Royal London Asset Management (RLAM) is committed to being a responsible investor. This means being a good steward of assets and promoting responsible investment with other stakeholders. The aim is to generate sustainable, risk-adjusted returns that reflect a wider understanding of what will drive economic performance in the future. As part of that commitment RLAM seeks to understand environmental, social and governance (ESG) risks and opportunities within the investment process. To achieve this we engage with companies and industry regulators to understand the issues and to promote best practice.

The technology sector has long been a pillar of our Sustainable funds. This is based on the belief that technology, used responsibly, can have a positive social and economic impact. We have evidenced this by analysing the merits of individual companies and inviting a comparison of countries and economies with and without broad access to technology.

A number of financial characteristics make technology companies particularly attractive for investment at the moment. Competitive advantage lies at the heart of the investment analysis we conduct. We believe this directly correlates with the inherent value and growth opportunities of an industry.

From a competitive advantage perspective, technology companies have improved meaningfully in recent years. One criticism of this area has been the short lifespan of technology companies, often due to relentless innovation. It can now be argued however that the competitive advantage of current incumbents, based around scale, brand, intellectual property and network effects, is as strong as any other industry an investor would choose to invest in.

The days of two people in a Silicon Valley garage changing the world would appear long gone.

Many technology companies also look compelling from a growth perspective. Only 10% of global retail is currently online, 6% of information technology spend is made in the cloud and 1% of cars electric. With artificial intelligence still in its formative stages, there would appear to be years of growth ahead for those companies with strong competitive advantages.

The social impact of technology does continue to change however, and this is something we must continually review as sustainable investors. The recent controversies at Facebook reveal a dark side. This is highlighted by the role social media played in the US elections, where it has been alleged that Russia used social media platforms to spread fake news in a way that influenced the outcome. Social media firms have since increased their capabilities in verifying content, but their response has been viewed by many as too little too late.

Serious concerns about data privacy continue to grow, particularly following the revelations that Facebook data was used inappropriately to target users with political content. With the Internet of Things and “always on” smart speakers becoming more prevalent in our lives, questions around data privacy will become increasingly high profile. Tax also continues to be a point of criticism of large technology companies.

The positive and negative impacts of technology continue to generate considerable debate. For now we believe the social and economic positives outweigh the negatives, however this remains under continuous review.

Mike Fox
Head of Sustainable Investments
The Sustainable Development Goals (or ‘SDGs’) are a set of 17 aspirations to mobilise global governments, private businesses, civil society and investors to work towards ending all forms of poverty, fighting inequality and addressing climate change. The aim of the SDGs, to promote prosperity while protecting the planet, fits well with the aim of RLAM’s Sustainable Funds. Our mission is to invest in businesses that provide a ‘net benefit to society’ and are leaders in environmental, social and governance (ESG) issues while generating excellent financial returns for our clients.

Here are just a few examples of how we invest our clients’ money to promote the aims of the SDGs.

**Affordable and Clean Energy**
We help finance companies that are making a commitment to green electricity (SSE, Aggregated Micro Power Infrastructure).

**Industry Innovation and infrastructure**
We invest in leading companies building out the infrastructure of the future, including telecommunications (Vodafone, America Movil) and green power distributors (WoDS Transmission). We also support truly innovative companies who are working to transform industries or improve industrial processes, such as through logistics (Amazon) or cloud computing (Microsoft).

**Sustainable cities & communities**
We invest in companies that are building the technology of the future for sustainable urban transport (AA plc, ASML), as well as those that are improving urban communities by developing on brownfield sites (St Modwen). We are also significant investors in the debt of social housing providers in the UK (Great Places, London & Quadrant).
November and December both proved to be record-breaking months for the green bonds sector. We saw the first Swiss Franc issue, the first sovereign green bond from a developing country – Fiji – and a good mix of corporate issuances. There is a healthy amount of diversification into new currencies, sectors and geographies - and we think this is still the tip of the iceberg. Not only does this market remain small relative to both the total debt market and to the amount of infrastructure investment required in order to “meet the climate challenge,” there continues to be strong evidence that labelled green bonds remain relatively inexpensive for issuers.

