ESG Policy - Schroder ISF Japanese Equity ("The Fund")

A. Statement of Purpose

Our goal is long term outperformance of market benchmarks, measured over at least one market cycle or, in practice, 3 – 5 years. We achieve this by focussing on long-term growth factors. This helps us form an opinion that often differs from the consensus and then determines how much conviction we should have in our view. ESG factors are integral to the differentiation of our views. Although Japan is a mature, developed market, many stocks remain under-researched, especially in the mid and small cap space. The commitment of many sell-side firms to Japanese equity research can vary dramatically across a cycle and we see frequent changes in resourcing and the extent of stock coverage. As a result, our long-term approach to independent company analysis differentiates us from many of our peers. This analysis is based on, and reinforced by, regular meetings with management.

As an experienced team in a mature market, most large and mid caps are already well-known to us, so most of our research in these areas is focused on identifying incremental change, rather than forming initial views. The potential risks associated with such an experienced and established team include a degree of complacency and inertia in our existing views. Therefore, we have deliberately designed an investment process that involves constant challenge and discussion of our underlying assumptions.

Although our processes have evolved over time, we have always been committed to identifying quality factors, with a focus on the long-term sustainability of company business models. ESG analysis is therefore a well-established, intrinsic part of our investment process. The established processes allow the team to anticipate and adapt to the market environment and regulatory changes, including successive revisions to the Corporate Governance Code in Japan.

Our principle of evolution and continuous improvement is designed to ensure that our processes remain forward-looking. The introduction of the Japanese Stewardship Code in 2014 and the Corporate Governance Code in 2015, together with subsequent revisions, underlines a commitment to improving corporate governance in Japan. Our commitment to stewardship and corporate governance is evident in our analysis and in our discussions both internally and when interacting with company management. Looking forward, we expect further regulation on company disclosures and, as a result, we have already begun proactively engaging with companies on these issues.

B. Proprietary Tools

1. SustainEx

SustainEx™ is a proprietary model which scientifically combines measures of both the harm companies can do and the good they can bring, to arrive at an aggregate measure of each firm's social and environmental impact, allowing investors to target their ESG investments effectively. It quantifies the extent to which companies are in credit or deficit with the societies to which they belong, and the risks they face if the costs they externalise are pushed into companies' own costs.

2. CONTEXT

Our flagship ESG research tool, provides a systematic framework for analysing a company's relationship with its stakeholders and the sustainability of its business model. Comprising over 260 metrics across over 13,000 companies, it is designed to support our investors' understanding of the sustainability of companies' business models and profitability, and provides structured, logical and wide-ranging data to support our analysts' views. This consistent structure makes information sharing easier and allows us to identify market wide trends and insights.

The tool is interactive and highly customisable, enabling analysts to select the most material ESG factors for each sector, weight their importance and apply relevant metrics. Analysts are then able to compare companies based on the metrics selected, their own company assessment scores or adjusted rankings (size, sector or region), with the flexibility to make company specific adjustments to reflect their detailed knowledge. The tool is fully integrated within Schroders' global research platform, which is readily accessible across investment desks and geographies.

We have also developed a number of proprietary quantitative metrics that can be used to demonstrate and measure a portfolio's sustainability characteristics.

C. ESG Strategies

1. ESG Integration

The Fund maintains a higher overall sustainability score than the Tokyo Stock Exchange 1st Section index (TOPIX) (Net TR), based on the Investment Manager's rating system. The Investment Manager performs due diligence on all potential holdings, including meetings with management, and assesses the company's governance, environmental and social profile across a range of factors. This process is supported by quantitative analysis provided by Schroders' proprietary sustainability tools, which are key inputs to assess how existing and potential investments for the portfolio are meeting the Fund's sustainability criteria.

For a company to be eligible to be held in the Fund, it is expected to show a commitment to its stakeholders, including customers, employees, suppliers , shareholders and regulators. The Fund selects companies whose businesses demonstrate good governance and aim to treat stakeholders equitably.

