Considering Principal Adverse Impacts

Our approach for investments

September 2021

The EU's Sustainable Finance Disclosure Regulations (SFDR) aim to provide transparency on sustainability within financial markets in a standardised way. This should help investors to make better comparisons between asset managers and, ultimately, make better informed financial decisions.

Some of these regulations seek to harmonise disclosure rules for financial-market participants such as ourselves. These include disclosure of any potentially adverse impacts of our investment decisions in the following areas:

(i) climate and the environment

(ii) social and employee matters, respect for human rights, anti-corruption and anti-bribery matters

In this document, we outline where we see the principal adverse impacts (PAIs) across our range of investment products. We also provide information on how we consider PAIs across asset classes such as equities, fixed income and real estate, and the processes that we follow. Finally, we detail our policies for engaging with the companies in which we invest on environmental, social and governance (ESG) matters, as well as our voting procedures at general meetings and the external codes to which we adhere.

Assessing PAIs across our investment range

We invest in a range of different assets on behalf of our clients, including those listed below.

1. Direct and indirect investment into public equities, fixed income, real estate and infrastructure

When investing directly in public equities, bonds and real estate assets, we assess PAIs as part of our process. For infrastructure, we focus our investments on projects that mostly relate to improving the environment and society. We do not believe these warrant an assessment of adverse impact.

We also manage products that invest indirectly using quantitative strategies. Here, we invest through an algorithm or by matching an index. With these investments, we do not consider PAIs. However, ESG is a core component of our quantitative strategies process. For example, when optimising and rebalancing portfolios, we incorporate sustainability factors such as ESG scores, carbon intensity and exposure to ESG controversies. Sustainability factors are also an important part of our portfolio monitoring and regular risk reviews. We monitor all portfolios against a range of internal and external ESG metrics. These include a variety of ESG scores, carbon exposures and green revenues.

In addition, we offer a range of sustainable index strategies. These track customised indices that aim to manage a broad range of sustainability-related risks. The indices exclude tobacco, thermal coal, unconventional oil & gas, controversial weapons and severe ESG controversies. We also offer bespoke passive solutions to segregated clients. These are based on custom exclusion policies and carbon-reduction targets.

2. Investments through funds of selected external managers

We invest through external managers in our private-equity and multi-manager products. For these investments, we undertake initial and continued due diligence. This helps us to fully understand how the selected managers consider ESG and sustainability factors. It also helps ensure that the managers we select meet our required standards. But as we don't decide to invest in the specific assets in these funds, we cannot consider the PAIs of these investments.

Understanding ESG factors and their impact

We believe that a thorough understanding of ESG factors helps us make better investment decisions. Ultimately, this leads to better outcomes for our clients and wider stakeholders. This understanding begins with rigorous research. We undertake thorough due diligence before we invest, considering material ESG risks and opportunities alongside other financial metrics. At this stage, we seek to answer three questions.

- Are such risks are being adequately managed?
- Have investors understood these risks and priced them accordingly?
- Are we comfortable with the possible adverse impact of an investment?

Each of our asset-class teams assesses ESG factors within its investment process. You can find out more about how they do this in the ESG integration documents for each asset class on our website. The teams' proprietary assessments form the basis of our analysis on how an investment is handling ESG risks. Where we feel an investment has a significant adverse impact on our portfolios, the teams will adjust our exposure accordingly.

Next, we detail our approach to assessing PAIs across public equities, fixed income and real estate.

Public equities

When researching equities, we focus our extensive resources on analysing ESG issues. This involves collaboration between our equity investors, our specialist ESG equity analysts and our central ESG investment team. Together, they generate a deep understanding of the ESG risks and opportunities associated with each company and the industries in which they operate.

Every research note that we write includes analysis of three key ESG questions.

- Which ESG issues are relevant for this company, how material are they, and how are they being addressed?
- What is our assessment of the quality of this company's governance, ownership structure and management?
- Are incentives and key performance indicators aligned with the company's strategy and the interests of its shareholders?

To answer these questions, we need a good knowledge of industry practices around ESG risks and opportunities. We also examine disclosure, annual reports and quantitative ESG metrics, as well as the company's track record. In addition, we interact with third-party experts and carry out further desk-based research. In doing this, we use our excellent corporate access to meet company management teams, as well as suppliers, customers and competitors.

