion to consider. If straightforward, the stock champion's voting recommendations are reviewed by a senior member of the team before being cast. In line with the firm's proxy voting policy and procedures, where there is any uncertainty or contention, senior members of the team, and relevant representatives from other teams, meet with the stock champion to agree on the best course of action. However, this does not mean that those AGMs that fall into the straightforward bucket don't involve research and engagement. Similarly, a vote 'for' by the stock champion doesn't always tell the full story. We raise areas of concern with management teams before voting. Sometimes the answer will be sufficient, on other occasions we will decide to give a management team 12 months to improve upon a particular are of concern.

A vote on board positions at the LVMH AGM in June was an example of the former. LVMH's board reports showed that non-executive director, Diego Della Valle, had attended only 67% of meetings, with no explanation for those absences. Whilst, clearly, we would not demand 100% by every member of the board 100% of the time, such a low attendance rate demands explanation before determined whether to vote for re-election. However, having engaged with the company, we were informed that some Board meetings last year relating to LVMH's proposed acquisition of Tiffany had in fact been called in on very short notice, which would have made it difficult for Mr Della Valle to attend. For the stock champion, this was an acceptable and warranted excuse removing any need to vote against board appointments this year. His attendance will however be monitored going forward.

NOVO NORDISK

E **S** G

The Research team had an upbeat call with Novo Nordisk's CFO. Amidst the Covid-19 pandemic, the business has proven its resilience and management have taken conscious steps to ensure that the company does the right thing in a societal context. Having not taken any financial assistance from the government and although its sales force has been grounded, the company has retained all its sales staff with pay in line with target sales. Novo's access programmes have also played an important public health role, especially in the US, demonstrating a commendable willingness to step up that will hopefully be remembered in time. Early signs in the US suggest an uptick in numbers accessing the programme for generic Novolog reflecting the obvious importance in patients accessing the insulin that they need. Engagement with patients has also changed. Like so many companies, moves into remote communication and enabled devices have accelerated. Patients can monitor blood glucose on their phone, and then store that data, allowing those patients to do more independently without the need for a medical professional at every stage.

Q1 2020

BOOKINGS HOLDINGS

E S G

Founded in 1998 as priceline.com, Booking Holdings is now the world's leading online travel agency. During an ESG-focused call with senior management in January, the general counsel conceded that, over much of its history, the company had not focused its attention on governance as much as it might have. The company's decentralised operating structure had meant that each brand was responsible for environmental and social issues with limited 'top-down' direction. That approach is however changing with the aim to maintain that localised approach whilst also ensuring more structure and more formalised reporting and metrics.

"The company's decentralised operating structure had meant that each brand was responsible for environmental and social issues with limited 'top-down' direction."

On social standards, the company has to balance many stakeholders: customers, suppliers (hotels), cities and municipalities (where its customers/tourists are going) and regulators. As with almost every global tech company, there has been unavoidable regulatory scrutiny in regards to competition, tax, data and privacy amongst other issues. By way of example, the UK Competition and Markets Authority has questioned some of the marketing tactics used. As a result, both Booking Holdings and Expedia made formal commitments to amend the criticised practices.

This call was an opportunity to discuss the company's approach to these types of issues and we were reassured by the sensible tone of that conversation. The difference between Booking's approach to the alternative accommodation market and that of AirBnB was highlighted. From Booking's standpoint, AirBnB has been far more combative with regulators and municipalities whereas Booking's approach has been to try to work within existing legislation and with government/regulators.

On the environment, historically the company has taken the stance that it is an asset-light business with a low direct carbon footprint. However, it was made clear in our discussions that Booking now recognises that it must take a much broader view and do more as a company. It has been scored poorly by MSCI and Sustainalytics on this area because of poor disclosure. This is a situation that the company will address. Booking is also focusing on important incremental initiatives like reducing energy demand in its offices as well as in its server farms. More broadly, management has also spent

"For us, this conversation was an important reminder of the value of our process, which requires stock champions to look beyond headline ratings and understand the material ESG risks and opportunities, which might enhance or detract from the rating given a particular rating agency."

more time thinking about the company's role within the wider travel ecosystem and in particular on the concept of "sustainable travel". Whilst Booking is not responsible for the environmental impact of suppliers/hoteliers, the company can at least try to encourage more sustainable activities potentially by rewarding such activities through prominence on the search page of booking.com. From our position, this was a reassuring call, although we will certainly continue to engage with the company to ensure that all these efforts are ongoing. Discussions around Booking's commitment to greater reporting on ESG metrics, helped by changes to its internal organisation, were also reassuring. More detailed reporting will be an important part of our work to judge maintained progress and improved standards..

