

Stewardship Criteria & Policies

This document outlines

- **The Stewardship Philosophy**
- **Summary of the Criteria**
- **Ethical, Social and Environmental Policies**

It can be found at www.fandc.com/stewardship

The Stewardship Philosophy

Many people believe that investors should have some moral responsibility for the investments they make. Stewardship is committed to this principle and offers people a way to invest in the stockmarket while expressing this sense of responsibility. Stewardship does this by applying ethical and environmental principles to the selection of investments, and by using its influence as a shareholder to encourage more socially responsible and environmentally sustainable behaviour by companies.

Investment in companies raises both ethical opportunities and ethical difficulties for investors. Opportunities, because companies can make a very positive contribution to society, by creating jobs and wealth and by providing many of the products and services on which a sustainable society depends. By becoming shareholders, investors have the opportunity to support the positive contribution some companies make. However, companies can also give rise to many social and environmental problems by, for example, making harmful products, acting irresponsibly with regard to customers, employees and the communities in which they operate, and by polluting the environment. Investors in such companies inevitably feel some responsibility for the harm that they do.

Companies do not, however, fit neatly into one category or the other. They commonly have a satisfactory approach to some aspects of their activities and weaknesses in others. Where the failings are not so serious as to disqualify a company outright for inclusion in the portfolio, Stewardship will take a balanced view across all its activities. An investment is more likely to be made in cases where there is clear scope for a shareholding to give opportunities to influence it for the better.

Stewardship is committed to taking a more socially responsible approach to investment by making the most of these opportunities and reducing its contribution to the problems through:

- **Investing in companies whose products, services and operations make positive contribution to society**, and those which demonstrate a responsible attitude in all aspects of their business, notably including their customers, employees, the communities in which they operate and the environment.
- **Avoiding investments in companies that do particular harm**, including those involved in the supply or production of armaments; or which operate irresponsibly, particularly with regard to the environment, human rights or animal welfare issues; or which are involved in the production of alcohol, tobacco or pornography; or in gambling. We recognise that Stewardship's core aim of investing only in those companies which, in what they do and the way they do it, on balance make a positive contribution to society cannot be fully captured in the policies described here. *Accordingly, we may on rare occasions exclude companies which we judge conflict with that aim even when they do not fall foul of any of the negative criteria set out in this document. We may also on rare occasions where a company is considered, on balance, to make a positive contribution to society, include a company that breaches a negative investment selection criterion in a minor, inconsequential or non-material way.*
- **Using its influence as an investor to encourage companies** in their efforts to improve their management of environmental and social responsibility issues.

Summary of the Stewardship Criteria

Positive criteria

- Supplying the basic necessities of life eg healthy food, housing, clothing, water, energy, communication, healthcare, public transport, safety, personal finance, education
- Offering product choices for ethical and sustainable lifestyles
- Improving quality of life through the responsible use of new 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 criteria

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

Policies underpinning the Stewardship Criteria

Detailed policies underpin the Stewardship criteria, with Stewardship having a clear position on a range of issues relevant to ethical investment. While recognising that many of these issues overlap, for practical purposes the policies are categorised as Ethical, Environmental and Social.

- **The Stewardship Ethical Policy:** covers the positive criteria and key negative criteria, including for tobacco, gambling, harmful or offensive materials, military, advertising, unnecessary exploitation of animals, the financial sector, private healthcare and luxury goods.
- **The Stewardship Environment Policy:** covers atmosphere (climate change and ozone depletion), energy (nuclear and renewable), land and water (pollution, persistent organic pollutants, endocrine disrupting chemicals, pesticides, genetic modification, access to water and water pollution), biodiversity and supply chain management.
- **The Stewardship Social Policy:** covers employee relations (equal opportunities and diversity, health and safety, professional development, rewards, participation and whistleblower protection) human rights (security forces, employee and supply chain labour standards, corruption and oppressive regimes), and the business environment (customers, suppliers, local communities, indigenous peoples, shareholders and corporate governance).

Stewardship Ethical Policy

Ethical Policy Statement

Stewardship exists to serve the needs of investors who have strong personal beliefs and who wish to derive financial returns from companies whose conduct and activities are aligned with those beliefs. Accordingly, Stewardship aims to invest in companies that make a positive contribution to society, while avoiding investment in those that have harmful effects.

On rare occasions, there will be companies that have harmful aspects, but where the overall business means the company is considered acceptable for Stewardship.

Positive Criteria

Companies meet Stewardship's positive criteria by:

- **Providing products and services essential for everyday life.** This includes public health and healthcare products, nutritious food, education, housing, social services, financial services, clothing, water, energy, transport, infrastructure in emerging markets, communication and safety.
- **Meeting sustainable development challenges** by offering products and services for lower carbon lifestyles or incorporating sustainable design. These include clean energy, low carbon technologies, sustainable transport, recycling, waste reduction, energy and water efficiency, urban regeneration and brown field development.
- **Improving quality of life through new technologies**, such as mobile telecommunications, internet services and consumer electronics.
- **Offering consumers ethical product choices**, such as fair trade and organic goods, ethical financial products and independently certified products e.g. Forest Stewardship Council certified timber

Positive Ethical Override

The Committee of Reference exercises its collective judgement to determine whether companies are acceptable for investment by Stewardship. The Committee may, on rare occasions where a company is considered, on balance, to make a positive contribution to society, include a company that breaches a negative investment selection criterion in a minor, inconsequential or non-material way.

The Committee of Reference will apply this 'positive ethical override' only in highly exceptional circumstances where a company fails to meet one or more of Stewardship's absolute negative ethical, environmental and social screens in, for example, a trivial or inconsequential way.

The absolute negative screens subject to this 'positive ethical override' are:

Ethical screens

- Direct involvement in production of alcohol, tobacco, gambling or pornography
- Manufacture of weapons systems
- Ownership and operation of nuclear power generation.
- Direct involvement in animal testing for cosmetics

Environmental screens

- Failure to move towards Montreal Protocol requirements regarding CFCs or other atmospheric ozone depleting materials.
- Sale/use of over 20,000 m3 tropical hardwood per annum and no commitment to certified timber or improving practices.

Social screens

- Systematic failure to uphold anti-discrimination policies and international standards.
- Exceptionally poor health and safety e.g. significant prosecutions or poor sector performance
- Significant links to an oppressive regime, where their presence is a cause of concern or their activities facilitate human rights abuses.

No matter how positive a company may be in other aspects of its business, a *significant* breach of any absolute negative screen will prevent a company's acceptability for investment by Stewardship.

Negative criteria

Companies breach Stewardship's negative criteria through significant involvement in alcohol, tobacco, gambling, harmful or offensive materials, military, advertising of unacceptable activities and unnecessary exploitation of animals. Stewardship also has specific criteria covering the financial, private healthcare and luxury goods sectors.

Negative Ethical Override

A negative ethical override is applied only in exceptional circumstances to companies that conflict with Stewardship's core aim, even if they do not technically fall foul of the negative criteria.

Alcohol

The Issue

The World Health Organisation has identified alcohol as among the highest risks to health in industrialised countries and as a growing concern in certain developing countries. While moderate drinking is harmless, there is a significant risk of harm to the health of individuals and their families from alcohol dependency, excessive consumption, drink driving and underage drinking - with young people and pregnant women most at risk. Alcohol misuse also impacts public health, with rising concern about alcohol-related diseases and the association of alcohol with domestic violence, unsafe sex, accidents and crime. As well as these social costs, there are economic costs for healthcare, social welfare and criminal justice systems and for business, with some companies experiencing lost productivity in the workplace.

Governments in both industrialised and emerging markets are already addressing concerns about alcohol misuse through imposition of excise duties, restrictions on sale and advertising, better law enforcement, alcohol education and provision of support services. Certain companies that produce or retail alcohol are also working together constructively to implement voluntary codes of good practice - although these currently focus mainly on developed markets. There continues to be considerable divergence across markets in public views on what a "safe level" of alcohol consumption constitutes and the most effective combination of regulation and voluntary measures to promote safer drinking. Government policy makers continue to debate what degree of intervention is appropriate to protect public health and how best to enable consumers to make informed purchasing and decisions.. For international companies, these issues are complicated by variations in the attitudes different cultures have towards alcohol consumption. These issues all raise challenges for ethical funds seeking to assess company good practice.

The Stewardship Approach

Stewardship considers abusive alcohol consumption to be a significant public health concern in many markets. The Fund therefore aims to serve investors who do not wish to derive financial returns from companies that produce alcoholic beverages. Stewardship recognises that many companies, such as restaurants and supermarkets, sell alcohol, but that this is not their core business; therefore only companies significantly involved in selling alcohol, such as pubs and bars, are excluded.

Stewardship also considers that the marketing practices of companies engaged in alcohol retailing may positively influence consumer behaviour. The Fund therefore views positively companies that support responsible consumption through clear measures to combat misuse, including providing consumers with sufficient and accurate information on health risks and compliance with local regulation. Stewardship positively views companies that combine robust group-wide management systems with sensitivity to cultural differences in attitudes towards alcohol.

Stewardship will not invest in companies that:

- *Derive any turnover from the production of alcoholic beverages.*
- *Operate in the hotel, restaurant or leisure industries and derive more than one third of turnover from selling alcohol.*
- *Operate in other industries and derive more than 10% of turnover from bottling, wholesale or sale of alcohol.*

- *Persist in selling alcohol in an irresponsible manner e.g. have exceptionally poor sales or advertising practices.*

Gambling

The Issue

Gambling has become popular and easier to access. Casinos are considered an “entertainment staple” for many Americans, and online gaming, particularly bingo, is increasingly popular in Europe. Unlike in the 1930s, when gambling was associated with casinos run by gangsters, major casino operators and online gaming companies have emerged as “legitimate,” publicly listed companies. Gambling regulation is under review and likely to be relaxed in the USA, Europe and the UK. Legalised gambling is also proliferating internationally, including in Mexico, Macau, Singapore and Russia.

Non-gaming sector involvement in gambling is increasing. Until recently, the main companies involved in gambling were gaming operators (e.g. global companies such as Las Vegas Sands, and UK names such as William Hill) and gaming manufacturers. Media companies are now becoming increasingly involved in TV and online gaming, and hotel companies are set to become more involved in operating casinos. Mobile phone and internet companies have also become involved in gambling, but their activities are typically limited to providing access to online gaming sites operated by gaming companies, meaning gambling is unlikely to account for a significant proportion of mobile and internet companies' revenues.

The Stewardship Approach

Stewardship aims to serve investors who do not wish to invest in companies that promote gambling – either because they would prefer to promote more socially productive and desirable activities, or because they regard less well regulated gambling as positively harmful.

Stewardship recognises however, the increasing spread and acceptance of gambling as part of the leisure and entertainment industry. It thus differentiates, between companies with major and minor involvement in gambling. Furthermore, even where there is minor involvement, it identifies companies with responsible approaches towards gambling.

Therefore, Stewardship will invest in companies in non-gaming sectors, such as media and hotels, only if gambling accounts for less than 10% of turnover and such companies demonstrate responsible business practice.

Tobacco

The Issue

Significant risks to public health arise from the activities of tobacco companies. The World Health Organisation (WHO) notes that tobacco kills 4.9 million people every year, raising serious concerns regarding the effects of tobacco products and tobacco dependence. Governments certainly have a role to play in greater regulation, tax measures to reduce demand, education, public awareness and cessation measures. However, there are significant public concerns regarding the approach that tobacco companies themselves take towards packaging, labelling, advertising, promotion, and lobbying of governments in developing and developed countries.

The Stewardship Approach

Stewardship aims to serve investors who do not wish to derive financial returns from companies involved in the production or sale of tobacco, tobacco-based or related products.

Stewardship will not invest in companies that derive any turnover in from the manufacture of such products, or those that derive more than 10% of turnover from their sale of such products.

Production of “tobacco, tobacco-based or related products” includes production of leaf, cigarettes, hand-rolling and pipe tobacco, cigars, snuff, chewing tobacco, paper and filters, packaging and machinery. Nicotine patches are not excluded because of their therapeutic intention.

Military

The Issue

A company's involvement in supplying the military may have far-reaching consequences for the security of people and their social and physical environment. Although government policies play the central role in defence procurement, the activities of companies may pose a serious concern. Defence and heavy industrials companies are most often implicated. However, a growing trend of outsourcing by defence ministries is drawing more non-defence companies into military contracting – especially technology and telecommunications firms.

Companies involved in providing products or services for military purposes may also be involved in exports to oppressive regimes or exports to countries involved in an armed conflict or region of tension, or exporting to countries whose social welfare is negatively impacted by military spending. While the root causes of conflict are generally complex, investing in companies that provide products or services for military purposes may exacerbate an already-unstable situation: for example, by increasing the likelihood of violent conflict, discouraging investment, driving up fiscal deficits, and contributing to poverty and environmental damage.

The Stewardship Approach

Stewardship aims to serve investors who do not wish to derive any financial returns from investment in companies involved in military procurement. This is defined as companies that sell or manufacture goods or services specifically designed for *strategic military* use. Accordingly, Stewardship will *definitely not* invest in companies that produce or sell weapons or weapons systems or platforms, including nuclear systems, products or services specific to such systems.

Moreover, insofar as a growing number of companies not formally classed as defence companies supply goods and services designed for *strategic military* use, Stewardship will also extend its review to avoid such companies. These will be evaluated on the basis of whether such goods/services have, *as a result of customisation*, a specific battlefield or combat-related application involving use in conjunction with weapons or weapons systems/platforms, or have other strategic military uses. 'Strategic' is defined as 'improving the ability of the military to achieve its objectives on the battlefield'.

Finally, Stewardship may invest in companies that sell or manufacture products or services that are essentially non-military in nature but can be used by military facilities or personnel. In cases where the military or non-military nature of a product or service may be unclear, or where companies provide products or services to both military and non-military customers, Stewardship will have regard to the extent to which such products have been customised for *strategic military* use.

Harmful & Offensive Products, Materials and Services

The Issue

Harmful material and its depiction may cause direct and serious harm to children, vulnerable groups in society, such as those with diminished responsibility, as well as the majority of people. Such material may be graphic portrayals of actual violence, , neo-nazi or other racist, sexist or homophobic material that might encourage attacks or discrimination.

Offensive material and its depiction may not be seriously harmful per se, but may undermine commonly accepted standards. This may prejudice respect for human dignity, discriminate on grounds of race, sex or nationality, incite crime or public disorder. Such material might include hard-core pornography, very violent computer games, 'X' (in the US) or 'R18' (in the UK) and unrated (NR) films, etc.

It is important to distinguish between material that has aesthetic merit and reflects and celebrates the physical and sexual nature and life of men and women, and clearly offensive portrayals of physical and sexual relationships in which personal caring and/or human dignity are either absent or insignificant.

There is particular public concern regarding adequate protection for children against harmful and offensive materials and their depiction.

The Stewardship Approach

Stewardship aims to serve investors who wish to avoid investment in companies involved in the production, distribution or retail of harmful and offensive material, products or services.

