AEGON Asset Management

Report on Ethical Investment Survey

June 2021

Miranda Beacham
Head of ESG – Equity & Multi-Asset

We believe investors in our ethical funds are best served by ethical screening which is clear and unambiguous. Although our approach to investing has remained broadly consistent for over 30 years, we have successfully evolved our policies to incorporate new ethical issues which have arisen and the evolving needs of investors.

We formally review our ethical screening every two years. In the first quarter of 2021 we asked investors and their advisers for their feedback on our approach to screening within our ethical funds range. This paper contains the results of our online survey, which collected responses until 30 April 2021.

81% of respondents are already investing in our ethical funds or advise clients who do so. This helps us to balance the requirements of existing investors with ensuring the attractiveness of our funds to prospective investors.

Thank you very much to everyone who completed the survey. Both the data and comments are immensely valuable to us and will help to ensure that our approach remains relevant to the needs of our clients.

Miranda Beacham
Head of ESG – Equity & Multi-Asset

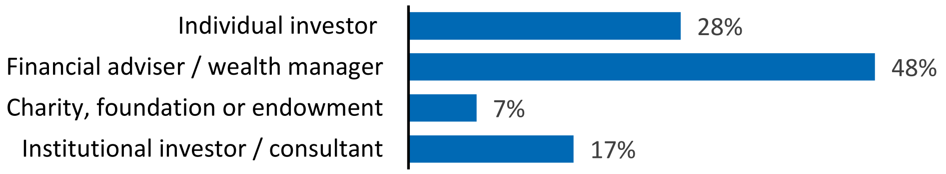
Summary of findings

Endorsement of our current approach to screening	Overall, the survey results demonstrated strong support for our current approach to screening across our range of ethical funds. Across the 12 categories there was an average of 72% for retaining the current screening approach.
Areas where opinion is shifting	We specifically asked clients to comment on political donations and 38% of respondents wanted a relaxation of screening restrictions in this area. We were also particularly keen to understand clients' views on nuclear power. As it stands, this exclusion impacts engineering companies which provide services to the nuclear industry. 39% of respondents wanted a relaxation on companies providing support services to the nuclear power industry. A small minority of respondents supported more stringent restrictions around oppressive regimes and tobacco.
Comments on themes raised by respondents	Given the enthusiasm for relaxing the screening on political donations, we are currently working through how we could best implement this change. This will most likely be through a threshold expressed as percentage of revenue, rather than the current low absolute cash-based restriction. We are also planning to relax the restriction which prevents us investing in engineering companies that provide services to the nuclear industry.

Green bonds	We asked if investors would be comfortable owning a 'green bond' in a company where the equity would not be considered suitable for an ethical fund? The results were evenly split, although marginally in favour of 'no'. As a result, we propose to retain our current policy.
Areas of focus	We asked if there were areas where investors would like us to focus our engagement activity over the next 12 months? Climate change was the dominant topic mentioned, although there is a growing interest in pay inequality.
Market trends over the next 2-3 years	There were some very insightful comments about how the responsible investment market is evolving, many of which echo our own experience as a fund provider. We are seeing more competition from ESG-themed passive funds and have worked hard to explain to clients the benefits of an active approach that is underpinned by deep fundamental analysis. As a manager with an ethical range stretching back over 30 years, but which also offers a range of sustainable, ESG best-in-class and low-carbon impact funds, we want to continue to satisfy the demands of our client base, while offering products to meet the needs of investors who want different approaches.