EOG RESOURCES

E S G

In January, a call was arranged with EOG Resources' IR team to discuss the company's latest ESG rating from MSCI. In December 2019, the company's rating was increased from 'B' to 'BB' largely because of progress, in the eyes of MSCI, on governance. However, the business continues to be penalised because of its carbon emission profile.

Our impression was that MSCI's report, and rating, had not captured recent developments at the company, developments that had been shared at the company's ESG-focused investor day in October 2019, that we attended. As part of EOG's efforts to address ESG concerns, and better communicate those issues, the company published a detailed strategy demonstrating its intention to reduce its direct environmental footprint (GHG emissions, fresh water usage intensity) and summarising the numerous initiatives underway. This activity stands in contrast to a statement in the MSCI report that there is "limited evidence of efforts by EOG to reduce carbon emissions compared to peers".

For us, this conversation was an important reminder of the value of our process, which requires stock champions to look beyond headline ratings and understand the material ESG risks and opportunities, which might enhance or detract from the rating given a particular rating agency. Engagement with a company to hear its perspective is key in reaching our own independent view on ESG criteria and credentials.

L'ORÉAL

E S G

The CEO and CFO of L'Oréal visited Walter Scott's offices in early March. Whilst the conversation was unsurprisingly focused on the company's approach, and actions to date, to the growing Covid-19 crisis as well as the company's longer-term strategic direction and focus, time was also spent discussing ESG commitments.

Management was keen to remind us of that Chief Corporate Responsibility Officer Alexandra Palt had been appointed to the company's executive committee last year. That appointment recognised the importance of the role, a key part of which is to keep up the pressure on L'Oréal's executive to meet the extensive ESG targets set out to 2030.

In discussing those ESG commitments, they are justifiably proud of the fact that L'Oréal is the only company to have achieved Triple A scores under CDP for four years. The company proudly dates its ESG journey back to 2013, whilst also conceding there is much more to do, as reflected in its extensive 2030 targets.

For the team at Walter Scott, engagement takes many forms. We regularly speak to individuals within companies charged with implementing, planning or reporting on aspects of ESG. Those conversations are often very useful in understanding targets and initiatives, as well as challenging those commitments where they seem insufficiently demanding or opaque in terms of a quantifiable result. But, in a far more general sense, the importance attached to these issues by the most senior management is also noteworthy as we judge a company's commitment to ESG. Of course, most CEO and CFOs will have a well-rehearsed script, but meetings such as this one with L'Oréal give us the opportunity to probe those soundbites.

In a busy meeting such as this, some management teams might have tried to steer the conversation clear of ESG. In this case, we were reassured by the time taken, and more importantly the tone and conviction of the discussions.

RECKITT BENCKISER

E S G

A comprehensive call with the CEO and CFO of Reckitt Benckiser (RB) provided an update on the areas of greatest focus for the company as it invests today to secure future growth as well as a timely reminder on recent steps to better define and thereby strengthen its culture. CEO Laxman Narasimhan joined RB in September 2019. In February, he presented a company strategy now focused on four 'mega-trends': (1) urbanisation and global warming and the consequent need for improvements in hygiene (2) the pressure on government health programmes that is increasing the need for self-care (3) demographic shifts with growth in youth categories as well

"The company proudly dates its ESG journey back to 2013, whilst also conceding there is much more to do, as reflected in its extensive 2030 targets."

as those for aging consumers (4) sexual health and well-being which remains a key societal issue with over 1 million transmitted infections daily. Despite the strong trends underpinning that growth strategy, the company also recognised the need to redefine its culture to both ensure execution of that strategy and attract talent to the company. Mr Narasimhan admitted that the CFO Jeff Carr, who joined RB in April 2020, took some convincing. Having previously worked at RB, Mr Carr needed to be reassured that the company's 'do what is right' values were part of its culture. The company has recently rearticulated its culture with new values and behaviours set out for the business to do the right thing and put customers and people first. Mr Narasimhan explained that he sees RB's real strength as it's 'can do nature'. Unlike many bureaucratic large companies, RB is a 'do more, talk less' place in his view. He conceded there was more work to be done especially around rebuilding relationships with customers but that there had been "terrific" progress since September. For Mr Carr, his key focus is to balance delivery and performance by making the right long-term investments. Mr Narasimhan said that this clarity of direction and cultural confidence is certainly bearing fruit as he recruits to his management team. On that team, he also noted that whilst there is currently one woman on the executive commitment, at one level below, 55% of executives are female.