This new policy statement aims to strengthen and clarify our previous criteria that applied only to violent and pornographic materials, and extend them to include racist, sexist, homophobic or otherwise discriminatory materials and products.

*Stewardship will definitely not invest in companies involved in the production, distribution or retail of **harmful** materials, products or services.*

*Stewardship will also not invest in companies that derive more than 3% of their revenues from the production, distribution or retail of **offensive** materials, products or services.*

Advertising of unacceptable activities

Stewardship does not normally invest in advertising agencies because of the likely inclusion in the wide range of products advertised of unacceptable products.

Animal Welfare

Stewardship aims to serve investors who wish to show respect for life, avoiding unnecessary, cruel exploitation of animals. The animal welfare criteria cover fur, meat and animal testing.

Fur

Stewardship definitely will not invest in companies involved in the production (e.g. rearing or hunting of animals for their fur) or processing of fur or fur products, or in the retail or wholesale of fur or fur products, unless retail is of a trivial nature. The Committee will exclude companies with over 3% of annual turnover from fur, that breach the biodiversity criteria, or with prominent involvement or a significant share of the fur market.

Meat: Animal treatment in the food industry

The Issue

The majority of meat products today are sourced from intensively reared ("factory") livestock around the world. Concerns have arisen regarding some of the farming practices, including inadequate livestock and poultry accommodation, productivity-enhancing treatments, and poor sanitary conditions. Animal transportation and slaughtering also remain areas of concern, as current practices may cause unnecessary pain and stress to the animals.

The Stewardship Approach

Stewardship recognises the concerns of investors with regard to some of the existing practices of farmers and abattoir operators which cause avoidable and unnecessary suffering to livestock.

Stewardship may invest in companies involved in the operation of farms, animal transportation or abattoirs, or companies sourcing from such operations, but only where such companies demonstrate robust policies and monitoring systems addressing animal welfare. Stewardship will expect these policies to address animal accommodation, feeding, and responsible use of veterinary medicine (e.g. antibiotics and growth-enhancing hormones) during rearing, transportation and slaughter.

Stewardship will exclude companies without such policies or where there is clear evidence of poor practices in animal welfare management.

Animal Testing

Animal testing is one of the most complex and contentious issues Stewardship has to consider. The broad Stewardship aim is to not invest in companies involved in unnecessary and cruel animal exploitation.

Stewardship will not approve investment in manufacture of cosmetics, soaps and toiletries, unless their products are animal test free. Stewardship will not regard products as free of animal testing unless the manufacturer has either not conducted or

commissioned any tests on the products or their ingredients within the past five years or has stated that, since a particular date, it has not and will not conduct or commission any such tests. Stewardship has similar criteria in relation to manufacturers' suppliers.

Bearing in mind, however, Stewardship's aim of investing in companies which are of benefit to the community, the Committee believes there will be occasions when investment in companies that are involved in animal testing is justified, especially when testing is required by law and where the company's products would be likely to provide outstanding and exceptional benefits, such as the alleviation of pain or the prevention or cure of a serious diseases. The Committee does not believe that Stewardship could properly exclude all possibility of investment in pharmaceutical companies which contribute to the fight against disease, for example in combating HIV/Aids, or providing drugs for cancer sufferers, or the vaccination and other forms of inoculation on which many people in both developing and developed countries depend.

At present there is no legal requirement for companies to provide information about their practices with regard to animal testing. It is therefore impossible for the Committee to satisfy itself, in the case of any particular company, that testing on animals is indeed essential, and is kept to a minimum, with avoidance of unnecessary suffering. The Committee will nevertheless do all it can to encourage disclosure, and will favour those companies that provide information both about their own practices and those of their suppliers. The Committee will itself be open about the decisions it makes: whenever an investment in a pharmaceutical company is approved, the Committee will record and make public its reasons.

Similar considerations apply to investment in companies that manufacture those veterinary products or food additives which the law requires to be tested on animals. In the case of manufacturers of other products, who themselves undertake or commission the (again sometimes obligatory) use of animal testing, approval for investment will be given only in the most exceptional circumstances. Examples of such products are household or industrial chemicals, including printing inks. If approval is given, the Committee will again record and make public its reasons. It will also seek to influence manufacturers of such products to find alternatives to animal testing and to encourage their suppliers to do the same.

With regard to retailing, Stewardship will consider investment in a company that sells cosmetics, soaps and toiletries only if it also sells an alternative range or products that are animal test free.

The Committee will not approve investment in companies that provide animal testing services to other companies.

The Committee recognises the question of animal testing as one of great sensitivity and complexity. It is an area where it is extremely difficult to obtain reliable information. Even on the basis of the restricted information that is available, no ethical fund can at present realistically claim to be completely animal test free. The Committee will continue to keep the whole question of animal testing under review, and in doing so it will wish to monitor and take account of fund holder views.

Financial Sector Policy

The Issue

The financial sector has a significant impact on the economy and society, at both local and global levels. A healthy financial sector is essential for the functioning of modern societies, enabling the flow of capital to sustain the world economy and facilitate international development. Private capital underpins western economies and, with private capital flows far out-pacing governmental aid to developing countries, the financial sector enables individuals and local communities worldwide to build up assets, companies to benefit from and contribute to economic growth, and local and international commerce to flourish.

Financial sector companies have “direct” impacts on the environment through their consumption of energy, paper and other resources, and their production of waste; and on society through their relationships with employees and suppliers. The sector also has “indirect” impacts that arise through the funding and management of corporate and individual client activities. It is increasingly important that the financial sector be encouraged in practices that are compatible with sustainable development objectives. Within the sector, companies offering financial services and products face ever-rising expectations from the public and regulators and, while many leading companies have made significant progress towards sustainability, public concern remains about both the direct and indirect impacts of the sector as a whole.

A key element of sustainable financial practices is promotion of financial inclusion, which involves addressing the needs of financially excluded people in relation to money management, financial information and advice, and also by designing products to meet the needs of people on very low incomes. For example, companies may foster financial inclusion by providing banking and insurance products - which are essential to everyday life - through active programmes to improve financial literacy and by extending access to affordable credit.

Other key elements of sustainable financial practices are appropriate, transparent and clear marketing and sales of financial products and services; customer relations that recognise the interests of the customer; effective anti-money laundering and compliance procedures; and strong employee and supplier relations.

Most importantly, sustainable financial practices involve companies integrating environmental, social and governance considerations into their core financing activities, and as part of their regular business decisions. Leading companies are already starting to report publicly on how they implement this approach, including how environmental, social and governance issues are incorporated into analysis and decision-making processes, as well as how they seek appropriate disclosure on such issues by entities financed.

The Stewardship position

Stewardship's policy at inception in 1984 was to exclude all financial services that might potentially finance activities that Stewardship would normally exclude. Stewardship did not invest in companies involved in corporate lending, insurance and investment or project finance, because it was not possible to obtain information to prove that the activities they finance are compatible with Stewardship principles. This position was first adopted at a time when the involvement of High Street banks in Apartheid South Africa attracted harsh criticism and was one of the main expressions of the ethical investment movement. Since then, considerable change has emerged in the financial sector; this is evident in certain leading companies responding

effectively to sustainability issues associated with both their operational activities and their financing decisions.

Following an examination of the sector's activities and practices, the Committee of Reference has determined in 2007 that although not all companies in the financial sector demonstrate good practice, certain financial sector companies do make a positive contribution to society, and investment in them supports Stewardship's objectives.

Stewardship supports the development of sustainable financial practices. Key elements for this are development of innovative banking and insurance products, including basic services for traditionally underserved communities, pro-active management of physical operations and staff (direct impacts) and good practice in integrating environmental, social and governance issues into financing decisions (indirect impacts).

Given that sustainable business practice within financial services and product provider companies is at an early stage of development relative to many industrial sectors, Stewardship expects companies to demonstrate clear evidence of commitment and progress in addressing both direct and indirect impacts. Stewardship aims to use investor influence to promote responsible practice on the part of individual companies in its investment portfolios and within the sector as a whole, focusing particularly on indirect impacts, where many of the most significant challenges lie.

The Committee will assess whether companies support Stewardship's vision of sustainable financial practices by examining companies' management of their direct and indirect impacts. The Committee will seek best practice across the full range of a company's activities, but may consider unusual strengths in one area as rationale for investment, and engagement to improve a company's minor weaknesses elsewhere, provided that these weaknesses are not fundamentally incompatible with Stewardship's investment selection criteria. Companies must always attain Stewardship's minimum levels of acceptable practice to be eligible for Stewardship.

Stewardship will exclude companies that on balance fail to achieve an acceptable level of good practice across the full range of their business activities and do not succeed in contributing sufficiently to establishing sustainable financial practices. Indicators of this may be a track record of unfair or inappropriate practices towards socially disadvantaged customers; a fundamental regulatory breach or a pattern of persistent and/or significant regulatory breaches; failure to demonstrate adherence to internal codes of best practice (e.g. significant involvement in global project finance without commitment to the Equator Principles); or failure to meet other Stewardship environment and social criteria.

Financial companies, like many other Stewardship companies, may have a wide variety of clients. Stewardship will not generally exclude companies solely on the basis of the type of customers they finance or insure. However, as with all stock approval decisions, the Committee reserves the right to exclude any company whose activities conflict with the overall aims of Stewardship and, while information on financial sector companies' customers is usually limited, Stewardship will strive to ensure that all possible research is undertaken in order to exclude any company which may be in conflict with Stewardship's aims. An example might be where information emerges that a company has a significant involvement with a corporate, sovereign or other major client whose behaviour breaches Stewardship criteria (e.g.

a large loan to or insurance for an oppressive regime, involved in human rights abuses).

Stewardship considers the following activities meet the Positive Criteria

- “Basic necessities of life” include health and general insurance, reinsurance, mortgages and savings products (including Islamic finance products), responsible lending to minorities and low-income customers, community re-investment, microfinance and micro-insurance.
- “Products and services for ethical and sustainable lifestyles” includes SRI funds, clean energy funds, private equity for sustainable businesses, green commercial and residential real estate and preferential insurance products for eco-friendly products.
- Companies “meeting sustainable development challenges” include financial research that incorporates environmental, social and governance issues, responsible lending to minorities and low-income customers, community re-investment, microfinance and micro-insurance, and development of innovative financing vehicles aimed at facilitating capital flows to sustainable technologies and services.

Stewardship considers practices in relation to the following key direct impacts

The standard Stewardship criteria already address direct impacts and are also considered when assessing financial practices:

- Management of key direct environmental impacts e.g. energy use, waste, paper and travel.
- Local community involvement.
- Employee consultation during business process outsourcing decisions, and good practices in equal opportunities and diversity, including promotion, remuneration and benefits practices.

In addition, Stewardship will give special consideration to the following sector-specific good practice standards:

- Responsible marketing, sales and advertising to ensure the suitability of products and transparent communication of charging policies, particularly when financing “vulnerable” customers.
- Internal controls and a company culture to manage conflicts of interest and business ethics.
- Proper checks and compliance with money laundering regulation to deter serious crime and protect the public interest.
- Responsible lending practices, both at a micro level – especially when financing “vulnerable” customers – and at a macro level, when financing activities with a potentially high impact on society.

Stewardship considers practices in relation to the following key indirect impacts, and will assess companies according to how significant their involvement is in each of these areas of financial activity.

- **Asset management**; offering SRI product options and/or commitment to The United Nations Environment Programme’s Principles for Responsible Investment (PRI), which commit signatories to incorporating environmental, social and governance issues in investment practices¹.

¹ The UN Principles for Responsible Investment were launched by a group of institutional investors in 2006, in the belief that environmental, social, and corporate governance issues can affect the performance of investment portfolios, and to better align investors with broader objectives of society. For more information see <http://www.unpri.org/principles>

- **Project finance;** commitment to the Equator Principles², which are voluntary social and environmental guidelines based on the World Bank Group/IFC's Performance Standards³. Signatories undertake to provide loans to high-impact infrastructure projects only where the sponsors demonstrate that the project will be constructed and operated in accordance with sound social and environmental management practices. Compliance with these safeguard policies becomes an explicit loan condition.
- **Corporate lending;** commitment to managing environmental risks in corporate loan portfolios, including development of sector-specific guidance for environmental credit risk assessment and implementing these through employee training, clear performance reviews and reporting. Companies developing management of social and environmental risks in corporate loan portfolios will be viewed positively, as this is an emerging area of good practice.
- **Retail customers;** promoting financial inclusion through facilitating access to mainstream financial products for people on low incomes, and by providing information and advice to improve financial literacy. Emerging good practice is to provide transparent social and economic data on the customer base.
- **Private equity:** Stewardship will look for:
 - o Whether the investment approach emphasises sustainability themes;
 - o Inclusion of sustainability issues in due diligence and operational involvement;
 - o Transparency and disclosure, including implementation of voluntary good governance practices (e.g. 2007 Walker recommendations) and participation in industry initiatives to improve transparency; and
 - o Where holdings are publicly disclosed, we will assess whether these breach the key negative screens. Where holdings are not disclosed, we will assess whether industry and sector focus likely breaches the key negative screens. The key negative screens are tobacco production, alcohol production, gambling, pornography or violent material, manufacture and sale of weapons, unnecessary exploitation of animals and nuclear power generation.

Regulatory breaches: Key regulated activities are marketing and sales practices, money-laundering and conflicts of interest. Given that repeated poor practice will typically only be evident once regulators have uncovered failures, the GSI Team will aim to take the following actions when major regulatory breaches are found:

- Maintain active monitoring of regulatory compliance, including regular monitoring of media, to identify if further research and analysis is needed.
- Review public communication from the relevant regulator
- Review public statements by the company regarding the breach

² Significant environmental and social risks can arise in large projects, such as construction of a power plant. Launched in 2003 by a group of financial institutions, The Equator Principles are a common set of voluntary guidelines, based on best practice, to help financial institutions and their clients to address environmental and social impacts related to such projects. The Equator Principles were revised in 2006 and as at June 2007, had been adopted by over 50 financial institutions. For more information, see <http://www.equator-principles.com>

³The International Finance Corporation (IFC) applies Performance Standards to manage social and environmental risks and impacts in private sector financing. The standards cover social and environmental assessment and management system, labour and working conditions, pollution prevention and abatement, community health, safety and security, land acquisition and involuntary resettlement, biodiversity conservation and sustainable natural resource management, indigenous peoples and cultural heritage. For more information, see <http://www.ifc.org/ifcext/enviro.nsf/Content/PerformanceStandards>.

- Review the corrective action taken, whether voluntarily or as required by the Regulator
- Report to the ISC meeting to review the acceptability rating

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Private Healthcare Sector Policy

The issue

In countries where healthcare is provided by public as well as private institutions, concerns exist regarding the lack of regulation in the private sector and consequently, the quality of care offered to patients by these providers. Public-private partnerships for health are proving increasingly important to health service delivery as they provide expanded capacity to treat patients. Nevertheless, there is public concern about these partnerships, particularly about the appropriateness of care provided and employee relations, including staff recruitment and its sourcing and staff retention.

