2016
ANNUAL REVIEW

AVIVA INVESTORS

Responsible Investment

Contents

Responsible Investment

Foreword

Euan Munro

Chief Executive,
Aviva Investors

2016 was another monumental year which began with the UN Sustainable Development Goals coming into effect and ended with the historic ratification of the Paris Climate Accord. In between these landmark developments, we also experienced game-changing political events such as Britain's historic decision to leave the European Union and a dramatic shift away from centrist politics across a number of critical markets.

As a leading global financial institution, Aviva Investors has had to rise to the challenge of helping clients navigate the immediate market volatility and uncertainty while ensuring that we remain focused on delivering long-term sustainable investment solutions.

To help deliver on these commitments, we have dedicated more resources to our responsible investment approach and I am particularly pleased with the progress being made in embedding Environmental, Social and Governance (ESG) considerations within our infrastructure and 'real asset' offerings. We were proud to be deeply involved in the Financial Stability Board Task Force on Climate-Related Financial Disclosures and continue to play an active leadership role in helping to shape the public policy agenda around the sustainability of our capital markets.

The year ahead is expected to bring more uncertainty and challenges. However, despite some disappointing policy reversals, we are confident that global efforts to support the transition towards a more sustainable future will continue to gather momentum.

Responsible Investment Highlights

Our Investment Philosophy

“We were proud to be deeply involved in the Financial Stability Board Task Force on Climate-Related Financial Disclosures and continue to play an active leadership role in helping to shape the public policy agenda around the sustainability of our capital markets.”

Euan Munro
Chief Executive,
Aviva Investors

Aviva Investors is a global asset manager with £345bn* under management in equities, fixed income, real estate and multi-asset. We seek to deliver the specific and meaningful outcomes that matter most to today’s investor. Our commitment to responsible investment is fundamental to delivering this goal. We focus on integration, active stewardship and market advocacy to deliver positive outcomes from our responsible investment approach.

1. **Integration of environmental, social and governance (ESG) considerations into investment decisions** – we work together with fund managers and analysts, customising ESG integration for each investment process, to deliver improved investment outcomes for clients.

2. **Active ownership and stewardship through engagement and voting** – we use our influence to promote good practice among those companies in which we invest, and to gain insight and reduce investment risk on ESG issues for our clients. We focus on generating outcomes that benefit our clients and in many cases society, the environment and the broader economy as well.

3. **Shaping markets for sustainability** – we advocate policy measures that support longer term, more sustainable capital markets. We aim to correct market failures such as a lack of corporate disclosure on ESG risks and climate change – at a national, EU, OECD and UN level – to improve long-term policy outcomes.

*As at 31 December 2016

- Responsible Investor Award for Innovation & Industry Leadership (2017)
- Voted 50,451 Resolutions at 4,259 shareholder meetings
- Voted against 26% of management resolutions
- Engaged on 1,222 occasions with companies as part of our Stewardship responsibilities
- Implemented new ESG integration process for infrastructure assets
- Launched investor guidance on Corporate Culture, Antibiotic Resistance and Sustainable Fisheries
- Aviva CEO addresses UN on financing of Sustainable Development Goals
- Member of the FSB Task Force on Climate-Related Financial Disclosures
- Launched policy toolkit to support the development of a sustainable capital markets union

Source: Aviva Investors, as at 31 December 2016, unless otherwise stated

Timeline

Our Heritage as Responsible Investors

1970

First records of Norwich Union exercising proxy voting rights

1991

Led first prominent form of shareholder activism at Tace plc where Norwich Union requisitioned an EGM and removed the entire board of directors

1992

Norwich Union Chief Investment Officer serves as a member of the Cadbury Committee which published the world's first corporate governance code

1994

Aviva Investors among first asset managers to publish Corporate Governance Voting Policy

1995

At the UN Summit Aviva pledges to 'balance economic development, the welfare of people and a sound environment, by incorporating these considerations into business activities'

2001

Aviva Investors founding CDP signatory (previously Carbon Disclosure Project) and first asset manager to formally integrate corporate responsibility into voting policy

2006

Aviva Investors is founding signatory of the Principles for Responsible Investment

2007

Aviva is founding signatory to ClimateWise and Accounting for Sustainability Principles

2008

Aviva Investors committed to publish proxy voting records online

2009

Advisory board member of Global Real Estate Sustainability Benchmark, an industry-driven organisation helping real estate investors assess the performance of real estate portfolios

Aviva Investors instrumental in the launching of The Sustainable Stock Exchanges (SSE) initiative, enhancing corporate transparency on ESG reporting and performance

2010

Aviva Investors was amongst the early signatories of the UK Stewardship Code

2012

Aviva Investors founded Corporate Sustainability Reporting Coalition with call to action at Rio+20 Conference

2014

Launched Aviva Roadmap for Sustainable Capital Markets & Sustainable Capital Markets Manifesto

2015

Mark Wilson speaks at UN General Assembly on Sustainable Finance

Aviva published Strategic Response to Climate Change & actively participated in COP21

Aviva Investors joined Investor Forum Board

2016

Aviva Investors asked to join European Commission's High Level Expert Group on Sustainable Finance

Aviva Investors asked to join the Financial Stability Board Taskforce on climate-related financial disclosures

Interview

Steve Waygood

Chief Responsible Investment Officer,
Aviva Investors

Q: What does responsible investment mean to you at Aviva Investors?

A: To us responsible investment means investing our clients' money to deliver superior long-term sustainable returns, being responsible owners of the assets we manage on their behalf, and leveraging our influence to help shape a more sustainable future.

Q: So does this mean you look beyond just maximising the size of your clients' savings and investments?

A: We are entrusted with money by our clients to help them achieve financial security. Growing assets and providing investment income is obviously fundamental to what we do. However, our clients' future welfare will be determined by not only the scale of their retirement funds but also the state of the world that they retire into. Therefore, we are also focused on allocating assets, and using our voice to help build a thriving, fair, inclusive and sustainable economy and global society. This is the essence of our commitment at Aviva to be a 'Good Ancestor'.

Q: These are ambitious goals – what does it mean in practice?

A: Well it means a number of things really. It could mean adjusting our investments in the auto sector to take account of 'disruptors' such as engine electrification and trends in shared mobility; it could mean valuing infrastructure projects based on their resilience to a low-carbon policy environment or exercising our rights as shareholders to push back on excessive executive pay and drive trends in gender diversity.

Q: Are the actions of Aviva Investors and like minded investors enough to move the broader market?

A: Allocating our clients' capital to responsible and sustainable companies, securities and real assets is an important first step. However, to achieve the wider objectives we need to help change the 'rules of the game' and fundamentally reshape how our capital markets operate. With this in mind, we strongly welcomed the decision by the European Union to appoint a high-level expert group, which we currently serve on, to develop recommendations for a comprehensive EU strategy on sustainable finance. The development of a sustainable capital markets union was a key recommendation of a white paper published by Aviva in 2015.[1]

1. http://www.aviva.com/media/thought-leadership/roadmap-sustainable-capital-markets

Q: To what extent do you consider some of the surprising outcomes of public votes in 2016 were triggered by a disillusionment with big business?

A: We believe that UK Prime Minister Theresa May was right to identify the need to restore the public trust in business as a key priority for government. Companies do not operate in a vacuum; their long-term success is dependent on their ability to create value for all stakeholders. Unfortunately this relationship has been undermined by pockets of misconduct in the financial services sector, some extravagant and unjustified executive pay packages, and irresponsible business practices where short-term profits have been pursued to the detriment of employees, local communities and the environment.

Q: So how are you working to address this problem?

