

Governance & Sustainable Investing



CAPABILITIES OVERVIEW

F&C is a leader in the provision of sustainable investment solutions and engagement and proxy voting services, which have continued to expand over the last 28 years. Our suite of ethical funds is complemented by a range of thematic funds focused on opportunities providing access to the return potential of some of the fastest moving investment themes in the global marketplace.

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Why F&C for sustainable investment?

Sustainable investment is a core expertise at F&C and a significant part of our business. It includes ethical funds enabling investors to match investment returns with a clear set of principles and thematic funds which target the focused delivery of returns for investors from a specific set of investment themes. We are active investors and seek to have a positive impact on corporate behaviour through constructive engagement with company management and the voting of shares.

There is increasing pressure on companies to take seriously their wider social and environmental responsibilities and this is something embedded within our approach to ethical and sustainable investment. We consider a diverse range of issues that could affect a company's share price to identify ways of eliminating, reducing and mitigating such risks.

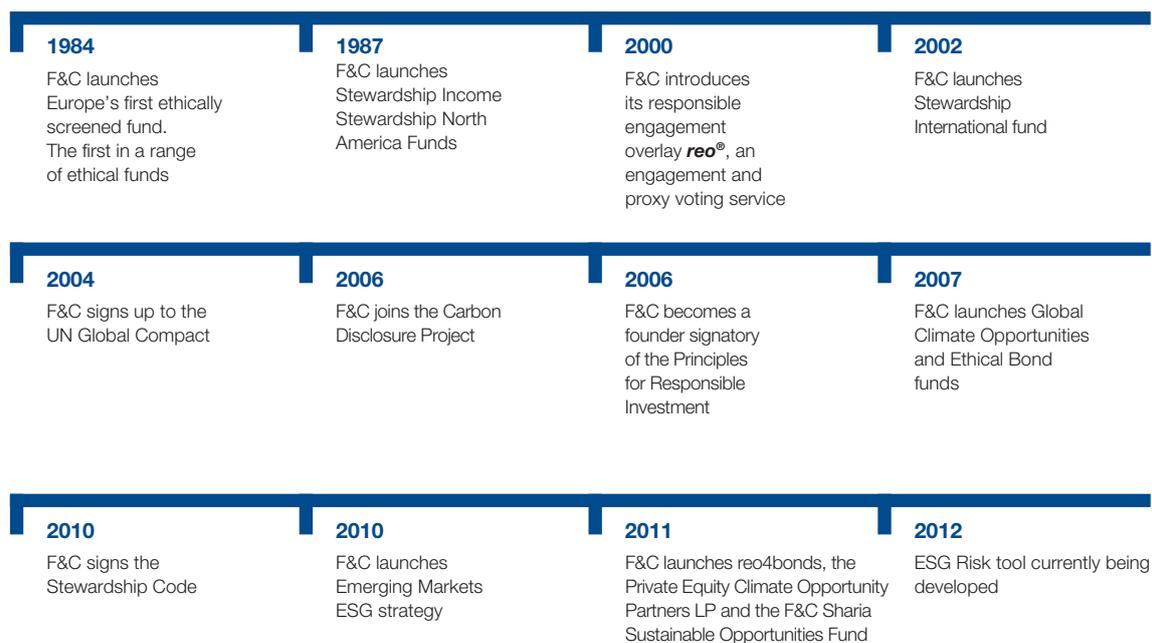
A series of sustainable investment themes are then taken further in terms of focus through our thematic funds, providing investors with access to the potential opportunities offered through climate change, water and agriculture and the growing importance of environmental, social and governance issues (ESG) in the emerging economies.

As a sustainability leader we have a clear aim to run our business in line with the principles and practices we expect from the companies in which we invest. We were a founder signatory to The United Nations-backed Principles for Responsible Investment (PRI) and the UK Stewardship Code. We also support responsible business and investment groups including:



F&C has unrivalled heritage and experience in sustainable investment

F&C is at the forefront in developing sustainable investment services to meet the needs of our institutional clients.



We have developed a range of solutions for institutional clients.

Sustainable investment – A range of ethical and thematic equity, corporate bond and private equity funds designed to enable institutional clients to access the growing number of opportunities available across asset classes and the risk/reward spectrum.

Responsible ownership – **reo**[®], an ESG engagement and proxy voting overlay service, which does not impact on portfolio construction.

Sustainable investment

The long-term sustainability of a company's business and the way it takes into account its ESG responsibilities play an important role in its attractiveness as an investment. This concept is embedded across our ethical funds, which include the pioneering Stewardship range and our thematic funds.