The Stewardship Approach

Stewardship recognises healthcare as an intrinsically positive product and therefore regards positively companies involved in the provision of healthcare.

Stewardship may invest in companies involved in the provision of healthcare, whether in the public or private sectors, where such companies demonstrate commitment to the best interests of the patient, including patient rights and fair and transparent billing. Note: Good practice in preventing potential conflicts of interest and corruption are covered in the Stewardship Social Policy.

Stewardship also expects such companies to demonstrate good practice in employee relations, including health and safety, benefits for part-time employees and provision of professional development, as covered in the Stewardship Social Policy.

Cosmetic surgery

Stewardship is aware that cosmetic surgery and procedures are a growing area of private healthcare and recognises that they can deliver positive health and individual lifestyle benefits. Accordingly, Stewardship will consider companies involved in the provision of cosmetic surgery as it would any other healthcare provider.

Luxury Goods Sector Policy

The Issue

Historically, the provision of products that cater exclusively to the wealthy members of society has given rise to concerns over the promotion of social inequality, and excessive and irresponsible consumption. More recently, the line between providers of luxury goods and high-street retailers has become increasingly blurred, with companies at both ends of the spectrum offering products to a widening range of consumers, and taking responsibility for the management of their negative impacts. Nevertheless, concerns remain about the luxury industry's negative impacts, particularly on the disadvantaged members of society through marketing intended to create demand among those for whom such products are not affordable.

The Stewardship approach

Stewardship recognises the concerns of investors with regard to the luxury industry and its contribution to social inequality and excessive consumption, but is also aware of the changing structure of the industry and the diversification of its products, the steps taken by the sector to improve its conduct and the possibility that some impacts of very high-value goods may not differ significantly from those of consumer products of lower value.

Stewardship may invest in companies providing luxury goods where such companies demonstrate commitment to best practice in the areas of responsible product sourcing, environmental management, supply chain management and advertising, all of which are addressed by Stewardship's existing policies.

Stewardship Environment Policy

Environment Policy Statement

We are all as consumers responsible directly or indirectly for environmentally unsustainable behaviour, but so are companies. Stewardship believes that companies can contribute substantially to reducing their own impact on the environment and to providing solutions to many of the long-term problems.

Stewardship aims to avoid those companies that have the most serious environmental impacts and prefers to invest in those which adopt high standards in their operations and report fully and openly on what they do. If their products or services in themselves contribute to a more sustainable world, that is also viewed favourably. In all cases, changes in a company's behaviour should be substantial and speedy enough to be relevant to solving the underlying environmental problems.

The unsustainable use of natural resources, which is increasing at a rate of around 2% per annum, the reduction of biodiversity and the pollution of land, sea and air are all of concern to Stewardship.

The 'precautionary principle' is also supported - encouraging companies to err on the side of caution when judging the possible impacts of their activities and in using new technologies such as genetic modification.

When assessing companies the Stewardship Committee of Reference pays particular attention to the following areas:

- **Atmosphere** Climate change impacts, ozone depletion
- **Energy** Nuclear power, and power from renewable sources
- **Land and Water** Pollution, including Persistent Organic Pollutants, Endocrine Disrupting Chemicals and Pesticides. Genetic modification of living organisms. Access to water and water pollution.
- **Biodiversity** Understanding, managing and reducing biodiversity impacts
- **Waste** Managing and reducing waste
- **Supply chain** Suppliers applying good practices in all aspects of their operations

Atmosphere

Climate Change

The Issue

The temperature of the surface of the planet is rising fast, due substantially to increasing human-induced emissions - most commonly CO₂. The main contributors to rising temperatures are worldwide growth of industrial output, traffic, current land management practices and deforestation. Most of the global warming seen over the last fifty years is likely to have arisen from increasing concentrations of man-made greenhouse gases¹, principally from the burning of fossil fuels.

Climate change, which is already altering our weather patterns, is predicted to accelerate further. Resultant effects could involve further rises in sea levels and an increase in the number of extreme events, such as storms, hurricanes and droughts. Climate change and its resultant effects will lead to property damage, displacement of people, increased spread of disease, crop failure and damage to wildlife that is unable to adapt sufficiently rapidly to a changing environment.

Sectors widely recognised to have a disproportionately high impact on climate change include oil and gas, automobiles, transport, construction, producers and processors of metals, minerals (including building materials), food, chemicals, waste management and pulp (from timber or other fibrous materials).

Certain sectors are of significant public concern, as they have a high impact on climate change, but are excluded from current regulations, have a history of lobbying against mitigation measures or do not participate in voluntary initiatives. Industries of concern are aviation, automotive manufacture, oil and gas, producers and processors of metals, minerals (including building materials), chemicals, waste management and pulp (from timber or other fibrous materials).

The Stewardship Approach

Stewardship recognises that:

- Society worldwide currently depends on fossil fuels and that demand is rising worldwide for use of cars, roads, aviation, container shipping, ports and rail.
- Fossil-fuelled transport systems bring benefits to the economy and offer mobility to individuals, including access to everyday work and leisure activities in many markets.
- To develop more sustainable societies, governments, companies and individuals must change their practices to mitigate their impacts on climate change, but there will inevitably be a period of transition

Stewardship seeks to support the Kyoto Protocol goals and views positively companies that are working towards a low-carbon economy. Examples include companies that provide public transport, design automobiles that have lower emissions, develop alternative technologies such as hybrid, or provide alternative fuels such as biodiesel or hydrogen. Stewardship also views positively companies that manage transport of their goods in a way that minimises fuel consumption and greenhouse gas emissions.

For companies whose products or services contribute disproportionately to climate change, Stewardship may invest only if they are able to demonstrate commitment to developing sustainable products or services, at a speed that is relevant to the time scale within which the environmental and social impacts of climate change must be addressed. The Stewardship approach to these key sectors is set out below.

Extractives

Oil, gas and coal extraction contributes significantly to global warming through consumption of energy during extraction activity, the flaring of natural gas, and natural gas and methane fugitive emissions during extraction and transmission. Nevertheless, Stewardship recognises the essential role played by oil, gas and coal in the global economy. However, in light of their disproportionate contribution to climate damaging emissions, Stewardship will only invest in companies operating in these sectors on the condition that they meet the following criteria:

- **Direct environmental impacts:** Managing adverse environmental impacts through, for example, maximising energy conservation and efficiency, land rehabilitation and water reuse;
- **Product:** Developing clean fossil fuel burning technologies, such as carbon capture and storage (covered in more detail in the section on Power generation);
- **Policy:** Developing a policy against gas flaring or methane release, and enforcing it at all sites; supporting governments, in countries where production takes place, in designing and implementing anti-flaring measures;
- **By-products:** Recovering gas and methane resulting from oil extraction or coal mining;
- **Innovative technology:** Developing clean extraction and production technologies;
- **Transparency:** Publishing information and key statistics on emissions and resource use, as well as a clear strategy for reducing overall emissions over time irrespective of the company's growth. A comparison with sector peers may be used to assess the quality of this strategy.
- **Advocacy:** Supporting public initiatives in favour of developing solutions to climate change.

In addition, Stewardship will not invest in extractive companies that do not meet the standards of good practice detailed in the Stewardship Social Policy.

Aviation

Stewardship will not invest in companies that disproportionately contribute to climate change if they fail to take sufficient steps to reduce their greenhouse gas emissions. With particular regard to the aviation industry, Stewardship believes that air transport or travel without the necessary steps to reduce CO₂ emissions is harmful to society in the long-term. Accordingly, Stewardship will not invest in companies whose core business is aviation, including airline companies or airport operators involved in airport expansion, unless and until there is clear evidence that companies in this sector are taking sufficient steps to address their own carbon footprint to a degree commensurate with the problem.

Stewardship recognises that it is inappropriate to invest in companies whose core business is transporting goods that are unacceptable to the funds, including arms, nuclear weapons, tobacco and alcohol. Given the difficulties in knowing the nature of the goods being transported by a company, Stewardship will assess companies on a case by case basis and only exclude companies where there are clear and significant concerns.

The Stewardship position on nuclear and renewable technology is covered in the “Energy” criterion.

Utilities

Use of fossil fuels in power generation has one of the most significant impacts on climate change through emissions, although steps are being taken to mitigate this, through, for instance, the use of combined heat and power technologies. Companies are also working on the development of the carbon capture and storage technology, which would allow power generators to capture and minimise their emissions. Stewardship is concerned about the very high impact of power generators on the environment, and will only invest in companies that demonstrate the following:

- **Energy-efficient plants:** increasing investment in the development and integration of efficient energy technologies, upgrading existing power plants or decommissioning particularly carbon-intensive ones, and ensuring that all new plants are carbon-efficient;
- **Fuel mix:** increasing investment in gas, renewable energy projects and developing new technologies to enable wider use;
- **Offering carbon efficiency services:** energy audits; energy efficiency products; consultancy and installation of micro-generation technologies; green tariffs;
- **Strong performance:** demonstrating good current carbon intensity relative to regional peers (measured in tonnes of CO₂ emitted per Kwh of energy produced), as well as a strategy for moving towards low-carbon energy production through further emissions reductions in the future.
- **Transparency and advocacy:** reporting on greenhouse gas emissions with clear targets, disclosing the climate change policy and related strategies and promoting awareness of climate change in countries of operation.

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Sectors of concern to Stewardship

Stewardship considers certain sectors to be significant users of fossil fuels and emitters of greenhouse gas emissions, with more detailed guidelines for these below.

Oil and gas

Please see Policy above.

Aviation

Airlines contribute significantly to climate change, with airport operators also significant indirect contributors as they expand to service capacity demands.

- Virtually no airlines have taken serious steps to reduce their greenhouse gas emissions; noise and other air pollution are additional concerns for the sector.
- Airport operators’ environmental management systems do not cover the climate change impacts associated with aircraft emissions.

Stewardship will not invest in any companies whose core business is air transport.. This position may be reviewed if there are significant changes in the aviation industry or by specific airlines and operators.

Automobiles

Use of automobiles and road transport disproportionately contributes to climate change, with cars being the highest contributors, followed by heavy goods vehicles

and vans. Manufacturers of automobiles, trucks and vans have relatively high direct impacts. Companies offering car hire, dealership and auction services have a lower level of impact.

Stewardship will only invest in:

- **Automobile manufacturers** with good practice in tackling climate change. Indicators of good practice that the Committee considers include:
 - o **Transparency and targets:** set and publish comprehensive targets for reducing CO₂ emissions for vehicles (e.g. g/km), and implement good practice in management of other greenhouse gas emissions;
 - o **Performance:** demonstrate outperformance relative to peers and/or improvements in vehicle fuel efficiency on a total fleet basis;
 - o **R&D:** allocate R&D budget to developing vehicles with lower emissions. This includes investment in new or alternative technologies such as Hybrid Vehicles, Plug-in-hybrid vehicles and Electric Vehicles. It also includes working with other companies on new or alternative technologies; and
 - o **Regulation:** Meet regulatory requirements on fuel efficiency and engage constructively in public policy debate on CO₂ regulation, including through responsible lobbying and political donations.
- **Car hire companies** that offer customers environmentally friendly options.
- **Dealership companies** that demonstrate basic commitment to environmental management and demonstrate an awareness of climate change.
- **Car auction companies** with adequate quality and safety controls on vehicles prior to auction, as covered by the “Business Environment” criteria.

Roads

Roads are essential for economic growth and individual mobility, but building new roads or widening existing ones may damage the environment and wildlife, with congestion and increased road use increasing CO₂ emissions, air pollution and the risk of road accidents.

Stewardship will only invest in companies involved in building, upgrading and maintaining roads if they undertake adequate public consultation and carry out social and environmental impact assessments prior to undertaking such activities. Companies must also meet regulatory requirements, as covered in the “Business Environment” criterion.

Stewardship will not invest in companies whose main business is building new roads, as this would be contrary to Stewardship's support for reducing greenhouse gas emissions. Stewardship will assess each case on its own merits but as a rule of thumb, Stewardship will exclude companies that are significantly involved in building roads (i.e. this accounts for more than 10% of total turnover) *and* where more than one third of road-related turnover is from constructing new roads.

Public transport: buses, coaches and trains

Buses and coaches are users of fossil fuels, but have higher carrying capacity than automobiles and are more energy efficient. Railways offer the benefits of efficiency in energy use, capacity and land space, as well as less pollution and congestion.

Stewardship will view positively:

- Companies whose main business is operating buses, coaches, trains or rail infrastructure, as long as they meet the Stewardship criteria in other key areas for this sector, including safety, employee relations and access for passengers with disability.

Maritime

Maritime transport impacts include ozone depletion from atmospheric pollution, particularly sulphur emissions from fuel burned by ships. Oil tankers have high impacts, while container shipping, cruise ships and ports have slightly lower impacts.

Stewardship will only invest in maritime companies with good practices in environmental management, as well as in other key areas for this sector, including labour standards, human rights, safety and anti-corruption policies.

Use of transport

Stewardship will view positively companies across all sectors that seek to minimise the negative environmental impacts of transporting goods, and of employee business travel.

Food

The production and sale of food is a significant contributor to climate change, resulting from possible deforestation, cultivation and fertilizer use, livestock maintenance and transport. Stewardship also notes that the production of meat (a fast-growing component of global diets) has a disproportionately large greenhouse gas footprint in relation to calorific value.

Global demand for food generally, and meat in particular, is projected to continue to grow as the world's population increases and becomes wealthier. Most food producers and retailers are still developing strategies for measuring and managing the greenhouse gas emissions that are 'embedded' in their products (e.g. released in the primary production and processing phases phase of food production), and have yet to communicate that information adequately to investors and consumers.

Stewardship expects that food producers at a minimum should be identifying the carbon-intensive elements of their food business and formulating a strategy to manage impacts.

Considering that best practices have yet fully to emerge in this space, Stewardship will view positively companies that have taken steps to assess their emissions from arable production and livestock; and/or, demonstrated initiatives to reduce impacts. For example, some food companies are conducting preliminary research into special cow feeds that reduce methane production. Retailers that provide information on food and climate change to their customers will also be viewed positively.

Ozone Depletion

The Issue

Ozone depleting chemicals, Chlorofluorocarbons (CFCs), have been widely used in refrigeration, air conditioning plants, household aerosols and fast food packaging, but are being phased out, at least in the developed world.

The Stewardship Approach

Following the Montreal Protocol in 1996 the manufacture and use of CFCs is being phased out. This process should be complete by 2010.

Stewardship will only invest in companies that comply with the protocol, and will favour companies that have shifted towards more responsible alternatives.

