First State Investments

Colonial First State
Global Asset Management

Responsible investment report

For the period 01 January – 31 December 2010

Contents

Scale of operations

1	Colonial First State Global Asset Management is the largest Australian-domiciled investment manager
4	Years CFSGAM has been a signatory to the UN Principles of Responsible Investment
5	Investment specialists in the Responsible Investment team
64	Pooled funds that integrate environmental, social and governance (ESG) considerations into the investment process
230	Specialist investment professionals
1,500+	Company meetings voted on during 2010
3,000+	Years of combined investment experience
8,000+	Retail clients globally
17,000+	Resolutions voted on during 2010
155,400,000,000	Funds under management (US$)

About Colonial First State Global Asset Management and First State Investments

In Australia and New Zealand, the company operates under the name of Colonial First State Global Asset Management (CFSGAM). Outside of Australia and New Zealand, the company is known as First State Investments (FSI). The entire company is collectively referred to as CFSGAM in this report.

CFSGAM is a global asset management business with experience across a wide range of asset classes and specialist industry sectors.

CFSGAM manages assets across a diverse range of global asset classes, including equities, cash, fixed interest and credit, property securities, listed infrastructure, listed and unlisted direct property, and direct infrastructure.

Being a global asset management business allows CFSGAM to focus on its key strengths in investing, while developing a performance culture to attract and retain talented personnel to underpin the performance of our clients' investments.

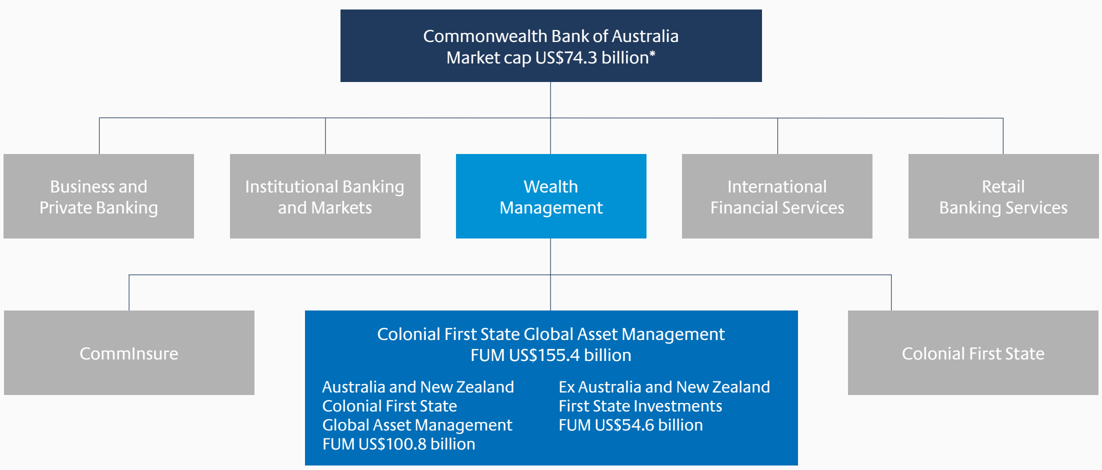
Aspirations

- To be a world-class global asset manager delivering superior investment performance to clients around the world
- Outperforming benchmarks and exceeding clients' investment objectives
- Upholding a culture that serves our clients' best interests

Key features

- More than US$155 billion in funds under management
- Guided by the expertise of 230 investment professionals globally
- CFSGAM's interests aligned with clients
- Strong risk management and compliance framework
- Signatory to the UN Principles for Responsible Investment (PRI) since March 2007
- A dedicated Responsible Investment team.

Ownership structure



Source: Colonial First State Global Asset Management as at 31 December 2010.
* As at 31 December 2010.

Foreword from the Chief Executive Officer

Welcome to CFSGAM's responsible investment report for the 2010 calendar year. This is our fourth report on our progress towards implementing the Principles for Responsible Investment (PRI) and I welcome the opportunity to share with you some of the successes and challenges we experienced during the year. I trust this report provides a useful insight into our approach to responsible investment and the work we are undertaking to implement the PRI. Collaboration is a key component behind the success of the PRI for our business and the wider industry, and I welcome interest from our clients in the work we are doing in this area.

The PRI has steadily been gaining traction in the investment community over a number of years and 2010 was no exception. This was evidenced by a marked increase in the number of ESG-related questionnaires and information requests we received from our clients, especially Australian superannuation funds. There was genuine interest from clients on our implementation of the PRI and how we are effectively implementing ESG considerations into our investment processes. I believe a best practice approach to responsible investment will become an increasingly important factor driving the allocation of capital from investors.

Successful implementation of the PRI means incorporating the six Principles into all areas of our business. As a multi-asset, global investment manager, successfully integrating ESG considerations into investment processes is more challenging in some areas than others. A focus for our business this year has been implementing a meaningful consideration of ESG issues into our credit and fixed interest products. These are among the most challenging investments in which to meaningfully integrate ESG factors, as they are exposed to duration and credit risk, as opposed to valuation risk.

Further, credit and fixed interest investors have traditionally had little traction in engaging issuers on ESG concerns due to the contractual nature of the relationship. Consequently, the ability to engage in meaningful discussions with issuers on ESG issues in the past has proved challenging. However, during 2010 our Global Fixed Interest and Credit team initiated discussions with a number of corporate and supranational issuers on ESG issues. These discussions helped to enhance the team's understanding of the risks involved with each issuer.

A challenge for our business since signing the PRI is that collaborative engagement between our investment teams has often been difficult, due in part to the autonomous approach of our investment teams and the scale of our global operations. Further, in some respects our investment teams actually compete with each other in the marketplace. During 2010, CFSGAM held an investment offsite in Hong Kong, where investment teams came together to discuss how we can improve our investment processes for the ultimate benefit of our investors.

High on the agenda was improving collaboration and knowledge sharing between our investment teams. Our company engagements, which number many thousands per year, have traditionally taken place at a team level and the outcomes of these engagements have been difficult to capture or leverage from in a meaningful way. Consequently, we have implemented a more centralised, coordinated approach to engagement which enables all investment teams to monitor what issues and which companies each team is engaging with. This is an important development as it allows for greater collaboration across teams and asset classes, enhanced thought leadership and effective active ownership.

Climate change continues to be among the most pertinent of environmental issues and remains a long-term focus for our business. I was pleased to contribute to the discussion on the effect of climate change for the investment management industry through my participation on the CEO Panel on Climate Change. This panel, which is comprised of nine CEOs from Australia's leading superannuation funds and fund managers, was established to encourage clarity and certainty on climate change policy. The panel engages with political parties on Australia's carbon pricing framework and inputs into the Federal Government's Business Roundtable on Climate Change.

Policy frameworks need to be transparent, long-term and credible to support private low-carbon investment. The current uncertainty surrounding carbon pricing hinders investment decision-making across both emissions-intensive and low-emissions assets.

The framework for pricing emissions must be resolved to allow for informed, long-term investment decisions. As outlined in our statements on climate policy, we are supportive of a market mechanism that sets a price for carbon to stimulate the move to a low carbon economy. I look forward to contributing to the future activities of the panel, which will involve meeting with political leaders and leading company CEOs to contribute to the debate on carbon price design.

CFSGAM takes its success in implementing the PRI seriously, and our effectiveness in doing so is built into CFSGAM's strategic planning process. Our rankings in the annual PRI survey form part of our business's balanced scorecard, which means key performance indicators are set across the business towards achieving this goal. Our balanced scorecard target is to be ranked in the top quartile in five out of the six Principles for the 2011 reporting year. It is pleasing that since signing the PRI in early 2007, we have made significant steps towards achieving this target and now sit in the top quartile in four of the six Principles. We will be paying particular focus to Principle 2 and Principle 3 during 2011 to improve our relative scores in these areas.

A key driver behind our success in implementing the PRI is our dedicated Responsible Investment team. CFSGAM remains one of the few investment managers to have a dedicated, specialised team that works across all asset classes globally. The Responsible Investment team works closely with investment analysts, research analysts and portfolio managers to seamlessly integrate ESG considerations into all of CFSGAM's investment processes. The team also encourages the progress of responsible investment in the wider industry through education, collaboration and thought leadership. During the year, Nicholas Edgerton joined the team, which bolsters the team to five responsible investment specialists, up from just one member in early 2007. The growth of this team is a reflection of the increasing emphasis that our business, and our clients, are placing on the PRI and responsible investment.

In addition to the support provided by the Responsible Investment team, each investment team has a responsible investment champion who focuses on responsible investment-related activities for approximately half a day per week. The responsible investment champions from each team meet monthly to discuss the approach they are taking to learn from each other and ensure continuous improvement. As our investment teams deepen their approach towards responsible investment, we are finding that many team members are spending more and more time on ESG-related matters.

The education of our investment professionals in matters relating to responsible investment remains a priority for our business. We need our staff to become responsible investment specialists if they are going to successfully and effectively integrate ESG considerations into their investment processes. CFSGAM made a significant investment in training staff during 2010 and of particular note was a globally-recognised training program for the direct infrastructure team. Given the long-term nature of direct infrastructure investing, it's critical that CFSGAM understands and manages ESG issues to both maximise value for our investors and to reduce investment risk.

All Australian-based analysts were also trained in the use of ESG research tool ASSET4, which was rolled out across the organisation with the support of the Responsible Investment team. The use of ASSET4 and RepRisk continues to supplement the information gathered through company engagement. The effective use of third party ESG research tools, combined with direct company engagement, is expected to significantly enhance the effectiveness of ESG integration for all our investment teams.

To successfully implement ESG considerations into all of our investment processes we need high quality ESG research which is on par with more traditional financial research. To encourage sell side brokers to provide this, our collaboration with ESG Research Australia continued in 2010. The second year of ESG Research Australia saw a substantial improvement in the quality and quantity of ESG research produced by the sell side for the Australian market. In 2010, CFSGAM was pleased to chair the ESG Research Australia Awards judging panel and host the awards event. These awards were created to encourage brokers to provide quality ESG research and recognise excellence in this area.

It is pleasing to witness responsible investment, supported by the framework of the PRI, gain real traction in the investment management industry. CFSGAM has been committed to responsible investment for a number of years now, which puts us in a strong position to respond to the future needs of our clients and industry. Increasingly, clients are demanding that ESG issues are integrated into investment processes, as it becomes clear that a proper consideration of ESG issues in the investment process can help investment managers make the best possible investment decisions. It is our role as a fiduciary to make the best possible investment decisions on behalf of our clients, and this is what drives our approach to responsible investment and the PRI.

Mark Lazberger
Chief Executive Officer

CFSGAM's approach to responsible investment

CFSGAM's approach to responsible investment is to integrate a consideration of ESG issues into every investment process across the organisation. This is driven by a belief that ESG issues are material investment issues that have the potential to impact long-term investment performance.

As a fiduciary, CFSGAM has regard to the long-term interests of its clients. This drives the long-term focus on responsible investment, with ESG considerations an integral part of the investment process employed by all asset class teams.

CFSGAM's approach to responsible investment does not look to build socially responsible or ethical strategies that screen out particular companies or sectors. Rather, ESG issues are considered in the same manner as traditional financial issues in terms of their capacity to affect long-term investment performance. This is highlighted because there is still some misunderstanding across the investment industry around the definitions of mainstreaming ESG versus socially responsible or ethical investing.

Key aspects

- A strong governance process is in place to ensure continuous improvement
- A strong focus on achieving global best practice
- A specialist team dedicated to responsible investment

CFSGAM's leadership team is passionate about delivering global best practice in the whole-of-business approach to implementing the PRI. To achieve this goal, PRI performance is embedded into CFSGAM's balanced scorecard. This means that the PRI are an important part of the business strategy and are used to set key performance indicators throughout the business. CFSGAM's balanced scorecard target is to achieve top quartile ranking across five of the six Principles by the 2011 reporting year.

