SUSTAINABILITY AT SCHRODERS

June 2021

Marketing material
Environmental, social and governance is referred to as ESG throughout.

Schroders

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We are committed to creating a better future by investing responsibly for our clients, shareholders and the community as a whole to ultimately deliver a positive outcome for all.

INTRODUCTION

As a global investment manager we recognise we have an important part to play in shaping the future of all our stakeholders.

Our focus on doing the right thing for our clients, our people and wider society lies at the heart of our culture.

As investors, the way we direct capital not only shapes the financial returns we achieve but also the type of impact we have on the world. Social and environmental change is colliding with financial markets. Issues like climate change are quickly becoming defining drivers of the global economy, society and financial markets and will become increasingly important in coming years. Investors no longer have a choice over whether to seek exposure to environmental, social and governance (ESG) risks or opportunities; all companies and portfolios will be impacted.

Initiatives like the Sustainable Development Goals, and the focus they have attracted across the investment industry, reflect the widening intersection between social priorities and investment goals.

As a result, a forward-looking view of those structural changes and their implications is an important consideration in long-term risk assessment, albeit not captured in conventional risk models.

At Schroders, we committed to integrating ESG analysis into all of our investment processes by the end of 2020 and we achieved this goal*.

Only by considering a broadened data set that include the impacts of various ESG risks and opportunities can we uncover an asset's real investment potential and achieve the best outcomes for you.

Active ownership is also critical. We engage with the companies we invest in to encourage them to transition towards a more sustainable business model – one which is more resilient and can support future growth over the long term.

This commitment goes hand-in-hand with advocating for what's most important. Channelling capital into sustainable and durable businesses creates value and helps speed up positive change. Because funding the future is a privilege; we use it wisely and responsibly.

* For certain businesses acquired during the course of 2020 we have not yet integrated ESG factors into investment decision-making. There are also a small number of strategies for which ESG integration is not practicable or not possible, for example passive index tracking or legacy businesses or investments in the process of or soon to be liquidated, and certain joint venture businesses are excluded.

INTRODUCTION

ESG integration explained

Embedding ESG considerations: our journey so far

Schroders has a proud history of investing sustainably. Our long-term approach leads us to the belief that generating returns for our clients will be intrinsically linked to our ability to identify, measure and engage on the impacts of social and environmental change attributable to the companies in which we invest.

In 2017 we launched Schroders' sustainability accreditation framework to drive and monitor ESG integration across our investment processes. The goal was to achieve full ESG integration by the end of 2020. We achieved that target thanks to the collective efforts of our fund managers and analysts. ESG integration means that our fund managers and analysts systematically and explicitly consider ESG factors alongside or within traditional financial analysis. It means a broader assessment of the world in which we operate: one which captures sustainability risks and opportunities in our investment decision-making.

HOW DOES THE ACCREDITATION PROCESS WORK?

Our sustainability accreditation process starts with a collaborative effort between the sustainable investment team and each of our 60+ investment teams. The goal is to map the end-to-end investment process, from idea generation through to portfolio construction, to ensure sustainability risk considerations are integrated systematically and meaningfully into the relevant steps.

Our approach is holistic – we integrate ESG factors into established investment processes rather than create separate processes which run the risk of becoming an afterthought or a box-ticking exercise.

It is also robust; teams articulate and demonstrate how relevant issues are identified, investments are examined, portfolio decisions are influenced and how they monitor and manage emerging sustainability risks.

WHY IS INTEGRATION IMPORTANT?

Ensuring that our 60+ investment teams, each with their own investment philosophy and approach, integrate ESG consistently across the firm has been a hugely rewarding journey for us as investors and we believe it has benefited our clients. As active investors, ESG integration has been crucial in helping us differentiate ourselves in the search for superior investment performance. The lack of widespread ESG data availability and consistency means that our proprietary ESG research and tools position us strongly to systematically identify and understand material information about the assets in which we invest. At the same time, we can enable each investment team to customise its use of such research and tools.

WHERE DO WE GO FROM HERE?

The "minimum bar" for ESG integration is being raised beyond simply understanding sustainability risk and opportunities. With an increasing focus on the impact of our investments, we believe that being able to measure that impact and the outcomes of our investment activity will only become more important to performance over time. We are broadening our strong active ownership approach across our investment teams. Our fund managers and analysts are increasingly leading on ESG engagements.

With over 20 years of engagement, voting activity and related outcomes recorded by our sustainable investment team, we have enhanced our digital systems, building a more robust and user-friendly online network to support our fund managers and analysts to record their own engagements and track progress.

Our role in facilitating change at the companies in which we invest represents a significant opportunity to create and secure the returns we seek for our clients as active investors. It is also a critical aspect of meeting our responsibilities as stewards of our clients' capital.

The tools we have developed combine a range of proprietary technologies driven by traditional and non-traditional data. These tools help our fund managers and analysts quantify the sustainability risks and impacts of assets in which we seek to invest. They enrich our research process and enable our fund managers and analysts to ask questions of how a company is managing its business and the impact this has on society.

We continue to invest in our systems and processes, including evolving the measurement and reporting on the impact of our investments.

TOOLS USED IN ESG ASSESSMENTS

We have developed a suite of proprietary tools to provide our analysts and fund managers a broader assessment of ESG impacts across portfolios.

CONTEXT provides a structured approach to analysing a company's relationships across a wide range of stakeholders, such as communities, customers, employees, the environment, suppliers and regulators and governments.

We have also developed SustainEx™, designed to measure the positive and negative impacts a company may have on the environment and society. It quantifies that impact in dollar terms, allowing us to better understand the social and environmental impact of the companies in which we invest and helping to ensure consistency of outcomes for our clients.

Currently, investment teams across Schroders use SustainEx™ in a variety of ways, from considering the output of the tool as part of the assessment of individual holdings through to portfolio construction, where the tool can be used to drive individual security selection.

Exclusions

At a company-wide level, we exclude (negative screen) securities from certain industries.

At Schroders, we fully support the international conventions on cluster munitions, anti-personnel mines, and chemical and biological weapons. We will never knowingly hold any security that is involved in the production, stockpiling, transfer and use of these weapons. These restrictions apply across all Schroders funds globally.

