REPORT TO: **PENSION INVESTMENT SUB-COMMITTEE OF THE POLICY AND RESOURCES COMMITTEE – 02 DECEMBER 2013**

REPORT ON: **SOCIALLY RESPONSIBLE INVESTMENT - SIX MONTHLY REPORT**

REPORT BY: **DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **499-2013**

1 PURPOSE OF REPORT

This report reviews the progress by the Fund Managers regarding the positive engagement Policy on Environmental, Social and Corporate Governance approved by the Sub-Committee on 17 November 2008.

2 RECOMMENDATIONS

The Sub-Committee is asked to note the information contained within this report with regard to the activities of the Fund Managers during the six month period ended 30 September 2013.

3 BACKGROUND

On 17 November 2008 the Sub-Committee approved a revised Policy on Environmental, Social and Corporate Governance. This policy recognises the over-riding fiduciary duties but encourages the managers to engage with companies. They are requested to summarise this engagement activity quarterly. The key areas continue to be Employee Care, Human Rights, Sustainability and the Environment.

4 ALLIANCE BERNSTEIN

Alliance Bernstein's latest activity is shown at Appendix 1.

5 BAILLIE GIFFORD

A summary of recent engagement activity is shown at Appendix 2. This shows the wide range of topics covered and the diversity of companies approached.

6 FIDELITY

Appendix 3, shows various examples of issues Fidelity have considered in the last quarter.

7 OVERALL CONCLUSION

The managers have continued to develop their strategy in this area and link more closely with the long-term effect on share value.

The fund is still committed to following the United Nations Principles of Responsible Investment.

8 POLICY IMPLICATIONS

This Report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

The Fund's policy on Socially Responsible Investment requires its investment managers to engage with companies on Sustainability and the Environment and Employee Care and Human Rights.

9 CONSULTATIONS

The Chief Executive and the Head of Democratic and Legal Services have been consulted in the preparation of this report.

10 BACKGROUND PAPERS

None

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES **14 JANUARY 2014**

APPENDIX 1

ALLIANCE BERNSTEIN – SOCIALLY RESPONSIBLE INVESTMENT UPDATE

Tayside Global Diversified Value Portfolio – Engagement Examples, Second Quarter 2013

JPMorgan Chase - JPMorgan Chase faced a great deal of scrutiny heading into its May 2013 shareholder meeting. CtW Investment Group was leading a “Vote No” campaign against the Board’s Risk Committee for oversight failures related to last year’s London Whale incident, which resulted in over $6 billion in trading losses and widespread concern about the company’s internal controls. In addition, a group of shareholders consisting of the AFSCME Employees Pension Plan, Hermes Fund Managers, The City of New York Comptroller’s Office, and the Connecticut Retirement Plans and Trust Funds heavily promoted their co-sponsored proposal requesting a policy requiring the Board Chairman to be an independent member of the Board.

After reviewing the arguments presented by the interest groups, we engaged with management to understand their perspective and discuss our view. We expressed concerns about the qualifications of the Risk Committee members. While there was adequate Board-related expertise, direct experience involving risk oversight of a large diversified financial services institution was not as apparent. In light of this, we chose to oppose the Risk Committee member with the least experience. Voting against all the members, which may have resulted in the entire Risk Committee being removed from the Board, was not considered appropriate as this could cause further risk oversight problems.

We opposed requiring the Board Chairman to be independent. The Board had adequate counter-balancing mechanisms in place to support a combined Chair and CEO position. The company has also had superior performance under the current structure so disrupting this arrangement was not considered in shareholders’ best interests.

Norilsk Nickel - Since Norilsk is a very large deposit, it is still being mined today but a lot of the processing technology being used is very old and polluting. Most other mines and smelters of its generation shut long ago as the ore bodies were depleting. From decades of sulfur emissions, Norilsk is one of the most polluted places on Earth. In addition, corporate governance at Norilsk Nickel was poor – it was run for the benefit of the oligarch majority owners vs. the shareholders. A feud between the two major shareholders has occurred over the past few years that worsened the corporate governance.

We continue discussions with Norilsk about their historical pollution and their plans to reduce it and clean up the area. For years, we were not comfortable with how they were handling the issue and with the overall corporate governance of Norilsk and have limited investment despite attractive valuations.

Vale SA - We have had ongoing discussions with Vale on their corporate governance and the use of cash. Vale’s desire was to be a bigger global player. As a result, they spent a lot of money on large-scale M&A and on investing in and developing greenfield projects in countries and minerals in which they had no expertise. We felt they overpaid for the acquisitions, many of which were in high risk countries (e.g., Guinea), and had not taken into account an appropriate level of risk when estimating project returns. They were entering into projects where they had no expertise and the expected returns were going to be lower than they expected and unacceptably low. We believed Vale was better off paying a higher dividend as these investments were unlikely to pay off.

We discussed these issues with Vale on numerous occasions over the years. In 2011, a new CEO and CFO came in that were much more inclined to focused on shareholder returns and receptive to this sort of discussion. Since then, Vale has changed the way it has behaved considerably for the better. Changes include a stated focus on generating shareholder returns vs. growth, revised factors for evaluating

projects, canceling or selling off of poorly performing projects, and returning cash to shareholders. We continue to monitor these changes and the strategic plans of management.

Tayside Global Diversified Value Portfolio – Engagement Examples, Third Quarter 2013

Royal Dutch Shell - A global oil and gas company engaged in such operations as the recovery of crude oil and natural gas, transportation of oil and gas, and production of base chemicals

Background: We engaged with Royal Dutch Shell to obtain an update on production outages occurring in its Nigerian operations due to sabotage and to understand any divestment plans. We learned that it intends to reduce its onshore exposure in Nigeria, but to continue to develop opportunities offshore where it is believed there is more value and the security is easier to manage.

Outcome: Royal Dutch Shell concluded that ensuring the integrity of the more mature onshore assets was only partially within its control. We determined that its development plans would not have a material impact to the financials of the company, but we did believe it was a sensible move by management.

Eni SpA - Primary operations include global oil and gas exploration and production, power generation, chemical manufacturing, and oilfield services.

Background: Discussions were held with management to gain insight into the supply disruptions and underlying political disputes in Eastern Libya. We learned that several different disputes were influencing production on different fields and terminals. However, the core issue is that this is an attempt by the Eastern region to gain more autonomy from Tripoli.