Investment policies, reports and statements

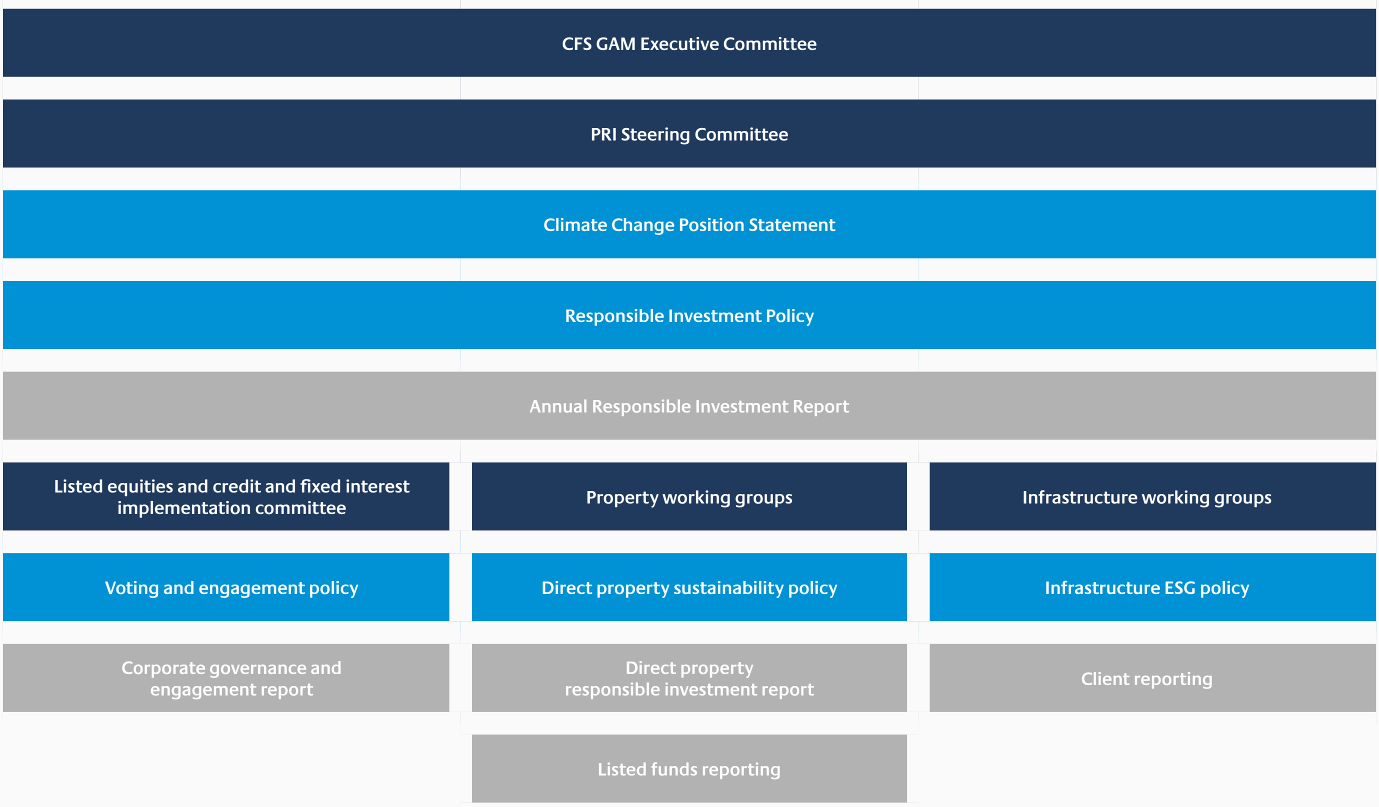
There are a number of entities within CFSGAM and these may have their own responsible investment policies, reports and statements. These documents are publicly available on CFSGAM's website and are listed in Appendix A.

Governance, policy and strategy

The global responsible investment policy and strategy is set by the PRI Steering Committee, which is comprised of 17 senior representatives from across the business and chaired by the Chief Executive Officer.

Reporting to the PRI Steering Committee are sub-committees and working groups that deal with asset class-specific ESG issues. These sub-committees ensure that ESG considerations are integrated into the investment strategies across the organisation. There are also asset class-specific policies which are reported against. This structure is illustrated in the diagram below.

Governance structure



Key
Committee
Policy
Reporting

1. Investment policies, reports and statements

There are a number of entities within CFSGAM and these may have their own responsible investment policies, reports and statements. These documents are publicly available on CFSGAM's website, www.cfsgam.com.au, and are listed in Appendix A.

The six Principles for Responsible Investment

Principle 1

We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2

We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3

We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4

We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5

We will work together to enhance our effectiveness in implementing the Principles.

Principle 6

We will each report on our activities and progress towards implementing the Principles.

Possible actions that can be undertaken to help signatories fulfil their fiduciary obligations under the PRI are provided by the PRI organisation. Where these suggested actions have been addressed by CFSGAM, they are referenced by the sub-section heading number. Refer to Appendix B for a list of references.

Work towards global best practice

CFSGAM is proud of its track record in the consideration of ESG issues and was one of the first global investment managers to become a signatory to the PRI in early 2007. CFSGAM was the first Australian-domiciled investment manager to release a detailed annual report on its progress of PRI implementation, now in its fourth year.

CFSGAM's continued work towards global best practice in its approach to sustainability and responsible investment was recognised in the 2009–10 PRI survey results. CFSGAM maintained top quartile ranking for Principles 4, 5 and 6, second quartile ranking for Principles 3 and 4, and improved its ranking for Principle 1 from second to first quartile. The integration of ESG research supplied by ASSET4 and RepRisk, combined with the continued activities of all investment teams, contributed to the improved relative performance under Principle 1. CFSGAM now sits in the top quartile in four of the six Principles relative to global investment managers.

The leadership team is passionate about delivering global best practice in a whole-of-business approach to responsible investment. Performance under the PRI is now embedded into the business's balanced scorecard, which means it is now part of the business strategy and is used to measure company performance and set key performance indicators throughout the business. The balanced scorecard target is to achieve top quartile ranking across five of the six Principles by the 2011 reporting year.

Full consideration and integration of ESG issues in the investment process remains a long-term focus for CFSGAM and we are committed to demonstrating leadership in this area.

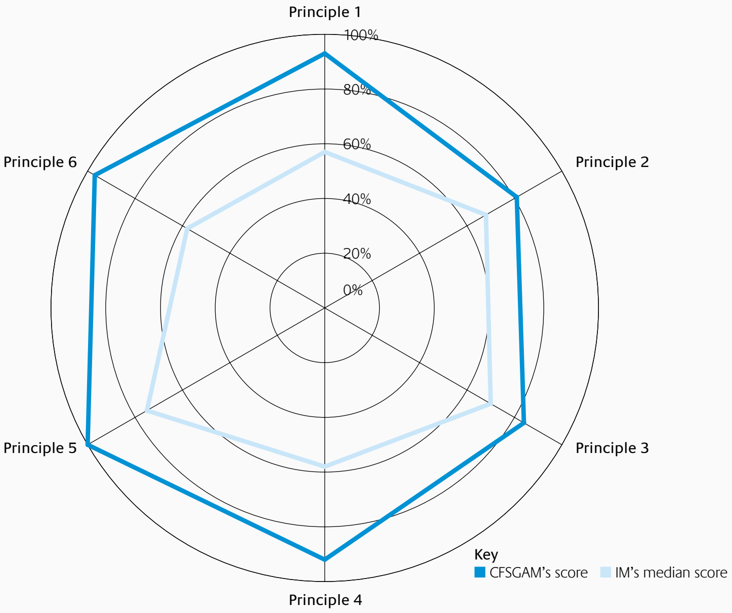
Work towards global best practice
continued

CFSGAM quartile summary against all investment managers

	2008	2009	2010
Principle 1	Quartile 2	Quartile 2	Quartile 1
Principle 2	Quartile 4	Quartile 2	Quartile 2
Principle 3	Quartile 3	Quartile 2	Quartile 2
Principle 4	Quartile 2	Quartile 1	Quartile 1
Principle 5	Quartile 3	Quartile 1	Quartile 1
Principle 6	Quartile 3	Quartile 1	Quartile 1

Source: PRI.

2010 PRI scores against all investment managers globally



Source: PRI.

Note to charts: Scores have been calculated based on signatories' self assessment and using the scoring methodology approved by the PRI Assessment Group. Although a limited verification exercise was undertaken with a proportion of signatories, responses have not been independently audited by the PRI Secretariat, PRI Assessment Group, or any other third party. Individual results including comparisons to the overall results (quartiles) are indicative and do not imply an endorsement of signatory activity. While this information is believed to be reliable, no representations or warranties are made as to the accuracy of information presented, and no responsibility or liability can be accepted for any error, omission or inaccuracy in this information.

The scope of ESG considerations

CFSGAM broadly takes the following approach to ESG considerations, although there is no exhaustive list as ESG issues are continually evolving and changing.

Environmental issues

CFSGAM takes a broad consideration of environmental issues, such as considering the track record of how companies have dealt with past environmental issues, how companies have acted in environmentally-sensitive areas and sound public leadership on environmental issues. 'Environmentally friendly' companies are not preferred, rather evidence is sought that companies have effective management, processes and behaviours in place to mitigate any environmental impacts. Where CFSGAM has the ability to influence outcomes in its unlisted property and infrastructure businesses, environmental impacts are minimised through resource efficiency and recovery.

Examples of specific environmental issues include:

- physical impacts of climate change and related regulatory risks
- environmental pollution and waste
- ongoing supply of natural resources
- new regulation expanding the boundaries of environmental liability with regard to products and services
- increasing pressure by civil society to improve performance, transparency and accountability, leading to reputational risks if not managed properly
- emerging markets for environmental services and environment-friendly products, and
- the impact of carbon pricing on future investment returns.

Social issues

It is important that companies are supported by the people they affect, in order to be able to operate without undue interference or hindrance. This concept is referred to as a 'social licence to operate' and is especially important in large organisations, direct property and infrastructure operations.

As a shareholder in many large organisations, and direct owners of large property and infrastructure assets, a social licence to operate is an important part of CFSGAM's operations.

Good corporate citizenship, strong community relations, good employee safety records, sensitivity around vulnerable communities and public leadership on social issues are considered.

Examples of social issues include:

- human capital and associated metrics such as staff turnover, engagement, and absenteeism
- customer and consumer relationships
- workplace health and safety
- community relations
- human rights issues at the company and supply chain level
- government and community relations in the context of operations in developing countries, and
- society increasing pressure to improve performance, transparency and accountability, leading to reputational risks if improperly managed.

Governance issues

The scope of governance, in relation to ESG considerations, covers the impact that company management, processes and behaviours have on the long-term interests of the business, its investors and the community in which it operates. It complements the required standards of governance as mandated by regulation.

Examples of governance issues include:

- board structure, diversity and accountability
- accounting and disclosure practices
- audit committee structure and independence of auditors
- executive compensation, and
- management of corruption and bribery issues.

Principle 1

We will incorporate ESG issues into investment analysis and decision-making processes

Principle 1 is key for CFSGAM as it is the Principle which has the most potential to impact investment returns. Principle 1 underpins CFSGAM's goal of achieving responsible investment best practice through the successful integration of ESG considerations into every asset class and investment product globally.

A number of resources are made available to support the investment teams implement Principle 1, including education sessions, dedicated internal resources, governance policies and external ESG research providers. Governance processes are in place to help ensure continuous improvements in activities relating to Principle 1.

Each investment team completes a quarterly survey of responsible investment activities as they relate to the investment process, and details the engagement undertaken with companies. The sharing of information in this manner allows investment teams to effectively collaborate on engagement across asset classes and geographies. This survey also ensures CFSGAM is pushing down the supply chain to encourage ESG research to be produced by sell side brokers.

By successfully implementing Principle 1 throughout the business, CFSGAM will ultimately realise the full investment proposition of responsible investment, which is to make the best possible investment decisions on behalf of investors.

2. Integrating ESG: equity investment approach

Each equity investment team takes an autonomous approach to integrating ESG considerations into the investment process, and so the approach to integration varies from team to team. This autonomous approach empowers each investment team with responsibility for integrating ESG into its own investment process. ESG research tools, including ASSET4, RepRisk and specific sell side research, are used by all equity investment teams to support their research process.

The approach that each equity investment team takes to integrate ESG considerations into its investment process is outlined below.

Australian equities, core

Funds under management:	US$9.7 billion
Inception date:	1993
Team size:	18
Location:	Sydney

Sustainability and governance are an explicit part of the stock research process for the Australian Equities, Core team. This stock research feeds into the team's overall view of the company in a similar way to traditional financial analysis.

The team considers ESG issues as the 'sixth factor' in its research process because it helps it make more informed investment decisions.

The Australian Equities, Core team has always considered ESG when researching companies, because the team believes that the approach a company takes to ESG issues provides an insight into the quality of the company's management. Making ESG considerations an explicit factor in the research process, as part of the PRI integration process, has enabled the team to formalise this approach.

