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Aberdeen Standard Investments

# Global ESG Investment

Q1 ESG Report 2019

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# Foreword

**Euan Stirling**
Global Head of Stewardship
and ESG Investment

As we prepare for the spike in our activities associated with the Spring Annual General Meeting (AGM) voting seasons from around our investment world, we also look back on a busy start to 2019.

Last year, we voted on nearly 55,000 resolutions and we expect this year to be just as active. In around 10% of those resolutions, we voted against management recommendations, for a variety of reasons. We expect executive remuneration to remain a point of significant debate. Executive pay continues to rise due to increasingly complex schemes. Remuneration committees feel they must increase inducements to attract and retain talent. Meanwhile, executives feel less incentivised if paid in shares. As for investors, they seek to balance requests to support increasing amounts, with demands for restraint to tackle rising inequality. In addition to managing these areas, we have also strengthened our policies on board diversity, as well as director and auditor tenure.

**"Last year, we voted on nearly 55,000 resolutions and we expect this year to be just as active."**

The report details our extensive work in Asia, including our views on the quality of corporate governance in the region. We also discuss our thoughts on the Asian Corporate Governance Association's most recent report on the issue. In addition, we have included our views on the current approach and development of Environmental Social or Governance (ESG) in Japan. During a recent visit, we met with numerous companies to discuss the linkages between growth strategies and ESG. We note some significant progress in corporate governance standards in the country.

Our thematic research includes reports on topics as diverse as the need for structural changes in auditing; the developments we are seeing in the uses and sale of cannabis; and the numerous questions arising from the use of, and need for, oversight of social media. The nature of social media platforms makes misleading and harmful content a global issue. Although many platforms apply voluntary standards, there remains a lack of an internationally enforceable code. Regulators and shareholders alike are now beginning to question the effectiveness of these voluntary policies.

We offer a detailed review of the companies that we have engaged with over the quarter. Topics included board independence at UK company Mitchells and Butler, risk management at Asian insurer AIA and the impacts of deforestation with US-based Deere & Co.

Finally, I wish to highlight that we were shocked and saddened by the rupture of the Feijão dam in the city of Brumadinho on 25 January, which caused a significant loss of life. We have had ongoing engagement with Vale and are also engaging across the mining sector to try to ensure similar tragedies do not occur in the future.

# Events

**Alison Kennedy**
ESG Investment Director

**Andrew Mason**
Senior ESG Investment Analyst

## The International Corporate Governance Network conference

In February, we attended the International Corporate Governance Network conference in Amsterdam. Appropriately, the conference took place in the Beurs van Berlage, the site of the world's first stock exchange. The first ever publicly traded company was also listed here, in 1602.

The conference covered a wide range of topics. One clear theme was the increasing shift from shareholder engagement to engagement with a broader group of stakeholders. This chimes with the wider debate about whether focusing on the creation of 'shareholder value' as the sole measure of corporate success has promoted short-term behaviours and undermined sustainability. It is increasingly recognised that what is good for equity shareholders is not always in the interests of everyone else. As such, companies must now carefully consider their wider role in society. Hence the increasing requirement for engagement with a broader group of stakeholders. However, this requirement does not just apply to companies but also to investors. For example, the new Shareholder Rights Directive highlights the need for investors to engage with stakeholders of the companies in which they invest. It is vital that we understand the perspective of key stakeholders and how this interacts with our investment view. As part of our stewardship activities, we support engagement with a broad number of stakeholders.

Another clear theme was the need to integrate ESG factors into the investment process and the benefits that brings. Participants looked at how this could be achieved in the debt markets, covering private, public and sovereign debt. One of the challenges is the ability to find relevant, reliable and comprehensive data to help with this integration. It was clear that investors are thinking hard about how to achieve this.

## Consultation on proposed revisions to the German Corporate Governance Code

Policymakers first introduced the German Corporate Governance Code in 2002. Since then, they have revised it several times as best practice has developed both within Germany and internationally. In November, the Commission that oversees the Code announced a consultation on a number of further changes.

As long-term investors in German corporations, we had responded to similar consultations in the past. We were therefore keen to do so once again.

The consultation proposed a number of further improvements to governance arrangements at German companies. This included directors no longer qualifying as independent after 12 years on the board. There was also the reduction in the maximum term of director election from five to three years. We welcomed the suggestion that the Supervisory Board Chair should be available to investors. This is a key change, which should lead to better engagement. However, it was disappointing that this was merely a suggestion. We would prefer that it be a recommendation as it carries more weight within the Code. There were two proposed negative changes. One was the removal of the wording that "in principle, each share carries one vote." The other was the removal of wording which supports shareholders' pre-emptive rights. The principles of "one share, one vote" and of shareholder pre-emption are fundamental to good governance. In our response, we recommended that officials reinstate this wording.

The consultation closed at the end of January. We are currently awaiting the final outcome of the Commission's deliberations. We will then consider whether this has any implications for our engagement and voting policies in Germany.

## Annual Rights and Responsibilities of Institutional Investors (RRII) conference

On 14 March, we attended the fourteenth annual RRII conference, held in the Netherlands. The event was attended by managers and owners as well as legal and compliance experts from across Europe and the US. The main focus was on the varying macro trends affecting the investment industry. This included how investors can best exercise their fiduciary obligations and engagement goals.

There were several topics under discussion, including:

- the impacts of globalisation on free trade
- corporate governance in emerging markets
- the scope of company directors' responsibilities.

Euan Stirling, our Global Head of Stewardship and ESG Investment, acted as an advisory board member of the event. Andrew Mason, our Senior ESG Investment Analyst, hosted a session to discuss how short-term investment drivers affect long-term share value. We believe this event offers an excellent platform for discussing emerging trends. It also helps to understand how the investment and compliance community can responsibly allocate capital.

# Thought pieces

## ESG trends in Japan

**Jerry Goh**
Investment Manager –
Asian Equities

A number of our investment analysts recently visited Japan. There, they met several companies in the technology and consumer sectors. We continue to be encouraged that companies are keen to talk about their ESG initiatives. Our discussions focused on the linkages between growth strategies and ESG. This included why we consider ESG a key plank of our investment approach. In making this link, we aim to help companies relate ESG to their broader corporate strategy and risk management activities – rather than seeing it as separate discussion.

Low birth rates in Japan, coupled with an ageing population, are leading to increased pressure on companies to attract and retain talented employees. There is also a pressing need for process automation. Against this backdrop, one of our key discussion topics with portfolio companies was employee turnover. We also discussed initiatives undertaken to automate operational processes. We saw good progress. Many companies are looking at employee turnover rates more closely, and developing or implementing talent retention strategies. In addition, we took the opportunity to discuss general risk management. This included what we think are key ESG issues and the potential financial impact of these risks on businesses.

Pleasingly, Japanese boards are increasingly involved in ESG discussions. Topics include everything from talent retention to broader ESG issues. In many cases, we believe Japanese businesses are ahead of their Asian peers in terms of what they do. However, many are short-changing themselves by not fully communicating their ESG efforts. We continue to encourage companies to disclose more fully their ESG efforts, and their efforts to manage risk. Our discussions here are encouraging, and we are seeing continued improvement in disclosure. That said, we have noted a clear gap in standards between large-cap and small-cap companies. The latter lag their larger peers, and we are working with our smaller companies to evolve their ESG efforts. This is not unique to Japan. Nonetheless, it is an area of focus for us. We will therefore continue to encourage small-caps to grow and progress.

