



Investing in sustainability

NEWSLETTER ON RESPONSIBLE OWNERSHIP

No. 4 | September 2010

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Investing sustainably – beyond the stock exchange

The sustainable investment debate tends to focus on investments in shares of listed companies. But APG's puts its clients' money to work in a far wider range of assets: infrastructure, commodities, hedge funds, private equity and unlisted real estate funds make up around 20 percent of our portfolio. Here, too, sustainability is integrated into our investment policy. Below are some examples of how we approach sustainability and corporate governance issues when investing in illiquid asset classes.

No decision without a sustainability check

On 1 January 2009, we adjusted our investment process for illiquid assets to include an extra step: getting advice on the sustainability perspective. Our eight-strong Sustainability and Governance Team is now consulted on every investment decision we make. The team advises on which social and environmental issues need to be considered and whether the risks involved are manageable. Investments in these asset classes can touch on a broad spectrum of issues: from climate change, water management and biodiversity at the environmental end to human rights, working conditions and safety at the social end. Our goal is to see that all external investment managers working for us adjust their own sustainability policy to APG's Responsible Investment Policy. One of the things APG checks is whether external managers apply the proper procedures and resources (such as staff training) to implement such policy. In some cases, we even ask managers to live up to specific sustainability codes. All our forestry investments, for instance, must be FSC-certified or equivalent. We also expect regular sustainability performance reports from our external managers, detailing how they dealt with specific issues. All this is covered in the contracts that we sign with them.



Soy pods. We have asked the farming corporation we invest in to commit to the guidelines developed by the Round Table on Responsible Soy.



*Logging in Peru is largely illegal.
Our forestry investments must be
FSC-certified or equivalent.*

