Emerging Risks and New Opportunities

Changing Landscapes: Towards a sustainable economy in Asia
June 2008
Alexis Krajeski – Governance & Sustainable Investment, F&C Investments
Agenda

Section I  Introduction

Section II  Responsible Engagement Overlay: reo®

Section III  Emerging Risks: Case studies

Section IV  New Opportunities: Climate change and sustainable development
Section I

Introduction
F&C’s Responsible Investment Heritage

Responsible Investment Overview

- Heritage is in ethical investment – acknowledged leader and innovator in the field
- F&C Investment Trust is oldest global investment trust
- Over US$6bn* of ethically-screened and thematic funds
- Responsible engagement overlay applied to US$118bn funds

A History of Innovation in Responsible Investment…

- 1984: Launch of Stewardship Growth – first ethical fund in UK
- 1987: Launch of Stewardship Income and Stewardship North American funds
- 1997: Stewardship North America becomes Stewardship International fund
- 2000: Launch of Responsible Engagement Overlay (reo®)
- 2006: F&C founder signatory to Principles for Responsible Investment (PRI)
- 2007: Launch of Global Climate Opportunities and Ethical Bond funds

*As at 31 March 2008
Responsible Investment: Coverage

Asset Owner/Asset Manager

**Fixed Income**
- Sovereign (developed markets)
- Asset Backed
- Corporates
- Sovereign & quasi Sovereign (EM)*

**Equities**
- Direct Investments
- External management
- Domestic / International

*Voting does not apply
Responsible Investment Capability: 47 People

- **Top Level Commitment:** 4
  - Chairman, CEO, CFO & Head of Investments

- **Fund Managers:** 16
  - Sustainability specialists + 223 broader investment professionals

- **Specialist GSI Team:** 17

- **Support Staff:**
  - Marketing, Client Servicing, Back-office, Administrative Support

- **Independent Committee Members:** 10
  - Committee of Reference & Ethical Review Committee

Expect excellence
Section II

Responsible Engagement Overlay: reo®
Context for Shareholder Engagement

- Wide acceptance that influences on **global economy** are changing
  - Governance is a value driver

- Increasing **risks*** including:
  - Environmental accords
  - Geopolitical conflicts
  - Globalisation in emerging nations
  - Growth in China
  - World health conditions
  - World oil supply

- Capitalising on **opportunities** eg. energy efficiency & sustainable development products

- Engagement key to **safeguarding** investor interests

* From: Top 10 Risks to Global Economy, Global Markets Institute at Goldman Sachs (GMI) Conference, September 2005
Integrating Fundamental & ESG Analysis

**Fundamental Analysis**
- Corporate Strategy
- Industry Dynamics
- Quality of Management
- Regional Dynamics
- Risk Management
- Relative & Absolute Valuation

**Integrated Working Relationship**
- Daily Morning Meeting
- Regular Discussions

**Impact of ESG Issues**

**ESG Analysis**
- Corporate Strategy
- Industry Dynamics
- Quality of Management
- Regional Dynamics
- Risk Management

**Action**
- Investment Review
- Engagement opportunity
In 2007 F&C averaged 20 contacts with top 10 most engaged companies.

### Volume of Engagement: 2007

- **Controversial**
  - High risk, high exposure
  - Intensive meetings

- **One on One Engagement**
  - Dialogue at Board/CEO/CFO level
  - Focus on specific issues e.g. Climate Change

- **All Holdings**
  - Full portfolio monitoring
  - Companies receive F&C’s tailored engagement and voting guidelines

Source: F&C’s Responsible Investment Report 2007
Summary of Top Level Engagement: 2007

Engagement by issue 2007

- Corporate governance, remuneration, capital, internal controls, shareholders rights: 17%
- Transparency & Performance: 15%
- Human Rights: 14%
- Labour Standards: 13%
- Climate Change: 12%
- Biodiversity: 12%
- Bribery & Corruption: 10%
- Environmental Management: 7%

Engagement by geography 2007

- UK: 30%
- North America: 39%
- Continental Europe: 16%
- Japan: 5%
- Asia (excl Japan): 8%
- Other Emerging Markets: 2%
Section III
Emerging Risks: Case studies
Case Study: Climate Change & Insurance

The risks

Insurance products are exposed to risks & opportunities presented by climate change
Policy pricing, underwriting & capital adequacy rates are effected by losses associated with extreme weather events
Invested assets underpinning policies are exposed to climate-related impacts
Regulatory pressure to maintain coverage & affordability in highly exposed areas affect growth
Engagement by F&C

Published “In the Front Lines: The insurance industry’s response to climate change” in September 2007

Founding signatory to *ClimateWise* & current Steering Committee member

Incorporated key questions into regular engagement discussions with all insurance companies, including those in emerging markets

In-depth engagement with lagging companies, particularly in the US
Outcomes

*ClimateWise* standard published September 2007 with 38 signatories

Major US insurers including **Travelers**, **Hartford Financial** and **Chubb** publish comprehensive climate change strategies

National Association of Insurance Commissioners (NAIC) publishes draft mandatory disclosure statement in April 2008

Danish insurer **Trygvesta** signals review of company products and pricing in response to climate impacts
Case Study: ESG Risks in the Mining Sector

The risks

- Maturity of old mines leads to growth in “frontier” operations in increasingly challenging operating environments that present significant environmental and human rights risks.
- Changing industry dynamics means risks are transferred to independently-managed operators who are poorly equipped to manage them.
- Significant gaps exist between major mining companies’ own practices and those of joint-ventures or subsidiaries.
- Long-term impacts of poor ESG management may materially impact project success.
Case Study: ESG Risks in the Mining Sector