During the trip, we had fruitful meetings with the companies in which we have invested. For instance, we discussed the integration of ESG into business strategy with Renesas Electronics and encouraged better disclosure of its ESG activities. Renesas has comprehensive oversight of its supply chain. It is also focusing on talent retention, particularly engineers, given the tight labour market. Mandom, meanwhile, showed great improvement since our visit last year. Company officials discussed ESG risks and opportunities, and they appear to manage these well. The company has published more ESG-related data, which is positive. We also discussed cyber security, and the linking of ESG targets to remuneration. At the same time, we encouraged Mandom to improve its return on equity through the better utilisation of the cash on its balance sheet. Sanken Electric continues to progress along its ESG journey. We had encouraging discussions around cyber security, labour management and ESG disclosures. For instance, while almost all of its research and development expenditure is channelled towards developing eco-friendly products that are more energy efficient, this is not well-communicated to the market. Elsewhere, we had positive discussions with Daibiru, a property management company. In particular, we encouraged it to improve disclosure in this area.

Following the trip, we continued our discussions with management of these companies, focusing on ESG risk mitigation, disclosure, along with the chain of command in terms of accountability and governance oversight. We also emphasised the importance of risk management practices and, in some cases, encouraged companies to better think about their capital management, including the return of excess cash to shareholders. We will continue to engage with companies on these issues and develop governance standards in Asia. Our view on the Asian Corporate Governance Association Survey features later in the report.

## "Japanese boards are increasingly involved in ESG discussions."

179th
Japan's world birth-rate ranking

2nd
highest median age in the world

Source: http://worldpopulationreview.com/countries/total-fertility-rate/
Median age: https://en.wikipedia.org/wiki/List_of_countries_by_median_age

# Executive remuneration 2019

**Mike Everett**
ESG Investment Director

Executive pay continues to dominate interactions between companies and investors. And, judging by recent press commentary, it is also a topic of great scrutiny for policymakers and society.

For companies, senior executive pay is a way to attract and retain the talent needed to implement their strategies. To achieve this, firms structure pay so that it appears more attractive than their rivals. This leads to pay reviews based on 'benchmarking' pay structures against peers. Unfortunately, the practice also acts as a ratcheting mechanism and a race to ever-higher pay.

Policymakers and society often look at executive pay through the lens of inequality. This is understandable. There are countless instances where the pay gap between executives and the average employee is impossibly large. In addition, executives' pay is not often explicable or reflective of the value they deliver.

This puts investors in a bind. On the one hand, they want the right people for the job. They realise talent costs money. On the other, they want companies to consider what stakeholders and wider society think about excessive pay.

### Who wins?

When it comes to executive pay, most of those involved are unhappy with the process. Pay continues to rise due to increasingly complex schemes. Remuneration committees then feel they must increase inducements in order to attract/retain talent. Meanwhile, executives do not feel incentivised. This is because they are increasingly paid in shares that they are required to hold for ever-longer periods. Investors struggle under the burden of company consultations due to the complicated nature of pay structures. This includes balancing requests to support increasing pay, with demands for restraint to tackle rising inequality. Policymakers and society are also under pressure. Many think businesses and institutional investors work in cahoots on executive pay to maintain the status quo. And so on.

We are now headed into the 2019 voting season. This is a time when we and other institutional investors face a barrage of pay consultations from UK companies. The process involves a lot of back-and-forth between interested parties and can take three- to six-months. As before, we expect executive pay to be a major talking point.

### The cult of CEO

The 'problem' of excessive executive pay receives the most attention in the UK. However, we are seeing other markets address the issue. Global investors are applying similar standards to their investments around the world, which is primarily driving the issue. Policy changes and societal concerns about levels of inequality are also major factors.

## "The cult of CEO may have gone too far."

As we have said many times before, excessive pay is often an indication of other governance failures. Boards that heavily rely on a 'star' CEO tend to be ill-prepared for life after they leave. Worse, few challenge the views of their irreplaceable, highly paid CEO. This can lead to companies going astray. In other words, the cult of CEO may have gone too far. The latest round of pay negotiations will tell us more.

"There are countless instances where the pay gap between executives and the average employee is impossibly large."

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surge in FTSE 100 CEO pay in 2017 versus 1.7% inflation

Source: https://www.theguardian.com/business/2018/aug/15/uk-top-bosses-pay-rise-average-earnings-hit-39m-2017-high-pay-centre

# New ACGA Corporate Governance (CG) Watch survey

**David Smith**
Head of Corporate Governance
– Asia Pacific

We are a members of the Asian Corporate Governance Association (ACGA). This quarter, it published the latest edition of its widely followed "CG Watch." Released every two years, it reports on the quality of corporate governance around Asia.

The most recent report struck a fairly reflective tone. On the one hand, it acknowledged the progress Asia has made in the last 20 years. On the other, it highlighted some of the more negative developments in the region over the last few years. Most notably, the introduction of dual-class shares (DCS) in Hong Kong and Singapore. We were vocally opposed to this at the time. The ACGA's concern (shared by us) was and remains that the introduction of DCS in some markets could lead to a contagion effect. That would cause exchanges elsewhere to introduce DCS to compete for listings. We continue to speak with exchanges and regulators around the region. The hope is that we can prevent the introduction of further DCS. Such listings would be disappointing, but bit surprising.

As for the report, Australia remained the clear leader in Asia, retaining the number-one spot. Singapore dropped from second place to third, while Hong Kong leapfrogged Singapore to second place. This is still a strong performance by both markets. However, the introduction of DCS in each affected their scores on an absolute basis. More positively, Malaysia (now fourth, up from seventh) improved markedly year-on-year. The ACGA attributes this to ongoing corporate governance (CG) reforms, including a new companies act and CG Code. We have invested in Malaysia for a long time. As such, the market's improvement does not comes as a surprise. It is home to many well-managed companies, and has a regulatory ecosystem that has a strong focus on CG.

Meanwhile, Japan fell from fourth place to seventh (tied with India). The ACGA reflected on the focus on soft law rather than hard law. It also highlighted the slow evolution of board culture through the addition of independent directors. As substantial investors in Japan, we have seen marked improvements in corporate governance in recent years (you can find more information in our Q4 ESG report). We have also engaged with Japan's regulators to encourage rule changes and to protect our clients' interests. This includes from third-party placements and related-party transactions. Many of our portfolio companies have made important steps with regards to governance. Emphasis on capital management and return has also improved. In addition, we are starting to see the introduction of performance-based remuneration schemes. This is something we have been discussing with companies in Japan – and beyond – for some time. Japan is a good example of a market where engagement takes time and trust. We are happy our engagement is paying off.

The final four markets were unchanged from 2016 – Korea (ninth), China (tenth), Philippines (eleventh), and Indonesia (twelfth). Our hopes were high that we'd see CG reform in Korea under the new Moon administration. The introduction of a stewardship code in July 2018 was a notable positive. The momentum is there and investors will be hoping for sustained progress over the coming years. China, Philippines, and Indonesia all score relatively poorly. Nonetheless, we actively invest in these markets. In our view, the regulatory environment has room for improvement. However, this demonstrates the importance of bottom-up research and stock selection. We regularly meet the companies in which we invest. This means we fully get to know a business and are confident in our investment case. As a result, we have invested in a number of high-quality companies in each of these markets.