STARBUCKS

E S G

As we engage with companies ahead of AGM voting, shareholder proposals have become an increasingly prevalent topic of conversation. The shareholder proposal might seem sensible and appropriate, but often in discussion with the company we will learn more about the broader context and/or steps being taken by the company to address the particular issue in a different way. It is then for the team to consider the value in voting for the shareholder resolution when weighed up against the company's proposed actions. A vote at Starbucks' AGM in March was one such example. Following discussion with the company during a call ahead of the AGM, we decided to vote against a shareholder proposal to require a report on the risks of omitting viewpoint and ideology from the company's EEO (equal employment opportunity) policy. Whilst recognising the vital importance of equal employment opportunities in any workplace and the importance of reporting, we are also alert to the fact that more information and reporting doesn't necessarily provide greater value or clarity. As long as we are assured that the company is operating as it should, we will typically judge such proposals from a standpoint of pragmatism and reasonableness.

"Whilst recognising the vital importance of equal employment opportunities in any workplace and the importance of reporting, we are also alert to the fact that more information and reporting doesn't necessarily provide greater value or clarity."

Q4 2019

KEYENCE

E S G

We met with General Manager Kimura-san at Keyence's headquarters in Osaka in October 2019. We were updated on Keyence's long-term strategy for growth in international markets whilst also steering the conversation to corporate governance and balance-sheet efficiency. Following up on a series of letters we have sent Keyence explaining our reasons for voting against the proposed Allocation of Income at the company's AGM, we took this opportunity to reiterate our view that the company should increase its dividend pay-out ratio.

On governance, the company was keen to stress that it has spent more time considering the contents of Japan's Corporate Governance Code and is working on further improvements in disclosure. Not long after the meeting, we were pleased to see that the dividend pay-out ratio was effectively doubled by means of a 2 for 1 stock split.

> *"From a less practical and more philosophical, and cultural, perspective, the data principles are grounded in a belief that consumers own their data and therefore have the right to control it."*

MASTERCARD

E S G

MasterCard's CFO and IR visited us in Edinburgh in November 2019. The CFO gave a strong account of the business and explained how the core card opportunity remains significant. The holistic nature of MasterCard's service offering which includes, amongst other things, fraud detection, processing, loyalty programmes and marketing makes for a very powerful proposition in winning market share. Data is of course key to all of that, a subject that has become increasingly contentious and regulated. The CFO spent time explaining the company's data principles, which are a set of non-negotiable principles that guide everything the company does and stands for. To ensure safety and integrity of the network, MasterCard engages heavily with secret services and police departments worldwide. From a less practical and more philosophical, and cultural, perspective, the data principles are grounded in a belief that consumers own their data and therefore have the right to control it. In management's words, consumers should have the opportunity to benefit from it while it is the company's duty to protect it.

SIKA

E S G

Sika is a specialty chemicals company with leading positions in the development and production of systems and products for bonding, sealing, damping, reinforcing and protection in the construction, building and manufacturing industries.

Sustainability is central to the company's strategy with its long-term growth supported by four important trends. (1) urbanisation, which will demand larger, longer lasting, more complex buildings and infrastructure in mega cities (2) sustainability and sustainable products that allow a reduction in raw material consumption whilst also meeting the shift towards energy efficient buildings (3) mobility, as we progress towards lighter, more energy efficient vehicles, there will be a need for new materials (4) refurbishment and regulation leading to rising construction standards in terms of quality and safety in construction materials.