Our analysts have a wide range of data sources to draw on. This includes company financial data and disclosure, other market data, third-party research, data and research from specialist ESG providers such as Trucost, carbon-footprint data and our proprietary ESG House Score data. We are also developing tools using natural language processing and data science to further enhance our ESG research capabilities.

Throughout this comprehensive research, we apply a systematic and global approach that allows us to compare companies consistently on their ESG credentials. Having considered the region and peer group in which the company operates, our equity team then assigns a bespoke ESG rating between one (leaders) and five (laggards). We apply this across every stock we cover worldwide.

Our policy requires that we do not invest in companies with a score of 5. These are the companies with, in our view, the most significant risk of adverse impact on our portfolios and the wider environment or society.

Fixed income

Working with the central ESG investment team, our fixed-income credit team developed a proprietary tool designed to help our credit analysts substantiate the ESG risk rating (low/medium/high) assigned to a debt issuer. We based the framework on sector analysis, covering all corporate and financial sub-sectors and identifying the environmental and social risks that a company operating in a particular sector is likely to face. We identify these risks in three ways:

- the Sustainable Accounting Standards Board (SASB) Materiality Map (materiality.sasb.org)
- ESG sector risk assessments
- 'heat maps' from two major credit-rating agencies (Standard & Poor's and Moody's).

Within each 'environmental' and 'social' risk category, we list more granular risk factors, such as greenhouse-gas emissions. Using our experience, we devise an initial indication of the impact and the timing of these granular risks. So when we assess any company under the framework, we have a pre-defined sector starting point: a suggested set of likely ESG risks broken out by impact and timeframe. Our credit analysts then work through the framework, risk by risk, to determine whether the starting assessment is appropriate given the idiosyncratic aspects of the company in question. For example, it may be the company is quite 'generic' for its sector and hence requires little adaptation. But this is becoming less typical. Corporate structures and business models have had to adapt (and will continue to do so). This means that while a sector 'label' might still be appropriate, a company's underlying operations may mean it faces quite different or additional risks to its peers.

Five key components of quality assessed by abrdn's analysts for all companies under coverage

Industry	Business Model	ESG	Management	Financial Strength

Analyst ESG rating	1	2	3	4	5
	Best in class	**Leader**	**Average**	**Below Average**	**Laggard**
Examples of inputs	• ESG considerations are material part of the company's core business strategy • Excellent disclosure • Makes opportunities from strong ESG risk management	• ESG considerations not market leading • Disclosure is good, but not best in class • Governance is generally very good	• ESG risks are considered as a part of principal business • Disclosure in line with regulatory requirements • Governance is generally good but some minor concerns	• Evidence of some financially material controversies • Poor governance or limited oversight of key ESG issues • Some issues in treating minority shareholders poorly	• Many financially material controversies • Severe governance concerns • Poor treatment of minority shareholders

In constrast to our treatment of environmental and social risks, we do not pre-populate the more granular governance risks in the framework, except for country of domicile. In our experience, governance standards can vary significantly different between countries, given local laws, regulations and common practices. Using our in-house sovereign, economic and ESG expertise, we map each country into low/medium/high-impact and short/medium/long-term timeframe categories, in keeping with the overall framework. For example, we would assign a country with generally high corporate governance standards a low impact score with a long-term timeframe designation. By contrast, we may map a country with poor governance standards (e.g. political instability, potentially resulting in corruption or bribery at the corporate level) as high impact/short term. Aside from this, the credit analyst populates all other governance risks given the idiosyncratic nature of how companies are managed and their respective oversight arrangements.

This assessment enhances the fundamental analysis carried out by our credit analysts. Ultimately, it can significantly influence our decision as to whether we are receiving adequate compensation relative to all relevant risks. As a result, analysis using the framework is now a core component of all our internal credit notes. The ESG risk rating and analysis key insights feature on the very first page of all reports.

