



Shropshire County Council

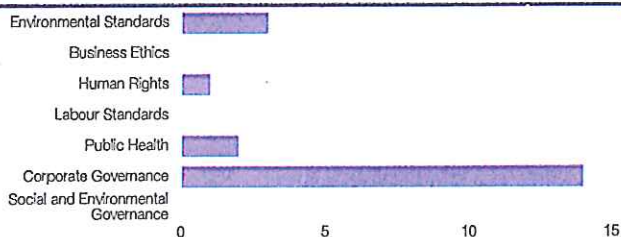
Responsible Ownership Activity Report Q2 2013

The purpose of the **reo**® (responsible engagement overlay)* service is to engage with companies held in portfolios with a view to promoting the adoption of better environmental, social and governance (ESG) practices. The **reo**® approach focuses on enhancing long-term investment performance by making companies more commercially successful through safer, cleaner, and more accountable operations that are better positioned to deal with ESG risks and opportunities. Through a combination of constructive dialogue and active share voting, **reo**® works to drive behavioural change with companies, and records successful outcomes as 'milestones' – changes in corporate policies or behaviour following intervention.

Companies engaged this quarter

| | |
|---------------------|----|
| Companies engaged | 32 |
| Milestones achieved | 20 |
| Countries covered | 1 |

Milestones achieved by issue



Companies engaged by country



Companies engaged by issue**



* **reo**® is currently applied to £82.1 billion (€97.1 billion / \$124.7 billion) of assets as at 31 March 2013

** Companies may have been engaged on more than one issue.

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After the Rana Plaza disaster: Transforming factory safety in Bangladesh

With the death toll from the Rana Plaza factory collapse on 24th April reaching over 1,100 people and many factories closed following social unrest, the retail sector is facing intense public pressure about whether the demand for low-cost clothes production has led to irresponsible business practices. The collapse of Rana Plaza is the latest in a string of disasters in Bangladesh, with a major fire in the Tazreen factory having claimed over 100 lives in 2012. Since F&C started engaging the apparel sector on supply chain labour standards in 2000, there have been clear improvements in policies and practices, but these accidents indicate the depth of the problem. As well as the human cost, such events have a business cost in terms of reputation and supply interruption, particularly for high-profile brands vulnerable to a consumer backlash. We have drawn on the expertise of our Governance & Sustainable Investment team members covering the USA, Europe and Asia to speak to companies and independent experts to analyse the problem, and to encourage companies to take further steps to mitigate future risks.

Causes of the accident: F&C analysis

Poor practices in the Bangladesh garment industry are nothing new. Controversies over health and safety standards and workers' rights have persistently plagued the sector. To understand the root causes of the Rana Plaza disaster, and broader weaknesses in safety standards in Bangladesh, we spoke with local experts including Transparency International Bangladesh and labour consultancy Impactit, as well as companies that sourced from Rana Plaza.

Our findings are that:

- Company understanding of the risks relating to structural problems with buildings has traditionally been weak. Risk management systems have not to date been designed to identify and correct problems with the integrity of buildings in Bangladesh, where there has been an upsurge in high-storey, mixed-occupancy buildings.
- Weak government institutions in Bangladesh are a significant barrier to change, with anti-corruption and other laws routinely flouted by factory owners and in the construction industry. The Rana Plaza factory was allegedly erected on land gained through an opaque land deal, made of poor quality construction materials, with inadequate foundations and provisions for a high-storey building that would be used by a large number of workers and that needed to bear the weight and vibrations of sewing machines and generators.
- Undue political influence of the Bangladeshi textile industry is perceived by some as an obstacle to improving labour standards. The industry is suspected of lobbying against trade union rights, minimum wage increases and other changes.
- Weak mechanisms exist to receive and act on workers' safety concerns. Although some companies have mechanisms to encourage

worker-management dialogue in the absence of trade unions, at Rana Plaza workers did not have influence over factory management to ensure safety concerns were acted on.

All these combine to create an unacceptable level of risk for low-paid workers operating in this industry.