A: Everything we do is about encouraging businesses and markets to operate more responsibly. We are naturally heavily involved in responding to the government consultation on governance reforms. Beyond that, we are focusing on a number of themes in 2017 to support the transition towards a more sustainable and inclusive economy. This includes encouraging more responsible tax practices, limiting the overuse of antibiotics in the food chain, promoting gender diversity, and helping to launch the Corporate Human Rights Benchmark (CHRB), the first-ever ranking of the world's largest publicly listed companies on their human rights performance.

Q: Finally what would you highlight as your key initiative for 2017?

A: It's difficult to pick out one thing. A project I am particularly excited about is our work with the World Benchmarking Alliance which is looking to create global benchmarks measuring how companies perform against the UN's Sustainable Development Goals. This is a truly unique multi-stakeholder project, which will create free-to-access public league tables of how companies are behaving. We hope that this will help catalyse a global 'race to the top' within corporate sustainability.

With so many initiatives underway, we were particularly pleased to be recognised by Responsible Investor for our innovation and leadership in the field. This is an important win for everyone at Aviva Investors, not just the Global Responsible Investment team.

About Aviva Investors

Aviva Investors is part of one of the largest and most secure financial institutions in the UK. As the investment arm of Aviva plc, the UK's biggest insurer, we can trace our origins in the London insurance market back more than 300 years. Today, our investors have entrusted us to manage more than £345bn (see source) across a broad range of asset classes.

	£m	€m	$m	%
Fixed Income	220,157	257,916	272,036	64
Equities	63,799	74,741	78,833	19
Real Estate	37,429	43,848	46,249	11
Other	23,134	27,102	28,585	7
Total	**344,518**	**403,606**	**435,704**	**100**

Totals may not add up due to rounding. Source: Aviva Investors, as at 31 December 2016.

Our goal is to deliver the specific and meaningful outcomes that matter most to today's investor. To achieve this, we are committed to managing investments according to these areas of focus.

WE ARE INSPIRED BY OUR CUSTOMERS' NEEDS

By listening to our customers' aspirations and understanding their challenges, we aim to create funds that focus on delivering the specific outcomes they need such as growing capital, providing a steady income or protecting against inflation.

WE COLLABORATE TO INNOVATE

Our global business acts as one team. By bringing together our knowledge, skill and creativity across major asset classes, disciplines and regions, we can unearth great investment opportunities.

WE BELIEVE IN INFORMED RISK, EFFECTIVELY MANAGED

We manage risk with discipline and rigour. By combining our extensive experience and unique insights, we reach an informed view on every decision taken throughout the whole investment process.

WE ARE RESPONSIBLE INVESTORS

We promote sustainable business practices in global markets, encouraging companies towards greater transparency and improved corporate governance. This helps to reduce risk and can enhance the long-term value of our customers' investments.

WE ARE CONVICTION-LED, LONG-TERM INVESTORS

Our long-term perspective drives all our actions. We focus on creating funds that are built to last, which ensures we grow long-lasting partnerships with our customers.

Our Responsible Investment Philosophy and Strategy

Aviva Investors is a global asset manager with £345bn[2] under management in equities, fixed income, real estate and multi and alternative assets. We seek to deliver the specific and meaningful outcomes that matter most to today's investor. Our commitment to responsible investment is fundamental to delivering this goal. We focus on integration, active stewardship and market advocacy to deliver positive outcomes from our responsible investment approach.

Pillar 1

Integration of environmental, social and governance (ESG) considerations into investment decisions

we work together with fund managers and analysts, customising ESG integration for each investment process, to deliver improved investment outcomes for clients.

Pillar 2

Active ownership and stewardship through engagement and voting

We use our influence to promote good practice among those companies in which we invest, and to gain insight and reduce investment risk on ESG issues for our clients. We focus on generating outcomes that benefit our clients and in many cases society, the environment and the broader economy as well.

Pillar 3

Shaping markets for sustainability

We advocate policy measures that support longer-term, more sustainable capital markets. We aim to correct market failures such as a lack of corporate disclosure on ESG risks and climate change – at a national, EU, OECD and UN level – to improve long-term policy outcomes.

2. Source: Aviva Investors, as at 31 December 2016

Pillar
1

Integration of ESG in the Investment Process

We incorporate ESG issues into our investment analysis and decision-making processes because we believe it delivers improved investment outcomes for our clients and increasingly for society and the environment. As long-term investors, we see factors such as corporate culture, good governance, climate change strategy, hard and soft regulatory landscapes, resource availability and employee and market place attitudes as core to the success of our investments.

Responsible Investment Officer Network

We believe that for responsible investment considerations to have a positive and meaningful impact on investment decisions, they must be fully embedded within the fundamental investment process. Aviva Investors has established a Responsible Investment Officer Network (RIO) of over 20 investment and business specialists representing various asset classes and offices across the organisation.

Members of the RIO network work collaboratively with a team of 8 responsible investment specialists and together are responsible for developing and implementing bespoke ESG integration strategies for each asset class and region.

"The rise of populism has emphasised how politics, economics and social considerations are inextricably linked. Having a holistic analytical framework, which includes ESG, is essential to our ability to navigate and interpret a world experiencing unprecedented change."

Ian Pizer
Head of
Investment Strategy

Shaping the Macro View

Aviva Investors has developed an intra-departmental approach towards forming forward-looking positions on key political, economic and social trends and expected outcomes. Quarterly meetings of representations from across the business culminate in the official Aviva Investors' House View, which cascades back through the organisation and helps guide medium to long-term investment positions.

The Global Responsible Investment Team (GRI Team) is a key component in this process and ensures that material ESG factors are considered when determining the firm-wide macro outlook. As a result, themes such as the implications of global climate negotiations, social trends in urbanisation, and the relationship between corporate governance and the political landscape in key emerging markets have been included in our macro view.

INTEGRATION IN PRACTICE
Macro Analysis

Following the outcome of the US elections, the GRI Team provided a detailed analysis of the likely fallout on global climate commitments. Our conclusions were that the net outcome of possible actions of a Trump Administration would be likely to slow rather than derail the future transition to a low-carbon global economy. Our projections were based on a number of factors including the legal framework of the Paris Accord, commitments of other major global players, particularly China, and the actions of non-government actors including those in the United States. We also leveraged the insights of business leaders obtained through our extensive corporate engagement.

Shaping the Sovereign View

The Aviva Investors sovereign debt team has developed a robust analytical model to evaluate the forward looking prospects of sovereign debt issuers. The model is based on an assessment against six key data themes including growth, the monetary and fiscal environment, the current account, and political conditions.

The Responsible Investment Team has been instrumental in identifying factors and helping to develop relevant data inputs to support the assessment of a country's political condition. Factors that have been fully integrated into the sovereign rating model include corruption control, rule of law, freedom of the press, and accountability of governments.

"The assessment of the political environment is a fundamental consideration for sovereign debt. The inclusion of indicators monitoring the prevalence of corruption and freedom of press, helps us evaluate the likelihood of future instability in a country and price the associated risk."

Charlie Diebel
Head of Rates

INTEGRATION IN PRACTICE
Sovereign Analysis

Since 2014 Turkey has experienced an increasingly challenging political environment, with greater centralisation of government powers, restrictions on the freedom of press, a clamping down on political opposition, and a heightened security threat. This culminated in the failed military coup in the summer of 2016. This has been reflected in Turkish 10 year government bond spreads which reached a historic high in January 2017. Over this three year period the ESG indicators which underpin Aviva Investor's assessment of Turkey's political risk experienced a steady deterioration. This was a critical factor in our negative outlook on the country and consequently our emerging markets sovereign debt portfolios have generally maintained an underweight position on Turkish government debt during 2015 and 2016.

Pillar 1

continued

Shaping the Sector View

Aviva Investors provides both equity and debt finance to support companies across global markets. Consequently we have fostered an integrated research philosophy and platform to assist in the evaluation of sector specific risks and opportunities. Dedicated research specialists built around six key sectors meet on a quarterly basis to update industry outlooks and share conclusions with portfolio managers and evaluate portfolio positions.