Outcome: Thus far, the disputes have been calm with no damage to installations or threat to Eni personnel. Nonetheless, we view this situation as potentially negatively impacting the company's outlook given that the problems appear unlikely to be resolved quickly.

APPENDIX 2

BAILLIE GIFFORD – SOCIALLY RESPONSIBLE INVESTMENT UPDATE

GLOBAL ALPHA FUND Q2

Intuitive Surgical

We wrote to the Compensation Committee Chairman ahead of the AGM to affirm our continuing support for the existing compensation policy. Option issuance under the Stock Option Plan has been relatively high in recent years as all employees are eligible to participate in the plan. We believe this is appropriate given Intuitive's current growth rate and dispersion of options throughout the organisation, but we outlined our expectation that the committee exercise discretion to ensure future awards are aligned with shareholders' interests. We will continue to engage with the company to encourage further improvements in its compensation policy.

Schindler Holding AG

We had a call with Schindler, the Switzerland-based lift and mobility devices company, to discuss safety and reputation. We encouraged the company to improve disclosure on safety and quality as we believe they are significant indicators in assessing the business. We were glad to hear Schindler is setting up a Corporate Social Responsibility team and will provide shareholders with a better insight into its activity with the publication of its first GRI-based (Global Reporting Initiative) report next year. We would also like the company to disclose information on its approach to managing bribery and corruption risk. The Head of Treasury assured us that the company is aware of the challenges and the low level of sales in certain countries demonstrates its stance against any bribery. We look forward to seeing improved disclosure efforts in 2014.

GLOBAL ALPHA FUND Q3

DIA

We initiated a constructive dialogue on remuneration with DIA, the Spanish hard-discount supermarket distributor. While we have no major concern with the current pay structure, we feel there are areas where it can be improved, notably to allow for the building of a significant share ownership for executives and employees. In our view, this is crucial to create a long-term owner culture at a time when DIA is expanding in new markets, and where managers and franchisees may have to sacrifice short-term profits to gain sustainable market shares. We also encouraged the company to identify a remuneration structure that is specific to its strategic needs rather than adopting 'standard practice'. Our discussions were a starting point for the company to design the new 2014 pay scheme, and we followed our call with a letter to the Remuneration Committee Chairman. We hope the company will take forward our recommendations and we are looking forward to further collaboration.

Naspers

We met Naspers, the South Africa-based media company, to discuss governance and succession planning. The founder and long-time CEO Mr Bekker had his tenure extended following the sudden death of the designated successor. We discussed the succession process and now expect the company to announce a successor in November. We fully expect Naspers to remain dynamic and entrepreneurial after the upcoming changes at senior level.

Richemont

Richemont contacted us ahead of its AGM. Historically, although we have always reviewed the AGM resolutions, we have not processed any votes because the shares would be subject to blocking, the situation whereby we lose the authority to sell shares between the date we process the votes and the day following the AGM. At the 2013 meeting, there was a proposal to move Richemont bearer shares into a registered form and therefore allow voting entitlements to be exercised without any blocking restrictions. This was obviously positive for shareholder rights. Following discussion with all the Baillie Gifford investment managers, we felt it was important to vote in favour of this resolution despite the fact that on this occasion the shares would be blocked. All resolutions were passed. The vote

brings Richemont into line with other large Swiss companies, reflecting the move away from bearer shares across Europe.

Ryanair Holdings PLC

We spoke to Ryanair prior to its AGM. The primary reason for our engagement was to see if the company would provide us with additional disclosure on its proposed share option scheme. Ryanair was unable to provide the required information and so we opposed the resolution. Around 33% of shares voted opposed the introduction of the new scheme. A separate matter that puts Ryanair in an interesting position is that, although it is not required by law or listing rules to provide a vote on the remuneration report, most large Irish companies do because this is deemed best practice. The company received a 13% vote against its Annual Report and Accounts, as other shareholders used this as a proxy for a vote against the remuneration report. We did not oppose the Annual Report and Accounts, but the vote is a significant one. We will follow up our initial engagement to encourage improved disclosure prior to the 2014 meeting.

Wellpoint

Wellpoint is an American healthcare insurance provider. We withheld our support for the executives' compensation at the 2013 annual general meeting as we did not believe the performance and vesting conditions attached to the long-term incentive plan were sufficient. Furthermore, we were strongly opposed to the inducement or 'golden hello' granted during the year to the new Chief Executive. During our conversations with management, we explained that we did not believe this to be a suitable or necessary use of shareholders' funds. The company was receptive to several of our suggestions for future amendments to the executive compensation policy. These included a simplified structure with increased disclosure of targets and performance assessed over an extended timeframe of at least three years. We are encouraged by the company's response to our concerns and recommendations and look forward to continuing our discussions on this and other governance issues.

UK PORTFOLIO Q2

Standard Chartered

We met the Standard Chartered Chairman, several other board members and the company secretary in April. The challenges for board members of international companies are increasing, particularly in the banking sector. They must stay up-to-date with global and regional regulation, ensure the company is exposed to controlled levels of risk, and make long-term decisions on the regions to which they want exposure. We discussed why anyone would want to be a non-executive director on a Bank's board, let alone be the Chairman of a Remuneration Committee as well as how easy or difficult it is to ensure the banks culture and values are known and understood throughout the organisation. An interesting meeting.

UK PORTFOLIO Q3

IG Group Holdings

IG Group offers spread betting and other financial derivative products to retail customers in the UK and international markets. The company has recently had a consultation about a new remuneration scheme. Initially it proposed 20% pay rises for the executive management. We were one of a number of investors that did not support the large increase and the re-balancing of remuneration towards fixed pay. This was subsequently reduced to a 7.5% pay rise with additional changes to the variable pay. The new scheme combines short and long-term schemes into one, has a five year performance period and pays out over eight years. It is innovative and company specific. One concern we had regarded the fact that the earnings target will be set annually. Following initial conversations, we met the Chairman of the Remuneration Committee who is also the Senior Independent Director to discuss this and broader governance questions. We understand the reasons behind setting earnings targets annually and will ensure we review these as they are disclosed. We are supportive of the new scheme.

