Aviva Investors: Sustainable Stewardship

UN Sustainable Development Goals Alignment Framework

September 2023

The purpose of this document is to outline the Aviva Investors approach to the inclusion of the UN Sustainable Development Goals (SDGs) and their alignment within our Sustainable Stewardship fund range.

1. **Background**

Introduced in 1984, the Sustainable Stewardship Funds have a proud heritage as the UK's first ethical fund range. The investment philosophy and policies underpinning the franchise have always been to guide capital allocation responsibly and to exclude or include a company based on what it does and how it does it. This philosophy has been kept under review since launch, to ensure it remains relevant for the changing requirements of investors. Following a review at the beginning of 2023, it was decided that we would use the UN SDGs as our framework for positive selection, as the 17 goals that exist are all aligned to transforming the world into a more equitable and sustainable environment.

In 1987, the United Nations Brundtland Commission defined sustainability as "meeting the needs of the present without compromising the ability of future generations to meet their own needs." Set in 2015, the UN's 2030 Agenda for Sustainable Development now represents the framework guiding action toward global peace and prosperity, for people and the planet both now and into the future.

With under 10 years to deliver the 2030 agenda, there is an estimated US$2.5 trillion annual financing gap, which could be further exacerbated by the Covid-19 pandemic to an increased gap of up to US$4.2 trillion [1], calling for greater alignment of all forms of financing to support the Sustainable Development Goals.

Source: UN Sustainable Development Goals.

[1] https://www.oecd.org/development/global-outlook-on-financing-for-sustainable-development-2021-e3c30a9a-en.htm

2. Philosophy – the UN (United Nations) SDG Investment Case

The implementation of the UN 2030 Sustainable Development agenda has significant economic implications. The focus is often placed on the cost of action, with many organisations carrying out costing exercises to estimate the annual financing required to deliver the UN Sustainable Development Goals, highlighting the pervasive issue of a widening financing gap. However, more focus ought to be placed on the cost of inaction and the global economic losses that would result from failure to deliver UN's 2030 Agenda for Sustainable Development. With under 10 years to deliver the 2030 agenda, deteriorating progress to finance and delivering the global goals increases the risk of these economic losses being realised if urgent and concerted action is not taken.

The economic cost of **inaction** can be framed using the concept of national wealth, failing to invest in human capital and natural capital related global goals being the depletion of a country's "assets", eroding total wealth[2] and impacting its ability to sustain future GDP (Gross Domestic Product) growth in the long-term. **Inaction** on climate mitigation related global goals will result in physical impacts, further compounding and accelerating stress and depletion of human capital and natural capital assets.

The Sustainable Outcomes team develop sustainability related investment insights and research. The team is built on three pillars of People, Earth and Climate which feed into, as well as inform the team's research into the SDGs and consequently the Sustainable Stewardship fund ranges.

A firm committed to building a sustainable world

3 Pillars	People	Earth	Climate
3 Challenges	Social inequality	Biodiversity loss	Climate change
3 Outcomes	Social justice	Nature positive	Climate positive

Source: Aviva Investors, UN SDGs.

[2]Wealth accounting provides an estimate of the total wealth of nations by aggregating values of these different components of wealth; produced capital, human capital, natural capital, and ne foreign assets.

3. Sustainable Stewardship Investment Philosophy

The Sustainable Stewardship belief is that every sector will, either positively or negatively, have an impact on or align to different SDGs, and therefore the sustainable Stewardship funds do not target specific SDGs or sectors but take a broad view of companies with either (i). positive alignment to one or more SDGs or (ii). on balance, positive alignment to the SDGs overall.

The Sustainable Outcomes team assess alignment to the SDGs using a proprietary framework and third-party data[3], with two key methodological principles:

a. Positive and negative alignment to the SDGs should be assessed, to identify the companies that positively align to the delivery of the UN SDGs who should be supported, and the companies that fundamentally undermine the delivery of the UN SDGs and should therefore be avoided;

b. The Sustainable Stewardship SDG alignment should also consider the operational effectiveness of a company, such that sustainable business practices can support the transition to a more sustainable economy and therefore in line with the spirit of the SDGs.