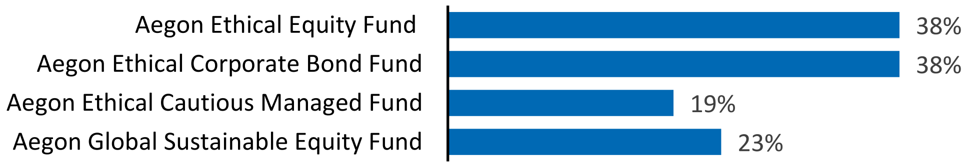
Detailed survey results

Your investor status

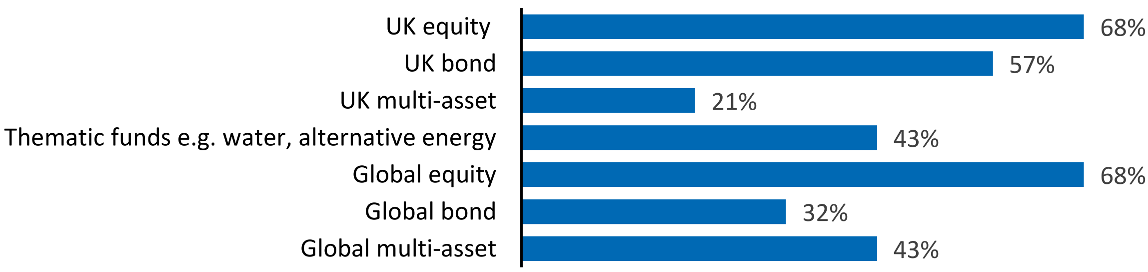


Do you currently invest in or recommend Aegon AM's ethical or sustainable funds?

Which ethical or sustainable funds managed by Aegon AM do you invest in or recommend to clients?

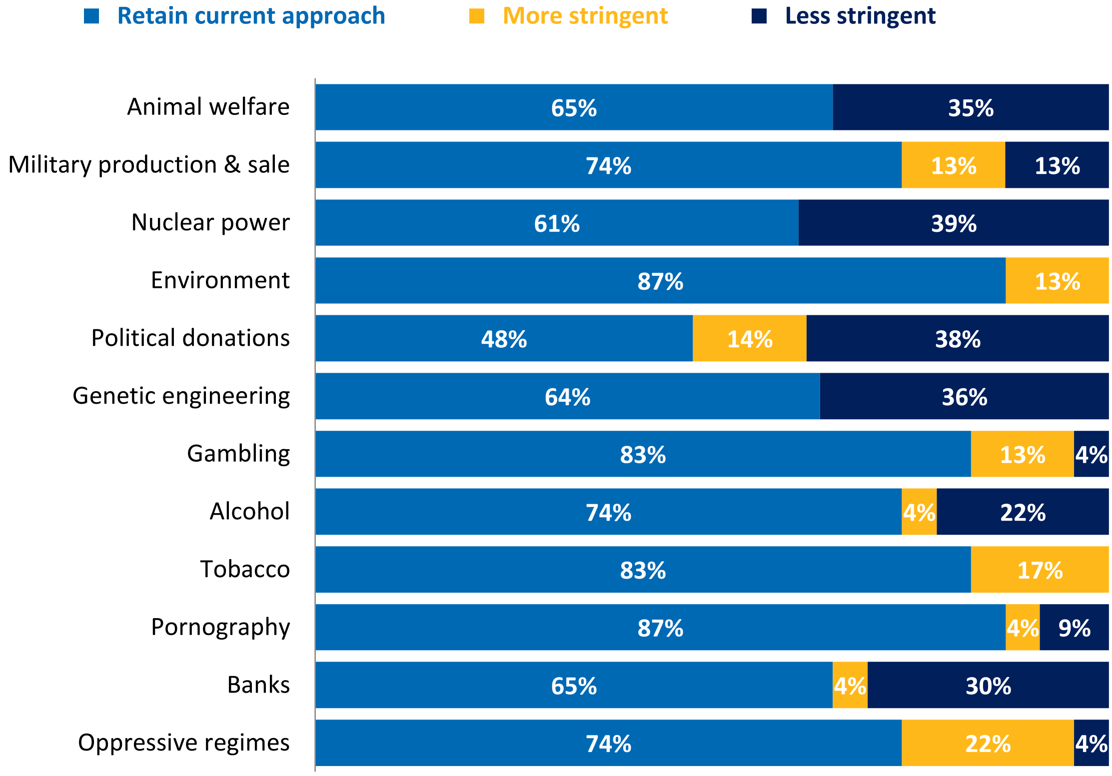


Which types of ethical funds do you invest in or recommend to clients?