Our regulatory engagement in these, and other markets, continues.

"We continue to speak with exchanges and regulators around the region. The hope is that we can prevent the introduction of further DCS."

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ACGA members come from 18 markets

Source: https://www.acga-asia.org/who-we-are-acga-members.php

"Our view is that the consolidation from the 'big eight' to the 'big four' over many years has led to complacency over standards."

# Auditing – why structural change is necessary

**Euan Stirling**
Global Head of Stewardship
and ESG Investment

The auditing profession is under more scrutiny and pressure than, it has experienced in a generation. The role of auditors in high profile corporate failures, from HBOS to Carillion, brings back the spectre of Arthur Andersen and its role in the collapse of Enron. This ultimately led to Andersen's collapse. In these extreme cases, weak or complicit behaviour by auditors has drawn attention away from the company directors who were, in fact, the architects of the corporate failure. The core concern of most investors is the quality of auditing, which, when discussed, raises a number of structural issues.

The concern over audit quality is linked to the consolidation of the accounting profession into four dominant global firms. That is why we took an active part in the review of the structure of auditing businesses by the Competition and Market Authority (CMA). It is difficult to find a direct link between quality and concentration. However, our experience with PwC, one of the 'big four' accounting firms, instructed our view. We received a complaint from the chair of the Audit Committee at Vodafone about PwC. The latter was appointed to audit Vodafone in early 2014. However, it since took on the administration of the insolvency of Phones4U. Phones4U explicitly blamed the network operator for its demise. As a result, this raised the prospect of PwC taking legal action against one of its clients. We brought up this issue with PwC, both directly and through industry bodies. PwC believed that no conflict of interest existed. Our view is that the consolidation from the 'big eight' to the 'big four' over many years has led to complacency over standards. We think this is affecting audit quality, which in turn diminishes investors' and observers' faith in the auditors.

The Financial Reporting Council (FRC) is the UK body responsible for regulating auditors. It also applies sanctions when things go wrong. The FRC is an amalgamation of various boards and panels that oversee accounting and auditing standards. Its remit has expanded extensively over time, but on a piecemeal basis. Sir John Kingman conducted a structural review of the FRC. It was no surprise that Sir John's team consulted extensively with the CMA. The recommendations of the two reviews were published on 18 December 2018. As a result of the reviews, a body with statutory authority and much sharper teeth with replace the FRC.

### Conflicts of interest

We believe that public (and investor) confidence in auditing is almost as important as the auditing procedures. Conflicts of interest can devalue all the hard work that goes into auditing. There is widespread concern among investors that auditors are too close to finance executives and audit committee chairs. Many believe this affects the rigour that the auditors apply. In addition, as the 'big four' have grown, their audit and assurance activities have shrunk as a proportion of their turnover. We believe the current situation, whereby audit only represents a small fraction of firms' activities (and apparently a low-margin one at that) is inappropriate. It makes us uncomfortable that the most valuable service that auditing firms provide is the one that appears least economically attractive to them.

The CMA and Sir John Kingman have made a number of recommendations, which we believe will change the face of auditing. They will also continue the trend of improving audit quality.

The clamour to change to auditing practices reflects growing demand for the corporate sector to behave with a greater emphasis on long-term success. This has generated an unstoppable momentum which we hope, and believe, will positively change the face of auditing for the next generation.

**$65b**

market-cap of Enron before it went bankrupt

Source: https://link.springer.com/article/10.1007%2Fs11156-006-0043-2

# Cannabis – investment opportunity or social risk


**Jamie Govan**
Senior ESG Investment Analyst

**Shola Akinosho**
Graduate Business Analyst

Deriving from the cannabis plant, there are over 100 types of cannabinoids. Two primary cannabinoids are used in cannabis-based products and it is important to distinguish between them. The first is Cannabidiol (CBD). It is primarily extracted from the hemp plant and does not possess the psychoactive property of cannabis. However, it can be used for pharmaceutical purposes, such as anti-anxiety, anti-inflammatory and sleep assistance.

The second is Tetrahydrocannabinol (THC). It is the psychoactive compound within marijuana causing the 'high' sensation. It also has similar traits to many pain relief drugs. We can break down the uses of the two primary cannabinoids into four key verticals:

- Adult/recreational use
- Beauty & nutraceuticals
- Over-the-counter pain relief/sleep.
- Pharmaceutical.

### Health and social impact

Cannabis has a wide range of medical uses. In the healthcare space, it is primarily used to address chronic pain/anxiety. In states where it is legal, there is also evidence that cannabis contributes to a reduction in opioid-related deaths. That said, while there is no evidence that marijuana consumption will result in death, the long-term effects of cannabis use may not be positive.

Some studies suggest that cannabis use in adolescence increases the risk of psychotic disorders. This can cause maturational problems. Effects include disinhibition and neurocognitive abnormalities, especially in learning and memory processes. In legalised states, there are also reports that recreational cannabis use is linked to increased road-traffic accidents and pedestrian fatalities.

Looking forward, much work and change still needs to occur in order for this nascent industry to realise its full potential. Understanding health and social implications of the recreational use of cannabis will be a key determinant of both regulation and future growth.

**Four Distinct Verticals**

**Adult Use**

- THC Focused
- Substitute "Social Lubricant"
  - Cannibalises on alcohol/beer
  - Flower, vapor, edibles, dabs, beverages
- Large, illicit markets moving into legal channels
- Canada launch on 17 October

**Beauty & Nutraceuticals**

- CBD Focused
- Health & wellness focuses consumers
- Oil extracts /tinctures, tropicals, capsules
- Wide application of uses across large international markets

**OTC Pain / Sleep**

- CBD/THC Blend
- Maintence of occasional/ persistent but not chronic ailments
- High incidence levels of pain management and insomnia among adults

**Pharmaceutical**

- CBD/THC Blend
- Treatments for chronic/ severe conditions
- Capsules, tinctures
- Increasing use cases and clinical trials
- Expanding global acceptance

Source: Cowen and Company, LLC, November 2018 marketing report

**Regions and regulations**

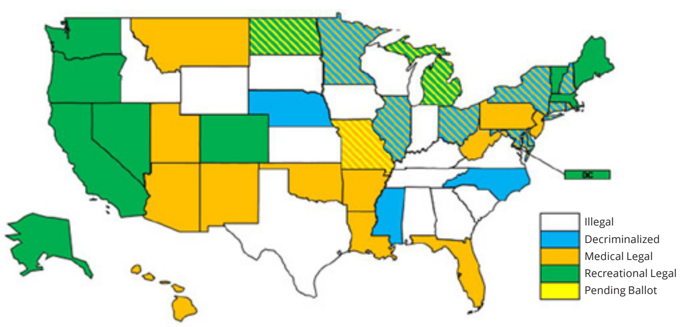
In the US, over 50% of the US population is in favour of legalising cannabis. Yet, only a few states have thus far legalised it for adult/recreational use (see map on page 15). Cannabis also remains illegal at the federal level.