Energy [also see Extractives policy below]

Nuclear Power

The Issue

The growing appreciation of the urgency of the climate change threat has meant that nuclear power, with its low CO₂ emissions, is increasingly seen as an important part of the solution to global warming. However, concerns about its use remain, focussing principally on the treatment of nuclear waste, and the safety of nuclear power plants for employees and neighbouring communities. Although some technological advances have been made in resolving these challenges, the final solution still remains elusive, and public acceptance is still lacking. More widely, the possible overlap between civil and military applications of nuclear power gives rise to difficult questions of ethics and equitable treatment in the international arena.

The Stewardship approach

Stewardship recognises the positive implications of nuclear power for combating global warming, but remains concerned about key aspects of nuclear power generation. *Stewardship will therefore not invest in companies that own or operate nuclear power stations until a widely-recognised satisfactory solution is found to challenges related to plant safety and waste management.*

Stewardship also avoids companies that derive more than 3% of their revenues from selling products or services to the nuclear power industry, except those that provide standard, non-customised, safety-related products/services.

Renewable Energy

The Issue

Reduced use of fossil fuels and nuclear energy has become a real possibility, with companies increasingly investing in emerging technologies, which include wind power, solar thermal and fuel cell. These forms of renewable energy offer a viable alternative to fossil fuels and nuclear fission, with significantly reduced pollution, safety and security risks.

Hydrogen fuel cells, for example, have been presented as an alternative energy source for cars, but only in highly polluted areas. The cost of fuel cell technology and producing hydrogen is still prohibitively high at present, and the environmental implications have still to be worked out. In the long run and with new anti-pollution regulations, the cost of fuel cell technology is expected to fall in relation to other sources.

Demand for fossil fuels and nuclear energy is likely to continue for some time. For with the exception of wind power, commercial renewable technologies are in the development phase. Supply of fossil fuels is also plentiful; oil companies are increasingly developing innovative methods of exploiting existing oil reserves and it is estimated that much of the world's total natural gas supplies have yet to be discovered.

However, the renewable energy technology market has already demonstrated considerable growth. This is likely to increase in the UK in the long term, with the government commitment for 10% of electricity to come from renewable sources by 2010. Investors are now presented with a chance to support more sustainable energy companies through their financing decisions.

The Stewardship Approach

Stewardship positively regards companies that provide renewable energy.

Stewardship seeks to invest in companies involved in research, development or provision of wind power, small scale hydro projects, bioenergy, solar thermal, geothermal, fuel cell, co-generation and liquefied petroleum gas.

Stewardship positively regards companies in energy and non-energy sectors that seek to source a significant percentage of electricity from renewable sources or demonstrate year on year increases in this.

Land and Water

Persistent Organic Pollutants and Endocrine Disrupting Chemicals

The Issue

A wide range of synthetic chemicals is used to manufacture everyday products that cause environmental damage and can threaten human health. Of particular concern are persistent organic compounds (POPs), which include endocrine disrupting chemicals (EDCs). As their name suggests these chemicals are of great concern as they have the ability to disrupt human and other species' hormonal systems.

Despite a binding UN treaty which nearly 100 countries signed agreeing to phase out certain POPs - their use and trade continues, particularly in pesticides which work their way into the food chain. According to the World Health Organisation an estimated 200,000 people die from pesticide poisoning each year. An estimated 67 million birds are also killed as a result of their ingestion. In addition to pesticides there are polychlorinated biphenyls (PCBs), a group of 200 industrial compounds. Exposure to these can cause poisoning, neurological defects and even death. Another well known POP is Polyvinyl Chloride (PVC), the widely used plastic. This is considered particularly dangerous during manufacture and when it breaks down as it emits toxic chemicals. For example, concerns arise from incineration of PVC products or when PVC is contained in childrens' toys.

The Stewardship Approach

Stewardship will look to avoid companies that are considered to have an irresponsible approach to the manufacturing or marketing of persistent organic compounds. Stewardship will avoid companies that manufacture or market the most damaging pesticides and will not invest in companies that manufacture organochlorines, including PVC.

Genetic Modification

The Issue

Genetic modification is a technology that involves altering genetic material of living cells or organisms in order to make them capable of producing new substances or performing new functions. Genetically-engineered products include plants that are resistant to diseases, insects, and herbicides, yield fruits or vegetables with desired qualities, or produce toxins that act as pesticides.

The current lack of conclusive information regarding the impacts of GM crops and foods on the environment and public health has resulted in a wide range of opinions and practices regarding the use of these products. Consumption and exposure to GM products may lead to the development of new toxins or allergens. In addition, GM products may help build bacterial resistance to treatment, making consumers vulnerable to infection or disease.

Genetically-modified crops also raise serious environmental concerns, particularly regarding the impacts upon local ecosystems, as pollen and seeds from genetically modified crops are carried over to non-GM fields and natural areas. Leading developers and manufacturers of GM crops have recognised this risk and confirmed that contamination of non-GM crops with GM traits may be inevitable. In addition, the increased resistance of GM crops to herbicides and pesticides allows farmers to use higher amounts of these products, which may adversely affect the local ecosystem.

The Stewardship Approach

Stewardship recognises that greater clarity of information is needed to understand clearly the risks and benefits of these technologies.

Stewardship seeks to invest in companies that provide clear labelling for genetically-modified food products, enabling customers to make purchasing decisions according to their preferences. However, Stewardship is aware that consumers' attitudes towards genetic modification may vary in different regions, and will therefore, in line with its practice of taking into account local market preferences, not exclude companies that operate in markets where the use of these technologies is not of public or regulatory concern.

Stewardship recognises the concerns surrounding the use of genetic manipulation technologies, and therefore will not invest in companies involved in the development or manufacture of GM crops or seeds, including pharmaceutical or medical technology companies involved in gene-based research or treatment.

Water

Food and Water

Food production accounts for more than 70% of all global fresh water use, and it can have a strong impact on the quality of water supplies necessary for neighbouring ecosystems and communities. Some cultivation techniques use very large amounts of water for irrigation. Some livestock production systems have potentially significant impacts on water quality. Many processed foods have high impacts from water use "embedded" in the supply chain. The issues of water use are especially important in the light of climate change and its impact on water availability and reliability.

Stewardship seeks to invest in food producers that actively address both water withdrawal and water pollution through their environmental management systems. Other actions will be viewed positively:

- Water inventory and reporting on water use
- Geographic water risk assessment based on the company's operating footprint, drought history, the appropriateness of the crop or livestock husbandry system for the area where it is grown, and population growth
- Projects and initiatives to increase water efficiency and protect water quality in primary production and in food processing. In the case of primary producers, this may extend to engagement with agricultural suppliers and agricultural advisory services
- Initiatives aimed at retail customers to promote awareness of water use in the production of finished food products

Access to water and water pollution

The Issue

Water is fundamental to life on the planet. Access to sufficient, affordable, and safe water supplies and to safe sanitation services, continues to be a major hazard and is the main subject of a recent report by the United Nations Development Programme. In 2003, over one billion people in the world currently have no access to safe drinking water and nearly 40% of the world's population lack safe and hygienic sanitation.

Furthermore, it is estimated that by 2025, nearly two thirds of the world's population will be living in countries of significant water stress.

Rising demand for fresh water through industrialisation, urbanisation and population growth present serious problems, while the availability of water resources will remain the same. While agriculture is currently the largest actual user of water and agricultural chemicals are responsible for significant water pollution, growing industrialisation worldwide means that companies are increasingly both competitors for and polluters of water resources. In addition, global procurement by companies across all sectors may have an indirect negative impact on ecosystems, through encouraging water consumption, pollution, deforestation or over-exploitation of aquatic species such as fish.

There is growing international awareness that water is core to the sustainable development agenda, inextricably linked to issues of poverty, health, ecosystems, food and energy. Integrated water resource management is increasingly regarded as vital to tackling the challenge, offering a means of balancing social, economic and ecosystem goals. However, considerable controversy exists on the subject; for example, over the value of dams, the role of the private sector and the place of micro-technologies. Resolving many of the current problems also requires governments to build capacity, price water correctly and ensure adequate regulation.

The Stewardship Approach

Stewardship supports the UN Millennium goals to halve the proportion of people in the world without access to clean water and sanitation by 2015. However, Stewardship believes that the issues regarding private sector involvement have yet to be resolved by the people most significantly affected, primarily in developing countries.

Stewardship therefore positively regards companies that provide water, sanitation and sewerage services. Stewardship also positively regards companies involved in water-saving technologies and water companies that seek to reduce leakage. Stewardship also favours companies that seek to reduce water use and prevent pollution.

Stewardship will not invest in water companies that demonstrate a lack of stakeholder involvement or poor performance in public-private partnerships. This may be evident in cases of inadequate water resource management, abuse of a dominant position, bribery and corruption, local-pricing disputes or provision of inappropriate technologies.

Stewardship will not invest in companies in non-water sectors that perform poorly in managing their direct impact on the environment, particularly in water use and pollution.

Biodiversity

The Issue

Biodiversity loss is one of the key environmental challenges facing the world. The Convention on Biological Diversity (CBD) was agreed at the Rio Summit in 1992, and establishes three fundamental objectives for biodiversity:

- Conservation of biodiversity
- Sustainable use of biological resources
- Equitable sharing of biodiversity benefits.

The concerns about biodiversity loss are about both the ethics of human beings causing other species to become extinct and the fact that the interaction between species creates 'ecosystem services' that provide a stable environment and productive economy. The latter concern has most recently been reflected in the UN's Millennium Ecosystem Assessment.

Most companies that have a negative impact on biodiversity are only now beginning to take this into account and to develop policy frameworks; on the other hand, companies can also have a very positive impact on biodiversity, both by driving higher standards through their supply chains and through good land and marine management practices. It is also notable that companies' impacts tend to be higher in developing countries, where local communities may also be more dependent on surrounding biological resources for their livelihoods. Invasive species, often transferred through trade, have become a significant problem in many areas of the world. In general, companies do not use the terminology 'biodiversity' but refer to it in terms such as land management or nature conservation.

The Stewardship Approach

The overall approach is that companies with a high negative impact on biodiversity should have a management system in place that assesses and manages their biodiversity impacts such that negative impacts are reduced and positive impacts are enhanced.

*Companies will be **excluded** if they are*

- *High-impact and do not demonstrate an adequate understanding of their negative impacts on biodiversity and an intention, such as an appropriate management system, to reduce this impact to acceptable levels*
- *Using or selling species in contravention of the law or CITES (Convention on International Trade in Endangered Species).*

Exceptions

- *Companies that are assessed as medium or low impact are not currently expected to have a management system in place, although it is viewed positively when they do.*
- *If a company is found to be using or selling species in contravention of the law or CITES, it may remain Acceptable if it can show that it had taken reasonable steps to prevent this, had transgressed unwittingly, and is taking appropriate remedial action.*
- *If the Committee judges that the impact of the company is not material, then the company will be Acceptable.*

Assessing a company as 'high-impact'

The Stewardship definition of a high-impact company is:

- Significant land-holdings in or near ecologically-sensitive areas – example: an extractive company with operations that border on a national park; or

- Involvement in the use, trade or sale of threatened species - example: a construction company using threatened species of tropical hardwood; or
- Use of biological resources in significant and unsustainable quantities – example: sales of endangered fish species that are not from certified sustainable sources.
- Impact on biological resources that threatens the lives/ livelihoods and/or culture of dependent local communities.

For the purposes of practical implementation, there is a presumption that Oil & Gas, Mining and Forestry & Paper companies will be high-impact, and that other companies may be high-impact – this will be assessed on a case-by-case basis. Companies in the following sectors will be researched in greater detail to establish whether their activities are high-impact: Construction & Building Materials; Food & Drug Retailers; Food Producers & Processors; Forestry & Paper; Leisure & Hotels; Mining; Oil & gas; Utilities & Electricity.

Standards required from a 'high-impact' company

- When it has been established that a company is high-impact, the company should be expected to have appropriate management systems in place to ensure that negative impacts are reduced and positive impacts are enhanced.
 - o They should demonstrate an understanding that biodiversity is a key impact area within their business, in terms of both direct and indirect impacts – for example, by having a policy that references biodiversity or sustainable sourcing.
 - o They should demonstrate a process for understanding and managing the key biodiversity impacts in a manner that seeks to minimise negative impacts and enhance positive impacts – for example, by setting targets for sourcing sustainable tropical hardwood.
 - o They should manage land-holdings that are in or near ecologically-sensitive areas in a manner that is compatible with local or national conservation objectives, and should, where possible, respect traditional access rights to biological resources
 - o They will be expected to apply an approach in relation to dependent local communities that is consistent with the Stewardship policies on Local Communities and Indigenous Communities
 - o Companies producing food crops that have high biodiversity impacts will be expected to meet the same standards of biodiversity protection that apply to high-impact crops in the energy sector (see 'Biofuels' policy below).
- Companies that use, trade in or sell species or habitats that are categorised by IUCN as 'vulnerable', 'endangered' or 'critically endangered', need to demonstrate that this is done on a sustainable basis.

Absence of information

Absence of data is likely to be a significant issue when assessing companies' impact on and understanding of biodiversity, as it is a relatively new subject for companies. This will be the case for companies in the UK outside the FTSE100, and for many companies that operate outside the UK.

In the absence of information, a minimum standard should apply to the three highest-impact sectors, such that:

- When a company operates in the Oil & Gas, Mining or Forestry & Paper sectors, it should at minimum be able to
 - o Demonstrate an understanding of its impact on key species, habitats and local communities

- o Demonstrate a commitment to managing the key biodiversity impacts in a manner that seeks to minimise negative impacts and enhance positive impacts
 - Appropriate evidence for these would be a commitment to sustainable sourcing or sustainable land management; participation in industry initiatives and certification schemes such as the Forest Stewardship Council; or setting targets for reducing negative impacts within a specified timeframe; or the use of relevant standards, such as those of the Climate, Community & Biodiversity Alliance.

For all other companies, in the absence of evidence that they are 'high-impact':

- they should not automatically be excluded on grounds of unknown biodiversity impact.
- if, however, research suggests that they are potentially high-impact but fail to produce evidence either way, this should be considered for engagement by the GSI team with the company involved.

Biofuels

In rating biofuels companies, Stewardship will take into account the following factors:

- **2nd generation:** The oil and gas majors have made investments in second generation biofuels (e.g. lignocelluloses), which may have lower sustainability impacts and offer higher carbon savings. Second generation biofuels are still in the research and development stage, with no opportunities presently for Stewardship to invest in publicly listed second generation biofuels companies.
- **Deforestation:** Biodiesel produced from feedstock based on vegetable oils such as palm oil has been linked to destruction of tropical rainforests and peat bogs, which act as carbon sinks and are also important for biodiversity. Environmentalists including campaign group Greenpeace have provided evidence linking biodiesel to unsustainable business practices.
- **Human rights:** concerns have emerged in Colombia, where low-income farmers have been displaced by force and violence to make way for biofuels crops. In Brazil, where sugarcane-based ethanol is used in a high proportion of cars, cases of slave labour have emerged on sugarcane plantations.
- **Rural economies in emerging markets:** Development practitioners, including campaign group Oxfam, have indicated that if governments develop appropriate public policies, biofuels crops may bring provide low-income smallholder farmers and rural communities with new income streams, and help to improve their livelihoods.
- **Food security** and scarcity of land have become major political concerns; biofuels crops have been criticised for competing with food crops and contributing to food price inflation, impacting severely the food intake and nutrition of low-income people in developing countries. It remains unclear to what extent biofuels have contributed to food price inflation, with other contributory factors including land availability, population growth and speculation. Biofuels were discussed at the UN's recent World Food Summit, but countries were unable to reach any agreement on the extent to which

biofuels contribute to food security concerns and public policies for tackling this. The US was particularly vocal in defending biofuels.