View on our screening criteria

For each screening category we asked respondents to share their views on whether we should retain our current screening approach, adopt more stringent screening or adopt less stringent screening. The chart below shows the results for each of the 12 screening categories.



What is clear from these results is that there is broad endorsement of our current approach to screening.

We now summarise the comments we received for each of the 12 screening criteria within our ethical fund range.

Animal welfare

We were particularly interested to receive investors' views on the stringency of the animal welfare criteria that we apply. Specifically, our exclusion of supermarkets because of their sale of any meat, poultry, fish or dairy products. In many instances we regard their supply chain standards as good and - in some instances - excellent, especially where vertical integration enables good oversight of the provenance of meat products sold.

So, given the broad provision of foodstuffs that the UK supermarkets provide and their efforts to improve supply chain practices and provision of alternative proteins, do investors still feel they should be captured by the animal welfare criteria? We asked investors to note that the stringency of the existing animal welfare criteria, combined with a number of the other ethical criteria, significantly impacts our ability to invest in 'defensive' sectors, which in turn has an impact portfolio risk management.

We summarise our current policy as:

- We believe our current criteria for animal welfare is the strictest in the UK ethical fund market. As such we do not believe there is potential to make the criteria any stricter and so exclude a 'more stringent' option on that basis.

- We currently exclude companies which provide animal testing services or manufacture or sell animal-tested cosmetics, household products or pharmaceuticals. We also exclude companies which have any involvement in intensive farming; operate abattoirs or slaughterhouse facilities; or are producers or retailers of meat, poultry, fish or dairy products or slaughterhouse bi-products. These restrictions have a significant impact on how we manage the ethical portfolios.
- For the Aegon Ethical Equity Fund we exclude companies in the following sectors, with the figures in brackets representing the proportion of the FTSE All Share Index – Pharmaceuticals & Biotechnology (8.2%), Supermarkets (1.9%) and Luxury Goods & Personal products (2.3%).
- We also have significantly restricted investment in Chemicals (0.7%), Food (0.2%), Health Care Equipment & Suppliers (1.5%) and Specialised Retail (0.9%).

Comments on animal welfare

“I think that excluding supermarkets is too harsh. I am in favour of all other elements of the current process on animal welfare, but relating to your first explanatory paragraph, surely you can research and have a view on supermarket supply chains - therefore I think a blanket exclusion is OTT”.

“Our investors would be happy for supermarkets to be considered as potential investments, given the breadth of goods sold and assuming robust supply chain practices. However, we would not expect any other animal welfare exclusions to be relaxed. And if the supermarket is involved in any other area other than the retail of animal products, we would expect it to remain excluded.”

“There must be some scope within the final group as shown in your guidance notes, particularly with a strong positive story.”

“Most clients are not vegetarian or vegan, so need to buy their meat products from somewhere, which are predominantly supermarkets. Therefore, I see no reason to exclude them. Animal welfare to the vast majority of clients means that they are not subject to cruelty and are treated humanely.”

“Improvements in animal welfare standards would perhaps point to allowing the inclusion of supermarkets, particularly given the sale of animal products represents only a portion of revenues. One potential argument against this may be the weakening of UK environmental regulations or future trade deals which permitted the sale of goods that are not subject to such high levels of welfare.”

“This maintains the difference between ethical and sustainable.”

“The approach is sufficiently stringent to capture relevant exclusions.”

Military production and sale

We currently exclude companies which manufacture armaments, nuclear weapons or associated strategic products. We define strategic as specialist products or services essential to modern weapon systems or combat operations. There are no suitable investments in the aerospace and defence sector (1.5% of the FTSE All-Share index).

This screen also often impacts the ability of our Ethical Equity Fund to invest in a number of engineering companies, while there is also some impact on the software sector.