The team's primary source of ESG information is company engagement. The team will generally meet with the managers of companies in which it invests at least twice per year, along with site visits and collaboration with other industry participants. The team will typically engage with companies on sustainability concerns and encourage companies to improve their management of potential risks. The team will also enquire about the approach that company management is taking to address relevant ESG issues, and it will look for evidence of this in company reporting.

Australian equities, growth

Funds under management:	US$14.5 billion
Inception date:	1989
Team size:	18
Location:	Sydney

The Australian Equities, Growth team analyses ESG issues at both the industry and stock level under two discrete sections: board governance, and environmental and social issues.

The team uses Porter-style[1] analysis to focus on areas of competitive advantage and areas of potential threats. ESG analysis is used to provide insights into the quality of company management, which then feeds in to the broader view of company management. The team also commissions bespoke ESG analysis from sell side brokers to support its research and company engagement.

ESG considerations are key to the team's ownership practices. Through engagement and proxy voting the team sends an important message to companies that they must take ESG issues seriously.

To embed ESG consideration across the team, it forms part of analysts' key performance indicators to ask a question related to ESG at every company meeting, identify a material issue and engage with the company to encourage change.

The team also proactively encourages brokers to increase the quality and coverage of ESG issues. This is achieved through feedback that the team gives its brokers, broker ESG research awards and proprietary work, such as looking at the performance of directors on boards.

Global equities

Funds under management:	US$3.1 billion
Inception date:	1997
Team size:	9
Location:	London

ESG analysis is a fundamental part of the Global Equities team's stock research process. The team has a particular focus on the ESG issues that may be a catalyst for share price movements, or which provide insight into the quality of company management. The adoption of RepRisk has proved particularly useful for supplying this information.

Each sector specialist in the team includes ESG considerations in their evaluation of investment risk. Where a company is weak on ESG issues, the sector analyst will increase the company's risk rating which, in turn, will scale down the company's weighting in the portfolio.

The team monitors on a monthly basis the ESG rating on all stocks which are either in the portfolio or that are potential investments. The team looks to engage with the management of any poorly-rated companies to encourage them to address and improve on their ESG performance.

Note:
1. Porter's Five Forces analysis is a framework for industry analysis and business strategy development formed by Michael E. Porter of Harvard Business School, 1979.

Listed property securities

Funds under management:	US$4.1 billion
Inception date:	1997
Team size:	9
Location:	Sydney, London, Hong Kong, New York

A key part of the Listed Property Securities team's process is the assessment of ESG issues of companies. The team believes that companies with stronger ESG ratings are better placed to achieve strong long-term returns for shareholders.

An in-depth understanding of a company, the industry in which it operates and the company's position within that industry is gained through fundamental research. The team analyses a company's management, asset quality, financial position, strategic direction, regulatory environment and overall competitive landscape. This includes a consideration of ESG issues for the firm. Typically this involves information gathering from company management and asset visits, Colliers research, broker research and discussions with local sources or competitors.

The qualitative weighting factors in the team's process are based on a set of three major qualitative criteria that influence performance. These include 'capital management', 'strategic direction', and 'management and ESG factors'. Each of these three qualitative factors receives a score out of a potential of five, to create a potential total of 15.

Management and ESG factors scoring is based on environmental policies, social policies, board quality and composition, alignment of interest with shareholders and remuneration factors. This element uses pure ESG analysis and other qualitative factors.

Global resources

Funds under management:	US$5.6 billion
Inception date:	1997
Team size:	9
Location:	Sydney, London

The Global Resources team has implemented sustainability considerations into its investment process which provide enhanced information upon which to base investment decisions. The team believes the consideration of ESG issues will lead to better risk return outcomes, which will ultimately improve long-term returns for clients.

ESG issues are particularly pertinent for natural resources companies due to the nature of the industry and the countries in which they operate. The Global Resources team has a deep understanding of the industry's key ESG issues and is highly skilled in recognising best practice management of ESG issues. The team also actively engages with companies where it sees there is room for improvement in the management of ESG issues.

The Global Resources team has developed a tailored ESG framework that is part of the stock review process; when an analyst reviews a resource company, an ESG review will also be done. While the primary source of ESG information is company dialogue, the team also utilises ASSET4 and RepRisk to streamline the sourcing of data and information.

Asia Pacific and global emerging markets

Funds under management:	US$44.5 billion
Inception date:	1988
Team size:	26
Location:	Edinburgh, Singapore, Hong Kong

ESG analysis is a fundamental part of the research and portfolio construction process for the Asia Pacific and Global Emerging Markets team. The team has a strong conviction that the sustainable positioning of companies plays an important role in determining long-term shareholder returns for all companies in emerging economies.

The macroeconomic and political backdrop is often challenging, and the ESG risks are high in developing markets. The team believes that by understanding how companies in emerging markets are managing ESG risks, it can make superior investment decisions. The team believes that governance in particular is a vital consideration when investing in emerging markets companies.

The team is very active in engaging with companies and will regularly raise ESG concerns with company management. This positive engagement on ESG issues is a powerful tool to drive shareholder value and protect and enhance the value of the team's portfolios.

The team also actively participates in broader discussion and thought leadership around responsible investment in emerging markets. An example of this, written by Analyst Sashipal Reddy, is at the end of this section.

Global listed infrastructure

Funds under management:	US$0.5 billion
Inception date:	2007
Team size:	5
Location:	Sydney, Hong Kong

ESG risks and opportunities are fully integrated into the Global Listed Infrastructure team's security selection and portfolio construction through the team's 'quality rating' process. The quality rating of a company consists of six categories: infrastructure, management, finance, regulation, sustainability, and equity flows. ESG issues are captured in the 'sustainability' and 'management' categories and account for 20% of a company's quality rating. The quality rating is combined with value ranking which gives an overall score for the company. Consistency by region and sector ensures scores are comparable.

To ensure robustness and consistency when integrating ESG considerations into the investment process, the team subscribes to a number of third party ESG research providers to cross-check and validate its own analysis.

3. Integrating ESG: credit and fixed interest approach

Credit and fixed interest

Funds under management:	US$23.6 billion
Inception date:	1986
Team size:	29
Location:	Sydney, Hong Kong

The credit and fixed interest asset class faces some unique challenges when it comes to successfully integrating ESG factors into the investment process. Unlike equity investments, where a view can be formed whether an ESG risk is factored in to the share price, this is not the case with credit and fixed interest investments, especially corporate credit and structured transactions. This is partly because of the fact that credit and fixed interest investments mature. Keeping in mind that equities are perpetual securities, the maturity dates for credit and fixed interest securities are quite short, and the average corporate or government bond matures within 5 – 7 years of the purchase date. Some ESG risks, though present, may not be significant for the pricing of securities that mature over such a comparatively short timeframe. Further, whereas a company only has one share price, it may have many bonds on issue of different maturity dates and which therefore trade at different prices. In other words, credit and fixed interest investments are exposed to duration and credit risk as opposed to valuation risk.

Fixed interest and credit investors are often not provided with the same level of access to information flows or company management that an equity investor would typically have. Corporate governance is the most important ESG issue for fixed interest investors. Corporate collapses can seriously impact a fixed interest portfolio's performance and corporate collapses usually occur as a direct result of poor corporate governance. High profile company collapses, such as Enron and Parmalat, are evidence of this.

The Global Credit and Fixed Interest team have vigilantly incorporated corporate governance risks within their disciplined investment process, as poor governance practices can elevate default risks for the team's suite of portfolios. This is taken into account within the credit risk rating assigned to each issuer, where quality of management and the business plan is a factor. It is also quantified through Information Quality Scores (IQS) which measure the potential for 'credit surprises'. Assessments are conducted on the quality and transparency of the information provided as well as the overall standard of governance. The focus of the team has also broadened to include the assessment of environmental and social risks following CFSGAM becoming a PRI signatory in 2007.

The team's credit analysts also assess ESG risk as part of the overall investment process, accessing ESG research through providers such as ASSET4, RepRisk and Responsible Research, in addition to the support provided by CFSGAM's Responsible Investment team. Environmental and social risks can also point to weaknesses in standards of governance and highlight any potential issues with risk management.

The Responsible Investment team continue to engage the credit analysts in ongoing training, contributing to increased ESG research output and coverage (particularly of Asian issuers), as well as expanded sovereign, supranational private loans coverage. Moreover, the team continue to focus on downside risks and materiality to credit securities. ESG risk assessments and rankings have also been integrated into the team's proprietary research analytics web tool, CRED.net.

As part of the transition from the previous service providers to ASSET4, the team cross-referenced and tested scores from the two existing service providers for specific credit issuers to ensure the continuity in data integrity. The team also collaborated with ASSET4 to apply more relevant ESG indicators to supranational and sovereign issuers. The team concluded that company-based criteria in ASSET4 did not always reflect the real ESG risks for these issuers, which can more closely reflect a sovereign issuer and their inherent risks. This also includes new data points which examine the social and sustainability purposes of an issuer's core business, such as funding mass transit networks in the EU. This provides the team with a sense of the risk associated with the activities of the credit issuer.

Recently, the team has enhanced its ESG assessment of counterparty risk. Counterparties are now assessed on a weighted range of indicators under ESG and controversies using data from ASSET4. Results will be provided to the counterparties during the review process and will include some examples of where they can improve based on the analysis. The team plans to implement this during the first quarter of 2011.

Fixed interest investors have historically had little traction in engaging issuers on ESG concerns due primarily to the contractual nature of the relationship. Consequently, the ability to engage in meaningful discussions on specific issues – which the issuer believes has little relevance to the relationship – has been difficult. During the past twelve months, the team's credit analysts, with the support of members of the Responsible Investment team, have conducted numerous meetings with both corporate and supranational issuers on ESG issues pertinent to our overall investment process.

This engagement has greatly assisted the credit analysts with their review of individual companies, enabling them to make better informed decisions in support of our portfolio risk management. The team is also involved in ongoing discussions with the Australia's four major banks, which are among the largest issuers in the Australian credit and bond markets. These discussions are focused largely on the materiality of ESG business risks, such as lending practices and financing risks as well as reputational risks for the banks, rather than their direct environmental and social policies. The focus remains on each bank's over arching ESG policies so that ESG risks can be identified, measured and reviewed when assessing the bank's lending and business practices. The impact of this decision making infrastructure is used to enhance the team's internal credit assessment.

4. Integrating ESG: direct property and infrastructure approach

Direct property

Funds under management:	US$35 billion
Inception date:	1984
Team size:	727
Location:	Australia, New Zealand

The Direct Property team is focused on the implementation of ESG principles into the day-to-day operational management of the properties, particularly as they relate to risk mitigation and value creation. The ability to improve the environmental performance of properties through operational efficiencies has led to the reduction of operating costs and so the increase in value of the properties generally. A case study of Direct Property's approach to integrating ESG can be found later in this chapter.

Direct infrastructure

Funds under management:	US$2.5 billion
Inception date:	1984
Team size:	23
Location:	Sydney, Melbourne, London

As one of Australia's first direct infrastructure investment managers, CFSGAM has long been a driving force in implementing ESG matters into investment strategies, particularly as they relate to risk mitigation and value creation.

With a long track record, the process of dealing with ESG issues has been in itself an evolutionary process. Infrastructure was a relatively new investment class, presenting its own unique set of challenges, when CFSGAM first became involved in this asset class.

The team has consistently developed and refined its commitment to ESG and today recognises it as being a fundamental part of its investment process. The team has a rigorous and detailed policy that outlines its global commitments and has trained the team to ensure ongoing improvement. A case study of Direct Infrastructure's approach to integrating ESG can be found later in this chapter.

5. ESG research and the investment process

One of the challenges when integrating ESG considerations into the investment process lies in putting an accurate dollar figure on ESG risks. To be able to do this, investors need reliable data and research.

The breadth of ESG considerations and their measurability makes pricing ESG risks complicated. For example, what is the dollar value of a social licence to operate? ESG research needs to address the vagaries of different investment processes, asset classes and geographies. It needs to balance short-term risk with long-term outcomes and normalise inconsistent reporting by companies.

A number of specialised research providers and mainstream investment research providers are now responding to the demand from investment managers to produce research that addresses these needs. As previously reported, in 2009 CFSGAM undertook a global review of ESG research providers to ensure its investment professionals were able to access the most relevant information for the various investment processes. A new suite of ESG research providers was appointed in early 2010.

CFSGAM has ESG research needs across the business. For example, research is needed for the listed equity teams across global markets for stock level research, while the credit and fixed interest teams need research related to default and duration risk.

No single ESG research provider is able to meet all the needs of a large, diversified investment manager such as CFSGAM. Also, the best insights are the ones that analysts get from actually visiting companies and seeing how businesses operate first hand.