Locally, we adhere to an excluded securities list which restricts additional securities from certain sectors. The table below sets out our excluded securities for Australian portfolios:

Excluded Securities	
Excluded sector	**Exclusion criteria**
Cluster munitions, anti-personnel mines, biological and chemical weapons	Not permitted
Tobacco manufacturers	Not permitted
Nuclear weaponry	Not permitted*

* Securities deriving 5% or more of revenue from the manufacture of nuclear weaponry.

Within our Quantitative Equity Product (QEP) portfolios, the team has additional global exclusions such as predatory lending, significant exposure to thermal coal and civilian weapon involvement. Exclusions in addition to these are client and market led and so will vary across the QEP investment strategies, ranging from our dedicated ESG strategies where we apply our broadest exclusion policy, to segregated accounts where exclusion policies are tailored to suit client specific requirements.

We are also a signatory to the UN Global Compact (UNGC) principles and have committed to making the UNGC and its principles part of the strategy, culture and day-to-day operations of our company, as well as to engaging in collaborative projects which advance the broader development goals of the United Nations.

Outcomes and reporting

Providing more transparent sustainability measurement and reporting both for our investments and for clients is a key focus.

We continue to enhance our suite of tools for analysing our portfolios' ESG ratings and their impact relative to industry standard benchmarks.

Some of these tools include SustainEx™ (our impact measurement tool), CONTEXT (our research tool for analysing company stakeholder relationships and business models), Country CONTEXT (our sovereign issuer rating tool), our Carbon Value at Risk model (which captures the impact of higher carbon prices on companies), and reporting using standardised rankings from MSCI and Sustainalytics.

The QEP team has also created its own suite of ESG-based analysis and reporting tools to facilitate the ongoing monitoring of ESG exposures across its strategy range.

We are also using our tools to provide more transparent reporting for clients and standardised sustainability reports are currently in development.

Active ownership

Investing sustainably is not just about targeting superior portfolio sustainability metrics relative to a benchmark.

Sustainable investment requires active management and engagement with companies, particularly those we invest in. Owners can be more influential through positive engagement. In 2020, our global analysts undertook over 2100 engagements on ESG issues across 58 countries.

We engage with companies to monitor ongoing exposure to ESG factors, and importantly to seek change in ESG performance and processes that will protect and enhance the value of the investments for which we are responsible. In particular, we want to help drive more sustainable outcomes. Companies that are on a more sustainable path and that are reducing ESG risks will be re-rated by the market; identifying these companies early will deliver a source of alpha. For bond holders the key is to influence and demonstrate that superior performance on ESG risk metrics generally leads to lower risk assessment and is then reflected in lower borrowing costs.

We are clearly one voice amongst many investors so it would be disingenuous to claim our engagement was the direct cause of a change, but we're confident our conversations with companies contribute to positive change.

58 countries

2100+ engagements

Net Zero

ACTIVE OWNERSHIP IN THE SPOTLIGHT

Within our Australian equities team, we have engaged heavily with Santos which we hope has helped effect the considerable change that has occurred in recent years. Santos has made significant progress in its climate policies and now has one of the more aggressive timelines and more defined pathways to net zero amongst its peer group.

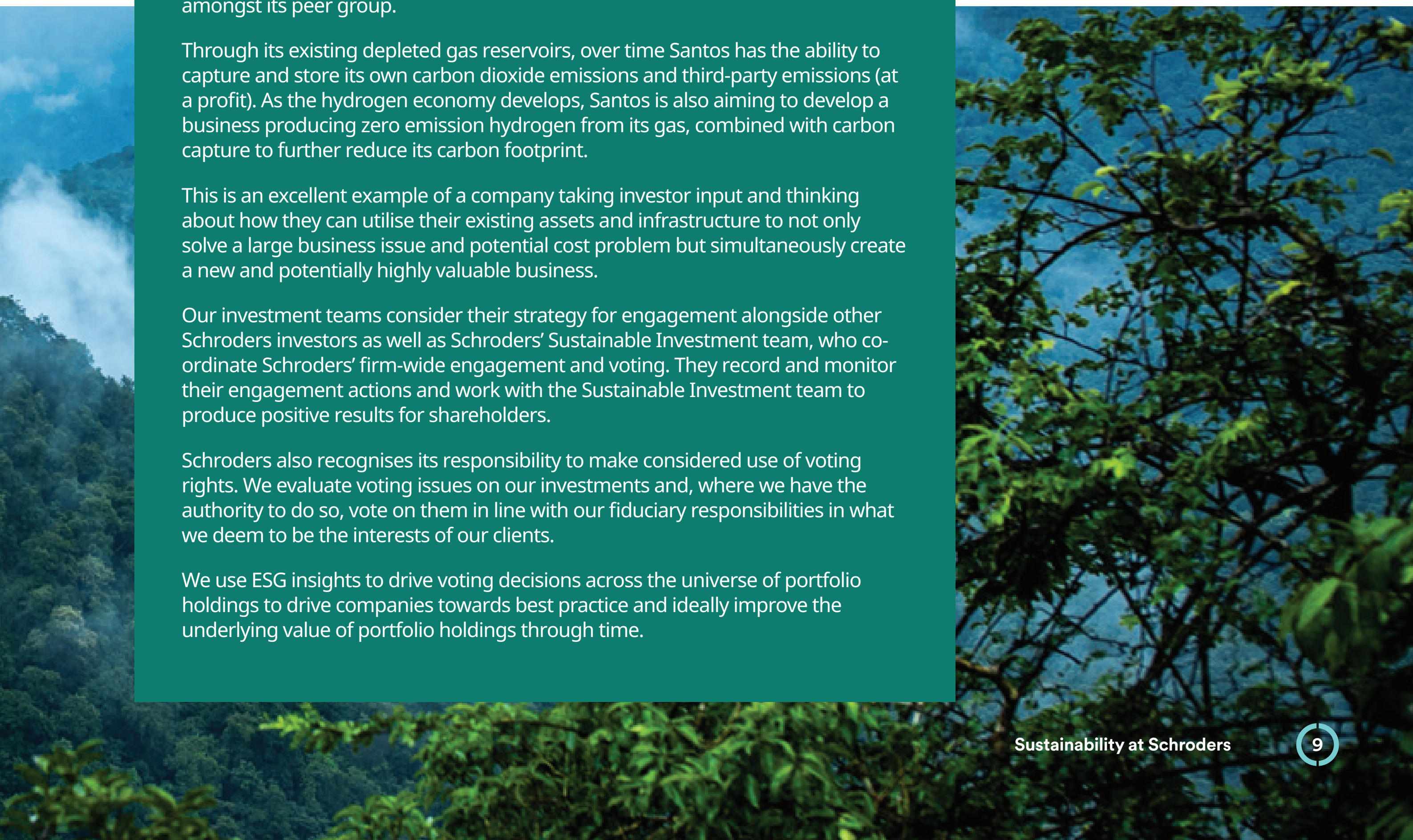
Through its existing depleted gas reservoirs, over time Santos has the ability to capture and store its own carbon dioxide emissions and third-party emissions (at a profit). As the hydrogen economy develops, Santos is also aiming to develop a business producing zero emission hydrogen from its gas, combined with carbon capture to further reduce its carbon footprint.