“Positive SDG alignment” is therefore defined as companies demonstrating sustainable practices or delivering solution orientated products and services through the lens of the SDGs, rather than as a contribution to achieving SDGS (which would necessitate a view of impact and additionality).

[3]Third-party data providers are selected based on the robustness and coverage of data.

4. Investment Process

The Sustainable Stewardship funds have a consistent three-layered investment process of capital allocation, stewardship and measurement:

a) **Layer 1: Capital Allocation (investment selection).** Allocate to companies where there is strong evidence that the company has an overall positive alignment to the UN SDGs. This is achieved by first applying negative screens to exclude numerous companies, and then further analyses potential investments to take a view on whether the company is sufficiently positively aligned to the SDGs to meet the Fund's sustainable investment objective.

b) **Layer 2: Stewardship.** Engage with investee companies on thematic issues to encourage sustainable behaviours.

c) **Layer 3: Measurement.** Monitor and reports on the Fund's alignment to the SDGs in aggregate, to ensure positive sustainable outcomes for investors.

4.1 Layer 1 – Capital Allocation: Identifying companies for investment

The Sustainable Stewardship funds are actively managed. The Investment Manager will identify suitable companies for investment by applying the exclusions policy and then assessing if the investment is (i). positive alignment to one or more SDGs or (ii). on balance, positive alignment to the SDGs overall.

In summary, the investment process both negatively screens and positively assesses all potential investments across the Sustainable Stewardship funds to: i) avoid strongly misaligned names- through exclusion criteria, and ii) identify areas of positive alignment through a set of operational and product/service key performance indicators, applying enhanced due diligence where necessary. This process is set out in more detail below.

An approval for investment will therefore be based on whether, in the Investment Manager's view, a company is considered to have a net positive alignment to the UN SDGs – a net negative alignment would not be acceptable for investment.

(i) SDG Alignment Framework

Aviva Investors have designed a proprietary SDG Alignment framework to categorise a company's level of alignment to SDG themes. This framework assesses company alignment to SDGs through two key lenses, and consequently the company's suitability for assessment:

a) **Operational Effectiveness:** considers a company's policies, practices and performance (3Ps). It assesses the quality of sustainability practices within a company's operations and the degree of alignment to the UN Sustainable Development Goals.

b) **Products and Service Provision:** considers the revenues that companies generate through products and services in business segments and the degree of alignment it has to the UN Sustainable Development Goals.

The framework is built off AI (Aviva Investors) internal research and leverages insights from third party data providers, predominantly MSCI's Impact and SDG Alignment data[4] and other third-party research (including broker and NGO research).

[4] The framework also utilises MSCI ESG Ratings, ESG Controversies and Global Norms, Business Involvement Screening data modules. As of July 22, 2020, MSCI SDG Alignment covered approximately 8,600 listed and unlisted companies.

Investment Objective	INVEST			AVOID	
Activity Assessment	**Positive and "Net" Positive Alignment** - support the delivery of the UN SDGs.		**Neutral -** neither support nor undermine the UN SDGs	**Negative Alignment** - undermine the delivery of the UN SDGs.	
	"Positive"	**"Net Positive"**		**"Net Negative"**	**"Negative"**
Operational Effectiveness	**Industry Leaders**			**Operational Harm**	
	Issuers with leading sustainability practices and no high-risk exposures.	Issuers with leading sustainability practices, *with evidence of adequate mitigation and management of high-risk exposures and controversies.*	Not subject to controversies but also does not evidence sufficient positive action in one or more thematic area or areas.	Subject to moderate or severe controversies, *with no evidence of remedial action or;* Demonstrates high exposure to intensive operations (>20%), *with no evidence of mitigation action.*	Captured by Stewardship Exclusionary Policy, through being subject to very severe controversies, where there has been adverse social or environmental impact.
Product and Services Provision	**Solution Providers**			**Harmful Products and Services**	
	>10% and no high-risk exposures.	**>10%** *with evidence of adequate mitigation and management of high-risk exposures and controversies.*	Minor or inconsequential exposure to products and services considered as solutions or causing adverse impact (0<10%)	**>10%** from high-risk products/services **or;** industry ties to negative screening themes, *with no evidence of mitigation action.*	Captured by Stewardship Exclusionary Policy, by being exposed to sector-based exclusions.