Attitudes towards legalisation vary across the world. At present, the US and Canada are the key legalised markets, but others are gradually looking to change their laws. In Europe, Amsterdam has tolerated recreational use for many years. That said, Germany has the most robust framework for current sales and continued growth.

Companies that have licences to produce cannabis are heavily regulated and unlicensed sales carry large penalties. The legalisation of cannabis has resulted in reduced levels of organised crime and illegal sales.

One area that is difficult to regulate is cannabis use and driving, where there is a zero-tolerance in legalised states. Testing technology is still weak. For example, THC consumption is assessed using saliva swabs. Further, the substance remains in the system for around 30 days. This makes it extremely difficult to prove when the user consumed it or how long its effects have lasted.

| U.S. Cannabis Overview | | |
|---|---|---|
| **# of Medical States** | **% of U.S Population** | **% of U.S. GDP** |
| 33 | 65.8 | 68.6 |
| **# of Adult-Use States** | **% of U.S Population** | **% of U.S. GDP** |
| 10 | 21.5 | 24.9 |




Source: Cowen and Company, LLC, November 2018 marketing report

**A changing attitude to cannabis creates opportunities**

In recent years, consumers, especially Generation Z, have begun to substitute alcohol consumption with cannabis. This is due to the lower risk-perception towards smoking cannabis in comparison to drinking. Interestingly, the second largest monthly user group of cannabis, behind 18-25 year olds (35%), are those in the 55+ age bracket (16%).

## "The second largest monthly user group of cannabis, behind 18-25 year olds (35%), are those in the 55+ age bracket (16%)."

In the recreational space, early commercial adopters include tobacco and alcoholic beverage companies. Here, the infrastructure already exists to manufacture cannabis products to the mass market, counteracting waning demand for existing products. Many beverage companies are looking to capitalise on the shifts in consumer demand by creating non-alcoholic CBD-infused drinks. It must be noted that the tobacco product suite is a little less clear at this point. However, it is likely to include CBD-infused vapour oils at some point.

Cannabis is a weed – hence the nickname. Like a weed, it is easy to grow, although it does favour warmer climates. This may create opportunities for growth in many emerging markets.

**50%**

of the US population is in favour of legalising cannabis

**100**

Types of cannabinoids

# Unsocial media

**Elizabeth Meyer**
ESG Investment Analyst

In 2017, there were 3.3 million posts on Facebook, 500 hours of video uploaded to YouTube and 29 million messages sent via WhatsApp – every 60 seconds. Commentators often praise social media sites for their role in connecting people and facilitating community action. But recently, they have been heavily criticised for manipulating users and promoting harmful content. Media allegations against Facebook include disrupting elections in the US and inciting genocide in Myanmar. Meanwhile, advertisers are concerned that YouTube may be facilitating paedophile networks.

In response, many social media sites voluntarily enforce their own 'community standards.' They exercise the right to remove content that does not meet their standards, and restrict users who repeatedly post inappropriate content. However, no clear-cut, industry-recognised standards exist for what constitutes inappropriate content. And regulators and shareholders alike are beginning to question the effectiveness of these policies.

The nature of social media platforms makes misleading and harmful content a global issue. However, in lieu of an international regulatory framework, many are calling for action in their own country. For example, UK Health Secretary Matt Hancock recently called for a ban on social media platforms that failed to remove harmful content. Germany took the lead on regulations with its German Network Enforcement Act. This came into effect in 2018 and is seen by many as a testbed for future regulations in other regions. It requires online platforms to remove "obviously illegal" content within 24 hours of receiving a complaint. A platform that receives more than 100 complaints in a year must publicly report biannually on complaint volumes and management. Public disclosure is currently limited to German volumes. However, this may become more global if other regulators follow suit.

In 2018, Facebook and Twitter also faced their first shareholder resolutions demanding transparency about the effectiveness of their content moderation policies. Aberdeen Standard Investments voted in favour of these resolutions, although both failed to pass. Over the past year, we have been researching the issue and its implications for our investments. These include:

- examining the current standards
- incoming regulations
- the available mechanisms for identifying and removing harmful content.

These issue mostly affect social media providers most directly. However, they also have implications for companies that advertise on these sites. They want users to engage with their products and services, without being associated with harmful content. Potential loss of earnings from these associations could be considerable. Indeed, large customer-facing companies such as Disney, AT&T, Walmart and Verizon have at times withdrawn advertising as a result of links to inappropriate content. As public scrutiny intensifies and regulations are introduced, the costs associated with moderating user-generated content are likely to increase.

Changes to regulations and public expectations will require more effective mechanisms for moderating content. These include technology solutions to identify harmful content, as well as people employed to review flagged items and decide whether they meet the appropriate standards. While technological solutions are advancing, they are currently limited in their ability to interpret context. As such, human intervention is required and content moderator roles are growing in number. Multiple companies offer outsourcing solutions and will be in a prime position to capitalise on commercial opportunities. However, viewing potentially harmful content can be a difficult – at times traumatic – experience. Businesses must ensure that content moderators have access to robust support systems.

Determining whether content is appropriate for public consumption will remain the focus of much debate. However, companies facing the day-to-day realities of the exponential growth in user-generated content have been compelled to act. They have created their own standards, developed technology solutions, and put tens of thousands of content moderators to work globally. Social media platforms face risks of reputational damage, loss of users, poor employee relations and falling earnings from advertising. They also face an uncertain regulatory environment. This is an area that we will continue to monitor and promote best practice.

"The nature of social media platforms makes misleading and harmful content a global issue."