This is an excellent example of a company taking investor input and thinking about how they can utilise their existing assets and infrastructure to not only solve a large business issue and potential cost problem but simultaneously create a new and potentially highly valuable business.

Our investment teams consider their strategy for engagement alongside other Schroders investors as well as Schroders' Sustainable Investment team, who co-ordinate Schroders' firm-wide engagement and voting. They record and monitor their engagement actions and work with the Sustainable Investment team to produce positive results for shareholders.

Schroders also recognises its responsibility to make considered use of voting rights. We evaluate voting issues on our investments and, where we have the authority to do so, vote on them in line with our fiduciary responsibilities in what we deem to be the interests of our clients.

We use ESG insights to drive voting decisions across the universe of portfolio holdings to drive companies towards best practice and ideally improve the underlying value of portfolio holdings through time.



Australian Equities

Our team's investment process has always revolved around sustainable return on capital and ESG considerations are a logical and important input into forming views on the sustainability of a business and its earnings stream. Our overriding objective for integrating an ESG approach into our investment process is to, wherever possible, enhance returns and protect value for our clients.

ESG integration is primarily achieved through direct valuation adjustments made to capture the expected impact of ESG factors on the cashflows of a business and through an active approach to voting aimed at driving companies towards improved practices in both an economic value and ESG context (we assume improved sustainability will almost always equate to improved long run economic value).

We believe the expected future direction of all ESG factors – but especially those related to climate change – is as, if not more, important than current levels. For example, with regard to carbon emissions, on the basis that the global goal is to reduce emissions to zero, our view is, valuation allowing, that we will not shy away from owning emitting companies. Rather, we would like to be part of the emission solution and through engagement and incentivisation to reduce emissions we can help to facilitate change and improvement as opposed to divesting emitters and washing our hands of the problem which will in no way help to lower emissions.

We prefer to minimise stock exclusions as excluding stocks necessarily compromises the delivery of optimal returns, i.e. if a coal or gambling exposure is excluded which was otherwise attractively valued, we are compromising returns. Correspondingly, if we believe removing these stocks is in the best interests of client returns, we are inherently expressing a lack of faith in their valuation. Our preferred approach is to address any lack of faith in valuation at source. We firmly believe in positive screening and encouraging companies to improve their ESG practices. It is often the most offending companies that are the most incentivised to drive positive change.

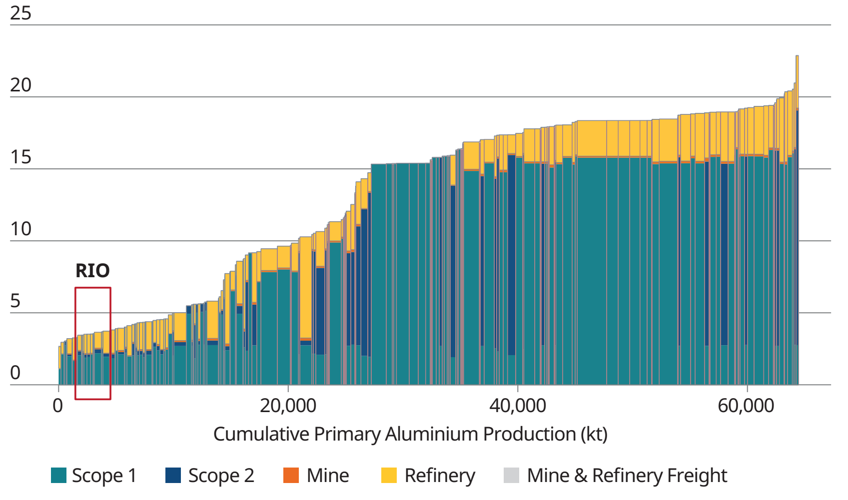
Our portfolio construction process inherently takes into account the degree of risk in valuation stemming from our expectations around revenue and margin volatility together with the degree of financial leverage utilised in the business. Where ESG factors also dictate a high degree of uncertainty in the forecast revenues and margins of a business, this will also impact portfolio exposure.

CASE STUDY

Environmental factors such as energy sources used, prices paid for this energy, emissions resulting from operations, waste production and disposal, remediation obligations and liabilities are amongst the factors considered. To complement our assessment, we collect carbon emissions by all companies and impute the ongoing dollar cost of this (emissions translated at an assumed carbon price) in valuations. Importantly, to broaden our environmental views beyond emission scores, we also collect data on water usage and waste volumes.

A good illustration of the broad way we think about environmental factors is Rio Tinto's aluminium business. Rio's aluminium division currently accounts for a disproportional (around two-thirds) share of Rio's emissions when compared to revenue (20% in 2020). However, when compared to the global industry, the majority of Rio's production sits at the very bottom of the aluminium emissions curve courtesy of their Canadian smelters powered by hydroelectricity.

Aluminium cost curve (E1GHG Intensity, tCO_2e/t Al)



Source: Skarn Associates research

As carbon gets priced globally this position on the curve, or their ability to produce green aluminium, should allow Rio to extract additional profits either via green premiums or through a steepening of the cost curve and a higher aluminium price to match marginal cost. Put another way, it is reasonable to assume Rio's Canadian smelters will be more valuable in a world pricing carbon.

The analysis above is largely around scope 2 emissions (i.e. from the power source feeding the smelters), with the other main source of carbon emission being scope 1 in the smelting process itself (through using a carbon anode). Rio, in conjunction with Alcoa, has been developing a technology "ELYSIS" to remove carbon from the anode and essentially eliminate all scope 1 emissions from smelting. If commercialised this would eliminate carbon emissions in the Canadian smelters, further adding to shareholder value and/or potentially offer significant upside if the venture chose to sell the technology to other smelters.