The company has a strong record in working towards environmental improvement and Sika used its capital markets day to announced changes to scope one and two emissions, with a commitment to reduce the CO_2 intensity per ton sold by 12% by 2023. Scope three emissions also present a material opportunity for improvement and the company was also clear that creation of products that reduce these emissions will also be a key strategic focus. One example cited was the creation of concrete admixtures that reduce the amount of concrete required for the same structural strength, and/or reduce the water consumption. Other products under development deal with the energy efficiency of buildings.

Q3 2019

ALIMENTATION COUCHE-TARD

E S **G**

A positive development at Alimentation Couche-Tard's AGM was the inclusion on the agenda of its first advisory say-on-pay proposal. Towards the end of 2018 we engaged with management regarding shareholder proposals at the 2018 AGM, one of which was an advisory vote on pay. We made it clear to Alimentation Couche-Tard that we consider an advisory vote on executive pay as a positive step. We decided to vote in line with management – against the shareholder proposal – on this occasion, but we made clear to the company that we would consider supporting any similar proposal in the future. in fact, this shareholder proposal was withdrawn prior to the 2018 AGM. We were pleased to see the addition of a say-on-pay resolution on the agenda for the 2019 AGM and voted 'for', in line with other investors as the item received 99% votes 'for'.

"A meeting with the CEO of Danish medical product company Ambu was a reminder of the judgements that are often required in balancing ESG risks and benefits."

AMBU

E **S** G

A meeting with the CEO of Danish medical product company Ambu was a reminder of the judgements that are often required in balancing ESG risks and benefits. Founded in 1937, the company has proven its innovative credentials across endoscopy, neurology, cardiology and airway management. The devices created

"Gilead has strong credentials in terms of social impact given the HIV products it produces. For a long time it has made its patented products available as licenced generics in various geographies – particularly Africa."

by the company bring efficiencies in cost and time, aid the doctor and ultimately help the patient. The company has also demonstrated strong financial success over time. However, its focus is on single-use devices, prompting obvious environmental concerns. Those concerns must be balanced against the reduced cost and improved patient care delivered.

The company's view is that for surgeons, single-use devices offer reduced contamination risk. For hospital purchasing boards and procurement departments, single-use devices are often cheaper than reusable systems where the total cost must be taken in account, including cleaning costs and lower levels of efficiency. Whilst acknowledging that the company has a growing responsibility to work with hospitals on waste management around these single-use produces, management also pointed to the environmental cost in cleaning reusable scopes due to the chemicals and CO_2 emissions required to clean them.

GILEAD

E S **G**

Gilead has strong credentials in terms of social impact given the HIV products it produces. For a long time it has made its patented products available as licenced generics in various geographies – particularly Africa. A meeting with the CEO provided an update on its operations whilst also giving the opportunity to discuss executive pay. In our view, the executive management remuneration policy is appropriately balanced in terms of its split between fixed annual awards and performance-based short and long-term incentives. However, we discussed whether revenue was the most appropriate P&L metric to incentivise, and we were encouraged to hear that this is something Gilead is actively discussing. We also mentioned our discomfort around the existence of preferred shares. Here, the response was perhaps less encouraging, in that the company put forward its view that they are a helpful defence against hostile takeovers and could potentially be useful currency in the event of acquisitions.

PROXY VOTING

We have always recognised our responsibility to not only vote but to consider those votes carefully. Proxy voting is a central tenet of our stewardship. Therefore, responsibility for proxy voting rests with the Research team rather than a separate corporate governance team.

"Walter Scott believes that the quality of a company's management is an important consideration in determining whether the company is a suitable investment."

Specifically, responsibility for voting a proxy falls to the member of the Research team that champions that investment (the 'stock champion'). This is typically the person who recommended the original investment and, with long holding periods, that stock champion will not only understand the company in depth but will have engaged with it over time and established constructive communication. The stock champion uses that accumulated knowledge, all the relevant proxy materials, as well as third-party research to determine how to vote. Very often, there will also be specific conversations with the company ahead of an AGM.

Throughout the proxy process, stock champions are supported and challenged by members of the Investment Operations team. This team collates materials, provides guidance, and highlights areas of potential concern. With knowledge of voting discussions and decisions across all holdings, the team offers a valuable perspective as well as technical knowledge. Final voting decisions are signed off by the stock champion and a Co-Head of Investment Operations, Investment Director or a nominated Senior Investment Manager.

