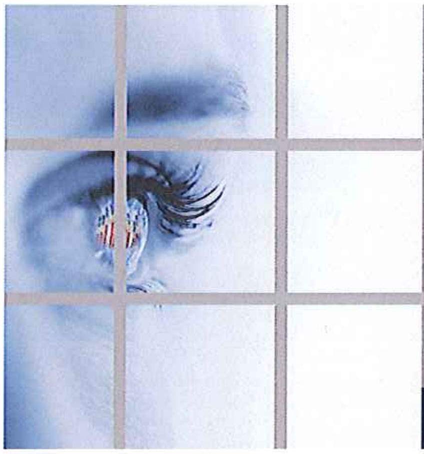


reo® viewpoint

Engagement Activity Report Q3 2011

Activity report: How *reo*® implements your responsible investment commitments

F&C's responsible engagement overlay is unique in the depth and breadth of its engagement, and in its ability to help clients implement their own commitment to responsible investments. Key features are:

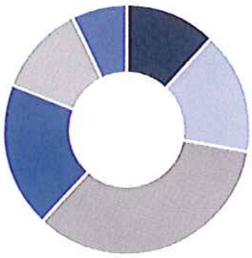
- A 18-person team of Governance & Sustainable Investment specialists, allowing full monitoring of the portfolios for environmental, social and governance (ESG) risks and the capacity for in-depth and prolonged engagement with individual companies where necessary
- Global engagement across all markets
- Comprehensive voting – F&C votes all of its clients' shares worldwide, as well as publishing the voting record each month.

Number of companies engaged this quarter

Programme name	Number of companies engaged
Corporate Governance	94
Business Ethics	46
Sustainability Management & Reporting	79
Environmental Management	31
Ecosystem Services	49
Climate Change	26
Labour Standards	55
Human Rights	32
Public Health	15

Total number of companies engaged[1] this quarter	209
Number of countries	36
Company meetings voted[2]	772

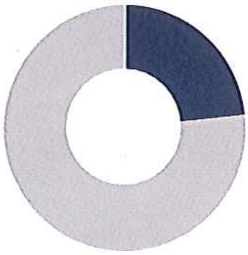
Geographical spread



UK	12%
Continental Europe	16%
North America	34%
Asia (ex Japan)	19%
Japan	12%
Other	7%

This chart shows the domicile of companies that have been engaged by F&C in the last quarter.

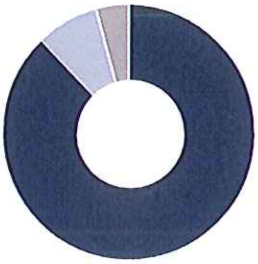
Number of company meetings



Board members[3]	18
Company representatives (non-board)	59

This chart shows the number of company meetings – both face to face and by telephone – carried out by F&C this quarter.

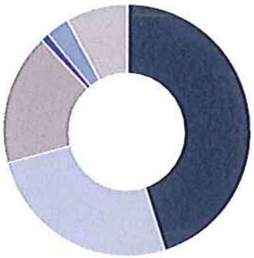
Resolutions at shareholder meetings



For	88%
Against	8%
Abstain	4%

This chart shows how F&C voted at shareholder meetings over the past quarter.

Reasons for Votes Against Management



Directors & Board	45%
Remuneration	26%
Capital	17%
Mergers/reorganisation	1%
Anti take-over	0%
Shareholder Proposals	3%
Other	8%

This chart shows the reasons why F&C has voted against management in the last quarter.

[1] Companies may have been engaged on more than one issue.
[2] i.e. company meetings for which F&C has issued voting instructions. This period covers 1st March to 31st May 2011.
[3] Includes Named Executive Directors in the US.

F&C Investments

reo® viewpoint

George Dallas, Director, Corporate Governance

October 2011

Banking as if the economy mattered

Summary/Overview

In an important fundamental review of the UK banking sector the Independent Commission on Banking (ICB) produced a report on 12 September 2011 for the UK government with recommendations that extend further than other recent financial reforms of the banking sector – with a view to reinforce the stability of the sector and make the state less vulnerable to costly bank bailouts. F&C contributed to this thought process, and is broadly supportive of the ICB's main recommendations:

1) to "ringfence" core retail banking operations from wholesale banking activities, and

2) to call for higher levels of capitalisation within the ring-fenced entities.