ESG House Score

Alongside the equity and fixed-income assessments detailed above, we have built our own ESG House Score framework. We based this on data for 140 key performance indicators (KPIs) arranged in categories aligned with frameworks such as the SASB and the United Nations Global Compact. These KPIs allow us to assess the performance of companies in each category and to analyse the possible adverse impact of our investment and the impact on our portfolios. Our proprietary methodology aggregates the KPIs for each company into an overall score. This allows us to include an assessment of adverse impact in our investment decision-making.

Our ESG scoring system also enables us to identify key ESG risks and opportunities at the company and portfolio level. The scores stimulate challenge and discussion among our investment professionals on ESG issues. And they complement and support the ESG analysis and frameworks within our equity and credit teams. Transparency on every component of the score allows us to easily see why key areas are flagged and how improvements can be made. It also allows us to easily identify themes and trends across the full range of ESG issues.

Using our ESG scores, we can compare how companies around the globe manage ESG issues. The output makes it easy to spot the ESG leaders and laggards in each field.

However, the ESG score is a combination of many different, sometimes unrelated, factors. So, while it offers a rough view of the company's relative position, a single ESG score alone cannot provide a full picture.

For this reason, we can break our scoring system down into more specific themes and categories. The level just below the composite ESG score consists of operational and governance scores. These give a more detailed and nuanced view of how each company manages its ESG issues.

- **The Governance score** assesses the company's corporate governance structure and the quality and behaviour of its corporate leadership and executive management.
- **The Operational score** assesses how good the company's leadership team is at carrying out effective environmental and social risk reduction, and using mitigation strategies in its operations.

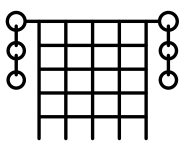
We have constructed our governance and operational scores to mirror our approach to ESG thematic research. They cover five core areas: climate change, the environment, labour management, human rights & stakeholders, and corporate behaviour & governance. Subject-matter experts in our ESG investment team support each area.

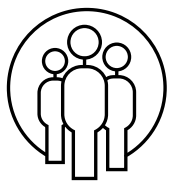
We then break down these five core areas to highlight more specific risk categories. So, within labour management, we consider labour practices, employee health & safety, and employee engagement & diversity. In each risk category, we have identified the relevant data points or KPIs to assess companies. So the risk category 'greenhouse-gas emissions and business-model resilience' includes KPIs related to scope 1, 2 and 3 emissions, carbon intensity and the aggressiveness of carbon-reduction targets. In total, across all five key areas, our scoring framework includes over 100 possible KPIs.

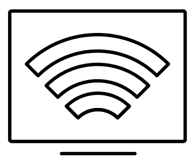
ESG Score

Operational score				Governance score	
Climate Change	Environment	Labour Management	Human Rights & Stakeholders	Corporate Behaviour	Corporate Governance
GHG Emissions & Resilience	Water & Wastewater	Employee H&S	Human Rights & Communities	Controversies	Board Issues
Air Quality	Waste Management	Engagement & Diversity	Privacy & Data Secutiry	Polices & Practises	Accounting & Audit
Energy Management	Supply Chain & Materials		Product Quality & Customer Welfare		Remuneration
	Ecological Implants		Supply Chain Management		Ownership & Control