Comments on military production and sale

“Engineering companies that manufacture parts for weapons should be excluded. I don't feel there is any leeway here - weapons shouldn't be held in an ethical fund.”

"Exclusion by indirect association with military production could be reconsidered on a materiality basis i.e. should a company which derived (say) 5% of its revenues from the provision of software or services to such companies be excluded?"

"Include engineering companies which are part of the supply chain."

"Having positive engagement might be more beneficial as using technology in peace keeping rather than human life has to be preferable. Stringent screening as to which countries buy such products and services could be a way of investing and using the power of capital to influence?"

"The UNPRI and Global Compact measures should be adhered to if not already included."

Nuclear power

We were particularly keen to understand clients' views on nuclear power. As it stands, this exclusion impacts engineering companies that provide services to the nuclear industry (among other industries).

We were therefore specifically seeking views on relaxing the restriction to allow us to invest in these companies, given the existing significant range of exclusions that are already applied.

Our guidance note on nuclear power are:

- We currently exclude companies which provide critical services to, own or operate nuclear power facilities.
- This screen prevents investment in three of the four largest listed mining companies due to their uranium mining exposure (4.8% of the FTSE All-Share).
- It also impacts the ability of our Ethical Corporate Bond Fund to invest in European electricity generators.
- This criteria also renders some engineering companies unsuitable for investment.

Comments on nuclear power

"I would not like to see any investment in mainstream mining companies."

"Owners and operators, yes, but perhaps excluding service providers to the nuclear industry is a bit harsh."

"Our investors expect the exclusion of businesses associated with nuclear power and it is an area that is actively discussed and where investors feel strongly. We would like to see the current approach retained."

"With regards to the engineering companies I personally think it would be a question of how much of their revenues stem from services to the nuclear industry. If below 5% or 10% then that could be deemed acceptable. They could be doing a lot of good with the other 90/95%."

"Client views on nuclear have evolved and as part of a transition mix it should be viewed as acceptable, with the inevitable caveats about quality management of risk."

"Could a distinction be drawn between existing nuclear and new nuclear? Faced with an energy transition, there is an argument that would support retaining nuclear over new gas or coal fired generation and ensuring the safe and effective wind down of such generative capacity in favour of renewable generation. The arguments on materiality for engineering services as set out above should also apply here."

"Include mining companies (although I appreciate that they could be excluded elsewhere). Include engineering companies that provide services to this sector. Include the corporate bonds of electricity generators."

"Once more, using capital as an influencer would seem to make sense whilst maintaining strict investment criteria. I think associated engineering companies in the supply chain should be investable as should mining companies if all other criteria are met."

Environment

We currently exclude companies which are involved in activities which are commonly held to be environmentally unsound – specifically manufacturers of PVC, ozone-depleting chemicals and hazardous pesticides. We added oil and gas exploration and production companies to this list as a result of client feedback from our last survey.

We also exclude companies which are in breach of internationally recognised conventions on biodiversity and companies in energy-intensive industries which are not tackling the issue of climate change. For example, we exclude companies with coal-mining operations and those which operate tar sands production facilities.

This typically affects our ability to invest in sectors which can have a high environmental impact, including transport, mining, construction and materials, electricity, gas, water and multi-utilities.

Comments on the environment

"Investment in companies that manufacture or provide renewable/sustainable energy & water would be acceptable, but I believe this is your existing approach."

"The basis for inclusion of these factors seems sound, considering the externalities. However, could a test be made to allow the inclusion of companies that are making significant efforts to change their business practices and where defined thresholds for environmentally impactful practices are not exceeded?"

Political donations

We currently exclude companies which have made political donations of more than £25,000 in the past year.

We were interested in hearing investors' views on the political donations criteria as it is currently applied. For UK-listed companies that the ethical equity fund invests in, very few make political donations (in the true sense), while those companies that do are generally excluded on other grounds. This means that the political donations exclusion has limited practical impact in the UK.