So rather than viewing all carbon emissions as a negative and something to avoid we would rather (where valuation justifies it) invest in companies which are low on the emissions curve and/or have credible strategies and initiatives to further reduce emissions and create additional value. In many cases this will not only help the progression towards far lower global emissions but could also improve company profitability, as carbon costs are avoided.

Fixed Income

Our primary goal is to deliver on client return objectives with a focus on the risk taken to achieve those objectives. To the extent that ESG factors can be properly assessed, and where we believe they will influence returns and risk, the Australian Fixed Income team systematically incorporates these factors in its investment framework and the proprietary fundamental analysis that sits within it.

Sustainability is integrated throughout the beliefs that underpin our philosophy:

- Countries and companies with better (or improving) ESG factors should have more sustainable cash flows (as they are more willing and able to service their debt) and make better long-term investments.
- Integration of ESG factors into our investment process will lead to better investment decisions.
- ESG risk factors need to be integrated across all levels of the portfolio: asset allocation, stock selection, implementation and measurement.
- While more sustainable is preferable to less, it's more than just the metrics. Active Fixed Income investors need to engage with the borrowers they lend to.

Our investment process incorporates ESG assessment at each stage.

At the asset allocation stage, we include modelled impacts of climate change in our country-level long run growth and inflation estimates. These include both the impact of rising temperatures on an economy's potential growth rate and the transition impacts of economy-wide decarbonisation and the shift to renewables. These adjustments then feed into our assessment of the medium term valuations of assets and the risks around them, a key input into our asset allocation process.

Additionally, we complement the ESG factors captured in our valuation framework with further analysis through our strategy research work. The impact of ESG factors on our assessment of the opportunities and risks associated with different sovereigns is particularly important, and these can influence decisions across duration, yield curve, country-relative rates and currency dimensions.

At the security selection stage, our credit analysts integrate ESG factors within their analysis of the creditworthiness of an issuer. Exposures to various ESG risk factors are analysed along with the effectiveness of a company's policies, procedures and corporate culture in addressing them. This assessment then directly feeds into our internal rating formulation, either through the adjustment of financial forecasts for the impact of the factors, or by adjusting our qualitative risk assessments.

We follow a similar approach with sub-sovereign issuers, where issuers are assessed on a relative basis on a list of relevant factors which are aggregated into an issuer ESG score. This ESG score is then a key variable, alongside macroeconomics, fiscal strategy and debt position, in determining our overall relative assessment of quality of each of the issuers.

Finally at the portfolio construction stage, we combine, implement and manage all of the exposures achieved through our asset allocation and security selection. This includes measurement and risk assessment of aggregated ESG exposures.

The Australian Fixed Income team is an integrated part of a global team of experienced investors and we leverage company-wide research and analysis into ESG risk factors. In addition, Schroders has a dedicated Sustainable Investment team which provides investment process and policy guidance with respect to ESG risk factors and assessment, as well as overseeing the development of our proprietary tools and updated ESG risk factors at a company and country level.

Our approach will continue to evolve along with research, data and technology and implementation options.

CASE STUDY

Within our Fixed Income team, our credit analysts integrate ESG factors within their analysis of the creditworthiness of an issuer. This case study illustrates one example of their assessments made at a company level against ESG criteria.

Westpac Banking Corporation: Governance insights uncover buying opportunity

All the major banks – including Westpac – have been under pressure due to the revelations of poor banking practices that were exposed in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. More recently Westpac was the subject of legal action by Austrac, the financial transactions regulator, over non-reporting of 23 million suspect client transactions. In response to these issues we increased our forecast cost-to-income ratio to factor in increased compliance costs and IT costs to improve systems. We had also factored in a one-off fine for the failure to report suspect transactions to Austrac. These issues were offset somewhat by other measures the bank had taken over the past few years regarding increased capital and improved liquidity along with the simplification of their business. This meant there was no change in our internal rating meaning the spread widening in Westpac bonds compared to the other major banks represented a buying opportunity.

Multi-Asset

Our primary goal within Multi-Asset is to achieve the investment objectives agreed with our clients, in particular, delivering the desired return outcomes while minimising the size and frequency of losses. Accounting for ESG risk factors is important because they will directly impact return outcomes and present both risks and opportunities at all levels within a portfolio.

Our approach to integrating ESG risk factors in our Multi-Asset investment process recognises that:

- Proper assessment of E, S and G factors will lead to better investment decisions both in terms of returns and risk.
- ESG risk factors need to be integrated across all levels of the portfolio. Multi-Asset portfolios are complicated by breadth of exposure and in the different ways they can influence outcomes. We consider ESG factors throughout all aspects of the portfolio construction process including asset allocation, stock selection, implementation and measurement.
- Whilst at an implementation level, more sustainable is preferable to less our approach is more nuanced than a simple divestment/avoidance approach. Active investors need to engage with companies in which they invest; both as an owner and a lender and take an active role in achieving better outcomes. The metrics themselves only tell part of the story.
- Our approach will continue to evolve along with research, data and technology and implementation options.

ESG considerations are integrated firstly at the asset class level, incorporating ESG factors into our medium-term return and risk forecasts. For example, our valuations include a climate change adjustment, which takes into account the impact of rising temperatures on an economy's potential growth rate. Some economies' potential growth rate will decline, others will benefit. In addition, we are estimating transition impacts of economy-wide decarbonisation and the shift in investment to renewable. These are long-term considerations which impact our 10- year forecasts for risk and return. Over shorter periods, other factors can override or augment these assessments, such as business cycle analysis and liquidity considerations.

ESG risk factors are then assessed at a stock level within our equity and debt allocations, influencing which strategies we choose to implement. We believe companies that are well governed and operate transparently, responsibly and sustainably, will have the culture to support the long-term health of the organisation.

Healthy companies are more likely to deliver long-term earnings growth and repay their debt. We therefore embed the impact of ESG risk factors into our assessments of company quality and valuations which impacts our decisions on individual securities.

We also evaluate the impact of key thematic ESG risk factors on particular sectors and individual companies and analyse companies' progress in developing policies and strategies to reduce ESG risks.

When looking at new assets, we consider their sensitivity to ESG factors and how they can impact valuation. More sensitivity means we need to understand these factors in more detail.

The Australian Multi-Asset team is an integrated part of a global team of experienced investors and we leverage company-wide research and analysis on ESG risk factors. In addition, the team leverages the work of the dedicated Sustainable Investment team which provides investment process and policy guidance with respect to ESG risk factors and assessment, as well as overseeing the development of our proprietary tools and updated ESG risk factors at a company and country level.