However, while F&C believes these are steps in the right direction, it has two principal concerns: first, we believe that these reforms require more fundamental changes in culture at banking institutions for the system to be fundamentally safer. Second, we are concerned that the proposed structural changes to the banking sector may make bank equities and bank debt less attractive as investment opportunities.

Does the structure of the banking system call for reworking?

The financial crisis of 2008 demonstrated very clearly how mismanagement within the banking sector can badly affect the global economy and financial markets – well beyond the banking sector itself. This crisis has prompted regulatory scrutiny and reflection in many jurisdictions. In the UK one such regulatory initiative was launched in 2010 by the new coalition government to establish a new body, the Independent Commission on Banking (ICB), with the mandate to review the UK banking system and consider possible structural changes to bolster its strength and stability. F&C believes that the issues raised by the ICB are relevant not only for the UK banking sector but also for banks in other jurisdictions more generally.[1]

F&C's perspective on banks as investors

F&C's submission to the ICB reflects its perspective as a long-term investor in the debt and equity of banks, both in the UK and globally. Importantly, it also reflects F&C's even greater investment activity in the non-banking sector, whose long-term success hinges on a robust banking and financial system. Given the ongoing economic challenges brought on by the recent financial crisis, F&C believes that the guiding objective of the ICB review should be promote the health and stability of the banking system for the benefit of the economy overall – not just for investors in bank securities.

At the same time, we recognise that in a competitive international market for capital, the health of the banking system depends on the existence of efficient, competitive and profitable banking institutions that are able to attract debt and equity capital from institutional investors. This implies the need for banks to be able generate adequate risk-adjusted returns for equity investors, and to remain acceptable credit risks for bondholders and other creditors. The financial stability objectives must therefore also take into consideration the need for banks to be competitive with other sectors in terms of attracting capital.

Structural reform/ring-fencing

F&C supports the ICB's proposal to ring-fence core retail banking activities in separately capitalised subsidiaries; this will not only protect those aspects of banking that are critical to the functioning of the economy, but should also ensure that taxpayer protection will be confined to these activities, while rightly excluding higher-risk activities that do not fulfil this systemically vital function from hidden cross-subsidy at taxpayer expense. F&C also agrees that ring-fenced entities should have a clear resolution scheme – to facilitate a smooth legal windup of failed banks – that can be activated when problems do occur. F&C believes that this combination of measures can contribute to a sounder banking system, and reduce – though not fully eliminate – the contingent liability that the UK government will assume on behalf of certain elements of the banking sector.

F&C believes this approach is preferable to reverting to complete separation for two reasons:

1) there are benefits to be gained from the synergies that exist within universal banking models, and it would be counterproductive to sacrifice these entirely if the benefits in terms of enhanced systemic stability do not warrant it; and

2) subject to this appropriate balance being struck in restricting risk in the banking system, UK banking institutions should be free to compete in a global banking market with universal banks from other jurisdictions

[1] The ICB published an Interim Report in early 2011, putting specific proposals on the table to address issues relating to the legal separation of traditional retail banking from wholesale banking to consider the levels of appropriate bank capitalization and to review the competitive environment in the UK banking sector. As part of this review process, F&C met with the ICB on two occasions in its capacity as member of the Investment Committee of the Association of British Insurers, and also made its own submission, focusing on ringfencing, capital requirements, "bail-in" of bank debt, and corporate governance in the banking sector.
Please see: http://www.fandc.com/FundNets_FileLibrary/file/co_gsi_submission_independent_commission_banking.pdf .

F&C Investments

The actual practice of ring-fencing requires considerable reflection on what specific banking activities should be included in, or excluded from, the ringed fence. The purpose should not be to eliminate risk but to protect those banking activities where UK enterprises, large or small, and retail customers have no other alternatives – and where the UK government may be an implicit lender of last resort. The financial relationship of the ring-fenced entity to the parent holding company will be critical for holders of both equity and debt securities, as will be the quality and frequency of the interaction of the distinct board of a ring-fenced entity with the board of the bank's holding or parent company.