The criteria significantly impacts our ability to invest in US issuers of sterling debt within the Aegon Ethical Corporate Bond Fund. The threshold of £25,000 is very low in the context of the relatively opaque US political system, where it can be difficult to differentiate between individual and corporate donors. We are not aware of any other ethical funds that apply such a criteria. We therefore welcomed feedback on the extent to which investors value its inclusion, relative to the significant impact it has on the number of US companies that the ethical corporate bond fund could invest in.

Comments on political donations

"I think either scrap it or make it far more onerous - as you say, £25k is far too low a hurdle rate. Personally I would not be offended if the managers invested in a bond issues by a US company which had made political donations multiple times this size."

"Our investors feel less strongly about this than the other screening factors. In that regard we would be happy with a less stringent approach."

"While donations are a source of some angst, this is hardly a hot topic, and what happens (as now for example in the USA) when the party in power is aligned on a number of issues with the wider views of investors."

"Could this criteria be redefined with reference to political lobbying by companies against the other criteria that have been imposed?"

"A difficult situation, could you amend your criteria so that say US$100,000 donations are acceptable, which might widen the scope? Or to use a definition whereby the donation or series of donations is influential?"

Genetic engineering

We currently exclude companies which have patented genes. This principally impacts our ability to invest in the pharmaceutical & biotechnology sector, which together constitute 8.2% of the FTSE All-Share.

Comments on genetic engineering

"A large exclusion in percentage terms, but I can see your point here."

"I am guessing that the pharma and biotech companies are already excluded."

"Medical research & healthcare should be part of an ethical fund's remit."

"I think the current approach is right, however is there a more preferable balance where some pharma can be included?"

Gambling

We exclude companies which have investments in betting shops, casinos or amusement arcades accounting for more than 10% of their total business. This means we avoid all UK-listed gambling companies.

Comments on gambling

"Most clients aren't comfortable with this."

Alcohol

We avoid companies which derive more than 10% of their total business through involvement in brewing, distillation or sale of alcoholic drinks. This means we screen out all alcoholic beverage manufacturers, such as Diageo.

In addition, half of the companies in the travel and leisure sector by number are deemed unsuitable because of the alcohol and gambling screens.

Comments on alcohol

"I don't have clients objecting to this."

Tobacco

We currently screen out companies which derive more than 10% of their turnover from the growing, processing or sale of tobacco products. No tobacco manufacturers are suitable for investment, representing 3.6% of the FTSE All-Share Index.

Comments on tobacco

"Most people don't want to invest in tobacco these days."

Pornography

We currently exclude companies which provide adult entertainment services. This impacts a limited number of companies, principally in the media sector.

Comments on pornography

"Spot on."

Banks

We currently exclude corporate or international banks with exposure to large corporate or Third World debt. This screen also significantly impacts the available universe for our Ethical Corporate Bond Fund.

The UK-listed banks HSBC, Barclays and Standard Chartered are currently excluded from investment (5.3% of the FTSE All-Share Index). The retail and mortgage-focused banks are suitable for investment e.g. NatWest Group, Lloyds and Virgin Money.

Comments on banks

"Quite a large exclusion here in percentage terms, but I can see your point."

"The basis for exclusion of banks with exposure to developing world debt seems unclear unless the practices around such debt are overly penal. Consideration should perhaps be given to the exclusion of banks which are not adopting policies to limit the finance of FF companies."

"Exposure to the largest international banks is preferable."

Oppressive regimes

We currently exclude companies which operate in countries with poor human rights records, and which have no established management policies on human rights issues. This has a significant impact on our Ethical Equity Fund's ability to invest in the mining sector (8.1% of the FTSE All-Share Index).

Human rights are also a consideration when we invest in retail companies which operate international supply chains.

Comments on oppressive regimes

"Very supportive here."

"I think that the screen should remain at a company level rather than country level. If there is no engagement then the areas will have no incentive to improve, so positive use of capital to influence seems a good plan."

Additional questions

Would you be comfortable with our ethical corporate bond and cautious managed funds owning a 'green bond' in a company where the equity would not be considered suitable for an ethical fund?