Company practices in Bangladesh

In 2012, as part of our engagement project on migrant worker labour standards, we contacted a number of major international brands and asked for details of their management systems in this region. Overall, their responses indicate that leading companies already have programmes covering certain risk areas such as fire safety, and are deeply aware of the need for industry collaboration to raise the bar. However, few indicated existing programmes aimed at addressing structural problems with buildings in Bangladesh. Examples of good practices highlighted by companies include:

| Company | F&C findings* |
|---------------------|--|
| Abercrombie & Fitch | Runs a specific action programme focused solely on improving fire safety in factories in Bangladesh. |
| American Eagle | Collaborates with local Bangladeshi organisations and other companies to support a country and industry-wide solution to enhance safety. |
| H&M | Requires all factories go through an electrical assessment; H&M shares this cost with the factory. |
| Levi Strauss & Co | Does not source from factories located in multi-storey buildings with multiple owners, due to lack of control over fire safety and evacuation procedures. All suppliers in Bangladesh must undergo a third-party electrical safety audit. |
| Under Armour | Participates in a fire safety task force as part of the American Apparel & Footwear Association. It has supported fire safety training for all of its assembly-level suppliers through Worldwide Responsible Accredited Production (WRAP). |

* This information was collated after the Tazreen fire, but before the Rana Plaza disaster. We welcome companies providing us with further updates on their practices in Bangladesh.

Other brands we spoke to had taken the active decision to not source from Bangladesh for reasons including poor conditions.

F&C action following the Rana Plaza factory collapse

In the aftermath of the accident, we have been engaging with one of the companies directly affected, **Associated British Foods (ABF)**, as well as pressing for a broader, industry-wide response to the underlying causes of safety failings across the country.

Associated British Foods

Less than a month after the accident, F&C held an in-depth meeting with the Company Secretary of ABF, a company that sourced from the Rana Plaza factory for its Primark stores. At this meeting, we asked the company to outline how the board reviews supply chain risks, and whether the company had already identified risks relating to building safety at Rana Plaza and at other factories in Bangladesh. We asked about allegations that workers at Rana Plaza had voiced concerns about the safety of the factory, but were ignored by the factory owner and required to return to work. We discussed solutions for the deeply entrenched problems in Bangladesh, including the question of whether companies should source from the country at all, and the prospects for effective industry action to raise labour standards and governance.

Overall, our assessment is that ABF's board is committed to improving factory labour standards in Bangladesh, but needs to review how the board and management can be alerted to significant safety risks earlier and have better oversight of what is happening on the ground. The company has a six-strong team based in Bangladesh focusing on sourcing practices, but indicated that until recently, companies have paid insufficient attention to the structural risks of buildings, with more effective mechanisms needed to ensure workers do not feel compelled to work in dangerous conditions. We are pleased that the company was among the first to come forward and accept 'moral responsibility', committing to compensation for victims, and that it will continue to source from Bangladesh and improve practices. In 2013, we will monitor closely how ABF creates real improvements in its risk management and supply chain practices, and will meet the company again to assess the progress made.

ABF has also indicated its commitment to co-operative industry action and was the first British company to support a new multi-stakeholder initiative, the Accord on Fire & Building Safety in Bangladesh – see below.

Industry-wide response

Given the scale of the changes needed, we wrote to the Ethical Trading Initiative (ETI), a UK-based multi-stakeholder initiative whose members include global companies, urging its board and members to consider a new industry-wide initiative on safety. We encouraged the ETI to ensure such an initiative is both ambitious and implementable, given the local context of weak governance and institutions.

We also signed a collaborative investor statement, endorsed by 16 institutional investors representing \$1.3 trillion in assets, calling for stronger supply chain risk management in light of events in Bangladesh¹; and wrote to the President of the Bangladesh Garment Manufacturers & Exporters Association, encouraging local industry support for better labour standards.

ETI's response has been to call on members to support the new Accord on Fire & Building Safety in Bangladesh². This Accord is underpinned by ILO Convention 155, whereby workers have the right to refuse dangerous work. Although the jury is still out on how effective this initiative will be, it marks an important step forwards for ABF and the industry. Crucially, the Accord is binding. It requires companies to conduct fire and safety inspections, factory repairs, establish worker-led health and safety committees,

collaborate with labour unions, and stop doing business with factories that do not make improvements. Although much work is still needed to make the Accord 'implementable,' the growing list of signatories sends a strong signal that companies are more focused on labour standards and will use their influence to improve conditions in Bangladesh.

