Schroders

Marketing material

Sustainable investing for a changing world

Annual Report 2016

About Schroders

At Schroders, asset management is our only business and our goals are completely aligned with those of our clients: the creation of long-term value to assist them in meeting their future financial requirements.

We have responsibility for £397.1 billion (€465.2 billion/$490.6 billion) on behalf of institutional and retail investors, financial institutions and high net worth clients from around the world, invested across equities, fixed income, multi-asset, alternatives and real estate.

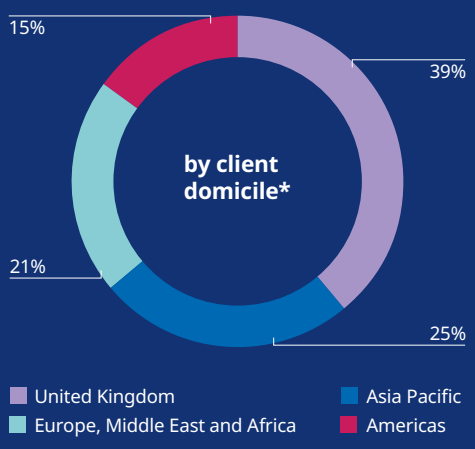
As responsible investors and signatories to the UN's Principles for Responsible Investment (PRI) we consider the long-term risks and opportunities that will affect the resilience of the assets in which we invest. This approach is supported by our Environmental, Social and Governance (ESG) Policy and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

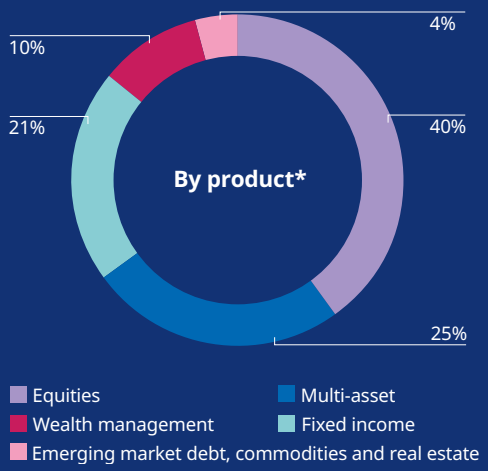
Presence in 27 countries

41 offices globally

£397.1 bn assets under management and administration

4,100+ employees





Source: Schroders, as at 31 December 2016

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

2016 has shown that the social and environmental backdrop facing companies is changing quickly and pressures are coming to a head.

Peter Harrison

Group Chief Executive,
Schroders plc

Over the last decade:

- The ratio of mean to median incomes has reached levels not seen in the post-war era as inequality has widened. The last ten years have been the first in which median real incomes have fallen in the US and UK.
- Society's trust in the corporate sector and political institutions has dropped to new lows, prompting widespread agitation for change.
- Multi-decade declines in voter turnout have reversed, rising by 5-10% in major economies over the last decade.
- Global trade growth dipped below economic growth last year for the first time in four decades (outside recessionary blips) as the surge of globalisation that lifted the world economy subsides.

- We estimate that some 20-25% of the cashflows generated by the world's listed companies may be at risk from the higher carbon prices that will be needed to deliver global commitments to reduce emissions by 2050.

Against this backdrop, ESG integration into active fund management has never been more important. Those companies able to adapt and thrive will continue to benefit disproportionately while weaker peers fall further behind. We are committed to the ongoing development of an ESG team and tools that will enable us to leverage proprietary insights, and deliver alpha for our clients.

Schroders has retained the highest possible ESG score of A+ this year for our overall ESG approach from the UN PRI (UN Principles for Responsible Investment). We are also assessed as a top tier signatory to the UK Stewardship Code by the Financial Reporting Council, and continue to broaden our transparency, for example by publishing our global voting record on a monthly basis. Stewardship is becoming of increasing global importance with a number of new codes being introduced around the world in 2016, and we have been extending our engagement activities globally to recognise this.

The numbers speak for themselves. We have eleven on our ESG team, including dedicated client resources. We conducted over 700 ESG engagements with companies this year, up from 500 a year ago, and we wrote a number of investment-relevant thematic pieces addressing long-term structural issues. Collaboration with investment desks has progressed substantially. Senior investors across asset classes and geographies now collaborate on a regular basis to share best practice and shape the ESG research agenda. Finally, a wave of new proprietary research tools is being rolled out.

Our 2016 Global Investor Study showed a strong global interest in ESG, especially from millennials in the US and Asia. This was of little surprise to us as we have seen the incoming requests for ESG education and discussions grow exponentially in 2016. The ESG landscape is changing fast and we are committed to helping clients navigate this area; for example, through our "Climate Conundrum" work on how asset owners can manage climate risk, and our consideration of the role ESG integration can play in 401k plans. Policymakers are increasingly thinking about the role that ESG analysis and investment can play in creating a more sustainable future. We have been responding to the calls for evidence from the Financial Stability Board Task Force, the UK government and the European Commission, among others, in 2016.

The scope of our ESG activity is broad: it impacts all of our asset classes and geographies, encompasses a number of stakeholders from clients to policymakers, and has never been more relevant in our changing world.

ESG and Intelligent Investing

Recognition

A+ UNPRI Strategy & Governance Approach score

Active engagement

760+ engagements across 34 countries

Top five engagement sectors

Financials 18%
Industrials 17%
Consumer discretionary 17%
Healthcare 10%
Consumer staples 9%

Active governance

5,160+ company meetings voted on

New ESG policy

More detailed and transparent policy

Increased transparency

Monthly voting reporting

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ESG and Intelligent Investing

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

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

We call it Intelligent Investing and the pillars of our discourse below are our core beliefs and how we conduct our approach.

Insight

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

Interpret

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

Influence

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

Integrity

We're committed to managing yourassets responsibly

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Contents

Integrated approach

At Schroders, we see ourselves as long-term stewards of our client's capital and this philosophy naturally leads us to focus on long-term prospects for companies in which we invest. That's why we seek to integrate ESG considerations into our research and overall investment decisions across investment desks and asset classes. We recognise that different asset classes, portfolio strategies and investment universes require different lenses to most effectively strengthen decision-making. Our integration approach spans the breadth of the investment process, from identifying trends, analysing securities and constructing portfolios, through to engagement, voting and reporting.

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

Integration in Equity case study

ESG from an Equity Value perspective

In this case study Simon Adler (Senior Equity Value Fund Manager) discusses how the Value team have long incorporated ESG as part of their investment analysis, as well as his thoughts behind the approach.

Focus on governance and stakeholders

As a Value team, we have always focused on a business's governance and stakeholders, and how these areas could impact risk or future profits.

It should go without saying that the quality of a company's management and board, how they are remunerated and the degree to which their interests are aligned with those of shareholders are very important considerations for us. If we do not believe a company is acting in the interests of its long-term shareholders, we will do all we can as investors to try and bring about a change.

Similarly, the way a business treats its stakeholders – not just its investors, butits employees, its suppliers and the governments and regulators with which it deals – helps us determine the sustainability of margins for that company.

After all, if a business is paying too low a tax rate, underpaying its staff or squeezing its suppliers, fundamental economics would indicate the associated risks increase. For us then, being satisfied a company is behaving itself both inwardly and outwardly makes a huge amount of sense as a risk-reduction technique and to help determine our view of sustainable margins.

Adjusting for potential stakeholder risk

To start with a relatively straightforward example, one financial business in which we are interested and about which we have written in the past, pays a 10% tax rate, which is well below that of the jurisdiction in which it operates. As we do not believe this is a particularly sustainable course of action for too many businesses, we have adjusted our numbers – reaching a judgement on the company's valuation as if it were paying a more appropriate 20% tax rate.

Another business we have been looking at recently is, let us say, rarely held out as a shining example of how to treat employees. Among other things, it does not appear to be paying its entire staff in a sustainable manner and it has been earning a higher margin than similar businesses. Taken all together, this suggests the margin it makes across the next cycle may be lower than the last. In our valuation of the business therefore, we have taken an extra 200 basis points off the historic margin to reflect that particular stakeholder risk.

Better business, better investment

We can be less coy with our next example because Tesco has been working hard to address the widespread view of a few years back that it was not offering the greatest deals to its customers, its employees or its suppliers.

The main components of CEO Dave Lewis's turnaround strategy for the business he joined in July 2014 have been to reduce prices, re-engage colleagues and reset the group's relationships with its suppliers. Evidence from customer and employee satisfaction surveys and supplier rankings suggests the strategy is working on these fronts and this is feeding through into a better business – and a better investment for our clients.

This is why we pay such close attention to whether a company's governance is appropriately aligned and why we are so attuned to potential stakeholder risks. It is also why, if we find an "ESG-related" issue we think is unsustainable, we will make an appropriate adjustment based on a business's normalised numbers. We would never claim to get it right every time but the important point is that we can and do make these adjustments at all.

A differentiated perspective

Equally, when we do so, we have a huge advantage because we are able to take a much longer-term and more independent view than many of our peers. Most professional investors are obsessed with trying to forecast what will happen to earnings over the next year or two (or sometimes even quarter) – and thus find themselves constrained by having to compare themselves with consensus on tax rates, employee costs and so forth. We say what we think a business can earn over a cycle and so end up with a much purer number.

What is more, when we make an adjustment, we do not have to specify a precise reason. If, for example, a company's margin is artificially high because it is underpaying its staff, then we know there is a risk that margin could fall. It could be because the staff turnover rate is too high or employee costs go up or the customer is seen to be valued less highly or any of a number of other reasons.

Unlike most analysts, however, we do not have to pick one to forecast (for which, read "guess") what might happen. In this example, we may not know the exact mechanics of the margin decline; it is simply enough to understand that some stakeholders have been under pressure, and so the past may not be a good guide to the future. All we then have to do is acknowledge that fact in our valuation by introducing a figure based on normalised profits, say, or in some circumstances enterprise value.

Driving better investment performance

We do not do ESG because it is in "vogue" but because we believe identifying governance and stakeholder risks improves investment performance for clients. At its core, value investing is about buying cheap stocks with an asymmetric risk-reward balance. In analysing the risk part of that equation, we will take into account anything that helps us make the best analysis. This includes the "ethical" and "socially responsible" considerations of the past, the "ESG" factors of today and whatever else it may be called in years to come.

Integration in Fixed Income case study

The role of ESG in credit investing

For some, incorporating ESG factors into fixed income investing may be limited to having a small allocation to green bonds, or not investing in the debt issued by tobacco companies. These efforts are worthy, but only scrape the surface. Our main objective for integrating ESG analysis into our investment process is to enhance returns and protect value for our clients, across the full spectrum of financial instruments.

Why do it?

Our credit portfolios offer investors a platform to invest in idiosyncratic opportunities. To deliver that promise, we employ a holistic approach to credit combining fundamental analysis with ESG insights.

Integrated ESG analysis focuses on a company's capacity to develop valuable products in the future and to maintain cost efficient operations and other activities that will lead to long-run competitive advantages, growth and profitability. Thus we focus on management teams, their track records, their values, and how they employ debt and equity capital, in addition to their product portfolios and profitability. For a company to be a long-term holding in our portfolios we require cashflows that are sustainable in every sense of the word and ESG analysis is central to this work.

Some may argue that it is sufficient to rely on the rating agencies' assessments of these factors. Our experience is that rating agencies largely deal with explicit ESG risks in their most formal manifestations on an ex-post-facto basis, e.g. mandatory regulation, product recalls and consumer boycotts. This often is too late to have a positive impact on our portfolio performance.

How do we do it?

Our researchers use a variety of sources: ESG data providers such as Bloomberg and MSCI, data from issuers, governmental bodies, non-government organisations, consultants and academics, as well as work done by think tanks. ESG information is loaded into Schroders' proprietary research database, Nexus, which shares knowledge across various asset classes.

Much of the analysis of ESG risks is done by credit researchers at the initiation of a company's coverage. Ongoing identification of emerging ESG issues that can impact the credit is also important as credit researchers assess a company's track record and outlook on this front. This often is the result of collaboration between ESG and credit researchers to derive a better understanding of changing market dynamics.

We use data gathered by external ESG and credit rating agencies as a reference for our fundamental work in this area, but the final conclusions on ESG impacts are made by our credit researchers.

Portfolio construction

While fundamental analysis of individual issuers is important, especially at initiation, we take a thematic approach to ESG issues, conducting proprietary in-depth research on ESG topics and their impact across our holdings. We will draw on granular information sources such as official government statistics on meteorological data, employee turnover or wage trajectories to determine how a factor will impact issuers across countries or sectors. This deep exploration of how external factors will affect a company's operating model and its operating environment ensures that we are capturing broader structural trends across portfolios.

Engagement

Our engagement concentrates on each company's ability to create sustainable value, and we question or challenge companies about issues that we perceive might affect the future value of those issuers' bonds, including those relating to ESG factors. It has been through the combined efforts of our fixed income, equity and ESG teams that we have been able to effectively interact with companies, stimulating awareness of and highlighting potential solutions for key ESG issues.

Our integrated ESG approach differentiates our credit process

We have been explicitly incorporating ESG factors into our fixed income credit analysis since we published our first Responsible Investment Fixed Income ESG Policy statement in 2011. It is the deep resources Schroders has across asset classes, combined with the efforts of our dedicated ESG team that truly differentiates our credit process from competitors. Schroders is gifted with an extensive reach across the world into multiple industries, giving us a reputation as a long-term investment partner with both companies and investors. We now have one ESG policy and this unified and consistent policy encourages the routing of information and insight across our network, which ensures we can continue to guard and grow our client capital.