- **Corn-based ethanol**, produced in the USA, has been criticised particularly for 1. Energy intensity; scientific evidence indicates that it contributes more to climate change than it saves (see charts in Appendix based on research by Earthwatch), and 2. Contributing to food price inflation; US farmers have responded to heavy government subsidies for ethanol by switching to this from food crops, resulting in a shortage of commodities important for food in the world markets. For example, Brazil is increasingly making up the shortfall in soy used for animal feed, with Brazilian soy plantations linked to destruction of the Amazon.

Stewardship expects companies to demonstrate the following good practice:

- **Carbon savings:** companies must not only conduct a greenhouse gas life-cycle assessment, but also provide evidence that they assist genuinely in mitigating climate change through net carbon savings. US corn-based ethanol companies may remain acceptable for Stewardship, but only if companies provide credible evidence that their greenhouse gas emissions are lower than conventional petrol, that they provide genuine carbon savings, or that they are investing significantly in second generation biofuels.
- **Food security:** the Committee will monitor the extent to which biofuels contribute to food price inflation and food security concerns. Not all biofuels compete with agriculture - for example, jatropha can be grown on “marginal” land and some biofuels are derived from plant waste material and can therefore be produced in conjunction with food. The GSI Team will research whether a company sources biofuels crops grown on land normally used for agriculture, so that the Committee can assess the potential impact on food security on a case by case basis. Stewardship will view negatively companies that clearly source biofuels crops grown on land that has been or could be used for food crops, and that have neither engaged with local or international public policy makers to address potential impacts on food security, nor joined industry initiatives to do so.
- **Second-Generation biofuels:** the Committee view positively company involvement in research and development of second-generation biofuels, as these offer to reduce transport-related greenhouse gas emissions, with fewer negative impacts than first-generation biofuels.

Waste

The Issue

Waste is the by-product of procuring, producing, transporting, selling and using products. The creation, management and disposal of waste can raise environmental concerns. Due to rising populations and increasing per capita consumption, waste is being produced in increasing quantities, with pressure on governments and local authorities to provide appropriate disposal routes.

Waste presents three core concerns: 1) the inefficient (“wasteful”) use of resources that could otherwise generate an economic benefit, and whose production can cause negative environmental impacts; 2) the pressure it places on space and/or industrial capacity for its storage and processing; and 3) the environmental and social damage caused by its presence and breakdown.

The first is of particular concern when waste comprises materials that are derived using resources that are non-renewable or consumed at unsustainable rates; examples include the use of precious metals for mobile phones, high use of water to grow cotton for clothing, or the use of fossil fuels in metal refining.

The second and third concerns have historically been addressed via “end-of-pipe” solutions (i.e. by processing waste once it has been produced), including via landfill, incineration (sometimes with the production of energy), anaerobic digestion and recycling. Each approach has its own set of potential impacts. Even recycling, which is often viewed positively, may involve high energy use, transport and pollution impacts, not to mention health & safety and public health ones. Most direct impacts can be managed through regulation, but the generation of methane (a potent greenhouse gas) from biodegradable wastes is a particular concern; this is only partially regulated in developed countries, and the potential regulation of greenhouse gases remains under international discussion.

The main sources of waste in developed economies are mining and quarrying, construction and demolition, commercial and industrial activity and households. “Wastes” from agriculture (livestock and crop wastes) are not usually included in these statistics. Waste production per head is strongly correlated with affluence and economic activity, but also reflects country-specific circumstances. For instance, waste per capita in Japan is half that of the USA. Despite the attention given to waste, curbing the growth rate of waste while continuing to increase economic growth remains a significant challenge for all countries.

Policy

Stewardship considers that companies’ waste management practices are an important factor in achieving sustainable growth.

Stewardship will therefore avoid investment in companies that have a poor track record in complying with national regulations and international agreements pertaining to the management of waste in the countries where they operate. Where companies operate in countries whose waste regulation is weak or poorly enforced, and for which waste constitutes a significant concern, Stewardship will seek evidence of appropriate waste management practices and will view positively companies that adhere to global good practice standards.

In sectors where waste is a significant concern, Stewardship will expect companies to have clear policies, whether in a specific waste strategy or forming part of an environmental management system, that will generally be expected to include promotion of at least one of the three “Rs” – reduce, reuse, recycle – and a clear commitment to continuous improvement. For companies that generate waste deemed high-risk or hazardous, Stewardship will require evidence of strong policies and an effective record of implementation.

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Sectors with wider responsibilities for waste issues (“Sustainable products”)

Certain sectors stand out as having responsibilities for addressing the waste challenge that go beyond responsible management of their direct waste generation impacts. These are sectors that source materials and/or use products whose supply chain and/or final disposal (after use by the consumer) give rise to particularly significant wastes. Significance may reflect a product's contribution to climate change and/or concerns about the resources it has consumed during processing. Companies in these sectors are potentially exposed to emerging national and international policies to promote sustainable products. Stewardship identifies sectors with wider responsibilities as: **Food and beverages; General retail; Electronic and electrical equipment; Automobiles; Construction; and Extractives.**

Stewardship therefore looks for, and views positively, companies that recognise their impacts and responsibilities in this area by adopting “sustainable product” policies.

A sustainable product policy may include:

- Actions to reduce consumption of materials in a product's supply chain and/or to reduce the impacts of its production;
- Actions to enable and encourage the re-use and/or recycling and/or responsible disposal of materials contained in products when the product reaches the end of its life;
- Actions to address waste management in the company's own operations as identified in the general part of this policy.

Note on waste management companies

Stewardship views the provision of waste management services as positive, as it provides an important municipal and commercial service in helping businesses and individuals manage their waste streams. However, it recognises that all waste treatment and management operations (transport, recycling, anaerobic digestion, composting, incineration, landfill and others) have potential to cause direct environmental impacts. It also recognises that such operations can contribute to the emission of greenhouse gases, but where emissions are used to generate energy from waste, this can offset emissions from fossil fuels as well as consume feedstocks that would otherwise generate far more damaging methane.

Stewardship will only invest in waste management companies that have a good track record in managing the direct environmental impacts associated with waste treatment and management, and will avoid investment in companies with a poor track record.

Stewardship will also expect waste management companies to have strategies to manage their greenhouse gas emissions, in particular by introducing systems to

capture waste methane as well as transition to waste-to-energy technologies where feasible.

Stewardship will also take into consideration whether waste management companies operate appropriate community engagement strategies, in line with Stewardship's policy on local communities.

In the longer term, reducing the amount of waste requiring disposal and making greater use of re-use, recycling and energy recovery will be important in tackling the rising global waste problem and contributing to a more sustainable way of living. This trend is already evident in some parts of the world. *Stewardship will therefore view positively waste management companies whose business strategy and range of services suggests a readiness to address this challenge.*

Supply Chain

The Issue

Manufacturers and retailers may significantly impact the environment through their supply chains. Transport of goods has major environmental impacts, with international aviation the fastest growing source of greenhouse gas emissions. Poor management of environmental issues by a company's agricultural suppliers may degrade the environment, by threatening ecosystem or species diversity, damaging forests or soil, putting freshwater systems under pressure or by causing pollution.

The Stewardship Approach

Stewardship views positively companies that recognise these issues and have started to address their supply chain environmental impacts. Stewardship recognises that air freight and "air miles" significantly contribute to climate change and the criteria will be regularly reviewed to reflect changes in public policy debates and company good practice.

Extractive Industries Policy

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Introduction:

The following policy proposal seeks to address the environmental, social and governance impacts of companies in the extractive industries, which are defined as:

Oil & Gas sector

- Large, integrated oil producers;
- Smaller, upstream producers;
- Refiners;
- Oil services companies, covering a range of activities from drilling, well servicing to engineering and construction;

Mining sector

The mining and metals sector includes exploration, mining and primary metal processing (including smelting and basic fabrication). The sector can be divided into following groups:

- Global diversified majors with the capacity to develop and operate major mines around the world ;
- Single commodity miners;
- Smaller exploration companies ('juniors') that focus on finding new ore bodies and sell them to larger companies;
- A service segment, consisting of companies involved in supplying mining equipment and products, environmental testing and metallurgy analysis.

Overall Approach

Although the extractive industry has high social and environmental impacts, Stewardship will invest in companies in this sector, provided they meet high standards in all areas. In addition to assessing policies and management systems to address social and environmental impacts, Stewardship will also consider historical performance in these areas, and may exclude a company based on significant past incidents, or evidence of poor historical management of its impacts.

1. Product

Stewardship views certain natural resources as having potentially adverse social or environmental impacts, in particular:

1.1. Uranium

In view of Stewardship's current exclusion of companies involved in the operation or ownership of nuclear power stations, the fund will not invest in companies deriving a significant proportion of revenues from extraction of uranium. In addition, the fund will invest only in companies that sell uranium exclusively for use in non-defence related applications.

Stewardship will also avoid companies that derive a significant proportion of their revenues from selling products or services to the uranium mining industry, except those that provide standard, non-customised, safety-related products/services.

"Significant proportion" will be defined as exceeding 3%.

1.2. Fossil fuels

Resources used to generate energy – principally coal and oil and, to a lesser extent, natural gas – are also contributors to climate change, through the carbon dioxide emissions released in their consumption.

In recognition of this factor, Stewardship will invest only in companies that demonstrate a clear commitment to actively participate in the transition to a low-carbon future.

Stewardship will avoid investment in companies that focus exclusively on the extraction of coal, unless the company demonstrates a leading commitment to climate-friendly technologies, and to making a positive contribution to local communities or environment (e.g. investing in low emissions solutions to coal consumption, or using methane to meet local energy needs in remote communities).

In recognition of the important role that natural gas plays in transition to a low-carbon future, Stewardship will invest in companies involved in the extraction of natural gas.

Stewardship will invest in oil companies, provided they demonstrate a commitment to a low-carbon future in proportion to their size, such that:

- For larger oil companies, Stewardship expects active support of robust climate change regulation in countries of operation, significant investment in extraction or natural gas (over 40% of turnover derived from natural gas), and investment in low-carbon fuels and renewable energy solutions.
- For smaller oil companies, Stewardship expects monitoring of greenhouse gas emissions and efforts to reduce these, and active support of international regulatory efforts to reduce these.

1.3. Additional product areas:

Luxury products (diamonds, gold)

Stewardship will invest in companies involved in extraction or refining of luxury metals of minerals such as gold or diamonds, subject to these companies meeting all other standards.

For discussion of 'blood minerals' (e.g. resources used to finance conflict), please refer to Blood Metals and Minerals, Policy 4.7.

2. Environmental impacts largely covered by existing Stewardship policy:

Following environmental impacts are largely covered by existing Stewardship policy. Additional indicators of particular relevance to the extractives sector have been added where appropriate.

2.1. Climate Change

Stewardship policy on climate change impacts addresses this issue. Additional indicators of particular relevance to the extractives sector relate to flaring of associated natural gas (oil projects) and methane gas leaks (oil projects and coal mines).

Flaring:

Required standards – Stewardship will only invest in oil companies that have a commitment to reducing impacts from flaring for all operations, in particular in countries with a historical legacy of flaring, such as Russia and Nigeria.

Methane:

Engagement areas – Stewardship will encourage companies to improve in following areas. However, non-compliance with these practices would not constitute a breach of Stewardship policy:

- Active involvement in policy lobbying on the capture of methane in oil and coal projects;
- Participation in development and implementation of technologies to capture methane and use it for local consumption where practicable.

2.2. Air Pollution

Stewardship policy on atmospheric impacts addresses this issue. In addition to greenhouse gas emissions, extractives companies generate a range of air pollutants consisting of particulate emissions, sulphur dioxide (SO₂) from smelters and refineries, nitrogen oxides (NO_x) and volatile organic compounds (VOCs), which are only partially covered by Stewardship policy.

Required standards – In addition to meeting the Stewardship policy on atmospheric impacts, extractives companies need to provide evidence of following practices to be Acceptable for investment:

- Groupwide air quality control standards;
- Emissions monitoring (incl. particulate gas and vapour exposure) and controls to minimise health or environmental impacts, as well as evidence of positive trends and targets;
- Dust suppression sprays for open pit operations where relevant (NB: water consumption for dust suppression needs to be balanced against impacts from dust)

2.3. Water

Stewardship water policy addresses this issue. Extractives companies have relatively high water impacts due to water-intensive extraction processes and water pollution impacts. Effective water management is particularly urgent in countries affected by severe drought (e.g. Australia, Chile), or in areas where increased water

consumption by extractives companies potentially destabilises already fragile ecosystems (e.g. Arctic, Albertan oil sands).

Required standards – In addition to meeting the Stewardship water policy, extractives companies need to provide evidence of following practices to be Acceptable for investment:

- Measures to improve water efficiency as well as indication of positive trends and targets for reducing water consumption.
- Disclosure of water consumption performance data and targets. A comparison with sector peers may be used to assess the quality of this strategy.

2.4. Energy

Stewardship policy on climate change and energy address this issue. Indicators of particular relevance to the extractives sector include:

Required standards – In addition to meeting the Stewardship policy on climate change and energy, Extractives companies need to provide evidence of following practices to be Acceptable for investment:

- Strategies to minimise the energy intensity of operations. These include development of technologies that reduce greenhouse gas emissions during extraction and refining processes (e.g. such as carbon capture and storage);
- Extent of involvement in particularly energy-intensive extraction and refining processes (e.g. oil sands). This needs to be balanced also against the overall product impacts [See section on Oil Sands as example for applying a maximum threshold for involvement in energy-intensive extraction and production processes].

2.5. Biodiversity

Stewardship policy on biodiversity addresses this issue. Extractives companies are considered 'high impact' by Stewardship and will be assessed based on the 'Standards required from a high-impact company'. Additional indicators for use when assessing extractives companies include:

Required standards – In addition to meeting the Stewardship policy on biodiversity, extractives companies need to provide evidence of following practices to be Acceptable for investment:

- In addition to having clear processes to minimise direct and indirect impacts of their operations on biodiversity, companies also need to demonstrate a clear plan and capacity to adequately respond to accidents [See also policy 3.4.on Oil spills].
- A commitment to explore compensation mechanisms where biodiversity impacts can not be avoided.