CASE STUDY

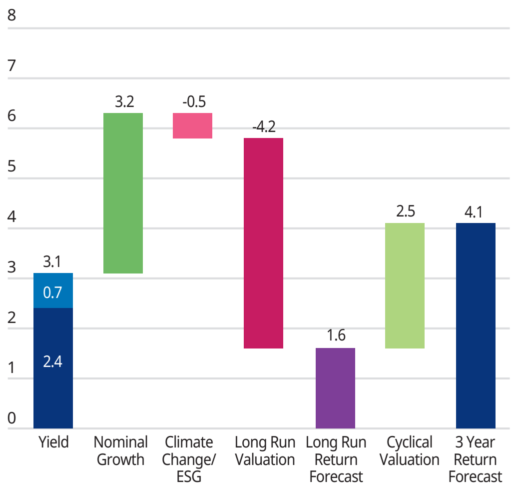
Adapting the work of our global Economics team and our global Multi-Asset teams, which was based on the research presented in the Burke and Tanutama paper[1], we are now incorporating the impacts of climate change into our long run return forecasts.

Our forecasts are adjusted for the physical and transition costs associated with global warming in three steps:

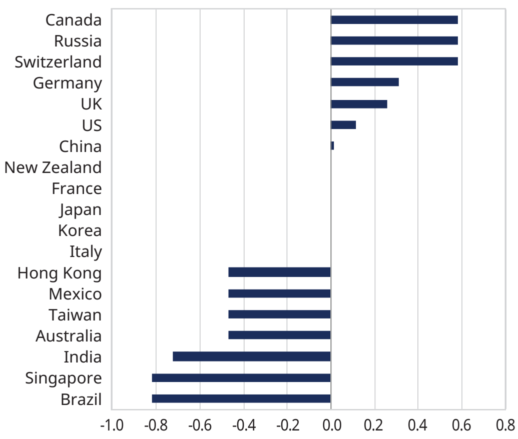
1. The first step is a focus on what happens to output as temperatures rise, which we will refer to as the 'physical cost' of climate change.
2. The second considers the economic impact of steps taken to mitigate those temperature increases, or the 'transition cost'. This second step is slightly more complicated, in that there are a range of possible transition scenarios.
3. Finally, we adjust for the effects of stranded assets. This is where we take account of the losses incurred where oil and other carbon-based forms of energy have to be written off, as it is no longer possible to make use of them, such that they are left in the ground.

This analysis leads us to make an adjustment to our return forecasts to explicitly include a climate change adjustment factor. The adjustments to our core methodology to reflect climate factors plus the adjustment factor across key markets are illustrated below.

Australian Equities – Return Breakdown (Local return % p.a.)



Net impact of Climate Change on Returns – Globally (%)



Source: Schroders as at 31 March 2021. **Forecasted returns are not a guarantee of future returns. For illustrative purposes only.**

[1] Burke, M., Tanutama, V. "Climate constraints on aggregate economic output" Working Paper 25779, NBER (2019).

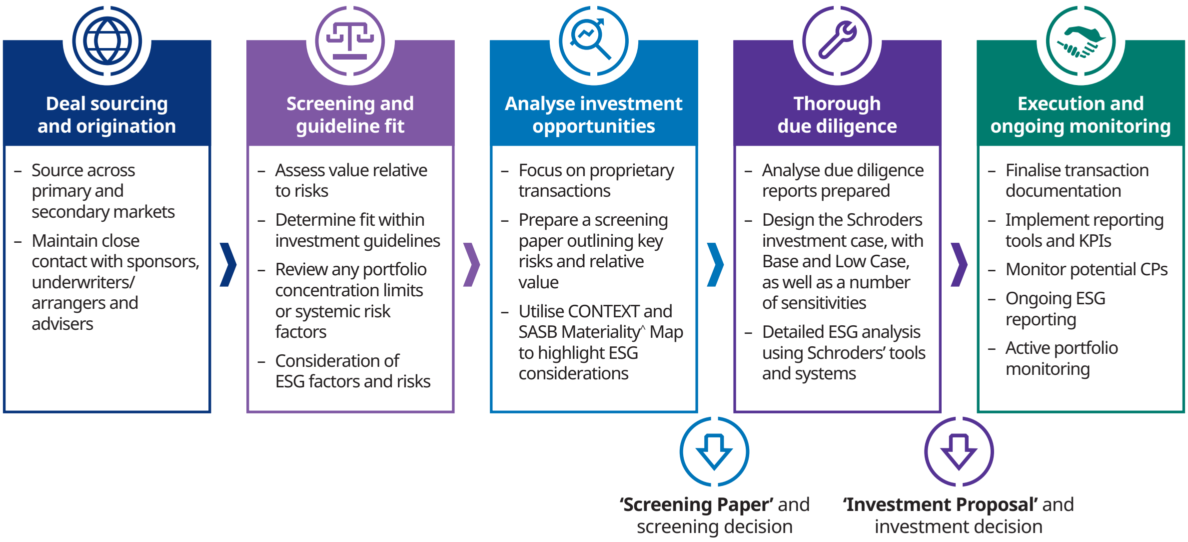
Private Assets

Private Debt

The Australian Private Debt business runs a buy and hold debt strategy lending to companies domiciled in Australian or New Zealand. As a long-term investor without the intention to ever exit the position, ESG analysis is fundamental to every investment we make, before any investment decision is made.

As such, the strategy uses ESG integration to support guiding investments into sustainable companies in an attempt to manage risk and mitigate the risk of loss. Our overall aim is to invest in companies that can demonstrate their commitment to ESG principles and to hold the debt instrument to maturity.

ESG is considered throughout all steps of our investment process, which is split into the five different phases below:



Source: Schroders, 2020. For illustrative purposes only. ^SASB Materiality Map references the Sustainability Accounting Standards Board's (SASB) tool which allows investors to analyse portfolio exposures to specific sustainability risks and opportunities and understand the metrics that underpin various disclosure topics across different industries and sectors.

In sourcing deals the team focuses on those sectors and companies that conduct their business in a sustainable way and in compliance with our ESG policies and, as a buy and hold investor, focus on businesses where we see a sustainable growth story. Sustainability considerations are systematically discussed with the investment committee to develop our responsible investment approach and reported to our investors upfront and on a quarterly basis.

