INVESTMENT PHILOSOPHY AND PROCESS

FOR THE SCOTTISH WIDOWS ETHICAL FUND
SCOTTISH WIDOWS IS COMMITTED TO BEING A RESPONSIBLE INVESTOR ON BEHALF OF OUR CUSTOMERS, WITH PARTICULAR FOCUS ON STEWARDSHIP, ETHICAL INVESTMENT AND ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) ISSUES.

Here we look in more detail at the fund management philosophy and process used to select companies for investment in the Scottish Widows Ethical Fund (the Fund). This also applies to the following life and pension funds which are solely invested into the Fund.

- Scottish Widows Ethical Pension Fund.
- Scottish Widows Ethical Life Fund.

THE FUND MANAGER
Our Ethical Investor Fund is managed by Schroders PLC. They manage £444 billion for clients globally, as at 30th June 2019.

INVESTMENT PHILOSOPHY
The Ethical Fund invests primarily in UK companies that demonstrate ethical attributes and practices. We carry out our own fundamental research on companies to identify attractive, long-term investments fitting the ethical criteria.

We use a broad range of negative ethical screening criteria to exclude undesirable investments, such as shares in companies which sell weapons or tobacco.

INVESTMENT PROCESS
The Schroder UK Equity team look beyond short-term news flow and focus on long term value creation. When determining a company’s ability to generate sustainable value and earnings growth, we examine its earnings both quantitatively and qualitatively. The portfolio managers are supported by a well resourced analyst team who contribute an exceptional breadth of experience and a diversity of views to our idea generation and research process.

We have a number of proprietary ESG investment tools at our disposal which help us integrate a wide array of ethical considerations into our fundamental analysis.

One of the tools available to us scientifically combines measures of both the harm and the good companies can do. This gives us an aggregate measure by which we can quantify a firm’s social and environmental impact. The tool incorporates a wide range of measures such as wages, carbon emissions, tobacco sales, workplace stress and so on.

Another tool we can use provides us with a systematic framework for analysing a company’s relationship with its stakeholders (such as the environment, communities, employees and customers among others) and the sustainability of its business model, allowing us to identify market-wide trends and insights. This helps us identify material issues, particularly in advance of a meeting with a company’s management team. By identifying such issues, challenging management and conducting our own internal research, we are able to assess how well a company is positioned to deal with these ESG issues.

NEGATIVE SCREENING CRITERIA
A negative screening approach is taken for the following areas:
1. Alcoholic beverages
2. Animal testing
3. Gambling
4. Military involvement
5. Pornography
6. Tobacco
7. Weapons

We will review the ethical screening criteria regularly and will update them to reflect changing market developments that may have an ethical or social impact.

ENGAGEMENT POLICY
Schroders firmly believe companies that are well governed, operate transparently, responsibly and sustainably will support the long-term health of the company and increase shareholder value. Therefore, engagement with companies is a key part of our investment process as an active investor. It has the advantage of enhancing communication and understanding between companies and investors.

When engaging with companies our purpose is to either seek additional understanding or, where necessary, to seek change that will protect and enhance the value of investments for which we are responsible.
Our focus will be on issues material to the value of the company's shares or debt instruments. These may include, but are not limited to, business strategy, performance, financing and capital allocation, management, acquisitions and disposals, internal controls, risk management, the membership and composition of governing bodies/boards and committees, sustainability, governance, remuneration, climate change, environmental and social performance.

We generally engage for one of three reasons:

1. To seek improvement in performance and processes in order to enhance and protect the value of our investments.
2. To monitor developments in ESG practices, business strategy and financial performance within a company.
3. To enhance our analysis of a company’s risks and opportunities.

Our mechanism for engagement typically involves one of the following methods which may vary by region:

- One-to-one meetings with company representatives (e.g. members of the Board including Board Committee chairs, senior executives, Investor Relations, managers of specialist areas such as a sustainability or environmental manager) either collaboratively with our investment analysts and portfolio managers, or focused ESG engagements undertaken by the ESG specialists;
- Written correspondence;
- Phone calls;
- Discussions with company advisers and stakeholders;
- Voting;
- Collective engagement with other investors.

We prioritise our engagement activities based on the materiality of the issue and our exposure to the individual company, which is based on the absolute amount invested or percentage owned on an instrument.

We arrange meetings with any companies which we own that we see as ESG laggards or that have experienced a controversy. We also undertake reactive engagement as a result of any negative incident involving a company, in order to understand why it may have occurred, the actions the company is taking as a result, and what the current and future investment risks may be.

**Disclosure on**

- Directors’ pay.
- Executive compensation packages, including company stock options.

**Environment**

We recognise that the adoption of sustainable business practices is critical to the health and well-being of our planet and its citizens. As such, companies are expected to:

- Disclose their environmental policies and practices.
- Demonstrate a commitment to industry/government codes and standards (e.g. UNEP, ISO, EMAS).
- Develop products or processes which reduce or minimise environmental impacts.
- Implement pollution prevention programmes and conserve the use of energy, water, materials and/or land.
- Set targets for the reduction of ozone depleting and/or greenhouse gases.

**Labour / Workplace issues**

The Fund looks to see if companies:

**Labour standards**

- Demonstrate a commitment to industry/government codes regarding labour practices.
- Publish an equal opportunities policy covering global operations.
- Have policies regarding child and forced labour which are in line with International Labour Organization (ILO) standards.
- Respect the right to organise unions and bargain collectively.
- Support the hiring, training, and promotion of women and minorities.

**Working conditions**

- Provide working conditions which meet basic health and safety standards.
- Publish a health and safety policy covering all of the group’s business.
- Conduct annual audits of manufacturing operations, particularly in under-developed countries.

**Employee and family friendly benefits**

- Ideally, offer basic health care insurance and incentive plans or packages for employees.
- Provide programmes and benefits supporting workers and their families.
Human rights
The Fund looks to see if companies use their influence to protect human rights around the world. Ideally, companies will adhere to the human rights policies outlined in the United Nations Declaration of Human Rights and in the core labour conventions of the ILO. We would like to see particular adherence to ILO Convention 182, covering the abolition of the worst forms of child labour, child slavery, forced labour, and debt bondage. We pay close attention to a company’s history of supporting the rights and dignity of citizens in every country in which it operates, and keep particular watch on the activities of corporations in countries where political repression and/or basic human rights violations take place.

SHAREHOLDER ADVOCACY
We recognise our obligation to be involved in monitoring Board activities and to actively participate in the corporate governance process. We do this through ASI’s proxy voting process. This is one way that the management decisions governing a company’s day to day operations can be influenced.

It is standard practice to vote in support of: positive social and economic impacts, transparent corporate governance practices, and the reasonable disclosure of company policies and financial returns, with special attention given to those issues which impact the fair and equal treatment of shareholders.

FURTHER INFORMATION
You can find more information regarding Responsible Investment as well as the Stewardship Code and UN Principles of Responsible Investment on our website: www.scottishwidows.co.uk/about_us/responsibleinvestment

Information about the makeup of the Fund’s portfolio is available on the fund factsheets, which can be accessed through the following links. Please note that the life and pension funds are invested directly into the Fund:

Scottish Widows Ethical Fund
Scottish Widows Ethical Pension Fund
Scottish Widows Ethical Life Fund