CFSGAM has taken the approach of sourcing a diverse range of ESG information that is then used by teams to supplement the information they get from their own ESG research. External ESG research needs are divided into four categories: ESG data, ESG news, stock-specific and thematic ESG research, and proxy voting research. This additional research helps investment managers more systematically incorporate a consideration of ESG issues into their investment processes and practices.

6. ESG news and data

Many companies only report their ESG performance annually, and the companies themselves are not always the most reliable source of ESG information; the number of smiling children in sustainability reports often correlates with the number of problems lurking beneath. Rather than waiting on information from companies themselves on ESG developments, Zurich-based RepRisk provides investors with a real-time ESG news service. It is useful for CFSGAM's analysts to receive the most up-to-date information as they monitor company developments daily. It also allows potential ESG risks to be highlighted swiftly and enables company engagement to cover the most pertinent issues.

Gathering information and data from company reporting and various websites is time consuming, so CFSGAM subscribes to the services of ASSET4, which provides ESG data that is used when making investment decisions. This data includes information on ESG performance, such as greenhouse emissions, workplace injury statistics, the number of independent directors, and industrial disputes.

This data is used by each of CFSGAM's investment teams in the consideration of a company's management of ESG issues. Each investment team has a slightly different investment process, so the raw data can be individually utilised. ASSET4 collects up to 600 data points on almost 3,000 companies across 178 key performance indicators. ASSET4 also collects a considerable amount of data on sovereign entities that can be used by CFSGAM's Fixed Interest and Credit team. Not all data points are relevant for all companies, but they provide analysts with a number of useful ESG factors to consider.

7. Stock-specific and thematic ESG research

In-depth, stock-specific and thematic ESG research and analysis play an important role when integrating ESG considerations into the investment process. Goldman Sachs JBWere and Citi were the pioneers of ESG research in Australia and have since been joined by many major sell side brokers, such as RBS, Deutsche Bank and Macquarie. The quality and quantity of this research has improved dramatically in recent years as ESG considerations become increasingly mainstream. CFSGAM's investment teams can use high quality research to broaden their knowledge on companies and better understand the potential materiality of ESG issues.

CFSGAM also purchases specific ESG analysis for different investment markets. For example, CFSGAM has considerable exposure to emerging markets, and so Singapore-based Responsible Research provides detailed thematic ESG research on Asian companies.

8. Proxy voting research

Voting on shareholder resolutions is an important part of an active shareholder's responsibility and one that CFSGAM takes seriously. CFSGAM voted on more than 17,000 resolutions in 2010. To satisfy responsibilities as a shareholder, CFSGAM subscribes to the services of Risk Metrics and Glass Lewis. These companies gather company and resolution information and provide voting recommendations. Each investment team then considers these recommendations before making their own voting decision.

9. Mainstreaming ESG research

There is a need to send a clear signal to the research community regarding the lack of quality ESG research and CFSGAM has been an active participant in the discussions leading to the formation of the ESG Research Australia Initiative.

CFSGAM seeks to incentivise sell side brokers to produce ESG research which supplements the traditional financial research they provide. CFSGAM has a particular focus on Australian-based ESG research, given CFSGAM's position in the market as one of Australia's largest investors.

In 2010, CFSGAM hosted the inaugural ESG Research Australia Awards. These awards were created to encourage brokers to provide quality ESG research and recognise excellence in this area.

All ESG Research Australia members were invited to submit ESG research produced by brokers in 2010 that they believed added value to their investment processes. A judging panel, chaired by CFSGAM's Head of Responsible Investment, was formed from a sub-group of ESG Research Australia signatories from the superannuation and funds management industry. This judging panel then assessed the research against a set of predetermined criteria.

ESG Research Australia members also voted on an award for the best broker service. This was voted on by investment managers and superannuation funds that directly manage Australian equities investments.

Together, the awards are designed to recognise and promote the important role that brokers can play in identifying and assessing the impact of ESG matters on investments and investment returns.

10. Internal research and education

Despite sourcing third party research, in-house research remains the most important source of reference when integrating ESG considerations into the investment process.

Responsible investment sessions are held as part of an internal education and awareness-raising program which helps to provide CFSGAM's investment professionals with a better understanding of the opportunities and challenges presented by responsible investment.

These education sessions equip staff with the knowledge to engage on ESG issues with clients and the wider funds management industry. The following table summarises some of the guest speakers who were invited to present at the investment sessions during 2010 and the topics they covered.

Paul Curnow	Partner	Baker and McKenzie	The end of 2009 saw numerous headlines on the Copenhagen climate negotiations and the politics of climate change here in Australia. With a fresh perspective for 2010, Paul Curnow from Baker and McKenzie presented on what it means for investors.
Josh Dowse	Principal	Dowse CSP	Josh Dowse, the principal of Dowse CSP, spoke on the ESG due diligence process, assessing the relevance of ESG issues and linking ESG opportunities to the investment's operational strategies.
Lucy Carmody	Executive Director	Responsible Research	Lucy Carmody from Responsible Research summarised key findings from recent work on Water in China, Green Buildings in Asia, Pharma, Healthcare and the Brewery sectors. The presentation also included the current findings from a study of the Top 100 companies within the Asian Sustainability Rating and from RepRisk.
Julie Hudson	Head of SRI & Sustainability	UBS Investment Bank, Equity Research	Julie Hudson, Head of SRI & Sustainability at UBS, presented via video conference to our Sydney, London and Edinburgh offices and summarised key findings surrounding ESG Integration and, specifically, the framework UBS applied in its ESG Analyser.
Richard Fuller Talieh Bentley	Investments Analyst (PRI) Head of Governance and Sustainable Investment	HESTA UniSuper	Richard Fuller from HESTA and Talieh Bentley from UniSuper outlined how their respective funds are approaching the integration of ESG to their investment practices and the broader United Nations Principles for Responsible Investment. They also made some observations on what they expect of their fund managers and what they think 'best practice ESG integration' looks like.

11. Case study: The Global Resources team's transition to ASSET4

During 2010, CFSGAM's Global Resources team transitioned to ASSET4 as its key provider of ESG data. In undertaking this process, the Global Resources team implemented two key reforms to its investment process.

The first change was the establishment of a new, company-specific ESG scorecard. This scorecard displays key operating metrics for a particular company and its rank within the Materials and Energy sectors. This is then used in the team's regular stock review process and investment committee meetings at which investment decisions are made. The team is also working towards increasing the number of stocks that have ESG reviews included in the stock guideline review.

The second development was a sector-specific comparisons table. This table allows the Global Resources team to compare company performance by sector, such as gold companies, steel companies and exploration companies. One of the challenges of implementing ASSET4 data into the investment process has been that many data points provide an 'N/A' response due to lack of disclosure by the companies and limits in ASSET4's research universe.

The Global Resources team also established RepRisk watch lists for its funds and maintained the team's track record of assessing ESG impacts on all of the stocks invested in the Global Resources long only portfolios.

12. Case study: Direct property – incorporating ESG

During the management and ownership process of CFSGAM's direct property portfolio, ESG considerations are incorporated into every aspect of managing the buildings in accordance with the Responsible Property Investment Strategy and Sustainability Policy.

The investment process for buildings can be explained through the following three broad steps as it relates to responsible investment and ESG:

1) Acquisition: Responsible investment and ESG is incorporated in the due diligence process when the team looks at acquiring new buildings through a standard checklist and sign-off process. This process investigates the environmental and physical aspects relating to the property, with regard to both its construction and ongoing operation. The social aspects are investigated with regard to the community and society in the vicinity and how the building interacts with them. Regarding governance, the asset is reviewed for compliance with regulatory controls and its economic performance. These aspects form a part of the entire due diligence process. This is not a screening process, but one of risk mitigation and investigation which is taken into account in pricing.

2) Performance: The day-to-day management of buildings is closely guided by the Responsible Investment Principles and Operational Performance Strategy. This strategy is focused on setting and achieving performance targets for the operation of buildings based on an appropriate benchmark for the class and use of the building. The benchmark used is the NABERS Performance Tool, which is a performance-based rating system for existing buildings. CFSGAM monitors, manages, analyses and reports on the actual achievement of these targets.

The occupant use of buildings plays an integral part of achievement of the targets. This interaction is managed through a detailed Tenant Engagement Strategy, which includes a Green Lease strategy and a Green Lease schedule. The Green Lease strategy also focuses on the tenant fit-out guide and house rules, governing the operation of the asset.

3) Valuation: The valuation of buildings takes into account both the income from the occupants and the costs in running and maintaining the building. ESG factors are integral to both these aspects. With regard to income, Green Lease clauses are in place for certain buildings and are being further developed to assist with managing the occupant use of the building. With regard to maintenance and management of plant and equipment, lifecycle costing is used taking into account ESG factors. The softer side of valuation is reflective of the facilities and attractiveness of the building to attract and retain tenants and therefore secure an income stream.

All of CFSGAM's building assets are covered by the Responsible Property Investment Strategy and ESG processes. All buildings are physically managed by the CFSGAM business, and all retail (shopping centre) properties are completely internally managed from the asset through to property and facility management. The office and industrial class properties are internally asset managed, with the property and facility management operations outsourced to third party managers who manage according to CFSGAM's operational policies, and therefore implement CFSGAM's ESG standard policies and principles.

The hotel properties are asset managed by CFSGAM, and the day-to-day operations of the hotel are outsourced to a hotel operator. In this asset class, both the ESG policies of CFSGAM, and those of the hotel operator, The Marriott Group, are implemented in the buildings.

Direct property lifecycle analysis

The Lifecycle Analysis model was borne from the need to find drivers for sustainability across shopping centre assets. Unlike office assets, where there are drivers in the forms of legislation and tenant requirements, retail property doesn't have these drivers. The Lifecycle Analysis model assesses whether the owners will realise a return if additional capital is spent currently, to save on operating costs in the future. This analysis allows for the selection of more efficient items of plant and equipment which otherwise may not have been selected due to capital costs being too high.

Lifecycle analysis presents opportunities to improve returns to owners, which then flow through various aspects of the property management business. For example, by improving the long-term efficiency and sustainability credentials of the assets and bringing the assets in line with world class standards, tenant satisfaction is enhanced.

13. Case study: Direct infrastructure – incorporating ESG

A consideration of sustainability issues is embedded into the lifecycle of the direct infrastructure investment process. ESG issues are considered at the following four steps.

Step 1

During initial due diligence, prior to an investment being made in an asset, reference on the key issues for the different infrastructure sectors will be made to:

- existing legislation
- the IFC Performance Standards and the Equator Principles, and
- applicable industry-specific environmental, health and safety guidelines.

Step 2

Ongoing active asset management post-acquisition is undertaken as part of a continuous improvement process to value-add to asset performance and effectively manage risk. This is done through an active asset management strategy.

Step 3

Appropriate management of ESG considerations is undertaken as part of the ongoing valuations of assets and is a consideration in decisions whether to divest an investment.

Step 4

Thematic ESG issues are considered as part of our overall investment strategy. Through participation in industry dialogue, CFSGAM ensures it is across emerging sustainability issues for different infrastructure asset classes.

Direct infrastructure corporate engagement guidelines

CFSGAM's guidelines for corporate engagement ensure that an adequate management framework is in place that identifies ESG issues within each asset under management. The guidelines identify potential and existing risks for infrastructure assets and set benchmark performance objectives that focus on key principles associated with ESG issues.

The corporate engagement guidelines help ensure that the long-term value of CFSGAM's infrastructure assets is enhanced and the reputation of its clients is protected.

14. Direct infrastructure ESG education

CFSGAM made a significant investment in its implementation of the PRI during 2010 by undertaking a tailored training program for the direct infrastructure team.

CFSGAM's asset managers sit on the boards of the infrastructure businesses that CFSGAM invests in. It is vital that the asset managers are well equipped and up-to-date on the most current environmental and social challenges in order to protect and enhance asset performance. To facilitate this, CFSGAM appointed Environmental Resources Management (ERM) to specifically develop a unique course for the direct infrastructure team on the environmental and social issues currently facing the infrastructure sector.

CFSGAM decided the International Finance Corporations (IFC) Environment, Health and Safety Guidelines provided the most structured framework for the direct infrastructure team to refer to in their consideration of environmental and social issues in the investment process.

Undertaking this training demonstrates CFSGAM is committed in its approach to understanding and managing environmental and social investment issues.

Challenges to implementation

The challenges for Principle 1 continue to be the lack of comparable ESG reporting by companies and the reality that traditional training for financial analysts does not include ESG.