FIDELITY - ENVIRONMENTAL, SOCIAL & GOVERNANCE REPORT (ESG)

OVERVIEW - Q2 2013

Below are highlights of environmental, social and governance issues noted by our investment teams in the last quarter:-

ENVIRONMENTAL

Subject - Arctic Mining

Background / Investment Case –

Although the oil and gas industry has been operating in the Arctic for almost a century, the global demand for natural resources
is rising and there is an increasing interest and competition in the area from international oil and gas operators. The region has so far been responsible for 10% of the world's discovered conventional resources and there is much more potential for production in the region. However, with this opportunity comes risks such as stringent regulations which may increase costs and cause production delays; court litigation potentially delaying drilling; territorial issues and internal politics; reputational risk of exploiting climate change; significant technical challenges resulting from oil spills; harsh weather conditions affecting machinery and health & safety procedures.

Regulatory Update –

• Greenland's new government is planning to ask foreign mining companies for royalties from the moment they become installed in the country rather than wait for fees stemming from profits from the mining in the region, although there is discussion that this policy may bring about a risk that these royalties could discourage investments in the region.
• Greenpeace has announced the launch of a whistle blowing site for employees in the Arctic drilling sector in order to encourage them to reveal the risks associated with offshore drilling activities in the Arctic region, and security risks in particular.
• The Arctic Council has announced that it has accepted applications from 6 new countries, namely China, India, Singapore, Italy, Japan and South Korea to serve as observers. Observer status is open to countries without any territory in the Arctic region, to intergovernmental and inter-parliamentary organisations and to NGOs. Their role is to participate in meetings and working groups, to propose projects to permanent members and to submit written statements to the various Council bodies. To date, 6 countries already have observer status, namely France, Germany, the Netherlands, Poland, Spain and the UK.
• In its most recent auction of licences to explore for hydrocarbons in Norway's northerly section of the Barents and Norwegian Seas, a total of 29 companies received stakes in the licenses. Statoil obtained the most permits: seven, three of which it will operate. OMV AG won six licenses, GDF Suez five, ENI SpA four, and Total SA, BP Plc and Lukoil OAO two each. Other groups receiving interests in licenses are Royal Dutch Shell, E.ON SE, RWE Dea Group, BASF subsidiary Wintershall Holding GmbH, Bayerngas GmbH, Centrica Plc, ConocoPhillips, Idemitsu Kosan Global and Lundin Petroleum AB.

Companies affected –

• China National Offshore Oil Corp (Cnooc Ltd.) has become the first Chinese oil company to make a play for oil in the Arctic after teaming up with Eykon Energy, a fledgling Icelandic group. The partnership plan to bid for an exploration licence off the northeast coast of Iceland.
• During the quarter, BP Plc announced that they will spend at least $1 billion to increase its Alaskan drilling activity over the next five years. BP credited its decision to Alaska's cut in oil taxes, including a 20% reduction in taxes collected for new oil produced. In addition, BP and its field partners – ConocoPhillips, ExxonMobil and Chevron – plan to invest $3bn to increase the production capacity at their projects in the Greater Prudhoe Bay Area of Alaska.
• During the quarter, FIL's ESG Specialist attended Royal Dutch Shell's SRI roadshow and at the event, the company acknowledged shortcomings in its due diligence procedures on the maritime transport aspect of its Arctic operations and that some of the equipment was not ready for drilling in reservoir areas in 2012. At the same time, the Company confirmed their long-term commitment to the Arctic region where it will invest $1bn in 2013 and has undertaken to review its procedures and intend to strengthen its collaboration with Noble and the coast guards before operations resume.
• FIL's Oils & Gas Analyst continues to monitor Shell and its peers' operations in the Arctic Region closely and engages with these companies on the issue.

Subject - Renewable Energy

Background / Investment Case –

The renewable energy market is an attractive investment opportunity, which is estimated to require significant capital investment over the medium to long term. Technological advances, oil price spikes, geo-political instability and climate change have all contributed to the need to find clean, green, renewable energy sources.
FIL's utilities analyst continues to monitor the introduction and impact of new legislation and regulations in relation to renewable energy.

Regulatory Updates –

- Europe's share of renewable power capacity will rise to more than 40% by 2020, spurring a need for additional back-up coal and natural gas plants. The EU's drive to generate 20% of its power from renewable energy by 2020 and cut reliance on carbon heavy coal and oil output is increasing the need for flexible back-up plants that can provide electricity during times of unfavourable weather when wind and solar output is limited.
- Germany will support building-up renewable energy in India by providing loans of up to €1bn for a 6-year period starting in 2014. The assistance is intended to finance joint development of technical solutions to overcome the problems facing the integration of power grids and to speed up the construction of power lines to efficiently transport electricity generated by renewable energy sources.
- Scotland has given the go-ahead for the world's largest wave energy project. At 40 megawatts, it will provide energy to nearly 30,000 homes. Last year, Scotland created a £18m Marine Renewables Commercialization Fund to assist commercialisation of the wave energy industry.
- The US Internal Revenue Service yesterday completed rules that define how wind-farm developers can qualify for tax breaks. According to the IRS, developers can qualify if they incur 5% of the total cost of the project and make continuous progress toward completion.
- During the quarter, President Obama released details of the US Government's Climate Action Plan. The plan aims to reduce carbon emissions, to prepare the US for the impacts of climate change and to lead international efforts to fight climate change and prepare for its impacts. The Obama administration aims to have the federal government consume 20% of its electricity from renewable sources by 2020. Among other actions, the plan also calls for:- preserving forests and reforestation to help mitigate climate change, an end to fossil fuel subsidies in the U.S. in 2014, working with partners worldwide toward this goal and encourages directs agencies to support local climate resilient investment.
- The United States, China and the European Union have had initial discussions on a possible "global" agreement to resolve solar energy disputes. This comes as the solar industry has been at the heart of trade disputes between China on the one hand and the US and EU on the other.