At the time of writing³, the companies listed below had announced their support for the Accord, covering more than 1,000 Bangladeshi garment factories:

| | | | |
|---------------------|-------------|-----------------|-------------|
| Abercrombie & Fitch | USA | Mango | Spain |
| Aldi | Germany | Marks & Spencer | UK |
| Benetton | Italy | Mothercare | UK |
| Bonmarche | UK | N Brown Group | UK |
| C&A | Germany | New Look | UK |
| Carrefour | France | Next | UK |
| Charles Vögele | Switzerland | Otto Group | Netherlands |
| El Corte Inglés | Spain | Primark (ABF) | UK |
| Esprit | Hong Kong | PVH | USA |
| G-Star | UK | Rewe | Germany |
| H&M | Sweden | s.Oliver | Germany |
| Helly Hansen | Norway | Sainsbury's | UK |
| Hess Natur | Germany | Stockmann | Finland |
| Inditex | Spain | Switcher | Switzerland |
| jbc | Belgium | Tchibo | Germany |
| John Lewis | UK | Tesco | UK |
| KIK | Germany | V&D | Netherlands |
| Lidl | Germany | WE Europe | Netherlands |
| Loblaws | Canada | | |

Support for the Accord, however, has not been universal, with many US companies balking at the binding nature of the agreement. F&C is arguing that if companies choose not to sign, they must make sure equivalent measures are in place. One such company is **Wal-Mart**, which F&C has engaged for over a decade on a range of issues including supply chain labour standards. Wal-Mart has significant influence with its key suppliers to improve practices in markets it sources from.

Following the Tazreen factory fire, the company announced a \$1.6 million donation to the Institute of Sustainable Communities to establish the Environment, Health and Safety (EHS) Academy in Bangladesh. It also adopted a 'zero-tolerance' policy on unauthorized subcontracting after its products were discovered in the ashes of Tazreen to the company's own surprise. In the wake of the Rana Plaza collapse, the company announced a unilateral plan to help raise safety standards in Bangladesh, including inspections of all its factories and disclosure of the results within six months. It will assess electrical systems using thermal circuit imaging to identify flaws and would also review building design and permits to identify collapse hazards. We are pleased to see these new public commitments, though they lack the enforceable and collaborative nature of the Accord, and will press for strong implementation through our collaborative investor engagement in the US. F&C has also encouraged French retailer and bond-only issuer **Groupe Auchan** to sign the Accord.



¹ https://www.amalgamatedbank.com/home/fiFiles/static/documents/Join_investor_statement_re_Bangladesh_51613.pdf

² For the full Accord text see: http://www.industrial-union.org/sites/default/files/uploads/documents/2013-05-13_-_accord_on_fire_and_building_safety_in_bangladesh_0.pdf

³ Companies list as at 20 May 2013

Bangladesh – are the risks too high?

Bangladesh is an exceptionally difficult operating environment. With 4 million people employed in the garment sector – mainly women working for a minimum wage of £25 / €30 a month with weak trade union rights – sourcing in line with international labour standards is a real challenge. The high levels of corruption and entwinement of business with politics are additional complicating factors. At the time of writing, the Bangladeshi government had announced a relaxation of certain laws meaning there may be stronger protection of freedom of association for workers, and is also reportedly considering a change in the minimum wage. Nevertheless, it is unclear to what extent workers can rely on government bodies to protect trade union rights and their livelihoods. The social unrest and factory closures in the wake of the Rana Plaza collapse raise significant challenges for local suppliers in meeting production targets, with an imminent local election bringing further short-term political risks.

In the wake of the latest accident, the European Union has warned that it may review the system of preferential treatment whereby Bangladesh receives duty-free and quota-free access to all exports into the EU. Changes to the arrangement might impact large multinational retailers that benefit from cheap imports of Bangladesh-made products. UK-listed companies meanwhile face legal risks if they fail to meet the requirements of the new UK Bribery Act, under which companies can be found guilty if one of their suppliers is paying bribes to obtain or retain business with them, and if they cannot prove they have adequate procedures to prevent such conduct.⁴

Walt Disney most recently announced it is cutting ties with the country. Companies that plan to continue sourcing from this region insist that it is possible to source responsibly manufactured goods from Bangladesh, and that the responsible thing to do is to stay in the country and engage with suppliers and factory owners to drive up standards.