Source: Aviva Investors.

Exceptions

The Sustainable Stewardship funds will focus on the importance of allocating capital based on positive alignment, defined as clearly evidenced best and good practice through key performance indicators covered by the SDG alignment framework. There may be occasions where an issuer may not easily be categorised and therefore an exception may be required:

1. **Data Quality and Coverage:** where data on an issuer/ issue is considered to be low-quality or incorrect, the Sustainable Outcomes team will conduct an internal qualitative assessment within the pre-investment deep dive to justify inclusion based positive alignment, where there is credible and sufficient evidence to support the view.

2. **Improving practice:** where we consider an issuer/issue to demonstrate a commitment to change in one or more thematic area but current performance lag expectations on best or good practice, we reserve the right to leverage internal qualitative assessment within the pre-investment deep dive to justify inclusion of a neutral classification based on positive momentum on an issue.

(ii) **Defining the Investment Universe and Security Selection**

The investment decision-making process utilises both data-driven and qualitative elements to categorise issuers into the SDG Alignment Framework outlined above and leverages on 3 key inputs:

1. **Exclusion criteria** – identifies issuers that have products, services and behaviour considered to cause significant harm and undermine the UN SDGs.

2. **Enhanced due diligence criteria** – identifies issuers that have products, services and behaviour considered to have the potential to cause harm and undermine the UN SDGs, if not appropriately managed.

3. **Positive alignment criteria** – identifies issuers that demonstrate operational effectiveness and solution provision that are aligned to the UN SDGs.

The Portfolio Manager is ultimately responsible for security selection, however, will work closely with SDG analysts to maintain the integrity of the fund's sustainable objective, drawing on research from the SDG Analysts and the wider Sustainable Outcomes team.

1. **Exclusion policy – Avoid companies Strongly Misaligned to the UN SDGs**.

The Investment Manager maintains an exclusionary policy, which relate to the circumstances in which the funds will avoid financing certain business lines/ corporate behaviours. The Funds aim to avoid issuers on certain environmental, social and ethical grounds, ensuring that the Funds do not invest in companies that the Investment Manager regards as strongly misaligned to the delivery of the UN Sustainable Development Goals. Investments that do not pass the negative screens are thus ineligible for investment.

The investment universe is defined by sectoral and behaviour-based exclusions to negatively screen out companies that are considered harmful and provide a minimum sustainability baseline to the portfolio.

Exclusion criteria focuses on issuers that either:

a) ***Manufacture products*** that cause social or environmental harm and are misaligned with the UN Sustainable Development Goals or other widely accepted treaties, conventions and norms; and/or

b) ***Demonstrate poor behaviour*** that has allegedly caused very severe environmental or social harm as a result of company operations and practices and is deemed to be in inconsistent with the UN Sustainable Development Goals or other widely accepted treaties, conventions and norms.

Override mechanism

The Funds aim to adopt a practical and pragmatic approach. Aviva Investors retains the discretion to override an exclusion on rare occasions if, at the issuer and issue level, the following exception criteria are met:

- At issuer level, its exposure to the excluded activity is minor, inconsequential or immaterial;
- (Relevant to the AI Sustainable Stewardship Fixed Interest Fund) at the level of issuance, use of proceeds bonds (green, social, etc) mitigate or are not exposed to the activity which sees the issuer excluded.

Further, an override will only be made where the issuer satisfies the Funds' positive selection criteria, as further described below.

2. **Enhanced Due Diligence – Invest in companies that align to the SDGs**

Following the exclusion of companies by the negative screens, the Investment Manager then performs further analysis on all proposed investments to ensure that they are eligible for investment by determining that the company is, in the Investment Manager's view: (i) positively aligned to one or more SDGs; and (ii) on balance, positively aligned to the SDGs overall (i.e. any areas of positive alignment to the SDGs are not outweighed by areas of potential misalignment to the SDGs).