Changing environment and climate


Increasing governance, engagement and calls for transparency


Changing demographics


Rapidly increasing technology, connectivity and infrastructure

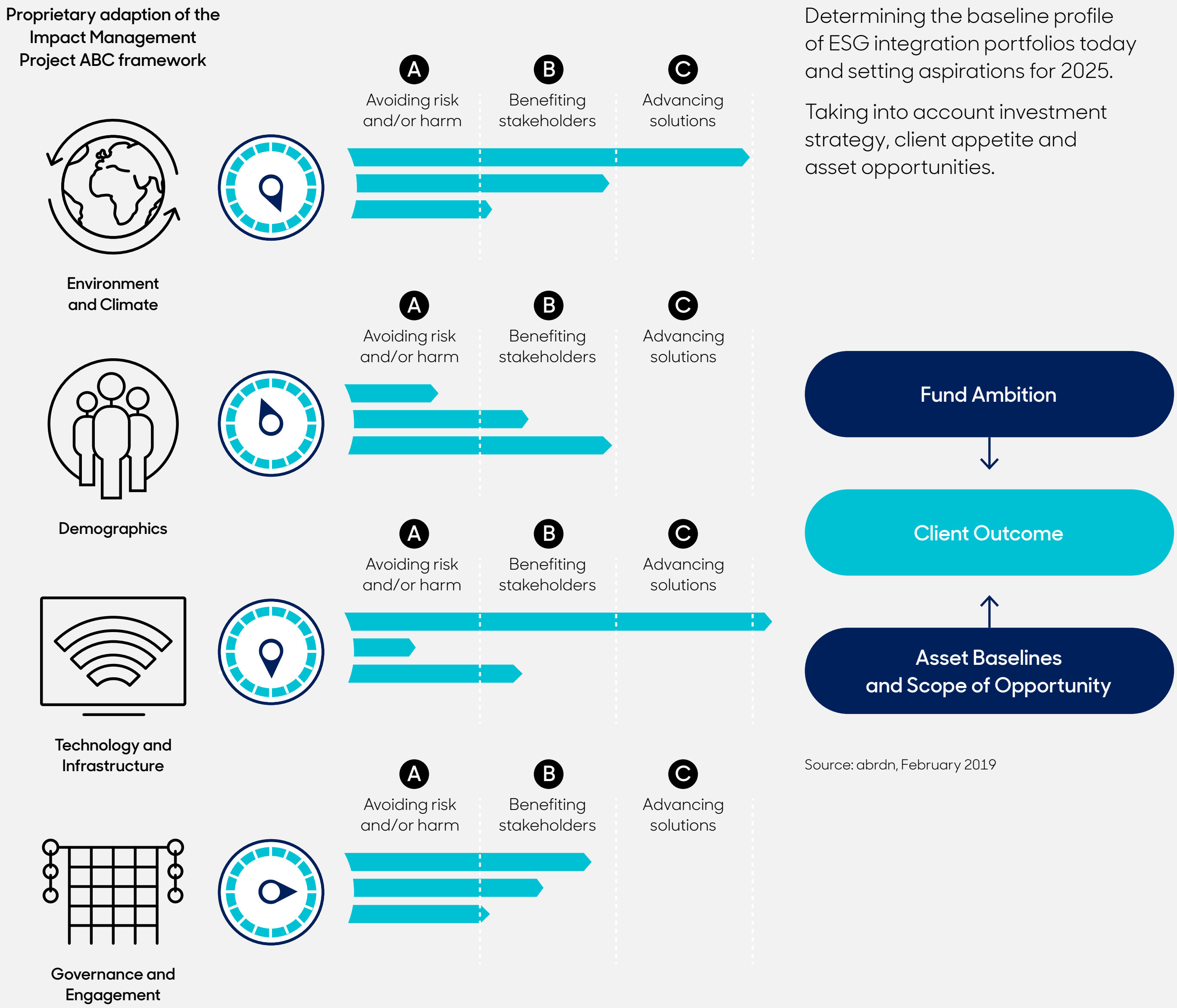
Real estate

Our real estate team operates a proprietary Impact Dial that identifies four 'forces for change' that we believe drive ESG integration in real estate.

These four forces naturally encompass a diverse range of topics and concerns. We have translated and codified these into our investment approach. We have also aligned them to the UN Sustainable Development Goals. We believe that these forces will shape the future. They will also shape our long-term approach by guiding how we prioritise ESG factors at the fund and asset level.

When we integrate ESG into real estate, our house standard is the minimum policy that we would use for all mandates. The house standard focuses on avoiding undue risk when managing a real estate asset. It influences the assets we buy, how they are managed and our longer-term plans for them.

After that, investors can decide which of the 'forces for change' are key priorities for them and where on the ESG investment spectrum they aspire to sit. There is a sliding scale from acting to avoid harm or risk through to policies that benefit stakeholders. There are even strategies for those who want to drive innovative ESG solutions (where they aim to solve specific problems or generate specific positive environmental or social impacts). This bespoke approach takes into account both investors' risk profile and their target return aspirations for now and the longer term.



Source: abrdn, February 2019

Our engagement policies

We maintain close contact with the companies and assets in which we invest. For listed assets and direct investments, we generally meet representatives of investee companies at least once a year. We recognise the importance of effective communication and the value of focused dialogue with directors and senior executives.