Loss absorbing capacity/capital ratios

The ability of individual banks, and the banking system as a whole, to absorb losses is critical to the stability of the financial system. We note that the Basel III 7% baseline ratio of equity to risk-weighted assets has been challenged by independent economists, with some urging minimum levels as high as 20%. Against this, the ICB's proposal for a 10% requirement signals a recognition that internationally-negotiated levels may have fallen short of what is needed. We therefore agree in principle with the ICB's proposal for higher capitalisation levels for banks, particularly those with systemic importance, but question whether the 10% threshold is sufficiently robust. At this stage, there is clearly limited evidence to guide us as to what optimal capitalisation should be. However, we also have very real concerns about this figure being determined on the basis of consultation with the very institutions whose equity returns stand to be directly affected. For this reason, we urged the ICB to seek expert input from genuinely independent parties, and engage constructively with fellow regulatory bodies in key capital markets to achieve consistency of approach.

Such expert independent input will rightly recognise that an excessively stringent approach to setting capital requirements will result in overcapitalisation, which risks depressing equity returns for banks and limiting the banks' own lending activity. This can, in turn, compromise the banks' attractiveness for equity capital compared to investment in other sectors, and over time could reduce the financial flexibility – and thereby increase the risk – of the banking sector. This suggests that the optimal capitalisation of banks should reflect an equilibrium between greater loss absorption capacity that ensures systemic stability, while still allowing banks to remain competitive with other sectors in attracting equity capital.

Bail-in and the creditor's perspective

As a fixed-income investor, F&C understands that bank debt also stands to play a role in supporting the loss absorbency of the bank, and that creditors ultimately bear the residual risk of the firm. While both shareholders and creditors suffer the effects of a failed bank, F&C considers it essential that the hierarchy of the capital structure be given full respect in situations where "bail-in" may be required to keep a bank afloat. However, to the extent that unsecured bank debt takes on a role in the capital structure that has quasi-equity characteristics, this could have the effect of making this debt inappropriate for traditional fixed-income investment mandates that seek a more conservative credit profile. A wider use of bail-ins could therefore ultimately depress the supply of unsecured debt available for banks, or possibly steer traditional bank bond buyers in the direction of covered bonds.

F&C understands the merits of contingent capital in terms of the flexibility and loss absorbency it can provide to bank balance sheets, but would caution that the effectiveness of contingent capital as a buffer has yet to be tested in practice. The quasi-equity nature of this type of debt security may limit its appeal to many asset owners, and it is not clear to us whether the supply of contingent capital will be sufficient for it to play a meaningful loss-absorbing role in the capital structures of the UK banks.

There is more to a robust banking system than capital alone

While capital adequacy and balance sheet flexibility are fundamental concerns for banks, this should not be the only focus of regulators and investors seeking to ensure a safer financial system. Much will relate to good management and governance across a range of factors. In addition to greater protections from higher capitalisation and ring-fencing core banking activities, F&C believes that other factors are necessary to promote a more robust banking system. Ongoing concerns for investor engagement with banks include:

- **Liquidity and funding**
  A bank's asset/liability management and prudent use of non-core wholesale funding are critical to preserving liquidity and preventing confidence-sensitive runs on the bank. While direct oversight of funding is more in the purview of regulators than investors, investors should seek to engage with companies if they find the company's funding strategy to create undue liquidity risks.
- **Prudent accounting and risk-weighting**
  In an environment that calls for higher levels of risk-weighted capital, both regulators and investors will have to pay particular scrutiny to the process of asset risk-weighting to ensure it is done meaningfully and consistently throughout the banking system. Otherwise, there is the risk that higher nominal levels of risk-weighted capital could be gamed and that higher capitalisation requirements could lose their meaning. If there is undue discretion given as to what constitutes an appropriate risk weight for a given asset, this could render meaningless the denominator of the equity to risk-adjusted assets ratio. Investors will not have a direct line of sight to this risk weighting, but banks should seek to show transparency on their approach to risk adjustments. This should form an important part of the dialogue between banks and regulators, and regulators should seek consistency of risk weightings from bank to bank.
- **Management incentives**
  Considerable attention has been focused on bank remuneration levels in other regulatory reviews in the UK and European Union. While structural improvements have been achieved in terms of greater deferrals, more share-based remuneration and the introduction of clawback/malus provisions, F&C believes that additional steps can be taken to create remuneration structures that incentivise prudent behaviour by bank executives. Specifically, F&C has called for banks to adopt a credit quality underpin/precondition for variable incentive awards to ensure that a bonus be awarded only in an environment when the bank is maintaining an acceptable level of financial strength and credit quality.[2]
- **Risk management**
  Regulators and investors should monitor a bank's approach to risk management and seek to ensure that the bank is managing its financial, operational and reputational risks completely across the enterprise. In particular banks need to ensure that they capture appropriately relevant environmental, social and ethical risks as part of a holistic enterprise risk management system. These broader risks can relate to all aspects of banking, including lending, underwriting and product development activities, and if poorly managed, have the potential to cause disproportionate loss – for example through failure to address such risks as exposure to extreme climate-related weather events. This needs to be actively managed by bank executives and overseen as a matter of priority by bank risk committees.