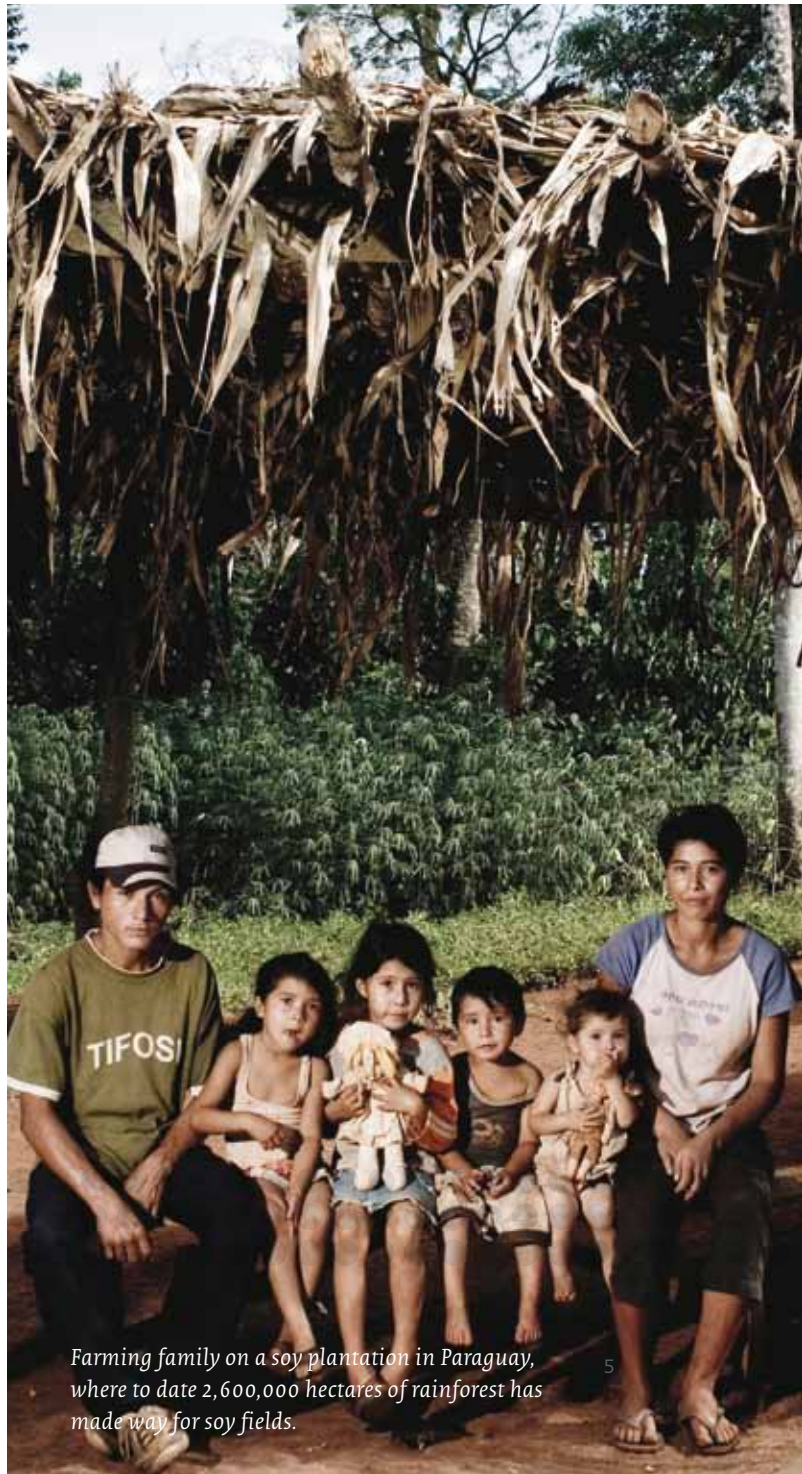
Walking the talk

Here are some examples of APG ‘walking the talk’ on sustainable investing.

- As a condition for our participation, we have asked one of the **Hedge Funds** we invest in, a fund specialised in energy projects in emerging markets, to base its policy on the Environmental and Social Standards set by the International Finance Corporation (part of the World Bank). These standards form the basis of the Equator Principles, which have gained wide acceptance as a guide to financing of projects in developing countries.
- In our **Commodities** portfolio, we have asked an Argentine farming corporation to commit to the guidelines developed by the Round Table on Responsible Soy. A bio-energy fund has been asked to participate in the Round Table on Sustainable Biofuels. Elsewhere, we’ve incorporated the World Bank standards in our contract with an investor in African mines. In Australia, a livestock firm has followed our suggestion to contribute actively to the development of new sustainable beef production standards in a process led by the World Wildlife Fund.
- In **Infrastructure**, we agreed to participate in a new fund covering the European market, on condition that the manager develops formal environmental and social guidelines. We are now closely monitoring compliance with these guidelines.
- Our **Private Equity** partner AlpInvest has its own CSR policy which is fully in line with our Responsible Investment Policy. Our partnership contract explicitly demands adherence to this policy, and it is a recurring item in talks between the partners. AlpInvest, like APG, has made engagement of companies on their ESG performance a key feature of its policy. AlpInvest makes a point of staying in touch with the managers of the private equity funds that our clients’ money has been invested in. Recently, for instance, one of these funds, Sun Capital, was approached about its holding in US supermarket chain Marsh, which had seen its relations with trade unions sour. AlpInvest’s urgings led to real talks taking place between Marsh and the trade union UFCW.

- For our unlisted **Real Estate** investments, we have developed a questionnaire on environmental practices that is given to the manager of every new investment we contemplate. If necessary we ask real estate fund managers to adjust their policy, and, as is our habit with all our investments, we monitor progress.

Implementing our Responsible Investment Policy in every part of the large and highly diversified investment portfolio that we manage for our clients is a task we take very seriously.



Farming family on a soy plantation in Paraguay, where to date 2,600,000 hectares of rainforest has made way for soy fields.



Red Mud Pond in Lanjigharh, India, a Vedanta dumping site.