The results were evenly split, although marginally in favour of ‘no’. There were some strong views from clients, particularly among those who were worried about green bonds being associated with ‘greenwashing’.

Comments on green bonds

“Yes, as long as it was earmarked for the specific project.”

“A very interesting question, and I guess one to review on a company-by-company basis i.e. a green bond issued by an oil major, BP, Shell etc would not be desired, as the percentage of green to overall non-green side of the business is very minor. A green bond issued by a car manufacturer to aid the transition would be more appealing. A tough one to say without looking at it on a case-by-case basis. A green gilt would be okay.”

“I think clients are unlikely to be comfortable with green bonds issued by companies deemed to be unsuitable for investment elsewhere”.

“Probably not - surely the same standards/exclusions should be applied across equities and fixed income?”

“Our ethical investors would not be comfortable with this. We have verified this with them directly. They are keen on the concept of green bonds and have indeed invested in some directly. However, they do not want to invest in a green bond issued by a company that would not ordinarily pass the ethical screens.”

“No as this would raise questions as to whether they are ‘greenwashing’ or if the proceeds from the bond sale are actually being used as intended.”

“This makes sense in the current environment.”

“Yes, subject to meeting the investing criteria.”

“Yes, although it would likely depend on the reason for exclusion from the equity fund.”

Are there particular areas where you would like us to focus our engagement activity over the next 12 months?

Climate change was the dominant topic mentioned, although a growing interest in pay inequality.

Comments on engagement activity

“Technology - content, data, debate, AI.”

“Banks are still financing fossil fuels exploration”.

“Climate change.”

"The area of green bonds would be an interesting place to start. How can a company with no ethical credentials raise money for a green bond?"

"I think climate will be a very key issue for 2021".

"Plastic waste, and the disclosure of scope 3 carbon emissions as well as scopes 1 and 2."

"Areas are of less interest than outcomes."

"Climate change and environmental issues."

"Environmental issues, including biodiversity."

"Reducing inequalities and improving labour standards."

"Carbon neutrality and clean energy."

"Social impact, including the treatment of staff and other stakeholders."

"Corporate pay and remuneration structures, ensuring senior executives are not earning an imbalanced amount to employees, especially where there is a high proportion of minimum wage or near to employees. Share options in the pharmaceutical industry, way too much money is paid in salaries with generous share options. Founders and early investors should be rewarded for risks, but I have concerns about 'other people's money' really being what is at risk".

"Climate".

"Pay gap between highest and lowest paid in a business. How can companies pay top management eye-watering amounts while paying others so little that they cannot sustain 'normal' living requirements of paying bills and putting food on the table?"

"For our institution the priority is environmental sustainability - so we would expect appropriate influence to be put on companies to move quickly to adhere to the UN sustainability goals."

How do you see the responsible investment market developing in the next 2-3 years?

There were some very insightful comments to this question, many of which echo our own experience as a fund provider. We are seeing more competition from ESG-themed passive funds and have worked hard to explain to clients the benefits of an active approach that is underpinned by deep fundamental analysis. As a manager with an ethical range stretching back over 30 years, but which also offers a range of sustainable, ESG best-in-class and low-carbon impact funds, we want to continue to satisfy the demands of our client base, while offering products who meet the needs of investors who want different approaches.

Comments on responsible investment market

"More trackers posing challenges for engagement."

"I believe it should be seen as mainstream investing already, if it is not, it soon will be!"

"Evolving further as regulations increase."

"It will continue to grow and beyond that time period I think it will become the norm."

"Booming."

"I think there will continue to be many new fund launches over the next few years and many investment professionals looking to specialise in this area. However, a lot of the new vehicles seem to have a strong emphasis on ratings agencies and quantitative (positive or negative) screening methods, rather than the detailed in-house qualitative analysis, which can be more impactful in my view."

"More regional sustainable equity funds, complementing the excellent cohort of global sustainable equity funds. dormant/dull fixed income funds being reinvigorated and relaunched as sustainable bond funds."