Ethical funds

F&C has been a market leader in ethically screened equity and fixed income solutions for institutional investors for almost three decades. Fund managers work closely with F&C's expert Governance & Sustainable Investment (GSI) team and for our Stewardship Funds, an independent Committee of Reference, to identify companies for inclusion in the universe of acceptable investments. F&C also offers a Sharia Sustainable Opportunities Fund, which benefits from an additional layer of screening provided by specialist Islamic Scholars.

Ethical investment at F&C goes beyond simple negative screening. Our approach identifies companies that meet our ethical screens, excludes those that do not and we engage with companies in which we invest to improve standards and promote industry best practice.

Strict 'dark green' screening puts ethics at the forefront of our approach, enabling investors to tie investment returns to a clear set of ethical principals.

Invest

We invest actively in companies whose activities are considered of long-term benefit to communities and make a positive contribution to the planet, its people and its wildlife. We look for companies providing the basic necessities of life, those with strong environmental management and companies with safe and fair supply chains.

Avoid

Companies that have any exposure to weapons, alcohol and tobacco production. Companies with a record of human rights abuses, poor relations with employees, customers and suppliers, weak animal welfare standards and testing for cosmetics, and environmental practices will also normally fail our screens.

Improve

We engage with companies held in our funds on a range of environmental, social and governance issues through our **reo**[®] engagement service, and we aim to promote and improve industry best practice on ESG issues.

Committee of Reference

To ensure the integrity of our ethical screening we have appointed an independent Committee of Reference. The committee's members are experts in sustainability and business ethics, which they blend with experience in a number of industry sectors including oil, mining and utilities, along with public policy development and community relations. The committee is responsible for maintaining the principles that underpin our Stewardship funds and for ensuring the proper application of those policies to companies for investment.

Screening process

F&C's GSI team works closely with both fund managers and the Committee of Reference to identify companies that will pass our ethical screening. However, the ultimate approval of any company for inclusion in the ethical investment universe lies with the Committee.



Our ethical funds provide a clear investment medium for individuals who do not regard financial gain as the sole criteria for investment but who prefer to look at wider issues, which means that their strong ethics are the primary attraction for investors.

Equities

The Stewardship funds offer investors a choice of UK listed growth and income solutions, along with on-shore and off-shore international portfolios and a global ex US portfolio. Each fund's investment universe is underpinned by robust ethical screening and stocks must be approved by the independent Committee of Reference before they are available for investment. Stock selection is then based on fundamental analytical research. The wider investment universe available to the international funds enables an enhanced thematic approach to be incorporated in their portfolio construction.

F&C Sharia Sustainable Opportunities Fund seeks to invest in socially responsible industries and businesses and is compliant with the Sharia acceptability and financial screens and sustainability screening. Rather than take a 'zero tolerance' approach to activities unacceptable to Sharia, it allows a maximum of 5% of revenue to come from unacceptable products and services to broaden the investment universe, but so as not to benefit from any such activities income is cleansed through an equivalent donation to charity.

Fixed Income

The F&C Ethical Bond Fund also benefits from the Stewardship screening. It focuses primarily on investment grade credits but can also invest in higher yielding securities. Government issued debt is excluded. Any non-sterling denominated issues will normally have the currency exposure hedged.

F&C ethical investments range

Fund name	Fund type	Asset class
Stewardship Growth Fund	OEIC	UK Equities
Stewardship Income Fund	OEIC	UK Equities
Stewardship International Fund	OEIC	Global Equities
Stewardship International Fund	SICAV	Global Equities
International Heritage Fund	OEIC	Global Equities ex US
F&C Ethical Bond Fund	OEIC	Investment Grade Corporate Bonds
F&C Sharia Sustainable Opportunities Fund	SICAV	Global Equities



Thematic investments

There are sustainable themes that are being driven by secular changes at a global level and which offer attractive opportunities to investors. To ensure proper diversification and risk control within a portfolio, however, they are traditionally only accessible through a global mandate. At F&C we are focusing on providing investors with access to four such opportunities.

Emerging Markets Environmental, Social and Governance

Global Thematic Opportunities

Water & Agriculture

Climate change

By offering institutional investors a range of thematic funds we are able to provide the flexibility to invest in themes that meet their specific asset allocation requirements.

Emerging Markets Environmental, Social and Governance

Emerging economies must address ESG issues if they are to enjoy sustainable long-term growth. They can learn from similar issues faced by developed economies with the advantage of being able to address them at an early stage in their development.

We enable investors to access companies driving or benefiting from sustainable development trends within emerging markets through six sustainability themes:

Infrastructure development – Providing critical infrastructure

Financing the future – Delivering financial services to under-banked and under-leveraged economies

Rise of the low income consumer – Supplying products and services to low and middle income consumers

Human capital – The provision of services such as education and healthcare

Access to new technologies – Offering leading technology to promote sustainable development

Energy for growth – Providing energy responsibly from conventional and alternative sources

Global Thematic Opportunities

The world is changing, whether through population growth, the emerging economies becoming industrial powerhouses or the digital age. This is set to give rise to economic and cultural dislocations and unprecedented pressure on human and natural resources. Long-term thinking is therefore necessary as we seek potential solutions. The F&C Global Thematic Opportunities Fund aims to tap into a series of investment themes looking to tackle the economic challenges these changes will present.