Whistle blown on Vedanta

For the past two years, APG and several other investors have been engaging the Anglo-Indian mining giant Vedanta about its approach to social and environmental problems. Particularly controversial are the company's plans for a bauxite mine on Indian 'holy ground', but Vedanta has also taken flack for lax safety procedures following the collapse of a power plant chimney killing 41 workers.

Reputational risk and its consequences

In our discussions with Vedanta, we focused first and foremost on the apparent lack of adequate measures to protect the environment and the health and safety of workers on its sites, as well as on the company's possible involvement in human rights abuse. We are concerned about reputational risk and the resulting financial risks for shareholders. How justified our concerns are became apparent when the Indian Ministry of Environment and Forests turned down Vedanta's application for a licence to start a bauxite mine in the state of Orissa. The announcement had a significant negative impact on the projected cost of the mine - and on the share price. Which just goes to show yet again how important social and environmental themes are for a company's financial success.

Vedanta sticking its head in the sand

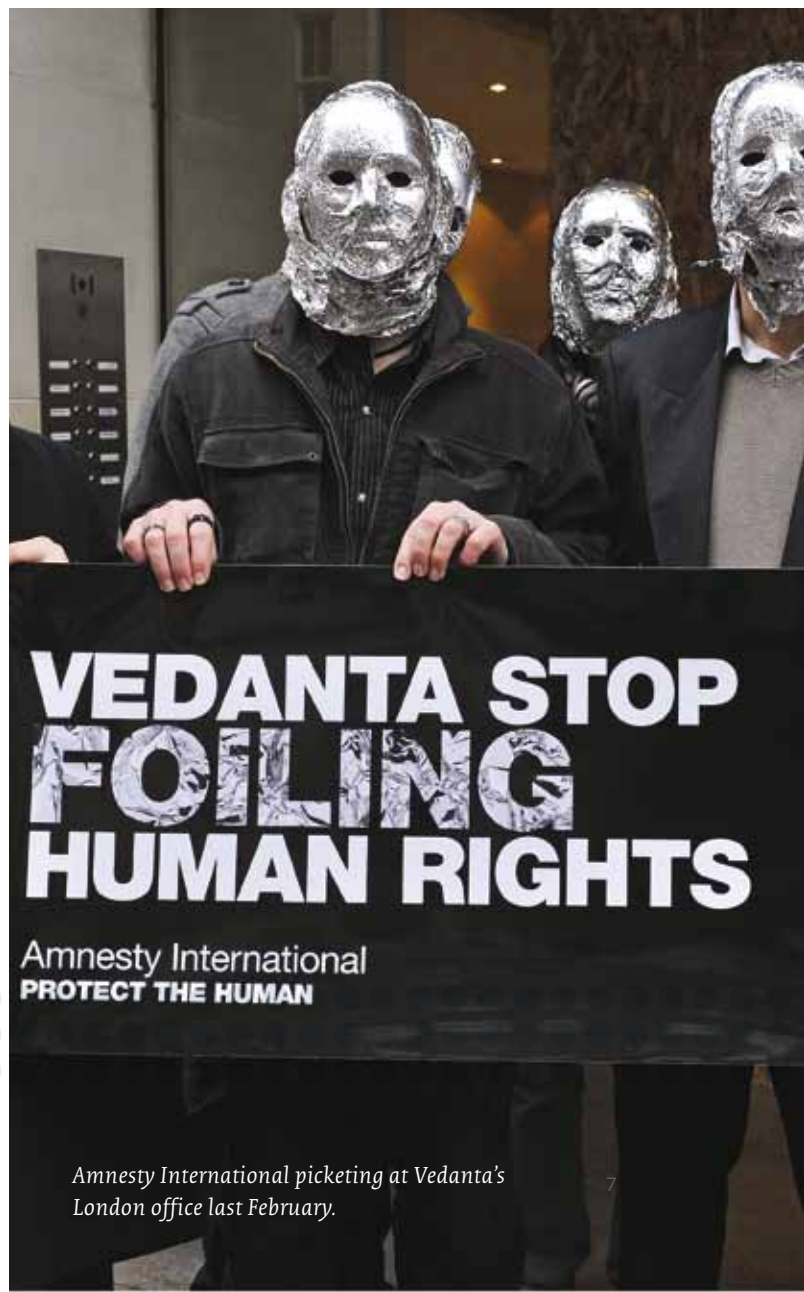
We're unimpressed by the way Vedanta communicates with its shareholders, but we have indications that management is slowly waking up to shareholders' concerns about its disappointing sustainability performance, and the door to dialogue seems to be opening. This became clear in talks with the company's senior independent director, who also chairs its HSE committee.

