



# Stewardship at AAM

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# What is Stewardship and why do we do it?



# Stewardship

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## What is it?

- Stewardship is taking good care of assets that are entrusted to us by our clients
- Key to our investment philosophy – part of being fundamental, disciplined and active investors

## Why do we do it?

- Because we need to be aware of all risks when investing, which allows us to:
  - See the whole picture; makes for better forecasting, decision-making and long term investing
  - Strive to mitigate (downside) risk
- Clients/Consultants/Stakeholders expect us to consider ESG risks

## How does Aberdeen Asset Management do this?

- Undertake risk assessment of assets pre- and post- investment
- Link holistic risk management to culture, strategy and remuneration
- Use outcomes from risk assessments in investment decisions
- Engage our holdings on their key, material concerns

# Stewardship related terms

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## ESG

Environment, Social and Governance – factors that are integrated into an investment decision making process to give a holistic and enhanced picture of an asset's risks / opportunities. Not a box ticking exercise.

## SRI

Socially Responsible Investing – meeting client's ethical concerns. We provide a negative screening service for clients who want to avoid any particular activity/ product.

## Responsible Investing

The umbrella for ESG and SRI. These can also include other SRI methodologies, such as best in class/sector or thematic investing, positive screening, etc.

## Impact Investing

A fund through which, alongside financial returns, investors seek a measurable and defined social or environmental benefit.

## CSR

Corporate Social Responsibility – refers to the efforts that a group makes to demonstrate to the world that it is a 'good corporate citizen.' Often confused with marketing material and branding/reputation.

## Sustainability

Very generally indicates whether something can go on indefinitely or not. Now is often an indicator of how “good” a company is with regard to softer issues.

# What's the difference between ESG and SRI at AAM?

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# How ESG / risk assessment is different from SRI

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## ESG & our approach to risk assessment

- **Company / asset driven**
- Focused on a company's management of its own risks
- Holistic approach – assessing financial and ESG risks together and focusing only on those risks which are material to the company's operations
- Constantly evolving as material risks change over time
- We engage and encourage positive change over time (to improve Quality rating)

## SRI

- **Client driven**
- A negative screen based on ethics/SRI criteria such as tobacco, alcohol (pass / fail)
- Top down on best in class
- Looking at top down issues to the business – not focused necessarily on materiality

# SRI screening criteria

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**This process is led by our stewardship centre and applied to various mandates across the investment division**

## **Examples of screens offered:**

- Abortion
- Access to pharmaceuticals
- Adult entertainment (% revenue)
- Alcohol (% revenue)
- Animal testing
- Business practices
- Cluster munitions and anti-personnel land mines
- Contraceptives
- Embryonic stem cell research (exclusion)
- Environment
- Gambling (% revenue)
- Human rights
- Labour
- Military (% revenue)
- Nuclear energy (% revenue or exclusion)
- Pork production (% revenue)
- Tobacco (% revenue)
- Weapons (% revenue)

# AAM's equity investment philosophy

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## **Fundamental**

- Understand asset before making investment
- Bottom up, conviction investors (equity)
- Long term investors

## **Disciplined**

- Investment process is the same within asset classes
- We adhere to the process

## **Active (Engagement + proxy voting)**

- Understand all the unique risks and opportunities (short and longer term)
- Not taken by surprise
- Know best way to engage and (potentially) make investment better



# Benefits (or “Value Add”) of ESG integration

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## **Because we take Stewardship seriously, we have:**

- ‘Baked’ ESG into our equity investment process
- ‘Baked’ ESG into our processes for fixed income, property and alternatives

## **By integrating ESG into our investment decisions, we are able to:**

### **Better price**

- Understand the true price of an asset and act accordingly

### **Better size**

- Allocate the most appropriate weighting of an asset within a portfolio

### **Better engage**

- Know the best way to engage a group
- Know what to push for/encourage the group to improve

## **Also:**

- Helps mitigate downside risk

# ESG integration at Aberdeen Asset Management

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## **Holistic risk assessment – examining all the risks and opportunities of an asset**

- Concerned with material risks
- Focuses on how a company manages those key risks
- Assessment of both risks and opportunities of an investment

## **A deep dive into the issues and management techniques for ESG related issues through:**

- Identification of risks
- Prioritisation of risks
- Target setting/KPIs for risk mitigation
- Remuneration
- Strategy/culture/opportunity set

# The risk assessment process - equities

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We look **holistically** at a company's risks (financial and ESG) and weigh these against each other to determine the material risks. This supports our long term perspective on investing.