The GRI Team has accordingly been organised around industry themes and formally contribute to the sector assessments by leveraging ESG insights from internal and external research, proxy voting records and experience from company engagements.

> *ESG trends are fundamentally changing industry dynamics, from regulation, and supply chains, to shifting consumer patterns. Understanding these ESG factors allows us to appreciate risks and opportunities within each sector.*
>
> **Paul Lacoursiere**
> Global Head of Corporate Research

INTEGRATION IN PRACTICE
Sector Analysis

Recent momentum towards banking deregulation has triggered increased optimism of improved returns. The GRI Team highlighted the multi-billion dollar fines and compensation the top global banks have paid since the financial crisis. Therefore, while the scaling back of disproportionate regulation will unlock value, investors need to be wary of the impact on culture and behaviour. Accordingly, governance lapses and conduct risk was included as one of the key themes for the sector and we have maintained sell recommendations on poorly governed banks, despite their capital positions being strengthened.

Shaping the Company View

Our ESG heat map is our key company specific integration tool. It includes a range of material ESG data and analysis, including our internal governance rating, which is based on our historic voting record for the individual stocks in which we invest. This is available to all investment teams through the Bloomberg platform.

The ESG heat map is supplemented by additional fund manager and analyst briefings, provided before company meetings, votes or investment decisions. These briefings draw on our heat map and more detailed independent ESG data and research. We leverage the expertise of the team, bespoke research commissioned from brokers and research organisations, and additional information from less conventional sources such as NGOs and civil society to build up a rich picture of how the ESG issues impact businesses.

"Our investment philosophy is built upon identifying and investing in companies that are positioned to deliver sustainable shareholder returns. A company's ESG strategy and credentials provides invaluable insights into the quality of management and the alignment with our long-term investment horizon."

Chris Murphy
Global Head of Equities

INTEGRATION IN PRACTICE
Corporate Analysis

Aviva Investors is a significant long-term investor in emerging markets. Each market has a unique set of characteristics including corporate ownership structures. The presence of controlling shareholders from both private and state entities presents both risks and opportunities. Consequently, the emerging markets equity team relies on governance analysis provided by the GRI Team as part of its formal valuation models and focus investments on companies with a strong track record of protecting minority interests.

ESG is central to who we are and what we do

Trevor Green, Head of UK Equities

During my 26 year career as a fund manager, I have not worked within a business that has dedicated more resources than Aviva Investors to ESG. We have a strong commitment from the very top of the organisation to be engaged and accountable investors. Importantly, we don't just talk about sustainability, but have fully integrated ESG within our investment principles.

There is much more to our approach than screening and excluding companies from our funds. We spend considerable time working with portfolio companies to understand their ESG strategy, risk management and identify areas for improvement.

We regularly initiate discussions and debate over a wide variety of ESG matters with board members and senior management, often leading to some form of action. One example of this is a real estate company where we are the second largest shareholder; and undertook an in-depth study of its approach to ESG. The company demonstrated best practice with respect to pre-acquisition due diligence and on-going management of assets. The company worked through an example where it was able to show a material increase in the value of an asset after investing in photovoltaic panelling. This project produced an Internal Rate of Return (IRR) of 8.17% and a capital cost payback over 9.5 years.[3] This action provided additional income and capital value uplift to shareholders, created cost savings for the tenant, and improved the property credentials through an enhanced Energy Performance Certificate (EPC) rating. Such examples strengthened my view that ESG is not only about 'doing the right thing' but also about improving the financial returns on our portfolios.

3. Source: Tritax, as at October 2016

Multi-Manager Monitoring

The Multi-Manager (MM) team is the central source of external manager research and selection within the Aviva Group and is directly responsible for selecting, appointing and monitoring fund managers for Aviva Investors.

The MM team aims to assess whether a manager can demonstrate added value from its investment decision-making. Fund managers are analysed, assessed and ultimately selected according to our 7P process covering Parent, Product, Philosophy, Process, People, Performance and Position. Each of these criteria include ESG considerations. The MM team recently awarded a new fixed income mandate to a manager that scored highly on ESG. The manager demonstrated best practice through a fully integrated research process and the hiring of a dedicated resource to conduct ESG engagement with bond portfolio holdings.

The monitoring process is equally robust – asking fund managers to justify stocks that perform poorly on ESG criteria and discussing their responsible investment approach, including voting and engagement activity, on a regular basis.

"Our focus on external manager selection gives us valuable insight into the activities of our underlying managers, specifically with regards to their progress on ESG integration. We have spent considerable time incorporating ESG criteria into our due diligence process to build a picture of ESG integration at both the fund house level and in the investment processes of our external managers. This work, as well as our biennial industry wide ESG survey, has revealed encouraging progress that has been and continues to be made in this area."

Isabel Emo Capodilista
Senior Multi-Manager Analyst

ESG and Alternative Assets

Responsible Investment and ESG has been traditionally biased towards liquid assets such as equities and bonds. This has been for several reasons including the weight of assets under management, availability of information and the rights and access provided to shareholders. However, recently the importance of ensuring ESG factors are also appropriately embedded within alternative asset classes has risen in prominence. This is primarily due to a reallocation of assets amongst pension funds towards alternative solutions and a recognition that more illiquid assets by definition tend to have a longer-term investment horizon and consequently are arguably more exposed to ESG risks.

At Aviva Investors we understand that alternative asset classes have unique investment considerations and have made significant progress in developing bespoke ESG strategies from real estate and infrastructure to structured finance and private corporate debt.

Sustainable Real Estate

We believe that integrating ESG considerations can deliver real value in terms of cost savings, enhanced returns and reduced regulatory and obsolescence risk within our real estate assets. Consequently, we consider ESG issues in our investment decision-making and due diligence processes for new investments, as well as existing direct and indirect investments. Our environmental policy, implementation and performance is overseen by our Real Estate Investment Committee.

We were founding members of the Global Real Estate Sustainability Benchmark (GRESB), the industry-driven organisation assessing the ESG performance of real assets globally, and have maintained a seat on the GRESB Advisory Board since its launch in 2010. It is supported and used by both our direct and indirect real estate businesses in different ways. In 2016, we submitted 14 funds from our direct real estate business for benchmarking assessment and were delighted that 8 of our funds received GRESB "Green Stars" in recognition of their sustainability credentials.[4]

Our indirect real estate business engages all our unlisted and listed real estate funds to complete the GRESB survey (we had an 83 per cent global response rate in 2016, up from 78 per cent in 2015). The GRESB results are fed back to each underlying fund and follow-up discussions are held with every manager.

INTEGRATION IN PRACTICE
Real Estate

Aviva Investors recently undertook a major refurbishment of an office building in London's Covent Garden. The project was awarded, at the time, the highest ever Building Research Establishment Environmental Assessment Method (BREEAM) rating for an office refurbishment.[5] Targeting an 'Excellent' BREEAM rating helped occupiers meet their sustainability requirements and reduce occupational costs. This allowed us to advertise the letting 20% above the original price target when the project began.

"Buildings are considered one of the most cost-effective sectors for reducing greenhouse-gas emissions. We expect the responses of regulators, occupiers and investors will increasingly alter real estate markets around the world."

Richard Levis
Global Real Estate Analyst

4. Source: Carbon Credentials, as at 16 September 2016.
5. Source: Breeam, as at 30 July 2013.

Pillar 1

continued

Sustainable Infrastructure

In July 2015, Aviva plc announced an investment target of £500 million annually for the next five years in low-carbon infrastructure. We also set an associated carbon savings target for this investment of 100,000 tonnes of CO^2 annually. We worked together with an independent consultant to develop a 'carbon calculator' tool to enable us to measure the carbon equivalent savings associated with low carbon infrastructure investments aligned with the Green Investment Bank "Green Impact Reporting Criteria" guidance. In 2016, Aviva Investors signed £450 million of new investment in wind, solar, biomass and energy efficiency.

