F&C Investments

RESPONSIBLE OWNERSHIP ACTIVITY REPORT
Q2 2014

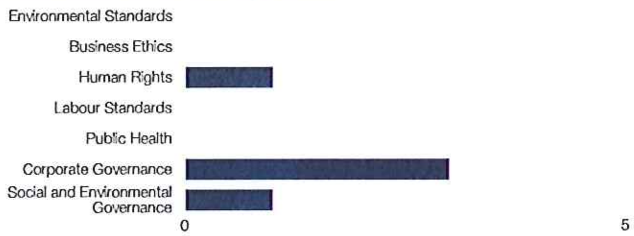
Shropshire County Council

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.

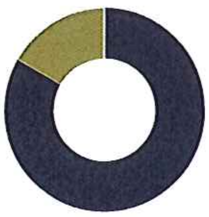
COMPANIES ENGAGED THIS QUARTER

Companies engaged	12
Milestones achieved	5
Countries covered	3

Milestones achieved by issue



Companies engaged by country



United Kingdom	10
Continental Europe	2

Companies engaged by issue **

Environmental Standards	7
Business Ethics	7
Human Rights	6
Labour Standards	8
Public Health	1
Corporate Governance	9
Social and Environmental Governance	8

* ***reo***® is currently applied to £89.3 billion (€111.6 billion / $152.8 billion) of assets as at 30 June 2014

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

Company Engagement and Your Fund

Name	Country	Priority Company	Engagement	Milestone	In this report	Environmental Standards	Business Ethics	Human Rights	Labour Standards	Public Health	Corporate Governance	Social and Environmental Governance
Anglo American	United Kingdom	✓	✓		✓	●			●		●	●
AstraZeneca	United Kingdom	✓	✓		✓		●			●		●
Barclays	United Kingdom	✓	✓		✓						●	
BP	United Kingdom	✓	✓		✓	●	●	●	●			●
Bwin.Party Digital Entertainment	Gibraltar		✓	✓	✓						●	
Experian Plc	United Kingdom		✓		✓						●	
GlaxoSmithKline	United Kingdom	✓	✓		✓							●
HSBC	United Kingdom	✓	✓	✓	✓						●	
Marks & Spencer	United Kingdom		✓		✓		●		●			
Royal Bank of Scotland Group	United Kingdom	✓	✓	✓	✓	●	●				●	●
Royal Dutch Shell	United Kingdom	✓	✓	✓	✓	●	●	●	●		●	●
Unilever NV	Netherlands		✓		✓				●			
Vodafone Group Plc	United Kingdom			✓	✓			●				

F&C Investments

reo® VIEWPOINT MAY 2014

Matthias Beer, Associate Director, Governance and Sustainable Investment

ESG RISKS IN THE OIL AND GAS SECTOR – OUT OF THE LIMELIGHT, OUT OF SIGHT?

- The management and reporting on environmental and social risks among developed world mid-cap and emerging market oil and gas companies often lags behind industry leading standards. Companies receive little pressure to improve despite being widely held by investors.
- Over a two-year period, F&C engaged 15 companies with significant reporting gaps, outlining specific recommendations across a range of areas such as health and safety, pollution prevention, corruption and human risks.
- Despite some positive momentum, particularly among the mid-cap US players, significant disclosure gaps remain and continue to make it difficult for investors to distinguish effectively between leading and lagging performers.

It is common for oil and gas companies to deal with pressure and controversies over their environmental and social impacts. Yet, it is mostly the major international oil companies (IOCs) facing the media spotlight, often on a multitude of issues – ranging from climate change, spills and pollution risks, to tax and royalty payments for corrupt regimes in developing countries. This focus on the oil majors, though justified given their size and scope of operations, risks overlooking the great number of mid-sized companies in the developed markets and emerging market companies that often operate in the shadows of the IOCs. Investor exposure to these companies can be large, both in active and passive investment strategies, as even mid-sized players in this sector are large enough to feature in the standard benchmark equity indices.

F&C designed a project to engage a subset of 19 widely held companies that exhibit high environmental, social and governance (ESG) risks but often receive little shareholder pressure to improve their management of these issues. The aim of the project was to encourage companies to adopt enhanced industry-wide management and reporting standards on key ESG issues.