When an agenda item potentially raises a conflict of interest or is otherwise controversial, a "sub-group" (including members from Research, Investment Operations and Risk & Compliance) is called to discuss the matter and to determine how to vote. From a governance standpoint, the Investment Management Committee (IMC), a subcommittee of the Walter Scott board, is notified of these meetings on a weekly basis and scrutinises these decisions in quarterly governance meetings.

Most of the time, votes are cast in line with management recommendations. As stated in the proxy voting policy: "Walter Scott believes that the quality of a company's management is an important consideration in determining whether the company is a suitable investment." However, the firm will vote against management or abstain if a proposal is not considered to be in the best interests of clients.

ENGAGEMENT AHEAD OF COMPANY AGMS

In addition to the more regular dialogue between the research team and company management, there is often specific engagement around proxy voting.

The firm's proxy voting policy guides decisions on items such as excessive dilution, political donations or unacceptably vague proposals. However, proxy voting must be more than a straightforward cross reference against a policy statement. Analysis and judgement are also required. Engagement is an important part of that information-gathering process. It also gives us the opportunity to understand the company's position and/or put forward our case for change or reconsideration.

Having listened to that case, and put our views forward, we might decide to vote with management on this occasion in effect giving them the opportunity to address the issue in the coming 12 months. Alternatively, we might decide to vote against. Where we vote against management on a contentious item we will usually ensure that the reason for the vote, and the underlying point of concern, is communicated directly to the company. A vote against management may also prompt a review of the investment.

"The firm's proxy voting policy guides decisions on items such as excessive dilution, political donations or unacceptably vague proposals."

Q3 2019

28

NO. OF MEETINGS

23

TOTAL VOTED AGMS

5

TOTAL VOTED SPECIAL MEETINGS

BASED ON ALL / VOTED MEETINGS	NO. OF VOTES	AS A % OF TOTAL PROPOSALS VOTED ON
Total all / voted proposals	317	100
Total votes against management recommendation	30	9.5
Total votes against ISS recommendation	36	11.4
Total proposals voted 'For'	281	88.6
Total proposals voted 'Abstain'	3	0.9
Total proposals voted 'Against'	32	10.1
Total proposals voted 'One Year'	1	0.3
Total proposals voted 'Withhold'	0	0

RATIONALE FOR VOTES AGAINST MANAGEMENT RECOMMENDATION	NO. OF VOTES
Political donations	4
Due to potential dilution >10%	21
Bundled resolutions	3
Corporate governance issues – member of compensation committee	2

Q4 2019

24

NO. OF MEETINGS

19

TOTAL VOTED AGMS

5

TOTAL VOTED SPECIAL MEETINGS

BASED ON ALL / VOTED MEETINGS	NO. OF VOTES	AS A % OF TOTAL PROPOSALS VOTED ON
Total all / voted proposals	234	100
Total votes against management recommendation	13	5.6
Total votes against ISS recommendation	29	12.4
Total proposals voted 'For'	215	91.9
Total proposals voted 'Abstain'	1	0.4
Total proposals voted 'Against'	17	7.3
Total proposals voted 'One Year'	1	0.4
Total proposals voted 'Withhold'	0	0.0

RATIONALE FOR VOTES AGAINST MANAGEMENT RECOMMENDATION	NO. OF VOTES
Political donations	1
Due to potential dilution >10%	9
Bundled resolutions	1
Corporate Governance Issue – excessive number of outside board appointments	2

Q1 2020

31

NO. OF MEETINGS

31

TOTAL VOTED AGMS

BASED ON ALL / VOTED MEETINGS	NO. OF VOTES	AS A % OF TOTAL PROPOSALS VOTED ON
Total all / voted proposals	472	100
Total votes against management recommendation	21	4.4
Total votes against ISS recommendation	37	7.8
Total proposals voted 'For'	448	94.9
Total proposals voted 'Abstain'	7	1.5
Total proposals voted 'Against'	17	3.6
Total proposals voted 'One Year'	0	0.0
Total proposals voted 'Withhold'	0	0.0

RATIONALE FOR VOTES AGAINST MANAGEMENT RECOMMENDATION	NO. OF VOTES
Political donations	2
Due to potential dilution >10%	12
Bundled resolutions	3
Ad hoc items	4