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Integration in Real Estate

Schroder Real Estate has managed real estate funds since 1971. Our real estate business is headquartered in London with six offices across Europe and currently has £12.1 billion (€14.2 billion / US$14.9 billion) gross of real estate assets under management (at 31 December 2016) across direct real estate, real estate securities and real estate capital partners.

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

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

We also participate in the Global Real Estate Sustainability Benchmark "GRESB" which is the global standard for assessing the ESG performance of real estate funds and companies. Our approach can be best demonstrated by looking at our activity over 2016.

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

Case study

In November 2016 Mermaid Quay, a waterfront retail and leisure scheme held in a UK portfolio, was awarded a Silver Green Apple Award for Environmental Best Practice for waste management. The new solution included installing a food digester to reduce volume, moisture and weight of restaurant food waste by approximately 70%, lowering disposal cost and vehicle movement. The digestate is used as "soil enhancer" in Mermaid Quay planters and in landscaping and farming. As a result of its Green Apple Award success, Mermaid Quay has been invited to have its winning paper published in The Green Book, the leading international work of reference on environmental best practice, so that others around the world can follow its example and learn from its achievements.

Case study

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Case study: leasing the refurbished E-Lite Building, Avenue Louise, Brussels, Belgium

The E-Lite Building in the prime Louise district of Brussels was purchased in 2015 on completion of renovation works to BREEAM[1] Very Good. The specification focuses on efficient heating, cooling and ventilation systems to deliver a low energy building with good natural light and views over the gardens behind. The result provides an uplifting working experience and the service charge is materially lower than an equivalent building without such environmental initiatives, which together has enabled a good tenant profile to be secured. The onsite property management team is focused on ensuring the building operates to its efficient design credentials. Benchmarking is also undertaken and the building has demonstrated carbon intensity lower than typical office buildings[2].

1 Building Research Establishment Environmental Assessment Methodology – an environmental assessment method and rating system for buildings

2 Carbon dioxide has been assessed against CIBSE TM46 energy benchmark "General Office" (category 1)

Integration in Wealth Management

A view from Cazenove Capital

Cazenove Capital Management ("Cazenove Capital") is the wealth management and charity investment business of Schroders plc in the UK, Channel Islands and Asia. We offer personalised, discretionary investment services and wider wealth management services to a broad range of clients. Alexia Zavos, Head of Responsible Investment at Cazenove Capital works closely with Schroders' ESG specialists, allowing Cazenove Capital to offer a pragmatic and flexible approach to responsible investment (RI).

RI continued to garner considerable interest in 2016, as indicated by the results of the Schroder Global Investor Study and wider research reported in the media. Traditional screens and environmental concerns remain a common theme but clients are increasingly raising issues such as corporate culture and modern slavery, and would like to understand more about the wider impacts of their investments.

Increased options available

For those clients investing via third party funds, we have expanded our recommended list of ethical funds and now have a range of passive options available, if appropriate. It is now much more viable to build a portfolio of RI funds subject to the same rigorous analysis as their mainstream counterparts across the majority of asset classes and geographies. The only limiting area is absolute return. However, clients need to be aware that often these funds are harder to benchmark and tend to have more of a small- and mid-cap bias.

Enhanced philanthropy offering

This year we have also been developing our philanthropy offering for our clients. It has become increasingly clear that philanthropists view impact investment as the most positive philanthropic trend. We are advising clients on making investments that qualify for social investment tax relief and on making investments in social enterprises, which also qualify for Seed Enterprise Investment Schemes (an initiative launched by the UK government in 2011 to encourage investment in small start ups).

As part of this move, we held an event to celebrate the rise of the social entrepreneur. It was held at Brigade Restaurant, a social enterprise that provides apprenticeships for people that have experienced homelessness. We were thrilled to be joined by Sir Harvey McGrath who spoke about his experiences as a philanthropist and social investor. A quarter of all new businesses started in London last year were social enterprises and we welcomed four of the more established companies to the event. They highlighted how their businesses are helping to solve some of our most pressing social problems such as food waste and providing employment for trafficked and vulnerable women.

Charities events

This year our charities team hosted their third annual charity investment lecture at the Royal Institution of Great Britain and were delighted to have Professor John Kay, the renowned economist, author and regular contributor to the Financial Times, present to our attendees. His talk followed two main themes: investment uncertainty and long-term decision-making in endowment asset management. This was pertinent to us as long-term investors who behave like owners rather than renters of capital.

We also spoke at the European Foundation Centre's annual conference with the Association of Charitable Foundations. The session tackled the issue of fossil fuel divestment by exploring diverse viewpoints, up-to-date financial analysis and key governance. In line with Schroders' climate conundrum report, it concluded that divestment is just one of the many tools available for Foundations who want to play their part in tackling this challenge.

Looking ahead to 2017

After an eventful 2016, we are looking forward to the year ahead. We hope to continue to build on our responsible investment approach as we are sure it will continue to rise higher on the agendas of private clients and charities.

Insight

Creative work comes from great insights. At Schroders, we try to ensure we are at the very forefront of thinking on existing and emerging ESG topics. Our thematic reports are to further enhance our understanding of the material ESG risks and opportunities that may impact a company's valuation and risk profile.

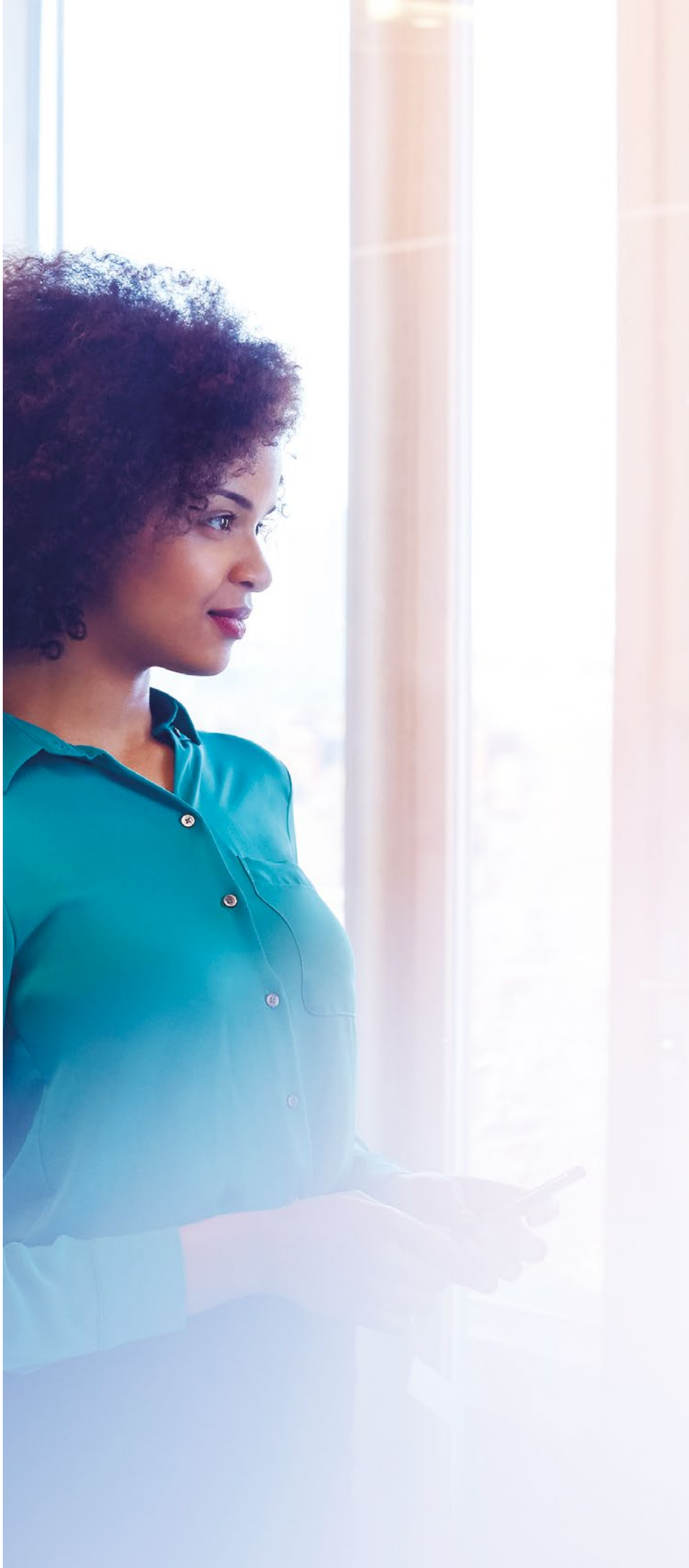
To fully understand a company's potential you need to look beyond the annual report. Analysis of how companies deal with all their stakeholders – such as customers, clients, and employees – are all vital clues to a company's long-term ability to grow and deliver consistent returns.

Schroders ESG team also produces these insightful multi-sector and multi-region thematic reports on key ESG trends to help educate clients, internal investment teams and the public.

During 2016 we produced research on the following topics:

- A new financial consumer awareness
- A Schroders review of US corporate governance
- Modern slavery: how new regulation will impact consumer companies
- Process safety: the hidden risk companies aren't disclosing
- Aviation: the wings of (climate) change
- Caring about the sharing economy
- The climate conundrum: how to assess climate risks in your portfolio
- The road that led to Brexit (and where it's heading)
- Fiduciary duty: turning sustainable intentions into fiduciary practice
- Water stress: the rising costs faced by beverages companies
- Oil and gas companies: the carbon risk
- How not to tick the box in 401k

In this section we cover three hot ESG topics: process safety, climate change policy reforms and the outlook for the high street.



Insight
Process safety and hidden risks

The hidden safety risks companies aren't disclosing

Against a backdrop of rising financial losses from man-made safety incidents (Figure 1), we investigated the discipline of process safety, researching Schroders' top ten holdings in the mining and chemicals sectors. Our goal was to identify good risk control, and to understand how companies were managing and recording safety processes.

Process safety is a management system that helps prevent major incidents. It is managed, tracked and measured differently to traditional "occupational" safety measures such as "lost time injury"[4] or accident data. We no longer believe traditional indicators are a good proxy for identifying major safety incidents, and believe alternative and forward-looking data should be sought.

Major hazards, although rare, result in lasting consequences for both stakeholders (fatalities, widespread environmental impact), and shareholders in terms of ongoing costs, liabilities and the licence to operate.

Chemicals companies are more open about process safety

Our preliminary research found that chemicals companies were better at talking about process safety than miners. In the chemicals sector, the potential scale of damage plus increasing regulation means process safety is discussed more. Partly as a result of regulation such as the EU Seveso Directive, which requires companies to have a process safety management system, process safety is now a key risk management tool within the sector. However, underwhelming disclosure makes it hard for investors to fully understand exactly how the issue is being approached.

None of the mining companies in our sample set reported any leading safety indicators that might help investors spot red flags (such as training, near misses, or 'high potential' incidents). Given the increasingly complex nature of mines and mining regions, this is a concern for investors.

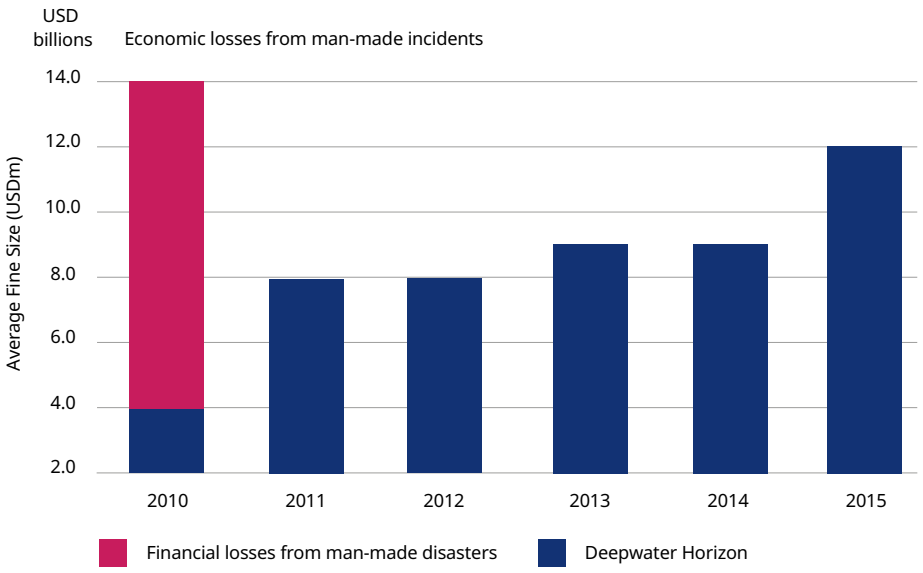
Encouraging clearer disclosure

As active investors, we have been encouraging clearer disclosure of process safety among our top 20 mining and chemicals holdings. We have held calls or exchanged information with several of these firms so far. The new information is helping us build a clearer view of the systems in place behind the brief text within annual and corporate responsibility reports.

Reassuringly, our findings so far demonstrate that process safety systems are being employed, albeit to varying degrees of implementation, but are not widely disclosed. We identified an upward trend: five companies spoke of forthcoming improvements, with evidence that some are starting to collect forward-looking data. In fact the majority said data such as near misses are tracked internally, with many indicating that if such data was useful for investors, it could be disclosed.

We expect our engagement to bump process safety management – and disclosure – up the internal discussion agenda within our key investee companies. We also anticipate that the 2017-2018 reporting period will see an improvement in disclosure. In the meantime, our dialogue with companies continues. Where company responses have been less than reassuring, we are pursuing and escalating the issue.