F&C's view is that presently, there are significant reputation risks for companies sourcing from Bangladesh; boards need be alert to these and encourage strong and effective action by management to mitigate these risks.

Will things improve in Bangladesh? F&C assessment and next steps

The Rana Plaza factory collapse indicates companies must take urgent action to protect workers' lives and security of supply. There are significant risks for companies that turn a blind eye to challenges in Bangladesh. We cautiously welcome the new Accord on Fire & Building Safety in Bangladesh and encourage companies to support it. For companies that feel unable to sign the Accord as it is, we encourage them to consider how they can best ensure strong controls are in place for building safety and solutions needed to protect workers from unsafe conditions.

Over the period since the factory collapse, company reputations have been in the firing line but the share prices of many of the companies sourcing from Rana Plaza have not reflected the risks of sourcing from unsafe factories. This reflects many factors – including the failures of financial markets to sufficiently factor in supply chain risks.

As a responsible investor, we will actively seek to build a better understanding of the risks in the supply chains of companies we invest in, and will engage with companies to protect their reputations and the value of our investments.

If you would like further details on the information in this note, please contact your **reo**[®] client director.

⁴ For more information on the UK Bribery Act and the Ministry of Justice's guidance please see <http://www.legislation.gov.uk/ukpga/2010/23/contents> and <http://www.justice.gov.uk/guidance/docs/bribery-act-2010-guidance.pdf>.

Agricultural Commodities and Sustainable Investment: Cultivating Sustainable Practices in the Agricultural Value Chain

Food price inflation and volatility has had a major impact on the global economy. It has caused disruptions to world trade, driven acute inflationary pressures in both developed and developing countries, and had wide-ranging social impacts, particularly on low-income consumers.

The impact has also been felt by institutional investors, who can be exposed to commodities in a number of ways. The most obvious is investing in financial instruments such as commodity-based exchange traded funds and other derivatives. This type of investment has led to claims that investors are exacerbating commodity price inflation. A second route is direct investment in productive assets (such as farmland), which has proven increasingly attractive; Initiatives such as the Principles for Responsible Investment in Farmland have sought to provide guidance on how to ensure such investments are genuinely sustainable. The 2013 G8 summit¹ focuses on transparency surrounding land investments in countries where opaque land deals and complex systems for land registration facilitate corruption, ignore citizens' rights and undercut legitimate businesses seeking access to land for productive investment.

Whilst these types of participation by financial actors have been the subject of intense scrutiny, less attention has been paid to the exposure investors have through their holdings in listed equities and bonds along the agricultural value chain. Such investments make up a sizeable proportion of portfolios, with the food, beverage and food retail sectors constituting almost 7% of the benchmark MSCI All Country World index. F&C has undertaken engagement with 50 companies across the agricultural value chain over the past 18 months, and we heard almost universal consensus that global food security was a material issue to companies, presenting significant risk at some points of the chain, and sizeable opportunity at others.

Through identifying those companies best positioned to benefit from the risks and opportunities, and engaging companies and policymakers to better manage these, we believe an important contribution can be made to long-term investor value.

Background

Scrutiny of the root causes of food price volatility has been especially intense following the commodity price peaks of 2008, and more recently 2010-2011 and 2012. The World Bank estimated that the peak of 2010-2011 alone pushed a further 44 million people into extreme poverty. Even though media attention has tended to centre on the role of investors in contributing to the turbulence, the reality is more complex and consensus has yet to be reached on the exact impact of different variables and whether relationships are causal, consequential or incidental.

The impact of short-term commodity price volatility on food security needs to be viewed within the context of long-term economic, demographic and climatic 'mega trends' which are reshaping the very fundamentals of supply and demand. The world population is projected to top 9 billion by 2050 and urbanisation is continuing to accelerate with 70% of the global population expected to live in towns and cities by 2050. Estimated income levels will be many multiples of today's levels and there will be 3 billion new middle-class consumers by 2030²; as a result of these trends demand for the modern diet is increasing. The increasing unpredictability of weather as climate change progresses, as well as competition for food and biofuel/biomass crops, adds further to the pressures.