These meetings are ideal opportunities to monitor the performance of companies and their management. We support our analysts with on-desk stewardship and ESG resources, as well as through our specialist ESG investment team. Our activities include a regular engagement programme to discuss various relevant ESG issues. These include strategy and performance, risk management, board composition, remuneration, audit, climate change, labour issues, human rights and bribery and corruption.

The engagements we undertake fall into four categories.

- **Review** – part of our ongoing diligence and frequent interactions led by the analyst responsible for oversight of the investment. Other members of relevant investment teams will usually attend.
- **Respond** – reacting to an event that may impact a single investment or a selection of similar investments.
- **Enhance** – designed to seek change that, in our view, would enhance the value of our investment.
- **Thematic** – resulting from our focus on a particular ESG theme, such as climate change, diversity & inclusion or modern slavery.

Although we may discuss topics relating to ESG factors in any of the categories, 'respond' and 'enhance' engagements are bespoke interactions with specific intended outcomes. So we define these as 'Priority' engagements.

We normally hold our regular 'review' meetings with the executive management responsible for our investments. But we also engage with board members – generally the chair or other non-executive directors. Such meetings further develop our understanding of how the board is fulfilling its responsibilities. They also give us the opportunity to communicate views constructively, as and when appropriate.

Our 'respond' and 'enhance' engagements also focus on the delivery of long-term value from the investments we make on behalf of clients. The nature of ESG risks are such that they are ever-present but require a long-term outlook to fully assess them. Our engagements will often therefore be with board members, both executive and non-executive. We will also include detailed assessment of specific risk mitigation through engagement with sustainability experts.

In addition to the planned Priority engagements, we select investments that we see as significantly affected by the ESG themes identified by the ESG investment team. These themes may arise in the short term because of particular events or may be long running and impact many sectors and investments.

We believe that it is important for our engagement activities to lead to improvements in our investments. So we record concerns and issues raised with our investments. We also set timeframes within which we expect those responsible to address our concerns. To do this, we have defined the following 'lifecycle' steps.

- **Identify** – we have identified specific concerns or issues to raise with those responsible for the investment.
- **Acknowledge** – those responsible for the investment acknowledge the concern.
- **Plan** – there is a credible plan to address our concerns.
- **Execute** – those responsible are executing the plan.
- **Close** – they have executed the plan and addressed our concerns.

Using these lifecycle steps, we can track our concerns and issues. This feeds into our overall analysis and investment decision making.

Collaborative engagement

In certain circumstances, we may decide to join with other investors who are seeking to achieve similar change from a single investment or a range of investments. We may use collaborative engagement because of an escalation of our own activities or to drive change relating to a specific theme across a group of investments. These collaborations may involve a bespoke group of selected investors or one of the many affiliation groups created regionally or in relation to a specific theme. We make the details of collaborative groups with which we regularly act available publicly.

Public statements

We will make our views known publicly when we believe that the additional scrutiny they bring would help in achieving the change we are seeking. We can make such statements through the press or, if appropriate, at a company's general meeting.

"When investing across asset classes, we believe that a thorough understanding of ESG factors helps us make better investment decisions. Ultimately, this leads to better outcomes for our clients and wider stakeholders."

Mike Everett

Stewardship Director
abrdn

Voting/ownership rights

A general meeting provides an opportunity for us to take action where we believe that companies are not addressing issues that we raise as part of our engagement. We believe that voting at company meetings is one of our most important activities when investing on behalf of our clients. We therefore take great care to set high expectations in our custom-voting policies and assess in detail the resolutions at the meetings of companies in which we actively invest.

We endeavour to vote all shares globally for which we have voting authority. The exceptions are when we are otherwise instructed by the beneficial owner or where, for practical reasons such as share-blocking, this is not appropriate.

We use ISS, which is a reputable provider of proxy-voting research and voting recommendations. Although ISS has its own voting guidelines, we provide our own guidelines to establish a custom policy. We then require ISS to follow these guidelines when making voting recommendations to us. For companies held in our actively managed funds, we use recommendations from ISS as an input to our own analysis before making a final voting decision.