Q2 2020

144
NO. OF MEETINGS

128
TOTAL VOTED AGMS

5
TOTAL VOTED SPECIAL MEETINGS

11
TOTAL MIX MEETINGS

BASED ON ALL / VOTED MEETINGS	NO. OF VOTES	AS A % OF TOTAL PROPOSALS VOTED ON
Total all / voted proposals	1886	100
Total votes against management recommendation	105	5.6
Total votes against ISS recommendation	231	12.2
Total proposals voted 'For'	1725	91.5
Total proposals voted 'Abstain'	28	1.5
Total proposals voted 'Against'	130	6.9
Total proposals voted 'Withhold'	3	0.2

RATIONALE FOR VOTES AGAINST MANAGEMENT RECOMMENDATION	NO. OF VOTES
Political donations	5
Due to potential dilution >10%	55
Bundled resolutions	6
Ad hoc items	8
Compensation and stock option plans - not reasonable or excessive dilution	5
Concern over outside role	1
Corporate governance issue	4
Excessive non-audit fees	1
Non-disclosure of individual board member's remuneration	2
Persistent failure to attend board meetings	2
Preference for a one vote per share structure	1
Shareholder proposal - eliminate above-market earnings in executive retirement plans	1
Shareholder proposal - independent board chairman	3
Shareholder proposal - majority vote for the election of Directors	1
Shareholder proposal - one vote per share	1
Shareholder proposal - submit severance agreement (change-in-control) to shareholder vote	1
Vague/poorly-defined proposal	8

COLLABORATION

Over the past year, members of the Investment team have attended events organised by the PRI, the Investment Association, ICGN and the Financial Reporting Council amongst others. These events inform our view on best practice as well as issue-specific insight that is shared amongst the team. We have also continued to collaborate within Climate Action 100+ to drive a common agenda with other large investors through engagement with the world's largest greenhouse gas emitters.

Whilst our approach to engagement is typically direct, discrete and very much behind the scenes, through our membership of industry associations we benefit from, and value, both the sharing of ideas and the option of collaborative engagement.

PRI

Became a PRI signatory in 2017. Adhere to the six principles and report annually. 2020 rating: A+, A, A

UK STEWARDSHIP CODE

Stated commitment to the Stewardship Code since its launch in 2010. Response rated Tier 1 by the Financial Reporting Council

JAPANESE STEWARDSHIP CODE

Stated commitment to the Stewardship Code since its launch in 2014

INTERNATIONAL CORPORATE GOVERNANCE NETWORK (ICGN)

Joined in November 2019

CDP (FORMERLY CARBON DISCLOSURE PROJECT)

Joined in 2017. Supportive of its work to better assess environmental impact and its non-disclosure programme

CLIMATE ACTION 100+

Joined in July 2018 and supportive of its collaborative engagement with some of the most significant corporate polluters, seeking environmental improvement and setting standards

INVESTMENT ASSOCIATION

Longstanding membership with more recent participation in its Stewardship Reporting Working Group

WE EXPECT NO LESS OF OURSELVES

In reaching investment decisions, we set the ESG bar high. Through our engagement on ESG issues, we look for best practice and expect companies to strive for continual improvement. When we look at our own operations, we set the same standards.

“When we look at our own operations, we set the same standards.”

On governance, the past 12 months have seen a number of developments. In response to the Senior Managers and Certification Regime (SMCR) required by the UK Financial Conduct Authority we reassessed and questioned our existing governance framework. As a result, we made a small number of changes to reporting lines and responsibilities to bring clarity whilst also keeping reporting and communication lines short.

We also restructured our ESG Group (ESGG), giving it a more formal status, to both reflect the importance of its remit and to ensure that its recommendations are heard. The ESGG is chaired by Co-Head of Research Alex Torrens and its role is to ensure adequate governance, oversight and challenge of the firm’s ESG activities as well as compliance with our related policies. The formalisation of the group is part of management’s ongoing commitment to ESG and recognition of how important it is to our clients. The group brings together various areas from across the firm including Research, Communications, Client & Consultant Operations, Investment Operations, Client Service and Compliance. The Group reports into the IMC.

We also established an ESG @ WS group that reports into the firm’s Executive Management Committee. Its role is to challenge existing practices and consider ESG initiatives at a firm level to ensure that we continue to improve our own E and S credentials. Its focus is threefold: to consider the firm’s environmental impact, to consider the wellbeing of everyone at Walter Scott and to support our broader community, primarily through the Walter Scott Giving Group.