The team conducts ongoing monitoring of all fund and mandate assets, including the monitoring of ESG risks as part of our ongoing credit review. During any on-site visits or lender meetings we engage with the borrowers/ sponsors where possible to ask updates on ESG points and any issues or plans for improvement. If any unforeseen ESG issues arise during the investment, we generally cannot exit the position (without our clients' consent) so as such we would rather need to "vote with our feet" and decline to invest into the next tranche of debt the company issues and/or seek repayment at the maturity date.

Private Equity

Under the Schroders Capital brand, we offer a specialist global private equity strategy focusing on specialist segments, including small and medium buyouts, venture and growth.

Our commitment to ESG and responsible investment starts with its mission and guiding principle of 'Making investments that our investors can be proud of'.

The team was an early adopter of ESG principles in its investment practice and strives to stay at the forefront of responsible investing within the institutional private equity industry. Each investment is assessed for its ESG risks and opportunities. Each private equity firm, in which it makes a commitment, is examined for its adoption of responsible investing practices and ESG principles within the firm's overall operations and its investment process. Additionally, we carry out ongoing ESG monitoring throughout the life of an investment.

Our approach to responsible investing and sustainability combines engagement, positive selection, and exclusion:

Positive selection

- Emphasis on fund managers and portfolio companies with positive ESG elements

Exclusion

- Exclude investment in certain industries (e.g. weapons, tobacco)
- Exclude funds and companies with significant ESG issues or insufficient commitment to ESG

Engagement

- Interact with funds and companies to encourage and enforce positive ESG changes

Source: Schroders Capital.

Given the historical application of ESG principles to its investment process, investment exclusions due to ESG risk tends to be triggered early on in the assessment of an investment project. Through our due diligence and post-investment monitoring, we also actively encourage private equity managers and portfolio companies to pursue positive ESG practices through active engagement.

Schroders Capital's approach to responsible investing is directed by its ESG Committee, which is responsible for developing and implementing a firm-wide approach to responsible investing that is actively embraced across all functional roles. The ESG Committee meets no less than quarterly, reports to Schroders Capital Executive Management, and maintains close coordination with the Schroders Sustainability Team.

In addition, all investment professionals at Schroders Capital are required to complete the 'RI Essentials' course with the PRI Academy. Schroders Capital's approach to responsible investment is led and further advanced by the Responsible Investment Committee ('RI Committee').

CASE STUDY

In 2018, Schroders Capital (then known as Schroder Adveq) was offered the opportunity to co-invest alongside a private equity firm in a fast-growing cosmetics company. A key differentiating factor and growth driver for the target company is the company's effective use of social media and influencer marketing to grow the brand identity and attract customers.

Our due diligence included an extensive review of influencer marketing which led it to raise concerns on some aspects of how the target company approached marketing its products via social media. It subsequently engaged with the company to address those issues, leading to marketing messages being updated on materials and on its products.

INTEGRATION IN PRACTICE – GLOBAL

Asian Equities

As long-term, bottom-up investors, assessing the sustainability of a company's returns and financial position has always been at the core of our research and investment decisions.

ESG analysis is a fully integrated and rigorous part of our investment process and impacts our investment process in **four direct ways:**

1. **Initial screening** – ESG helps determine which companies we consider to be investable as part of our initial screening including the exclusion of certain industries (i.e. coal and tobacco).
2. **SRC Classification** – ESG helps underpin our analysis of the return on invested capital (ROIC) and Shareholder Return Classification (SRC) of a company. It is therefore the bedrock on how we assess the sustainability of a company's business model.
3. **Fair Value and recommendation** – ESG is an indirect and direct input into our fair value estimate of a company. Indirect, to the extent that a company's SRC influences the assumptions used in establishing our fair value estimate of a company; and direct, to the extent that we may apply an additional explicit discount/premium to that fair value estimate.
4. **Portfolio construction** – ESG helps shape portfolio construction and can impose limits on position sizing.

The team is focused on fundamental research where written ESG analysis for companies within scope helps the team identify and assess the potential effect of ESG issues on the investment case.

In supplementing their own research, the team also uses Schroders' proprietary tool CONTEXT and draws on the insights of the Sustainable Investment team as well as Schroders' Data Insights Unit (DIU), who provide support on a project basis.

INTEGRATION IN PRACTICE – GLOBAL

Global Emerging Market Equities

In the emerging market equities team, we use a combination of top-down country and bottom-up stock analysis in our investment process. ESG considerations are integrated at all stages.

In their bottom-up research, analysts complete a mandatory written ESG review for each company they cover. Reviews may result in adjustments to the cost of capital, provisions or cash flows. Where an explicit adjustment is not possible, ESG concerns will be reflected in a discount/premium applied to the initial fair value estimate. Significant ESG concerns will also affect the analyst's conviction in their recommendation.

Engagement is a natural part of our investment process. We engage with companies to seek improvement in ESG performance and processes; to monitor developments in ESG practices, business strategy, and financial performance; and to enhance our analysis of risks and opportunities.

Schroders' sustainable investment team supports the investment team in this area.

The portfolio managers formally review portfolio-level ESG characteristics at a monthly sustainability risk meeting. This review includes two proprietary measures of sustainability risk, Carbon VaR and SustainEx™, as well as MSCI and Sustainalytics scores.