RAISING THE INDUSTRY BAR

When it comes to ESG reporting practices, companies are often mainly concerned with avoiding lagging behind industry standards. Industry associations can play a powerful role in setting and disseminating these standards. For the purpose of this project, we based our analysis on the reporting guidelines developed by the global oil and gas industry association for environmental and social issues (IPIECA). IPIECA recently celebrated its 40th anniversary since its establishment in cooperation with United Nations Environment Programme (UNEP). Initially it focused on promoting safety practices in the industry, but it has since greatly expanded its coverage of a wide range of social and environmental issues. Its membership has grown to include, in addition to the majors, increasingly mid-sized and smaller companies as well as some emerging market players.

F&C has had a long engagement history with IPIECA dating back to 2006. Our main aim has been to foster the development of better reporting standards that would raise the bar of the industry as a whole. As the only investor representative on the organisation's stakeholder panel, we have been actively involved in shaping the IPIECA reporting guidelines to ensure that they adequately address the many ESG issues we typically engage oil and gas companies on.

PROJECT OVERVIEW

We used F&C's ESG risk tool to identify 17 widely held oil and gas companies that have weak ESG risk scores. Following a detailed analysis of their reporting practices against IPIECA guidelines, we sent letters to 15 of those companies with significant reporting gaps, outlining specific recommendations across a range of key areas such as health and safety, pollution prevention, corruption and human risks. All but three companies responded to our letters. Following this outreach, we had meetings to discuss our analysis and recommendations with eight of the companies across 2012 and 2013. We reviewed changes and improvements in management and disclosure practices across the reporting 2013/2014 cycle. Since the start of this project, we have been able to record 14 milestones, i.e. improvements in disclosure and management practices related to specific recommendations we have put to companies (see table below).

We have observed progress in a number of areas, particularly among some of the mid-cap US players, many of whom have substantial exposures to shale operations or tar sands. These companies have started providing more transparency on issues such as air emissions, water management and community impacts. However, most companies still lag significantly behind IPIECA guidelines as well as the standards set by the oil majors. Unsurprisingly, this transparency gap is most pronounced among the emerging market companies, though even here we have noticed some positive momentum in terms of adopting more structured approaches toward ESG risk management.

Companies analysed in this project	Outreach with customised recommendations	1:1 engagement following initial outreach	Number of Milestones recorded
Anadarko Corporation	✔		
Apache Corporation	✔	✔	1
Canadian Natural Resources Limited	✔	✔	1
Chesapeake Energy Corporation	✔	✔	3
China Petrochemical and Chemical Corp (SINOPEC)	✔	✔	1
CNOOC Ltd	✔	✔	
Devon Energy Corporation	✔		
EOG Resources	✔		1
Galp Energia SA	✔	✔	2
Gazprom	✔	✔	1
Hess Corporation			
Marathon Oil Corporation			
Murphy Oil Corporation	✔		
Oleo e Gas Participacoes SA (OGX)	✔		
OMV AG	✔		
PetroChina	✔	✔	2
PTT Exploration & Production	✔	✔	2

F&C ACTS

In analysing companies' reporting practices we focused on a wide range of areas from environmental and safety issues to human rights and business ethics around revenue transparency. The following summary outlines issues where we have identified the greatest commonalities in terms of reporting standards that fall short of IPIECA industry guidelines, namely: greenhouse gas (GHG) emissions; and safety and emergency response.

Greenhouse Gas Emissions
By now, it has become established practice among many OECD-market oil and gas companies to report on GHG management within the Carbon Disclosure project (CDP) framework. This type of disclosure often provides good insights into companies' overall approach and also yields performance data, e.g. on total GHG emissions from operations, that ESG rating agencies use for benchmarking purposes. However, most companies in the subset have not set specific targets to reduce their carbon emissions. Even some of the oil majors that used to have carbon reduction targets in the past have yet to set new ones.

Analysing GHG reduction targets helps investors determine the scale of the company's ambition and its capacity to implement efficiency improvements. While targets are more commonly set for refining operations, exploration and production activities typically lack any specific improvement objectives. Companies often justify their inability to set clear targets for reducing total carbon emissions by referring to their fluctuating exposure to early stage oil developments, when the most carbon-intensive activities typically occur. We therefore encouraged companies not only to set objectives for total emissions reductions but also to identify targets for reducing the emissions-intensity by business activity. This should give companies an opportunity to show the efficiency of their operations relative to the amount of oil and gas produced.