In order to feed this larger, more urban and affluent population, the UN Food and Agriculture Organisation (FAO) estimates that food production (net of food used for fuel) needs to increase by 70%. To achieve this, the FAO suggests that net investments in developing country agriculture must increase to a staggering \$83 billion per annum. This will require a major reallocation of national budgets and the development of policies that encourage and reward farmers and other private participants in the value chain to increase investment, including infrastructure development for storage, refrigeration and transportation.

¹ F&C is attending the main pre-Summit event on 15 June to testify on the need for greater transparency of agricultural investments in developing countries.

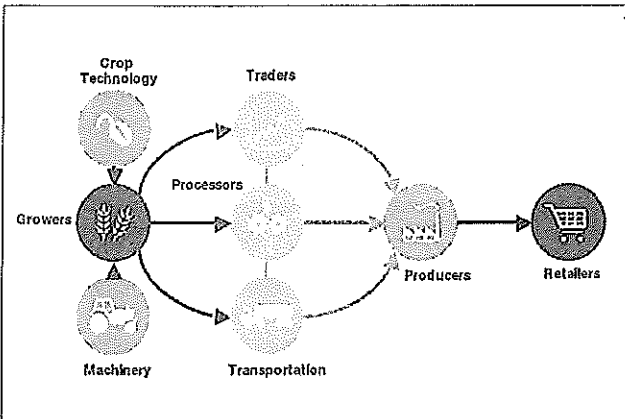
² See, for instance, "Resource Revolution", McKinsey, 2011.

F&C engagement

In 2012 F&C wrote to 50 equity and bond issuers that own, trade or have business models highly dependent upon agricultural commodities. We had a high response rate of 80%, and engaged in in-depth discussions with 29 companies. We chose companies primarily for their sensitivity to commodities markets and our *reo*[®] clients' exposure.

The companies span five key categories:

1. Growers
2. Crop technology & machinery
3. Traders, processors & transportation
4. Food producers
5. Food retailers



In each of the five categories, our discussions allowed us to identify examples of good practice which demonstrate how some companies are capitalising on the business opportunities in the market, or minimising commodity-based risks relative to their peers. Our sector-specific recommendations are detailed in our full report.

Key findings

Through our engagement, it was clear that supply and price uncertainties are seen as material drivers of performance for companies along the entire whole agricultural value chain. Interruptions at one point of the chain have a knock-on effect for all participants, and no single company or sector can entirely control the risks. However, the risk/opportunity profile of exposure to these uncertainties varies across the chain. Some companies are primarily focused on managing downside risk, whilst others are able to exploit significant business opportunities.

- **Growers** are at the sharp end of the food chain, having to manage the operational risks of growing food in an uncertain physical and pricing environment. Their ability to manage risks is influenced, in part, by the implementation of effective farming techniques, such as efficient soil and water management, and access to technologies, such as mobile data services and new seed varieties.
- **Crop science and machinery companies** are set to benefit from food security concerns, as they offer solutions to enhance yield, improve efficiency and respond to challenging operating environments. They face challenges in adapting their business models to find a commercially viable way to meet the needs of large numbers of small emerging market farmers, transitioning from their historical focus on large developed market operators.
- **Trading houses** provide risk management services and price protection tools to other players in the chain, such as food producers. These services tend to be in high demand in periods of price uncertainty. The same players also profit from arbitrage opportunities that result from market volatility and regional disparities – although this can put them at the centre of controversy. **Processing and transportation** are essential in ensuring the smooth operation of markets; here too there are growth opportunities through efficiency and infrastructure improvement.
- **Food producers** are highly exposed to price and supply chain risk. They have to ensure they get a relatively stable and good quality supply of agricultural raw materials; mitigate the impact on their bottom line and cash flow of high and volatile food input costs; and provide fairer and more transparent terms for suppliers to ensure lasting relationships and licence to operate, which will help producers manage their brand image and reputation.³
- **Retailers** are constrained in their ability to pass on food price increases to consumers by weak economic conditions and depressed spending power. In order to protect their margins, successful companies use other levers that offset high input costs including product innovation and cost savings initiatives. Helping consumers waste less in times of austerity can also help to secure customer loyalty.