All infrastructure projects that are being considered for either debt or equity funding are subject to a an ESG due diligence process that covers a full spectrum of considerations including biodiversity impacts, climate strategy, labour rights and safety, stakeholder relations and political lobbying. The conclusions from the due diligence process are reviewed by the Investment Committee prior to the approval of any project.

INTEGRATION IN PRACTICE
Infrastructure

A number of proposed infrastructure projects have been rejected by Aviva Investors' Investment Team due to issues highlighted during the ESG due diligence process. This includes a transaction in the oil and gas sector where checks identified a poor track record on contamination, and a large European coal power plant which lacked a robust strategy to address climate-related risks and impacts.

"Sustainable infrastructure is increasingly becoming a strategic priority for governments across Europe. Aviva's long-standing ESG commitment and capability means that we are well positioned to become a financing partner of choice."

Veronique Leroy
Head of Infrastructure Asset Management

Sustainable Lending

Our growing private lending business provides our clients access to enhanced income, capital preservation, diversification and cash flow matching. This includes commercial real estate debt, structured finance (mortgage-backed securities, government-guaranteed loans, trade and credit financing), and private corporate debt.

Higher premiums are achieved in exchange for less liquidity and transparent reporting associated with listed securities. This places additional responsibilities on us to apply greater rigour during the due diligence process to assess ESG risks. Each investment team in collaboration with the GRI Team has begun developing an asset specific ESG assessment framework which applies both pre and post investment. As an example, our Paris-based corporate debt team have recently implemented a comprehensive online ESG due diligence questionnaire developed with the support of an external consultant.

INTEGRATION IN PRACTICE
Lending

The structured finance team worked with the GRI Team when considering purchasing a financial instrument where the underlying counterparty was a local educational establishment. The initial due diligence flagged a concern with past conduct of the parent entity. After further investigation, the specific school was not directly implicated in any past controversies and had recently adopted a robust conduct policy and oversight process, and was consequently cleared for investment.

"Forthcoming environmental regulations have the potential to impact on building owners' letting options and resultant cash flows. Therefore, the ESG characteristics of properties and the credentials of our customers to manage these will increasingly become a material factor in our lending decisions."

James Smith
Senior Portfolio Surveyor

Pillar

2

Active Ownership & Responsible Stewardship

At its simplest, stewardship means taking responsibility for something entrusted into our care. In this case, it involves the effort and activities undertaken by asset managers to monitor, engage and, where appropriate, intervene on matters that may affect the long-term value of investee companies and the capital invested in them. This can encompass issues such as strategy, performance, corporate governance, and environmental and social challenges that may materially affect the future sustainability of companies and shareholder returns.

We consider active stewardship to be a fundamental responsibility as investors. We were amongst the vanguard of signatories to the UK Stewardship Code. In December 2014, we were pleased to receive independent assurance on our Stewardship Code Statement under the AAF 01/06 Stewardship Supplement by PwC. At the time, less than ten percent of signatories had received independent assurance. We will continue to refresh this assurance periodically.

Voting

In 2016 we voted at 4,259 shareholder meetings and withheld support on 26% of management proposals.

We consider voting to be an important part of the investment process and have had a formal and considered voting policy since 1994. We have explicitly incorporated corporate responsibility disclosure and performance into our voting since 2001; being one of the first asset managers to do so globally. Our Corporate Governance and Corporate Responsibility Voting Policy is reviewed annually and signed off by the Aviva Board.

During 2016 we voted at 4,259 shareholder meetings (up from 3,930 meetings in 2015). This represents 88.9% of meetings where we had a legal right to do so (91.9% when excluding French domiciled funds). Unvoted meetings were primarily due to additional costs associated with the vote which were not justified by the benefit delivered to clients.

We vote against items where we consider that the specific proposals are not in the best interests of our clients; where we have wider concerns with individuals, strategy, oversight and reporting; or to reflect disappointing outcomes from prior engagement. In 2016 we voted against 12,625 management proposals (25.6%) and supported 653 shareholder resolutions (60.6%).

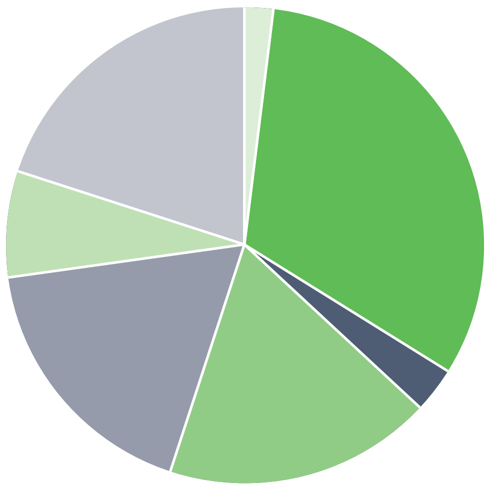
2016 Voting Activity by Issue

	Total Number of Resolutions	Number of Against /Abstentions	%
Directors	24601	6846	28
Remuneration	4976	2425	49
Auditors	4166	1055	25
Share Issues/Capital Related	5376	1067	20
Report & Accounts	2471	277	11
Related Party Transactions	804	131	16
Takeover/Merger/Reorganisation	538	44	8
Anti-takeover Measures	111	66	59
Shareholder Resolution	1095	442	40
Other	6313	714	11

Source: Aviva Investors, as at 31 December 2016

2016 Voting Activity by Region

Africa	2%
Asia	32%
Australasia	3%
Europe (ex UK)	18%
North America	18%
South America	7%
United Kingdom	20%



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Executive pay

SPOTLIGHT
Executive pay in the dock

2016 was the year that executive compensation rose to the top of the government agenda. Following Britain's decision to leave the EU, the Prime Minister singled out irresponsible pay practices as one of the key factors behind unprecedented levels of mistrust in big business.[6] We believe that executive pay has been a problem for some time, as highlighted in our voting and engagement records below. At Aviva Investors we have long challenged the status quo, doing what we believe is right and in the interests of our clients. The government's intervention is both welcome and timely as the systemic nature of the problem requires a market-wide response.

Aviva Investors Voting Record – Remuneration

Remuneration related resolutions (Global)	2016	%	2015	%	2014	%		2006	%
For votes	2478	51*	2827	59	2989	59		796	58
Against	2131	44	1708	36	1822	36		461	33
Abstentions	248	5	231	5	235	5		123	9

* The sharp increase in 2016 of votes against was triggered in part by a stronger position taken in the US on the granting of time vesting share awards.

Engagement on remuneration

	2016	2015	2015
Total companies engaged on pay	143	161	229**
Responses to company consultations on pay	45	41	49

** notably higher, as 2014 was the first year in which binding remuneration policy votes were introduced.

Aviva Investors is a member of the Investment Association Remuneration and Share Schemes Committee which is responsible for the continuous review of executive remuneration and evolving best practice and providing views on specific company pay arrangements.

6. The FTSE is trading at broadly the same levels as eighteen years ago and 10% below its peak – however, executive pay over the same period has more than trebled and there is an increasing disparity between average wages and executive wages. Source: Executive Remuneration Working Group interim report, as at 21 April 2016

Our Main Concerns:

- We have consistently opposed and flagged concerns over (poor) decisions by remuneration committees that are not appropriately aligned with performance, sometimes resulting in votes against re-election of directors. This has typically involved payments of substantive bonuses and granting of maximum share awards despite a significant fall in shareholder returns. We are also unsupportive of material pay increases post an acquisition; rich pay packages for new (unproven) directors; and significant vesting of Long-Term Incentive Plan awards for mediocre performance.
- Whilst quantum has generally not been our primary concern, it has become a flashpoint due to an increased reliance on benchmarking. Levels of executive remuneration cannot be justified by the value added for shareholders, and runaway pay has not only become a reputational risk affecting employee morale but can materially impact a company's bottom line. Excessive pay is also typically a sign of poor succession planning.
- Shareholders tend to only focus on the most egregious cases. As such, there is no deterrent for the majority of companies and the ratcheting up will continue without intervention.
- Although shareholders have gradually been empowered with more rights, we are still unable to block payments considered inappropriate or unjustified.