Internally, we continue to consider the optimal level of participation in the labelled green bond market to optimise our clients’ risk adjusted returns. While we remain supportive of financing the transition to a low-carbon future, we remain convinced that we can access better risk-adjusted returns for our clients by applying our bespoke analysis to the unlabelled green bond market – and recent research by Karpf and Mandel supports this view.

To support our bespoke analysis, we have reviewed the processes of select green bond ‘Second Opinion’ providers – companies who specialise in issuing comprehensive opinions and assurance around the environmental credentials of the projects within each green bond issue. It is important to us that our own, internal opinion on the “greenness” of the project represents best practice. We know that the transition to a lower-carbon economy will require both tactical and strategic architecture. Accordingly, we need to be able to appropriately assess projects ranging from short-term efficiency improvements to fossil fuel infrastructure, to ground source heat pump – zero emissions infrastructure with a design life of over 100 years. Our internal analysis looks at each issuer and project on their own merits, the environmental credentials of the asset, our security as a lender, the longevity of the asset, and the governance of the entity or company. Given the fungible nature of cash, we think it is impossible to appraise these assets without forming a holistic view of the asset and issuing entity.

The growth rate of this market is encouraging and we think that by benchmarking our internal analysis to leading ‘Second Opinion’ providers and keeping an open dialogue with issuers, we will play our part to ensure that standards of “greenness” are upheld across the market – whether the issuer chooses to be labelled ‘Green’ or not. Ensuring that our internal analysis is robust and represents best practice will mean that we can finance projects that are genuinely supportive of the move to a lower-carbon economy without sacrificing returns.
What we discussed:
• The social impact of technology, and the requirement of technology companies to remain abreast of the impact of their tools on wider society
• The Dow-Dupont merger, and whether the legacy issues that accompany Dow can be outweighed by the culture at Dupont
• The social case for investing in privately run prisons, and the challenges that might accompany outsourcing service providers

Performance

<table>
<thead>
<tr>
<th>Fund Size</th>
<th>1 year</th>
<th>3 years (p.a.)</th>
<th>5 years (p.a.)</th>
<th>10 years (p.a.)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sustainable Leaders</strong>&lt;br&gt;UK All Companies</td>
<td>£574.4m</td>
<td>1st</td>
<td>1st</td>
<td>1st</td>
</tr>
<tr>
<td><strong>Sustainable World</strong>&lt;br&gt;Mixed Investment 40-85% Shares</td>
<td>£404.2m</td>
<td>1st</td>
<td>1st</td>
<td>1st</td>
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<tr>
<td><strong>Sustainable Diversified</strong>&lt;br&gt;Mixed Investment 20-65% Shares</td>
<td>£490.7m</td>
<td>1st</td>
<td>1st</td>
<td>1st</td>
</tr>
<tr>
<td><strong>Sustainable Managed Growth</strong>&lt;br&gt;Mixed Investment 0-35% Shares</td>
<td>£114.8m</td>
<td>1st</td>
<td>1st</td>
<td>1st</td>
</tr>
<tr>
<td><strong>Sustainable Managed Income</strong>&lt;br&gt;Fund income vs target in PPU†</td>
<td>£26.5m</td>
<td>4.8 v 3.7</td>
<td>5.3 v 3.9</td>
<td>–</td>
</tr>
</tbody>
</table>

Source: RLAM and FE as at 31 March 2018.
† Fund Performance shown is based on the C Acc share class net of fees.

Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested. For more information concerning the risks of investing, please refer to the Prospectus and Key Investor Information Document (KIID).
PAYING FOR THE LONG-TERM – ALTERNATIVE MODELS OF PAY
Sophie Johnson – Corporate Governance Analyst

Like many other investors, we are concerned about the alignment of pay in the UK with long-term, sustainable investment performance. We have some concerns that long-term incentive plans (LTIPs) are not always effective, can be confusing and complex for both executives and investors, and can lead to perverse outcomes. As such, we are open-minded about considering and approving alternative models of pay.

Our View
Fundamentally, we believe remuneration committees are best placed to decide on the most appropriate pay structure for their company. Engagement with investors is important to help inform the board, but it is not a replacement for good, sensible decision-making and discretion. For this reason, we will hold remuneration committees directly accountable for pay structures and pay decisions.