CFSGAM is encouraged that the global discussions on integrated reporting will result in a trend towards reporting that integrates a discussion on how ESG issues drive company value. CFSGAM also hopes to see more consistent and comparable data provided by companies.

The development of the Responsible Investment Academy is also valuable for the investment community. CFSGAM has enrolled 40 executives from across the business to complete the Certificate for Responsible Investment.

There has been a tangible increase in the number of questions and surveys from clients and other stakeholders on CFSGAM's approach to ESG. While the interest is welcomed, the information gathered isn't necessarily being incorporated meaningfully into the allocation of capital. Only rarely are further questions asked on the information provided in these surveys.

Viewpoint

Sashipal Reddy, Analyst.

"What have I done? If this is a victory, what's a defeat then?"

Nearly 2,200 years ago, King Ashoka, the Emperor from the Maurya Dynasty, asked this after waging one of the bloodiest battles in Indian history; the conquest of Kalinga, or the state of Orissa as it is known today. The war claimed 100,000 lives. Ashoka was so devastated at the carnage that he took to Buddhism, preached Ahimsa (non-violence) and authored one of the first writings on administration and good governance. A couple of millennia later, a similar war is being waged, across several states in India. Corporate India has become increasingly entangled, sometimes as victim, sometimes as perpetrator. The state of Orissa is home to some of India's largest deposits of coal, iron ore and bauxite, while sheltering some of the country's most disadvantaged communities.

A town called Kalinga Nagar is facing the brunt of this 'war for resources' as a reputable Indian group plans to set up steel plants in this area. Kalinga Nagar is a small town in the Jajpur district of the state of Orissa. It is rich in iron ore and the state government plans to make it the biggest steel hub in the world. While the company's record of managing community issues has been one of the best in India, even it is struggling to get the project off the ground due to land acquisition issues. Not too far away, one of the world's largest steel makers has failed to start India's biggest foreign direct investment project for the last five years for similar reasons. While development is necessary, the current approach fails to gain the trust of local communities. There is enough evidence to suggest even fair compensation is not awarded as the state and corrupt politicians have made windfall gains by acting as intermediaries in land deals. Local communities here are adivasis (tribals) with little or no skills required for industrial labour and so losing their land is losing their livelihood.

Though the trumpet blowers talk about uninterrupted 8-10% growth of the economy, we believe this growth will incrementally get more difficult unless the country finds a way to take all communities along with it. Fortunately, there are signs of improvement. The Environment Ministry has woken up from its previous slumber following a change in its leadership. It is playing a very active role in trying to ensure there are no short cuts for corporates when it comes to developing valuable resources. One can point to lots of instances of companies running head on into the Ministry and failing to make too much progress beyond that.

Take for example the Lavassa project, India's largest hill township built on 25,000 acres. We believe this project should have raised a lot of questions ranging from land acquisition, ownership, and source of funds to environmental impacts. Interestingly, the project was engineered in such a way that it does not fall into the ambit of the Environment Ministry but it has now forced its way in and has put the project on hold. While some commentators argue that the Ministry is using the environment as a political tool, we believe it has at least done a very good job in creating awareness on such issues.

Following in the Ministry's footsteps, markets have begun to recognise the importance of ESG risks to investments. Companies that commanded a premium back in 2007 for being able to 'manage the system' are unable to 'manage their discounts' now.

Like India's new generation of taxi drivers, most Indian companies are looking at short cuts to success. Such a strategy usually comes fraught with risks, dead-ends and accidents. Unlike Ashoka, India cannot afford to wage a war before learning its lessons; it needs to make that leap to good governance straight away. We are looking to invest in companies who focus on what can go wrong and take a more risk aware approach. We believe such companies, possibly at the cost of short-term profits, will deliver value to investors over the medium to long term.

Sashipal is an Investment Analyst in First State Investments' Global Emerging Markets/Asia Pacific (ex-Japan) team. Sashipal is responsible for providing research support to portfolio managers and focuses on Indian equities. This article was first published in January 2011.

Principle 2

We will be active owners and incorporate ESG issues into our ownership policies and practices

CFSGAM is an active shareholder through proxy voting and direct discussions with company management and directors. CFSGAM's large scale and reputation in the investment management industry provides its investment managers with the opportunity to engage in dialogue with individual companies on ESG issues.

Through company engagement, CFSGAM seeks to highlight areas for potential improvement, encourage disclosure on ESG issues and commend companies that are making progress in addressing ESG considerations. CFSGAM also seeks to positively influence companies towards ESG best practice for the ultimate benefit of its investors. CFSGAM has guidelines and principles for corporate engagement which are publicly available on the company website.

Active ownership and engagement are among CFSGAM's top priorities as a fiduciary, because of the belief that there is a correlation between companies with good governance practices and strong, sustainable shareholder returns. For example, the Global Listed Infrastructure team's top-rated ESG stocks outperformed the bottom-rated stocks by more than 20% over three years to May 2010. Consequently, CFSGAM seeks to positively influence companies towards ESG best practice to ultimately benefit investors.

Given the varying nature of the asset classes CFSGAM manages, the engagement approach is adjusted according to the asset class and the level of influence. Further, due to the autonomy of funds, one investment team may have ESG concerns about a particular stock that is a major stock holding in a different fund.

CFSGAM believes that engagement with companies is key to achieving ESG improvements. Collaborative initiatives with third party engagement providers exist to gather necessary information to help obtain maximum value from engagement. A focus for 2010 was to improve collaboration between investment teams on engagement on controversial issues.

As an owner of company shares, CFSGAM will engage companies on ESG issues in the following circumstances:

Risk

Where CFSGAM's assessment shows that certain ESG factors have a material impact on company earnings or value or have the potential to do so.

Management performance

Where, in CFSGAM's assessment, management is not adequately addressing ESG issues that could have a material impact on earnings and/or value.

In keeping with CFSGAM's approach, company engagement on ESG issues, when necessary, will be primarily carried out on a direct basis and indirectly via its proxy voting process.

CFSGAM takes its ownership and engagement responsibilities seriously and will only engage companies on material issues. CFSGAM engages companies to achieve specific outcomes, namely to ensure good ESG practices and thereby protect investor interests. In instances where management does not respond adequately to CFSGAM's engagement, this may impact negatively on its valuation assessment and/or could result in CFSGAM divesting its ownership.

Accountability

As engagement is an integral part of ownership, company engagement is best carried out by the responsible portfolio managers and their investment teams.

Themes

CFSGAM recognises that ESG covers a wide range of issues and therefore it will concentrate its efforts on those material ESG issues in which it has a significant understanding and where it can exert influence towards achieving a specific outcome.

Collaboration

CFSGAM recognises the benefits of collaborative engagement and therefore may collaborate in industry initiatives and forums where appropriate.

Form

CFSGAM's approach to engagement varies on a case-by-case basis. Engagement may take the form of:

- ESG issues being raised in a face-to-face company meeting with management or on a company site visit
- a telephone conversation

- a formal letter or email raising an ESG issue either for consideration or requesting formal action, or
- a joint letter with other investors through a collaborative initiative.

15. Internal collaboration

CFSGAM held an offsite in Hong Kong for global investment teams which was mostly based around the teams outlining what differentiates their investment process. The Responsible Investment team ran a session on engagement and the potential for greater collaboration across the teams.

During the discussion there was broad agreement that engagement was valuable for investment teams and for clients by providing a better view on risk management and management quality. The opportunity for improved collaboration between investment teams was discussed in order to better leverage the large scale of CFSGAM when engaging companies in order to provide greater influence. It is acknowledged, however, that in many instances collaborative engagement is not an option due to sensitivity around investment decisions.

CFSGAM's investment teams have agreed to collaborate more on ESG engagement. A list of companies that are being engaged across the business is now shared across all of the investment teams globally and there are discussions on where the teams may be able to collaborate. Each team also now completes a quarterly survey on the engagement they have had with companies. This allows investment teams from across various asset classes and geographies to collaborate and benefit from engagement that takes place across the group.

This internal collaboration is coordinated by the Responsible Investment team. This development is significant, given many teams have different investment strategies and in some ways actually compete with each other. However, there is benefit in using our significant global investment weight strategically, and there is recognition that all teams will benefit if companies better manage ESG issues.

16. Examples of engagement

Engagement is an important part of the investment practices of all of CFSGAM's investment teams. Reporting on voting and engagement activities is undertaken twice yearly. These reports can be found on the CFSGAM website.

Australian-listed major corporate

The Australian Equities, Core team engaged with the Chairman of a major corporate during the period regarding adjustments in the company's governance and sustainability process. The team noted that the corporation has a focus on improving customer satisfaction and has improved structures within the organisation to improve the focus on governance and environmental and social stakeholders. This positively impacted the team's view on management, given the changes in the executive team and improving relationships with the Government and community.

The team is concerned, however, that transparency around remuneration and KPIs could be improved. This is the subject of ongoing discussions between CFSGAM and the Chairman and other board members. The team also provided feedback on the company's sustainability report, suggesting there was potential to improve the content in order for the document to be a more useful reflection of how management was incorporating ESG practices across the organisation.

Major retailer

CFSGAM looks to encourage companies to achieve industry best practice in their approach to energy and water use. There was concern that some companies in the retail sector were lagging behind, so CFSGAM looked to engage with companies on these issues on site visits.

A site visit with the CEO of a major supermarket chain gave the Australian Equities, Growth team confidence that energy usage was a priority for the company and that innovative ideas were being implemented to save costs. For example, power-down automatically took place at the time of store closing, blinds are pulled down over open chiller displays, heat from the refrigeration and air conditioning is redeployed to other areas of the store.

Airport operator

The Global Listed Infrastructure team met with a power and infrastructure company who own the concession to a major Indian airport. Part of the land within the concession area currently contains slums where a large number of people live. As the airport continues to expand, residents of the slum will have to leave their homes and be relocated. The Global Listed Infrastructure team encouraged the company to consider its long-term social licence to operate in the way it pursues its development plans. The team continues to monitor the situation with the company as it sees this as a potentially significant social issue.

Agriculture company

An Asian agricultural company announced a discounted placement to a select group of new shareholders. The Global Resources team wrote to the company expressing its disappointment at the company's decision to selectively place shares with investors that were not on the register. The team received an immediate response from the company, which gave it some comfort. Following significant shareholder feedback, the company has stated that it will make all future capital raisings available to all shareholders. Despite this, the team remains cautious on the company as this has impacted the company's reputation.

Mining company

The Indonesian Equities team invested in a large mining contracting company. Around mid-year it received news that the company planned on acquiring a coal company related to a business group with a reputation for poor governance. After researching and finding out that the listed company is related to the business group, the team decided to sell its holdings. The Indonesian Equities team believes that the company is going to have unnecessary price volatility because of its association with the business group and its reputation for poor governance.

The below table provides an example of the types of topics we engage with companies on. These examples are a small selection taken from the fourth quarter, 2010.

Sector	Country	Engagement issue	Complete/ongoing	Behavioural change/ research process*
Soft commodity	Hong Kong	Corporate governance	Complete	Behavioural change
Retail	Australia	Community programs – store visit	Complete	Research process
Retail	Australia	Supply chain management	Ongoing	Research process
Insurance	Australia	Remuneration and KPI/ management indicators and risk management	Ongoing	Research process
Energy company	US/Australian region	Environmental and landowner issues	Complete	Research process
Uranium exploration	Australia	Corporate governance	Complete	Behavioural change
Banking	Australia	Staff satisfaction and investment, remuneration	Complete	Research process
Manufacturing	Australia	LTI and bonus/ management KPI structures plus reporting on sustainability	Ongoing	Behavioural change
Food and beverage	Australia	Remuneration and incentives	Complete	Research process
Uranium exploration	Australia	Corporate governance	Ongoing	Behavioural change
Telecommunications	Australia	Remuneration and board structure	Complete	Research process
Rail	Australia	Safety records and management	Complete	Research process
Banking	Australia	Board and management	Complete	Research process
Soft commodity	US	Environmental, corporate governance	Ongoing	Research process
Engineering	Australia	Governance and management	Complete	Research process

* Behavioural change/research process denotes whether the engagement is attempting to achieve a change in management/ company actions or whether it is part of informing the research and investment process only.

17. External collaboration

CFSGAM recognises the benefit of collaborating with other investors on engagement. In 2010, CFSGAM participated in collaborative engagement on the Forest Footprint Disclosure Initiative and encouraged other investors to participate. CFSGAM also collaborated through the PRI on a Carbon Disclosure Project engagement program. Further detail on collaborative engagement initiatives is covered under Principle 4 and Principle 5.