Companies affected –

- A unit of Honda Motor Co. Ltd in Brazil will invest approx $50 million in a wind farm. It will be built in the city of Xangri-la in Rio Grande do Sul and is expected to start running in September 2014.
- SSE Plc has announced that it is to move ahead with plans for a £30 million hydro-electric project in Scotland, confirming that construction work on the project will begin in the summer.
- Nippon Paper Industries Co. and Mitsubishi Corp. will build a 21MW solar power station in western Japan. The companies set up a JV in March and will begin construction of the plant in Tokushima prefecture this fall, Nippon Paper said in a statement today.
- Coal India Ltd, the world's largest coal mining company, says it will install solar across its operations to save on energy bills. By 2030, renewables are targeted to supply 11% of the energy in India. Going green would create 600,000 jobs in the country and could account for 3% of annual GDP.
- IDFC Ltd., India's biggest financier of clean-energy projects, will increase its investment in wind power, investing approx $44 million over the next six months in its Green Infra Ltd. Unit.
- Kyocera Corp. won a $90 million order for solar panels from a venture set up by Mitsubishi Corp. and a Japanese agriculture association. The Kyoto-based company will supply 30 megawatts of panels to be installed at 80 locations.
- Shanghai Electric Wind Energy Co., a Chinese joint venture of Siemens AG, plans to capture approximately 30% of China's offshore wind market by 2015. Siemens and Shanghai Electric Group Co. agreed to set up their venture in 2011.
- Siemens AG agreed to develop systems that convert waste industrial gases into fuel using technology from LanzaTech NZ Ltd. Siemens' Metals Technologies unit will collaborate with LanzaTech for 10 years to commercialize and market systems for the steel industry.

<u>SOCIAL</u>

Subject – Nutrition

Background / Investment Case –

Recent issues such as increasing attention from NGOs, growing interest around "fat taxes" globally and rising publicity on food and health will materially impact earning growth in the food industry and may see a strong positioning on health as a critical driver of continued growth in mature markets.

Update –

• FoodDrinkEurope and EFFAT (European Federation of Food, Agriculture and Tourism) have published a joint report in which they suggest that taxing the foods held responsible for causing obesity would ultimately be discriminatory. The document goes on to say that such a tax would pose a risk to the competitiveness of the European food industry, without doing anything to fight obesity. Lastly, there is no proof that a system wherein specific foods or ingredients are taxed would help reduce obesity rates among European consumers. Instead, FoodDrinkEurope and EFFAT both favour greater efforts by industry firms to encourage consumers to change their eating habits which they consider the primary factor in obesity.
• Denmark, the biggest supporter of food taxes, decided during the quarter to eliminate soft drink taxes. This represents a clear recognition of the inefficiency and negative economic impact of such measures. The tax on soft drinks is to be halved by July and completely abolished by next year,
• In the UK, new red warning logos will be marked on food that are high in calories and thus considered 'bad' for health under a new traffic light labelling system, as part of the anti-obesity drive to encourage healthy eating. The UK government will unveil the scheme that will signal products that are 'bad', 'medium' or 'good' for health. Food products high in fat, saturated fat, sugar and salt will be marked red. Amber and green will indicate foods deemed 'medium' or 'good' in terms of health value. The system will aim to reduce the £5.1billion a year expenditure by the government on obesity-related illnesses such as cancer, heart disease and diabetes.
• The Canadian Beverage Association reaffirms that education, not taxation, will be key to combating obesity, a complex health issue that shouldn't be addressed with simplistic solutions or used as an excuse for a tax grab. The President of the Association said punitive taxation of specific products such as beverages will not achieve this, while it will hurt Canadian families financially.
• The New York City Health Department is concentrating on sports drinks, teas and energy drinks that it says can be "deadly". New television ads and subway placards flash pictures of fruit-flavoured drinks containing added sugar, saying the healthier sounding choices can cause obesity and diabetes. Beverage makers have come under increasing pressure in recent years as officials try to curb high obesity rates in the U.S. by slowing consumption of sugary soft drinks.

Companies affected –

• FIL's Utilities Analyst continues to monitor ongoing regulatory changes and their affect on the following companies - Nestle SA, Unilever Plc, Danone S.A., Kerry Group Plc, Glanbia Plc, Aryzta AG.
• Coca-Cola Co. announced during the quarter that it will expand calorie labelling to the front of all packages and reiterated its pledge not to advertise to children under 12 anywhere, as the world's largest soft-drink maker steps up its fight against criticism that it is contributing to obesity. The company will also emphasize low- and no-calorie drinks in emerging markets.
• The Access to Nutrition Index (ATNI) assessment highlights the various policies implemented by 25 major food companies to combat obesity and under-nutrition. Among other aspects, the assessment shows that multinationals in Europe are doing better than their American counterparts in this area, and that Barilla SpA, Ferrerro SpA and Coca-Cola Co. still need to make a lot of progress. The three leading enterprises in the rankings are European, namely Danone SA, Unilever Plc and Nestlé SA.
• FIL's ESG Specialist attended a seminar discussing the Access to Nutrition Index and how investment managers can use the index as part of their responsible investment practices and to aid ESG integration.

Subject - Supply Chain Management

Background / Investment Case –

Organisations face a host of reputational, operational and financial risks resulting from insufficient management of ESG practices and their impacts in their supply chain. The global reach and operational complexity of supply chains has resulted in new risks to emerge, and the need for innovative solutions to address these risks. Supply chain risks exist throughout the entire life-cycle of products and services, from design, raw material input, production/manufacturing, and transportation to retail use and through end-use and disposal.
The danger to investors, in addition to practical issues in global supply chains, is that activist campaigns are spanning a wider range of products including high technology electronic goods. These campaigns can potentially cause reputational and brand damage, which may impact the company's valuation. FIL believes that effective supply chain management can potentially be a valuable way of securing a competitive advantage and improving organisational performance. For this quarter, FIL's ESG Specialist concentrated specifically on the supply chain issues linked to the Bangladeshi factory collapse in April.

Update – Bangladeshi Factory Collapse

• On 24 April 2013, an eight-story commercial building, Rana Plaza, collapsed in Savar, Bangladesh. The death toll reached 1,127 and approximately 2,500 injured people were rescued from the building alive. It is considered to be the deadliest garment factory accident in history, as well as the deadliest accidental structural failure in modern human history.
• The building contained clothing factories, a bank, apartments, and several other shops. Warnings to avoid using the building after cracks appeared the day before had been ignored. Garment workers were ordered to return the following day and the building collapsed during the morning rush-hour. It came after a series of deadly fires in that area already prompted activists to call for Western retailers to take more responsibility for work conditions there.
• At a meeting of retailers and NGOs a week after the collapse, a new Accord on Factory and Building Safety in Bangladesh was created. The accord is a five-year legally binding agreement between international labour organisations, non-governmental organizations, and retailers engaged in the textile industry to maintain minimum safety standards in the Bangladesh textile industry. The accord would require companies to pay suppliers more so factory owners could afford to implement safety upgrades.