What can be done to address the issues?

- In our response to the Government's Green Paper on Corporate Governance, we recommended that shareholders are given stronger powers to control pay. We advocated the introduction of a new model whereby companies that receive more than a 25% vote against would be obliged to table a binding vote the following year. Should a company subsequently receive less than a 50% majority vote, then any variable elements of pay would be withheld.
- We also recommended that companies be required to publish executive/average worker ratios alongside absolute levels of pay, and that equivalent data be provided for selected industry peers. This will ensure remuneration committees are more cognisant of the wider workforce when setting pay levels.
- As per the Executive Remuneration Working Group's recommendation, there should be more flexibility afforded to remuneration committees to choose a structure which is most appropriate for the company's strategy and business needs. We have no objections to alternative proposals such as restricted/free shares or share options provided the proposals can evidence fairer outcomes such as a large discount in total pay in lieu of more certainty of pay-outs.
- Efforts should be made to broaden the talent pool through encouraging better diversity on boards and succession arrangements. This should help ease the supply-constrained upward pressure on pay.
- Shareholders should be more willing to vote against directors who are responsible for excessive pay packages. Individual accountability is essential to changing behaviours.

> *"Companies and boards now face unprecedented levels of scrutiny over their pay practices. Aviva Investors is ready to use its voting power to express discontent if companies fail to properly align executive pay with the value they deliver to us as long-term shareholders"*
>
> **Nathan Leclercq**
> Head of Corporate Governance

Pillar 2

continued

SPOTLIGHT
Shareholder proposals

Our voting records stretch back over two decades, showing a rich history of supporting Shareholder Resolutions.

Shareholder resolutions are proposals submitted by shareholders for a vote at the company's annual meeting. Typically, resolution content is opposed by the corporation's management, hence the need for a contested vote. Resolutions span a range of topics and are frequently related to environmental, social and governance issues from antibiotic resistance to zero hours contracts.

We have supported shareholder resolutions relating to topics as wide ranging as LGBT rights to curbing the use of the most harmful pesticides.

We actively supported the 'Strategic Resilience for 2035 and Beyond' shareholder resolutions proposed at the BP and Shell, and later Statoil, AGMs. We attended both the BP and Shell AGMs in support of the resolution and to question the Board. These resolutions called for routine annual reporting to include further information about certain activities related to climate change, including ongoing operational emissions management, asset portfolio resilience to the International Energy Agency's scenarios, and public policy positions relating to climate change.

We also co-filed similar resolutions at three mining companies (Anglo, Rio and Glencore) in 2016.

Aviva Investors Voting Record – Shareholder Resolutions

	Number of shareholder resolutions	Number supported	Per cent supported	Number not supported	Per cent not supported
2011	734	478	65	256	35
2012	766	524	68	242	32
2013	1071	575	54	496	46
2014	1114	629	56	485	44
2015	1075	654	61	421	39
2016	1095	653	60	442	40
TOTAL	**5855**	**3513**	**60**	**2342**	**40**

Percentages have been rounded.

CASE STUDIES

Company improvements following a negative vote

Moneysupermarket.com Group plc

Despite our discussions with the company in 2015, the Remuneration committee decided against introducing mandatory deferrals of bonuses, implementing holding periods for share awards, or increasing minimum shareholding guidelines in accordance with market norms. As one of the company's largest shareholders, we were concerned with the risk this creates in respect of management not being properly aligned with the long-term interests of shareholders, particularly in the case of newly appointed directors. As our issues hadn't been addressed, we voted against the company's pay report at the 2016 AGM. 11.6% of the total votes cast were against the remuneration report.

Later in the year, we welcomed the decision by the company to restructure future pay arrangements in line with our earlier recommendations. The changes were particularly timely following the news that the long-standing chief executive was planning to step down.

Headlam Group plc

After extensive engagement, we voted against the company's auditors, KPMG, who had served as its external auditors for over 20 years. Mandatory auditor rotation is an effective mechanism for mitigating the potential risks borne by long-term auditor-client relationships, and helps safeguard audit quality. We noted at the time that the audit committee considered a tender process unnecessary.

At the Company's 2016 AGM, we welcomed the decision of the company to rotate their external auditor to another firm amongst the big 4.

Marui Group Co., Ltd.

At the 2015 AGM we withheld support from a number of management proposals to reflect our concerns with the lack of reporting on supply chain policies and systems. As a large retailer, the company is exposed to significant labour risks within its supply chain particularly across its clothing businesses.

We welcomed the subsequent steps taken by the company to update its procurement policy to include standards set out by the International Labour Organisation. Marui Group has also published supporting information on its work with private brand suppliers on monitoring labour practices. As a result of enhanced disclosure, we supported the relevant resolutions at the 2016 AGM.

> *"Responsible stewardship is about more than just flagging our concerns with companies. Our robust monitoring process ensures that our multi-year voting and engagement programme is designed to generate real change in company behaviours and practices."*
>
> **Mirza Baig**
> Head of Investment Stewardship

Pillar 2

continued

Engagement

While stewardship is most commonly associated with equity investments, we consider engagement to be an important part of our investment process across a range of asset classes. The aim of our engagement is to identify and reduce ESG risks in our portfolios. For example, by improving our understanding of the quality of the board of directors of a company and its strategy in responding to issues, such as climate change or the living wage, we can gauge how well prepared companies are to deal with current or emerging ESG risks and opportunities. Where we consider the company's response or performance falls short of the required standards, and that this shortfall will have an impact on our investments, we will engage with the board to improve performance over time.

> In 2016 we undertook 1,222 company engagements to encourage better ESG practices within organisations represented in our equity and fixed income portfolios.

Our approach to engagement, including how we escalate concerns, is set out in our Stewardship Code Statement. Engagement routinely takes the form of meetings or calls with the Board or senior sustainability executives. We set out clear objectives for the engagement and follow-up where appropriate. Engagement outcomes are reflected in our voting and thereby fed back into our ESG heat map. For active holdings, engagement is undertaken in close co-operation with the fund manager(s) and the company's response feeds into the investment decision-making process. As investors we recognise our role in supporting the UN's Sustainable Development Goals through our stewardship activities.

“From the farm to pharma, from livestock to life sciences. the widespread complacency in the administration of our invaluable antibiotics, especially in intensive farming, has led to dangerously high levels of anti-microbial resistance that risks wiping $100trn off potential global output by 2050.”

Abigail Herron
Head of Responsible Investment Engagement

CASE STUDY
Antimicrobial Resistance (AMR)

Antibiotic resistance occurs naturally, when bacteria adapt in response to contact with antibiotics. However, the speed of emerging resistance is being accelerated by the misuse and overuse of antibiotics. Global consumption of antibiotics soared by 40 per cent between 2000 and 2010, with usage in Brazil, India, Russia, China and South Africa accounting for three-quarters of this growth.

Currently, at least 700,000 people are known to die globally of antibiotic resistant infections each year. The UK government launched a review on AMR in collaboration with the Wellcome Trust, a biomedical research charity, in July 2014. The UK AMR Review Team, led by economist Lord Jim O’Neill, predicted that, left unchecked, AMR could be a bigger killer than cancer by 2050, with 10 million people dying of antibiotic resistant infections.