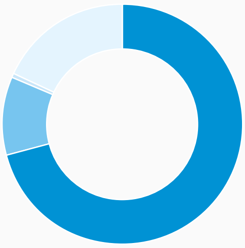
18. Engagement through voting

With more than US$155 billion invested in Australian and global equities, CFSGAM is a significant shareholder on behalf of investors in many listed companies around the world. Voting on company resolutions is an important component of shareholder responsibility, and CFSGAM votes on all possible resolutions at company meetings. CFSGAM is restricted from voting for the approval of share issues where it has participated in the placement.

Prior to voting, the relevant investment manager and company equity analyst carefully consider each resolution, with guidance provided by internal policy and recommendations from a selection of independent corporate governance research houses.

Shareholder resolutions voted on during 2010

- 1,541 company meetings
- 17,091 resolutions voted on



Types of issues voted on: All votes	Number of votes	Per cent of total votes
Non-voting	2,920	17.1
Director election	5,807	34.0
Executive remuneration	602	3.5
Non-executive remuneration	475	2.8
Issue of new shares	385	2.3
Remuneration report	643	3.8
Financial scheme/reconstruction of capital	70	0.4
Constitution/articles of association change	669	3.9
Appoint/reappoint auditor	822	4.8
Takeover or merger acquisition	134	0.8
Shareholder proposal	187	1.1
Shareholder proposal – environment	35	0.2
Shareholder proposal – social	52	0.3
All other proposals	4,290	25.1
Total	**17,091**	**100**

Types of issues voted on: Against votes only	Number of votes	Per cent of total votes
Non-voting	0	0.0
Director election	597	3.5
Executive remuneration	147	0.9
Non-executive remuneration	24	0.1
Issue of new shares	47	0.3
Remuneration report	138	0.8
Financial scheme/reconstruction of capital	3	0.0
Constitution/articles of association change	98	0.6
Appoint/reappoint auditor	56	0.3
Takeover or merger acquisition	25	0.1
Shareholder proposal	71	0.4
Shareholder proposal – environment	13	0.1
Shareholder proposal – social	9	0.1
All other proposals	558	3.3
Total	**1,786**	**10.5**

Direct investments

Principle 2 is also relevant to unlisted asset classes such as property and infrastructure, where CFSGAM has a direct investment in the asset. However, the implementation of this Principle is somewhat different from listed investments, given the different nature of the ownership.

The relative lack of liquidity in unlisted investments makes ESG issues potentially more material if not managed proactively. As investors in unlisted assets, CFSGAM typically takes a longer-term view than may be the case with publicly traded equities.

The investment process for unlisted investments seeks to:

- price ESG risk as part of the consideration during the initial transaction process
- incorporate ESG considerations into the due diligence process
- incorporate ESG management through the governance process, primarily through board representation, and
- continually monitor all aspects of the investments, including consideration of ESG risks.

19. Direct infrastructure

As one of Australia's first unlisted infrastructure investment managers, CFSGAM has a long history of implementing ESG issues into investment strategies, particularly as they relate to risk mitigation and value creation.

For unlisted infrastructure investments, CFSGAM generally seeks representation at the board level or equivalent. CFSGAM is active on ESG issues through this representation or company engagement. CFSGAM seeks to ensure that there are adequate sustainability policies in place and that reporting against these policies takes place.

CFSGAM has developed a detailed ESG policy for its direct infrastructure investments which outlines how assets are engaged with, and how those assets should engage relevant stakeholders. This policy will allow for greater alignment with clients' long-term investment interests.

The CFSGAM Infrastructure investment strategy is to typically manage a large enough interest in each individual business to enable CFSGAM Infrastructure to add value through board and board committee representation. If CFSGAM does not have a board seat, it will seek to add value and influence management decisions by actively exercising shareholder rights.

ESG issues are managed through the following activities:

Engagement with management

Regular discussions and site visits focus on business risks and opportunities.

Engagement with co-investors

ESG issues are discussed both during the initial due diligence acquisition phase and throughout the management of the operation of the asset.

Engagement with clients

ESG opportunities and exposures are addressed at both CFSGAM and client portfolio levels. All material ESG issues are reported as part of mainstream client reporting in line with the existing fund and mandate reporting processes.

Engagement with other stakeholders

CFSGAM encourages management within the infrastructure businesses to engage relevant stakeholders to understand any concerns they may have. Key stakeholders generally include regulators, local communities, unions, customers, government, shareholders and suppliers.

20. Direct property

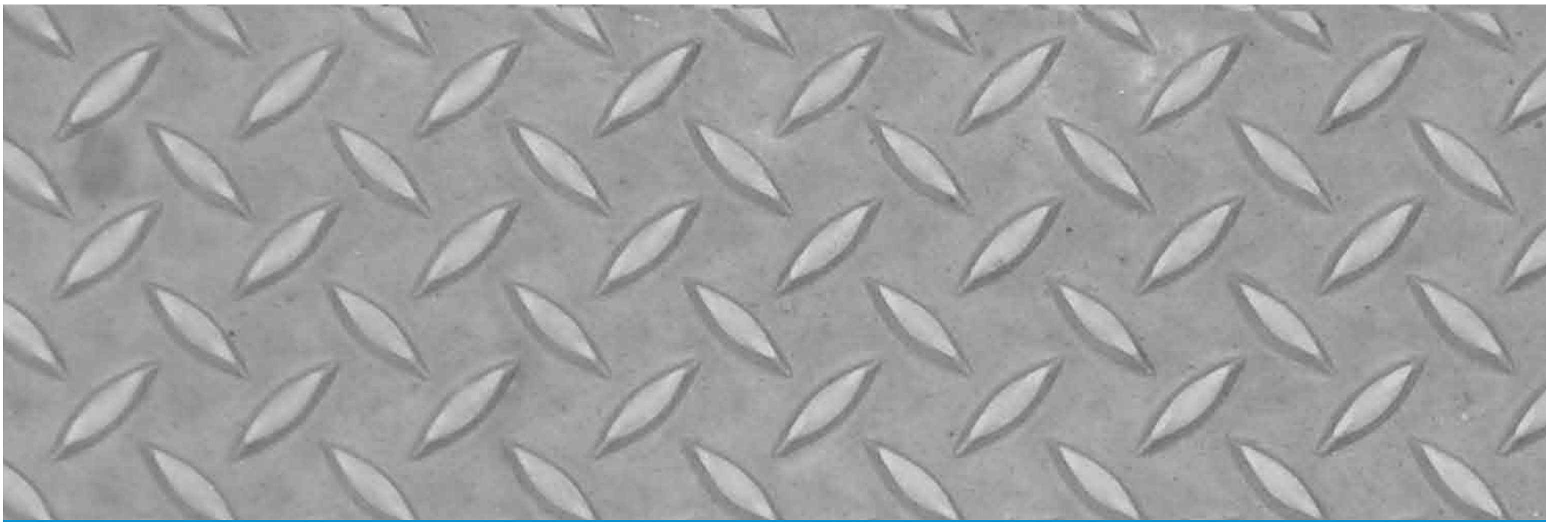
CFSGAM is an active owner in incorporating ESG into ownership policies and practices in the management of its direct property business and the Responsible Property Investment strategy is endorsed by the board. To support the implementation of this strategy, a Direct Property Sustainability Policy and an Operational Performance Strategy are in place. The Direct Property business also has an Environment Policy, Risk Policy and Resource Recovery Policy. A Green Lease strategy guides the business in tenant engagement, and is instrumental in assisting to manage tenant expectations, tenant practices in occupation of our buildings, and building tenant goodwill.

Challenges to implementation

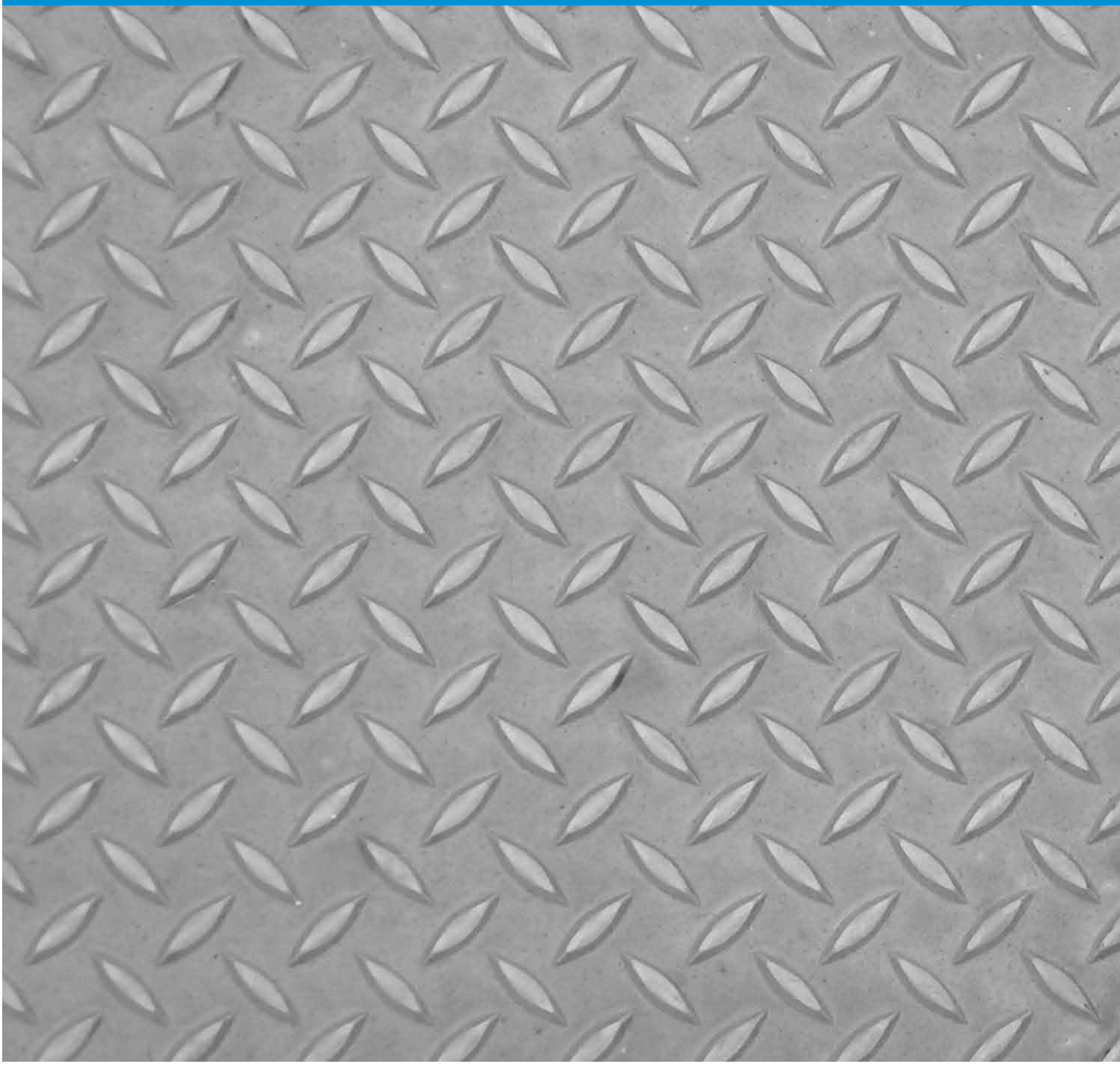
The large scale and complex structure of our business provides challenges when capturing the success or otherwise of engagement activities. Given the autonomy of the investment teams in the business and the different investment styles, it is very difficult to capture the engagement that occurs in an efficient manner. As a result, tracking our success is challenging.

This, combined with the fact that the actual outcomes of engagement are difficult to measure, means we cannot accurately monitor outcomes of engagement.

During 2010, we looked to improve collaboration between our investment teams to better leverage off the outcome of each team's engagement. Following an investment team offsite, it was agreed that, on a quarterly basis, the Responsible Investment team will circulate a list of issues currently being engaged on to ensure broader understanding of targeted issues and provide the opportunity to collaborate where desired. We also expect this will give us better reporting capability in 2011.



Principle 3



We will seek appropriate disclosure on ESG issues by the entities in which we invest

The most important activity undertaken for Principle 3 is direct engagement with companies when providing feedback on their existing reporting, or encouraging them to begin reporting. CFSGAM welcomes these discussions and understands the challenges that companies face in trying to meet all the various stakeholders' demands. There was a large increase in this type of engagement by CFSGAM's investment teams globally in 2010.