Cleaner energy – Low carbon / alternative energy and transition fuels

Resource efficiency – Reducing energy and raw material use, and developing advanced materials

Water stress – Reducing water wastage and increasing access

Environmental services – Waste management, recycling and environmental remediation

Social health – Healthcare and feeding a growing population

Knowledge economy – Education, access to information and data security

Financing the future – Responsible banking, finance for development and insurance

Infrastructure development – Telecommunications, sustainable mobility, utilities and affordable housing

Water & Agriculture

Population growth and global economic development, especially in the emerging markets, are driving rapid industrialisation and urbanisation. Increased affluence and improvements in hygiene and diet are in turn leading to longer life expectancy. As a result, systems, businesses and infrastructure are running close to capacity, putting pressure on water resources and driving the need for a sustainable increase in food production.

We believe there are significant and attractive investment opportunities from these changing business drivers in the traditionally defensive sectors of water and agriculture.

Global Climate Opportunities – Listed equities

We invest in nine climate change themes within three broad areas:

Mitigation – Providing practical solutions which reduce emissions which contribute to climate change, including energy efficiency, alternative energy, waste management and sustainable mobility.

Adaptation – Providing practical solutions that enable companies and communities to adapt to the impact of climate change, including water desalination and new crop development.

Supporting services – Providing a support infrastructure for companies involved in mitigation and adaptation, including trading and consultancy services.

Global Climate Opportunities – Private equity

Accessing climate change themes through private equity opens up wider investment opportunities for institutional investors. In particular, private equity can access a larger number of pure climate change plays and invest in companies at a much earlier stage in their development (when the motivation of management is normally at its highest).

Such an approach does, however, come with a number of risks:

- Illiquid investments in smaller, typically less mature companies
- Untested business models
- Limited track records
- Policy and regulatory risk

To address these risks while aiming to maximise return potential, we blend a number of direct investments with a portfolio of climate change funds.

F&C thematic investments range

F&C offers a range of geographically diversified thematic funds that provide investors with the flexibility to invest in themes that meet their specific asset allocation requirements.

Fund name	Fund type	Asset class
F&C Global Climate Opportunities Fund	SICAV	Global Equities
F&C Climate Opportunity Partners LP	Private Equity	Private Equity
Thames River Water & Agriculture Absolute Return Fund	Offshore OEIC	Global Equities
F&C Emerging Markets ESG	Pooled Fund	Emerging Markets Equities
F&C Global Thematic Opportunities Fund	OEIC	Global Equities

Sustainable investment and responsible ownership [®]

We combine sustainable investment solutions with responsible ownership, which we address through our engagement service **reo**[®].

reo[®] applies across F&C's ethical and thematic funds*, which benefit from our engagement with companies on ESG issues by pooling their investment holdings with those of other investors.

*At present, **reo**[®] does not apply to the Water & Agriculture Fund



Responsible ownership

Responsible ownership is embedded in our culture and approach to sustainable investment. We believe investors have a responsibility to use their influence to ensure companies take account of ESG business risks to maximise long-term value for investors. At F&C we use our vote at shareholder meetings and our voice through engagement to improve ESG practices.

Assets under engagement

Assets under engagement on behalf of institutional investors, local authority and corporate pension funds, insurance companies and supranational organisations were £85.6bn (as at 30 June 2012). We use our votes and our voice to encourage companies to manage ESG risks and capitalise on sustainability-linked opportunities.

Engagement

In 2000 F&C launched **reo**[®] to enable institutional investors to address ESG issues within their portfolios. Engagement through **reo**[®] also enables institutional investors to comply with the PRI, the UK Stewardship Code and other responsible ownership codes.

What is **reo**[®]?

reo[®] is a global engagement and proxy voting service, which aims to enhance investor value by encouraging the adoption and development of industry best practice. We believe we can best serve our clients and protect the long-term value of their investments through sustained and constructive dialogue with companies and active voting. Our approach to engagement is focused on delivering outcomes, called milestones, and we seek to drive changes in corporate behaviour, policy and practice to create sustainable alpha through enhanced business performance.

reo[®] is an engagement overlay service and does not impact on portfolio construction. It can be applied to the portfolios of institutional investors who do not use F&C for asset management services. Initially focused on global equities, the **reo**[®] approach now also covers corporate credit; F&C has been at the forefront of defining what responsible investment means in practice for bondholders.