3.3m

number of Facebook post per minute in 2017

Source: https://www.acga-asia.org/who-we-are-acga-members.php

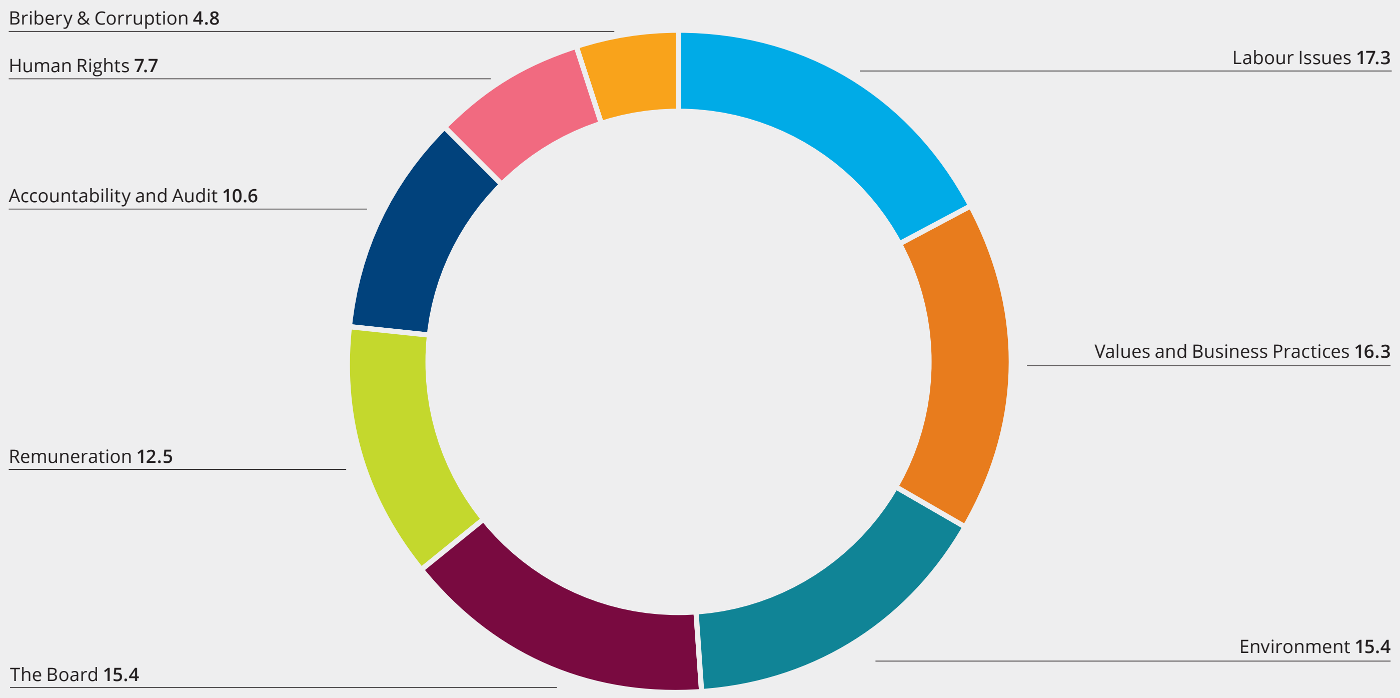
# ESG voting and engagement summary

**Voting summary Q1 2019**

| | **Total** |
|---|---|
| Shareholder meetings at which our clients' shares were voted | 630 |
| Percentage of meetings with at least one vote against or abstention | 34.6% |
| Number of resolutions voted | 4,697 |
| Percentage of resolutions voted with management recommendations | 89.3% |
| Percentage of resolutions voted against management recommendations | 10.0% |
| Percentage of abstentions | 0.8% |

During the quarter Aberdeen Standard Investments met with and discussed ESG issues with over one hundred companies. The chart below and table opposite offer examples of companies that have been engaged with and the specific ESG topics discussed.

**Engagement summary Q1 2019 (%)**




Source: Aberdeen Standard Investments

# Engagement summary Q1 2019

| UN Global Compact Principles | Human Rights | Labour Issues | Environment | Bribery & Corruption | The Board | Values and Business Practices | Remuneration | Accountability and Audit |
|---|---|---|---|---|---|---|---|---|
| AIA | | | | | | • | | • |
| Anheuser-Busch Inbev | • | | • | | | • | • | |
| ASML | | • | • | | | | | |
| Banco Santander | | | | | • | | • | |
| Bankinter | | | | | • | | • | • |
| Bausch Helth | | • | | • | • | • | | |
| Bayer | • | | | • | | • | | |
| Bim Birlesick | | • | | | | • | | • |
| Boohoo | • | • | • | | | | | |
| Centamin | | | | | • | | • | • |
| Chesnara | | | | | | • | | |
| Cranswick | | | | | • | | • | • |
| EDF | | • | • | | | | | |
| EI Group | | | | | • | | | • |
| Elecom | | | | | | • | | |
| G-III Apparel Group | | | | | | | • | |
| Greene King | | • | | | • | | • | |
| Greggs | | | | | | • | | |
| Hibernia REIT | | | | | • | | • | |
| Imperial Brands | | | | | • | | • | |
| Itau Unibanco | | | • | • | | • | | |
| JD Sports | • | • | | | | | | |
| Johnson Matthey | | | | | • | | | |
| Klepierre | | | • | | • | • | | |
| L'Oreal | | • | | | | | • | |
| M&S | • | • | • | | | | | |
| Misumi | | | • | | | • | | |
| Mobile Telesystem | | | | | | • | | • |
| Naspers | | • | | | • | | • | |
| Naturgy | | • | • | | | | | |
| Pernod Ricard | | • | | | • | • | | |
| Petrofac | • | • | • | • | | | | |
| Pilot | | • | • | | | | | |
| Samsung Electronics | | | • | | • | • | | • |
| Sanne Group | | • | | | | | | • |
| Siemens | | | • | | | • | | |
| Superdry | • | • | • | | | | | |
| Swedbank | | | | • | | • | | • |
| TUI | | • | • | | | | | |
| Ubisoft | | | | | • | • | • | |
| Ultrapar Participacoes | | | | | • | | • | • |
| Vesuvius | • | • | • | | | • | | |
| **Total** | 8 | 18 | 16 | 5 | 16 | 17 | 13 | 11 |



Our voting is disclosed on our website each month
**https://www.aberdeenstandard.com/en/what-we-do/esg-investment/proxy-voting**

# AIA

Jerry Goh


| Key Driver | Key Outcome |
| --- | --- |
| Performance-based engagement, internal mandate, client mandate | On-track to meet objectives |

Recent incidents around Asia, notably in Australia, have heightened scrutiny of insurance companies and their behaviour. These events served as the backdrop for our recent discussions with AIA Group, a pan-Asian life insurance group. We have invested in the company since its IPO in 2010. We spoke with the group's chief risk officer, focusing on the company's risk management framework. This included its oversight of agents on the ground. We sought to better understand the governance of risk, and the way the board's risk committee operates.

We discussed the importance of financial, information, and regulatory risks. We also talked about cyber security and the risk of data loss. Digital risks are increasingly important for all companies. This is certainly the case for financial services firms with large operational and digital footprints. This is not a new area of discussion for us. Over the past five years, we have spent an increasing amount of time with our portfolio companies, including those in financial services, to better understand their preparedness for cyber risk. On this occasion, we had a positive conversation with AIA on these issues. The company is aware of, and prepared for, the risks that digital and cyber security present. It has been investing in both IT hardware and software. It is also working hard to maintain and increase organisational resilience with regards the risk of hacking.

We also attempted to get more colour on the company's oversight of its insurance agents. For example, we wanted to see how it ensures standards are upheld and how it reduces mis-selling risks. The CRO explained that sales standards are uniform across the group. This is something that has been ensured via the use of technology. IT systems have standardised workflows and processes, reducing to the risk of mis-selling. Meanwhile, it uses mystery shoppers to provide additional layers of assurance.

Pleasingly, the group recognised the importance of culture and 'tone from the top'. This is something that we see as a central tenet of good risk management. In our experience, corporate misdeeds and failures are invariably due to the company's culture as much as its systems – if not more so.

The meeting was encouraging, and AIA and ourselves recognise the importance of these risks. We'll continue our discussions with AIA, and its peers, on these issues.

## "The company is aware of, and prepared for, the risks that digital and cyber security present."

# Boohoo

Peter Silver


| Key Driver | Key Outcome |
|---|---|
| Internal mandate | Escalation candidate |

Boohoo is a UK based online fashion retailer, aimed at 16- to 24-year-olds. The company offers women's and men's clothing and apparel through its websites. It operates and distributes products globally.

Over the past few years, Boohoo has been on the receiving end of a number of negative news stories. In 2016, Channel 4's Dispatches outlined allegations of poor working conditions within the company's distribution centres and further an FT article in 2018 highlighted apparent non-compliance with minimum wage standards within the firm's UK supply chain.