21. Company reporting

To ensure CFSGAM has adequate information to assess the value at stake (risks and opportunities), CFSGAM encourages companies to disclose their material ESG risks and performance in keeping with emerging global standards. More specifically, companies are encouraged to provide the following information to investors:

- An articulation of the business strategy and the key strategic drivers, and how ESG issues could impact the company's ability to deliver on its strategy.
- A description of the most relevant ESG issues for the company and the timeframe of any potential impact.
- The governance process in place for managing ESG issues (eg which ESG issues are managed by risk, strategy, the board or operational management).
- Information on whether and how externalities are identified, measured and potential liabilities estimated (in the event that regulation were to internalise that cost in future).
- Relevant performance data to demonstrate the progress and success (or otherwise) of the approach. This should include the data points that are the most meaningful for the company and ideally would be reported consistently year on year and across companies in the same sector to enable cross company comparisons. ESG performance data should ideally be verified and related back to strategic drivers and key risks and opportunities. Reference should be made to the best practice reporting standard; for example, the Global Reporting Initiative.
- A discussion around materiality and how ESG issues are being managed.
- Quantification where possible of the relevant ESG metrics and potential financial impacts.
- Forward looking discussion on how ESG issues are going to be managed and how these issues may impact the forward looking financial statements of the company.
- Identification of future ESG regulatory risks which could impact the balance sheet; for example, through asset impairment.
- A simple concise summary of the key ESG issues without marketing gloss.

CFSGAM consistently gets feedback from companies that very few investors ask for ESG information, particularly in emerging markets. This may be partly because companies often classify ESG issues as only environment issues. Many engagements cover human capital issues; however, companies often view this as a 'normal business' discussion, rather than an 'ESG' discussion. Questions that companies received through collaborative initiatives or engagement are also often not seen as investor driven.

A number of initiatives were undertaken during the year to encourage transparency and disclosure on ESG issues from companies. CFSGAM sees significant benefit in collaborating with other investors and stakeholders on matters of disclosure, as everyone benefits from increased transparency on ESG issues.

Value is added as an investment manager by analysing ESG information; a competitive advantage cannot be gained from the information itself. As a result, we focus many of our efforts under Principle 3 through collaboration. Examples of some of the initiatives that CFSGAM has undertaken are outlined below.

22. Engagement with the Hong Kong Exchange and Clearing

We were invited to provide investor feedback to the Hong Kong Exchange and Clearing (HKEx) as part of its stakeholder consultation on ESG reporting guidelines for companies listed in Hong Kong. In a meeting with representatives from HKEx we provided an investor perspective on a range of proposed indicators and language of the guide. This is a new approach for the Hong Kong market and provided the opportunity to lead other exchanges in guidance and requirements from companies. We encouraged them to promote company transparency on all material ESG issues, using a culturally appropriate approach to the guideline language. We believe stock exchanges have an influential role to play in encouraging better disclosure on ESG issues from listed companies, and maintaining rigorous best practice corporate governance standards while executing exchange and clearing services.

23. Asian Corporate Governance Association

CFSGAM continued its membership of the Asian Corporate Governance Association (ACGA) in 2010. The ACGA is an independent, non-profit membership organisation dedicated to working with investors, companies and regulators in the implementation of effective corporate governance practices throughout Asia.

24. Carbon Disclosure Project

CFSGAM is a signatory to the Carbon Disclosure Project (CDP) and a lead participant in the Australian Working Group for the CDP through the Investor Group on Climate Change. CFSGAM continues to participate in the CDP as it harnesses the collective power of investors globally to encourage better disclosure by companies.

More than 2,500 organisations in 60 countries now measure and disclose their greenhouse gas emissions and climate change strategies through CDP, so that they can set reduction targets and make performance improvements. CFS Retail Property Trust, Kiwi Income Property Trust, and the Commonwealth Property Office Fund all disclose to the CDP.

Through the PRI, we are participants in the CDP Engagement Steering Committee. This steering committee aims to encourage improved disclosure through the CDP, thereby improving the quality and quantity of information available to investors.

The focus of engagement is to encourage companies that operate in energy-intensive sectors to take action on climate change and report this through CDP. Specifically, it requests that companies:

- disclose a greenhouse gas emissions inventory with scope 1 and 2 emissions, and
- establish and disclose emissions reductions targets and activities.

These actions can be considered key indicators of companies' preparedness for climate change and potential regulatory changes in the future. The steering committee aims to support the CDP by encouraging dialogue with companies in the months prior to the annual CDP questionnaire. Following the CDP deadline, responses are reviewed to gauge improvement and the impact of the engagement. In 2010, the group engagement included about 90 companies in collaboration with about 35 investors.

25. CDP Water Disclosure Project

In 2011, the CDP Water Disclosure Project will be requesting information on the risks and opportunities companies face in relation to water on behalf of 354 investors with assets of US$43 trillion. This includes water usage and exposure to water stress in companies' own operations and in their supply chains and on companies' water management plans and governance. CFSGAM has agreed to participate in this project.

26. Extractive Industries Transparency Initiative

The Extractive Industries Transparency Initiative (EITI) was established in 2003 to support improved governance in resource-rich countries through the full publication and verification of company payments and government revenues from oil, gas, and mining. The EITI arose following public concerns about how much companies are paying, and what countries are doing with the funds. About 30 countries are currently participating to help protect their social licence to operate, including Yemen, Peru, Albania and Nigeria. The EITI helps companies improve stakeholder and community relations, mitigates reputation risk and helps provide transparency to investors.

CFSGAM is a signatory to the EITI because it contributes towards improvements in governance and transparency in emerging markets in which we invest. Country reporting is expected to provide a better understanding of sovereign and political risk which may be particularly useful for our Credit and Fixed Interest investment teams.

In late 2010, we wrote to 35 of the largest Australian resources companies that operate in EITI countries or countries listed by Transparency International as having a perception of corruption, and encouraged them to report to the EITI framework. This engagement will continue in 2011.

27. Financial Services Council ESG Working Group

During 2010, CFSGAM participated in the Financial Services Council (FSC) ESG Working Group. This working group was established to help drive existing FSC work on appropriate investee company disclosure related to ESG issue exposure and management. One of the strategic priorities in the group's first year is to release an ESG reporting template. This template aims to provide guidance to ASX 200 listed companies on the minimum level of reporting expected of all companies, regardless of size or sector.

It is still a challenge that most investment managers are not asking for the necessary ESG information. There needs to be a critical mass of investors to drive companies to produce the information needed. It is envisaged that this reporting template will assist with simplification of reporting, thus allowing for more meaningful analysis of issues and a better understanding of the business impacts of ESG factors. The target audience is for those companies not currently reporting ESG issues or those with minimal reporting.

28. Forest Footprint Disclosure Project

The Forest Footprint Disclosure Project (FFDP) is a UK Government-supported initiative, created to help investors such as CFSGAM identify how an organisation's activities and supply chains contribute to deforestation, and link this forest footprint to the company's value. Modelled on the Carbon Disclosure Project, the FFDP aims to create transparency and shed light on a key challenge within investor portfolios, where currently there is little quality information. CFSGAM became a signatory to the FFDP in early 2009.

29. PRI Cluster Munitions Group

CFSGAM has participated in the PRI Cluster Munitions Group. This Group is made up of nine institutional investors with approximately US$3.8 trillion total assets under management and who are all signatories to the PRI.

These signatories recognise that their international investment universe may include companies that have involvement in the manufacture of weapons or component parts that contravene the Convention on Cluster Munitions 2008 or the Ottawa Treaty. The Convention on Cluster Munitions and the Ottawa Treaty prohibit the use, production, stockpile and transfer of cluster munitions and anti-personnel mines.

The ultimate aim of the PRI Cluster Munitions Group is to establish a definitive list of such companies in order to produce a factual and widely-accepted list for use amongst the investment community.

As a part of this process, the investor group is actively collaborating through research and company engagement to gain greater clarity on company exposure to cluster munitions or anti-personnel mines, to better inform their investment decisions and also to ensure compliance with legislation prohibiting investment in such companies where applicable.

30. Enhancing business reporting; Business Reporting Leaders Forum

In 2010, CFSGAM participated in the Australian Business Reporting Leaders Forum (BRLF). The BRLF is a multi-stakeholder group, established by the Society for Knowledge Economics, to explore the interest of concerned stakeholders in establishing a network to advance Australia's business reporting practices and processes. CFSGAM was one of the investor participants in this roundtable.

Attendees included Chief Financial Officers from some of the 100 largest Australian companies, public sector policy leaders, standard setters, academics and representatives from CFSGAM.

The aim was to confirm the practical problems that reporting entities experience with the volume, timing and relevance of the information they are required to prepare for stakeholders, and then discuss potential solutions to reduce cost and improve timeliness and relevance of reporting.

There was also discussion on the benefits of establishing the BRLF in Australia to engage in this global process and progress the agenda. CFSGAM supported the development of this forum primarily because of the involvement of the CFO community, who have traditionally been a largely silent group in the discussions around sustainability reporting. With the involvement of CFOs, there should be a high level of integration of sustainability discussion into company strategy.

The BRLF will seek to collaborate with Australian stakeholders to promote and drive the development and implementation of an integrated business reporting framework. The purpose of the BRLF is to collaborate with Australian stakeholders to promote and drive the development and implementation of an integrated business reporting framework, to reduce complexity and enable efficient allocation of capital.

31. Direct infrastructure ESG reporting

CFSGAM's active investment management typically involves taking a seat on the board of directors of the company, participating in the planning and budgeting process, selecting management and maintaining ESG and reporting standards. By taking active roles on the boards of our invested companies, CFSGAM is fully informed of the current asset condition and applicable risks.

Through regular and ad hoc reporting, investors are kept appraised of policies and procedures that are implemented to mitigate and manage ESG risks and which help to protect the assets' social licence to operate.

Case study – Origin Energy

An example of the feedback CFSGAM provides to companies on their suitability reporting is the dialogue with Origin Energy. CFSGAM discussed what information investors need to get a better understanding of ESG issues. The outcome of this engagement was featured in the Origin Energy 2010 Sustainability Report which is reproduced below.

Understanding the drivers of long-term business performance

Traditional financial analysis is based on the assessment of a company's current metrics and financial accounts, with some view of the value of projects going forward. The Principles for Responsible Investment go beyond this, to integrate traditional financial analysis with sustainability metrics, in order to make investment decisions today about which companies are likely to perform well in the longer term.

Colonial First State Global Asset Management's Amanda McCluskey, who has carved out a successful career in sustainable investment for more than a decade, believes understanding a company's approach to sustainability is one of the best ways to do this.

In her role at Colonial First State, Amanda works with the investment teams across the company's global asset management to help them identify the environmental, social and governance issues that are relevant to assessing the prospective companies in which they invest. By fully understanding these issues, and their potential impact on a company's value, the investment teams can ensure they take on the appropriate levels of risk for any investments they make.

We asked Amanda what she looks at when assessing a company's prospects of performing well in the long term.

"One of the first things I look for is companies that have taken a really good consideration of the different stakeholders who can impact on their ability to deliver on a successful business strategy. This means knowing what these stakeholders are seeking to understand about the company, and then managing their needs effectively, in order to protect their licence to operate," Amanda said.

This is an important first step, as different industries can require a greater focus on a different group of stakeholders.

"If we look at the example of an airport operator, they have very physical impacts on the people who are in the immediate vicinity of their operations as these people hear the planes. Whereas for a company focused on retailing, the most important thing is their customers," she said.

Beyond stakeholders, Amanda said screening for sustainability involves understanding the issues that are relevant to a company's business strategy, and then looking at how the company demonstrates an understanding of those issues and puts in place plans to manage issues. There also needs to be demonstrated performance through various data or metrics to give confidence that the company is actually doing a good job managing the issues. In order to do this, Colonial First State depends primarily on its own research, but also uses third party economic, social and governance data providers to help collate the information.

"If we use the energy sector as an example, clearly one of the important longer-term issues is carbon emissions. We would want to understand what companies in the sector are doing to manage their energy mix, including how they are weighting their business towards high-carbon or low-carbon energy sources. Then we are going to look at the performance data to prove whether the company is actually delivering on its sustainability issues."

When asked if there are any specific criteria that tend to be really good indicators to top performing companies over the long term, Amanda is generally pretty clear about what's at the top of her list.