For all other companies held in our actively managed portfolios, an analyst from the ESG investment team will instruct the voting decisions for each of the resolutions at the general meeting. In making these decisions, the analyst will use the ISS recommendations and research as an input.

We identify any resolution at a company meeting that we deem to cover environmental and social factors. These are generally resolutions proposed by shareholders, with the majority currently occurring in the US. In this case, a specialist from the ESG investment team will assess the resolution and consider the specifics of the company to which it is proposed. In deciding how to vote, the specialist will the following:

- the proposals in a resolution
- the company's current handling of concerns raised in the proposal
- the impact of the proposals on the company's operations.

When we vote our clients' shares against a resolution, we aim to discuss this with the company beforehand and explain our reasons. We also aim to do this when abstaining from a vote. In certain circumstances, we attend and speak at shareholder meetings to reinforce our views to the company's board.

Where we lend stock on behalf of clients, and subject to the terms of client agreements, we may consider recalling shares from stock-lending programmes. We do this where it is in clients' interests to maintain full voting weight on a particular meeting or resolution. We also look to recall shares on a precautionary basis where there is a controversial issue or a dissident shareholder.

Adherence to external codes

We strive to meet the highest standards of business conduct and codes. These activities are described in the abrdn Sustainability Report and the company's report in line with the Taskforce for Climate-related Financial Disclosure (TCFD). Below are links to the most recently published reports.

abrdn Sustainability Report

Taskforce for Climate related Financial Disclosure (TCFD)

The table below shows how we rate rates against various standards of good business conduct.

External indices, initiatives and frameworks

Ratings and recognitions	Unit	2020	2019	Definition
DJSI (Robecosam) Score	%	98	97	Percentile ranking for our sector on our management of material ESG issues
FTSE4Good	%	97	97	Percentile ranking for our sector on our management of material ESG issues
CDP	Score	B	C	Score based on our environmental performance
MSCI	ESG rating	AA	A	MSCI ESG Ratings aim to measure a company's resilience to long-term, financially relevant ESG risks
GRESB Real Estate	Number of green stars	22	33	GRESB Real Estate assessment measures fund ESG performance, awarding green stars for reaching an absolute level of performance
Principles for Responsible Investment (PRI)	Rating	-	A+	PRI rating for the Strategy and Governance module, 2020 figure is not available until April 2021
Hampton-Alexander Review	Rank	13	10	Ranks all FTSE 350 companies on the gender representation of their Boards and Executive teams
Bloomberg Gender-Equality Index	Included (Yes/No)	Yes	Yes	Recognises our progress and transparency on gender equality at all levels of the business

We also believe it is important that we demonstrate adherence to the highest standards of stewardship and due diligence. We are therefore signatories to standards of best practice around the world. Below are some of the codes relating to due diligence to which we adhere.

Australia: 'Principles of Internal Governance', (FSC Standard 23), Financial Services Council, expected July 2017

Brazil: 'Amec Stewardship Code', Associação de Investidores no Mercado de Capitais, October 2016

European Union: 'Code for External Governance', EFAMA

Hong Kong: 'Principles of Responsible Ownership', Securities and Futures Commission, March 2016

Italy: 'Stewardship Principles for the Exercise of Administrative and Voting Rights in Listed Companies', Assogestioni, October 2013

Japan: 'Principles for Responsible Institutional Investors', Financial Services Agency, February 2014

Korea: 'Principles on the Stewardship Responsibilities of Institutional Investors', Korea Stewardship Code Council, December 2016

Luxembourg: 'ALFI Code of Conduct for Luxembourg Investment Funds', Association of the Luxembourg Fund Industry, June 2013

Malaysia: 'Code for Institutional Investors', Minority Shareholder Watchdog Group, June 2014

The Netherlands: 'Best Practices for Engaged Share-Ownership', Eumedion, June 2011

Singapore: 'Singapore Stewardship Principles for Responsible Investors', Stewardship Asia, November 2016

UK: 'UK Stewardship Code', Financial Reporting Council, September 2012 (abrdn will be applying to be signatories to the new 2020 UK Stewardship Code in 2021)

US: 'Stewardship Framework for Institutional Investors', Investor Stewardship Group, January 2017