Our investment views are structured around a long-term assessment of quality and central to this is an opinion on the sustainability of a company's business model. These views are explicitly quantified by our analysts within our Fair Value model for each stock under coverage. By forming a structural element within our Fair Value model, the positive and negative scoring applied to ESG factors contribute symmetrically to our views of both downside risk and upside potential.

Within the Japanese equity market, where disclosure and analysis of ESG issues is still evolving, it is critically important for us to identify, and differentiate between, early signs of positive change, even if these still appear modest in comparison to other developed markets. By identifying strengths, weakness and changes in these areas, especially in governance, we believe we can materially strengthen our understanding of companies and improve our investment decisions.

We currently believe that the principal ESG risks are related to governance factors. Looking forward we expect further regulation on company disclosures, particularly around succession planning and increased transparency around the nomination process. As a result, we have already begun proactively engaging with companies on these issues.

When building our investment case, we particularly emphasise capital allocation, structural improvements in return on equity (ROE) and enhanced shareholder focus. These have been our key focus areas for the Japanese market and this is where we have seen tangible changes over recent years. We feel progress in these areas will be increasingly linked to whether a company has the ability to adapt to the increasing risks of Environmental &Social factors such as climate change and data security as well as being able to demonstrate this to stakeholders.

2. Normative Screening

We recognise the importance of companies respecting and protecting human rights, ensuring decent working conditions and upholding labour rights, promoting greater environmental responsibility and having robust anti-corruption measures and practices in place. Through our ESG integration and active ownership process we take into consideration how companies are interacting with all their stakeholders (customers, suppliers, environment, regulators, employees and communities) and the contribution this might have (both negative and positive) to their long-term success. We consider the UNGC principles within this framework, in addition to a broader range of issues. That analysis also informs our engagement with companies; where we consider companies' business practices may be unsustainable we regularly engage with management teams to better understand their plans, and to promote more responsible behaviour.

The Fund will not knowingly invest in companies not meeting these minimum norms.

3. Exclusion

a. Tobacco

The World Health Organisation has estimated that tobacco use (smoking and smokeless) is currently responsible for the death of about seven million people across the world each year, with more than 10% of deaths due to the effects of second-hand smoke.

The Fund excludes any companies involved in the production or wholesale trading of tobacco products or providing dedicated equipment or services. Companies are excluded category if their revenues from these activities exceed the 5% threshold.

b. Weapons

We fully support the international convention on Cluster Munitions and Anti-Personnel Mines:

- The Convention on Cluster Munitions (2008): prohibits the production, stockpiling, transfer and use of cluster munitions
- The Anti-Personnel Landmines Treaty (1997), also known as The Ottawa Treaty (1997): prohibits the production, stockpiling, transfer and use of anti-personnel landmines

We will not knowingly hold any security that will derive revenue from these sources.

The Fund excludes any company active in the production of Nuclear, Biological or Chemical weapons, anti-personnel mines, submunitions, depleted or industrial uranium, white phosphorous or supplies any components linked to them. There is no revenue threshold applied.

The Fund also excludes any company that generates more than 5% of revenues from conventional and civilian weapons.

c. Coal

Coal producers will bear the brunt of decarbonisation's impact. Coal is the most carbon intensive fossil fuel, generating twice as much carbon as gas to produce the same amount of energy. The Fund excludes the complete Carbon Underground 200 list.

In addition, we exclude any company which generates more than 5% of revenue from coal-related activities. Through our due diligence process, including contact with company management, we avoid companies who we believe are planning an expansion of their absolute capacity or production for thermal coal-related products.

d. Unconventional oil and gas

Unconventional oil and gas, such as tar sands, oil shale and shale gas, Arctic onshore and offshore, require more energy-intensive production methods compared to conventional oil and gas. There are also health and environmental impacts through air, water, land and soil pollution. The Fund excludes the complete Carbon Underground 200 list.

In addition, we exclude any company which generates more than 5% of revenue from unconventional oil and gas related activities. Through our due diligence process, including contact with company management, we avoid companies who we believe are planning an expansion of unconventional oil & gas extraction.

e. Conventional oil and gas

While conventional oil and gas are less carbon intensive than coal, they are major contributors to global greenhouse gas emissions and their use will have to fall significantly in the future.