Figure 1: Trend in economic losses from man-made accidents



Adapted from Exane, Swiss Re, 2016[3]

3 Exane, "Take a walk on the safe side", March 2016

4 Defined as an injury that results in time lost from work, whether temporary or permanent

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Insight
Green transition: the changing role of policy

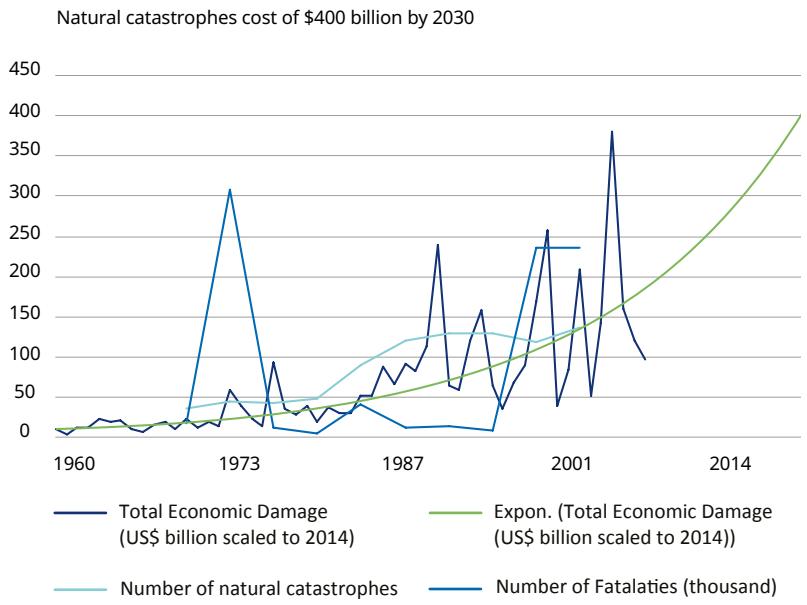
The changing role of policy in the green transition

This last year has seen confused political messages on the climate change front. Optimism for faster progress followed the agreement of the Paris Accord last December, which was further buoyed by ratification by the US and China mid-year. The Accord was pushed into legal force faster than most observers had expected - signalling a more consistent global commitment than past talks. By the end of the year, that optimism had fallen apart, with US scientists apparently rushing to safeguard climate data that they feared might be destroyed by an incoming administration sceptical of the climate challenge. We doubt 2017 will present us with a much clearer picture. However, there are many reasons to remain very confident about the low carbon transition that has been quietly accelerating in the last couple of years.

- European and Chinese policymakers have a very different set of priorities to US counterparts, and already see low carbon as a way to achieve competitive advantages in future generation technologies
- The corporate sector has passed a tipping point: it is an increasingly important driver of change both in terms of funding research and development into low carbon technologies (e.g. electric vehicles), and in decarbonising their own energy consumption
- City authorities are taking the lead in environmental goals in many countries, as they attempt to make themselves attractive locations for people to live and work. Smart, connected cities, with good public transport, support for low emission vehicles and clean air policies are all driving rapid change

The essential nature of political support also appears to be waning, and we believe it is more fruitful to focus on the underlying trends that have driven climate investments so far and those that will continue to do so.

Figure 2: Growing costs of extreme weather events



Source: Schroders; CATDAT, 2015; Mckinsey, 2009

The climate challenge continues

The climate challenge is undoubtedly becoming more acute. NASA data indicates that 2016 looks to have been the warmest year on record, and extreme weather events are becoming more frequent, which is associated with greater costs as shown in Figure 2. Data from the International Energy Agency implies that within a couple of years, new investments in fossil fuel energy infrastructure will become stranded (unable to operate to the end of their productive lives) if the two degree targets to which global leaders committed in Paris are delivered. These trends raise climate change ever higher on corporate agendas.

Declining state support no longer spells disaster

Industries and markets exposed to climate drivers can therefore continue to grow even with weakening political commitment or clarity. This is demonstrated in the chart below, which shows that despite a structural decline in commentary on climate change and the rate of climate policy implementation, renewable capacity globally has continued to grow at a rapid pace for many years.

Dramatic improvements in technology economics have also reshaped the ability of markets that historically relied on the public sector, to compete without the state's support. Subsidies and political backing for renewable energy has been reduced or withdrawn from many markets over the last few years with little effect on investment or growth. This is in contrast to the picture even five years ago, when moves by Spain and Japan to reduce support for solar power dramatically undermined those markets.

Picking up the baton

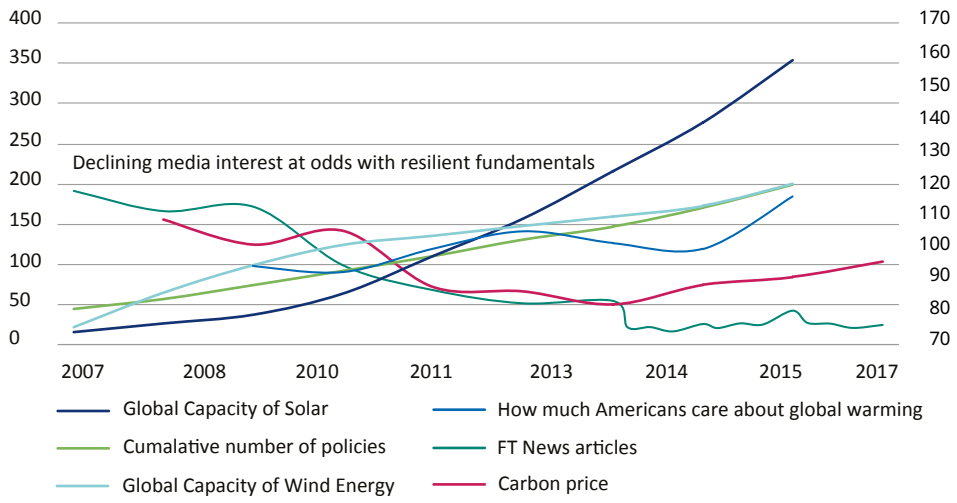
We therefore remain optimistic about the outlook for the green transition; the effects of climate change as an investment theme will spread far wider than clean energy, into markets where public support has never historically been a driver of growth. Even in areas where state aid has been key, we are encouraged that other groups, including the corporate world, appear to be picking up the baton.

Insight
Green transition: the changing role of policy cont'd

The role of ESG in credit investing

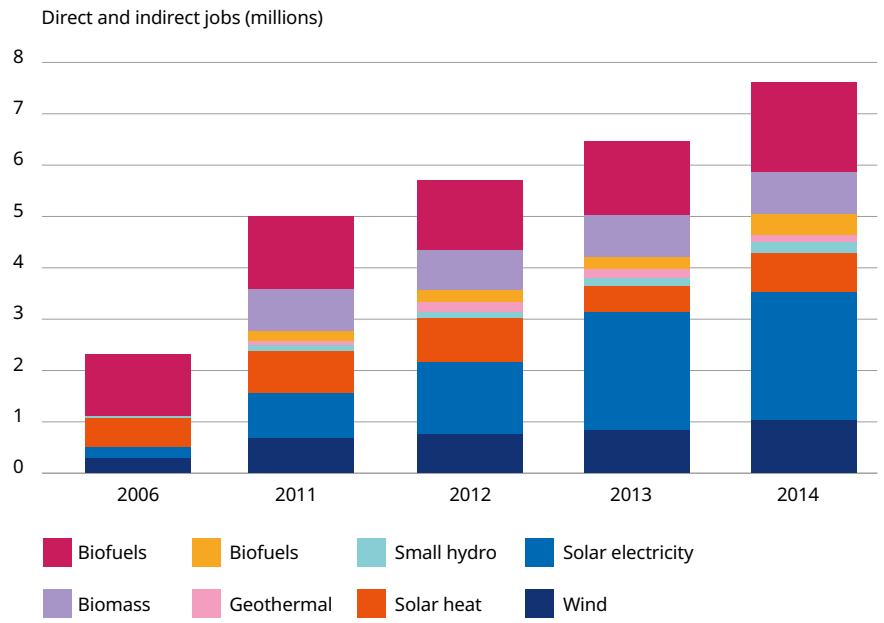
Figure 3 shows the compelling growth of solar and wind capacity even in an environment of declining state backing. The strength of renewables is also reflected in employment statistics. Globally renewable energy accounted for over 7.5 million jobs in 2014, as seen in Figure 4.

Figure 3: What's influencing climate change policy support?



Source: Schroders; Bloomberg; FT; Gallup, 2016; IRENA, 2016; Climate Tracker, 2016.

Figure 4: Renewable jobs globally by source



Source: IMF, 2015.

Insight
Retailing a new story

The changing role of policy in the green transition

Brexit may have dampened consumer spending at the tail end of 2016, but the decline in high street sales can be tracked over a longer period. Essentially, the way consumers shop has changed. With the bankruptcies of British Home Stores (BHS) and Austin Reed, 2016 has shown that the penalties are high for companies that are slow to adapt. We have a number of investments in UK retailers and engage regularly with them about how they are navigating structural and cyclical challenges to create value for shareholders.

Our message is consistent:

- Focus on disciplined capital allocation that can deliver long-term benefits for shareholders;
- Maintain a robust balance sheet;
- Refresh boards to obtain relevant expertise in digital and e-commerce;
- Ensure that management have the correct long-term incentives.

Disciplined capital allocation

Changes in consumer preferences have led to the demise of the "big box", out-of-town retail site in favour of small convenience stores and internet shopping. However, retailers have often already committed to new 25-year leases on property making it difficult to be nimble. Many retailers are attracted into expansion by rent-free periods offered by landlords. After all, it is easier to grow by opening new shops, even if they are in poor locations, than by investing in distribution infrastructure improvements. We have been urging caution among our retail holdings, highlighting the potential hindrance signing a new, long lease may pose to a retailer's ability to adapt.

Robust balance sheet

To understand the risks associated with our investments, we examine the balance sheet, adjusting for leases and working capital commitments in particular. We like to see the fixed charge cover ratio, which represents a firm's ability to pay off its fixed costs (including rent and interest costs), at manageable levels. This has become more important given changes in accounting rules that require lease liabilities to appear on the balance sheet.

Experienced management

Having the right management and board in place, particularly against a backdrop of change, is essential. We engaged with Tesco in 2013 and 2014 about the lack of retail experience on their board, highlighting it as one of the reasons we were not investing in the company. Tesco subsequently had a difficult period in which it suffered accounting scandals and poor operational performance, the combination of which led to a weak share price. We are pleased that the board now has a much more relevant skill-base and have increased our holdings as a result.

In general, e-commerce skills are in short supply, but have never been more important than in today's world. One key development in this sphere was the management change seen at Debenhams, which we supported at the time, where a new CEO from e-commerce giant Amazon, Sergio Bucher, was hired in 2016. This was after the appointment of Sir Ian Cheshire, an experienced retailer, as chairman. We are encouraging all companies in the retail sector to look carefully at their succession planning and as areas such as digital marketing become increasingly important, to make sure that they have the right talent coming through.

Remuneration: asset efficiency improvements most important

Executive pay is a hot topic and an examination of the targets used in the retail sector points to some worrying issues. The data below shows how some of the UK's top retailers calculate short- and long-term targets.

There is a large focus on growth in profits and sales. Short-term profit growth has sometimes been achieved in the sector by increasing prices and margins at the expense of the customer proposition and long-term value creation. This has contributed to the rise of discounters like Aldi and Lidl in the UK and to the rapid expansion of retail space, much of which is now unsuitable.

We believe management should be incentivised on asset efficiency improvements and a focus on returns, adjusting for leases. At Debenhams we insisted that they include a return on capital employed underpin within the strategic measure of their long-term incentives, which was to include a capitalised value of future store rental payments and profitability items on a pre-rental basis. We also like relative total shareholder return as a target because management can easily be benchmarked against their peers. Targets need to be seen as stretching yet attainable, with boards using discretion to ensure that there is a good alignment with all stakeholders.

Conclusion

The challenges facing the British High Street aren't going to be solved overnight. We want to encourage companies to make the right long-term decisions to ensure that these well-loved names survive for another generation.

Figure 5: UK firms' short- and long-term targets

Company	Schroders ask	Outcome
Tesco	Sales growth, Operating profit	Relative shareholder returns, Cash generation
Sainsbury's	Profit, Sales	Return on capital, Earnings, Cashflow
Morrisons	Profit	Cashflow, Sales, Earnings
Marks & Spencer	Profit, Cashflow	Growth in earnings, Return on capital
Debenhams	Profit	Earnings (Return on capital underpin)

Source: Schroders, company annual reports

Interpret

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

In this section, we define ESG terms, interpret the results from the independently collected Schroders Global Investor Survey 2016 and discuss how clients should integrate climate change into their policy.

Interpret ESG investment terms

Today, nine in every 10 of the world's largest fund managers have signed the UN PRI, which reflects a public commitment to ESG integration[5]. As the number of investors focusing on ESG topics has expanded, so has the volume of terms applied. The field has become saturated with confusing nomenclature and lack of clarity on the various approaches.