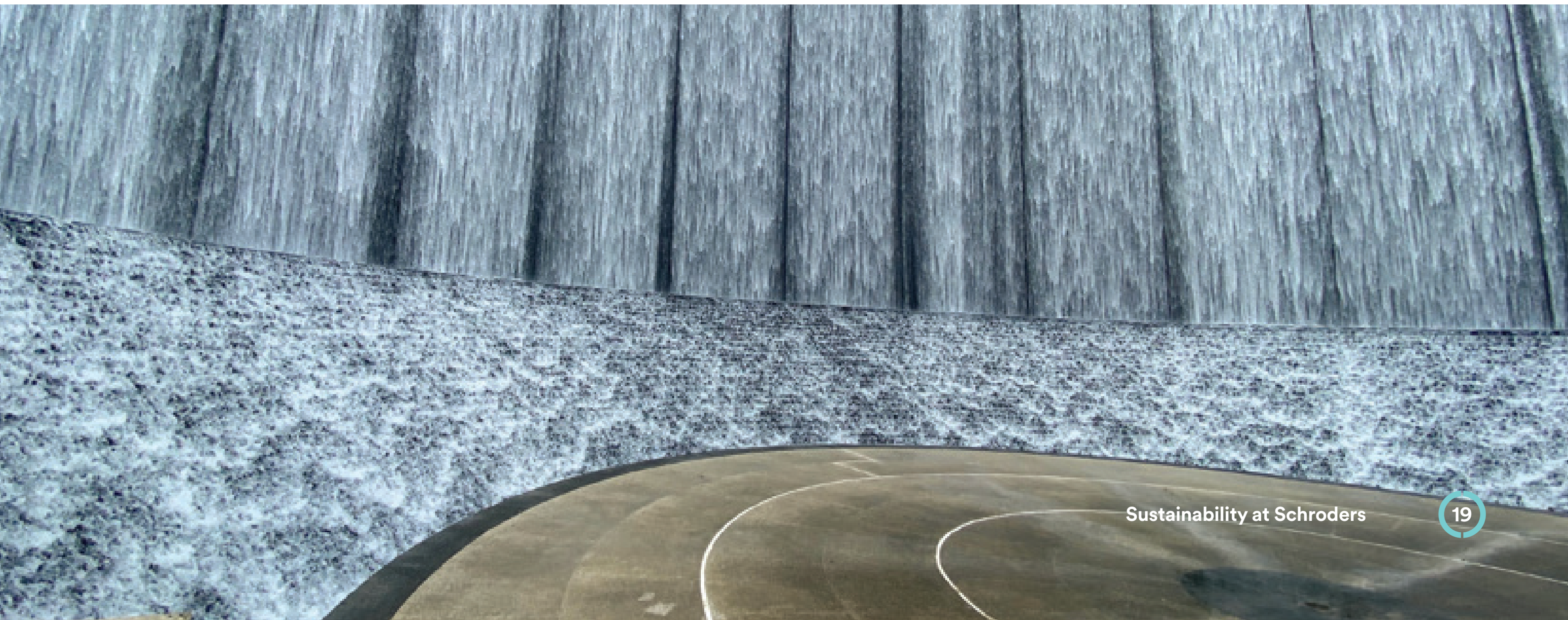
CASE STUDY: SELLING NORILSK NICKEL ON ESG CONCERNS

Schroders' data insights unit (DIU) supports the emerging market equities team with ESG analysis on a project basis. For instance, geospatial and meteorological analysis by the DIU helped the investment team gain a better understanding of Russian assets in the Arctic circle and their vulnerability to climate change.

In May 2020, an ageing fuel tank at one of Norilsk Nickel's power plants in the Arctic circle collapsed, leaking 21,000 tons of diesel fuel into two Siberian rivers. The government declared a state of emergency and ordered an investigation.

In early July, the national environmental watchdog imposed a record $2.1 billion fine on the company. The analyst had previously applied an additional 2% cost of equity to his valuation model to account for the elevated environmental and governance risks at the company. He now includes the additional cost of the $2.1 billion fine in the valuation, and has raised the cost of equity premium to 2.5%.

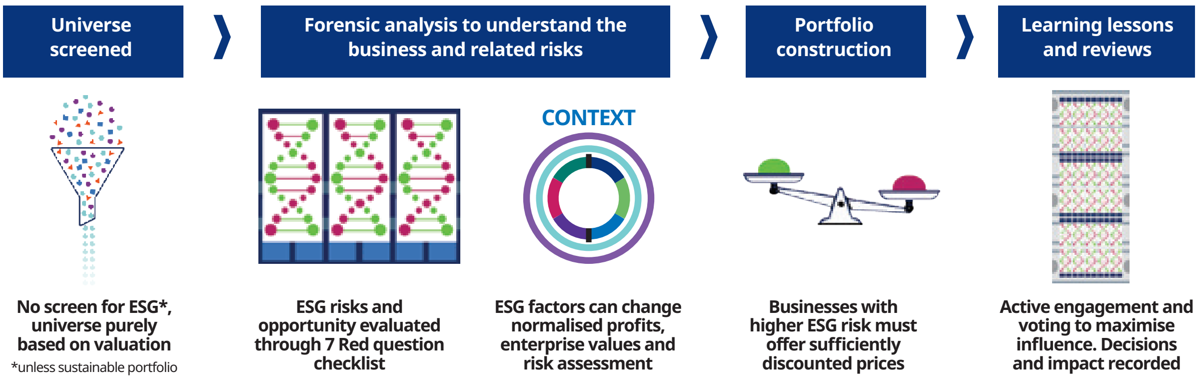
We held a small position in Norilsk in our core emerging market portfolios, which we sold in early June on learning of the diesel spill. The fund manager decided to sell the stock given the increased ESG concerns.



INTEGRATION IN PRACTICE – GLOBAL

Global Recovery

The Global Value team focuses on ESG integration as a source of alpha generation and downside protection. ESG factors are a fundamental and integrated part of the Global Value team's investment process.



At its core, value investing is about buying cheap stocks with an asymmetric risk-reward balance and ESG related factors are integral to this.

In their forensic analysis of companies, the team uses a designated set of questions to identify ESG risk and opportunity. The team considers how a business treats its stakeholders – its investors, employees, suppliers and the governments and regulators with which it deals – to help them determine the sustainability of margins for that company. For example, if a business pays too low a tax rate, underpays its staff or squeezes its suppliers, fundamental economics would indicate the associated risks increase. The team also evaluates the quality of a company's management and board, their remuneration and the degree to which the management team's interests align with those of shareholders.

This analysis can result in the team adjusting normalised profits, enterprise values, or multiples, therefore reflecting the impact of ESG factors in the intrinsic value of a company, or their risk grading to reflect ESG factors

For their analysis, they leverage internal resources, such as Schroders' proprietary SustainEx™ and CONTEXT tools and the expertise of the Schroders Sustainability team's sector specialists.

In portfolio construction, in the same way as any other risk, higher ESG risk must also offer greater upside to fair value, to ensure the team is being compensated for taking on more risk.

QEP Global Equities

The Quantitative Equity Products (QEP) investment process follows a consistent philosophy by which we have been managing assets since 2000.

Analysing a universe of over 10,000 companies, the team constructs highly diversified portfolios typically containing over 300 stocks with stock selection grounded in the analysis of company fundamentals indicating Value (earnings, assets, cash flows, dividends) and Quality (profitability, stability, financial strength, governance and sales growth), with portfolios typically exhibiting a style bias towards both of these factors.