Leading by vote

To express our dissatisfaction with Vedanta's behaviour, our representatives at the AGM voted down the

reappointment of the chairman of the HSE Committee. We also abstained when the annual report was presented for approval, as we feel social and environmental themes are not sufficiently integrated into the company's strategy. We advised Vedanta to adopt the Principles of the International Council on Mining and Metals and instigate an external investigation into its stakeholder consultation process.

Although the hotly protested Odessa mining project is now off the table, Vedanta will find other bauxite prospects to mine. APG will continue to urge Vedanta to truly incorporate sustainability into its strategy to prevent further exposure to social and environmental risks. And we will continue to stress the importance of good shareholder communications.



Amnesty International picketing at Vedanta's London office last February.

Brazil, land of sustainable opportunities

Brazil, a country blessed with natural resources, is on a path of rapid economic development, and APG invests actively in this market. For minority shareholders like APG, however, it can be difficult to exercise their voting rights. Therefore APG has joined 11 global investors encouraging Brazilian companies and the local regulators to improve the situation by making electronic voting possible.

APG invests – with sustainability very much in mind – across many sectors of the Brazilian market. For example in several Brazilian property companies which participate in the so-called ‘Mia Casa Mia Vida’ programme to build one million affordable homes. We have also encouraged these companies to participate in next year’s Global Environmental Real Estate Survey.

For investors in Brazil, of course there’s no ignoring the natural resource sector. We met with several mining companies including Vale, Usiminas and Gerdau to discuss how the companies integrate sustainability into their company strategy and governance. We expect them to allocate board-level responsibility for sustainability issues, formulate a clear set of policies and implement suitable management systems, which not all of them did. We made recommendations on issues like biodiversity management and human rights, which we will follow up on when we next speak to them. With oil & gas company Petrobras we discussed safety standards for deep-water drilling and how to deal with different regulatory standards in Brazil and the Gulf of Mexico.

Challenges in biofuel industry

Biofuels are big business in Brazil. They have clear environmental benefits, but there have been concerns about working conditions on plantations, the energy

used to make biofuels and the negative impact of this industry on land use. The Brazilian government takes its watchdog role seriously, witness its very stringent monitoring systems to prevent child labour. We were able to ascertain that Acucar Guarani upholds good labour standards and honours government agreements to stop burning sugarcane. Going forward, the Brazilian biofuels industry faces a new challenge, as increasing mechanisation will make thousands of people redundant who will need to be retrained.

Access to banking services

We also met with financial companies Bradesco and Itau Unibanco to discuss the management of environmental and social risks in project finance and corporate loans, as well as the provision of banking services to the poorer segments of society. We believe that there is a huge market for innovative banking models designed to serve the poor - which is why we also support microfinance through direct investments.

Better information

As an investor APG needs better disclosure by companies to make better investment decisions. So we attended a meeting of the World Federation of Stock Exchanges organised by the Brazilian stock exchange BM&F Bovespa, where we pointed out to stock exchanges that they have an important role to play in promoting better and more transparent company disclosure by making it part of their listing requirements and/or codes.