Companies Affected –

• Wal-Mart Stores Inc is making its biggest push yet to try to improve conditions at factories that produce its clothing. The company said it would donate $1.6 million to help start a new Bangladesh training academy, and outlined its efforts to regain control over the complex and global web of factories that make its products. The company also announced it would make public safety inspections at all of its suppliers' authorised factories in Bangladesh, but labour groups say that measure falls short of what's necessary to ensure worker safety.
• The CEO of H & M Hennes & Mauritz AB said his company is considering sourcing solutions in Latin America, Central America and even Africa. This statement comes as those regions are currently facing growth. Finally, talking about the will of the company to continue to produce clothes in Bangladesh, the CEO said that if local suppliers respected the company's code of conduct they are willing to stay.
• Gap Inc's chairman and CEO said the company is ready to sign the sector accord designed to prevent another deadly disaster in Bangladesh's garment industry, provided there were some "very minor accommodations" which were not detailed. But IndustriALL, a union organisation based in Europe which helped create the pact, had said the agreement could not be amended to address concerns of U.S. companies.
• Primark, whose supplier Simple Approach occupied the second floor of the Rana Plaza building that collapsed in April, has begun the process of paying compensation to thousands of workers and their families who were involved in the Rana Plaza factory disaster, as campaigners said retailers must do more to protect workers' rights.
• Australian company, Kmart, will publish the addresses of factories it uses in Bangladesh, and other countries, enabling unions and independent groups to check working conditions. This level of transparency has previously tended to be resisted by Australian companies.

GOVERNANCE

Subject - Board Diversity

Background / Investment Case –

Recently there has been increased interest in board diversity and in particular, representation of women on executive boards. There has been growing recognition of the importance of including more women in strategic decision-making roles and the benefits that would be gained by businesses in doing so.
In the UK, the Lord Davies report (released in 2011) outlined a roadmap guiding businesses to achieve 25% female representation on boards by 2015. A more recent report released in March 2012 outlined how progress had been made due to an increasing number of women on FTSE company boards since 2011.

Update –

• The GMI Ratings' 2013 Women on Boards Survey includes data on 5,977 companies in 45 countries around the world and the results show that progress on most measures of female representation continues to be slow. Women now hold 11% of board seats at the world's largest and best-known companies, up 0.5 percentage points from a year ago and a total of only 1.7 percentage points since 2009.
• A report published during the quarter by the Cranfield School of Management indicating that the pace of women's appointments to UK boards is slowing in the 100 largest listed UK companies from 44% to 26%, whilst female appointments to the boards of the next 250 largest UK listed companies also fell from 36% to 29%.
• A "Balancing The Pyramid" project was launched by the UK's 30% Club and 16 companies to accelerate women's rise through the corporate ranks. It will collect data across firms to allow measurement of progress at all career points and devise new pre-employment initiatives to encourage young women at the start of their careers.
• The British government, which has staunchly opposed EU efforts to set gender quotas for corporate management, has warned it could introduce quotas if British companies fail to appoint more women to their boards.
• The French government is working on a draft bill to introduce stricter gender parity obligations. Some of the items on the agenda for this bill are female quotas for Boards of Directors will be extended to enterprises employing more than 250 people, and to public industrial and commercial establishments; Enterprises sentenced for breaching gender equality rules the previous year will be excluded from public sector tenders and contracts, and consideration

will be given when awarding public sector contracts to the ways in which bidding enterprises encourage gender equality within their organisations.
• The Bundestag in Germany rejected legislation during the quarter that would have set a 40% quota for women on corporate boards starting in 2023.
• During the quarter, the European Parliament backed the Commission's pledge to create binding rules to increase the number of women in top jobs, if member states have not voluntarily taken action to redress gender imbalance in the workplace.
• Tokyo Stock Exchange announced a revision to its "Corporate Governance Report" manual stating that it's listing companies should report on the current status or future plan of women directors and women executives in the company. Corporates are taking more tentative steps to get more women into Japanese boardrooms. Last month some 60 female board members and executives started a Japan chapter of Women Corporate Directors with the aim of providing role models in a market where women comprise just 1% of directors—the lowest in the world.
• Tokyo Electric Power Company recently promoted a female executive to be its first women director, although the move may have been affected by the fact that the troubled firm is effectively under government control.
• The Ontario government in Canada will work with the Ontario Securities Commission to consider the best way for firms to disclose their approaches to gender diversity, with a view to increasing the participation of women on boards and in senior management, bringing them in line with a US Securities and Exchange Commission requiring disclosure of board diversity policies.
• FIL's ESG Specialist attended various roundtable discussions regarding women on boards and is active in discussing this issue at company meetings.

OVERVIEW – Q3 2013

Below are highlights of environmental, social and governance issues noted by our investment teams in the last quarter:-

ENVIRONMENTAL

Subject - Shale Gas

Background / Investment Case –

Shale gas is natural gas that is found trapped within shale formations. Shale gas in the United States is rapidly increasing as a source of natural gas. Led by new applications of hydraulic fracturing technology and horizontal drilling, development of new sources of shale gas has offset declines in production from conventional gas reservoirs, and has led to major increases in reserves of US natural gas.
In the United States, surging oil and natural gas production brought on by hydraulic fracturing is lifting the economy by lowering energy costs for consumers and manufacturers, and the development of shale resources supported over 1 million jobs in 2012. Affordable domestic natural gas is considered essential to rejuvenating the chemical, manufacturing, and steel industries. The economic success of shale gas in the United States since 2000 has led to rapid development of shale gas in Canada, and, more recently, has spurred interest in shale gas possibilities in Europe, Asia, and Australia.
Environmental & Social issues -
Shale gas extraction raises concerns in relation to:
• carbon dioxide (CO_2) and methane (CH_4) emissions, particularly the potential for increased fugitive CH_4 emissions during drilling compared with drilling for conventional gas.
• the volumes of water and the chemicals used in fracking and their subsequent disposal.
• the possible risk of contaminating groundwater.
• competing land-use requirements in densely populated areas.
• the physical effects of fracking in the form of increased seismic activity.