2.6. Hydraulic fracturing

The Issue

Hydraulic fracturing involves pumping fluids, consisting of water, sand, and chemicals, into the ground to create fractures around a wellbore to enhance the recovery of oil and natural gas. The method has triggered controversies because of risks of soil and water contamination from spills and waste water. As more consistent national regulatory standards are being developed for the industry, pressure is building on companies to improve safety standards and disclose the chemicals used in fracturing fluids, which would enable better tracing of pollutants in instances of potential contamination.

The Stewardship Approach

Stewardship views the extraction of natural gas as preferable to oil, as it can serve as a transition fuel toward a lower-carbon economy.

Stewardship will avoid investment in companies that do not meet an “adequate” level of transparency on the use of chemicals used in fracturing fluids and have a poor safety record with inadequate spill remediation [See *policy 4.2.on Health and Safety and 3.4. on Oil spills for relevant indicators*].

“Adequate” disclosure will be defined as providing information on all types of chemicals and overall concentration of chemicals used in fracturing fluids.

Stewardship will favour companies that explicitly support regulatory initiatives to develop consistent environmental standards for the hydraulic fracturing industry.

3. Environmental impacts partially covered by existing Stewardship policy

Following environmental impacts are only partly covered by existing Stewardship policy. Additional Stewardship policy approaches and committee guidelines have been added to cover impacts relevant to the extractives sector.

3.1. Tailings management

The Issue

The extraction and processing of ore generates ground-up rock and process effluents that need to be disposed of safely, and without contaminating the environment.

These waste products are known as tailings, and can be disposed of in two principal ways:

- through disposal into nearby rivers or sea;
- through containment in specially-designed tailings ponds, contained by storage dams;

While the first approach is sometimes claimed to be a necessity, especially in areas where high seismic volatility may make other means of tailings disposal unsafe, it has attracted significant criticism for its negative impacts on local communities through contamination of water, soil and animal populations.

The Stewardship Approach

Stewardship will avoid investment in companies that dispose of tailings into rivers or seas (riverine or submarine tailings disposal).

Stewardship will invest in companies that use other methods of tailings disposal, provided these effectively minimise risk of contamination of the surrounding environment, and present minimal long-term environmental risks.

3.2. Leaching

The Issue

One of the processes for extracting precious metal compounds, copper compounds and uranium compounds from the ore is leaching, i.e. the use of a chemical solution frequently containing cyanide to expose the desired metal. Leaching is done in three ways:

- *In-situ* leaching, which involves pumping leach solutions directly into the ore deposit through drilled holes and fractures: this is most frequently applied in uranium mining;
- *Heap leaching*, which involves mined ore being heaped on an impermeable plastic and/or clay-lined leach pad where it is irrigated with a leach solution (e.g. cyanide) to dissolve the minerals.
- *Tank leaching*, which involves placing crushed ore in large vats containing a leaching solution.

The use of cyanide in extraction processes has become increasingly controversial because of risks of severe soil and water contamination, and damage to the health of employees and local communities. The use of *in-situ* leaching has come under particular scrutiny for its unpredictable impacts and the high risk of environmental damage.

The Stewardship Approach

Stewardship will avoid investment in companies involved in *in-situ* leaching because of its potential for causing significant damage to the environment.

Stewardship will invest in companies involved in other forms of leaching, provided these demonstrate strong commitment to avoiding or effectively minimising any negative environmental impacts.

3.3. Post-closure remediation

The Issue

Extractives projects can generate significant long-term environmental and social impacts well after the resource has been exhausted, requiring companies to make adequate financial provisions and put in place resources to address issues that may arise after operational sites have been disposed off or closed.

There are numerous environmental impacts associated with closing extractive operations, such as ground water and soil pollution, unprocessed tailings and mining pits, damage from landslides, waste piles, surface instability due to underground voids, etc. Success in decontaminating and rehabilitating sites may vary depending on the type and degree of contamination, with heavily polluted sites sometimes requiring indefinite containment measures and monitoring systems.

Changes in ownership of assets often complicate a company's exposure to post-closure remediation risks. When buying assets, companies can become exposed to legacy issues from insufficiently remediated sites left by a previous owner or its

business partners. In case of asset sales to a new operator, companies can be placed in the difficult position of accepting responsibility for assets over which they no longer have any control.

The Stewardship Approach

Stewardship will only invest in extractive companies that have policies, management systems and procedures to address impacts associated with post-closure remediation, and can demonstrate adequate financial provisioning to fund it for as long as is necessary.

Stewardship will exclude all companies that do not have post-closure remediation policies, management systems and reporting. For companies that have received significant fines for poor post-closure practices, Stewardship will apply Committee Guidelines on Regulatory Breaches and Controversies.

3.4. Oil Spills

The Issue

The occurrence of oil spills is a key strategic and operational risk for oil and gas companies. Oil spills, in both on-shore, off-shore and mid-stream operations, result in soil and water contamination, damage to local biodiversity and loss of livelihood for host communities.

The magnitude of oil spills can range from large-scale catastrophic events – such as the Deepwater Horizon or Exxon Valdez spills – down to small ongoing operational leakages. Whereas the single instance of a minor oil leak may be negligible or easily remedied, the cumulative effect of leakages throughout a pipeline network can have significant environmental impacts.

The causes of oil spills can be traced back, in most instances, to failures in company risk management and inadequate safety measures. In addition, there are also cases where oil spills are the result of corruption or armed conflict, highlighting the importance for companies to develop social engagement strategies that mitigate risks associated with spills when operating in politically unstable regions.

The Stewardship Approach

Stewardship will invest in oil and gas companies, provided they have adequate spill prevention measures in place, including verifiable emergency response measures, and can demonstrate a good safety record.

Stewardship will avoid investment in companies with a poor safety record and frequent involvement in spill-related controversies. For companies that have been involved in significant oil spills, Stewardship will examine the adequacy of their spill containment response and the effectiveness of their spill remediation measures.

3.5. Unconventional Oil Operations:

3.5.1. Oil Sands:

The Issue

The extraction and processing of oil sands through open-cast or *in situ* mining are associated with significant social and environmental challenges, ranging from high energy and water intensity to impacts on land, biodiversity and communities. The high energy intensity of oil sands production derives primarily from the production of large quantities of steam that are required to fluidise bitumen for extraction and transportation. Additional key impacts, in particular for mining operations, are high water consumption and physical footprints (e.g. through the use of tailings ponds).

There has been some notable success in reducing energy intensity through methods such as adding solvents to steam, but the improvements achieved to date have been outpaced by the rapid growth of the industry; the energy footprint of oil sands will therefore remain high unless radical breakthrough technologies are discovered and commercialised. In the meantime, some in the industry are exploring the use of carbon capture and storage as a means of mitigating the existing technologies' high CO₂ emissions. As regards water, some companies report operational efficiency gains, but as with emissions, the cumulative water needs of increased oil sands production in Canada are at risk of exceeding current regulatory water allowances⁴, which are designed to protect scarce water resources in the region.

The Stewardship Approach

Stewardship does not exclude companies on the basis of involvement in oil sands. However, given the absence of technologies that mitigate the key environmental impacts associated with *in situ* and open-cast mining, Stewardship will avoid investment in companies that derive a substantial proportion of their total production from oil sands, unless the company is demonstrated to be leading the industry to develop transformational solutions to resolve these impacts; this would include taking an active, transparent and visibly successful public policy stance to drive regulatory and industry-wide change. "Substantial proportion" will be defined as exceeding 3% of total production derived from oil sands.

For companies with investments in oil sands below this threshold, Stewardship will deem those Acceptable that can provide clear evidence of having mitigated environmental and social impacts associated with oil sands exploration and production.

3.5.2. Deepwater Operations

The Issue

Deepwater operations (defined as drilling in water depths greater than 500m) involve a number of inherent risks due to the high-pressure environment and difficulties in responding to operational challenges in great water depths. Although deepwater operations are generally considered more challenging than conventional offshore drilling, the risk profile of a particular well depends on a range of factors, including in particular the pressure of the deposit in which the drilling takes place.

⁴ See Ceres and RiskMetrics Group report, Canada's Oil Sands - Shrinking Window of Opportunity, May 2010, p.10

Major risks that have been identified for deepwater operations concern the integrity of the well design, drilling and completion procedures, the reliability of essential safeguards, and spill response capabilities.

The Stewardship Approach

Stewardship will invest in companies involved in deepwater operations, provided they can demonstrate compliance with the industry's highest safety standards and have adequate spill prevention and response measures in place. Stewardship will avoid investment in companies with a poor safety record in deepwater operations and a history of inadequate spill remediation incidents.

Stewardship recognises that key concerns and challenges associated with deepwater operations have been changing significantly as a result of the recent oil spill in the Gulf of Mexico. Stewardship will continue to monitor the emerging risks as well as the evolving technological solutions and regulatory frameworks in this area, and may modify its position if necessary.

3.5.3. Operations in the Arctic

The Issue

Oil and gas operations in the Arctic involve a range of inherent risks due to the remoteness of the region and the harsh climate in which operations take place. As an ecosystem, the Arctic is characterised by a short productive season, low temperatures, and limited sunlight, which means that environmental impacts, such as habitat disruption and damage, are typically more severe and the recovery period longer. Consequently, infrastructure developments for extractives operations – such as harbours, roads, gravel mining for well pads, etc. – can have significant impacts on culturally and ecologically sensitive areas.

Due to the region's remoteness and lack of infrastructure, companies also need to develop extensive contingency plans to deal with operational challenges on-site. Offshore drilling operations can only take place during the ice-free summer months and companies must leave adequate contingency periods to be able to respond to potential emergencies, such as oil spills, before having to seal off wells with the onset of winter. In addition, operations in areas with icebergs require adequate capacity for ice management to protect drilling equipment from collisions.

Companies need to have on-site spill response capacity, as shipping equipment to remote locations would take too long in case of emergency. The long-term environmental impact from oil spills in Arctic conditions is potentially more severe than in warmer regions: colder seawater means that spilt oil takes longer to degrade and ice conditions can render standard methods for containing and cleaning up oil spills ineffective.

The Arctic is a fragile and ecologically important region and many stakeholders consider that it should remain untouched.

Evolving Debate and Stewardship Approach

With new areas in the Arctic currently being opened up to oil and gas and mining operations, companies are confronted with novel environmental and social risks and

need to adopt new technologies and operational standards. As a result, regulatory frameworks in some countries are undergoing significant reforms to adapt to these new conditions. This is particularly the case in the US, where environmental and safety requirements for the oil industry have been tightened following the oil spill in the Gulf of Mexico in 2010, resulting in a *de facto* moratorium for offshore operations in the Alaskan Arctic.

Key areas of concern for Stewardship relate to the considerable uncertainties surrounding companies' spill prevention and response capabilities, particular when dealing with potential 'worst-case' scenarios. Many of the techniques typically used to respond to oil spills are largely untested in the remote and extreme offshore environments of the Arctic. As a consequence, the debate between regulators and the industry on requirements for dealing with 'worst-case' spill scenarios is still very much in flux and has yet to yield a clear understanding and set of standards. Finally, there are also significant uncertainties relating to the long-term environmental consequences of infrastructure developments and companies' ability to remediate sites in ecologically fragile regions once operations have come to an end.

Stewardship recognises the deep controversy that surrounds extractives activities in the Arctic. At present, the scale of activity is limited, not least due to the regulatory review noted above. However, other regions remain active, in particular Greenland and Russia, and many extractives companies are poised to gain some exposure to Arctic operations in the coming years.

For this reason, Stewardship will develop investment criteria that reflect emerging global best-practice standards as these become better understood, drawing on the expertise that will feed into the current US-led review, and will expect any company with exposure to this area to uphold these.

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4. Social impacts

4.1. Equal Opportunities and Diversity

Stewardship Social policy addresses this issue.

4.2. Health and Safety

Stewardship Social policy addresses this issue.

Required Standard: In addition to meeting the Stewardship policy on health and safety, extractive companies must demonstrate the following practices to be Acceptable for investment:

- Ongoing monitoring of mines, oilwells and related infrastructure (refineries, pipelines, smelters) to ensure continued structural integrity, and to identify areas with high risk of accidents.
- For oil companies: clear evidence of safety training, such as emergency drills and exercises, for operators of oil related infrastructure (rigs, wells, refineries). Certification of maintenance for key safeguard equipment, such as blowout-preventers (BOPs). [See also required standards for 3.5.2. Deepwater Operations]

4.3. Whistleblower protection

Stewardship policy addresses this issue.

Required standard: In addition to meeting the Stewardship policy on whistleblowing, extractive companies must demonstrate the following practices to be Acceptable for investment:

- When operating in sensitive areas, companies must develop mechanisms for escalating complaints to the board;

4.4. Community Impacts

Please note that this issue is partially addressed by the existing Stewardship Business Environment policy.

The Issue

Extractive companies often have a significant impact on the communities located around their assets, both directly, through community displacement and relocation to conduct seismic studies or mine development, and indirectly, through contribution to the overall economic and industrial development in the region. Mismanaging these impacts can destabilise surrounding communities, jeopardise operational stability, and erode the companies' license to operate.

The Stewardship Approach

Stewardship will only invest in companies that actively contribute to positive change for local communities and sustainable broad economic development. Stewardship expects companies to demonstrate strong systems for building robust, constructive relations with host communities, and to take steps to help ensure their activities contribute to regional economic and/or industrial development. Stewardship will exclude companies that fail to respond to significant concerns of local communities, or that have exceptionally poor relations with them.

4.5. Security forces

Stewardship Human Rights policy addresses this issue.

Required Standards: In addition to meeting the Stewardship policy on the use of security forces, extractive companies that operate in sensitive areas must demonstrate evidence of the following practices to be considered Acceptable for investment:

- Commitment to avoid, where possible, the use of weapons by security forces;
- Commitment to evaluate track record for respecting human rights as part of the security providers' selection process;
- Provision of ongoing training and monitoring of security providers to ensure compliance with company human rights policies and conduct standards, and to identify any risks of community abuses;
- Provision of complaints mechanisms that enable local communities to report any abuses of power by security providers at local and company level;
- Provision of arbitration and mediation mechanisms to address concerns from local communities or other stakeholders;
- Provision of ongoing training and monitoring to security forces that do not report directly to the company (e.g. national military or police forces); systems enabling corrective action in case of breach of policy. *(Please note this is*

likely to occur in certain countries, such as Indonesia and Pakistan, where extractive companies may be required by the government to rely on the military forces for security services.)

- Absence of serious controversies related to the employment or use of security forces.

4.6. Oppressive regimes

Where companies operate in countries or regions with weak rule of law, or with high levels of political instability, Stewardship will only invest in companies that provide **clear** evidence that their operations and practices contribute to positive change for host communities and the region.

Countries raising Human Rights concerns:

Please refer to the list of countries of concern addressed by existing Stewardship Human Rights policy.