Over the past half century, increased agricultural output has been driven by the intensification of production. The human population climbed to slightly over seven billion in 2014 from 3.2 billion in 1963. To meet rising demand, world food production has soared while higher incomes and urbanisation (particularly in developing nations) have encouraged higher demand for meat and fish. By 2013, the number of cattle, pigs, sheep, goats and poultry had leapt to more than 25 billion, with the majority contained in factory farms, from approximately seven billion in 1963.

Excessive use of antibiotics in farming, and the corresponding dangers to human health, creates systemic risks across the food, farming and pharmaceutical industries. These include potential costs of regulatory change and reputational damage. Furthermore, as the momentum for a concerted global effort to address AMR grows, companies risk being caught on the wrong side of the debate; putting short-term profitability before the common good.

Aviva Investors convened and chaired the first ever investor conference on antibiotic resistance with the UK Government’s Antimicrobial Resistance Review team. On World Antibiotics Awareness Week, we launched Superbugs and Super Risks: A Guide for Investors.

We are proud to be a founding signatory to the Farm Animal Investment Risk & Return (FAIRR) investor initiative which has, in just its first year, amassed a coalition representing $1.1 trillion of assets under management.

Alongside this collective action we meet individually with the companies we invest in, mainly in the pharma, food retailer and producers sectors to discuss their strategy on antibiotic resistance.

Pillar 2

continued

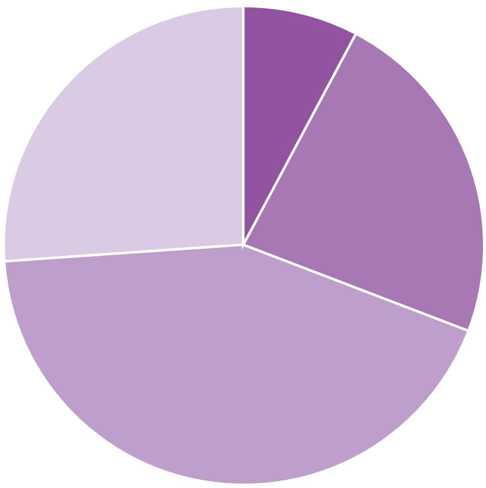
Effective engagement is resource intensive and we therefore need to prioritise where we focus our efforts. We draw up engagement plans on an annual basis, and these are subsequently reviewed on a quarterly basis. We use our ESG heat map to prioritise areas of greatest concern and overlay considerations. Factors we monitor include the size of our holding, thematic priorities (such as climate change), AGM-related priorities and event-triggered engagement. The latter may, for example, take place in response to a major health and safety incident.

In 2016 we undertook 1,222 company engagements with 872 individual companies. Approximately 50% of the engagements involved substantive dialogue. Engagement includes a range of activity undertaken by our GRI team, fund managers and collaboratively with other investors. Engagement intensity ranges from a single letter to multiple meetings. Due to the nature of our holdings, the majority of our engagement (77% per cent) was with UK companies.

Engagement by Category

Climate Change	8%
Environment & Social	23%
Governance	43%
Strategy	26%

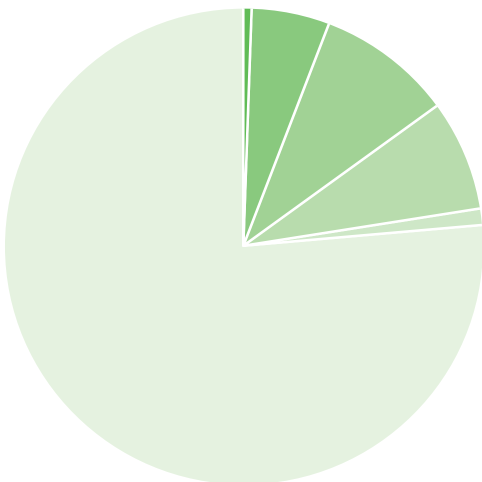
Source: Aviva Investors, as at 31 December 2016



ESG Engagement by Region

Africa	1%
Asia	5%
Europe (ex UK)	9%
North America	7%
South America	1%
United Kingdom	77%

Source: Aviva Investors, as at 31 December 2016



CASE STUDY
Corporate Culture

In December 2016 Aviva Investors published a document entitled 'Shareholders and Corporate Culture: The Stewardship Challenge'. Culture is important because it guides the behaviour of all those who work for companies and provides purpose and values to organisations. It can also act to mitigate the risk of inappropriate behaviours.

The five main takeaways from our document are:

- Shareholders should talk to a wide range of stakeholders and engage with the executives as well as the non-executive directors on the topic of culture
- Key performance indicators (such as employee and customer feedback) can be useful but can also be misleading so there is a premium on good judgement
- Incentives matter. Financial reward will drive behaviour but so will other things like harsh pressure to meet unrealistic goals
- Culture is not static or monolithic. It can vary across a company or weaken over time
- Shareholders are not impotent. They can identify weakness and help boards address it

CASE STUDY
Coal 40 (Engagement led Divestment):

We consider engagement to be an important step in our investment process but recognise that this must carry the threat of divestment to be meaningful. In July 2015, we identified an initial set of 40 companies with more than 30 per cent of their business (by revenue) associated with thermal coal mining or coal power generation. We undertook focused engagement with these 40 companies, setting out our expectations on the governance, business strategy, operational efficiency, responsible climate and energy policy advocacy and crucially whether the company has any plans for new investment in coal generating capacity.

In the first year of this multi-year engagement, we have had meaningful engagement, often with multiple meetings or calls, with 80% of companies. There are eight companies we have not been able to engage, despite at least three attempts to set up calls or meetings. All eight companies are based in Asia, predominantly in China and South Korea.

We have chosen not to disclose the names of our target companies in advance of any potential divestment, for commercial reasons in order to both manage our ability to engage effectively as well as sell at a reasonable price according to prevailing market conditions. However, we plan to disclose the names of the companies post divestment.

We have now identified 2 companies for potential divestment on the basis of further planned investment in coal capacity, in addition to 8 companies on the basis of non-responsiveness. We are participating in a specific collaborative engagement project to address the 8 unresponsive companies but will take a decision in Q1 2017 whether to also mark these companies for divestment.

Pillar 2

continued

Collaboration with Other Investors

Aviva Investors actively engages with other investors in the belief that collaboration is an important and sometimes essential requirement for being able to exercise appropriate influence at companies. It is important to share information or areas of concern regarding companies, not just in times of stress, but also in normal times in order to identify potential issues or risks.

In this regard we are founder members and active participants in a number of UK and international investor networks. These networks facilitate discussion and sharing of information through which individual institutions may decide to work collaboratively when appropriate. The following are examples of organisations and networks where Aviva Investors are active participants:

- Association for Sustainable and Responsible Investment in Asia
- CERES (US organization advocating for sustainability leadership)
- ClimateWise
- Corporate Human Rights Benchmark (CHRB)
- Council of Institutional Investors
- European Sustainable Investment Forum (Eirosif)
- Extractive Industries Transparency Initiative
- GIGN - Global Investors Collaboration Services
- Global Real Estate Sustainability Benchmark (GRESB)
- Institutional Investors Group on Climate Change (IIGCC)
- Interfaith Center on Corporate Responsibility (ICCR)
- International Corporate Governance Network (ICGN)
- Pensions and Lifetime Savings Association
- Principles for Sustainable Insurance
- Sustainable Accounting Standards Board
- Sustainable Stock Exchange Initiative
- The Investment Association
- The Investor Forum
- UK Sustainable Investment and Finance Association
- UN Global Compact
- UN Principles of Responsible Investment
- University of Cambridge Institute for Sustainability Leadership (CISL)
- US Sustainable Investment Forum
- World Benchmarking Alliance
- World Business Council for Sustainable Development
- Shareholder Voting Working Group (SVWG)
- 2020 Stewardship Working Party

CASE STUDIES
Collaboration in Action

Palm oil: a burning issue

Indonesia and Malaysia account for around 75 per cent of the global palm oil market, which was worth $61 billion in 2014 and is forecast to hit $88 billion by 2022. The country lost more than six million hectares of natural forest between 2000 and 2012, which could rise unless the industry transitions more fully to a sustainable model.