Regulatory/Research Update –

• During the quarter, the U.K. government outlined plans to give tax breaks to companies involved in the UK's shale gas industry. It proposed cutting the tax on some of the income generated from producing shale gas from 62% to just 30%. But they have been criticised by environmentalists, such as Friends of the Earth and Greenpeace who added that communities affected by fracking faced a lot of disruption for very little gain. Britain's Prime Minister has given his unequivocal backing to the fracking process, he said fracking for shale gas could help reduce energy bills, create jobs and provide extra funds for communities where the resource is found.
• UK shale gas exploration would have a similar carbon footprint to other fossil fuels, according to a new study by the Department of Environment and Climate Change which estimates that greenhouse gas ("GHG") emissions would be similar to home-grown gas but lower than imported gas or coal.
• According to the first results of study on hydraulic fracturing communicated by the US Department of Energy, there is no evidence that chemicals from the fracking process contaminated drinking water aquifers at a Pennsylvania drilling site. The report concluded that low levels of methane found in samples were mostly from biological activity

inside shallow aquifers, not from shale gas production contamination.
• A recent wave of small earthquakes in Texas, U.S.A, was probably the result of extracting oil and in some cases water used for hydraulic fracturing, according to a study released during the quarter. Clusters of small-magnitude seismic events between November 2009 and September 2011 were often associated with fluid extraction. The study follows previous research that links earthquakes to the disposal of drilling wastewater by injecting it underground.
• California has passed a state law on natural gas fracking. Starting next year, the state's vast Monterey Shale reserve is officially open to regulated drilling where drillers must get a permit before they can frack and must notify neighbours. They must also monitor ground water and air quality, and disclose the chemicals they use.
• Amid a continued ban in France on hydraulic fracturing, a French parliamentary report concluded in June that France should ease the ban so it can estimate the size of its shale oil and gas reserves. However, French President Francois Hollande said in July he will not allow fracking.

Companies impacted –

• Repsol SA delayed plans to explore for shale gas in the north of the Spain, where the local government has outlawed drilling projects that use water-intensive hydraulic fracturing. Repsol's Luena project was licensed in 2011 for 6 years during which the company is required to invest at least EUR30mn in exploration. The company had targeted July 2013 to begin seismic studies at its Luena project that extends over 290 square miles across the Cantabria region, where Spain's richest shale gas deposits is expected to lie.
• Chevron Corp has obtained permits to explore for shale gas in Eastern Romania despite strong local opposition to fracking. The permits will allow Chevron to prospect in three villages in this rural area where thousands of people took to the streets to say "no to shale gas".
• GDF Suez SA is considering exploring for shale oil and gas in Germany, Poland, the U.K. and Latin America and the CEO recently said that they are adding Brazil and Chile to the list. GDF Suez's move into shale exploration would come amid a continued ban in its home country of France on hydraulic fracturing.
• Oil & Natural Gas Corp. and Oil India Ltd. have won the Indian government's approval to extract shale oil and gas for the first time. They will be allowed to tap shale resources in blocks allotted to the companies more than a decade ago. India is seeking to cut its energy import bill by 50% in seven years and to zero by 2030. Increased purchases of crude oil and coal have led to an unsustainable current account deficit and a slump in the rupee to a record low last month.
• FIL's relevant Analysts and Portfolio Managers actively monitor the evolution of the shale gas industry and the potential effects it will have on the environment and on society. In particular, one of FIL's Portfolio Managers has been looking in detail at the shale gas industry in the US and monitoring the new regulatory environment evolving in the country.

Subject – Shipping

Background / Investment Case –

Energy efficiency and the reduction in CO_2 emissions from shipping go hand in hand with sensible business practice, reducing fuel consumption saves on the bottom line. If vessels can be developed with lower energy consumption it is beneficial from an environmental footprint point of view and to the owners and operators.
Emissions from the global shipping industry amount to around 1 billion tonnes a year, accounting for 3% of the world's total GHG emissions and 4% of the EU's total emissions. Without action, these emissions are expected to more than double by 2050. This is not compatible with the internationally agreed goal of keeping global warming below 2°C, which requires worldwide emissions to be at least halved from 1990 levels by 2050.
The European Union and its Member States have a strong preference for a global approach to reducing GHG emissions from international shipping led by the International Maritime Organization (IMO). Considerable efforts have been made over recent years, within both the IMO and the United Nations Framework Convention on Climate Change, to reach such an agreement. In 2011 the IMO made progress by adopting the Energy Efficiency Design Index, which sets compulsory energy efficiency standards for new ships, and the Ship Energy Efficiency Management Plan, a management tool for ship owners.
However, the international discussions have yet to bring agreement on global market-based measures or other instruments that would cut GHG emissions from the international maritime transport sector as a whole, including existing ships.
EU governments have agreed that legislation to reduce emissions from ships will have a beneficial impact on human health. The European Commission has said that this could cost the shipping industry up to €11billion but is outweighed by the public health savings of approximately €30 billion.
Update –

• The European Commission recently set out a strategy for progressively integrating maritime emissions into the EU's policy for reducing its domestic greenhouse gas emissions. The strategy consists of three consecutive steps:
- Monitoring, reporting and verification of CO_2 emissions from large ships using EU ports;
- Greenhouse gas reduction targets for the maritime transport sector;
- Further measures, including global market-based measures, in the medium-to-long term.
• Campaign groups have accused EU decision-makers of weakening a regulation designed to end the practice of

beaching old ships in foreign countries, saying the new law offers loopholes to shippers and would unilaterally exempt European vessels from international rules barring the export of hazardous materials to developing nations. The EU regulation, obligatory for all member states, bans shipping companies from beaching European-registered vessels in coastal areas for dismantling. But under pressure from national governments, a Parliament-backed effort to require EU inspections of overseas facilities recycling ships was stripped from the legislation and exemptions were made for potentially toxic contents.