[2] See F&C Viewpoint piece "Credit quality as a bonus underpin", February 2011: http://www.fandc.com/FundNets_FileLibrary/file/co_GSI_reo_Viewpoint_February_2011.pdf

Banking reform – are we there yet?

In sum, F&C supported the broad direction as outlined in the ICB's final report. However, we note that by not requiring full implementation by 2019, the impact of the report's recommendations on the structure of the banking system will not be immediate. F&C's broader concerns about overall bank management and governance, noted above, are a critical complement to the capital requirements-oriented approach adopted by the ICB. This will form the foundation of F&C's ongoing engagement with banks. Important in any new banking framework will be strong oversight by regulatory bodies. But we also believe that investors – both shareholders and creditors – have a role to play in complementing regulation through their engagement with banks on these subjects and by encouraging banks to strive towards best practice in a wide range of corporate governance issues.

They said...

"My Lords, in the words of Hunter S Thompson, banking is a 'shallow money trench ... where thieves and pimps run free and good men die like dogs'. As he is claimed to have said, it also has a negative side....Ring-fencing and increased capital will help in some way but they will not address the core failures of management and governance, which were at the heart of the banking failure."

Lord Paul Myners, address to the House of Lords, Financial Times, 15 September 2011.

We said...

"F&C believes that the guiding objective of the ICB review should be promote the health and stability of the banking system for the benefit of the economy... [however] the financial stability objectives of the ICB must therefore also take into consideration the need for banks to be competitive with other sectors in terms of attracting capital."

F&C Submission to the Independent Commission on Banking Interim Report, July 2011.

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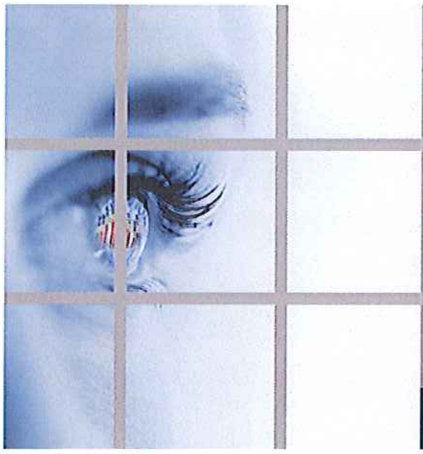

reo® viewpoint

Yo Takatsuki, Senior Analyst

October 2011

London must stand by Premium rules for Polyus Gold listing

Moving companies from Russia to Britain has become a well trodden path for oligarchs in recent years. The latest to do so are Mikhail Prokhorov and Suleiman Kerimov who made their billions from precious metals and are now transferring their mining business Polyus Gold to list its shares on the London Stock Exchange.

Newspapers say Polyus want entry into the gold-standard of U.K. listing. The "Premium segment" requires companies to have a high standard of corporate governance, shareholder protection, reporting and disclosure. Membership opens the doors for potential inclusion in the FTSE 100 index and all the advantages that brings with it of higher liquidity and better access to capital.

F&C Investments became concerned at reports that Polyus are seeking a waiver from the 25 percent free-float rule that's a Premium entry condition. With the powerful oligarchs owning most of the company, only 13 percent of equity will be available to the public. We are worried about the extent to which minority shareholders will be respected if the waiver was granted by the UK Listings Authority.

