The Stewardship Funds Philosophy and Investment Policies

The Stewardship Funds Philosophy

The Stewardship Funds give our customers the opportunity to provide a secure future for themselves and their families while helping to contribute to a sustainable long-term future for the world around us.

Introduced in 1984, the Stewardship Funds have a proud heritage as the UK's first ethical fund range. The original aims of the Stewardship Funds were, and remain, to:

1. **Exclude companies that do not meet certain ethical standards or that harm society or the environment.**
2. **Support companies that make a positive contribution to a sustainable future.**
3. **Encourage better business practices through active ownership and dialogue.**

The Stewardship Funds Philosophy recognises that the contribution companies make to a sustainable future depends both on the products and services they provide and on the way they provide them. Shareholders have a responsibility to address these issues actively with the companies they invest in to deliver a positive outcome for their customers, suppliers, employees, local communities and the environment.

Through our management of the Stewardship Funds, we aim to use our influence as a shareholder to support the positive contribution companies make to a sustainable future and to encourage positive environmental, social and governance (ESG) practices. The Funds avoid companies and sectors whose products or services cause unmitigated social or environmental harm.

Please remember, as with other funds, when investing in the Stewardship Funds the value of investments can go down as well as up and you could get back less than invested.

The Stewardship Funds Criteria

Companies and their shareholders can and do make a positive contribution to society. However, companies can also cause ethical, social and environmental issues by, for example:

- making harmful products;
- acting without regard to customers, employees and the communities in which they operate;
- polluting the environment; or
- failing to have acceptable governance practices.

Shareholders inevitably bear some responsibility for the harm done by the companies in which they invest.

Stewardship aims to determine whether the benefits delivered by a company or a sector outweigh the potential harm they may cause when creating those benefits and if, as shareholders, we believe we can influence them to reduce the harm and increase the benefits.

Companies generally operate in such a way that some aspects of their activities are acceptable to Stewardship while others are not. In some instances, failings may not be significant enough to disqualify a company from inclusion in the portfolio. In such cases, Stewardship will take a balanced view across the company's activities.

The Stewardship Funds investment approach is based on three layers:	
Layer 1	**Exclusion** – principally based on **what** a company does
Layer 2	**Engagement** – generally concerned with **how** a company goes about its business
Layer 3	**Outcome** – **measuring the ESG performance** of the companies we invest in at a fund level

Layer 1: Exclusions

Some industrial sectors and activities will always conflict with the values of the Stewardship Funds. The screens shown below are fundamental to the Stewardship Funds philosophy and a company engaging in them will not normally be considered for investment by the Stewardship Funds.

Ethical & Social Exclusions

Issue	Negative screening criteria
Adult entertainment, pornography and violence	• >10% of turnover from adult entertainment or pornography. • >10% of turnover from violent video games. • Any involvement in the manufacture of guns.
Alcohol	• >10% of turnover from the manufacture of alcoholic products. • >25% of turnover from the distribution or sale of alcohol products (e.g. retail, hotels, restaurants and leisure industries).
Animal testing	• Any involvement in the development and manufacture of non-medical related products (such as cosmetics, personal care, household cleaning products) where this has involved animal testing and where the company does not disclose an animal testing policy, or has a weak policy. • Any involvement in providing animal testing services, where the company either does not disclose an animal testing policy, or has a weak policy.
Animal welfare – fur	• Any involvement in production or design of fur pelt, raw materials and products containing fur or fur trim. It also includes companies that hunt, raise, trap animals for their fur.
Endangered species	• Involvement in the retail of threatened species, or components thereof, with insufficient action to prevent it.
Gambling	• >10% of turnover from gambling related activities.
Genetic Modification	• Companies that genetically modify plants (e.g. seeds, crops) and other organisms intended for agricultural use or human consumption.
Labour standards, human rights and Health & Safety controversies	• Companies that are the subject of severe controversies related to health & safety breaches or systematic failure to protect human rights and labour standards, with no evidence of serious or lasting remedial action.
Military – weapons and weapon systems	• Any involvement in the manufacture of whole weapons systems, components or support systems (including conventional, Biological-Chemical, cluster munitions, depleted uranium and nuclear weapons).
Tobacco	• Any involvement in the manufacture of tobacco related products. • >25% of turnover from distribution or sale of tobacco related products (e.g. retailers).