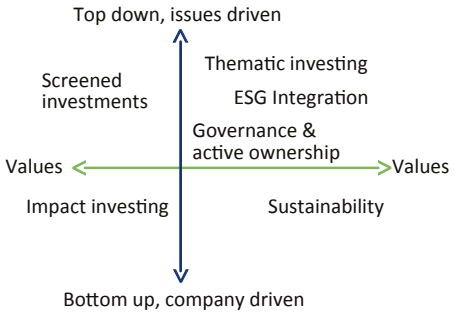
For most of the last decade, much of our industry appeared to be content focusing on rhetoric over substance. Keeping details, definitions and methodologies vague allowed investors to infer their own expectations of what constitutes "sustainability", with the consequence that the market now has an eclectic mix of strategies sitting under a "sustainability" banner. As much effort appears to have gone into labelling and positioning as into developing more effective tools, frameworks or strategies. With attention turning to the details of what investors/ companies are doing, how they conduct their business and why, we believe more clarity and precision is useful and use this opportunity to describe our view of the landscape.

Terms like "sustainable", "responsible", "impact" and "ESG investing" are often times used interchangeably to cover a wide spectrum of goals and strategies. At one end of the scale, ethical screens eliminate companies engaged in controversial activities reflecting asset owners' values and should have little expectation of improved investment returns. At the other end, sustainability analysis can, when approached thoughtfully and integrated with more traditional analysis, improve insights and enhance performance. Engagement, impact or thematic investment approaches occupy yet more positions. Each approach has different goals, requires different skills and demands different tools.

To illustrate this point, the chart below maps the main, broad approaches we have identified and their positions in terms of expected performance benefits relative to social benefits, and top-down thematic or bottom-up company-driven starting points.

The X axis runs from "Values" (based on clients' ethics), to "Value" (which focuses on financial outcomes). The Y axis quantifies the areas that our work and products seek to impact and the approach taken with respect to analysis or investment decisions. Essentially, the Y axis asks whether the issue is grounded in a macro view of cross-sector challenges and opportunities, or in a micro view of company's business models or activities.

Figure 7: ESG approaches

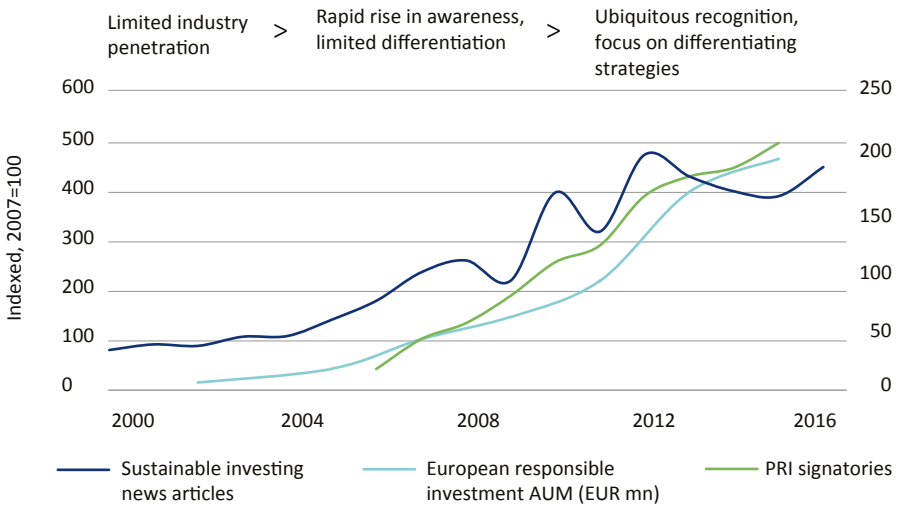


Source: Schroders. For illustrative purposes only.

Every approach plotted above covers a wide spectrum of distinct activities, and an even wider range of terms (many of which were intentionally left off for the sake of simplicity). The next several sections offer our assessment of the various areas of activity encompassed by each broad category. This is intended as a roadmap to help investors understand the different approaches used across the industry, and common interpretations of each.

This report is not intended to offer any views or recommendations on what might be the most effective or intelligent choices, as such decisions vary greatly depending on investors' goals and investment strategies.

Figure 6: ESG interest rising



Source: Hightail (news search for articles containing "sustainable investing" relative to all articles referring to "investing", Principles for Responsible investment (number of signatories) and EuroSIF (combined AUM invested in different ESG strategies, adjusted for double-counting)

5 Of the active asset managers listed by P&I (Pensions & investments), 91 of the 100 largest are shown as signatories on the PRI website

Interpret Schroder Global Investor Survey: the ESG results

Investor attitudes to ESG investing: what our Global Investor Study revealed

Asset owners often tell us that they struggle to understand how the end beneficiaries view ESG and responsible investing; engagement levels, even on long-term savings products like pensions, are low. The findings of our 2016 Schroders Global Investor Study help shed some light.

We asked a range of questions about attitudes to investment and ESG, and collected responses from 20,000 individuals in 28 countries with a minimum of €10,000 (or equivalent) invested, (see page 48). There were some interesting results.

Millennials are more ESG-focused than baby boomers

Respondents were asked to score out of ten how concerned they were about ESG factors when making investment decisions. The study showed that millennial investors – defined as those aged between 18 and 35 - were far more concerned with ESG issues than older generations, with an average score for the age group of 7.3 out of 10.

This compared with 6.6 for those aged 36 and over. Baby boomers – defined as those aged between 53 and 71 - and older investors presented with the lowest scores, at 6.2 for those aged 55 to 65 and 5.8 for those over 65.

Regional differences: European investors are the least concerned

There were also some interesting results when we looked at how investors in different regions approach ESG investing. Europeans scored below the global average in every case, and were the least concerned about ESG issues. Investors in the Americas, however, scored above the average each time, with the US in particular placing a high degree of importance on ESG considerations. Investors in Asia were also more likely to consider such concerns, particularly those in Indonesia and Thailand. China and India also ranked highly.

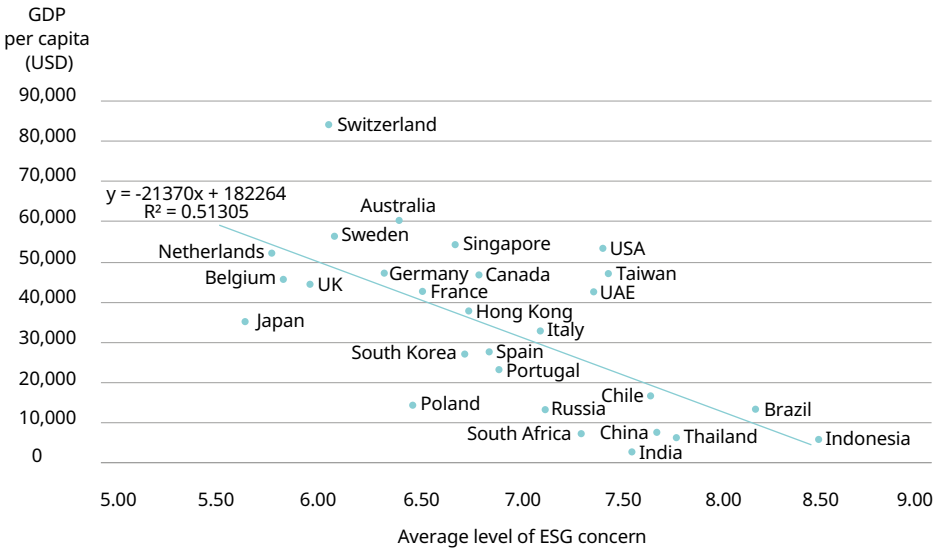
Interestingly, we noticed a correlation between the average wealth of countries and their interest in ESG issues: investors in wealthier countries appear less concerned about ESG issues than their counterparts in poorer countries.

Similarly there appears to be a general correlation between scores on the importance attached to ESG issues and relevant national indicators like corruption levels, environmental fragility or political risk. This indicates that investors seem to attach more priority to ESG issues in countries where they are exposed to these challenges more often.

Long-term focus

Encouragingly, 82% of investors were willing to stick with an ESG investment for the long term. The results indicated that investors are prepared to remain invested for 2.1 years longer than the average 3.2 years that investors usually hold onto their investments. This is good news given the general calls for a more long-term approach in finance.

Figure 8: Investors from wealthier countries appear less influenced by ESG issues



Source: Schroders GIS2016 for average ESG Score, UN data at data un.org for GDP per capita figures (2014). CIA The World Factbook for Taiwan GDP per capita figures (2015)

Interpret Schroder Global Investor Survey: the ESG results cont'd

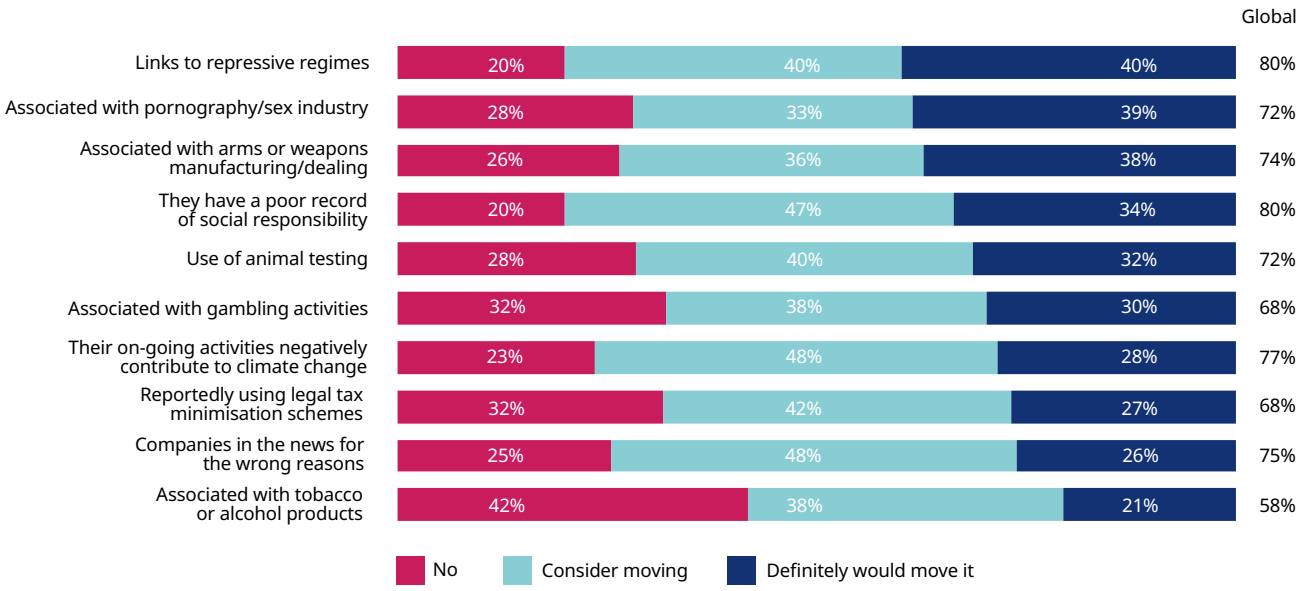
Which issues matter the most?

Traditionally, ethical mandates have simply excluded investments in companies involved in areas such as tobacco, arms, alcohol and pornography. Interestingly, our survey revealed that investors these days are more concerned about the environment in which the companies they have invested in operate (for example whether they are linked to repressive regimes). They are also more interested in a firm's overall record of social responsibility and approach to climate change. Attitudes appear to be changing from focusing on what a company produces, to how they are operating and who they are operating with.

Conclusion: new and unexpected insights

Our Global Investor Survey challenged some pre-conceived notions that we had about investor interest in ESG. American and Asian investors appear more interested in ESG investing than Europeans, even though ESG is more established in Europe. The purely ethical exclusions of the past present less of a concern to investors; they appear to be taking a more holistic, fundamental and rigorous approach to assessing companies on ESG grounds. The least surprising finding was the interest millennials show in ESG investing – we have already seen that this cohort is influenced by these factors in other choices that they make as consumers. Certainly the most encouraging finding was the willingness of investors to take a long-term view on these investments, something we believe to be vitally important in trying to achieve the best possible returns.

Figure 9: "Would you move, or consider moving, your money out of an investment that was performing well if you discovered it was invested in the following types of companies?"



Source: Schroders Global investor Survey (2016) – Global Consumers

Interpret
Climate conundrum

Rising climate risk and regulations

Climate risk is rising up the agendas of asset owners faced with both the growing prospect that more stringent climate regulation will impact portfolio returns and increasing scrutiny from beneficiaries and other stakeholders.

Incorporating climate change risk into investment decisions and oversight is increasingly becoming integral to fiduciary duties. Meeting the commitments that global leaders made at the Paris Climate Change Conference (COP21) negotiations in 2015 will require regulation and policy changes on a scale far greater than the efforts made to date. Limiting temperature rises to two degrees Celsius over pre-industry levels will mean cutting global greenhouse gas emissions by around 60% through 2050. Adding the effects of population growth implies an approximate 80% reduction in emissions per capita over that period.

While climate trends tend to be framed as long-term, multi-decade changes that will unfold gradually, the early years of a transition will be the most critical. The turning point in dismantling traditional fossil fuel energy infrastructure and building a lower carbon global economy will drive a rapid re-alignment in valuations and capital flows, even if those changes take much longer to play out.

It is unclear whether political leaders have the stomach or ability to implement the policy changes that will be needed to drive that transition. However, the likelihood of them doing so is constantly rising. We believe the prospect is likely enough that prudent investors will at least have a view of what that transition would mean for their portfolios and plan accordingly.

Asset owners and fiduciary duties

While climate risk has become an issue asset owners can no longer ignore, the understanding and analysis of how it is best measured and managed remains limited. It is therefore important for fiduciaries to demonstrate that they have identified and evaluated climate change risks in their investment portfolios, how these risks might impact investment returns in the short and long term, and their strategy to effectively manage the risks.