Engagement by F&C

- Published “Do You Know What Junior’s Doing? ” in June 2007, which included recommendations for best practice
- Incorporated key questions into regular engagement discussions with all major mining companies, and junior mining companies held in F&C portfolios
- Visited South African mining sites to assess current practices
- Presented key findings and indicators of good practice to the International Council for Mining & Metals (ICMM)
- Shared findings with oil companies, banks, and other affected sectors
Case Study: ESG Risks in the Mining Sector

Outcomes – Major mining companies

- **Rio Tinto** introduced a policy to apply its own ESG standards to all independently-managed operations.
- Gold producer **Anglo American** has begun a programme to review anti-corruption systems in its joint-venture operations.
- Following criticism of its JV partner’s practices in the Philippines, **Xstrata** is undertaking a thorough review of the ESG practices employed there.

Outcomes – Junior mining companies

- UK-listed **Peter Hambro** introduced sustainability management systems for evaluating and managing its ESG impacts.
- **Anvil Mining** overhauled its ESG systems to focus on risk management, rather than philanthropy.
Section III

New Opportunities:
Climate change and sustainable development
F&C Global Climate Opportunities Strategy

- Climate change will create new risks and opportunities for business
- We will seek out companies which have the technologies and strategies to reduce greenhouse gas emissions, and to help society deal with the changing climate
- A thematic fund, without negative screening constraints
Nine Investment Themes

**Mitigation**
- **Alternative energy**
  - solar, wind, geothermal...
- **Energy efficiency**
  - insulation, energy demand management...
- **Sustainable mobility**
  - alternative fuels, efficient cars...
- **Waste**
  - recycling, landfill, gas capture...
- **Advanced materials**
  - bioplastics, silicon...
- **Forestry and agriculture**
  - forestry projects...

**Adaptation**
- **Water**
  - desalination, water purity testing...
- **Acclimatisation**
  - new crop varieties, crisis response ...

**Supporting services**
- **Supporting services**
  - carbon trading, consultancy...
Mitigation – Reducing greenhouse gas emissions

- The political momentum to cut emissions is now overwhelming: the future is low carbon
- Companies providing technologies and solutions to cut emissions represent significant investment opportunities
- Emissions cuts will need to happen across all sectors of the economy
- Reflecting this, we have chosen a comprehensive set of six mitigation themes - our focus is much broader than the typical alternative energy fund

### Greenhouse gas emissions by source, 2001

- Power: 24%
- Industry: 14%
- Transport: 14%
- Buildings: 8%
- Other energy related: 5%
- Waste: 3%
- Agriculture: 14%
- Land use: 18%
- Forestry and Agriculture: 14%
- Advanced Materials: 14%

Expect excellence
Adaptation – Preparing for the changes to come

- Global temperatures have already risen 0.7°C. Even with efforts to cut emissions, the ultimate temperature rise could reach 2°C - 3°C, or even beyond.

- The changing climate will also bring more intense storms, floods and droughts.

- This is likely to lead to water shortages, crop failure, the destruction of property, and the spread of tropical diseases.

- We will invest in companies which can support society in coping with these challenges, with two investment themes:
  - Water: supplying clean water in an increasingly water-stressed world
  - Acclimatisation: products and services that help society adapt to the changing climate
Responding to climate change presents new opportunities for companies providing finance and advisory services.

The Stern Review found that low-carbon energy will require $500bn+ in investment by 2050.

Permits for carbon emissions represent an entirely new global commodity – already worth over $30bn a year and growing rapidly.

We will seek out companies taking advantage of these new growth areas: from carbon trading, to consultancy, to specialist finance.

**Volumes transacted in carbon markets, MtCO2**

Source: World Bank
Opportunities – Investing in sustainable development

- High energy prices & acceptance that dependence on fossil fuels is key contributor to global warming has been catalyst for increased investor interest in potential benefits (and profits) of renewable energy & related investments.

- Growing consensus that best long-term performance will come from companies that take seriously their wider ethical, environmental and social responsibilities.

- Increasing investment opportunities driven by sustainable development initiatives.
Stewardship’s Philosophy

- Invest in companies that make a positive contribution to sustainable development
- Use influence as an investor to encourage best practice management of environmental, social and ethical issues
- Avoid investing in companies that do particular harm
Stewardship Criteria

**Positive**
- **Providing the basic necessities of life** eg healthy food, housing, clothing, water, energy, communication, healthcare, public transport, safety, personal finance, education
- **Offering customers ethical product choices** eg. fair trade, organic
- **Improving quality of life through the responsible use of new technologies** eg Internet access
- **Meeting sustainable development challenges** eg clean energy, low carbon technologies
- Good environmental management
- Actively addressing climate change e.g. renewable energy, energy efficiency
- Promotion and protection of human rights
- Good employment practices
- Positive impact on local communities
- Good relations with customers and suppliers
- Effective anti-corruption controls
- Transparent communication.

**Negative**
- Tobacco production
- Alcohol production
- Gambling
- Pornography or violent material
- Manufacture and sale of weapons
- Exploitation of animals
- Nuclear power generation
- Poor environmental practices
- Human rights abuses
- Poor relations with employees, customers or suppliers
Summary

- Identify key ESG risks and opportunities
- Integrate material issues into investment analysis
- Engage poor performing companies
- Offer clients opportunities to invest in solutions