Companies impacted –

• Carnival announced during the quarter that it will invest over USD$180m in emissions scrubbers on around a third (32 ships) of its cruise ships to meet the air pollution standards set by the IMO, which will come into effect from 2015. To comply with new SO2 standards set by the IMO for 2015, ship operators can chose to either invest in scrubbers or switch to low-sulfur diesel fuels. FIL's Consumer Analyst has engaged with the company on this issue and views this news as a positive development and is a step forward for a solution to mitigate the expected impact from more stringent environmental regulations that kicks-in in 2015 and 2020.
• The CEO of AS Tallink Grupp says rules on sulphur emissions starting in 2015 will raise costs for ferries and cargo shipping. The new 0.1% cap for sulphur content in ship fuel in Emissions Control Areas will demand new investments from ship operators, and he said it is still not clear how companies will achieve the reduction. The CEO said price increases will have a greater effect on freight transport than passenger traffic, driving up the cost of goods to consumers.
• The CSL Group recently warned that environmental regulations are "insensitive" to short sea shippers and may have the unintended consequence of pushing the transportation of goods to the road and rail sectors.

SOCIAL

Subject - Nutrition

Background / Investment Case –

Recent issues such as increasing attention from NGOs, growing interest around "fat taxes" globally and rising publicity on food and health will materially impact earnings growth in the food industry and may see a strong positioning on health as a critical driver of continued growth in mature markets.
Food and beverage companies are acknowledging and adapting to changing consumer attitudes on the link between diet and health. Many companies are realising that it is wiser to invest now than potentially be forced to do so via future regulation and taxes.

Update –

• Recent studies in the UK have suggested that the amount of fresh fruit and vegetables eaten by lower income families plummeted during the recession, because of its high cost relative to mass-produced meals and fast food, and experts are worried about the effects on children and the obesity epidemic.
• The World Health Organisation (WHO) estimates that physical inactivity causes 6% of global deaths (3.2million) annually. It is also the main cause of 21-25% of breast and colon cancers, 27% of diabetes and approximately 30% of heart disease burden, as well as other health risk factors such as high blood pressure, raised blood sugar levels and being overweight. The problem is global, with 31% of adults considered to be insufficiently physically active, with women at highest risk and emerging markets at growing risk.
• Nearly 12% of Chinese adults (c114mn people) are suffering from diabetes, according to a new study published in the Journal of the American Medical Association during the quarter, making China's rate of prevalence of the disease higher than the U.S; and the highest in the world. The study notes that diabetes rates in China have risen dramatically over the past decades - while less than one percent of the Chinese population was diabetic in 1980 that number rose to 5.5% in 2001, 9.7% in 2007 and 11.6% today. The study also indicates that the prevalence of the disease has increased as economic development has given way to obesity.
• The economic benefits associated with cycling amount to €200bn a year, according to a new analysis from the European Cyclists Federation (ECF) that seeks to quantify the health, environmental, and commercial benefits associated with the recent boom in cycling participation. The group said the analysis highlighted the need for governments to invest more heavily in cycling projects that can deliver multiple economic benefits. It concludes that health benefits, including reduced mortality, are worth €114bn to €121bn a year, while fuel savings amount to €2.7bn to €5.8bn, CO2 emission reductions deliver €1.4bn to €3bn of benefits, and reduced air and noise pollution lead to €1.2bn of benefits.
• Mexico's President proposed during the quarter a sweeping overhaul of the country's tax system, intended to collect billions of dollars to finance new social programmes, including potential new taxes on carbon emissions and soft drinks. On the soft drink front, Mexico is second only to the U.S. in total soda consumption by resident. Mexico is struggling to contain an epidemic of diabetes (the number two killer) and recently overtook the U.S. for first place in a ranking of the world's most obese nations with populations of 100mn or more, according to a United Nations report.

Companies impacted –

• Danone S.A. said it is investigating claims that the company bribed hospital staff in China to use its products. According to press, Dumex (a Danone brand) allegedly paid doctors and nurses in the northern city of Tianjin to promote its baby formula products. The company has also recently been accused of misleading mothers with a marketing campaign in Turkey that warned they might not be providing enough breast milk to their babies and the company suggested mothers use its powdered baby milk to make up any shortfall. Danone says it based its advice on WHO guidance, and claims that both the WHO and the UN agency Unicef endorsed the campaign. But the WHO has demanded that Danone stop using its name and logo while Unicef has denied endorsing the company's actions. FIL's Consumer Analyst has been in dialogue with the relevant representatives in Danone about these issues and allegations and continues to monitor them in her analysis of the company.
• According to a report released by the Centre for Environmental Health (CEH) in the USA, PepsiCo Inc. is still using caramel colouring containing a chemical linked to cancer (as found in rodent testing) outside California. This comes more than a year after the company promised to phase it out to avoid the need to label the packages with a cancer warning following a California ballot initiative aimed at limiting people's exposure to toxic chemicals. However, the report of the CEH shows that some traces of that colouring chemical had been found in some Pepsi soda samples in several states across the US but never in California (where the complaint started). In response, PepsiCo said the modification for the rest of the United States would be completed by February 2014 and will take effect globally.
• Coca-Cola Co. launched an ad campaign during the quarter to reassure consumers about the artificial sweeteners used in Diet Coke. The ad defends low-calorie sugar substitutes in general and the sweetener aspartame in particular. The company has seen recent drops in sales of Coca-Cola with regular coke falling 1% and the diet option falling 3%. While most studies have found no link between aspartame and disease, one study found people who consume diet soft drinks are more likely to be obese and to suffer from diabetes and other diseases than those who do not.
• Campbell Soup Co. and the American Heart Association ("AHA") were sued by a consumer who claimed the AHA fraudulently certifies the company's products as healthy even though a can has at least six times more sodium than the organisation recommends, according to a complaint filed in federal court. Higher sodium levels contribute to elevated blood pressure, which can lead to heart attacks and strokes.
• Burger King Worldwide Inc. is launching a new crinkle-cut french fry that it says has about 20% fewer calories than its regular french fries. The company says a small order of the new product equates to 270 calories because of a new batter that doesn't absorb as much oil. By comparison, a small order of its regular fries has 340 calories.

Subject - Supply Chain Management

Background / Investment Case –

Organisations face a host of reputational, operational and financial risks resulting from insufficient management of ESG practices and their impacts in their supply chain. The global reach and operational complexity of supply chains has resulted in new risks to emerge, and the need for innovative solutions to address these risks. Supply chain risks exist throughout the entire life-cycle of products and services, from design, raw material input, production/manufacturing, and transportation to retail use and through end-use and disposal.
The danger to investors, in addition to practical issues in global supply chains, is that activist campaigns are spanning a wider range of products including high technology electronic goods. These campaigns can potentially cause reputational and brand damage, which may impact the company's valuation.
FIL believes that effective supply chain management can potentially be a valuable way of securing a competitive advantage and improving organisational performance.