Our social credentials are inextricably linked to the firm’s culture. As part of required reporting around the SMCR, we had to encapsulate that culture and put its strength into words. The impact of the Covid-19 pandemic on our way of working has by contrast given us evidence of our culture in action. Colleagues have supported each other and worked together, albeit remotely, to ensure that standards have been maintained, procedures followed, deadlines adhered to. Beyond the direct employees of the firm, we have continued to pay all contracted staff and have ensured that all those employed by outsourced companies, including cleaning and security staff, have been paid as normal.

ENVIRONMENTAL FOOTPRINT

Built in the early and mid-1800s Walter Scott's Edinburgh offices offer both benefits and challenges. Unlike most modern offices they don't come replete with air conditioning, which is good from an environmental perspective, but efficient heating can be a challenge without the benefit of triple glazing or underfloor heating. Over the last few years, a number of initiatives have significantly improved our energy efficiency. They range from introducing halogen lamps (2014), LED lamps (2017), installation of more energy-efficient boilers (2019) and draught proofing of windows in north and east elevations (2018). The result is that our electricity usage in 2019 (284,000 kWh) is approximately 85% of our peak usage 2013 and still less than that in 2008. We don't have the same history for our gas usage but, for 2019, it decreased by approximately 8% from 2018. Further, in addition to the physical improvements made to our offices during 2019, we also switched to a green energy supplier for 100% of the firm's electricity needs and approximately 25% of gas required.

Recycling efforts are long established but we continually raise the bar. In 2019, we recycled 72% of all waste (food, glass, paper and plastic) and more significantly reduced our overall waste levels. Food waste has gone from 4,680kg in 2017 to 2,805kg in 2019, waste from plastic bottles and cans has halved and paper usage has reduced some 37% from 2018 to 2019.

Travel is the biggest contributor to the firm's energy footprint. In 2019, business travel totalled 2.89 million km, producing 1,057 tonnes of CO_2. To put that into context, if our electricity usage in 2019 of 284,000 kWh had not been from renewable sources, it would have produced about 80 tonnes of CO_2. Clearly, 2020 will be different. The Covid-19 pandemic has stopped all non-essential travel.

WALTER SCOTT GIVING GROUP

Through the Walter Scott Giving Group, the firm supports charities focused on community, education and health. Through multi-year commitments to a number of charities, it is hoped a meaningful difference can be made. Through a selective and largely local focus, the group can also seek assurance that donations are properly spent and the benefits evidenced.

In 2019, the Giving Group supported 32 charities covering a diverse range of projects. There are a number of long-term relationships with multi-year financial commitments in place. The offer of financial security and visibility allows for longer-term planning by charities. Below is an example of some of the charities supported over the last 12 months.

HOMELESSNESS

—Bethany Christian Trust – since 2013, financially supported a lunchtime care van that has a route around Edinburgh delivering food to the homeless and signposting support when required.

—Rowan Alba – helps vulnerable and predominantly homeless women in Pilton, Edinburgh. Donation towards new furniture and fittings in their supported accommodation for a homely feel as the women seek to end the cycle of homelessness and gain confidence and independence.

EDUCATION

—Scottish Book Trust – 10 author residencies in schools in high deprivation communities throughout Scotland, to increase the pupils' confidence in creative writing and reading. The group funded a successful trial in 2016 and has supported an expanded project since then.

—Edinburgh International Science Festival – supporting educational science shows (Generation Science project) in schools in high deprivation communities in Edinburgh.

—Spartans Community Football Academy – support for the running of an alternative school which provides education to those children who need more tailored support when they have often found it difficult to settle into a formal education surrounding.

YOUNG PEOPLE

—Edinburgh Young Carers – there are many young people (5-20 years old) who care for somebody at home in Edinburgh. The donation supports their 5-9 years' old service and their counselling service to allow these children to take a break from caring, develop new friendships and provide a safe space for providing additional support.

—Hopscotch – provides respite breaks to their outdoor activity centre in

Ardvullin, north Scotland to some of Scotland's most vulnerable and disadvantaged children. The group has supported Hopscotch since 2013.