The table below summarises some approaches that we believe asset owners can adopt as part of their research to find an optimal outcome.

A full report on the potential catalysts, the benefits and the challenges of these approaches, can be found at our website under the insight section (http://www.schroders.com/en/about-us/corporate-responsibility/esg-at-schroders/)

Conclusion

There is no one-size-fits-all solution to managing carbon risk in an investment portfolio. The best solution will depend on an asset owner's beliefs, objectives and unique circumstances. Before selecting a strategy, asset owners should be clear on what they are trying to achieve and why, and understand the challenges and investment implications of the different approaches. The best approach may well be a combination of some or all of the above to achieve the optimal outcome.

Different approaches to the analysis of climate risk

Divestment	Carbon footprinting	Thematic / low carbon solutions	Engagement and active ownership	Integrating climate change risk
Reducing or eliminating exposure to specific fossil fuel- intensive companies or sectors	Measuring the carbon footprint of a portfolio with a view to managing risk	Investing in the technologies and solutions enabling the transition to a low carbon economy e.g. renewable energy, energy efficiency solutions, green bonds	Using share ownership rights to actively engage with company management to seek greater transparency on carbon emissions, carbon price assumptions and plans for decarbonisation	Understanding and quantifying the climate change risk within a portfolio, and integrating the results in forecasts and investment decisions

Source: Schroders

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

Influence

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

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

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

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

Influence Engagement

Engagement approach

As an active manager, company engagement happens on a daily basis across Schroders. In 2016, our equities teams held 11,158 meetings with companies, and our fixed income team held 3,322. While these meetings tend to focus primarily on financial performance, they also provide a platform to discuss ESG topics. We track ESG conversations across some of these meetings, and are currently developing tools to better capture the data across Schroders.

In addition, our ESG team undertook 761 specialist ESG engagements with companies in 2016, interacting with a total of 531 companies (2015: 495) across 34 countries (2015: 33). Figure 10 below demonstrates the global outreach of our engagement.

Given our decades of engagement experience, in 2016 our focus has been to better define the reasons behind why we engage, and importantly, the outcomes of our engagement.

Why do we engage?

The aim of our engagement is threefold:

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

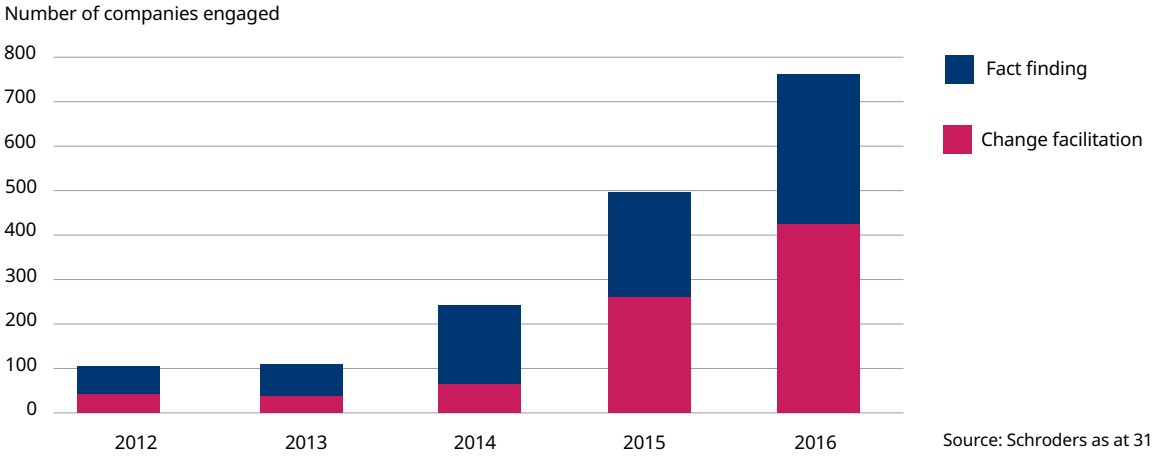
We divide our engagement into two categories: fact finding and change facilitation. Figure 11 shows how this has been split over the past five years.

Figure 10: Company engagement by region

UK	30%
North America	47%
Asia Pacific	11%
Europe (ex-UK)	10%
Middle East and Africa	1%
Latin America	1%

Source: Schroders as at 31 December 2016

Figure 11: Reasons for ESG engagement over the past five years



Source: Schroders as at 31 December 2016

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

Influence Engagement

How do we engage?

Our mechanism for engagement with company representatives varies but typically involves one of the following methods:

- One-to-one meetings with company representatives
  - E.g. members of the board, senior executives, investor relations, specialist managers such as sustainability or environmental managers
  - These meetings are either undertaken collaboratively with our financial analysts and investors, or are focused ESG engagements undertaken by the ESG specialists;
- Written correspondence or phone calls;
- Discussions with company advisers and stakeholders;

Joint engagement with other investors (further information on our collaborative approach can be found on p35).

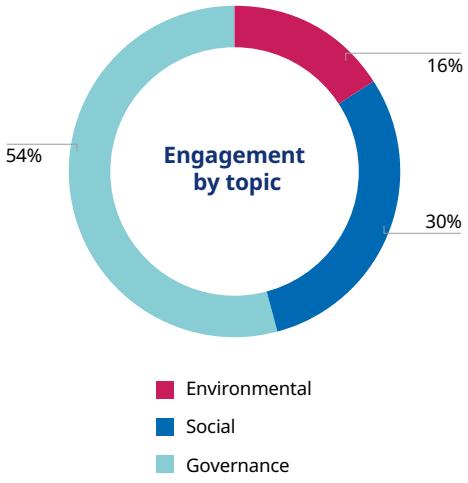
How do we prioritise engagement?

Our engagement activities are prioritised based on several factors:

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

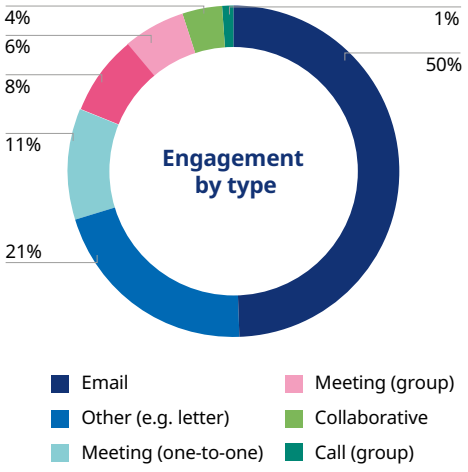
Our equity research, fixed income research, ESG and data teams frequently work together to identify areas that warrant discussion with companies. Engagement can be proactive or reactive.

Figure 12: Company engagement by topic in 2016



Source: Schroders as at 31 December 2016

Figure 13: Company engagement by type in 2016



Source: Schroders as at 31 December 2016

Influence Engagement

What issues do we engage on?

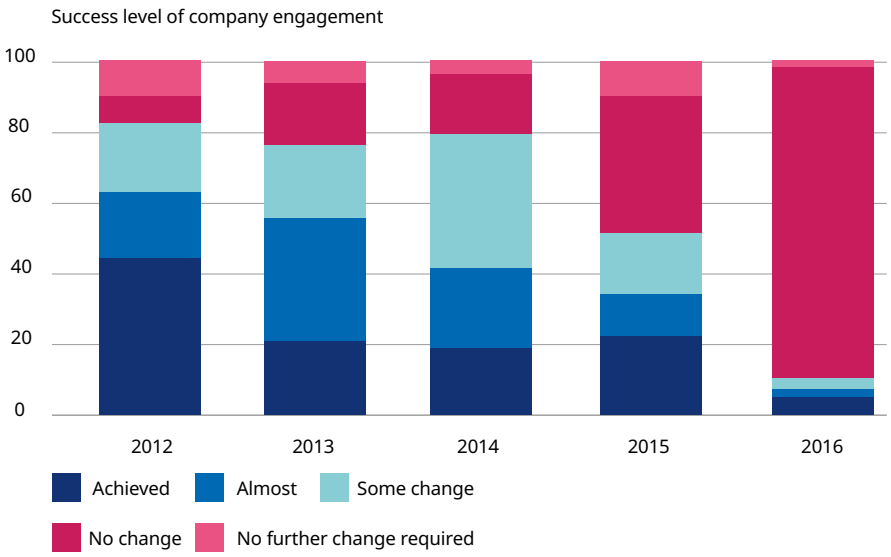
Figure 14 below provides an indicative list of issues we engaged on during 2016. During the year, we pushed governance topics in particular, with corporate governance in the US and the quality of viability statements featuring heavily in our work. The appendix on page 39 provides a full list of the companies we engaged with in 2016.

Figure 14: Indicative list of ESG topics engaged during 2016

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

Source: Schroders as at 31 December 2016

Figure 15: Effectiveness of requests for change



Source: Schroders as at 31 December 2016

What are the outcomes of our engagement?

We log all instances where we have requested change at companies on ESG-specific issues. We review company progress on an annual basis (Figure 15). We categorise progress in five ways:

1. Achieved
2. Almost
3. Some change
4. No change;
5. No further change required[6].

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

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

We realise that effective engagement requires continuous monitoring and ongoing dialogue. It is interesting to note that, of the companies we engaged with five years ago in 2012, 64% of our change requests to date have been "achieved" or "almost achieved", reflecting significant progress.

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

Influence Engagement case studies

Sugar roundtable

In 2015, we published a thematic research note exploring the possibility that sugar could be "the next tobacco". We believe that as the prevalence of global obesity, diabetes and other diet-related diseases continues to increase, the food and beverages sector will face greater pressures from stakeholders.

Our research suggests that there are three catalysts that have turned sugar into an investment issue:

1) increased awareness from consumers and public health bodies, 2) significant healthcare burdens for governments to address and 3) increasing scrutiny from the scientific community.

To gain a better understanding of the issue, we established a Sugar Roundtable in 2016, which enabled investors and companies to discuss the issues and challenges in adopting healthier product portfolios. As investors, this allowed us to build expectations about what future reporting around the broader health and wellness trends could look like.

We held several roundtables between investors and companies and then drafted an "investor expectations" document, which provides an engagement framework for investors to use when engaging with the food and beverages sector.

The document was peer-reviewed by a number of academics, non-governmental organisations, public health bodies, industry associations and corporates. The document has been shared with other investors through the PRI and has been endorsed by over 20 investors globally.

Company reporting: substance over form

In October 2015 we wrote to all of our UK equity holdings asking that they review their approach to quarterly earnings, in line with the removal of the Financial Conduct Authority's requirement for the publication of interim management statements.

We felt that there were misconceptions among UK companies about what investors expect of them in terms of reporting. With headlines about fund managers harnessing the power of big data and a Bloomberg terminal on every desk, it would be easy for any firm to think the key to attracting an investor's attention is to produce more numbers more often. Schroders values good company reporting but, as with all aspects of governance, substance is more important than form. We wanted to encourage executives and boards to focus their energy on setting and delivering their strategic objectives, rather than having to concentrate on discussing the previous 90 days.

Progress being made

At the time of our letter, approximately 15 companies have reverted to half yearly reporting. We were delighted when in November 2016 the Investment Association, the UK trade body representing investment managers, called for companies to cease reporting quarterly and to re-focus reporting on a broader range of strategic objectives.

In 2016, we saw a number of companies move away from quarterly earnings, life insurers in particular. Utility companies were early adopters of semi-annual reporting, but we feel that the practice could become more widespread in this and other sectors. In the real estate and pharmaceutical sector, only a handful of companies have made the move.

Balancing transparency and long-term goals

The fact that companies and other stakeholders are considering the appropriate balance and frequency to their reporting is encouraging. We believe this highlights the important role we can play as responsible investors in promoting debate and evolving market practice.

We are pleased to see that a growing number of large UK companies have begun to seriously consider the merits of quarterly reporting. Ensuring an appropriate trade-off between transparency to investors and other stakeholders on the one hand, while maintaining a clear focus on long-term strategic goals on the other, is critical to effective management and shareholder value creation.

Influence Engagement case studies

Utilities: when engagement fails

Executive remuneration monopolises the headlines and is a large portion of our engagement activity. However, we feel strongly that while pay is important, it should not dominate the board debate or our interactions with companies. Of much more relevance to shareholder value is ensuring that there is a sustainable approach to capital allocation. Regardless of where we invest in a company's capital structure, we look to assure ourselves that there is a robust capital allocation policy in place that will generate long-term value. To be clear, we are not looking to micro-manage day to day activities. However, we feel that as stewards of our clients' money it is important that we express our concerns where we feel this process is not working well.

Destroying capital

Utilities firms have been a particular area of focus for us. Since privatisation in the early 1990s, companies have embraced a variety of different strategies, from spinning out assets (upstream, generation, transmission and distribution networks), to embracing vertical integration by buying retail customers. As long-standing UK investors, we have found ourselves invested in the same asset through several different parent companies. More often than not this activity has generated fees for bankers, rather than returns for investors. Increasingly, we have come to the conclusion that management in this sector should be focusing on running their assets as effectively as possible rather than becoming distracted or destroying capital by diversification strategies.

As active fund managers we are invested in companies that we believe have attractive valuations. Often this arises because the market fails to recognise the long-term profit potential of a company, or they are encountering short-term cyclical issues. This can be frustrating for management teams, and often they are tempted to buy assets that are more fashionable in the hope of generating a share price re-rating or growth. However, these assets are often very fully valued, and acquiring them can lead to a destruction of shareholder value.