In the UK, the industry is also facing wider scrutiny from the Environmental Audit Committee (EAC). Its "Sustainability of the Fashion Industry" inquiry investigates the social and environmental impact of disposable 'fast fashion' and the wider clothing industry. In an announcement of companies' results in December 2018, Boohoo was among a number of apparel retailers flagged as "Less Engaged".

We hold Boohoo in our UK Employment Opportunities Impact and UK Ethical funds. We were eager to engage with the company to understand how it was managing these concerns. Its management team invited us to its head office in Manchester. We also toured its newly automated warehouse in Burnley.

Boohoo has improved the level of disclosure since we last engaged. However, comparisons with peers show there is still more it could provide. This includes greater detail into its auditing practices and outcomes. We would also like further clarity on how it mitigates the risks of human rights abuses in its supply chain. Its recent Modern Slavery Statement states that the company wants to be 'transparent' and 'best-in-class'. As such, we encouraged it to be more proactive in this area.

The EAC inquiry has called out Boohoo, alongside other clothing retailers, for a lack of sustainability actions and labour initiatives. However, the company is working to improve its environmental impact on a number of areas. As an example, we highlighted its textile recycling service. We expect to see more on this in the near term.

The most significant investment has been in its new warehouse which opened in March in Burnley (UK). This provides a more automated solution for the company and a higher quality and efficiency of work for employees. The company also showed us its improved on-site facilities, including the canteen and a gym. Through engagement surveys, we understand these improvements have been well-received. We encouraged the company to provide greater disclosure on these results in the upcoming reporting periods.

We will continue to engage with Boohoo to ensure it is effectively managing its labour management risks. We will also speak to other apparel retailers deemed 'best-in-class'. This will help us understand other improvements the company could make. With a new CEO having started in March, we hope to speak to the company again and see whether the long-term strategic view and risk management process will address our concerns.

## "Boohoo was among a number of apparel retailers flagged as "Less Engaged."

# Deere & Co

Fionna Ross


| Key Driver | Key Outcome |
|---|---|
| Internal mandate | On-track to meet objectives |

Deere & Co is a US-based manufacturer and distributor of agricultural, construction, forestry & commercial and consumer equipment. The company supplies replacement parts for its own products, as well as products and parts financing services. It also extends its services and products worldwide.

We spoke with Deere on several occasions over the first quarter of 2019. This was to gain additional insight into the group's sale of forestry machinery in Brazil. Our original concern was the potential association of Deere machinery with deforestation. This presented not only environmental litigation risks, but also significant reputational risks. To illustrate, deforestation of the Amazon rainforest in Brazil hit its highest rate in a decade in 2018. Loggers destroyed around 7,900 sq km of the world's largest rainforest between August 2017 and July 2018. This is an area roughly five times the size of London. We wanted to learn what protocols the company has in place to ensure its equipment isn't sold or used for illegal logging in places like Brazil.

We learned that in Brazil, Deere essentially owns the retail network, and is therefore the dealer. As a result, the group knows its customers and where they use its machines. Deere 's communication with construction dealers is clear: they cannot sell any piece of construction or forestry equipment for deforestation activities. The company also includes a clause in its distribution agreements. This informs dealers that they cannot sell products for native forests deforestation activities.

Deere spends a lot of time with its customers and on its dealer contracts. The latter includes explicit language within its clauses on where machinery is permitted to be sold. The group is clear and upfront with dealers with regards its expectations.

The company increasingly uses other safeguards, including telematics, which tracks where machines go. It then notifies the company of any issues, allowing them to identify a specific machine, dealer or owner.

Furthermore, Deere supports Brazil's Integrated Crop-Livestock-Forest initiative. This is an agricultural production strategy. It integrates different product systems – agricultural, livestock and forestry – within the same area. The company can implement this using mixed, rotation, or succession crops. As such, there is interaction between each component, generating mutual benefits. Further, a large proportion of Deere's Brazilian forestry equipment is used for plantation e.g. eucalyptus. The group also continues to include more technology in forestry equipment, allowing its users to be more efficient. For example, precision technology is increasingly coming into play. This involves cut-to-length forestry, which Deere designed to have a minimal environmental footprint and impact. Deere is at the cutting edge of such efficiency machinery in forestry.

As a result of these factors, there is minimal misuse of Deere's products in Brazil and we are comfortable that Deere's overall exposure to deforestation is limited. The company has also taken sufficient steps to minimises the potential misuse of its forestry machinery, reducing any associated risks for the company. We will continue to engage with Deere to ensure it continues to diligently sell forestry equipment.

**"We are comfortable that Deere's overall exposure to deforestation is relatively limited. It has also taken sufficient steps to minimises the potential misuse of its forestry machinery."**

# Enel

Alison Kennedy


| Key Driver | Key Outcome |
|---|---|
| Internal mandate | On-track to meet objectives |

Enel SpA is a global integrated energy company that generates, distributes and sells electricity and gas. The company operates a highly diversified portfolio of power stations, with almost half the energy it generates coming from renewable sources. Enel's largest shareholder is the Italian Ministry of Economy and Finance, which owns 23.6%.

Enel has a robust approach to sustainability, exemplified by a strong position in renewable energy. However, data from an external ESG provider suggested that Enel had a poor governance score. We have had concerns over remuneration policy and therefore voted against remuneration arrangements at the 2018 AGM. When we engaged with the company we sought to understand whether governance issues were contributing to increased investment risk.

We met a number of the management team, including the heads of corporate governance, corporate affairs and sustainability. A key discussion topic was board composition and independence. Given the significant government shareholding, we were keen to understand how the company protects minority shareholder rights. The majority of the board is independent, including the chair. Meanwhile, Enel splits the roles of chair and CEO. We were pleased to learn it had conducted a board evaluation since 2004 and that this encompasses the work of the board of statutory auditors. Both of these aspects are unusual for Italy and suggest a pro-active approach to governance. In terms of succession planning, the nomination & compensation committee conducts an annual analysis of succession plans across the senior management team. The board also meets managers below board level. We were reassured that the government does not interfere in this process. There is a 3% voting limit for any individual shareholder. However, there is no longer a formal Golden Share arrangement. In the past, this gave the government a higher level of control. Overall, we judged that governance arrangements were appropriate and did not pose any undue risk.

In terms of remuneration, we reiterated our concern that the long-term incentive scheme allows vesting for below median TSR (total shareholder return) performance versus their target index. We don't believe vesting for below median performance is a challenging target and is therefore inappropriate. We also expressed concern that both the short- and long-term incentives vest in cash. Our preference would be that some of the awards vest in shares, as this would provide better alignment with shareholders. The company expressed interest in our views on these issues and we are hopeful of some change this year. We will monitor developments ahead of the May 2019 AGM.

## "Overall, we judged that governance arrangements were appropriate and did not pose any undue risk."

# G-III Apparel Group

Nick Duncan


G-III Apparel Group is an American clothing company. It designs, manufactures and markets women's and men's apparel in the US and internationally. The company has many recognisable proprietary and licensed brands, including Guess, DKNY, Dockers, Calvin Klein and Tommy Hilfiger.