MENTAL HEALTH

- MYPAS – support to their counselling service to young people (12-21 years old) who are seeking help around issues such as mental health and drug & alcohol use.
- Place2Be – supporting two schools in Edinburgh in the provision of their on-site services through their Place2Be counsellors to those pupils who are seeking support around mental health issues. There is also a broader collaboration with a number of volunteers from Walter Scott visiting Longstone primary school once a week at lunchtime and giving one-to-one reading support.

COMMUNITY

- Pilton Youth & Children's Project – support their FACENorth programme. The aim is to offer opportunities for young people in the multiple deprivation area of Pilton, to engage in enjoyable experiences with positive outcomes for realising their potential and offering an alternative to anti-social behaviour and crime.
- St Columba's Hospice – longstanding support of its 'Light up a Life' Christmas appeal in Charlotte Square Gardens.

COVID-19

Covid-19 has had a major effect on charities, causing disruption and challenges. The lockdown and social restrictions have led to most planned events being cancelled and fundraising activities curtailed. Their future financial outlook is highly uncertain and their planning visibility is hugely restricted. The Giving Group has had active discussions with partner charities to offer flexibility on the redirection of the donation towards a different set of priorities.

More immediately and just as importantly, the demands upon many charities have escalated significantly. The Giving Group directed a proportion of its allocated resources to charities providing essential food and mental health services to vulnerable families and young people in the community. There have been donations to Spartans, Pilton Youth & Children's Project, Edinburgh NW Foodbank, Scran Academy, Edinburgh Children's Hospital Charity and Steps to Hope for the delivery of food parcels. The opening of the kitchens in the Charlotte Square offices has supplemented these efforts with over 1,000 packed lunches per week made up for delivery.

FURTHER READING

We have listed all our recent, relevant research reports. Some have been posted on our website, others are unfortunately restricted to particular client audiences. However, if you are interested in reading any of the reports referenced below, or on previous pages, please do get in touch and we can certainly review the request, and hopefully assist. Please contact clientservice@walterscott.com

Quarterly ESG Commentaries

Research Papers
On the Road: Talking ESG in Texas

Responsible Investing: An Integrated Investment Approach

Investment conference transcripts
Lecture Series 2019 (Toronto) – Dr Gabrielle Walker, A Climate for Change

Lecture Series 2019 (Toronto) – Dr Eliza Filby, Demographic Disruption

Research Journal articles

Journal 10
EOG and ESG – Fracking has transformed the US energy market but it has prompted widespread environmental concerns. A recent EOG Resources tour, focused on environmental, social and governance issues, aimed to address some of these concerns.

Taking stock – Vietnam and Bangladesh play a growing role in the clothing and footwear supply chain. A visit to both countries was an opportunity to assess their standards and practices.

Carbon confusion – Companies across multiple geographies and sectors are striving to reduce their carbon footprint and bold targets have become almost commonplace. But judging those targets and interpreting reported efforts remain a challenge.

The Zeitz way – Jochen Zeitz, former CEO of PUMA, is an environmental trailblazer. And he believes companies have a key role to play in the fight against global warming.

Journal 9
Fossil fuel challenge – The energy industry faces multiple challenges, amid rising demand and a growing need to find more sustainable alternatives to fossil fuels. We discuss the outlook for both traditional and new forms of energy.

Living the dream – The urgent need to address climate change tends to inspire fear, even panic. Dr Gabrielle Walker, a recognised expert on the topic, argues that a more positive approach is required.

Emerging markets and ESG – Emerging markets are often considered to lag behind the developed world when it comes to environmental, social and governance issues. But times are changing.

Eyes wide open – A steadfast focus on sustainability is integral to Walter Scott's investment approach, and is particularly applicable when investing in emerging markets.

Urban generation – Growing urban populations and shrinking resources are putting pressure on cities like never before. What can be done to address this challenge?

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Untitled 1

Walter Scott has been supporting emerging Scottish talent since 1988. In the same way that we believe that different perspectives within the team generate the best investment ideas, so we believe that our art collection should incorporate a wide range of work from an eclectic group of contemporary artists.

Our commitment to the art community is also reflected in our established partnerships with – and sponsorship of prizes at – the Royal Scottish Academy, the Royal Glasgow Institute of The Fine Arts and the Royal Scottish Society of Painters in Watercolour.

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