From colonist to responsible investor in Taiwan

Long ago, when the Dutch East India Company wielded considerable power in the Far East, Taiwan – then called Formosa – was for nearly forty years a Dutch colony. The Company made considerable investments on the island in agriculture, infrastructure and schools. Historians say that colonisation brought to Taiwan, among other things, economic success and good governance.

Now, nearly 350 years later, a lot has changed in this former Dutch colony, but investment capital of a different sort still flows from the Netherlands to Taiwan. APG, for example, invests on behalf of its pension fund clients in several Taiwanese businesses. We set great store by strong corporate governance and respect for shareholders' rights in the companies we invest in, but some of them in Taiwan are not quite up to scratch in these areas. So APG, working with a number of other investors, has tried to bring about change.

One share, one vote

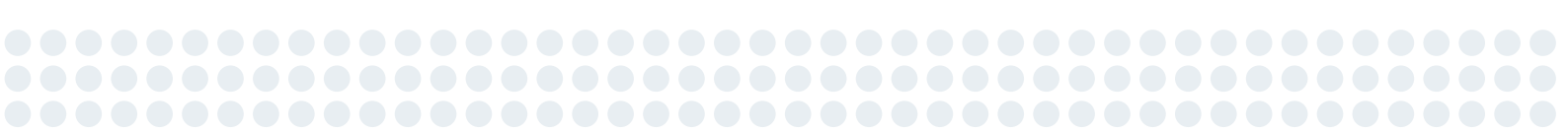
One way shareholders can show the company's management that they disagree with decisions made is by voting down proposals at the annual general meeting. APG believes in the one share, one vote principle, but that belief is not shared by all companies in Taiwan. At some AGMs, voting takes place by a show of hands of the shareholders present. Votes are only actually counted when they relate to the appointment of a board member. With other decisions, distance voters using a postal ballot or an electronic voting system have no way of knowing how their votes have been processed and counted. This is not really fair. Every shareholder should be able to cast one vote for every share held. After all, some shareholders have far more shares than others, and that should be duly reflected in the voting results on each decision taken.

The Asian Corporate Governance Network

APG regularly works with other investors and organisations that stand up for shareholders' rights around the globe. In Taiwan, the Asian Corporate Governance Network urged a number of companies to base all decisions taken at the AGM on the actual number of votes cast by the shareholders, and they were supported in their efforts by Dutch pension asset manager PGGM. PGGM Asset Management attended several AGMs in Taiwan, representing APG and several other large investors as well. At the meetings, they put their recommendations for better voting practices directly to the company boards. Several companies have also been asked to publish their AGM voting results.

Our recommendations appreciated

In Asia, the structure and operating methods of companies are often different from what we are used to, and Taiwan is no exception. However, interest in proper corporate governance and shareholders' rights is gradually growing there. Taiwan Semiconductor Manufacturing Company Limited, for instance, was the first company in Taiwan to voluntarily record all votes cast on every motion tabled at its AGM, and to make the results known at the meeting – and afterwards. So APG intends to continue supporting shareholder initiatives in Taiwan. In fact, it makes the companies happy. Just look what CEO of Chunghwa Telecom Co. Ltd wrote in his letter to us: 'We appreciate your recommendations for better organisation of our shareholders' meeting. They will help us further improve our corporate governance to meet international standards.'





Doing business in conflict zones

It is not always easy doing business responsibly in countries torn by conflicts or ruled by a dictatorial regime. We always ask companies we invest in that operate in such countries to take extra precautions to avoid becoming complicit in human rights abuse. To get a better idea of what we can realistically expect from companies in situations like these, we have actively participated in the development of a corporate code.

Under the umbrella of the UN Global Compact, we worked with companies that have on-the-ground experience in these countries to align investors' expectations with what can reasonably be demanded of companies. On the basis of these discussions, a document called *Guidance on Responsible Business in Conflict-Affected and High-Risk Areas: A resource for Companies & Investors* was written and presented in New York in June.