To have our opinion heard F&C wrote a letter to the Financial Times which was published on 19 October. We said "news that Polyus Gold is seeking a waiver of the 25 percent free-float minimum raises fresh concerns about the rigour of the listing process... Premium segments should be reserved for companies which are truly 'premium'."

Two days later there were reports saying Polyus will be increasing the size of its free-float from 13 to 20 percent. We think this is still not enough needed to safeguard minority shareholder interests. For example, it's less than the 25 percent threshold required to block a special resolution from the majority owners of the company that may be to the detriment of other shareholders.

As more and more overseas companies try to list in London, the distinction between the Premium and Standard segments takes on greater importance to investors. F&C wants the UKLA to do the right thing and stand by its rules for a Premium listing. We don't think the UKLA should relax its free float standards as a matter of principle for keeping the LSE's Premium segment at a high quality standard. We fear not doing so will risk the loss of many of the positive developments following listing regime reform last year. This is an issue we'll continue to follow closely.

F&C Investments

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reo® viewpoint

Eugenia Jackson, Senior Analyst

November 2011

Board diversity

F&C approach to board diversity and effectiveness:

- **Adding Value:** Boards should appoint directors whose individual expertise and diverse attributes add value to the company's strategy and the quality of board debate;
- **Making right choices:** A flexible approach with measurable diversity targets would enable companies to seek out and develop the best available talent within appropriate time-frames;
- **Diversity Beyond the Board:** Diversity must be addressed at all levels within the organisation. Only by investing today in the "pipeline" of tomorrow can companies hope to identify suitably-qualified board candidates;
- **Practice and Preaching:** F&C has adopted its own board diversity policy, and will encourage companies in its portfolios to adopt, actively implement and report publicly on a diversity policy across the organisation.

Board diversity and the "lost women" debate

The global financial crisis exposed a large-scale failure on the part of public company boards to provide sufficiently robust oversight and challenge to management teams. Critics zeroed in on the lack of effectiveness of many boards in meeting the necessary standards of judgment, critical thinking and openness. The spotlight quickly fell on how these boards' composition could affect their behaviour and therefore effectiveness: the main culprit was "groupthink" – a tendency for board members to yield to the group consensus at the cost of considering alternative courses of action – which resulted from excessive homogeneity – or conversely, inadequate levels of diversity.

As a result, the debate about the merits of boardroom diversity in corporate, political and media circles has taken centre stage. Diversity of perspectives and experience, including **professional experience, gender, psychological type, ethnicity** as well as **national, cultural and social background,** has risen up the agenda as regulators, boards and their shareholders increasingly regard them as key to achieving the right degree of challenge, fresh thinking and debate at board level.

The pace at which public company boards have improved their diversity – particularly of **gender** – over the last two decades can only be described as glacial. This has triggered a lively debate over the respective merits of "light touch" approaches, founded on encouraging equal employment opportunity, versus more radical regulatory solutions – viewed by many as heavy-handed and ultimately ineffectual – to force through immediate and visible change in public company boards.

In particular, a review of board diversity practices[1] led by former UK Minister for Trade Lord Mervyn Davies, commissioned by the UK government and published in February 2011, set out a clear business case for gender diversity on boards in four key areas: 1) improving performance; 2) accessing the widest talent pool; 3) being more responsive to the market; and 4) achieving better corporate governance. In addition, it drew attention to the **disproportionately "leaky" pipeline of female candidates,** which it argues is depriving companies of valuable talent at both management and board levels.

They said...

"Diversity in board composition is an important driver of a board's effectiveness, creating a breadth of perspective among directors, and breaking down a tendency towards 'group think'."

Guidance on Board Effectiveness, UK Financial Reporting Council, March 2011

Board diversity facts:

- Female representation on boards ranges from 3.6% in Asia-Pacific, to 6% in Emerging Markets, 9.6% in Europe and 11.4% in North America[2].
- In a 2010 sample of 340 Europe's largest companies, only 12.2% of directors were female[3]. By contrast, the international diversity of these boards stood at 27.8% on average, but varied significantly, ranging from 60% in Switzerland to 10% in Spain.