The Fund excludes any company that generates more than 5% of revenues from conventional oil and gas extraction. In addition, due diligence is being performed to make sure that the company's absolute capacity or production for conventional oil and gas related products/services shall not be increasing.

f. Power Generation

Japan's long-term energy policy is still evolving in the wake of the 2011 earthquake and the subsequent nuclear disaster at Fukushima. Currently, we do not invest in any power generating utilities and avoid investment in companies who are structurally increasing absolute capacity in coal or nuclear based energy. Any positions taken in future would be subject to detailed due diligence on adverse impacts and contributing activities, in the light of revisions to Japan's long-term energy policy. Specifically, through discussion with the company management, we would establish if the company has any plans for expansion of absolute capacity in coal or nuclear energy production. In addition, we would also establish the company's plans for capacity in contributing products and services, and related capex, as part of this due diligence process

4. Engagement

The Japanese equity team is committed to local stewardship activities in Japan and, in demonstration of this, we have been signatories to the Japanese Stewardship Code since 2014. In 2015 we established our Stewardship Committee, chaired by Kazuhiro Toyoda (fund manager) and three members from our team in Tokyo. The purpose of the committee is to engage with companies on their ESG activities with the aim of encouraging best practice and influencing change over time.

The prospects for improvement in these engagement stocks, within a stated timeframe, are judged against the ESG/Context analysis that is integrated into the research output for other positions. The process is designed to ensure that our resources are focussed on positions with the greatest potential for positive impact within our portfolios. The relevant analyst will attend the engagement meetings, ensuring that there is strong feedback within the process, which enables a robust debate on prioritisation, time horizon and themes for engagement.

So far engagement topics have been skewed towards governance issues, particularly capital allocation, return on equity and capital structure. As we expand the list of target companies, we also look to expand the topics of engagement to include more E&S issues (Environmental and Social issues). We currently see particular opportunities to engage with companies on how they treat employees as this is an increasing focus area for management and we would like to understand how they think about and assess employee satisfaction, turnover and productivity.

The Stewardship Committee members are also responsible for all proxy voting and the committee will discuss any contentious items. We are also in regular contact with the proxy voting team in London to ensure that our views are aligned and that we are sending consistent messages to companies. All records are disclosed as required by the 2017 revision of Japan's Stewardship Code.

5. Objective to outperform BM on ESG indicator

The Fund maintains a higher overall sustainability score than the Tokyo Stock Exchange 1st Section index (TOPIX), based on our proprietary tool Sustainex.

D. Embedded Policies

Biodiversity

Biodiversity – the variety of plants and animals, and where they live – is critical for our everyday lives. It provides us with food, water, clean air, shelter and medicines. Loss of biodiversity and changes to ecosystems can increase the risk of infectious diseases in animals, plants and humans.

We recognise that deforestations, changes in land use, increasing agricultural intensity, over-population, climate change and pollution contribute to biodiversity loss and we therefore take these factors into consideration in our ESG analysis of companies and would engage with companies where we believe their practices are unsustainable.

Water use

Water is critical to human and ecosystem health, necessary in many industrial processes, indispensable in food and energy production, an important vehicle for disposing of wastes, and integral to many forms of recreation. While ~70% of the earth's surface is covered in water, less than 1% of this is water available for consumption by people and business, and the supply of clean, fresh water is decreasing. At the same time, there is an increasing demand for water through agriculture, a growing global population and economic development. Supply side and demand side pressure means that water is increasingly becoming a material risk for companies that are struggling to source scarce, clean water. Understanding and managing water risk may be fundamental to a company's ability to continue as a going concern.

As a result, the water intensity of companies' operations, scarcity in the regions in which they operate and their strategies to manage their use all feature in our ESG analysis of companies. We would also engage companies with direct or indirect exposure where necessary.

Taxation

Taxes are probably the clearest form of companies' social contribution. They are reinvested by the state into society, providing vital public services. We believe it is important that companies behave responsibly and conduct their tax affairs in an open and transparent way. Responsible tax payment is reflected in the tools available to our analysts when examining ESG performances and is regularly included in our engagement with companies.