Findings and Milestones: Reporting on total operational GHG emissions has become more common, even among the emerging market players in the subset like **CNOOC Ltd.**, or the Thai **PTTEP.** Others like **Petrochina** and **Sinopec** still do not provide total emissions data but focus on improved energy conservation, a measure that does not enable an assessment of the total footprint and relative improvements. Only some companies give breakdowns of emissions intensity by business activity (e.g. **Gazprom**) and only very few companies have targets around emissions intensity (e.g. **Marathon Oil**, OMV).

We recorded two milestones, i.e. instances of companies having introduced specific GHG reduction targets in the course of our engagement. **Galp Energia** established a long-term target to reduce the greenhouse gas emissions intensity of its oil and gas production below the industry average. **Apache Corporation** set annual improvement targets for each operating region to implement emission reduction projects that would achieve a combined decrease in their greenhouse gas emissions equal to 2% of the previous year.

Safety and Emergency Response
Although safety management and spill response are arguably one of the more critical issues, it is surprising that a significant number of companies still do not report on key performance indicators in this area. Disclosure on occupational safety performance, such as number or frequency of injuries, are reported widely. Increasingly companies also have clear targets in this area and link safety

performance with executive remuneration. Such disclosure is essential for understanding management commitment around employee safety. However, it is insufficient for assessing the overall robustness of a company's process safety system, i.e. its ability to prevent potential incidents from turning into a major accident like a spill.

To get companies in line with industry practice, we asked for reporting on the number and total volume of oil spills, as well as details on emergency response programmes providing enhanced spill response capability globally. Furthermore, to get more insight into the effectiveness of safety systems and culture we recommended disclosure on the number and frequency rates of process safety events like high potential incidents. Such incidents represent breaches to safety barriers that did not result in an actual spill or injury, i.e. standard injury or spill metric would not capture them. We also asked for details on metrics that show how frequently employees or contractors use their authority to stop work due to concerns about safety. This is an area where even the oil majors still provide very little information.

Findings and Milestones: Transparency on occupational safety has improved overall, though some smaller companies in the subset did not provide any performance data in relation to worker safety (e.g. OGX, Murphy Oil). Breaking down safety data for employees and contractors is also becoming more common. This is crucial as companies that still only provide a single employee-only safety indicator, such as Sinopec and Petrochina, effectively do not report on the vast majority of activities executed by contractors. Likewise, data on spill performance is still absent with a number of companies, like EOG Resources and Murphy Oil. The standard model for reporting on spills and emergency response capabilities remains the provision of anecdotal information often in relation to major incidents, such as CNOOC's disclosure on the South China Sea spill in 2011.

However, even among companies like Gazprom that continues to face numerous safety issues across its vast operations we recorded some improvements. Since our engagement, the Russian company started reporting on oil spills, including data on frequency and volume of spilt hydrocarbons as well as implementation of corrective measures. Increased transparency in this area enables investors to better assess performance trends and push for management accountability.

In terms of transparency on process safety events, Marathon Oil stands out as a positive example in that it not only highlights high and low consequence incidents that involved spills, but also provides performance data on operating deviations that trigger alarms. This granularity of data ultimately enables more profound analysis of the company's safety systems and culture and helps make more forward-looking judgements about its ability to prevent accidents.

OUTLOOK AND NEXT STEPS

Using an established industry framework like the IPIECA reporting guidelines for our engagement has a number of advantages. It provides common concepts and reporting indicators that company representatives easily recognise. This familiarity can serve as an effective engagement tool especially with companies less accustomed to discussing these issues with investors. For example, the Head of Health and Safety at a Chinese company, who expressed great surprise that investor even care about his responsibilities, would more readily engage in dialogue about specific outcomes and challenges when asked about the implementation of standards set by IPIECA, of which his company is a member. Furthermore, referencing such established frameworks in turn helps corporate sustainability specialists to make the case for enhanced management and reporting to their management internally.