We met the chief operating officer and the chair of the remunerations committee. We discussed the disastrous say-on-pay vote at the 2018 AGM. Here, the company received a 62.8% vote against the executive say-on-pay proposal. The company has listened to the shareholder feedback and is making changes to its remuneration structure. The long-term incentive plan will now have a full three-year performance period before any shares can vest. Meanwhile, awards will be 100% performance-based and the company will eliminate all re-testing features of the previous scheme. The metrics used have yet to be finalised, but we highlighted that two metrics were preferable. For a total shareholder return metric, executives would have to achieve a financial underpin before any vesting.

That said, there has been no change to the chief executive's bonus scheme. We highlighted various issues with this. As part of the CEO's contract, he has the right to receive 6% of pre-tax income above $2m if he achieves certain targets. The total available is

**Key Driver**

Internal mandate

**Key Outcome**

Escalation candidate

capped at $6.3m. This year's target was $67.6m, with the company achieving $110m. Therefore, the bonus doesn't require a year-on-year improvement. Given the low performance target, this means the bonus is almost guaranteed. While the cap is welcome, we do not approve of this method of rewarding executives. The company put this arrangement in place when it was much smaller. As such, in our view, it is no longer appropriate. We asked the company to speak to the CEO with a view to renegotiating this arrangement. However, this seems unlikely. The chair of the remuneration committee was reluctant to propose anything that would "upset the apple cart". He also wanted to avoid anything that management might not like. We pointed out that the directors were there to represent shareholders' interests and to hold management accountable. As such, we made it clear that we did not agree with such a timid approach.

We also highlighted a number of other governance issues. These included the lack of refreshment of the board directors and directors with long tenure. We also highlighted the use of the plurality voting (i.e. first-past-the-post) for director elections instead of a more appropriate majority voting requirement. The company did mention that it was looking to refresh the board, possibly in the next six months. Additions would include a director with cyber security and digital experience. The company also mentioned adding a younger director. We are supportive of regular board refreshment, which can help bring in new perspectives and experience to boards. This should avoid directors becoming entrenched, which can impact their perceived independence.

> **"We pointed out that the directors were there to represent shareholders' interests and to hold management to account."**

# Mitchells & Butlers Plc

Deborah Gilshan


Mitchells & Butlers plc is a FTSE 250 company. It runs a portfolio of pubs, bars and restaurants in the UK. Headquartered in Birmingham, its subsidiaries include well-known chains such as All Bar One, Harvester, O'Neills and Toby Carvery.

Aberdeen Standard Investments is the third-largest shareholder in the company and the largest independent minority shareholder. We also have exposure to its debt securities. The long-term sustainability of the company, and the governance structures that underpin it, are of paramount importance to us.

We have engaged with the board of Mitchells & Butlers since we became shareholders during the company's listing.
Since November 2017, we escalated our engagement efforts by attending the company's 2018 and 2019 AGMs . We engaged with the chair of the board (twice), some of the other independent directors, and executive management.

At the 2019 AGM, we voted against the chair of the board. As with previous years, we also voted against the four board members nominated by the two largest shareholders, Piedmont Inc and Elpida Group.

We have consistently called for the independence of the board to improve. A properly balanced board, with sufficient independence, is a cornerstone of good corporate governance. It becomes even more important when large minority shareholders have board representation, i.e. Mitchells & Butlers. In such circumstances, independent shareholders need to ensure that there are sufficient independent directors. This is so that the interests of all shareholders are properly represented in the boardroom. It also ensures that no one group can dominate board decision-making. An effective board chair and senior independent directors further strengthen that independent dynamic.

| Key Driver | Key Outcome |
| --- | --- |
| Performance-based | Influential in achieving change |

In our view, board independence had deteriorated significantly – and demonstrably so. The senior independent director left the board at the end of 2018 to concentrate on other roles. By 2019, the role was still vacant. In addition, board gender diversity had not improved and there remained only one female non-executive director. The chair of the board is also chair of the nominations committee. Therefore, responsibility on the vital areas of board effectiveness, succession and diversity lie solely with him. We remained concerned that there were not appropriate governance structures in place to ensure the interests of all shareholders and wider stakeholders are properly represented. Effective stewardship requires both an engaged board and engaged shareholders. As shareholders, we have undertaken, and will continue to undertake, our stewardship duties responsibly.
At the 2019 AGM, we called on the board of Mitchells & Butlers to urgently do the same.

Voting results indicated that 21% of shareholders voted against the chair's re-election. Meanwhile, the four board members representing the two largest shareholders also received 21% votes against their re-elections. On 27 February 2019, the company announced the appointment of two new independent non-executive directors. Jane Moriarty joined the board with immediate effect. Susan Murray joined on 8 March 2019 as the senior independent director. We welcome these appointments as they improve both the independence and gender balance of the board. We will continue to monitor the overall performance of the board and the company.

**"We welcome the company's appointments as they improve both the independence and gender balance of the board."**

# Petrofac

Peter Silver


| Key Driver | Key Outcome |
|---|---|
| Internal mandate | Escalation candidate |

Petrofac is a global service provider to the oil & gas production and processing industry. The company designs, builds, operates and maintains oil & gas facilities. Aberdeen Standard Investments is one of the larger institutional investors of Petrofac. We were keen to engage with the company to understand its risk management process across the business.

The most material risk discussed was the ongoing inquiry by the Serious Fraud Office (SFO) into allegations of bribery for contracts procured in the Middle East. In February this year, the SFO announced that a former senior sales executive had pleaded guilty to bribery charges. Given the significance of this charge, there was a material negative impact on the share price. Our engagement provided greater comfort on the compliance measures that were in place to detect bribery concerns. It also provided details on how Petrofac was working closely with the SFO to bring the wider case to a close.

The second area discussed was succession planning for current CEO, Ayman Asfari. He has held the role for over 17 years and is also a founder and major shareholder. Mr Asfari has been instrumental in the company's development and it is important that the board properly plan his succession. We discussed the work the board is doing to ensure this risk is addressed.

Finally, we talked through Petrofac's overall approach to risk management. This is captured in its materiality matrix, which highlights a wide range of risks. These are then ranked ranked in order of importance. The more material risks were areas such as health & safety, security, and protecting the environment, as well as governance. Petrofac provided updates on the evolution of these areas, and how the company was mitigating these inherent risks.

Petrofact said risks around labour management had increased significantly over the past year. It therefore provided an update on this area. The company has a large employee base of 15,000 direct employees and over 60,000 subcontractors. Petrofac operates in countries with a high level of exposure to modern slavery, such as bonded labour. We learnt how it was seeking to mitigate both financial and reputational damage from potential exposure to modern slavery in its supply chain by rolling out a new Global Labour Rights Standard. This standard will be embedded across its entire supply chain. The aim is to improve the levels of due diligence and improve training and awareness for senior management and employees. We await an update in the latest annual report for progress in this area.

We will continue to engage with the company regarding the ongoing SFO inquiry and succession planning. We will also focus more on the work the company has undertaken to address labour management risks within its supply chain.

## "Petrofac operate in countries with a high level of exposure to modern slavery."

# Siemens AG

Rosie French


| Key Driver | Key Outcome |
| --- | --- |
| Performance-based engagement | On-track to meet objectives |

Siemens AG is an engineering and manufacturing conglomerate with eight divisions. It largely focuses on areas of electrification, automation and digitalisation. The company develops technology, software and equipment used across a wide array of sectors. These include power & gas, transport, construction and healthcare.