A tool for engagement

We use this guidance as a basis for our engagement of companies active in conflict zones. It helps us make clear exactly what we expect from them. It has proved particularly useful in dialogues currently ongoing with several companies operating in Sudan. But also, for example, in our dialogues with Shell in Nigeria, with Veolia, which is building a tram line in Jerusalem, with Total on account of its gas operations in Burma, with an Israeli bank that may be financing unlawful settlements, and with an Australian company importing phosphate from the Western Sahara.



Brittania's latest trend: a stewardship code for shareholders

Unlike other stakeholders in a company, shareholders are immediately impacted by the ups and downs of the company they invest in. Customers want cheap products, suppliers want to get paid, banks want prompt payment of interest due, employees want their salary at the end of the month. The rights of all these stakeholders are legally protected. But for a shareholder, nothing is certain. If business is good, they get some dividend. If business is not so good, they get less. If business is bad, they get nothing. Given how accommodating shareholders by nature are, it is surprising that they should get such a bad press.

Role in the crisis

Since the financial crisis broke out in 2007, shareholders have lost a great deal of money, but following the media coverage you would think that shareholders themselves are to blame for the crisis. Driven by greed, they forced banks to take irresponsible risks – that, at least is the story heard in many European countries. But not in the United Kingdom. There, several major banks had to be bailed out by the government following ill-advised take-overs. A case in point is Royal Bank of Scotland, which acquired a big chunk of ABN AMRO. The British take on the situation is different, though: shareholders failed to spot the big risks being taken by banks; they should have been paying more attention. Everywhere, the blame is laid firmly on the shoulders of shareholders, but for different reasons. In the UK for doing too little, in the rest of Europe for doing too much. The shareholder, it seems, is always wrong.

Stewardship code

British pension funds have taken the criticism to heart, and have vowed to do more. 'As shareholders, we want to act on our responsibility to society,' they say. From now on, British pension funds intend to pursue purposeful dialogue with investee companies on their strategy, performance and risk management. As an expression of their commitment, the major UK institutional investors have drafted a Stewardship Code specifying how they intend to engage their investee companies as responsible managers of the assets entrusted to them – in other words, as 'good stewards'.

Seven principles

According to the seven principles of the code, institutional investors must:

- publicly disclose their policy on how they will discharge their stewardship responsibilities
- have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed
- monitor their investee companies
- establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value
- be willing to act collectively with other investors where appropriate
- have a clear policy on voting and disclosure of voting activity
- report periodically on their stewardship and voting activities.

The British are proud of their code and would like to see foreign investors – who own nearly half of all shares traded on the London Stock Exchange – to comply with the code and adopt it in their own countries. In the Netherlands, 75 per cent of listed shares are foreign-owned. As we explained, the Dutch consensus is that shareholders, and particularly non-Dutch shareholders, have put too much pressure on banks. In the Netherlands, a parliamentary committee investigating the origins of the crisis concluded that shareholders were too focused on creating short-term shareholder value. 'The consequences were that the financial institution's long-term



objectives, such as sustainability and continuity, were given insufficient priority in daily practice,' says the report. The committee wants shareholders to take a more socially responsible stance and suggests introducing a separate code of conduct for institutional investors such as insurance companies and pension funds.

Topic of debate

Among Dutch pension funds, the idea of shareholder engagement is catching on, but not everybody agrees

whether this should be achieved through a separate code for shareholders. The Dutch corporate governance code already includes recommendations for institutional investors, either with or without a stock market listing. Should that perhaps suffice, with individual investors remaining responsible for their own role as shareholders? These are issues being discussed in great depth in Eumedion, the Dutch corporate governance forum for institutional investors.



The Sun King lives: absolute power in French business

Most Dutch listed companies have a two-tier board structure. They have an Executive Board, which determines the company's strategy, monitors risks, handles finance and sees to compliance with rules and regulations, and in addition to that a separate Supervisory Board which keeps an eye on what the Executive Board does and offers advice. Both boards have a chairperson. The chair of the Executive Board is commonly known as the Chief Executive Officer (CEO).