## **Analyse an asset's ability to manage risk:**

1. How does the group's culture reflect its approach to risk?
2. Can the asset identify its material risks?
3. Are key risks linked to targets?
4. Are targets linked to remuneration?
5. Are key risks linked to strategy and opportunity set?

## **Do a deep dive into the key risks for each group:**

1. Does the group have a fundamental understanding of risk and how to effectively manage it
2. What steps has it taken to date to mitigate a risk?
3. Is it using best practice?
4. How does the group see the risk evolving? How will its mitigation techniques evolve?

**Risks are dynamic and should be managed dynamically, over time.**

# ESG integration – some of the risks we engage companies on

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**A deep dive** into the specific material risk(s), not exhaustive:

- Cyber security
- Reputational risk
- Vulnerability to changes in legislation
- Human capital management
- Health and Safety
- Supply chain
- Waste and recycling risks
- Climate change
- Environmental safety
- Product safety
- Risk management and transparency
- Changes in consumer preferences based on social trends

**Risks are dynamic and should be managed dynamically over time**

# How ESG is integrated into our equity process

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- ESG is part of the team conversations on holdings
  - Not a box ticking exercise – risks are different for each investment
  - Not a top down or topical approach
  - We weigh all risks/opportunities together – not considered in silo
- Material ESG issues can (and do) impact **Quality** and **Value** ratings
- Companies must score a 1, 2, or 3 for both Q and V to be included in portfolios

# Stewardship across asset classes – Equities and Fixed Income

## Equities

### Active Equities

- Bottom-up stock selection process
- Materiality, risks and opportunities
- Active engagement
- Recommendations
- Vote proxies
- Offer SRI solutions

### Quantitative investments

- Stewardship for voting and engagement is robust
- Incorporate ESG
- Offer SRI solutions or ESG factor tilts

## Fixed income

- ESG policies in place
- ESG factors incorporated
- Research, relative value, portfolio construction
  - risk management at all levels
    - Examine credit, liquidity and price risks
    - Material ESG risks are also examined, noted on ‘Total Analytical Package’ (TAP)
- Also run segregated mandates with ESG themes
  - Best-in-class account on carbon
  - Tailored SRI requirements

# Stewardship across asset classes: Direct property and Infrastructure

## Direct property

- Bottom up stock selection and long term investors
- Financial and ESG type issues examined together
- Tangible asset
- Integrated climate change risk assessment
- Impact on investment decisions
- Impact on liquidity of asset
- Responsible Investment Property Team in place

## Infrastructure

- Investment policy focused on greenfield social infrastructure
- Thorough due diligence for new investments
- Existing investments – ensure and understand the long term ESG impacts

# Stewardship across asset classes: PE, Property FoF and Hedge Funds

## Private Equity

- Research and due diligence to identify all material risks and opportunities
  - Both financial and ESG risks and mitigation
  - Corporate governance
- Actively engage with General Partners (GPs)
- ESG questionnaires issued to all GPs
- Increasingly focus on ESG KPIs and crisis escalation processes

## Property Fund of Funds

- ESG issues of underlying property funds assessed via GRESB
- GRESB will assess ESG integration in investment process and stock selection
- This may influence investment decisions

## Hedge funds

- New manager due diligence incorporates strict governance standards across range of issues
- On-going due diligence involves active engagement with Managers
- ESG consideration varies by strategy