This was our first ESG-focused engagement with Siemens. Our aim was to better understand its approach to sustainability. This included the key risks and opportunities it faces from an ESG perspective. For Siemens, sustainability means two things. First, managing costs and risks. Second, adding value through growth in new products and services. The latter includes working alongside customers, as well as strengthening its corporate brand. Siemens actively focuses on opportunities with a strong approach to sustainability. It does not see ESG factors as purely risk-management. As such, sustainability is an essential aspect of its Group 2020 Strategy Program Vision. As a result, we view Siemens as a true leader in the sustainability space.

Siemens' approach to environmental impact is perhaps the best example of the company's leading approach to sustainability. There are two reasons for this;

First, the group has developed an Environmental Portfolio (EP). It encompasses products, systems and services that meet strict criteria on energy efficiency, renewable energy and environmental technologies.

The EP plays a key part in developing strategies to tackle global challenges. These include climate change, natural resource scarcity and environmental pollution. It also shows that Siemens understands the environmental footprint of its products and operations.

Siemens embraces the green transition, as customers are increasingly conscious of their environmental footprint. This helps Siemens contribute to the UN's 17 Sustainable Development Goals. In 2018, its EP accounted for 46% of revenues. As part of this, the group helped customers mitigate 73 million tonnes of CO2.

Second, the group has a strong approach to climate change management. This is due to its climate change strategy, risk management, data, targets and reporting. Its EP plays a large part in the group's ability to assess its carbon footprint and climate change impact. Siemens was the first global industrial player to set itself a target of carbon neutrality across all operations. It targets 50% reduction from 2014 to 2020. From a reporting perspective, the group is working to apply the TCFD (Taskforce for Climate-Related Financial Disclosure). This is a framework that Aberdeen Standard Investments supports and we consider it best practice.

We are happy with the company's approach. However, we did recommend two areas for improvement. First, we encouraged the group to consider explicitly including material ESG key performance indicators into executive remuneration. Second, we encouraged the group to stress-test its financial performance against a carbon price higher than the current $20t/CO2. According to the Paris Agreement-aligned carbon price for 2020, it should be $40-80/tCO2, and $50-100/tCO2 by 2030.

The company's proactive approach to sustainability and environmental impact has clear measurable benefits. This is from both an internal financial perspective and from an external perspective. Internally, the group's focus on energy efficiency saved it €20 million-a-year from 2016 to 2020. We welcome Siemens's leading approach and encourage others to follow suit.

**"We view Siemens as a true leader in the sustainability space."**

# TSMC

Jerry Goh


| Key Driver | Key Outcome |
| --- | --- |
| Performance-based engagement | Influential in achieving change |

TSMC is the world's largest dedicated semiconductor foundry. We have owned our shares for many years and always found it a well-run company. It combines strong technical competence with the ability to weather and grow through business and economic cycles. Meanwhile, continued optimisation and advancement of its manufacturing technology drive its operational excellence. This helps it attain tighter specifications and the product performance demanded by its clients.

The company has a sizeable and increasing research and development budget. This is centred on improving both operational capabilities and end-product efficiencies. For example, TSMC is actively exploring the use of EUV (extreme ultraviolet lithography). The goal is to further cut cycle time and improve productivity that we believe will reduce production costs. TSMC also focuses on innovation in microchip technology. It hopes this will reduce overall power consumption of next-generation microchips.

We've had numerous conversations with its management and industry stakeholders. We are comfortable with the company's risk management.

However, its recent journey has been bumpy. There were two incidents of note. First, a cyber security infection hit its manufacturing software. The cause given was a supplier that failed to run an anti-virus scan on its own system. This resulted in TSMC closing part of its plant operations for a few days while management rectified the problem. Second, poor quality materials contaminated the company's lab, which led to 10,000 defective wafers. To minimise secondary damage, the company disposed of the entire batch.

Given the company's quality, we were surprised it experienced two – albeit unrelated – events in quick succession. However, the company's quick responses to both incidents gave us comfort. This included its decision to publicly announce the details of the resolution as soon as was possible. We discussed these issues with TSMC as part of our ongoing engagement within this sector. We wanted to understand supply-chain risk management. This included the procedures it has to detect anomalies at the supplier level.

The company's response and eagerness for improvement were positives that reinforced our view of its quality. The company now requires vendors/suppliers to use more advanced testing tools. These will be able to detect substandard raw material before it ships. TSMC will also utilise more advanced tools to detect and verify vendors' test results. Furthermore, it is upgrading and employing inspection tools to detect anomalies during the wafer production process. This means it can immediately halt production in the event of any slight deviation in quality.

**"However, its recent journey has been bumpy. A cyber security infection hit its manufacturing software."**

# Vale

Fraser Harle


We were shocked and saddened by the rupture of the Feijão dam in the city of Brumadinho on 25 January 2019. The Feijão dam was acquired by the mining company Vale through the acquisition of Ferteco Mineração in 2001. It had been inactive, with no tailings additions, since July 2016. The vicinity of the dam to the city, hotels and Vale's administrative buildings, resulted in significant human cost: as of 3 March, 122 people are still missing and 186 are confirmed deceased. This contrasts with the last major incident in 2015.

In the immediate aftermath of the Feijão dam rupture, the Vale board of directors scheduled an extraordinary meeting. Here, the board approved the creation of three independent committees addressing key issues in response to the disaster, the suspension of the dividend and management variable compensation. Subsequently, Vale has accelerated the decommissioning of its remaining 10 upstream tailings dams, which had already been scheduled for closure in response to the Samarco incident. Between 2015 and 2019, Vale's investments in tailings dam management totalled R$786 million, a 180% increase in US$ terms. Operationally, Vale is reducing wet processing and increasing the proportion of dry processing to 70% by 2023. Vale will also invest around R$1.5 billion in the implementation of dry stacking disposal technology from 2020 onwards. This is paired with the acquisition of New Steel, from which Vale has gained intellectual property useful in the dry beneficiation of iron ore.

| Key Driver | Key Outcome |
| --- | --- |
| Performance-based engagement | Escalation candidate |

In response to the tragedy, the International Council of Mining and Metals (ICMM) announced that its governing council intends to establish an independent panel of experts to produce an international standard for tailings facilities. The standard is intended to apply to, and be used by, its members, including Vale. The ICMM believes this will catalyse a "step change" in safety and security within the mining industry. The overarching themes of the standard are intended to cover a more transparent and consequence-based classification system, robust independent reviews of tailing facilities and documentation requirements on emergency planning and preparedness.

We welcome these initial steps by Vale and the ICMM. From Vale, we particularly welcome the timely appointment of experienced, independent committees and we await the findings of both the internal and official investigations into the incident. We are further supportive of the ICMM's approach to develop an international best-practice standard for tailings dams.

We have had a number of initial engagements with both Vale's management and the board of directors. Once the facts of the case leading to the failure of the Brumadinho dam are clear, we will assess the appropriateness of responses and engage formally where necessary. We will offer further detail of our engagement with Vale and extractive sector with regard to managing tailing dams in future reports

**"Vale has accelerated the decommissioning of its remaining 10 upstream tailing dams."**

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