Oppressive regimes

Oppressive regimes are commonly associated with systematic human rights abuses, and often an absence of the rule of law, a lack of freedom of expression and land rights abuses. Through our ESG integration and active ownership process we seek to understand whether companies operate or have supply chains in countries governed by oppressive regimes.

We comply with the sanctions regimes issued by the EU, the UN, Her Majesty's Treasury (HMT), and the Office of Foreign Asset Control (OFAC) in the United States.

Cannabis

The Single Convention and the Psychotropic Convention have been implemented in the UK through the Misuse of Drugs Act 1971 (“MDA”) and the Misuse of Drugs Regulations 2001 (“MDR”) – making it a criminal offense to invest in companies that produce, distribute and sell cannabis in the form of THC. Investments in companies with exposure to the industry but for medicinal purposes only are still permitted. Please note this a regulatory requirement and not part of the ESG framework.

Pollution & waste (e.g. plastics)

While the Fund does not have a specific policy on pollution & waste, the Context score takes this into account when scoring the E (Environment) dimension.

Gender & diversity

While the Fund does not have a specific policy on gender & diversity, the Context score takes this into account when scoring the S (Social) and G (Governance) dimensions.

Death penalty

The Fund does not have a specific policy on death penalty

Forward contracts on agricultural commodities

The Fund does not invest in any agricultural commodities

RISK FACTORS

Concentration risk: The fund may be concentrated in a limited number of geographical regions, industry sectors, markets and/or individual positions. This may result in large changes in the value of the fund, both up or down.

Currency risk: The fund may lose value as a result of movements in foreign exchange rates.

Liquidity risk: In difficult market conditions, the fund may not be able to sell a security for full value or at all. This could affect performance and could cause the fund to defer or suspend redemptions of its shares.

Operational risk: Operational processes, including those related to the safekeeping of assets, may fail. This may result in losses to the fund.

Performance risk: Investment objectives express an intended result but there is no guarantee that such a result will be achieved. Depending on market conditions and the macro economic environment, investment objectives may become more difficult to achieve.

IBOR: The transition of the financial markets away from the use of interbank offered rates (IBORs) to alternative reference rates may impact the valuation of certain holdings and disrupt liquidity in certain instruments. This may impact the investment performance of the fund.

Derivatives risk – Efficient Portfolio Management and Investment Purposes: Derivatives may be used to manage the portfolio efficiently. A derivative may not perform as expected, may create losses greater than the cost of the derivative and may result in losses to the fund. The fund may also materially invest in derivatives including using short selling and leverage techniques with the aim of making a return. When the value of an asset changes, the value of a derivative based on that asset may change to a much greater extent. This may result in greater losses than investing in the underlying asset.

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Issued: September 2021

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Risk considerations : Schroder ISF Japanese Equity

The capital is not guaranteed. Investments denominated in a currency other than that of the share-class may not be hedged. The market movements between those currencies will impact the share-class. The Fund will not hedge its market risk in a down cycle. The value of the fund will move similarly to the markets. Changes in China's political, legal, economic or tax policies could cause losses or higher costs for the fund. Emerging markets will generally be subject to greater political, legal, counterparty and operational risk. Changes in China's political, legal, economic or tax policies could cause losses or higher costs for the fund.

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Schroders sustainability accreditation

Our Schroders sustainability accreditation helps investors distinguish how ESG factors are considered across our products. The fund has been awarded an Integrated accreditation. ESG factors are embedded into the investment process and can be clearly evidenced. There is a strong commitment to stewardship and company engagement. The fund has been awarded a Sustainable accreditation. Sustainability is a cornerstone of the investment process. The fund has been awarded a Screened accreditation. The fund has additional stock/security restrictions (not necessarily for ethical reasons) beyond cluster munitions and anti-personnel mines. For further information about our Schroders Sustainability Accreditation please visit www.schroders.lu/sustainabilityaccreditation

Issued: September 2021