Our Head of Engagement, Abigail Herron, visited Jakarta, Sumatra and Singapore in September 2016 as part of a 25-strong investor group that met with palm oil companies, small-holders, government officials and non-governmental organisations. The trip was organised by the Principles for Responsible Investment, an international non-governmental organisation backed by the United Nations.

The burning of carbon-rich peatland to make way for palm oil and pulp wood plantations is the primary catalyst for the so-called haze. It occurs every year, but the El Nino weather phenomenon warmed up the sea and delayed rainfall; allowing the fires to burn for longer over an extended area in 2015. Consumer boycotts, legal action, fines and tighter regulation followed as the reputation of the palm oil industry fell to a new low. In 2016 we ran a workshop with the Monetary Authority of Singapore on investor expectations around palm oil. We also co-hosted an event at the British Embassy in Singapore on the work of the Zoological Society of London's Sustainable Palm Oil Transparency Toolkit (SPOTT).

Encouragingly, a number of large palm oil players have pledged to end their involvement in deforestation and the burning of peat altogether. These include US-based agricultural trading house Cargill, Golden Agri-Resources, the world's second largest palm oil plantation company and Wilmar International. Aviva Investors will continue to work with these companies to help ensure that they follow through on their targets while continuing to encourage companies that have yet to make any formal commitment to change.

Sustainable Fishing: Net Benefits

For over three decades, the world's marine fish stocks have come under increasing pressure from fishing, loss of habitats and pollution. Rising sea temperatures and the increasing acidity of the oceans are placing further pressure on already strained ecosystems. Illegal fishing and unreported catches undermine fisheries management, while subsidies continue to support unsustainable fishing practices. Around 85 per cent of global fish stocks are overexploited, depleted, fully exploited or in recovery from exploitation.

China Tuna Industry Group shelved a planned $100 million initial public offering in December 2014 after Greenpeace delivered a letter of complaint to the Hong Kong Stock Exchange accusing the company of underestimating its exposure to environmental and sustainability risks. The concerns that tuna quotas had been breached were shared by the regulator but not by the company or its advisors who failed to mention the endangered status of their primary catch when drafting their listing prospectus.

Positive engagement with management can steer investee companies towards more sustainable strategies that both improve business performance and aid the environment and society. However, shareholders need to be able to ask the right questions of companies and press them for substantial answers.

On World Oceans Day we launched a report and engagement guide for investors designed to guide investor engagement with seafood investee companies. This builds on our seminar on sustainable seafood hosted with the UK Sustainable Investment Forum. Alongside this we have convened a UNPRI backed group of investors to engage with a selection of companies on the topic which was launched at The Economist South-East Asia and Pacific Regional Fisheries Summit in Jakarta.

SPOTLIGHT

Article 173 of the French Energy Transition for Green Growth Law

Article 173 of the French Energy Transition Law came into force on 1 January 2016. The Law introduced new carbon disclosure reporting requirements for institutional investors on a comply-or-explain basis. Specifically, asset managers were expected to disclose information on how ESG criteria are considered in their investment decisions and how their policies align with the national and international strategy for energy and ecological transition.

In July 2015, we published Aviva's Strategic Response to Climate Change setting out five pillars that encapsulate our approach to addressing the requirements of article 173.

The five pillars encompass how we allocate our capital and use our influence to support the transition to a lower carbon – 2°C aligned – economy. Achieving this transition without a significant, rapid and detrimental re-pricing of assets requires judicious capital deployment by us and within our investment assets.

Pillar 1 – Integrating climate risk into investment considerations

We remain deeply committed to ensuring ESG issues are included in our investment analysis and decision making and continue to drive better integration of carbon and climate risk factors. The dynamic and interconnected nature of climate risk, in addition to current limitations in some necessary data sets, means understanding and managing climate-related risks remains an important focus for our business.

Pillar 2 – Investment in lower carbon infrastructure

In July 2015, Aviva plc announced an investment target of £500 million annually for the next five years in low-carbon infrastructure, a fifth of which was pledged by Aviva France. We also set an associated carbon savings target for this investment of 100,000 tonnes CO^2 annually. This target was set in recognition of the scale of investment required in renewables-based power generation and energy efficiency. In 2016, Aviva Investors signed £450 million of new investment in wind, solar, biomass and energy efficiency.

> *"Investors can act to reduce their exposure to short-term climate risks arising from shifts in market sentiment, but they are unable to eliminate more than half of those risks. Economy-wide action is required to protect savers' long-term financial interests from the systemic component of climate risk."*
>
> **Dr Jake Reynolds**
> University of Cambridge Institute for Sustainability Leadership

SPOTLIGHT
continued

In France, the Energy Transition Law is a welcome development, asking the finance industry to disclose on how environmental, social and governance, but particularly climate-related considerations are factored into our investment portfolio. Indeed, we believe this will help us further align our investment towards the two degree goal.

Philippe Taffin
Chief Investment Officer,
Aviva France

Pillar 3 – Supporting strong policy action on climate change

Climate change is a clear example of market failure. The Paris Agreement was pivotal in committing nation states to address this failure. We provided strong and vocal support for a global climate agreement directly and in collaboration with other investors in the run-up to the United Nations Framework Convention on Climate Change (UNFCCC) 21st Conference of Parties (COP21). This included hosting an event during COP21 at the British Embassy in Paris on stimulating private investment in the low-carbon economy with representatives from the UK Government, the UK Green Investment Bank, the New Climate Economy and UNEP Inquiry alongside the CEO of Aviva France.

Pillar 4 – Active stewardship on climate risk

We consider active stewardship to be a fundamental responsibility as investors. This includes considered voting and engagement on climate risk, disclosure and performance. We have focused on in-depth engagement with companies strategically exposed to climate-related risks due to their significant carbon impact and exposure to transition risks (and opportunities). We undertake this engagement individually and collaboratively.

Pillar 5 – Divesting where necessary

In July 2015, we identified an initial set of 40 companies with more than 30 per cent of their business (by revenue) associated with thermal coal mining or coal power generation. We undertook focused engagement with these 40 companies, setting out our expectations on the governance, business strategy, operational efficiency, responsible climate and energy policy advocacy and crucially whether the company has any plans for new investment in coal generating capacity.

Institutions such as Aviva Investors stand willing and able to fund climate-relevant investment through green bonds, as long as we see meaningful standards put in place.

Colin Purdie
Head of Global Investment
Grade Credit

Pillar

3

Shaping Sustainable Capital Markets

Policy makers and regulators play a critical role in defining the framework within which companies and investors operate. In many cases, we witness market failures where the true cost of an activity, such as emitting carbon, is not adequately priced. We also see the way the capital markets have evolved and are structured today undermine the development of a sustainable economy. Crucially for us and our clients, this erodes the long-term potential for sustainable companies to create value.

We therefore advocate policy measures and market corrections to tackle failures such as a lack of corporate disclosure on ESG risks and climate change – with the aim of improving long-term outcomes. These should be coordinated at the global level though an inspirational and harmonising policy framework – such as a UN Resolution – with the objective of entire financial systems transformation.

Climate Change – Tragedy of Horizons

The world's institutional investment community has a financial interest, as well as a fiduciary and moral duty to future generations, to promote a rapid, yet well managed, transition to a net zero climate economy. However, it is essential financial actors work collaboratively with regulators to encourage a smooth and measured transition, and avoid policy shocks which may trigger an overly steep trajectory of change, which could result in dramatic and unmanageable shifts in asset values and returns.