Required Standards: In addition to existing Stewardship guidelines on the management of human rights, extractive companies that operate in these countries must demonstrate the following practices to be Acceptable for Stewardship:

- Proactively develop robust community relations strategies (detailed in Community Relation section below);
- Participate in local capacity-building initiatives;
- Where possible, engage with host government to minimise human rights abuses and to strengthen the rule of law (for example, through provision or sponsorship of relevant training to government officials);

4.7. Conflict metals and minerals

The Issue

Resources such as diamonds, gold, cobalt and oil may be used to finance or sustain conflict in volatile regions such as the Democratic Republic of Congo or the Niger Delta. While various certification and tracing protocols have been developed to mark legitimately-produced resources and to ensure that all other products are excluded from the production chain, extractive companies need to continue working with local and international regulators as well as end users of the resources to prevent illegally-sourced metals and minerals from entering the supply chain⁵.

The Stewardship Approach

Stewardship recognises that certification processes differ by resource, and takes a differentiated approach to conflict metals and minerals, as follows:

Diamonds

Required Standards: Stewardship will not invest in companies that have not endorsed the Kimberley Process Certification Scheme⁶.

Gold and platinum-group metals (palladium and rhodium)

⁵Responsible Jewellery Council (www.responsiblejewellery.com), for instance, unites 250 companies in the jewellery supply chain in a programme to promote responsible business practices in the diamond and gold supply chain.

⁶ The **Kimberley Process Certification Scheme**, is designed to certify the origin of rough diamonds from sources which are free of conflict fueled by diamond production.

As no universally-recognised certification scheme exists, Stewardship will expect companies to demonstrate commitment to developing certification through industry and government engagement. However, non-compliance with these practices would not constitute a breach of Stewardship policy.

Oil

As no universally-recognised 'fingerprinting' certification scheme for crude oil⁷ exists, Stewardship will expect companies to demonstrate commitment to developing certification.

4.8. Corruption

This issue is addressed by existing Stewardship policy. However, it should be noted that corruption can be particularly significant in the context of the extractive industries, as corrupt behaviour by companies can destabilise civil society and public institutions, and contribute to social and political conflict and weak rule of law.

Stewardship will therefore only invest in companies that have demonstrated robust systems for combating corruption, both in their own operations and in those of their partners.

Committee Guidelines

Required Standards: Extractive companies must demonstrate evidence of the following practices to be considered Acceptable for Stewardship:

- Internal anti-bribery systems, including whistleblowing systems to enable employees, contractors, suppliers and community representatives to report any concerns to dedicated officers;
- Groupwide endorsement of the Extractive Industries Transparency Initiative (EITI) in case the company operates in countries that have endorsed it (i.e. have achieved Candidate status);

4.9. Supply Chain and Third Party Labour Standards

Please note that this issue is addressed by the existing Stewardship Human Rights policy.

Required Standards: Extractive companies must demonstrate evidence of the following practices to be considered Acceptable for Stewardship:

- Systems for ongoing training of contractors and suppliers on social, ethical and environmental issues (especially on health and safety);
- Monitoring of suppliers and contractors for compliance with company social, ethical and environmental standards through regular audits;

⁷ Fingerprinting technology is used by oil companies to determine the unique signature of crude sources. However, there is currently no standard system of analysis for fingerprinting and no internationally recognized certification scheme for so called 'blood oil'. In addition to the political barriers to develop a common certification scheme, opinion is divided on whether the blending or mixing of oil during the trading process makes the precise tracing of its origins at all possible. For an overview, see e.g. USIP Special Report: Blood Oil in the Niger Delta, August 2009 (http://www.usip.org/files/resources/blood_oil_nigerdelta.pdf)

Stewardship Social Policy

Social Policy Statement

Stewardship is concerned about the impact companies have in all their relationships with their customers, employees and society. Companies may have significant positive or negative impacts on the quality of peoples' lives, not only through their economic activities - for example providing goods and services for consumption - but also through their behaviour towards their employees and local and global communities.

Companies today recognise that they have a responsibility to manage their social, environmental and ethical impacts. They do this in part through the development of robust and effective corporate social responsibility policies as well as through the effective governance of their operations.

The Stewardship funds aim to avoid companies that have serious detrimental effects on society, seeking to invest in those that are aware of the potential impact of their activities and consciously adopt best practices in their operations. Stewardship takes into account that companies operate in countries at varying levels of industrialisation and in different political and cultural contexts, and seeks to invest in companies that demonstrate commitment to international agreements and best practice in addressing social issues.

When assessing companies the Stewardship Committee of Reference pays particular attention to the following areas:

Employee Relations:	Equal Opportunities and Diversity, Health & Safety, Professional Development, Rewards, Employee Participation and Whistleblower Protection.
Human Rights:	Security Forces, Supply Chain Labour Standards, Corruption and Oppressive Regimes.
Business Environment:	Customers, Suppliers, Local Communities, Indigenous Peoples and Shareholders.

The guiding principle of Stewardship is to invest only in companies that both in what they do and in the way that they do it make a positive contribution to society. When considering whether or not to invest in a company, Stewardship also takes into account the other policies and practices that inform the company's behaviour. Deciding whether a company is suitable for Stewardship therefore requires thoughtful and careful judgement, rather than simply "ticking boxes." Stewardship may on rare occasions exclude companies which are judged to conflict with Stewardship's core aim even when they do not fall foul of any of the negative criteria set out in this document.

Employee Relations

The Issue

International trade has brought benefits as well as costs. On the one hand, international trade has brought opportunities for people to increase their incomes through industrialisation and employment. On the other hand, disruption to employment patterns and shifts in demand for professional skills have accompanied the rapid pace of economic transformation. The by-product is heightened job insecurity, a shift to more part time work, temporary or contract work, greater mobility and a need for continuous “re-skilling.”

In order to achieve healthy employee relations companies need to maximise the benefits and avoid or minimise the costs to employees. Where, as is increasingly common, companies in richer countries are employing, directly or indirectly, people in poorer countries, ensuring a fair distribution of the benefits of international trade to such employees becomes complicated

The Stewardship Approach

Stewardship believes that companies are responsible for providing fair, safe, fulfilling and attractive working conditions for employees. Stewardship seeks to invest in companies whose practices are in accordance with the International Labour Organisation (ILO) Fundamental Conventions. Stewardship will invest in companies that demonstrate commitment to high standards in equal opportunities and diversity, health and safety, training and development, benefits and employee participation.

Stewardship also considers how a company addresses labour standards within its supply chain and this is covered in detail within the section headed ‘Human Rights.’

Equal Opportunities and Diversity

The Issue

Companies operate in a variety of environments, most of which are marked by diversity of cultural, religious, age and ethnic make up. Enlightened companies are using this diversity for competitive advantage. They comply with legislation and understand equality as a right - respecting individual beliefs and valuing progress based on merit - and also understand how diversity within their workforce may strengthen their business, by improving the quality of their management decisions and attracting the best recruits from the widest pool of talent

Although in most developed countries strides have been made in increasing equality of opportunity through legislative and political reforms, certain members of the workforce continue to face significant barriers to accessing equal pay and attaining senior decision-making roles because of their belonging to a particular group. Changing the outcomes for such individuals requires extensive social and cultural change. Companies may play an important part in this process of change by treating individuals with dignity, fairness and respect in the workplace and by removing real and perceived barriers.

The Stewardship Approach

Stewardship seeks to invest in companies whose practices are in accordance with the spirit of the Universal Declaration of Human Rights and the ILO Conventions on discrimination and equal remuneration.

Stewardship will invest in companies that are committed to promoting and providing equal opportunities and diversity, which do not unlawfully discriminate against prospective or current employees on the grounds of race, ethnic background, religion, marital status, age, sex, sexual orientation, disability, health status or pregnancy.

Stewardship favours companies that are aware of the benefits of a diverse workforce and demonstrate this in their workforce practices at all levels.

Stewardship favours companies that demonstrate awareness of employee needs for a balance between paid work and home life, by offering flexible patterns of work and family-friendly policies that provide employee choice while meeting business needs. For example, this may include offering part-time work, flexitime, job-sharing, career breaks, childcare or crèche facilities.

Stewardship will exclude companies that systematically fail to uphold anti-discrimination policies and international standards. Stewardship will exclude companies that do not have an equal opportunities and diversity policy where a formal policy is the local norm, such as in the UK. In assessing a company's practices, Stewardship will look beyond process to assessing performance, where this is justified and appropriate for the local jurisdiction.

Health and Safety

The Issue

Health and safety risks may arise from physically dangerous work, such as work with hazardous machinery, or relate to less immediately visible factors, such as exposure to pollution, high levels of stress in the workplace or excessive hours of work. Accidents and ill health may ruin or seriously impair the lives of employees and their dependants. They also create unnecessary costs for employers, for example through lost output, litigation and insurance premiums.

The Stewardship Approach

Stewardship believes that companies are responsible for ensuring the health and safety of employees and contract personnel.

Stewardship will invest in companies that carry out risk assessment and mitigation, expecting not only local legal compliance, but evidence of a health and safety culture through strong management systems to achieve performance improvements relevant to the particular sector and business operations.

Stewardship will exclude companies that seriously fail in their duties, as evidenced by significant health and safety prosecutions or exceptionally poor performance compared to sector peers.

Professional Development

The Issue

Successful business performance depends on motivated employees, who have the right skills and competencies and feel that their reasonable individual aspirations are recognised. Investment in effective training and development is key to both of these.

The Stewardship Approach

Stewardship will favour companies that demonstrate a resourced commitment to effective training and development that is relevant to strong business performance. This may be evident in support for relevant recognised professional qualifications, provision of internal or externally run courses or coaching and mentoring schemes.

Rewards

The Issue

The pressure to be cost competitive can raise dilemmas for companies in how to reconcile obligations to their employees with the expectations of their customers and investors. Companies are expected to provide competitive pay and other benefits to reward employees for their efforts and have transparent and fair redundancy policies.

The Stewardship Approach

Stewardship will favour companies that offer locally competitive pay, pensions and benefits packages and a transparent redundancy policy and have a constructive approach towards working with representative bodies seeking collective bargaining on these issues. If companies need to adjust pay or other benefits, Stewardship expects them to fully consult with employees and make genuine efforts to reach mutually agreed outcomes. Stewardship expects companies to offer equal pay for work of equal value.

Employee Participation

The Issue

The trend towards flatter management structures and devolved responsibility means that employees increasingly need to know why they are required to take particular actions and to participate in decisions which are important to their work.

Communication should enable exchange of ideas and views, discussion of mutually shared problems and their resolution. Dialogue means that employees are properly informed about important developments, enabling companies to function effectively. Consultation requires management to actively seek and take account of employee views in making their decisions. Participation through profit sharing or share schemes may be a means of building employee commitment to delivering commercial objectives.

Although employee participation may require additional management time and costs, it is a vital means of engendering employee trust, improving the quality of management decision-making, employee commitment and motivation.

The Stewardship Approach

Stewardship will favour companies that involve employees in the running of their businesses through strong practices in employee communication, opportunities for participation and a consultative approach.

Stewardship will favour companies that adequately consult with employees on key issues that affect them, namely the business's economic situation, their employment prospects, work organisation or contractual relations, including redundancies and transfers.

Redundancy consultation should aim to reach agreement with representatives and include discussion about ways of avoiding redundancies, reducing the numbers to be dismissed and mitigating the consequences of redundancies.

Stewardship will exclude companies that fail to consult adequately with employees or their recognised representatives on important issues, such as health and safety at work matters, redundancies, transfers and benefits.

Whistleblower Protection

The Issue

All companies face the risk of employees or business partners breaking the law or failing to follow corporate policies and management systems. Employees within the company are often the first to suspect that malpractice may be occurring, but may fear the repercussions of raising their concerns within the company or consider this a cultural anathema. Fear may lead to silence, resulting in employees failing to protect their own and their company's interests - and irregularities going unchecked. Alternatively, fear may drive employees to feel they have no choice but to blow the whistle to the media - with unsatisfactory consequences for both the employee and the company concerned.

The Stewardship Approach

Stewardship believes that effective internal whistleblowing plays a constructive role in preventing and deterring wrongdoing, which is central to companies' business interests and public confidence in them.

Stewardship will favour companies that actively seek to create a culture that supports and encourages responsible whistleblowing, believing that this indicates commitment to good governance, transparency and accountability.

Human Rights

The Issue

Companies face growing Human Rights challenges in an era of increasing international trade. Some have been accused of supporting abuses of Human Rights, wilfully or through neglect, on occasions with profoundly devastating effects on peoples' lives. This has been directly, through financing or associating with illegitimate or repressive authorities, and also indirectly through poor supply chain practices and third party suppliers disregarding Human Rights.

The issue of Human Rights is complex. There is considerable debate over what exactly constitutes Human Rights, regulatory versus voluntary approaches and whose responsibility it is to ensure rights. Tensions exist between 'universalism' and 'culturally appropriate' approaches, collective and individual rights, and economic and political rights.

Companies face increasing demands to demonstrate their respect for human dignity by taking account of existing international standards. This is evident in the recent calls from Non-Governmental Organisations for transnational companies to support the United Nations Human Rights Norms for Business.

The Stewardship Approach

Stewardship acknowledges that all people should enjoy certain fundamental Human Rights, including the right to freely pursue economic livelihood. Stewardship seeks to support the Universal Declaration of Human Rights, the International Covenant on Economic, Social and Cultural Rights, and the International Covenant on Civil and Political Rights.

Stewardship recognises that responsibility for Human Rights lies with nation states, but believes that companies have an important role to play in respecting and promoting Human Rights, especially in the case of large companies that might have influence on governments through their contribution to the local economy.

Stewardship will favour companies that promote Human Rights, for example through indicating public support for the Universal Declaration of Human Rights, or the Global Compact or the United Nations Human Rights Norms for Business.

Stewardship will exclude companies whose activities clearly infringe international agreements and which are complicit in Human Rights abuses, either deliberately or through neglect.

Stewardship's position on oppressive regimes, security forces, employee and supply chain labour standards is set out in detail below.

Please note that a number of matters which relate to Human Rights are dealt with in other sections:

- Respect for the rights of indigenous peoples and local communities are covered by the 'Business Environment' criteria
- Bribery and corruption are covered by the "Business Environment" criteria.

- Protection of civilians and laws of war are covered by the “Military” criteria, which excludes companies that produce or sell weapons.

Oppressive Regimes

The Issue

Illegitimate and oppressive political regimes exist in countries where companies may wish to operate. These regimes may actively prevent freedom of expression or perpetrate atrocities upon the local population. In some situations, international trade and investment may provide an important source of employment for local people, as well as stimulate local opposition and encourage oppressive regimes to undertake reforms. Operating in or trading with such countries may however generate significant revenue for these regimes, which may serve to entrench them and thereby reinforce Human Rights violations.

The Stewardship Approach

Stewardship will exclude companies whose operations directly and significantly contribute to the persistence of an oppressive regime.

Stewardship will therefore exclude companies with significant links to an oppressive regime, where their presence in that country is a cause for concern and their activities facilitate Human Rights abuses.