Nine reo® programmes provide a balanced and integrated approach to engagement

Environment	Social	Governance
<p>Environmental Management</p> <ul style="list-style-type: none"> • Environmental standards • Supply chain environmental standards • Pollution control • Waste and recycling • Product opportunities <p>Ecosystem services</p> <ul style="list-style-type: none"> • Biodiversity management • Water • Access to land <p>Climate change</p> <ul style="list-style-type: none"> • Emissions management and reporting • Climate change strategy • Biofuels 	<p>Human rights</p> <ul style="list-style-type: none"> • Security • Privacy and free expression • Community relations • Weak governance zones <p>Labour standards</p> <ul style="list-style-type: none"> • Health and safety • ILO core conventions • Diversity • Supply chain labour standards <p>Public health</p> <ul style="list-style-type: none"> • Nutrition • Access to medicines • Product safety • HIV/Aids 	<p>Corporate governance</p> <ul style="list-style-type: none"> • Remuneration • Board structure • Shareholder rights • Audit and control <p>Sustainability management</p> <ul style="list-style-type: none"> • Disclosure and reporting • Governance of sustainability issues • UN Global Compact compliance • Stakeholder engagement <p>Business ethics</p> <ul style="list-style-type: none"> • Bribery and corruption • Political influence • Whistleblowing systems • Responsible marketing

Engagement in action

Case Study – GlaxoSmithKline solving access to medicines

F&C has engaged with all major pharmaceutical companies for many years, asking them to evaluate their business strategies in emerging markets and to seek commercial solutions to the access to medicines challenges, rather than thinking of developing countries only as charity cases. GlaxoSmithKline (GSK) has demonstrated its commitment to finding these solutions and making its operations in emerging markets a commercial success. The company has established a new Developing Countries and Market Access unit, which is tasked with adapting the company's existing price strategy and drug portfolio to meet the needs of the fifty poorest countries.

F&C has held regular meetings with GSK to monitor the progress of the new unit and of the company's overall access to medicines strategy. In particular, we suggested that, given the importance of emerging markets to the company's growth strategy, it should consider recruiting board members from outside Europe and the United States and with medical or consumer experience in key emerging markets. We believe enhancing the international perspective of the board will support the company's strategic direction of increasing access to its medicines – moving away from limited philanthropy towards new, commercially sustainable models that grow volumes and improve access.

Proxy voting

We believe exercising voting rights is essential to good governance and through **reo**[®] we vote on all companies held in client portfolios^{**}. We engage with companies before and after any vote to discuss our expectations, invite comment and explain votes against management. Our voting decisions are based on detailed in-house corporate governance guidelines. In the interests of transparency and disclosure we publish all voting reports on our website.

The table below shows our voting activity during 2011 and 2010.

How we voted in 2011 (2010) ¹					
Description	Number of resolutions	For management	Against management	Abstain	No vote ²
Board elections	35,919	73% (68%)	23% (26%)	3% (4%)	2% (3%)
Capitak structure	6,213	69% (67%)	21% (22%)	8% (7%)	2% (4%)
Remuneration	8,726	68% (67%)	20% (11%)	9% (16%)	3% (6%)
Routine & Other Business	21,676	88% (80%)	4% (6%)	2% (3%)	6% (11%)
Shareholder Proposals ³	729	30% (40%)	54% (53%)	14% (7%)	2% (0%)
All proposals	73,263	76% (72%)	76% (72%)	4% (5%)	3% (5%)

Public policy

We play an active role in public policy development as we believe that policy and regulatory change are often the catalysts for improved corporate behaviour. We also believe that participation in the public policy process is a central part of being a responsible investor. We engage with governments and regulators on policies that will improve ESG standards and enhance long-term investor value.

^{**} F&C will exercise its vote on all resolutions that it is mandated to on behalf of clients. The exception to this would be in markets that employ shareblocking, where most clients elect not to vote so as not to constrain their investment decisions.

¹ Totals may not sum to 100% due to rounding.

² The majority of 'no votes' take place in markets that employ shareblocking, where most clients elect not to vote so as not to constrain their investment decisions. The 'Routine & Other Business' category also includes non-voting proposals which is the reason for the relatively high proportion of no votes.

³ Typically companies will advise investors to vote against shareholder resolutions. Hence a vote in favour of a shareholder resolution is counted in our statistics as a vote against management, and vice-versa.

Sustainable investment sits at the heart of F&C's institutional investment proposition whether in the form of ethical, thematic and private equity funds, or our market leading engagement and proxy voting overlay service **reo**[®].

The deep coverage of ESG issues within F&C's GSI team means clients applying **reo**[®] to their investment portfolios comply with the Principles for Responsible Investment and other responsible ownership codes.

We continue to demonstrate market leadership in ESG issues, providing our institutional investors with a clear set of solutions for their sustainable and responsible ownership needs.



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Important information

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