[1] *The Davies Review, Women on Boards*, UK Department of Business Innovation and Skills, 2011
[2] *The Davies Review, Women on Boards*, Department of Business Innovation and Skills, 2011
[3] European board diversity analysis 2010, Egon Zehnder International

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They said...

"Part of the challenge is around supply – the corporate pipeline. Fewer women than men are coming through to the top level of organisations. Part of the challenge is around demand. There are women in the UK more than capable of serving on boards who are not currently getting those roles."

***The Davies Review, Women on Boards,* Department of Business Innovation and Skills, 2011**

To address board diversity concerns, a number of countries, including **Norway, Spain, France, Iceland, the Netherlands, Belgium** and **Italy**[4], have resorted to legislation to force through higher female representation on company boards via the imposition of **quotas**. In some countries, these were supported by sanctions for non-compliance, and have proved effective in achieving a rapid increase in board gender diversity, with full achievement of 40% quotas in Norway and a doubling of the proportion of women on the boards of CAC 40 companies in France from 10.5% in 2009 to 20.8% in 2011[5].

Opposition to quotas, however, remains fierce: chief concerns include that they: 1) correct the symptoms, not the causes, of the problem; 2) risk putting compliance ahead of merit and competence, which may result in poor choices that compromise board quality; and 3) risk undermining the credibility of women and minorities appointed to company boards.

To counter such objections, many countries have opted for a "soft law" approach that seeks to embed recommendations on board diversity in **best practice guidance** for public companies (e.g. **Denmark, Finland, Poland and Sweden**) or requires **disclosure of diversity practices** and gender diversity initiatives (e.g. US). Finland and Sweden offer examples of particularly successful implementation of such voluntary strategies with over 25% female representation on corporate boards.

In September 2011, **Germany** introduced a **flexible quota** for listed companies that will come into force in 2013. The "flexiquote" system asks companies to triple the number of women on their governing bodies voluntarily, failing which the government will introduce mandatory quotas.

Australia and the **UK** have adopted an alternative approach based on **measurable diversity targets, increased transparency, and demonstrable efforts to drive change by companies and investors.** The ASX Corporate Governance Council's best practice principles[6] were amended to include recommendations in relation to **diversity policies, self-determined targets and progress reports** effective as of January 2011. As a result of the Davies Review recommendations, the UK Corporate Governance Code has been amended to require "a description of **the board policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving these objectives**" from October 2012[7].

Finally, the European Commission has made clear that **EU-wide quotas are being considered** if companies do not take voluntary actions to improve gender balance on boards[8].

F&C approach: Measurement is necessary, but what about quotas?

F&C believes that achieving high-performing, effective boards requires that the **objective of each board appointment be to enhance the range of talent, experiences and perspectives on the board.** Boards should appoint directors whose **individual expertise and contribution to the collective diversity of skills and perspectives** add value to the company's strategy and the quality of board debate. This approach is reflected in our submissions to the European Commission and the Financial Reporting Council[9], and our engagements with investee companies.

To this end, F&C believes that a **process driven by companies and investors, rather than purely by regulation, is more likely to be effective in addressing both the symptoms and causes of company-specific diversity challenges**. The key in any approach is whether it succeeds in changing behaviours and cultures, rather than just outwardly visible indicators. Mandatory measures, such as gender quotas, may in certain circumstances, be effective in jump-starting behavioural change, for example by bringing higher numbers of target population groups into certain educational fields. But we are concerned that an overly compliance-driven approach at board recruitment level may result in poor choices that compromise board quality, effectiveness and cohesion. A more **flexible approach**, where **desired diversity outcomes are framed in terms of aims, not quotas**, and recruitment priorities and practices are re-designed to value non-traditional attributes alongside traditional ones, would, in our view, enable boards and management to seek out and develop the best available talent within the time-frame deemed appropriate for their companies. We do recognise, however, that failure to demonstrate genuine progress through these softer measures will cause frustration to build up, and fuel ever-growing calls for quotas and other forms of regulatory compulsion. If nothing else, the threat of rigid rules should serve as a healthy spur to boards to think differently and innovate when it comes to searching out talent.