Update –

• The group of 70 international retailers willing to improve safety among their suppliers' factories in Bangladesh has finalised a plan to conduct coordinated inspections of garment factories in the country. They will provide details of factories they source goods from, which will be inspected within the next nine months. Funds will be made available for any safety upgrades needed at the units. The implementation team, coordinated by Switzerland-based unions IndustriALL and UNI Global, said that all 70 signatory brands had to provide full details of the Bangladesh factories from which they source goods - the first time such data would be collected or shared in such a comprehensive way.
• Following the collapse of the clothing factory in in April 2013, the Bangladeshi government promised to present reforms aimed at improving working conditions in such plants. The new law adopted on 15 July comprises major changes, notably as it:
- Introduces the right to form trade unions without prior approval from the employer.
- Requires employers to devote 5% of their annual profits to a newly-created assistance fund aimed at improving employee living standards.
- Bans employers from transferring members of trade unions following industrial action.
- Bans employers from altering the structure of a building to install a machine.
• Violence broke out in Bangladesh during the quarter following demonstrations by more than 20,000 textile industry

workers demanding an increase in the minimum monthly wage to 8 000 Takas / month, i.e. €76 ($104), or more than double the current minimum wage of 3 000 Takas (€28.5). Around 500 clothing workshops have been forced to shut in the Dakar suburbs to limit the damage and at least 50 people have been injured, including 6 policemen. The police were forced to use tear gas to disperse the demonstrators who were threatening to smash up cars and damage the clothing workshops. The government is currently working on plans to reform this minimum wage and has indicated that it should present its recommendations in December, but the demonstrators consider this deadline to be too long.
• Chinese companies are increasingly designing sophisticated components for Apple's iPhones and iPads instead of just supplying low-cost labour for assembling the high-tech devices. The shift is an indication of how Chinese companies' rising technological capabilities are threatening the Taiwanese, Japanese and South Korean companies that now dominate the global electronics supply chain. There are very serious companies emerging in China that are beginning to see the pay-off of many years of rapid growth in their spending on research.

Companies impacted –

• Hewlett Packard ("HP") announced it is setting GHG reduction targets for first-tier supply chain partners involved in manufacturing and transporting products. The goal is for a 20% cut in GHG by 2020 from 2010 levels. HP has one of the largest supply chains in the industry.
• Hennes & Mauritz AB ("H&M") is working directly with the prime minister of Bangladesh to raise the minimum wages. The problem with raising payments to suppliers is that it is difficult to ensure this feeds through to workers. In addition, raising wages for textile workers too quickly can disrupt the labour market. If textile wages were to be raised in line with Human Rights Watch suggestions in Cambodia for example, this would mean a textile worker would make 3x more than a police officer. H&M believes that wage increases have to happen at central level and the company is also actively working to strengthen unions in the sourcing countries. This would also be neutral from a competitive perspective and easier to accept among apparel peers.
• FIL's ESG Specialist continues to monitor and engage with companies on their supply chain management and also continues to concentrate on the outcomes and repercussions of the Bangladeshi factory collapse in April.

GOVERNANCE

Subject - Board Diversity

Background / Investment Case –

Recently there has been increased interest in board diversity and in particular, representation of women on executive boards. There has been growing recognition of the importance of including more women in strategic decision-making roles and the benefits that would be gained by businesses in doing so.
In the UK, the Lord Davies report (released in 2011) outlined a roadmap guiding businesses to achieve 25% female representation on boards by 2015. A more recent report released in March 2012 outlined how progress had been made with an increasing number of women on FTSE company boards since 2011.

Update –

• The pay gap between men and women is exacerbated by bonus payments given to male managers which are on average double those for women, says the UK Chartered Management Institute (CMI). Male managers' average extra payments were £6,442 last year vs. with £3,029 for women. The CMI said their salaries were already almost 25% higher than women's. The CEO of the CMI said such practices will mean that businesses would lose out in terms of growth, employee engagement, and more ethical management cultures.
• Boardwatch UK recorded the first fall in the percentage of women on boards since the figures were first complied in 1999. The Lord Davies report in 2011 set a target for 25% women to be reached by 2015. The current representation is approximately 17%.
• The Voluntary Code of Conduct for Executive Search Firms (the "Code"), adhered to by many executive search firms, is to be reviewed. The Code was established in July 2011 on the recommendation of Lord Davies following his review into Women on Boards. The Code lays out steps for search firms to follow across the search process, from accepting a brief through to final induction, that aim to address gender diversity on corporate boards. The review will look to test the strength of the Code, develop areas of accountability, as well as identifying the practical changes that have been made to the recruitment process as a result of the Code. In particular the review will look at compliance with a specific provision of the Code; whether women account for 30% of the initial long-lists of candidates submitted to company Chairs by executive search firms.
• Shareholder advocates of greater board diversity will accelerate their push for a greater number of female directors going into 2014, according to the co-chair of the Thirty Percent Coalition's Institutional Investor Committee ("IIC"). To date, the coalition has been active in calling on nomination committees at firms with male-only boards to consider appointing female directors. In one sign of progress, IIC officials recently noted the appointment of female directors at eight companies, including QEP Resources, Noble Energy, Quanta Services, Riverbed Technology, Crane Co., LPL Financial Holdings, American Financial Group, and NetApp. During the 2013 proxy season, shareholder resolutions on board diversity were filed with 25 US companies, according to the IIC. Of the 25

shareholder resolutions filed, 18 have been withdrawn based upon mutual agreements, an important mark of progress in the work on board diversity. Three resolutions went to a vote at CF Industries, Urban Outfitters, and Freeport-McMoRan Copper & Gold, receiving support of 50.7%, 27.5% and 28.9% of votes cast, respectively.
• The recovering US job market has helped women rebound faster than men: They've now regained all the jobs they lost to the Great Recession. Men are still 2.1mn jobs short and the gender gap is expected to persist until the job market is much healthier. Lower-wage industries, like retail, education, restaurants and hotels, have been hiring the fastest and women are predominant in these areas. Men, by contrast, dominate sectors like construction and manufacturing, which have yet to recover millions of jobs lost in the recession.
• FIL's ESG Specialist monitors the regulatory environment in relation to diversity in general and engages with companies on their plans to increase their female board and senior management positions.