Our engagement work

Recently we had concerns about two management teams in particular. We engaged heavily with the executive management and other board directors trying to convince them to focus on their core activities rather than pursue acquisitions. We expressed additional concerns about the impact the acquisitions have had on their balance sheets and increasing the risk of our investment.

In both cases we were unsuccessful. Although the acquisitions made were relatively small, and management have termed them "strategic", we have real concerns over the price paid and the risk that management get distracted in integrating them. We have made our disappointment clear to management, and will continue to closely monitor their stewardship of their companies in 2017.

The reality is not all of our engagement produces the outcomes that we would like. Unsuccessful engagements lead us to re-evaluate our investment case. In both cases we feel that the risks around the companies have increased. Alternatively there may be a case for stepping up engagement levels, and looking to act collectively with other investors to effect change. We will continue to deploy the combined resources of our investment and corporate governance teams to secure the best possible outcome for clients under the circumstances.

Influence
Shareholder resolutions

Shareholder resolutions: re-examining our strategy

In 2016, we voted on 61,000 resolutions put forward by company management. Each year we also have the opportunity to vote on several hundred resolutions that have been filed by shareholders, rather than management. While these only account for a small fraction of total resolutions voted upon, they comprise over 10% of our votes against management, making them an important tool in engaging with companies.

Many of these shareholder resolutions are concerned with ethical, environmental or social topics, often requesting that management pay more attention to these issues through policy development or evidence of improved environmental and social performance. The success of a shareholder resolution filed at Royal Dutch Shell in 2015 by the investor coalition Aiming for A, which received support of 95.7%[7] from shareholders, was unique in that it gained management support. This demonstrates the increasing importance of shareholder resolutions as a way investors can engage management. Rising media scrutiny is also driving awareness on how investors use their voting rights for these particular resolutions.

Aligning voting and our ESG principles

As an active owner, Schroders has been voting on shareholder resolutions since 2000, but this year we have revised our shareholder resolution voting strategy to ensure greater consistency with our thematic research and our updated ESG principles. All of our shareholder resolution voting and engagement activity is driven by these principles, a summary of which is provided below:

Materiality: We focus on issues that are relevant to a company within the context of its sector and its relationship with stakeholders, and which enable a company to maintain its licence to operate.

Transparency: As investors, we believe transparency is critical in helping us better understand how companies identify and manage the ESG issues that impact their business.

Asymmetric knowledge: We recognise that beyond broad management systems and ESG issues, it is the company that has the day-to-day operational knowledge and expertise to manage these issues. We do not intend to micro-manage companies, but rather provide oversight and guidance on ESG practices.

Alignment with evolving ESG best practice: Through our voting and engagement we encourage companies to move towards ESG best practice, whilst acknowledging sector and individual company differences.

Evidence of policy implementation and progress: Whilst transparency is key, we want reassurance that the policies and practices published by companies are being implemented effectively. We want to see evidence of progress on mitigating ESG risks.

Responsible conduct: Whilst we encourage companies to move towards best practice, we accept that with large, multinational companies there are occasionally environmental- and social-related controversies. Where these do occur, we seek evidence that the company has understood the cause of the issue and has been proactive in strengthening its management systems to ensure the probability of future controversies has been minimised.

More effective engagement priorities

We have developed a proprietary framework that links all resolution categories with the principles above to ensure consistency in voting recommendations. This new approach will also allow us to more effectively identify engagement priorities for the year ahead.

7 ISS Proxy Research, 2016

Influence
Proxy voting

Why do we vote?

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

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

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

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

In 2016, we voted on approximately 92% of total resolutions, and instructed a vote against management at 46% of meetings. In total, we voted on 5,168 meetings.

Where do we vote?

As a global investor, Schroders votes across all regions in which we invest. The majority of voting is conducted from our London office; however our offices in Australia, Japan, Taiwan and Indonesia make their own voting decisions. We try to ensure a consistent house view is given to companies, but in order to maintain the necessary flexibility to meet client needs, these local offices may determine a voting policy regarding the securities for which they are responsible. Japan and Australia have their own voting policy, both of which are publically available. Figure 19 represents our regional voting activity in 2016.

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

Figure 16: Voting Activity 2012-2016

Year	Meetings	Resolutions	With management	Against
2016	5,168	61,114	84%	16%
2015	5,151	57,942	85%	15%
2014	5,616	60,330	91%	9%
2013	6,489	63,422	93%	7%
2012	5,633	49,536	93%	7%

Source: Schroders as at 31 December 2016

Figure 17: Global voting

UK	18%
North America	20%
Asia Pacific	28%
Europe (ex-UK)	26%
Middle East and Africa	4%
Latin America	4%

Source: Schroders as at 31 December 2016

Influence
Proxy voting

What issues do we vote on?

Schroders will engage and vote on any issue affecting the long-term sustainable value of a company in which we are invested. On the right, Figure 18 shows the resolution breakdown of topics that we vote on. The majority are targeted around issues required by local stock exchange listing requirements (e.g. director elections, acceptance of reports and the allocation of income, approval of remuneration policies and reports). We also actively engage and vote on shareholder resolutions and have dedicated Environmental and Social analysts who use their sector specific knowledge to make these voting decisions.

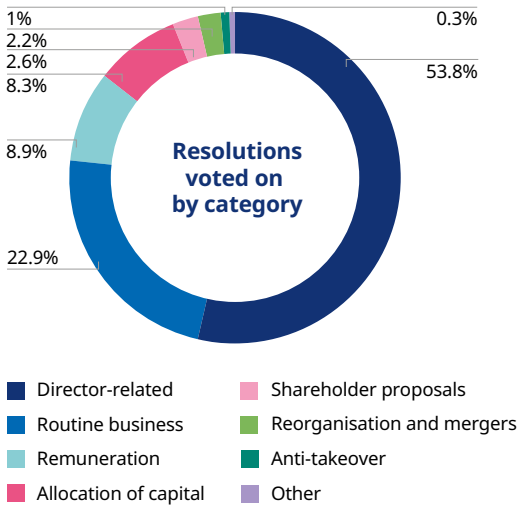
Why do we vote against company management?

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

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

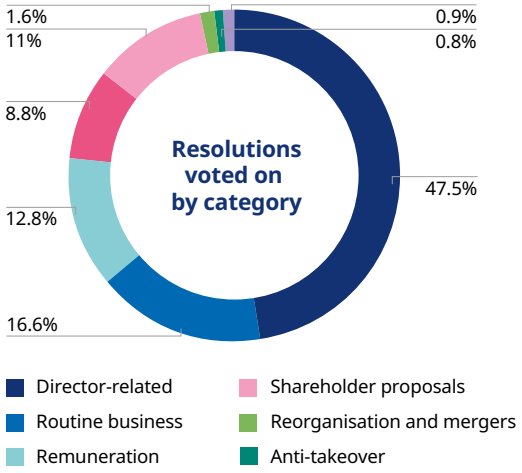
In recent years we have been increasingly voting against individual directors. For example where we have had ongoing concerns about remuneration we may vote against the chair or other members of the remuneration committee. Also, where there have been ongoing and significant areas of concerns with a company's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

Figure 18: 2016 breakdown of resolutions voted on by category



Source: Schroders as at 31 December 2016

Figure 19: Reason for "against" votes 2016



Source: Schroders as at 31 December 2016

Influence
Voting case studies

Anglo American: putting climate on the agenda

Schroders co-filed a shareholder resolution on climate change at mining company Anglo American's April 2016 annual general meeting (AGM). The "Aiming for A" investor coalition proposed a resolution requesting that the company approve "strategic resilience for 2035 and beyond", referring to the resilience of Anglo American's portfolio of commodities to climate change.

The resolution stipulates that annual reporting from 2017 should include further information about: (i) ongoing operational emissions management; (ii) asset portfolio resilience to the International Energy Agency's (IEA) scenarios; (iii) low-carbon energy research and development (R&D) and investment strategies; (iv) relevant strategic key performance indicators (KPIs) and executive incentives; (v) public policy positions relating to climate change.

We have been engaging with Anglo American in order to encourage disclosure of its carbon scenarios/pricing and to improve its reporting on this issue since 2014. The resolution was an important step forward in escalating this process. Shareholders representing 5% of the voting shares co-filed and the resolutions went on to be supported by management and were passed.

Since these developments, the company has separately announced a re-structure which aims to remove several assets from its portfolio (including thermal coal operations), which will alter the impact of such scenarios. We note the company has several good climate change initiatives in place - particularly its focus on energy efficiency and clean coal.

Tata: a complex decision

Tata Motors, a member of the Tata Group (a multinational conglomerate headquartered in Mumbai, India), was involved in one of the country's largest corporate disputes in 2016, which made global headlines. The feud developed when Mr Cyrus Mistry, the first person outside of the Tata family to head the group, was ousted as chairman of Tata Sons (the holding company of the Tata Group) in October 2016 after being in the position for four years.

The Tata Group stated that Mr Mistry had failed to deliver on the promises he had made before his appointment. Mr Mistry alleged that after his appointment, Tata had amended its holding company's articles of association – multiple times – to reduce the powers of chairman. In his view, this allowed for too much external interference from other members of the board, making it increasingly difficult for him to carry out his duties. There was a major disconnect between Mr Ratan Tata (one of the largest shareholders of Tata Sons and former chairman of the company) and Mr Mistry in regards to the strategic direction of the company. The controversy escalated when Mr Nusli Wadia, a non-executive director of Tata Motors and a close friend of Mr Ratan Tata, indicated that he was in support of Mr Cyrus Mistry.

At the annual general meeting for Tata Motors held in late December 2016, the company asked for shareholder support to remove Mr Cyrus Mistry and Mr Nusli Wadia from the board of directors. We voted for Mr Mistry's removal. We felt that due to the very public nature of the internal power struggle, the consequences of removing Mr Mistry from the board outweighed the benefits of him staying. However, despite Tata Motors' executives expressing frustration over Mr Wadia's support for Mr Mistry, we felt that this – alone – did not warrant his removal from the board.

Mr Cyrus Mistry resigned from all the Tata Group boards on 19 December 2016. On Thursday 12 January Tata Motors announced their new chairman, Mr Natarajan Chandrasekaran, the former chief executive of Tata Consultancy Services would take over the company in February 2017. We will be monitoring the company in the coming year to ensure the transition process is completed successfully.

Integrity

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

Our responsible approach isn't a new attempt to follow market trends, nor is it separate from our mainstream investment processes. Responsible principles drive our investment decisions and the way we manage funds. While Schroders has always considered the impact of responsible investment issues, over the past 19 years we have formalised how we responsibly engage and manage our investments.

We see ourselves as long-term stewards of our clients' capital and this means looking beyond the numbers. Our approach involves engaging with companies about their activities and helping them manage risks to drive better performance. Our investment experience and academic research show that companies with good ESG management often perform better and can deliver superior returns over time, both for investors and society[8].

8 Sustainable investing: Establishing Long-Term Value and Performance', Fulton, June 2012 and 'Can investors do well while also doing good?', Schroders Investment Horizons, issue 3, 2015.

Integrity
Policy and reporting changes at Schroders

In the almost 20 years since we have been integrating ESG at Schroders we have witnessed substantial changes. We have moved from working on integration in active equities to thinking about integration on multi-asset products. At the same time, interest in what we are doing has grown steadily.

Clients, investee companies, policymakers and civil society are all seeking a greater understanding of our commitment to, and implementation of, ESG in our active fund management processes. Against this backdrop we revised both our UK Stewardship Code statement and our ESG policy in 2016. We hope that by providing greater detail on our ESG philosophy and practice we can build a better understanding of the importance of ESG at Schroders.

Clarity of insight

We believe that no company operates in a vacuum, and that to ensure long-term success, companies need to have strong relationships with their stakeholders. In our fundamental analysis we pay particular attention to these relationships across the board (suppliers, customers, employees, communities, the environment, regulators, and fixed income and equity providers), and will engage with or vote against management teams that don't have due regard for stakeholders.

We see climate change specifically, and environmental risk in general, as a major challenge for future financial stability and are focused on integrating the understanding of this risk into our investment decisions. Our policy now makes this view clear, reflecting the voting, increased research, client education and policy activity that we have undertaken in this area.

We have long believed in the benefits of diverse boards, and have worked to identify and educate prospective non-executive directors from different backgrounds that we feel will be strong candidates for boards. We are making this commitment more explicit. Succession planning at both a non-executive and executive level, is in our view, an important part of improving diversity in particular and corporate resilience in general.

Influence better

Clients, policymakers and the public are increasingly asking for evidence of good stewardship. While we still believe that it is constructive to conduct private engagement, we realise that providing case studies of engagement work and detailing how voting decisions are reached is valued by our own stakeholders.

Since 2015 we have been sharing these experiences in our quarterly and annual reports to clients and to the public, as well as to a longer list of all the companies that we have engaged with. For the first time in this report we also give examples of where, despite our best efforts, engagement has not produced our desired outcome. We view ownership as an important part of the investment process and take our responsibilities seriously.

Increased transparency on voting

For some time we have published our UK voting record. In 2016 we moved to publish our global voting record. In addition, where we have not supported management we provide a brief explanation. We hope that this clarity will be of use to our stakeholders.

Importance of independence

We have seen a consistent increase in the number of corporate governance codes around the world and expectations continue to rise amid ongoing revision to these codes. The knock-on impact is increased workloads for directors. We think it is important to have high quality directors that have enough time to devote to these demanding roles. Ideally we like to see a separation of the chairman and chief executive officer role. Where this is not the case, we look for the appointment of a strong lead independent director.

Integrity

We have also revised our conflicts of interest policy on voting. We have identified more potential sources of conflict and have made the recording and escalation processes clearer.