Although there are obvious advantages to this approach, the drawbacks come with the limitations of these frameworks. IPIECA has been criticised for being too technical and for lacking leadership and vision on some of the industry's big challenges. It provides detailed workgroups for specialists as well as specific implementation guidelines and tools on a wide range of issues such as human rights, biodiversity or process safety. Yet, is not an organisation where CEOs gather to lead the thinking on key strategic issues, such as the role of the oil and gas sector in the context of climate change. This area has not been effectively translated into a reporting framework that would help investors encourage best practice and distinguish leaders from laggards.

We have highlighted this shortcoming in our engagement with IPIECA and pushed in particular for the development of reporting guidelines that address the issue of carbon asset risks or so-called 'stranded assets'. We are encouraging companies in this context to disclose the extent to which they manage the risk that some of their long-term fossil fuel assets might not be fully developed as the energy system shifts to lower carbon fuels. IPIECA is in the process of releasing a statement outlining its member companies' thinking on this issue. Our engagement on the topic of 'stranded assets' is part of a wider project currently underway, involving a multi-strand approach that includes outreach to companies held by reo clients, participation in a joint-investor initiative, as well as engaging industry organisations like IPIECA. We are planning to give an update on the progress of these activities related to the 'stranded assets' theme throughout 2014.

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

Anna-Sterre Nette, Associate Director, Governance and Sustainable Investment

EMPLOYING DISABLED PEOPLE IN THE DUTCH PRIVATE SECTOR

- Amidst increasing regulatory requirements for Dutch companies to hire more people with disabilities, F&C engaged 28 Dutch companies about their approach to integrating disabled employees into their workforce.
- F&C concluded that the companies with leading practices have in place a proactive approach that goes far beyond just a general policy statement and labour agreements. These include the implementation of special measures (e.g. policy, training and technology) which are relevant to the business.

The Europe Union 2020 Strategy aims to promote smart, sustainable and inclusive economic growth. Also, as ratified by the EU in the UN Convention of the Rights of Persons with a Disability (UNCRPD), people with a disability have an equal right to fully participate in society, including the labour market. One of the goals of the new Participation Act proposed by the Dutch government is to enhance participation in the labour market by people with a disability. In anticipation of the act coming into effect in 2015, it is essential that regular employers offer people with a disability the opportunity to work. According to last year's so-called "Social Accord", Dutch businesses and employers will take it upon themselves to place 2500 people with disabilities nationwide this year by means of supported employment and secondments. This rises to five thousand in 2015, ten thousand in 2020 and a hundred thousand in 2025.

While F&C supports the Dutch push to improve, we believe the rationale for companies employing disabled people is much more than compliance with regulations. F&C considers that companies that employ less-abled people benefit from:

- Developing a diverse workforce that reflects a company's customers and the society which it serves. Companies that successfully employ people with disabilities manage to turn social issues into business opportunities (e.g. responding to market needs, developing sustainable retention practices, workplace innovation, widening of consumer base).
- Utilizing the labour pool to tackle the challenges of an ageing population and rising global competition. The potential capacities of people with disabilities are currently underutilized.
- Acknowledging the growing body of evidence that strong human capital management is associated with long-term company performance (UN Principles for Responsible Investment's Human Capital work stream).

PROJECT BACKGROUND

PWRI, the pension fund for disabled workers in the Netherlands, requested F&C carry out an engagement project targeting Dutch companies. The goal was to gain insight into the companies' approaches to provide suitable employment to people with disabilities. In line with the United Nations Convention on the Rights of Persons with Disabilities and relevant ILO convention, PWRI takes great interest in the companies' efforts to enable disabled people to secure, retain and advance in suitable employment as a means of fully integrating into society.

F&C ACTS

Amidst the backdrop of these regulatory changes, F&C wrote to 28 major Dutch companies to investigate their policies and practices in integrating disabled people into the workforce. We received a reply from 24 companies. We considered the 85% response rate to be high and it highlighted to us a strong, widespread awareness on the topic of disabled workers among Dutch companies.