Environmental Exclusions

Issue	Negative screening criteria
Chemicals	• Any involvement in production of chemicals restricted by the following international agreements: the Stockholm Convention, Montreal Protocol and OSPAR Priority List. This includes persistent organic pollutants, PCBs and CFCs.
Aviation	• >10% of turnover from aviation related activities i.e. airlines, airport operators and aircraft manufacturers.
Thermal Coal	• Any revenue from thermal coal mining or thermal coal-fired power generation. • Any thermal coal reserves.
Oil & Gas	• Any revenue from Arctic oil and/or gas production (onshore and offshore). The definition of "Arctic" is geographical and includes production activities north of the 66.5 latitude. • Equal to or more than 10% of revenue from conventional oil and/or gas extraction and production*. • Equal to or more than 15% of revenue from natural gas electricity generation**. • Any revenue from unconventional oil and/or gas production (including oil sands, oil shale, tar sands, shale oil, shale gas, tight gas, coal bed methane, coal seam gas). • Equal to or more than 10% of revenue from liquid fuels* power generation. • Any unconventional oil and/or gas reserves (including shale gas, shale oil, oil shale, oil sands, tar sands, tight gas, coal bed methane and coal seam gas). • Equal to or more than 1000mmboe (millions of barrels of oil equivalent) of oil and/or gas reserves. • Equal to or more than 75% of revenue from oil and/or gas value chain activities, including distribution and retail, equipment and services, petrochemicals, pipelines and transportation, refining, and trading***. • Equal to or more than 25% of revenue from oil operations, including pipelines.
Nuclear power generation	• >10% of turnover from nuclear power activities. • Any company deriving revenues from the mining of uranium.
Pollution	• Companies that are the subject of severe controversies related to environmental pollution, with no evidence of serious or lasting remedial action.

*From 2025, we intend to reduce the threshold by 1% a year to 0% by 2035.

**From 2025, we intend to reduce the threshold by 1% a year to 0% by 2040.

***From 2025, we intend to reduce the threshold by 5% a year to 0% by 2040.

The Stewardship Funds aim to adopt a practical and pragmatic approach. On rare occasions, a company may be removed from the exclusion list where its exposure to the negative investment criteria is minor, inconsequential or immaterial and the company makes a strong, positive contribution to society.

We use a range of experienced research providers to constantly monitor our investment universe and supply us with accurate data and insights into each company's ESG performance. The large data bank we rely upon for screening the investible securities in our investment universe is updated every six months.

Layer 2: Engagement

Layer 2 primarily relates to the use of our stakeholder influence to encourage companies to enact best sustainability practices.

The Funds' engagement with investee companies has a number of components:

1. Chair Letter

On an annual basis, Aviva Investors outlines a set of sustainability priorities that we expect investee companies to take into consideration in the coming 12 months.

Three clearly defined priorities, namely tackling the cost of living crisis, transitioning to a low carbon economy and reversing nature loss, will shape our voting and engagement activities in 2023. We described in the chair letter in February 2023 what we would like to see from our investee companies in each of these areas, as summarised below:

On the cost of living crisis, multi-decade high inflation, rising borrowing costs and a challenging trading environment mean that companies might need to make difficult decisions on costs, pricing, budgets, financing and shareholder distributions. Businesses have a responsibility to protect their most vulnerable stakeholders in this period of stress and we will look unfavourably on any attempts to protect profitability and returns through the disproportionate and excessive transfer of costs to employees, suppliers and customers.

We expect companies to consider the following actions:

- Pay a living wage: Everyone has the right to live with dignity and receive a fair wage for their labour that covers their basic cost of living. Companies should commit to paying a "living wage" for all workers, provide secure contracts, predictable hours and appropriate holiday and sick pay. Companies should also seek to mandate comparable obligations on suppliers and contractors.
- Offer financial support: Lower-income workers lack the financial resilience to cope with current levels of inflation and interest rates, pushing many into poverty. Companies should consider providing additional financial support to their most vulnerable workers.
- Engage with trade unions: Companies must engage with trade unions in good faith and seek a balanced outcome recognising the impact of high inflation on real wages, and the physical and mental toll the pandemic has had on frontline workers. Companies should disclose policies for engaging with unions and report on outcomes and resolutions.
- Uphold human rights: High inflation has exacerbated the risk of exploitation of vulnerable workers. Companies must commit to upholding human rights, undertake robust due diligence, establish appropriate whistleblowing and grievance mechanisms, and provide regular reporting on their efforts to eradicate modern slavery. As part of these steps, we expect companies operating in high-impact sectors to implement the Employer Pays Principle to ensure ethical or responsible recruitment in their own businesses and supply chains.
- Show responsibility on executive pay: Executive compensation is an important signal and barometer of corporate culture. As the workforce are increasingly being forced to make trade-offs to afford essential spending, it would be inappropriate for highly paid executives to be fully insulated from the impacts of inflation. We expect any increases to executive base salaries to be below the average for the wider workforce. Companies should also be mindful of trends in pay ratios when determining total remuneration outcomes for executives.
- Support vulnerable customers: Companies should review their approach to identifying vulnerable and financially stressed customers, exploring opportunities to adapt their products, services and pricing models to provide financial support to those in need. Companies should also consider developing strategic relationships with charitable initiatives to help build greater financial resilience in the communities they serve.

Transitioning to a low carbon economy

We expect all companies to develop and publish robust and financially viable climate transition plans that will support the decarbonisation of economies in a socially just and inclusive manner.

We are strong supporters of the UK Transition Plan Taskforce Disclosure Framework and expect its recommendations to be integrated into the International Sustainability Standards Board (ISSB) guidance. We encourage companies to pay particular attention to the following components of the framework:

- Business models: Describe key impacts of the transition plan on products and services, asset acquisitions and disposals, organisational design, resource allocation, and operational and capital expenditures.
- Financial planning: Estimate the impact of the plan on the financial position of the company, including future revenues, costs, cashflows and investment returns. The transition plan should be fully costed and accompanied by sources of funding to implement the strategy.
- Incentives and remuneration: Integrate climate targets and metrics into variable incentive arrangements for executives and senior management. The percentage of total compensation linked to climate targets should reflect the extent to which transition plans will fundamentally reshape the business model, growth profile and investment thesis of the company.
- Engagement with value chain: Develop strategies to engage and incentivise customers, suppliers and partners to collectively drive the decarbonisation of the entire value chain. Companies should set Scope 3 emissions reduction targets and monitor and report on the success of upstream and downstream initiatives.
- Engagement with governments: Engage with governments, regulators, public sector organisations and civil society to help create a coherent, holistic and effective transition pathway. Companies should seek to evidence alignment between government engagement activities and corporate climate commitments, covering direct lobbying as well as indirect influence through trade associations.

Reversing nature loss

The Post-2020 Global Biodiversity Framework agreed at COP15 in Montreal established a 2030 mission and set new targets and goals, most notably the 30x30 target of conserving at least 30 per cent of global land and oceans by 2030.

Companies have a critical role in engaging governments to establish supportive regulatory regimes that align subsidies and fiscal policies with the delivery of the Montreal targets.

Companies need to demonstrate how they are aligning their internal policies and practices with a nature-positive ambition and quantify the financial risks and opportunities associated with their dependencies and impact on nature, providing decision-useful disclosures to investors.

Accordingly, we expect all companies to begin reporting within a reasonable timeframe against the Taskforce on Nature-related Financial Disclosures (TNFD) framework.

In preparation for reporting against the framework, companies should undertake the TNFD recommended business model assessment process, referred to as LEAP.

The framework has four core components:

- Locate interfaces with nature: Companies should begin by mapping the location of individual assets, business processes, value chains and downstream products to each ecosystem, to enable the appropriate prioritisation of issues and areas for assessment.
- Evaluate dependencies and impacts: Companies must identify and quantify all ecosystem services that support the generation of revenues, cashflows and enterprise value for each business process and location and measure the impact the business is having on nature.
- Assess risks and opportunities: Companies should determine the risks and opportunities associated with its dependencies and impact on nature, outline existing risk mitigation and identify additional potential actions.
- Prepare to respond: Companies should build on the outcomes of the previous steps to define a comprehensive biodiversity strategy. This should include the setting of short-, medium- and long-term targets and action plans to reduce and reverse the impacts of the business on nature. Companies should then determine the scope and substance of financially relevant public disclosures to be made against the TNFD framework.