In most other countries, companies have one-tier boards. Its members include executives and non-executives. The executive in charge is the CEO, the person heading the entire board is the company's chair.

Anglo-Dutch companies like Shell, Unilever and Reed Elsevier already have a one-tier board and if the Management and Supervision Bill recently submitted to Dutch parliament is passed, any company in the Netherlands can choose a one-tier board structure.

However, in countries with a one-tier board tradition, such as the United States, the United Kingdom and France, this structure can raise governance issues. In some companies, for example, the CEO and the chair of the board are one and the same person. In the UK and US, thanks to shareholder pressure, there is an increasing trend to separate these roles. But in France things are moving in the other direction: currently these roles are combined at nearly half of the 40 companies that make up the French stock market index (the CAC40¹). Investors are not happy with this situation. And they are not the only ones.

A risky combination

Already in the eighteenth century, the French philosopher of law Montesquieu wrote that good governance depended on properly balanced and separated powers and responsi-

bilities. His insights laid the foundation for the US constitution, and to this day also form the basis of American corporate governance practice. A US study has shown that companies whose CEOs also serve as chair of the board are exposed to greater risks. They are 'more likely to have certain troubling corporate governance characteristics than companies where the roles are separated'. APG believes, therefore, that the CEO and the chair of a company should be two different people. No matter how good CEOs are, we appreciate there being somebody not directly involved in the company's day-to-day business supervising them. This can be particularly useful in matters of succession. Experience has shown that CEOs who are also chairs have too much influence in the company. Things can sail along quite smoothly for a very long time, but it remains risky.

Comme il faut... il ne faut pas...

This year, several French companies had plans to combine the roles of CEO and chair. Ahead of their annual meetings, APG announced that it is not in favour of this board set-up. At AXA, Groupe Danone, Air Liquide and Thales, for example, APG voted against proposals to combine the roles or to re-appoint an incumbent CEO/chair. APG, speaking also on behalf of several large European and American institutional investors, engaged insurer AXA on its proposal to combine the CEO and chair roles, urging the company to keep the roles separated. In vain. Working with a group of French and other European and international institutional investors, APG called upon the banking giant Société Générale to table a proposal at its AGM to separate the roles of CEO and chair.

Unfortunately, Société Générale refused, because they see no reason to separate these roles and French law does not oblige them to do so. Undaunted, APG intends to continue its efforts to make certain French companies break their old habits.

Comply or explain

Prompted by the financial crisis, the European Commission (EC) is contemplating new European legislation on how financial institutions are organised. Stakeholders have been asked to respond to a set of questions and suggestions to explore how a similar crisis can possibly be prevented in the future. One of the questions was whether there

1 De Cotation Assistée en Continu.

should be a Europe-wide ban on combining the CEO and chair roles in companies.

In reply, APG explained why we think it is a good idea to ban the combination of CEO and chair roles, or at least to impose a 'comply or explain' rule, so that companies who

insist on combining these roles are obliged to explain why doing so can help improve governance in their company. As always, APG's aim as a responsible investor is to contribute to better corporate governance in France and elsewhere in Europe.



Remuneration and Sustainability

Companies are coming to recognise that it matters how they perform on social and environmental issues: to their bottom line, to their shareholders and to their stakeholders. Remuneration is one way of encouraging sustainable practices among employees, and hence a growing number of European and especially Dutch companies are linking corporate responsibility to bonus payments. Because they realise sustainability performance can affect the value of their company, or because they wish to give expression to their company values. The question is whether this is a logical way to create more sustainable business. In June, APG hosted a seminar with the European Social Investment Forum to allow investors to exchange views on this very topic. Panel speakers from Philips, RWE and KPMG helped set the scene.