ANALYSIS

Once we studied the results however, we concluded that the quality of practices varied greatly amongst the respondents. F&C considers it to be important that companies strive to go beyond the absolute minimum of a general human resource policy statement, and should proactively implement support systems, such as a detailed corporate-wide policy, specialized training, assisting technologies, and participation in industry partnerships. It is clear that creating work opportunities for people with disabilities may be easier in some sectors than others. Some industries can better accommodate workers in the short-term, as they offer flexible/ part-time, low stress positions that require less educational qualifications. The leading companies are trying to stay ahead of the expectations brought about by the Social Accord, and have initiated actions to better integrate disabled workers into its own workforce and see a leadership role for its own company to excel as an employer in this matter.

CASE STUDY: ING

The Dutch bank **ING** is in full preparation mode for the launch of a new scheme that links candidates with a disability to suitable and relevant job positions within the bank. The pilot Onbekend Talent ('Unknown Talent') initiative starts this autumn and aims to focus on peoples' strengths instead of weaknesses. Using an innovative method of analyzing job functions, more than ten different types of disabilities (visual impairment, autism spectrum disorder, chronic illness etc) are in the process of being carefully rated on their suitability with the entire ING Job Career Framework. The bank currently offers temporary work experience placements to seven people receiving WAJONG (Income Provision Act for Disabled Young People) benefits. After careful evaluation of this scheme, ING came to the conclusion that in order to become a more open and accessible employer for people with a labour disability it should offer sustainable possibilities with career perspective in combination with support when necessary. The two most important pillars of the ING set-up are therefore the function analysis and the support offered through a buddy-system that ING employees can volunteer for. However direct colleagues cannot fill the buddy-position as ING feels that this would create too dependent relationships within a team. The bank did not provide any information on the number of people it aims to hire but it said it targets are in line with the Social Accord.

Response quality: F&C categorized ten of 28 companies for the "developed response" category (see table 1). These companies provided detailed and insightful answers to our questions from which it was apparent that they see a clear role for themselves in advancing the labour position of people with disabilities. These companies had reviewed company strategy in response to the Social Accord. Though some of these companies launched programs well ahead of any of the recent political developments. For instance electronics giant **Philips** has run a program for disabled workers since 1983. The 14 companies in the "basic response" category had expressed their general awareness about changing societal expectations for employers to integrate disabled workers but were still exploring their options, or were awaiting clearer guidance from trade unions before taking any further action.

Industry differences: Our survey suggests that the food retail sectors have been the largest employers of disabled staff in the Netherlands. Of our respondents, **Ahold**'s supermarket chain Albert Heijn employed most of the workers with disabilities – 600 employees. Another food retailer **Sligro**'s EMTE supermarkets had 150 staff members with disabilities.

CASE STUDY: SLIGRO

A local distribution site of Sligro, the biggest food service company in the Netherlands, developed a number of partnerships with organizations in the region to advance the position of people with a disability in the labour market, a practice that is supported by the executive management of the company and widely encouraged throughout the organization. At the distribution center they practice a method called 'job carving'. This separates out part of a job description to create a role that is especially suited to a person with a certain disability. Sligro offers internal training and job-coaching to all candidates. Amongst other initiatives, the distribution center also participated in a project with Locus, a network organization advancing the position of people with a disability, which resulted in permanent positions for four people after they successfully completed a work experience placement. In addition, the distribution center developed a long-standing cooperation with local vocational schools, offering young students with learning disabilities training on the job and work experience placements, with a potential prospect of a permanent contract.

Creating opportunities: Of the 24 companies participating in this survey, 13 have created specific work opportunities for disabled workers. These companies had a formal program to create roles for new disabled hires. Most of these positions are targeted at applicants who qualify for the WAJONG benefit (Young Disabled Persons Act). Opportunities were also offered to people who quality for the Werk Social Werkplaats (working in a sheltered workplace) and WAO (Disabled Persons Act) benefit. It should be noted that three companies, **ABN Amro**, **Aegon** and **Delta Lloyd**, informed us they offer permanent positions, others offer work experience places.

Support and training: Many companies offer additional support to help integrate workers with disabilities. 18 companies offered their employees specialized training. Examples include trainings in skills such as speech recognition, empowerment workshops and job coaching. 19 businesses offered technological solutions. Examples include adjusted workstations, IT enhancements, customised furniture (large screens, special chairs and height-adjustable desks) and special facilities (e.g. disabled toilets).