Lastly, we acknowledged in the letter the magnitude of these challenges. We will evaluate companies on the strength of their commitments and ability to demonstrate progress over time.

The full letter can be found on **avivainvestors.com/en-gb/views/aiq-investment-thinking/2023/01/company-chairpersons/**

2. Proactive targeted engagement

We initiate a targeted thematic programme of engagement with companies on key ESG issues, identified through internal and external research. This may be to encourage companies the Funds invest in to improve practices where they fall short of our expectations or to push the boundaries of best practice in a specific area.

The current focus areas for the Stewardship Funds are:

1. **Diversity** - advocating for inclusive cultures and diverse workforces.
    a. We're encouraging companies to meet our expectations on gender and ethnicity board-level diversity in line with targets set by the UK Government and build a pipeline of female and ethnic minority talent at management and executive level.
    b. We're also encouraging UK-based companies to adopt best practice diversity reporting for the wider workforce and disclose the associated actions and plans in place to promote greater diversity and inclusion.
2. **Plastics** - supporting the circular economy.
    a. We're encouraging companies within the consumer goods sector to adopt best practice strategies relating to plastic use and waste, specifically to establish credible strategies and targets relating to reducing, reusing and recycling plastics more effectively and establishing closed loop packaging systems.

3. Reactive engagement

There may be instances where we engage as a response to key themes and issues highlighted in internal and external ESG research and ratings, where we believe there is a conflict with the Stewardship Funds' Philosophy. The purpose of reactive engagements is to better understand a company's approach and positioning on a particular issue.

4. Collaborative Initiatives

We collaborate with other investors and participate in industry initiatives to exert our collective influence to bring about change and encourage companies to enact best ESG practices.

Current industry initiatives which the Stewardship Funds are focusing on include:

1. **30% Club UK Investor Group:** we're a member of this initiative and have signed the 30% Club Investor Groups statement on Race Equity, to actively engage with UK company board chairs, nomination committees and executive teams on the issue of racial inequality in their leadership ranks and workforce.
2. **Carbon Disclosure Project (CDP):** we're a founding signatory of the CDP and take part in its annual campaign to encourage companies to participate and report to the CDP questionnaire to improve their climate related risk management and performance.

Aviva Investors fundamentally believes that companies which show good management of issues will outperform their peers in the long run. Engagement shouldn't be seen as the easy option for companies to satisfy the criteria for inclusion in the Stewardship Funds. When we engage with a company, we set out what we deem to be sufficient improvement for the Funds to remain invested. We anticipate that the time period for engaging with a company to see this improved performance will typically be three years. However, our intention is to allow the best possible chance of creating the desired response by company management, consequently the time period for engagement will vary depending on the particular circumstances. If companies fail to respond adequately within an appropriate timeframe reflecting the seriousness of the issue, we will consider divesting the Fund's position in that company.

Layer 3: Outcomes

At Aviva, we're committed to working with our clients to address societal and environmental systemic issues through our investments to shape real-world sustainable outcomes – which we also believe offers a compelling investment case and an opportunity to be on the 'right side' of change. Our Stewardship Funds' investment philosophy, to invest for a sustainable future, is built on the premise that capital should be allocated to those companies that

- are not involved in harmful activities, but which instead, in our opinion,
- are transitioning their business activities to demonstrate ESG best practice and/or where their products or services contribute to a sustainable future.

Layer 3 of the Stewardship Funds includes Key Performance Indicators (KPIs) that we use to assess and monitor long-term indicators of a portfolio's ESG performance. We consider a broad range of indicators, ranging from (for example) the carbon footprint of the Funds with respect to their investments, to the proportion of companies held by the Funds with equal opportunities policies. As these indicators are long term in nature, improvements may take time to become apparent. However, through the Stewardship Investment Policy's active engagement, the Funds apply rigorous oversight of those companies into which they have invested.

As the data disclosed by companies varies across different global regions and asset types, we currently only report to investors on layer 3 indicators in respect of UK and global equity holdings. This may change over time as the data tools available improve.

Further information

Further information is available on the following websites:
aviva.co.uk/retirement/fund-centre/stewardship/
aviva.co.uk/retirement/fund-centre/

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