*Stewardship will only invest in companies that operate in countries designated as having oppressive regimes if their operations do not generate a meaningful part of government income, or if there is **clear** evidence that their operations and practices are likely to promote Human Rights and be of benefit to the local community rather than the regime. In such instances Stewardship will make available the evidence on which it has based its decision.*

Security Forces

The Issue

In countries where there is a significant risk to the personal security of employees and day-to-day business operations, companies may sometimes need to use security forces with armed guards. Security forces seeking to protect the interests of companies and the safety of their employees have sometimes used excessive force or violent action. Some companies have consequently become tarnished with complicity in Human Rights violations.

The Stewardship Approach

Stewardship recognises that companies may need to use security forces to protect their business operations and their employees, and that the security forces may in some cases have to carry firearms.

Stewardship will therefore not automatically exclude companies that make use of security forces. Stewardship expects companies operating in the extractive and energy sectors to be signatories to the Voluntary Principles on Security and Human Rights.

Stewardship will exclude companies that have a pattern of knowingly, or through negligence employing or contracting security forces that perpetrate Human Rights abuses.

Stewardship will invest in companies that check that the security forces they work with are not known Human Rights violators, explicitly address Human Rights in security contracts and provide training in Human Rights, as well as the use of weapons and non-violent riot control techniques.

Employee Labour Standards

The Issue

International trade and investment have brought benefits as well as costs. On the one hand, they have brought opportunities for people to increase their incomes through industrialisation and employment. On the other hand, disruptions to employment patterns and shifts in demand for professional skills have accompanied the rapid pace of economic transformation. The by-product is heightened job insecurity, a shift to more part time work, temporary or contract work, greater mobility and a need for continuous “re-skilling.”

In order to achieve healthy employee relations companies need to maximise the benefits and avoid or minimise the costs to employees. Where, as is increasingly common, companies in richer countries are employing, directly or indirectly, people in poorer countries, ensuring a fair distribution of the benefits of international trade and investment to such employees becomes complicated

The Stewardship Approach

Stewardship believes that companies are responsible for providing fair, safe, fulfilling and attractive working conditions for employees. Stewardship seeks to invest in companies whose practices are in accordance with the International Labour Organisation (ILO) Fundamental Conventions.

Stewardship will invest in companies that demonstrate commitment to high standards in non-discrimination, health and safety, training and development, benefits and employee participation. Stewardship’s position on these issues is detailed in the “Employee Relations” criterion.

Supply Chain Labour Standards

The Issue

The growth in the practice of companies in Northern countries buying goods and services from Southern countries has transformed supply chain management. This creates more employment and income in Southern countries, while providing low priced and quality goods and services for those in Northern countries. However, a substantial number of companies are sourcing directly or through agents in countries where governments promote exports but do not provide adequate enforcement of labour standards for workers in the formal or informal economy.

Many workers in export processing zones have therefore felt the negative effects of international trade and investment: greater job insecurity and serious labour standards violations including long working hours, ill health and unsafe working conditions. Revelations of labour standards abuses by suppliers have resulted in the companies involved in purchasing from them being criticised for failing to protect and promote labour standards.

The Stewardship Approach

Stewardship supports the International Labour Organisation (ILO) Fundamental Conventions, which cover freedom of association, the abolition of forced labour, equality and the elimination of child labour.

Stewardship recognises that companies have varying levels of influence over their suppliers, depending on their commercial strategy, the nature of supplier relationships and the local cultural context. In many circumstances though, companies are able to make observance of basic labour standards a pre-requisite for winning business or continuing trade.

Stewardship expects companies to require their suppliers to support the ILO core Conventions. **All other things being equal**, Stewardship will favour companies that positively use their influence to uphold labour standards, through use of a vendor code of conduct that refers to core ILO standards and commitment to improving supplier compliance through monitoring, review and remediation processes.

Business Environment

The Issue

Governments hold responsibility for regulating markets so that they work well for the overall economy and their citizens, encouraging competition and providing protection against detrimental effects. Companies affect the business environment through producing, purchasing, selling and marketing of products and services. To ensure their licence to operate, companies need to deal fairly and honestly with customers, suppliers and competitors, and in a transparent and accountable manner towards local communities, the environment and shareholders.

The Stewardship Approach

Companies usually try to grow and frequently by increasing their market share but must conduct their business fairly vis-à-vis their customers, suppliers and competitors. Failure to do so will undermine trust and may lead to legal or regulatory sanctions.

Consumer empowerment demands value and informed choice. Companies need to respond to consumers' needs by providing products and services that meet them transparently. This requires not only commercial innovation but also respect for public concerns. Over a wide range of products and services, producers have more information relevant to consumers' choices than they disclose. Increasingly this is unacceptable and Stewardship will particularly favour companies that go beyond what legislation requires them to disclose.

Stewardship will favour companies that support the efficient functioning of markets, acting in a spirit of competitiveness, fair dealing and honesty. Stewardship expects companies to have strong governance practices, to forge mutually beneficial relationships with customers and suppliers, and to be mindful of fair practices when dealing with competitors.

Customers

The Issue

Competitive practices among companies can bring about healthy market conditions for consumers, including lower prices and wider choices. However, unfair and/or unregulated competition may risk abuse of market power, predatory pricing, discriminatory practices, unfair contracts or misleading advertising practices. Such practices undermine the interests of customers, suppliers and companies themselves in the long run.

Customers depend on companies to provide them with products that are fit for purpose, safe and priced in a way that allows them to make accurate comparisons. There is significant public concern, for example about nutrition, particularly about childhood obesity and advertising to children of products high in fat, sugar and salt and labelling that is difficult to understand. The gradual shift in the proportion of food preparation from consumer to retailer means that retailers' influence over nutritional content has increased, conferring on them greater control over, and responsibility for, the choices that are made available to consumers. Health claims made by food producers and retailers are also increasingly under scrutiny by regulators (such as through the EU Directive on labelling and nutritional claims) and consumer groups,

with an even greater pressure for companies to support nutrition 'enhancements' with credible scientific data.

In cases where health implications of products are unclear or potentially harmful, such as in cases involving allergies or other serious conditions, consumers expect companies to provide adequate information through their product labelling. This should also include relevant consumption advice and information regarding product origin, nutritional composition and health claims, to enable consumers to make informed purchasing decisions.

The Stewardship Approach

Stewardship supports consumer empowerment, seeking to invest in companies with strong ethical practices that respect customer interests. Stewardship believes that consumers are entitled to expect a high level of care in product safety, health claims and reliable information through labelling.

Stewardship supports the World Health Organisation's (WHO) recommendations on nutrition, the WHO International Code of Marketing of Breast-milk Substitutes and resolutions passed by the World Health Assembly.

Stewardship will take into account whether a company seriously and consistently acts against consumer interests through poor ethical standards, including anti-competitive practices, irresponsible or misleading marketing or advertising, and inadequate or misleading labelling or poor data protection.

Stewardship views positively:

- Food manufacturers, retailers and restaurants that offer healthy products. Stewardship recognises that certain products that are considered unhealthy, such as those high in saturated fats, may still be acceptable for consumption in small quantities. Stewardship will therefore favour:
 - o Retailers that promote a balanced diet to their customers, and offer consumers the choice of healthy alternatives.
 - o Food producers that demonstrate actions to improve the nutritional content of their products;
 - o Restaurants that offer healthy and balanced choices; and
 - o Companies producing 'healthy' food products that deliver *clear* health benefits. This may include the use of wholegrain in cereals, or development of products with improved nutritional content across all areas, e.g. reducing both saturated fat content and salt. As well as promoting balanced diets, companies producing products with health claims should be expected to demonstrate that the product truly delivers health benefits, such as through credible scientific data.
- Retailers that offer consumers a choice between different types of product sourcing and provenance (such as a range of fair trade, locally sourced or organic products) and/or promote consumer awareness of the potential health, environment and animal welfare benefits from alternative food production methods (such as organics and grass-fed meats).
- Companies with responsible marketing practices, particularly in promotions of food products towards children. This may include:
 - o Encouraging responsible consumption;
 - o Clear policies on marketing to children; and

- o Working with education or school authorities to meet their nutritional guidelines and objectives.
- Companies that have developed clear labelling policies and practices, including the labelling of GM product traces, nutritional information, consumption advice and disclosure of product origin. Stewardship will favour labelling policies that exceed local standards, particularly in less developed markets.
- Companies that demonstrate cultural sensitivity in tailoring their products to local markets and a responsible approach to marketing new products in favour of traditional ones where reliance on new products may introduce undesirable social or environmental impacts.

Stewardship will exclude:

- *Companies with repeated or significant prosecutions related to food or product safety and fail to take adequate corrective action.*
- *Food manufacturers and retailers involved in significant violations or controversies over lack of or misuse of labelling*
- *Companies that clearly work against customer choice and a balanced diet, or that significantly risk the health of their customers. For example, fast food companies that undertake aggressive advertising targeted at children will be excluded.*
- *Food companies offering predominantly unhealthy products that fail to demonstrate awareness of the health implications of their products. This includes retailers producing own-brand products.*
- *Companies with poor practices in the marketing of particular cultural diets or Western practices in developing countries. For example, companies that irresponsibly promote breast milk substitutes, pharmaceuticals, tobacco or pesticides in developing countries will be excluded. In judging irresponsible or responsible marketing practices, Stewardship will consider not just inherently harmful products but also those that have harmful end results if not appropriately sold and used.*

Suppliers

The Issue

In certain markets, the balance of power may be uneven and favour companies more than their suppliers. In situations where companies hold dominant positions within the market, they may abuse this through coercive or anti-competitive arrangements with suppliers, or through unfair practices such as continually failing to pay suppliers promptly or arbitrarily refusing to accept goods ordered.

Abuse of a dominant position and anti-competitive practices are likely to result in a business environment that provides insufficient choice and value to consumers and that harms suppliers and buyers in the long run. Unfair practices such as late payment of suppliers may bring uncertainty and financial difficulties for suppliers, as well as undermine trust.

The Stewardship Approach

Stewardship will favour companies that use their purchasing power appropriately, upholding competitive practices and fair treatment of suppliers. Stewardship will favour companies that honour contracts and ensure their processes enable payments to be made promptly.

Local Communities

The Issue

Companies do not operate as “islands” and have substantial potential impacts on local communities, through providing opportunities for jobs and trade, as well as in how they address other local needs. Companies may meet the needs of local communities through philanthropic efforts, such as charitable donations, employee volunteering programmes and cause-related marketing. Such activities may directly benefit the local community and enhance corporate reputations.

Addressing the rights of those in the local community requires consultation on issues that will significantly affect them. In some cases, a company’s activities may severely disrupt and alter lives; for example, a new supermarket might provide employment for some, but threaten the livelihoods of others in the local area. It cannot simply be assumed that new developments meet the needs of everyone in the local community. Where a company’s activities are likely to significantly impact the lives of local people, it is imperative that it actively consults with them before making a decision.

The activities of companies involved in projects such as large dams and natural resource projects may have serious adverse impacts on the livelihood and human rights of local communities. This applies particularly to communities which are dependent on natural resources for their livelihood and culture. In such cases, Stewardship will apply an approach and guidelines similar to the ones indicated in the section headed ‘Indigenous Peoples’ below.

The Stewardship Approach

Stewardship views positively corporate involvement in local communities and favours companies that voluntarily donate a significant percentage of their turnover or profits to charity and encourage employee volunteering.

Stewardship will favour companies that are sensitive to the rights of local people, consulting with them on issues that the local community believes will significantly affect its quality of life. Consultation should be fair, transparent and enable effective participation. Companies should address the issues that are raised through such consultation, acting in an accountable and sensitive manner.

Stewardship will exclude companies that fail to respond to significant concerns of local communities or that have exceptionally poor relations with them.

Indigenous Peoples

The Issue

Indigenous people in many parts of the world face considerable discrimination and lack of respect for their rights. Companies have at times carried out insufficient consultation and participation with such people in new development projects that threaten their rights and have enabled their oppression by governments and other segments of the population.

Dependent on consumer demand, companies with global production and supply chains are able to influence significantly the quantity of global production. In addition, companies – or countries – have the ability to secure or requisition land assets for the purpose of growing and exporting food, clothing materials or fuel. Stewardship is

mindful that companies' demands on industries such as farming and agriculture can have adverse consequences on the lives, livelihoods, security and culture of local communities. Indigenous groups, as they are land dependent, are particularly vulnerable. Companies can also have a positive presence in farming, agriculture and other industries, increasing jobs and local trade.

The Stewardship Approach

Stewardship seeks respect for the rights of indigenous peoples, as defined in the UN Declaration on the Rights of Indigenous Peoples and the ILO Conventions on indigenous and tribal peoples.

Stewardship will favour companies that carry out comprehensive assessments of their potential impacts on indigenous peoples, consult them in the development of a project and involve them in decisions that affect them.

Stewardship will favour companies that take a responsible attitude in meeting consumer demands for agricultural and local produce while respecting the land rights of indigenous communities.

Stewardship will view negatively companies that have unreasonable demands for production in unsustainable quantities, or that fail to safeguard the resources on which local economies depend, or that promote changes in land use which cause significant damage to the food security of local populations. For example, through charging uncharacteristically high prices, limiting the availability of water or distorting local pest/predator balances.

Stewardship will exclude companies that demonstrate inadequate respect for the rights of indigenous peoples, through failure to consult with them at all stages of a project or through involuntary dispossession and resettlement without appropriate compensation.

Business Ethics

Stewardship expects companies to demonstrate a "governance culture," including a commitment to business ethics and a robust system of internal controls. Indicators of good practice in business ethics are:

- Robust codes will cover: anti-bribery and corruption, insider trading, conflicts of interest, use of company assets and privacy and confidentiality.
- Internal controls will include: compliance monitoring, a confidential helpline through which questions can be raised and concerns reported, and regular review of the code
- The board will receive a report, at least annually, of the results of compliance monitoring and whistleblower systems. A review for material breaches should take place on a quarterly basis.
- F&C encourages companies to publish their code of ethics on the company website, and to report aggregated results of compliance breaches or whistleblower reports in the annual report and accounts.

Corruption

The Issue

Corruption diverts resources from the public good towards private gain, undermining the benefits of trade and government accountability to its citizens. Almost inevitably this worsens the living standards of the country by diverting wealth and lowering the quality of government service locally. Corruption also distorts markets, bringing uncertainty, discouraging investment and increasing costs.

The Stewardship Approach

Stewardship expects companies operating in countries where there is a high risk of bribery and corruption to have strong policies against participation in these.

Stewardship will favour companies that commit to anti-corruption practices, for example through their policies and disclosure of facilitation payments and building good employee relations.

Stewardship as a Shareholder

Stewardship currently follows the principles for corporate governance and the voting policy, set out in “Shareholders’ responsibilities – Voting Policy and Principles for Corporate Governance,” which is posted on both the F&C and Friends Provident websites.

The F&C Governance and Sustainable Investment Team carries out voting and dialogue with companies that Stewardship invests in. The F&C website details the voting record and outlines our engagement dialogue with companies to encourage them to develop a corporate governance culture. Visit www.fandc.com/governance for further information.