External agencies/partnership memberships: Many companies informed F&C about cooperating with an external agency or signing up to a partnership to aid the integration of workers with a disability. 12 companies highlighted in their response that they work with an external party and receive services in the area of job coaching, recruitment and research, in addition 11 companies mentioned they belong to a partnerships that aims to accelerate the integration of disabled workers in the labour market.

Responsibility: 17 companies responded that the human resources department is responsible for compliance with diversity and inclusiveness values. Some further specified on a country level and or group level. Five companies had made the oversight of inclusiveness and disabled employee-hiring a board level responsibility.

Disclosed targets: Ten companies discussed setting quantitative goals regarding retaining and advancing people with disabilities within the organization, nine of these companies also disclosed specific goals around the number of positions to be created specifically for disabled candidates.

Table 1: Overview of company responses contacted for this engagement project on company strategy regarding workers with disabilities.

		Temporary/ permanent positions	Training/ technological solutions	Cooperation with external agency/ partnership	Board responsibility	Future targets
Developed response	ABN Amro Bank	✓	✓	✓	✓	✓
	Aegon	✓	✓	✓		✓
	Ahold	✓	✓			✓
	Delta Lloyd	✓		✓	✓	✓
	Heineken	✓	✓	✓		✓
	ING	✓	✓	✓	✓	✓
	KPN	✓	✓	✓	✓	✓
	Philips	✓	✓	✓		✓
	Sligro	✓	✓			✓
	Unilever	✓	✓	✓		✓
Basic response	Akzo Nobel		✓	✓		
	Arcelor Mittal					
	ASML		✓	✓		
	ASM International		✓	✓		
	Nutreco	✓	✓			✓
	Rabobank		✓	✓		
	Randstad			✓		
	Reed Elsevier		✓		✓	
	Shell		✓	✓		
	UPC	✓	✓	✓		✓
	Vopak		✓			
	Wessanen					
	Wolters Kluwer		✓			
	Ziggo		✓	✓		
No response	Besi					
	Boskalis					
	SBM					
	Stork					

RECOMMENDATIONS

In October, PWRI will be inviting these 28 Dutch companies to attend an event on employing disabled people. F&C will be presenting a series of recommendations to the companies which following our survey we consider to be good practice and beyond just complying with regulation on employing and retaining disabled staff in the Netherlands. The following best practices are recognized by PWRI as essential factors for companies wishing to integrate persons with a disability in their workforce.

- **Early adopters:** F&C encourages early implementation of the new standards for inclusive hiring derived from the Social Accord. A proactive approach allows companies to test strategies and to develop appropriate job functions suitable for the business and disabled workers, as the required solutions will vary from industry to industry.
- **Transparent reporting:** Companies should adopt higher levels of transparency and accountability on inclusive hiring practices to enhance public trust and engagement of customers and employees. They should report openly on achievements and shortcomings to illustrate the work that is undertaken and accelerate the business' understanding of the business case, with companies challenging each other through performance benchmarking.
- **Sharing and accessing best-practice:** Identification and sharing of best practice is vital in improving company practices. Businesses that have not developed a refined strategy on integrating disabled workers yet are encouraged to learn from other companies' achievements. Industry organisations should lead on the development of sector specific strategies and offer a platform for companies to exchange and discuss best practices.

CASE STUDY: ZIGGO

Ziggo, the largest cable operator in the Netherlands, is participating in an industry wide initiative led by the WENb, the Association of Employers for companies in the Energy, Cable & Telecom and Waste Management industries, to advance the position of people with disabilities. Together with another 18 companies (30,000 employees), Ziggo participates in a project designed to help employers to adopt more inclusive hiring policies as agreed in the Social Accord. Recent research showed that the participating companies in the project employ about 1% of people from the specific groups targeted in the Social Accord (people with a disability, long-term unemployed and people on benefits). Until recently, most companies did not track the hiring of employees with disabilities or formulated specific policy to retain or advance their position in the workforce. However, when the Participation Act comes into force next year, companies must report transparently about these types of employee details. The WENb initiative is one of the first collective industry projects in the Netherlands and it aims to create a total of 75 extra workplaces suitable for people with a distance to the labour market. In order to achieve this number, the companies will make use of tools such as job carving and outsourcing from sheltered workshops.

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