We are mindful of the difficulties facing some companies in setting long-term performance targets, particularly smaller companies or those in more cyclical sectors. We are also cognisant of the difficulties companies and investors face when trying to set and discuss future theoretical performance targets and payout scenarios.

Therefore we accept that in some cases, it may be suitable for alternative models of pay to replace traditional LTIPs. These could be in the form of Restricted Share Awards (RSAs) or Deferred Bonus Plans. We are however cautious of approving schemes introduced to mitigate the fact that long-term incentive plans have not recently paid out. Companies seeking to introduce alternative pay models must provide a clear rationale for doing so.

Ultimately, pay must be tied to sustainable long-term performance and must be simple and easy to understand.

Our proposals
Below we set out our expectations for alternative models of pay:

• Simplicity
Our preference is for one single straightforward long-term plan to be proposed, and not the combination of numerous different performance and non-performance based awards.

• Performance underpin
To somewhat mitigate the lack of performance conditions, we would ask companies to implement a financial underpin. The goal would be to reduce the award in the event of significant underperformance.

• Performance on grant
We would be supportive of plans that apply performance on grant, either as an alternative or an addition to the performance underpin.

• Reduction in quantum
Due to the greater certainty involved in granting RSAs, we would expect a minimum of a 50% reduction in the total value of an award against current LTIP values.

• Holding periods
We would also expect a prolonged vesting and/or holding period to be added before shares are released.

• Discretion
Mathematical pay models do not lead to good outcomes. We believe many of the historic issues with pay could have been averted with the use of appropriate discretion.

• Post-retirement holding periods
We believe that by requiring executives to hold shares post-retirement or post-departure this encourages long-term thinking and can prevent the need for excessive buy-out awards.

Conclusion
Provided a company can show sufficient rationale for the adoption of an alternative model, such as an RSA or deferred bonus over a traditional LTIP plan, we are open to supporting them. We would require a company to demonstrate that they have sufficiently addressed the risks of granting a share award with a more certain outcome by reducing the size and implementing an underpin in order to reduce the awards in the event of underperformance. Alternatively companies could apply performance on grant to reduce the size of the initial award.
This quarter we focused our attention on our fixed income holdings in the water utilities sector. Our credit research team has been reviewing our holdings in light of growing regulatory pressures in the sector. We wrote to 11 water companies to seek further information on how they are managing key ESG risks, such as their use of renewable energy, water metering, customer arrears, complaints and leakage rates. We are using this information to build up a picture of each company’s strengths and weaknesses so we can integrate it into our investment decision-making. We met with Thames Water to talk about the work they are doing to address leakage issues and addressing customer complaints.

We continued to receive a number of pay consultations throughout the quarter as companies started to finalize their pay reports ahead of annual meeting season. We were in contact with 24 companies on pay, including Standard Life Aberdeen, Cineworld, Saga, Shire, Aviva, Prudential, Severn Trent and ZPG Group. A number of companies we met with revised their pay plans after consultation with us and other major shareholders.

We also met with Sophos to discuss improvements they are making to corporate governance to bring the company in line with the UK Corporate Governance Code. We participated in a group meeting with Dunelm, which covered a number of topics including succession planning, cyber security, supply chain, culture and workforce.

We also met with Segro in partnership with the 30% Club to discuss improvements they are making to gender diversity in the business.

Finally, we started a project looking at sustainable packaging and plastics. Our first meetings on this topic were with Unilever and Bunzl. We are developing some best practice principles from leading companies on this issue so that we can share them more broadly. There has been significant public focus on this issue since the UK Government announced action on tackling the issue of ocean plastic.

2017-2019 ENGAGEMENT PLAN
Over the next two years, we will be focusing our engagement on the following:

- Energy
- Water
- Data
- Corporate Governance
- ESG Leaders/Laggards
Engagement and voting stats

- Number of companies contacted: 50
- Votes against management: 8%
- Number of company meetings voted: 146
- Votes against pay: 20%
- Number of resolutions voted: 1938

Source: RLAM as at 31 March 2018

Engagement topics

- Remuneration
- Water
- Energy
- Environment
- Diversity
- Corporate Governance
- Other
- Data
- Reputational Risks
- Succession Planning

Source: RLAM as at 31 March 2018
Contact us

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Sophie Johnson, Corporate Governance Analyst