Aviva Investors takes a comprehensive view of whether an issuer is aligned to the UN SDGs in aggregate and believes that every sector will by nature link to different SDGs, including potential negative alignments.

The assessment process incorporates both quantitative and qualitative elements, with enhanced due diligence criteria applied where the data analysis has identified potential controversies, high-risk exposures or behaviours that are considered at risk of causing environmental or social harm and therefore being fundamentally misaligned to and undermine the delivery of the UN Sustainable Development Goals. These issuers will be subject to a custom, qualitative review to further assess its mitigation and remediation measures.

Enhanced Due Diligence criteria focuses on issuers that:

a) manufacture products or have exposures to intensive operations or industry ties to product/services that have the potential to cause social or environmental;

b) demonstrate behaviour that has allegedly caused environmental or social harm as a result of company operations and practices.

The custom review process assesses the level of mitigation and remediation employed by an issuer in relation to potentially harmful controversies, intensive business segments or product lines.

- For a), this will consider: (i) whether these exposures have been identified as a material or salient risk by the company; and (ii) evidence of a strategy to transition from the product area or minimise the negative externalities associated with product lifecycles or operational activities.
- For b), this will consider the associated controversy and global norms indicators and reports reviewed. The purpose is to query the data provided by the third-party data providers based on the following factors: (i) the scale of negative impact of the controversy at hand, (ii) evidence of remedial actions taken by the company, (iii) general sustainability profile of the company.

Please see appendix 5.2 for the full list of enhanced due diligence criteria and associated mitigation expectations and indicators.

Once the custom review has been completed, there are two outcomes from the assessment:

1. An issuer is considered to have adequately remediated controversies and mitigate high-risk business segments, through the implementation of robust transition and management strategies. Its classification is upgraded to a neutral position for these areas and reverts to its areas of positive alignment. Thus, considered "net positively aligned".
2. An issuer does not appear to consider these areas as salient or material and has failed to adequately remediate controversies or manage high-risk segments, its classification is downgraded to misaligned which overrides any areas positive alignment. Thus, considered "net negatively aligned" and not suitable for investment.

The Funds seek to invest in companies that are considered aligned to the Sustainable Development Goals, either through their operations or products/services.

The Fund(s) draw on research from the Sustainable Outcomes team and, in partnership with the investment teams, will invest in companies that they believe are aligned to the Sustainable Development Goals.

The Investment Manager maintains a set of operational and product alignment criteria within the SDG Alignment framework to identify issuers with positive alignment to the UN SDGs- examining industry leadership in operational effectiveness and solutions in product and service provision. These positive selection criteria identify companies that are considered to be **"positively aligned"**, which can be broadly categorised into two activities, **industry leadership in operational effectiveness** and/ or **solution provision through its products/services:**

1. **Operational Alignment:** invest in companies with high quality sustainability practices within its operations (relative to peers), which are positively aligned to the UN Sustainable Development Goals.

2. **Product and Service Alignment-Solution Providers:** invest in companies who generate revenue from product and services which are aligned to the delivery of the UN Sustainable Development Goals.

Operational Effectiveness

The framework assesses **positive** operational alignment based on company disclosures on policies, practices and performance on key themes linked to the UN Sustainable Development Goals:

a) **Policies:** Whether a company has publicly disclosed statements clearly articulating its approach, governance and risk assessment frameworks for social and environmental issues. This can include policies for specific themes (e.g.- biodiversity, human rights, diversity etc) or disclosures through widely accepted governance reporting frameworks (e.g.- CDP, WDI (Workforce Disclosure Initiative)).

b) **Practices:** Whether a company taken specific actions within its operations to manage and mitigate social and environmental issues. This can include embedding specific programmes (e.g.- Human Rights Due Diligence, Diversity & Inclusion, Talent Development and Health & Safety), participating in best practice external initiatives (e.g.- Race at Work Charter, Ellen MacArthur Global Commitment) and setting quantitative targets (e.g.- GHG, Water, Waste or Diversity) within its business model and strategy.

c) **Performance:** how a company's performance compares to peers (e.g.- quartile metrics), how a company's performance on specific measurements has improved overtime (e.g.- GHG emissions, RIDDOR) or if a company is meeting its internal targets (e.g.- GHG or Plastic reduction).