Whilst the issues companies face differ according to their place within the agricultural value chain, our research also clearly identified cross-cutting themes. We believe that companies across all sectors should focus on the key areas identified in the box on the following page, which have the potential to help protect and enhance long-term investor value:

³ See for instance Oxfam's Behind the Brands campaign: www.behindthebrands.org.

Areas for ongoing development

1. Strategy with board oversight: *Develop a strategy to manage commodity supply chain risks and opportunities, with evidence of implementation throughout the organisation and board level participation.*

Challenge: Companies demonstrate pockets of good practice, but few demonstrate a coherent strategy that covers the full spectrum of issues.

Opportunity: Discuss the issue at board level, actively seek out stakeholders to get an external perspective, and publish strategies for managing risks and opportunities.

2. Yield improvement: *Contribute to capacity-building and knowledge transfer within the farming sector with the goal of enhancing and protecting yield.*

Challenge: Improving yields and efficiency were identified as strategic priorities for actors along the value chain. However, particularly for smallholder farmers in developing countries, access to technology, finance and knowledge can be a major barrier to yield enhancement.

Opportunity: Consider the case for enhancing the long-term reliability of agricultural supply through programmes to assist farmers with technology and education attainment on modern agronomy practices. While examples of good practice abound, the industry has yet to develop a comprehensive, commercially viable and effective approach.

3. Suppliers: *Reconsider input sourcing mix and potential opportunities for a shift towards more direct sourcing to improve control and visibility into supplier base.*

Challenge: Food supply chains, especially for processed products, tend to be long, complex, fragmented and opaque. Companies have a choice as whether to source on global commodity markets, from large trading houses or directly from farmers.

Opportunity: Consider the long-term commercial case for more direct relationships with farmers. Explore new structures to improve sourcing practices such as co-operatives and contractual sustainability requirements when dealing with intermediaries. At an industry-wide level, explore how the uptake of commodity certification schemes can be accelerated.

4. Waste reduction: *Seek to increase efficiency and reduce waste within and beyond direct operations.*

Challenge: High rates of waste along the supply chain exacerbate existing supply stresses. While in developing countries 40% of food losses occur at post harvest and processing levels, in industrialized countries more than 40% of food losses occur at retail and consumer levels.⁴

Opportunity: Identify ways to improve infrastructure, such as storage, refrigeration and shorter transport chains, reduce waste and spoilage in the production process, and enhance customer loyalty through education on waste reduction. Typically, waste reduction measures can save money and have social and environmental benefits.

5. Strategic partnerships: *Work closely with peers, suppliers, industry bodies and governments to address systemic issues beyond the control of one company alone.*

Challenge: There is often poor co-ordination between companies at different points of the food supply chain, and between companies and policymakers, leading to unaddressed market failures and systemic risks.

Opportunity: Establish closer ties across sectors and call on policy makers to address the structural issues across the chain. There is a need for enhanced collaboration to ensure the development and application of policies that will stimulate private investment; facilitate wider access to commodities markets and finance; develop effective trade policies; most efficient management of agricultural assets.

Next steps

Based on the findings of this engagement project, F&C will take the following steps:

- Encourage improved sustainability practices across the full spectrum of the agricultural value chain by engaging with listed companies and bond issuers on the key recommendations of the report.
- Track and report on changes made by companies in response to our engagement.
- Communicate the results of our analysis to fund managers, in order to take into account in investment analysis where relevant.
- Work with fellow investors to engage with regulators, industry bodies, development agencies and civil society organisations on responsible investment in this area, and support multi-stakeholder initiatives aimed at increasing transparency and responsible agricultural investments.⁵

If you would like further details on the information in this note, please contact your **reo**[®] client director.

⁴ Food and Agriculture Organisation, Global Food Losses and Food Waste, 2011.

⁵ Examples of such initiatives include the Agricultural Market Information System (AMIS), Principles for Responsible Agricultural Investment, Principles for Responsible Investment in Farmland, and Voluntary Guidance on Responsible Governance of Tenure

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