# Objectives and considerations of engagement

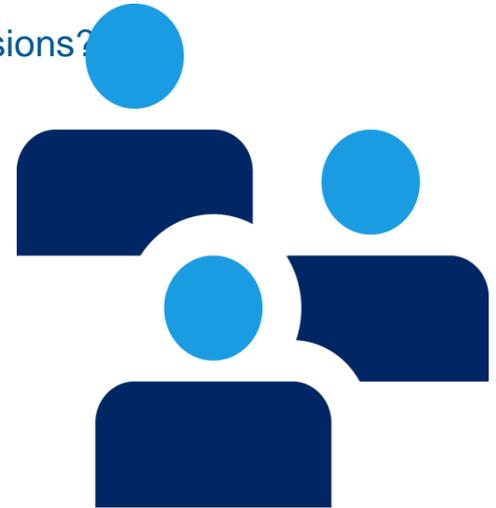
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## Objectives

- Communicate concerns on a range of relevant issues
- Establish/build on relationships with management teams/Boards
- Help to drive meaningful change which is measurable
- Improve internal and external reporting

## Considerations

- Which issues are of highest priority?
- What would a successful (or otherwise) outcome mean in terms of future decisions?
- Benefits of more targeted, regular engagement
- Target number of companies



# Examples of questions we might ask

Key Risks/Issues	Areas of engagement/potential questions
Poor labour practices in the supply chain	<ul style="list-style-type: none"><li>• What labour standards do suppliers adhere to and how is this monitored?</li><li>• How extensive is the coverage of supplier audits?</li><li>• What steps has the group taken to ensure against the use of child labour?</li></ul>
Sustainable sourcing	<ul style="list-style-type: none"><li>• Who has oversight / accountability for sourcing issues?</li><li>• How exposed is the group's supply chain to eg climate change impacts?</li><li>• Does the group adhere to industry standards eg RSPO?</li></ul>
Cyber security	<ul style="list-style-type: none"><li>• What is the group's IT governance structure?</li><li>• What systems are in place to mitigate security lapses, cyber and data breaches?</li><li>• Has the group ever suffered from a significant cyber attack, data breach or systems failure?</li></ul>

# Company specific examples

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## Mining group

### Problem:

- Weak relations with labour unions → causing reputational damage → costly stoppages in mining operations → loss of competitive advantage

### Investment:

- Our Q and V ratings were being impacted

### Aberdeen Asset Management action:

- Engage the company, stress the materiality of the issue and push for improvement
- Identify scale to which group was impacted by poor relationship with unions
- Put remedial action in place
- Improve source of problem
- Put oversight on Board and link performance to exec remuneration
- Encourage reporting fully on risk, mitigation techniques and outcomes

### The result:

- Group mitigated risk with unions/work force
- Boosted competitive advantage – reflected in share price

### Investment

- Holding remained in portfolio

# Company specific examples

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## **Integrated oil and gas company**

### **Problem:**

- Negative impact from climate change (GHG emissions, carbon trading, stranded assets)

### **Investment:**

- Our Quality and Value ratings could be impacted

### **Aberdeen Asset Management action:**

- Ascertain the relative impact to the group
- Create a KPI for reducing GHG emissions and raise understanding of carbon trading schemes
- Push for greater transparency on carbon emission data and how mitigation fits with group strategy
- Encourage the use of newer technologies for exploration, extraction, and refining
- Report on assets likely to be stranded longer term due to changes in legislation

### **The result:**

- Increase competitive advantage
- Mitigation of reputational damage
- Reduction of GHG emissions in the context of group's properties

### **Investment:**

- Holding remained in portfolio

# Stewardship structure

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## **Stewardship centre**

- Co-heads: Cindy Rose (Head of Responsible Investing - RI)  
Paul Lee (Head of Corporate Governance - CG)
- Provides PLC view on Stewardship issues to external stakeholders
- Provides cross-asset class support on Stewardship issues including research and company engagements, and encourages internal collaboration
- Provides corporate support, including policy setting and annual disclosure requirements, on issues such as remuneration, diversity and inclusion, supply chain management and greenhouse gas emissions
- Also covers voting of passive funds

## **RI analysts on regional equity teams**

- Report to regional equity desk head
- Conduct ESG risk assessment research on regional companies and undertake SRI screens
- Integrate ESG analysis into teams' assessment of a company's quality and support engagement

## **CG specialists on regional equity teams**

- Report to regional equity desk head
- CG experts on regional companies
- Integrate CG analysis into teams' assessment of a company's quality and support engagement

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