Integration

Finally, as we have highlighted elsewhere in this annual report, we took the opportunity to combine our equity and fixed income ESG policies. We feel that issues of sustainability are of huge importance, regardless of where in the capital structure you invest.

Everything articulated above reflects practices that are well established at Schroders. They also apply globally, exhibiting the fact that more and more countries are adopting stewardship codes. Revising the policies and statements has been an opportunity to be clearer about the importance of ESG issues across asset classes, countries, and investment processes. Given the rapid pace of change in this area, we expect ongoing evolution as we develop new tools and approaches, and hold companies to ever higher standards in these areas.

Integrity
Screening and exclusions

Screening and ethical exclusions

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

This remains an important area for our clients. We have continued to see a steady increase in the value of assets under management (AUM) to which some form of ethical exclusion is applied. As at 31 December 2016, Schroders managed £33.2 billion in ethically screened assets, representing almost 8.6% of our total AUM.

Of the £33.2 billion of AUM with ethical constraints as at 31 December 2016, approximately £1.9 billion was managed by Schroders' Private Bank team (including charities).

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

Cluster munitions

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

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

The following companies are on our group exclusion list (March 2016):

- Aeroteh
- Aerojet Rocketdyne
- Aryt Industries
- Ashot Ashkelon
- China Aerospace Science and Technology
- China North Industries Group Corporation (Norinco)
- Hanwha
- Israel Military Industries
- Orbital ATK
- Poongsan Corporation
- Poongsan Holdings Corporation
- Roketsan
- Splav State Research
- Textron

Please see our live group exclusion list at http://www.schroders.com/en/about-us/corporate-responsibility/esg-at-schroders/

Terrorist financing

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

Schroders meets its US clients' requests to screen out these companies. As at 31 December 2016 we estimate that £8.6 billion of our AUM was screened based on client-defined criteria.

Figure 20: Group ethical assets under management (2012-2016)

Year	Ethical AUM (GBP billion)	% of Group AUM
2016	33.2	8.6
2015	29.9	9.6
2014	27.8	9.3
2013	25.3	9.6
2012	15.0	7.0

Source: Schroders as at 31 December 2016

Integrity
Collaboration, industry involvement and public policy

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

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

Committees or initiatives promoting responsible investment

Trade associations:

- We serve on the board of the Investment Association (IA).
- We are also on the IA's Corporate Governance and Engagement Committee and the Investment Committee. We served as members of the Steering Group on the Productivity Action Plan in 2016 and on the Stewardship Reporting Working Group in 2015.
- We serve on the board of the European Funds and Asset Management Association (EFAMA).
- We make ongoing contributions to EFAMA's Responsible Investment Report.
- **UK Sustainable Investment and Finance Association (UKSIF):** In 2015, our Head of Socially Responsible Investing within our Cazenove Capital business was elected to serve on UKSIF's board. We are also a member on the UKSIF Markets Committee, which seeks to promote responsible investment and raise awareness among different stakeholder groups through initiatives and events, including Ownership Day and Good Money Week.
- **Principles for Responsible Investment (PRI):** We are a member of the UN PRI Integration Sub-Committee. We were instrumental in delivering feedback on the PRI's new integration publication. Since the report was published in 2016, it has become the PRI's most downloaded document. We have provided advice on the next steps, such as collaborating with the CFA Institute to include more relevant and meaningful ESG training in the CFA syllabus. We responded to the PRI's member consultations in 2016 on Sustainable Financial Systems, Principles, Impact and Strengthening Accountability and Recognising Diversity. We have also supported their work on ESG integration in credit ratings and fiduciary duty.
- **International Corporate Governance Network (ICGN):** During 2016, we contributed to the ICGN's yearbook, spoke at and attended their conferences.
- **Asian Corporate Governance Association (ACGA):** During 2016, we contributed to regional consultations. We also collectively engaged with companies and regulators through this body.
- **Ethical Corporation:** We presented to investee companies in 2015 and 2016 at the Ethical Corporation's CR Communications conference, to promote better reporting on sustainability from an investor's perspective.
- **Accounting standards:** We have been working with accounting standard bodies to make financial statements more relevant and usable for investors. In 2016, projects included working with the Financial Reporting Council on dividend disclosure and business model reporting. We also contributed to roundtables on reporting for banks, technology, business services and extractive companies. We consulted with the International Accounting Standards Board on alternative profit measures.
- **Credit Roundtable:** We were involved in a comment letter going to the Securities and Exchange Commission in 2016 in a bid to improve disclosure around fixed income instruments. The letter is in support of requiring companies to hyperlink related documents in their filings.
- **Investor Forum:** We are currently members and serve on the board. This group seeks to contribute to long-term investment performance by promoting cultural change and enhancing shareholder stewardship through collective engagement.
- **Banking Futures:** For the past three years we have been supporting a dialogue between banks, investors and other stakeholders to establish what a healthy banking sector could look like in the UK. Initial findings were published and presented to a wide audience in February 2016. These reflected the importance of a culture based on serving clients and re-building trust. The banking sector in particular has a tremendous amount to do before it regains societal, investor, consumer and regulatory trust. We are currently engaging on workstreams focused on making additional progress in these areas, providing financial and human capital support.
- **CDP (formerly known as Carbon Disclosure Project):** In 2015, as a member of CDP, we welcomed the opportunity to work collaboratively with other members to produce a white paper exploring the issue of deforestation and soy. While we are encouraged that increasing numbers of companies are working towards reducing deforestation linked to palm oil in Indonesia, our report highlights that the deforestation risk associated with soy has been overlooked by most companies. It is a material business risk, with soy widely present in global supply chains, either as feed for livestock or as a food ingredient. This paper allows investors to better understand the potential risks around regulation, increasing deforestation, and broader climate change risks associated with soy. In February 2016, we hosted a workshop in association with CDP to discuss their emerging strategic plans for the post-COP21 period, which gathered feedback and input from investors.
- **Corporate Human Rights Benchmark:** In 2016, we provided our input into the consultation for this project to benchmark the human rights management performance of (initially) the top 100 global companies by market capitalisation. We encouraged further emphasis on materiality and metrics to enable better end-use for investors.

Integrity
Collaboration, industry involvement and public policy

Collaborative engagement with companies on specific ESG issues

- **Human rights and extractive companies**: In 2016 and 2017, we worked with the UN PRI in a joint initiative to engage around 50 global extractives companies about how they implement the UN Guiding Principles on Human Rights. We are leading, and participating in, joint meetings with investee companies, with the aim of highlighting and helping address the business risks human rights can present to companies.
- **Animal welfare:** Along with other investors, we signed a joint letter in 2015 and in 2016, encouraging companies that ranked poorly on the Business Benchmark on Farm Animal Welfare to improve their disclosure around animal welfare standards. Schroders believes that good animal welfare practice is a useful proxy for supply chain management. Since the benchmark was updated, we were encouraged to see significant improvements at several companies that had previously ranked in the bottom two tiers of the index.
- **Carbon Action Initiative:** In 2016, we continued our work with this investor-led initiative driven by CDP, which aims to accelerate company action on carbon reduction and energy efficiency activities. We have engaged with selected emissions-intensive companies that have yet to establish an emissions reduction target and are part of an ongoing dialogue with Newcrest, Santos, and Sime Darby.

Advocacy and public policy

- **Financial Stability Board – Task Force on Climate-related Financial Disclosures (TCFD):** We made submissions in May 2016 and February 2017 to this public consultation. We argued that given the systematic risks climate change poses and the scale of the challenge to mitigate its effects, every sector will be impacted. We agree with the call for more standardised data in an audited setting, but feel that the report could have gone further than endorsing many of the disclosure projects currently underway. We also advocated and encouraged the development of stronger models and analysis tools in tandem with increased reporting.
- **European Commission – public consultation on long-term and sustainable investment:** As the impacts and evidence of environmental and social trends on corporate value become clearer, investors' fiduciary responsibilities increasingly demand identification and management of those risks in portfolios. Our March 2016 submission is publicly available.
- **EU non-binding guidelines for reporting of non-financial information for companies:** In March 2016 we called for objective and structured information that conveys evidence of performance and goals, rather than overly relying on discussions of commitment or aspiration. Key performance indicators should be established to encompass the breadth of significant issues facing companies across sectors, as well as issues specific to each sector. Our submission is publicly available.

Integrity
UN PRI Compliance

Investor outcomes	Investment technique	Page
P1: We will incorporate ESG issues into investment analysis and decision-making processes	Dedicated ESG team comprising eleven ESG specialists focused on integrating ESG considerations across investment desks Long-standing ESG training programme for financial analysts and portfolio managers Sector focus allows close working relationship between ESG and financial analysts Joint company meetings between ESG, credit and equity analysts Multi-sector and multi-region thematic research produced on key ESG trends to educate investors Proprietary ESG analysis tool developed in collaboration with portfolio managers and equity and credit analysts All research shared on our proprietary global research platform	pg 45 pg 45 pg 45 pg 22-23 pg 12 pg 45 pg 45
P2: We will be active owners and incorporate ESG issues into our ownership policies and practice	Engaging with companies and actively voting at AGMs since 1998 ESG policies covering equities, fixed income and real estate Global voting strategy Active engagement with companies in which we invest and monitoring of success	pg 21-30 pg 1,32 pg 28-29 pg 21-26, 37-44
P3: We will seek appropriate disclosure on ESG issues by the entities in which we invest	Active engagement with companies to encourage greater transparency Participation in collaborative disclosure initiatives to improve disclosure standards	pg 21-26, 37-44 pg 34-35
P4: We will promote acceptance and implementation of the principles within the investment industry	Members, leaders and participants of various forums and networks Collaboration with other investors to promote and develop ESG principles and practices Commissioning a global study on ESG as well as conferences, seminars and workshops Submissions to regulators, trade associations, legislators and other bodies Participation on speaker panels at conferences Working with clients who are considering becoming members of the PRI to help them understand the benefits and practicalities of membership Sponsoring and publicising responsible investment events to clients and encouraging attendance Trustee training and client education on responsible investment and ESG trends	pg 34-35 pg 18-19
P5: We will work together to enhance our effectiveness in implementing the principles	Collaboration with other investors, sharing information and exchanging our views Active participation in industry networks such as the Asian Corporate Governance Association and the International Corporate Governance Network	pg 34-35
P6: We will each report on our activities and progress towards implementing the principles.	Responsible investment activities available in our quarterly and annual reports Best practice case studies included in our reports and publications such as Schroders Investment Horizons Thematic and special ESG reports published on our website	Throughout this report

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

Appendix
Companies engaged on ESG in 2016

Company	E	S	G
Consumer Discretionary			
ABC Mart	✓	✓	
Aisin Seiki			✓
Alibaba			✓
Amazon	✓	✓	✓
Apollo Group			✓
Autogrill		✓	
Bajaj Auto			✓
Barratt Developments			✓
Bed Bath and Beyond			✓
Berkeley	✓		
BorgWarner			✓
Bovis			✓
Bridgestone			✓
Burberry		✓	✓
Carnival			✓
Charter Communications			✓
Chipotle Mexican Grill			✓
Compass		✓	✓
Daily Mail and General Trust			✓
Darden		✓	✓
Debenhams			✓
Delphi Automotive			✓
Dixons			✓
Domino Pizza		✓	
Findel			✓
Ford			✓
Garmin			✓
General Motors			✓
Genuine Parts			✓
GKN			✓
Granada			✓
H&R Block			✓
Haier			✓

Company	E	S	G
Halfords			✓
Harley-Davidson			✓
Haseko			✓
HI-LEX			✓
Home Depot			✓
Host Hotels			✓
Howden Joinery			✓
Inchcape			✓
Informa			✓
Intercontinental Hotel		✓	✓
Interpublic			✓
ITE			✓
ITV			✓
JD Wetherspoon		✓	
John Wiley	✓		
Kingfisher			✓
Kohl's Corp			✓
Macy's			✓
Marks and Spencer		✓	✓
Marriott International			✓
Mattel			✓
McDonald's		✓	
Merlin Entertainments			✓
Mitchells and Butlers		✓	
Mohawk Industries			✓
Netflix			✓
Newell Brands			✓
Next			✓
NH Hotels			✓
Omnicom			✓
O'Reilly Auto			✓
Paddy Power Betfair			✓
Patisserie		✓	
Pearson			✓

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Appendix
Companies engaged on ESG in 2016

Company	E	S	G
Persimmon			✓
Priceline			✓
PVH			✓
Ralph Lauren			✓
RELX			✓
Ross Stores			✓
Sky			✓
Staples			✓
Starbucks		✓	✓
Target		✓	✓
Taylor Wimpey	✓	✓	✓
Tegna			✓
Thomas Cook			✓
Topps Tiles			✓
Trinity Mirror			✓
Truworth	✓	✓	✓
TUI			✓
Urban Outfitters			✓
VF			✓
Walt Disney			✓
Whitbread		✓	✓
WPP Group plc			✓
YUM! Brands		✓	✓
Consumer staples			
AG Barr		✓	
Altria			✓
Anheuser-Busch		✓	✓
Associated British Foods		✓	✓
Avon Products			✓
British American Tobacco		✓	✓
Britvic	✓	✓	
Carrefour		✓	
Coca Cola	✓	✓	✓
Conviviality			✓