Remuneration as a tool

In APG's view, companies stand to benefit from good sustainability performance, but it has to be embedded firmly within company strategy and the corporate culture, and there must be a clear and strong commitment from the top. Remuneration can be a useful tool to support the strategic focus on sustainability and get management focused on the issue. But incentives must be structured carefully, as they can otherwise end up being counter-productive. And we should not forget that people are not motivated by money alone. Feeling appreciated at work depends on many other factors as well. It can be difficult, anyway, to differentiate between non-financial targets (e.g. more engaged employees), sustainability targets (e.g. better environmental performance) and financial targets (e.g. better sales). If more engaged employees are more innovative and design environmentally friendly products that increase sales, what is the best way to encourage that?



Relevant and measurable targets

Where sustainability or other non-financial targets are introduced, they ought to be relevant, measurable, comparable, challenging and clearly justified and communicated. In our view, a proxy target like the Dow Jones Sustainability Index (DJSI) does not fit the bill. Furthermore, only performance targets that can be measured across the entire business should impact executive remuneration. Linking executive pay to corporate responsibility no doubt can send a strong signal, but the real litmus test is whether sustainability targets form an integral part of everyone's performance appraisal.

Remuneration strategy is not enough

APG believes sustainability targets should not be viewed in isolation from financial ones. For example, green products need to be commercially viable. And the reward one can get for meeting sustainability targets should also depend on how well the company has met its financial targets. Vice versa, in extractive industries for example, financial awards should depend on achieving a minimum level of health and safety performance.

We do not believe that setting sustainability targets in remuneration policies will automatically lead to better long-term performance. They can be very material in the short-term. However, to build lasting relationships with stakeholders and prepare the business for future climate change, companies need a long-term perspective. Therefore the most important question is whether the overall financial remuneration strategy has a sufficiently long-term focus.

Voting for improvement

In APG's view, companies should actively consider whether it makes business sense to introduce sustainability or other non-financial targets in bonus schemes, and explain why (or why not). After all, full integration of sustainability into company strategy is the overarching goal, and remuneration is only one of several tools to achieve this. Where investors can be most effective is by making sure that the right people with the right skills and expertise are at the helm of the company, preparing the company for a future where social and environmental issues will become ever more important.

APG's responsible investment principles

1 Responsible investment is integrated into APG's investment process.
We take account of shareholder rights and environmental and social issues in our investment decisions. Our research on sustainability or corporate governance can form the basis for decisions not to make an investment, to sell an investment, or to reduce or increase the size of an investment.

2 APG engages with companies to promote sustainability and good corporate governance.
In our dialogue with companies we make clear what standards we expect in relation to sustainability and shareholder rights. To increase our influence we often work with other investors.

APG expects companies to operate in accordance with **3** the UN Global Compact and will divest from companies if engagement does not lead to improvement. APG does not invest in products that are prohibited under Dutch or international law.

This means we do not invest in companies that are directly involved in the production of landmines, cluster munitions or launch systems for these weapons, or of chemical or biological weapons. We also exclude companies involved in products or services that are generally considered in the Netherlands to be objectionable. The UN Global Compact sets out a minimum framework of standards for corporate practice on human rights, labour rights, the environment and the prevention of corruption.

4 APG makes active use of its rights as a shareholder.
We vote at the meetings of companies in which we invest. We publish our voting record and explain our voting decisions.

APG works in the Netherlands and internationally to advocate policy and legislation that support **5** sustainability and good corporate governance.

We regularly discuss sustainability and shareholder rights with policy-makers. We also contribute to the development of standards to promote the long-term integrity of financial markets.

APG seeks out attractive investments that promote sustainability.

6 APG invests in renewable energy, clean technology and microfinance and is constantly alert to new opportunities to make investments that contribute to sustainability.

APG promotes its responsible investment approach actively in order to encourage sustainability and good corporate governance.

7 We work with other investment managers and pension funds throughout the world in order to increase the impact of our responsible investment policy on behalf of our clients. We play an active part in numerous investor networks in the Netherlands and internationally. We communicate extensively about our work.



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Mixed Sources

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