Product and Service Provision

A standardised revenue approach is taken to identify companies that derive revenue from products and services in business segments that are linked to themes considered as solutions or barriers to delivering the UN Sustainable Development Goals. Revenue thresholds are applied to assess the degree of alignment of misalignment.

Please see Appendix 2 for the full list of operational and product definitions, alignment themes and KPIs. Note: these will be subject to change overtime, informed by our view on the quality and coverage of available data points.

4.2 Layer 2 – Stewardship

The Investment Manager will use its shareholder influence to encourage companies to encourage sustainable behaviours.

The Funds will benefit from Firm-wide and Sustainable Outcomes specific thematic engagement with investee companies- both proactive and reactive- seeking to improve how a company operates.

i. Firm-wide Stewardship Activities

On an annual basis, Aviva Investors outlines a set of sustainability priorities that we expect companies to take into consideration, articulated in an annual letter to company chairs. In addition, the Corporate Governance team within the wider ESG team proactively and reactively engage with companies on salient ESG issues as part of Aviva Investor's broader engagement effort.

ii. Thematic SDG Engagement

The Sustainable Outcomes Team are committed to pursue specific thematic and collaborative engagement programmes to support SDG topic. These programmes have specific engagement asks of portfolio companies to progress against a number of topics, including but not limited to human rights disclosure and due diligence, climate ambition and disclosure and biodiversity disclosure and assessments.

Engagement will be prioritised and reviewed on a rolling basis based on targeting underserved UN SDGs and the Funds exposure (sector and size or value of holdings).

4.3 Layer 3 – Outcomes and Measurement

Layer 3 focuses on measuring investor **outcomes**, primarily the portfolios degree of SDG alignment and the outcomes of active ownership.

Aviva Investors are committed to measuring and being transparent on a comprehensive set of metrics to assess the portfolio's alignment to each of the UN SDGs.

The sustainability performance of the franchise will be monitored ***internally*** on an ongoing basis using an internal framework of operational and product alignment KPIs **and** SDG Alignment KPIs integrated investment systems. Regular franchise meetings and reviews of the Funds will monitor performance against the sustainable objective and provide a feedback mechanism for engagement to ensure these insights are being considered and integrated into investment decisions.

An annual transparency report will be published ***externally*** on the progress to meet the stated sustainability objective of the Funds.

To ensure investors have a third-party view with which to measure performance the Sustainable Stewardship franchise will report fund level SDG metrics, including against the ***MSCI SDG Alignment Methodology***.[5] MSCI were chosen as their approach to SDG alignment, in terms of both a net contribution and considering operational alignment, is the closest to the Stewardship philosophy, and therefore the fairest reflection of the funds approach to meeting their Sustainable objective.

Definitions:

- The **SDG Operational Alignment Score** is calculated based on the sum of the underlying performance, positive operational impact and negative operational impact scores. The score has a range of -10 to 10 and corresponds to a degree of alignment between Strongly Aligned to Strongly Misaligned.
- The **SDG Product Alignment Score** assesses the net impact of a company's products and services on achieving targets associated with each of the 17 SDGs. Net impact implies that some of a company's products and services may be well aligned with the sustainable development objectives, while other products may have an adverse impact and show misalignment with the goals. The score has a range of -10 to 10 and corresponds to a degree of alignment between Strongly Aligned to Strongly Misaligned.

The annual transparency report will seek to report the portfolio weight (by MV%) allocated to companies with positive and negative alignment to the UN Sustainable Development Goals, as well as the fund performance vs the benchmark.

[5] **Coverage:** As of July 22, 2020, MSCI SDG Alignment covered approximately 8,600 listed and unlisted companies, including those that were constituents of the MSCI ACWI Investable Market Index. The assessments are refreshed weekly to incorporate any changes in the underlying data.

IMPORTANT INFORMATION

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Where relevant, information on our approach to the sustainability aspects of the strategy and the Sustainable Finance disclosure regulation (SFDR) including policies and procedures can be found on the following link: https://www.avivainvestors.com/en-gb/capabilities/sustainable-finance-disclosure-regulation/

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