And meanwhile, the pipeline problem must be addressed as a matter of priority: even as they strive to diversify their boards, companies should be investing today in the senior managers and board members of tomorrow – though concerted policies to mentor, train and retain women and other under-represented minorities, encourage gender-neutral parental policies and support senior managers in pursuing external board service.

We said...

"... high-performing, effective boards are needed to oversee and challenge executive management and tackle "groupthink"... Key to achieving the right degree of challenge and fresh thinking is to ensure that boards have sufficient diversity of perspectives and experience, which may include diversity of gender, ethnicity and national background and professional experience, and that debate at the board level be actively encouraged."

F&C response to *EU Green Paper on Corporate Governance*, July 2011

[4] **Norway:** quotas introduced in 2006 and required 40% female representation by 2008; sanctions for non-compliance include fines and dissolution of a company.
Spain: quotas introduced in 2007 and require 40% female representation by 2015; no sanctions apply but companies reaching the quota will be prioritised for government contracts.
France: quotas introduced in 2011 and require 20% female representation by 2014 and 40% by 2017; sanctions include void board nominations and suspended board fees.
Iceland: quotas introduced in 2010 and require 40% female representation by 2013; no sanctions apply.
The Netherlands: 30% female representation both supervisory and management boards by 2016 on a "comply or explain basis".
Belgium: legislation on gender quotas adopted in June 2011, requiring 30% female representation on boards within 5 years for large listed companies and 8 years for the rest; sanctions range from the loss of benefits to the loss of office by all board members. The law requires approval by the Senate.
Italy: quotas introduced in 2011 and require 33% female representation on boards of directors and statutory auditors by 2015; sanctions range from fines to the loss of office for all board members.

[5] CapitalCom's survey into the boardroom gender mix of CAC 40 companies, June 2011

[6] http://www.asx.com.au/governance/corporate-governance.htm

[7] Feedback Statement: Gender Diversity on Boards, The Financial Reporting Council, October 2011 (http://www.frc.org.uk/publications/pub2646.html)

[8] The European parliament will decide in March 2012 whether to introduce EU-wide quotas for 30% women in decision-making positions by 2015 and 40% by 2020.

[9] See F&C website: http://www.fandc.com/new/Institutional/Default.aspx?ID=82073

Irrespective of what different governments do, F&C believes that companies will do best on diversity by focusing on:

- **Innovation:** By enhancing recruitment policies to reflect non-traditional attributes;
- **Inclusion:** By ensuring newcomers have the support they need to fulfil the demands of board service;
- **Transparency:** By disclosing details of board recruitment, evaluation and succession planning processes;
- **Accountability:** By disclosing the actions taken and progress achieved in meeting diversity goals; and
- **Pragmatism:** By demonstrating a connection between board diversity and overall employment policies to help drive change throughout the company.

They said...

"In order to achieve long-term success in a competitive international environment, companies need to draw upon a diverse range of perspectives and competencies that are relevant in a globalised business world. A diverse board, therefore, sends a robust and positive signal to investors that companies are confronting this challenge by ensuring they have the guidance needed in the boardroom to steer them through every stage of their development."

***Report on Board Effectiveness,* Association of British Insurers, September 2011**

F&C has adopted its own board diversity policy[10] and will continue to encourage its investee companies to:

- **Adopt and disclose a policy** on boardroom diversity;
- **Develop measurable targets and timelines** for implementing the policy;
- **Demonstrate positive efforts** to broaden the pool of eligible applicants;
- **Report on progress** made in achieving board diversity targets;
- **Report on experience, skills and diversity characteristics** of board members and candidates.
- **Adopt and actively implement a diversity policy across the organisation, and report on progress to investors and stakeholders.**

[10] See F&C website: http://www.fcamplc.com/default.aspx?id=98616

F&C Investments

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reo® viewpoint

Vicki Bakhshi, Associate Director, Governance and Sustainable Investment December 2011

The Durban climate deal: Keeping the show on the road

- Not much was expected from the climate talks at Durban – against such low expectations, it can be counted as a modest success
- The climate change deal keeps the international negotiations alive, and holds out the promise of bringing the US, China and India into a single deal for the first time. But timescales are slow, and levels of ambition remain way below what is needed to achieve the stated aim of limiting climate change to 2ºC
- The EU's progressive stance reinforces confidence in the region's commitment to meet its climate change goals even at a time of crisis
- Action at national level will continue to be the key driver for investment, and is happening on a faster timescale than the sluggish international process would suggest

Climate change negotiations over the past years have been characterised by political wrangling, late-night compromises – and ultimately last-minute agreements to kick the can to the following year's conference. Durban was no different, except that this was the end of the line: the Kyoto Protocol faced expiry in 2012. After coming close to collapse, a deal was salvaged in the early hours of Sunday morning, a day and half after the scheduled close of negotiations.