"ESG is not going away and indeed funds will increasingly be reviewed for a high ESG score and as such will influence businesses to take this seriously as well."

"Aegon AM stands as one of the very few investment groups to retain strict negative screening. Many others have relaxed their criteria and transitioned to focus on engagement / ESG. I think the subset of strict negative screening might shrink further, but there will always be clients wanting this. And improved education of the differences between negative screening and ESG / sustainable / responsible investing will help. I view ethical as a subset of the latter, with similar principles but stricter screening, so a smaller investment universe. I think some people investing in ESG / sustainable funds might be surprised at what they are invested in, and not in a positive way. My view is that there is a place for negative screened funds. And I hope Aegon AM stays that way and continues to offer these funds."

"I think it will continue to grow as more clients are asking about responsible investments."

"There will be a growing focus on disclosure, the pricing of externalities and the outcomes that are generated from investment and stewardship activity. Investors will continue to demand more information and the scrutiny and challenge will continue to build."

"More transparency and clearer definitions will see growth continue."

"The majority of retail investments will adopt sufficient ESG credentials to satisfy most investors and it will fail to be a differentiator. The concept of 'impact' investing will rise in prominence for those with a deeper interest in how their money is invested. A significant minority will continue to ignore non-financial objectives and focus solely on returns."

"It will become the norm and non-responsible investing has to become the niche. Asset managers will also have to walk the walk and should be showing more progress already in this area."

"Growing strongly."

"Hopefully there will be greater range of funds on the market that offer different interrogations of what is 'responsible' investing. One size doesn't fit all. We are likely to see greater regulation, but this likely simply to create marketing opportunities, rather than do much to foster a more responsible mind-set across businesses, their suppliers and customers and thus, in turn, investment managers engagement on ESG issues."

"There needs to be a move away from blanket exclusions towards understanding how the investment market can influence companies to make changes (where appropriate). This needs more communication to a wide range of stakeholders so it becomes clearer why environmental goals may be better served by influencing oil and gas companies from the inside, rather than excluding them from investment portfolios."

Final comments

Thank-you to everyone who completed the questionnaire. We read every comment and think carefully about how to develop our offering as a result. Below are some of the final comments from respondents.

Final comments from respondents

"I think you need to revisit and update guidance for certain sectors to encompass complexities of some of the issues faced, such as hidden biases in AI. Also, make some of criteria more target/action focussed.

"Thanks for the opportunity to provide feedback."

"There is almost too much ESG noise out there at the moment. Almost too much to be able to take it all in!"

"Good range of funds, thanks."

"Overall, I think the criteria are about right, but there is some scope for relaxing your criteria."

"It has long been recognised that Aegon's 'dark green' approach is stricter than most. The evolution towards 'engagement' rather than 'exclusion' could place Aegon at a disadvantage, but equally some investors will always want to fully exclude certain sectors."

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Important information

Past performance is not a guide to future performance. The value of investments and the income from them may go down as well as up and is not guaranteed. Outcomes, including the payment of income, are not guaranteed.

Remember to read the Key Investor Information before making an investment decision.

These funds are medium to long-term investments and your capital is at risk. Any investment objective, performance benchmark and yield information should not be considered as an assurance or guarantee of the performance of the fund or any part of it. An initial charge reduces the amount available for investment. Investors should be aware that funds denominated in a currency other than investors' home state currency are subject to currency fluctuations which may decrease returns.

Please be aware that each fund presents its own risk profile.

Material risks for the Global Sustainable Equity Fund are: Liquidity, Concentration, Foreign Exchange and Other Markets.

Material risks for the Ethical Cautious Managed and Ethical Corporate Bond funds are: Credit, Interest Rate and Liquidity.

Material risks for the Ethical Equity fund are: Liquidity

Please read the KIID for an explanation and refer to the prospectus for information about all relevant risks.

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All data is sourced to Aegon Asset Management UK plc unless otherwise stated. The document is accurate at the time of writing but is subject to change without notice.

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