To input into UNFCCC policy discussions at the climate conference COP22, Aviva published a policy document – Seeing Beyond the Tragedy of Horizons: An Investor Perspective[7] – which outlined a series of recommendations for policy makers and the financial services sector including:

Asset Owners – must exercise greater oversight of asset managers on how they integrate climate risk in investment processes across asset classes. This should include credible data on engagement with portfolio companies.

Climate Risk Literacy – update director training, MBA syllabuses and the CFA curriculum to promote and increase climate risk literacy amongst key market participants.

Investment Intermediaries – credit rating agencies and sell-side brokers should disclose how climate risk and 2 degree scenario planning is integrated into ratings and valuation forecasts.

Financial Regulators – International Accounting Standards Board (IASB) should be encouraged to enhance the accounting disclosure framework for the extractive sectors, to standardise the disclosure of embedded carbon in the physical reserves of companies.

7. http://www.aviva.com/media/upload/Aviva_Tragedy_of_Horizons_Report.pdf
8. http://www.avivasustainablefinancetoolkit.com/#home

"Without the necessary information, market adjustments to climate change will be incomplete, late and potentially destabilising."

Mark Carney
Governor of the Bank of England

CASE STUDY
Framework for Climate Disclosures

In December 2016 the Financial Stability Board (FSB)'s Task Force on Climate-Related Financial Disclosures (TCFD) published recommendations for a standardised framework for companies to disclose the financial impacts of climate change. The TCFD, initiated by Financial Stability Board Chair, Mark Carney, and which included Steve Waygood, chief responsible investment officer at Aviva Investors, was charged with developing a framework for climate-related disclosures that could promote more informed investment, lending, and underwriting decisions, and enable stakeholders to better understand concentrations of carbon-related assets in the financial sector, and price the associated risk.

The TCFD recommended companies run scenario analysis that model potential performance under a range of different climate and policy outcomes, and publish the results as part of their mainstream financial filings. Companies and other financial institutions were also encouraged to report how they will incorporate climate-related considerations into four key areas of their businesses: governance, strategy, risk management and targets. The TCFD is due to publish updated recommendations following a public consultation in June 2017.

EU Sustainable Capital Markets Union

Following the announcement by the European Commission of its intention to develop a comprehensive European strategy on sustainable finance, Aviva launched a sustainable finance policy toolkit – Money Talks.[8]

The toolkit provides 13 key policy ideas for policymakers and practitioners for how to best create the change needed to catalyse and scale a sustainable financial sector. The toolkit includes the following key recommendations, which are also relevant in a global context:

8. http://www.avivasustainablefinancetoolkit.com/#home

EU Sustainable Capital Markets Union *continued*

Sustainable Stock Exchanges

Stock exchanges and their regulators play a unique role in delivering the standardised sustainability data which investors require – their listing requirements and guidance ensure companies file data that is material, meaningful and comparable with their peers.

However, sustainability disclosure rates globally remain low – only 47% of the world's large companies disclosed greenhouse gas emissions for 2014. There is already a market-led approach to improve disclosure through the United Nations Sustainable Stock Exchange (SSE) initiative, whose core aim is to improve sustainability disclosure amongst listed companies. The SSE initiative has achieved huge success with almost 60 stock exchanges across the world now participating much more actively in the debate. Aviva is proud of having played a part in establishing this initiative.

However, more could be done to provide clarity and improve and ensure consistency across stock exchanges. Unless the majority of exchanges all move at once, opportunities will arise for disclosure arbitrage. It also creates confusion for companies that list in multiple jurisdictions.

The body that is best-placed strategically to provide this consistency at a global level is the International Organization of Securities Commissions (IOSCO), which is the influential global hub for all securities regulators. The EU could work with Member States to encourage IOSCO to develop a consistent and comparable approach to corporate disclosure of sustainability performance.

> 58 stock exchanges, representing over 70% of listed equity markets, have made a public commitment to advancing sustainability in their market.
>
> SSE Initiative 2016 Report on Progress

Responsible Investment Standard

Retail investors have little visibility of the sustainability practices of the financial institutions that are managing their money. This is because there are no standards to which investors can be accredited to assure their clients that its investment approach is both long-term and responsible.

We believe there is a need to go further to develop a kite-mark in responsible investment – effectively a Fairtrade for Finance – so that companies can differentiate themselves on responsible investment and investors can make informed and responsible investment decisions.

The standard should be auditable and voluntary and could include requirements to report to clients how they integrate sustainability into their investment decisions, how they monitor firms' sustainability performance, how they exercise their voting rights and how they engage with companies in their portfolio.

The EU has already begun to show leadership in this area by including requirements on investors and pension funds to be transparent about their sustainability practices to their clients in the reviewed Regulation on Packaged Retail Investment Products (PRIPs) and the recently agreed Directive for Institutions for Occupational Retirement Provision (IORP).

The EU could build on this and take a leading role in driving this standard forward, working closely with the International Organisation for Standardisation (and its national equivalents), as well as stakeholders like the World Resources Institute and the Fairtrade Foundation.

> Aviva Investors was invited to join the EU expert group to develop a 'comprehensive sustainable finance strategy'. The group will help co-ordinate existing work streams and drive forward new initiatives targeting the financial sector that could be taken during the Commission's remaining mandate.

Sustainable Development Goals – World Benchmarking Alliance Corporate League Tables

“Sustainable business is all about enlightened self-interest. If business isn’t sustainable then society is at risk and if society isn’t sustainable then business is at risk. Our challenge is to turn rhetoric into reality. This toolkit is designed to help policymakers and practitioners do exactly that.”

Mark Wilson
Group Chief Executive Officer, Aviva Plc

The Sustainable Development Goals (SDG) recognise the critical role of the private sector in delivering inclusive growth within planetary boundaries. It is also widely agreed that capital markets play a critical role in unlocking the private sector potential to drive the SDG agenda.

However, our current sustainability reporting systems are failing to drive change at scale. The analysis of relative corporate performance is inaccessible to individual asset owners and civil society, due to high paywalls, lack of transparency in methodology and complexity of reporting.

This means there is no effective mechanism for individual investors, civil society and governments to hold companies to account for investing in and promoting good corporate performance on sustainable development. Consequently, there is not enough pressure on companies, either from investors or society at large, to improve their corporate sustainability performance over time.

An emerging solution is the creation of a set of publicly available, free corporate sustainability benchmarks, ranking companies on their sustainability performance and contribution to achieving the SDGs. These benchmarks provide financial institutions and other stakeholders with critical information they can use in their engagement with companies on sustainability issues. This model ensures a high degree of transparency and accessibility of corporate sustainability performance, driving companies to compete to out-perform each other on sustainability performance and transforming the nature of investor and civil society engagement with corporates on sustainability topics.

Aviva Investors is a founding member of a coalition of actors that are collaborating to establish the World Benchmarking Alliance, a publically funded, global institution that funds, houses and safeguards the quality of SDG-related corporate benchmarks.

SDG Benchmarks and the Theory of Change

Sustainable development impact	Benchmarks create a competitive pressure and a powerful incentive to companies to improve their contribution to sustainable development.
Public debate	Collaborative methodology and open availability of benchmarks facilitates informed public debate and scrutiny.
Clarification of societal expectations	The multi-stakeholder dialogue approach to developing benchmarks generates consensus around societal expectations of corporate sustainability performance. The broader the consensus, the more internal and external stakeholders will use the insights generated by the benchmarks.
Company assessment and comparison	Benchmarks enable stakeholders to compare the relative performance of companies within a sector quickly and easily over time, on a range of indicators, securing positive recognition for companies where appropriate, sharing best practice and stimulating further disclosure of non-financial information.
Stakeholder engagement	This process improves investor engagement around sustainability topics and drives societal consensus on expected standards.

CONTACT US

For more information,
visit **www.avivainvestors.com**

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