Key elements of the deal are:

- An agreement by all countries to work towards a global climate deal "with force of law" by 2015, to take effect by 2020 (the 'Durban Platform'). The wording on the legal force was the result of a hard-fought battle and it remains unclear exactly what the final compromise means
- The continuation of the Kyoto Protocol structure. Following the expiry of the current commitment period in 2012, a limited number of participants will take on targets for a second commitment period which will run from 2013 to either 2017 or 2020. The new deal will only cover the EU plus a few other nations, representing in total around 15% of global emissions. But as well as appeasing developing countries, the deal will safeguard the existence of key elements of the international climate change infrastructure, particularly the Clean Development Mechanism
- The launch of the Green Climate Fund, a structure that was first proposed at Copenhagen in 2009. The aim is to raise $100bn per year by 2020 from a range of public and private sources, with the Fund redistributing this to help finance climate change mitigation and adaptation in developing countries
- Technical developments in the Clean Development Mechanism and REDD+ (forestry) mechanism, although these fall well short of fundamental reform

A historic moment? The US, China and India come together

The most striking element of the deal is that the US, China and India all retreated from their previous standoff by committing to take on legally-binding commitments, breaking down the previous boundaries between developed and developing countries. While little has yet changed from an investor point of view – this is still only an agreement to hold more talks about talks – anything less would have dealt a damaging blow to confidence in climate change as an investment theme.

The decision by EU negotiators to agree to extend the Kyoto Protocol is also a strong signal that the region's commitment to climate change policy remains solid, despite adverse economic circumstances. The move will commit the region to legally binding targets, and is likely to improve confidence in its 2020 goals.

We will also watch with interest the creation of the Green Climate Fund, which has been established to raise and distribute up to $100bn per year by 2020. Although the details are thus far vague, we are hopeful that negotiators will work with the private sector to develop new mechanisms that can support the flow of investment into low-carbon solutions and into the finance of adaptation measures.

Too little, too late?

Clearly the timescale of the new negotiating track leaves a gap between the end of the first commitment period under Kyoto, which expires at the end of 2012, and the implementation of the new treaty in 2020. This gap is filled by a series of national and regional emissions targets for 2020, which were first submitted by governments ahead of the Copenhagen climate summit. Although they do not have legal force, the targets have a high degree of political authority and on the whole, governments are making efforts to achieve them.

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However, the commitments still fall well short of what is required to meet the internationally agreed objective of limiting the global temperature rise to 2°C from its present Business-As-Usual course of up to 6°C. Collectively, these targets get only about half-way to what the science tells us is needed to achieve the 2°C goal. Unless the level of ambition is raised, the world will be committed to a global temperature rise of 3°C or more.

The reports of the Intergovernmental Panel on Climate Change, including the analysis in November 2011 of the implications of climate change for severe weather events, make it clear that change on this scale would have significant implications for life, potentially including extreme heatwaves and droughts, the spread of tropical disease and more severe storms. This will serve to exacerbate existing stresses on the key resources of water, food and energy imposed by a world of 7 billion people[1]. Recognising the inevitability of the changes ahead, F&C will be questioning companies about how they plan to adapt to a world of more extremes of climate and ever tightening resource constraints.

The slow timescale of the Kyoto negotiating track reinforces our previous view that what now matters is domestic politics, not international talks. Identifying the investment opportunities arising from climate change requires a detailed understanding of policies at the regional and local level. F&C's belief is that these opportunities remain significant, with governments globally still committed to reducing emissions and improving the energy intensity of their economies, as well as meeting related goals such as greater energy security.

[1] See also 'Hungry Planet', F&C Viewpoint, June 2011

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