Company	E	S	G
Costco		✓	✓
Dairy Crest		✓	✓
Danone			✓
Delhaize		✓	
Diageo			✓
Estee Lauder			✓
Fevertree Drinks			✓
General Mills			✓
Greencore			✓
Greggs		✓	
Gruma			✓
Heineken	✓		✓
Hengan	✓		
Hindustan Unilever		✓	✓
Hormel Foods			✓
Imperial Tobacco		✓	✓
Indofood			✓
Kellogg's			✓
Kerry		✓	
McCormick & Company			✓
Mead Johnson			✓
Mondelez		✓	✓
Morrison		✓	✓
Nestle		✓	
Pepsico			✓
Philip Morris	✓	✓	
Reckitt Benckiser		✓	✓
Sainsbury's		✓	✓
SSP		✓	
Suntory Beverage & Food	✓	✓	
Tate & Lyle		✓	✓
Tesco	✓	✓	✓
Unilever		✓	✓
Universal	✓	✓	

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Appendix
Companies engaged on ESG in 2016

Company	E	S	G
Wal Mart			✓
Walgreens Boots Alliance		✓	✓
Wesfarmers		✓	
Wessanen		✓	
Woolworths			✓
Energy			
Anadarko Petroleum			✓
Baker Hughes			✓
BP	✓	✓	✓
Cabot	✓		✓
Chevron Texaco		✓	✓
Cimarex	✓		✓
CNOOC		✓	✓
Diamond Offshore			✓
ENI		✓	✓
EOG			✓
Exxon	✓	✓	✓
Halliburton		✓	✓
Hess	✓		
Hunting			✓
JSC	✓	✓	
Kinder Morgan			✓
Marathon Oil			✓
Marathon Petroleum			✓
Murphy Oil			✓
Newfield Exploration			✓
NK Lukoil			✓
Northern Oil and Gas			✓
Occidental Petroleum	✓	✓	
Petrofac			✓
Phillips			✓
Repsol	✓	✓	
Royal Dutch Shell	✓	✓	✓
Saipem			✓

Company	E	S	G
Sasol	✓	✓	✓
Schlumberger			✓
Sinopec	✓	✓	✓
Spectra Energy			✓
Statoil	✓		
Technip			✓
Tenaris			✓
Tesoro			✓
Total	✓	✓	✓
Transocean			✓
Valero			✓
Weatherford International Inc		✓	✓
Wood Group	✓		
Woodside Petroleum	✓	✓	✓
Financials			
3i Group			✓
ACE			✓
Admiral		✓	✓
Affiliated Mangers			✓
AFLAC			✓
Ameriprise Financial			✓
AON			✓
Assura	✓		✓
Aviva			✓
Bank of America		✓	✓
Bank Of Kyoto	✓		
Bank Rakyat Indonesia	✓		
Barclays		✓	✓
BB&T			✓
Berkshire Hathaway			✓
BlackRock			✓
BNP Paribas		✓	
Boston Properties			✓
British Land			✓

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Appendix
Companies engaged on ESG in 2016

Company	E	S	G
Capital One Financial			✓
Capital Shopping Centres			✓
Charles Schwab			✓
Chesnara			✓
Cincinnati Financial			✓
Citigroup		✓	✓
Close Brothers	✓		✓
Comerica			✓
Credit Agricole		✓	
Direct Line			✓
Discover Financial Services		✓	
DNB		✓	
Emirates			✓
Empiric Student Property			✓
Essex Property Trust			✓
Extra Space Storage			✓
Fifth Third Bancorp			✓
Garanti Bank			✓
GFB			✓
Goldman Sachs			✓
Grainger			✓
Habib Bank			✓
Hammerson			✓
Hargreaves Lansdown			✓
Hiscox			✓
HSBC Holdings	✓	✓	✓
Intesa Sanpaolo		✓	✓
Investors Capital Trust			✓
Iyo Bank	✓		
JP Morgan Chase	✓	✓	✓
Just Retirement			✓
KBC			✓
Land Securities			✓
Legal & General			✓

Company	E	S	G
Lloyds		✓	✓
London Stock Exchange			✓
M & T Bank			✓
Man Group			✓
Marsh & McLennan			✓
Metlife			✓
Morgan Stanley Group			✓
Old Mutual			✓
Paragon		✓	✓
PNC Bank			✓
Principal Financial			✓
Provident Financial		✓	✓
Prudential Corporation		✓	✓
Public Storage			✓
Rathbone Brothers		✓	✓
Regions Financial	✓		
Royal & Sun Alliance			√
Royal Bank of Scotland	✓	✓	✓
Sampo		✓	
Simon Property Group			✓
Societe Generale		✓	
St James's Place			✓
Standard Chartered			✓
State Street			✓
Storebrand			✓
Swedbank			✓
Synchrony			✓
Tai Cheung			✓
TP ICAP			✓
Unicredit	✓	✓	✓
United Overseas Bank			✓
Universal			✓
US Bancorp		✓	
Ventas			✓

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Company	E	S	G
Virgin Money		✓	
Waddell & Reed		✓	✓
Wells Fargo		✓	
Weyerhaeuser			✓
Workspace	✓	✓	✓
Worldpay			✓
Healthcare			
Abbott			✓
Abbvie			✓
Alexion			✓
Allergan			✓
Amgen		✓	✓
Ansell			✓
Apollo Hospitals			✓
Astellas		✓	✓
AstraZeneca			✓
Baxter			✓
Bayer AG		✓	✓
Biogen			✓
Boston Scientific			✓
Bristol Myers			✓
BTG			✓
Celgene		✓	✓
Centene			✓
Cooper			✓
Dentsply			✓
Essilor	✓	✓	✓
Fresenius Medical Care			✓
Genus	✓	✓	
Gilead			✓
GlaxoSmithKline		✓	✓
HCA			✓
Henry Schein			✓
Humana			✓

Company	E	S	G
Illumina			✓
Indivior			✓
Johnson & Johnson			✓
Laboratory Corporation of America			✓
Eli Lilly			✓
Lupin		✓	
Mallinckrodt			✓
Medtronic		✓	✓
Merck & Co			✓
Molina Healthcare		✓	✓
Novartis			✓
Patterson			✓
PerkinElmer			✓
Pfizer		✓	✓
Quest			✓
Regeneron			✓
Roche		✓	✓
Shire		✓	✓
Smith & Nephew			✓
Teva	✓	✓	
Thermo-Fisher			✓
Universal Health			✓
Varian			✓
Vectura			✓
Waters			✓
Zimmer Biomet		✓	
Zoetis			✓
Industrials			
3M Company			✓
ABB			✓
Adecco			✓
Air Partner			✓
Alaska Air			✓
Ametek			✓

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Company	E	S	G
Ashtead			✓
Avon Rubber			✓
BAE			✓
Bodycote			✓
Boeing			✓
Brenntag			✓
Bunzl			✓
CH Robinson			✓
Capita Group			✓
Carillion		✓	
Caterpillar			✓
Chemring			✓
China Communications			✓
China Railways			✓
China State Construction			✓
Cobham			✓
CSX			✓
Cummins			✓
DCC			✓
De La Rue			✓
Deere & Co			✓
Diploma			✓
DP World			✓
Dun & Bradstreet		✓	✓
EasyJet			✓
Emerson Electric			✓
Equifax			✓
Expeditors		✓	
Experian		✓	✓
Fastenal			✓
Fortive			✓
Fortune Brands Home & Security			✓
G4S		✓	✓
Galliford Try	✓		

Company	E	S	G
Gategroup		✓	
GEA			✓
General Electric	✓	✓	✓
Gujarat Pipavav			✓
Honeywell			✓
IMI	✓		
International Consolidated Airlines			✓
Interserve		✓	
Intertek			✓
Irish Contl Group	✓		
JB Hunt			✓
Johnson Electric			✓
Kansas City Southern			✓
KBR			✓
Keller			✓
Keppel			✓
Kuroda			✓
Larsen & Toubro			✓
Legrand			✓
Leoni			✓
Lincoln Electric		✓	✓
Lockheed Martin			✓
National Express		✓	✓
Nippon Densetsu Kogyo			✓
NWS Holdings			✓
Paccar			✓
Polypipe			✓
Quanta Services			✓
Raytheon			✓
Renold			✓
Republic Services			✓
Robert Half			✓
Rolls Royce			✓
Royal Mail	✓	✓	✓

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Appendix
Companies engaged on ESG in 2016

Company	E	S	G
RPS			✓
Shanghai Electric Group Co			✓
SIG			✓
Sime Darby Berhad	✓		
Smiths			✓
Snap-on			✓
Speedy Hire			✓
Spirax-Sarco	✓	✓	✓
Travis Perkins			✓
Union Pacific			✓
United Parcel Service			✓
United Technologies			✓
WEG			✓
Weir Group			✓
Wolseley			✓
WS Atkins			✓
Xylem			✓
Information technology			
Adobe Systems			✓
Amphenol			✓
Applied Materials			✓
Automatic Data Processing			✓
Broadcom			✓
Chroma			✓
Cisco Systems			✓
Citrix Systems			✓
Cognizant			✓
Corning			✓
Electronic Arts			✓
Fidessa		✓	✓
Fiserv	✓	✓	
Google			✓
Hewlett Packard			✓
IBM			✓

Company	E	S	G
Intel			✓
Laird			✓
Linear Technology			✓
Micro Focus			✓
Microchip Technology			✓
Micron Technology			✓
Microsoft		✓	✓
Motorola			✓
Nvidia			✓
Oracle			✓
Paychex			✓
Realtek			✓
Red Hat			✓
RIB Software			✓
Sage Group			✓
Salesforce			✓
SDL			✓
Sepura			✓
Skyworks			✓
Symantec			✓
Tencent			✓
Teradata			✓
Texas Instruments			✓
Total System Services		✓	
Western Digital		✓	✓
Xerox			✓
Xilinx			✓
Materials			
Anglo American	✓	✓	✓
Antofagasta	✓	✓	
Avery Dennison			✓
Ball	✓		
BASF		✓	
BHP Billiton	✓	✓	✓

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Appendix
Companies engaged on ESG in 2016

Company	E	S	G
CRH			✓
CVRD		✓	
Dominion Diamond			✓
Dow Chemical		✓	✓
Dowa		✓	
DSM		✓	
Du Pont			✓
Ecolab			✓
Fresnillo			✓
Gerdau			✓
Glencore	✓	✓	✓
GMK Norilsk Nickel		✓	
Goldcorp	✓	✓	
International Paper			✓
Johnson Matthey		✓	✓
LG Chemical		✓	
Linde		✓	
LyondellBasell	✓	✓	✓
Mitsuboshi Belting			✓
Mondi			✓
Monsanto		✓	✓
Orica			✓
Petronas			✓
Pohang		✓	
Polymetal			✓
PPG			✓
Randgold Resources			✓
Rio Tinto plc	✓	✓	✓
Sealed Air			✓
Sherwin-Williams			✓
Sinofert			✓
South32	✓	✓	✓
Stora Enso	✓	✓	
Symrise		✓	

Company	E	S	G
Synthomer			✓
T & K Toka			✓
Tyman		✓	
Ultratech Cement	✓		✓
United	✓		✓
Zhaojin		✓	
Telecommunication services			
AT&T			✓
BT			✓
CenturyLink			✓
KDDI			✓
Verizon			✓
Vodafone			✓
Utilities			
Alliant Energy Corporation			✓
Centerpoint			✓
Centrica plc		✓	✓
CMS Energy			✓
Dominion Resources			✓
Drax			✓
Entergy			✓
Eversource			✓
Exelon			✓
National Grid			✓
Next Era Energy			✓
Pacific Gas & Electric			✓
Public Service Enterprise			✓
Scottish and Southern Energy			✓
Sempra			✓
United Utilities			✓

Source: Schroders as at 31 December 2016

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Our Sustainable Investment Team Profiles

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

The team provides ESG training to all existing and new investment analysts to ensure that all investment desks are aligned in their efforts to integrate ESG considerations into their analysis. The programme includes general ESG training as well as sector-specific and tailored training for individual investment teams. As a result of a collaborative effort with our ESG specialists, analysts and portfolio managers are alsoable to draw on a proprietary ESG guidance document which identifies the key ESG risks and opportunities, along with relevant data points and metrics, specific to more than 170 GICS[9] sub-industries.

This ensures that our analysts and investors keep abreast of the latest ESG trends and how they can impact a company's valuation and risk profile. Our specialists also produce regular multi-sector and multi-region thematic research. This research is published on our centralised research platform, presented at investment team meetings and is easily accessible to all of our analysts and portfolio managers across all investment teams.The team also works with Alexia Zavos (Wealth Management) and Charlotte Jacques (Real Estate).

Jessica Ground
Global Head of Stewardship

Head of the team.
19 years in investment.

Andrew Howard
Head of Sustainable Research

Thought leadership and integration, climate change.
19 years in investment.

Elly Irving
Sustainable Investment Analyst

Consumer goods and services.
9 years in investment.

Solange Le Jeune
Sustainable Investment Analyst

Energy, financials and climate change.
9 years in investment.

Seema Suchak
Sustainable Investment Analyst

Healthcare and materials. 13 years in investment.

Ovidiu Patrascu
Sustainable Investment Analyst

Industrials and IT.
5 years in investment.

Felix Odey
Sustainable Investment Analyst

Energy, financials and climate change.
<1 year in investment.

Alex Monk
Graduate

Utilities and telecommunications.
<1 year in investment.

Daniel Veazey
Corporate Governance Analyst

Corporate Governance.
14 years in investment.

Pippa O'Riley
Corporate Governance Assistant

Corporate Governance.
1 year in investment.

Belinda Gan
Associate Product Manager

Product Management.
12 years in investment.

9 Global Industry Classification Standard

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