Within our approach to both stock selection and portfolio construction, Environmental, Social and Governance (ESG) considerations have been fully integrated across the full suite of QEP investment strategies since 2017. Sustainability has been a key research priority for the team for many years and continues to be given the ever increasing importance of ESG themes to companies, investors and regulators. Additionally, the breadth of opportunities available in global equities allows for the full integration of ESG considerations without having to sacrifice potential returns and we would argue that incorporating ESG enhances performance, providing it is integrated in an investment led manner, and that ESG considerations are likely to become increasingly additive in the future.

ESG INTEGRATION WITHIN QEP STRATEGIES

The QEP investment process integrates ESG considerations in the following ways across all investment strategies:

- **QEP Governance** has for many years been a key component of our assessment of business quality alongside profitability, stability and financial strength. Our assessment of the strength of a company's corporate governance therefore has a direct impact on our level of conviction.
- **QEP ESG Rating** is central to our assessment of company sustainability. It directly impacts a stock's final weighting in our portfolios by serving as a measure of stock conviction or risk adjustment.
- **QEP Country Risk Monitor** includes Political and ESG considerations. It is used as an input within our QEP ESG Rating as well as a stock level risk adjustment. It also contributes to our decision-making process for risk managing active currency exposures.
- **Active Stewardship Programme** – Collaborating with Schroders' Sustainable Investment Team, we have a robust approach to encouraging positive change through active engagement and voting seeking to integrate the insights gathered into our investment process.

Environmental

Selective implementation, avoid high risk areas with specific rewards for exposure to opportunities

- **Carbon emissions**
  e.g. intensity relative to sales, production & Carbon VaR
- **Stranded asset risk**
  Penalise thermal coal reserves, risk manage oil & gas
- **Carbon reduction strategy**
  Penalise lack of disclosure, assess delivered vs. promised carbon reduction
- **Opportunities**
  e.g. significant exposure to renewable energy & transitioning companies
- **Environmental Impact**
  e.g. Toxic waste, water stress & land use

Social

Focus on penalising significant negative impact and poor practices

- **Business Involvement**
  Penalise negative social impact e.g. tobacco
- **Safety**
  Penalise poor track record e.g. product recalls
- **Employee Welfare**
  Penalise high employee turnover and poor labour standards
- **Supply Chain**
  Penalise poor practices & historical production disruption
- **Data Privacy**
  Penalise lack of policy & track record of breaches

Governance

A key component of our assessment of business quality, applied universally across companies

- **Dividend Policy**
  Reward sustainable and increasing pay outs, asymmetric penalty for cuts
- **Accounting Risk**
  Over 20 red flags e.g. working capital stress
- **Risks to Shareholders**
  Penalise high risk ownership structures & exchange related risks
- **Business Oversight**
  e.g. reward independence, penalise low diversity
- **Country Risk Monitor**
  Penalise poor governance standards, used as a conditional criteria
- **ESG Trend**
  Reward positive trend in company ESG profile, penalise deterioration

Controversies
Leveraging machine learning and natural language processing to identify and analyse controversies

Active Stewardship
Identify priority engagement opportunities & integrate outcomes through collaboration with Schroders' Sustainable investment Team

Sources: Schroders. QEP ESG data sourced from a variety of data providers including MSCI, Refinitiv, BoardEx, Bloomberg, SEC Filings and internal metrics created by the Schroders Sustainable Investment team. For country level data, sources include Oxford Economics, the World Bank, World Economic Forum and World Justice Project.

– **Exclusion policies** – Alongside the firm-wide ESG exclusions, we apply QEP team-wide exclusions such as predatory lending, significant exposure to thermal coal and civilian weapon involvement, to all QEP portfolios. Exclusions in addition to these are client and market led and so will vary across the QEP investment strategies, ranging from our dedicated ESG strategies where we apply our broadest exclusion policy, to segregated accounts where exclusion policies are tailored to suit client specific requirements.

Bringing all of these elements together, we find that the overall impact on the characteristics of our portfolios from a valuation and quality perspective is not materially impacted by integrating ESG considerations, largely because the breadth of our global universe does not force us to trade-off one against the other. Indeed, we would argue that ESG integration actually enhances performance as long as it is incorporated in an investment-led manner, particularly on a forward-looking basis.

CASE STUDY: STEWARDSHIP

Leveraging the insights gained by our central Sustainable Investment Team, we look to penalise companies where we are not satisfied with the level of responsiveness or improvement on the specific topics we have raised. Our central Sustainable Investment Team has recently focused on engagements on modern slavery, specifically on FTSE 100 listed companies given legislation on this subject has already been enacted in the UK. We intend to carry out a second stage with a focus on Australian companies given similar legislation coming into force.

OUR MODERN SLAVERY ENGAGEMENT ACTIVITY TO DATE

Human Rights: UK Modern Slavery Act

Aims & Requests	• Highlight companies leading and lagging UK Modern Slavery Act's transparency requirements • Understand their current position & encourage more transparent supply chain reporting • Disclose policies concerned with modern slavery, the due diligence process and current training programmes available • Communicate KPIs used to measure success and improvements in complying with the new regulation.
Targets	54 companies engaged with, 24 of which are held by QEP • Companies identified by published research from the Business and Human Rights Resource Centre (BHRRC)
QEP Held Examples	intertek, sage, RELX, rb, PERSIMMON
Process	Stronger & weaker performers highlighted in BHRRC report Email and letter with our requests sent to each company Followed with a second stage engagement, supporting a collaborative engagement with he Fin It, Fixe It, Prevent It modern slavery initiative
Outcome	Engagement ongoing, >40 responses received *(e.g. Unilever, BT, Sage)* Companies where increased monitoring is needed identified *(e.g. Reckitt Benckiser, Royal Mail, Centrica)* Extending engagement across Australia-based organisations given regulatory changes in the country

Source: Schroders, QEP.

Conclusion

While ESG risk factor analysis has become more prominent in recent years, Schroders has been at the forefront of investing responsibly for many years. We were an early adopter of the UN Principles of Responsible Investment (PRI) in 2007 and hold an A+ rating for our strategy and governance. We remain committed to ensuring we continue to evolve our thinking and our approach to integrating ESG risk and sustainable investment, leveraging off the considerable investment Schroders has committed to.

We are committed to creating a better future by investing responsibly for our clients, shareholders and the community as a whole to ultimately deliver a positive outcome for all.

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