"It always needs to be company specific, but if we could have our dream metric with which to measure all companies, the first one would be staff turnover. Beyond that, for companies that have a significant environmental impact, we would select an environmental metric and then for more people intensive businesses likes banks or financial institutions, it would be staff engagement," she said.

The quality of management also plays an important role in company performance; however, this is a tougher thing to measure.

"You actually need to look at the company's performance on specific sustainability issues in order to get some rigour around measuring the quality of management. You can't just ask yourself is the CEO a good bloke," Amanda said.

Challenges to implementation

The biggest challenge to greater disclosure is the mixed messages companies get from investors as it relates to ESG information needs. Companies often complain to us that investors either don't care about ESG or they don't know what they want. Until investors speak with a united voice this will continue to be a challenge. We do see this united voice emerging however. With the move to integrated reporting globally and the collaboration between the Australian Council of Superannuation Investors (ACSI) and the FSC in Australia we do expect companies to be provided with better guidance from the investment community on their needs and requirements.

Principle 4

We will promote acceptance and implementation of the Principles within the investment industry

CFSGAM actively engages in dialogue, lobbying and initiatives pertaining to government policy and industry regulations, primarily through the Investor Group on Climate Change, the Financial Services Council, the Asian Corporate Governance Association, the Property Council of Australia, and the Green Building Council of Australia.

CFSGAM considers ESG issues when selecting proxy voting specialists, investment research and internal operations. Service providers, clients and peer organisations are encouraged to become PRI signatories and CFSGAM encourages the wider asset management industry to consider ESG issues. CFSGAM participated in a number of engagement initiatives to promote acceptance of the Principles within the investment industry during the year.

32. UK Stewardship Code

CFSGAM followed the development and introduction of the UK Stewardship Code (the Code) with interest during the year. After much consideration, CFSGAM decided not to become a signatory to the Code at this time. Representatives from CFSGAM attended a presentation in London introducing the Code and acknowledge that it aims to enhance the quality of engagement between institutional investors and companies.

In forming a view, representatives from CFSGAM met with Stephen Hadrill, CEO of the Financial Reporting Council (FRC) (UK), and discussed the 'business as usual' alignment with the principles behind the Code and active engagement as investors. Direct dialogue with companies is a key way to assess management quality and the risks and opportunities of the companies. CFSGAM exercises its voting rights thoughtfully, with diligence and care. CFSGAM believes the PRI provides a framework and forum for better engagement, and believes that there is little, if any, obligation in the Code that is not already covered by the PRI.

CFSGAM reviewed the 'Statement of Compliance' to the Code written by other investment managers and believes this view is supported, as many of the managers that have signed the Code have simply referenced existing activities. In addition, concern was expressed to the FRC about the strength of the Code and ability for it to make genuine improvements to real stewardship by investors. There is a risk that the absence of a review mechanism, combined with the number of signatories to the Code, may lead to many signatories failing to fulfil the Code's intention.

The development of the Code's implementation across the industry will be monitored and CFSGAM will ensure that it is always working towards, or achieving, global best practice. CFSGAM also continuously considers our position on the need to become a signatory to the Code.

While CFSGAM has not signed the Code, our statement of compliance can be viewed on the FSI website.

33. CEOs seek certainty on carbon pricing

Nine Chief Executives from Australia's leading superannuation fund and funds management organisations, including the CEO of CFSGAM, have formed a panel to pursue clarity and certainty on climate change policy, including the design of a carbon price in Australia.

The panel is the first group of Chief Executives in the Australian investment sector dedicated to addressing the uncertainty over carbon pricing. It will engage with all political parties on Australia's carbon pricing framework. It will also act as a reference group for the Investor Group on Climate Change (IGCC) input to the Federal Government's Business Roundtable on Climate Change.

Formation of the Investor CEO Panel on Climate Change extends the current work of the IGCC and sends a clear signal to policymakers that the investment community wants a resolution on carbon pricing. IGCC will continue to work on all aspects of the investment impact of climate change including carbon pricing, complementary measures to a carbon price, company disclosure and investor readiness. Most importantly, investors require policy certainty.

34. Government engagement

Representatives from CFSGAM met with Minister Bowen, representatives of the superannuation and funds management industry and the policy adviser from FSC. The purpose of the meeting was to outline the industry's position on the need to mainstream ESG into the investment process and also the need for APRA to provide clarity on ESG and fiduciary duty, given the ongoing concern by some Trustees. The difference between responsible investment and ethical investing was also discussed at the meeting and it is hoped there will be improved engagement in future.

35. Global Reporting Initiative roundtable

CFSGAM hosted a roundtable for the Australian representatives of the Global Reporting Initiative (GRI). The objective was to better inform the GRI of the needs of investors in terms of sustainability reporting from companies. Representatives from all aspects of the supply chain were invited, such as Christian Super, First State Super, JANA, other fund managers and a sell side representative from Deutsche Bank. The key messages to the GRI were that investors need factual reporting that can be integrated into financial reporting, while companies need to better identify their stakeholders and who they are reporting to. The role of the GRI is to facilitate consistent and comparable data sets.

36. The Property Council of Australia and the Green Building Council of Australia

CFSGAM is an active member of the Property Council of Australia (PCA), with both the Head of Sustainability (Property), and the Sustainability Manager Property, being members of the National Sustainability Roundtable and the Sustainable Development Committee (NSW and VIC). As such, CFSGAM actively promotes and encourages other investment organisations to implement ESG principles in their ownership models. Through these organisations, CFSGAM has actively lobbied government on the proposed policy formation and on practical aspects for implementation of these policies. Such policies and regulation include the National Greenhouse Energy Reporting (NGERS) act as well as mandatory disclosure of energy efficiency in office buildings.

Members of these committees, representing other direct property asset owners, published an industry guide to disclosure under the NGERS Act. This is available on the PCA website, and assists other owners in completing their ESG legislative obligations through the reporting of emissions.

CFSGAM was active in working with the PCA to ensure a practical approach to implementing the Commercial Building Disclosure (CBD) program, which came into effect in 2010. A selection of CFSGAM's properties were made available to the Federal Government to enable them to work through the practicalities of the 'lighting tool' part of the legislation in order to help them refine an implementation approach which is practical in application.

37. Australian Green Infrastructure Council

CFSGAM was the first, and remains the only, investment member of the Australian Green Infrastructure Council (AGIC), a member-based industry association committed to the delivery of more sustainable outcomes from the design, construction and operation of Australia's infrastructure. A representative from CFSGAM's Direct Infrastructure team is Deputy Chair and a Director of AGIC. Other members of AGIC include:

- NSW Department of Environment, Climate Change and Water
- Local Government Infrastructure Services
- Brisbane City Council
- Clayton Utz
- Bovis Lend Lease
- Worley Parsons
- Queensland Government
- Port of Brisbane
- Port of Melbourne
- NSW Government Transport Construction Authority
- Queensland University of Technology
- QR National

38. External presentations

Employees from across CFSGAM have presented at a number of key industry forums on various aspects of ESG integration, examples of which are given below.

Conference name	Speaking topic
AFR Carbon Reduction Conference 2010	Carbon emission profiles and investment opportunities, energy efficiency and governance and risk management systems
Bloomberg ESG Forum: Socially Responsible Investing for your Fund	SRI investing strategies, challenges of SRI, competitive and sustainable returns, and drivers of industry growth
Carbon Disclosure Project Briefing	CDP Panel on investor perspectives on CDP
CEDA's 'Renewable Energy'	Growing Australia's renewable energy industry – investment challenges and opportunities
Citi Group Investment Conference	CFSGAM approach to Responsible Property Investment
Cleantech Conference	New and emerging Cleantech funds, market performance and accessing institutional investment
Committee for Economic Growth of Australia	Panel discussion: Growing Australia's renewable energy industry – investment challenges and opportunities
CSR Asia Summit 2010	What investors are looking for on ESG issues
Environment Institute of Australia and New Zealand	Enabling the environmental practitioners to articulate clearly the risks of climate change to their organisation and develop adaptation pathways
ESGRA Research Awards	Recognising excellence in ESG research and service
Financial Services Partners Professional Development	Sustainable investing and the integration of sustainability into investment analysis
Fourth Annual China Investment Management Summit	ESG and socially responsible investment in Chinese securities
Girls Education Conference	Global and Ethical Responsibility Panel
Morgan Stanley Bi-Annual Environment Day	CFS Retail Property Trust (CFX) responsible property investment
PCA Outlook 2010	Going Green in the Retail Sector
PRI in Person Conference	Improving corporate disclosure in emerging markets
Tasmania Property Council Tasmanian Future Directions event	Challenges and drivers of responsible investment; what you aim to achieve in next five years
UNEP FI Summit	How the finance sector and capital markets have to act differently as an industry or as individual organisations to facilitate low-carbon growth. Is low-carbon growth high enough on governments' agenda and are incentives ambitious enough to unlock low-carbon investment at scale
UNPRI Meeting – Launch of PRI Country Network	CFSGAM implementation of PRI
Women in Super	Why we care about ESG as mainstream investors, how it differs for different investment strategies and difficulties with ESG integration
Green Cities 2010	Retail property – 'which is the most sustainable asset class', session
PRI Webinar Responsible Property Investment	Tenant engagement session
UNEPFI Property Working Group	An Australian Member's Perspective
UNEPFI Property Working Group	Annual meeting of members in Geneva

39. Balanced scorecard approach

The PRI are an important part of CFSGAM's business strategy and are used to set key performance indicators throughout the business. CFSGAM's effectiveness in implementing the PRI are embedded into the company's balanced scorecard, with the target of achieving top quartile ranking across five of the six Principles by the 2011 reporting year.

Challenges to implementation

There remains a persistent misunderstanding by the broader market that ESG issues are socially responsible or ethical issues that are only of interest to a niche group of investors that want to invest in accordance with their moral or ethical beliefs. These investors believe that their investments may be compromised through a reduction in their investment universe or a preference towards environmentally friendly companies, rather than ones that will provide the best possible investment outcome. This isn't the case for the mainstream investment managers that have signed the PRI, who effectively use ESG as a further means to measure the potential impact on long-term investment performance.

This creates a challenge for 'mainstreaming' because there is a pre-conceived notion of what 'responsible investors' are looking to achieve that sometimes limits the effectiveness of engagement. For example, when engaging regulators, if they think an investor is seeking guidance around fiduciary duty that broadens the mandate away from investment returns to a 'social outcome', they are less likely to listen to an investor's perspective. As a result, engagement of responsible investment issues takes longer because a restating of the objectives has to be made.

Principle 5

We will work together to enhance our effectiveness in implementing the Principles

During 2010, CFSGAM continued to communicate the business case for the PRI and promoted a deeper understanding of ESG issues through education in the industry. CFSGAM participated in a number of engagement initiatives and associations during the period to enhance the industry's effectiveness in implementing the PRI and contributed to a number of thought pieces, articles and academic texts.

This collaboration helps CFSGAM to stay abreast of developments in the sustainability and responsible investment arena more broadly, and also helps CFSGAM to work with like-minded investors to facilitate ongoing improvements in the industry's approach to sustainability and responsible investment.

40. Collaborative initiatives

CFSGAM's Responsible Investment team members and executives from across the organisation are well-regarded and active participants in their field and contribute their expertise to a number of third party organisations including:

ESG Research Australia
Board member

Chair of Evaluation Committee

Green Building Council of Australia
Member of the Board of Directors

Investor Group on Climate Change
Founding Deputy Chair

Member of the CDP Working Group

Member of the Research Working Group

Member of the Property Working Group

Property Council of Australia
Member of the National Sustainability Roundtable

Member of the PCA (Victorian division) Sustainable Development committee

Member of the PCA (NSW Division) Sustainable Development committee

United Nations Environment Programme Finance Initiative
Member of the Global Steering Committee

Co-Chair, Property Working Group

Member of the Asset Management Working Group

Financial Services Council
Member of the Investment Committee

Member of the ESG working Group

Australian Green Infrastructure Council
First Deputy Chair and Director

ASFA Investment Policy Sub Committee
Committee Member

Other collaborative initiatives that CFSGAM participated in, or continued to be a member of, during 2010 include:

- Asian Corporate Governance Association
- Association for Sustainable & Responsible Investment in Asia (founding member)
- Carbon Disclosure Project
- Extractive Industries Transparency Initiative
- International Corporate Governance Network
- Forest Footprint Disclosure Project, and
- Water Disclosure Project.

41. Substantial initiatives

Launch of the PRI Country Network
To support signatories in the implementation of the PRI, the Australian Council of Superannuation Investors (ACSI), Financial Services Council (FSC), EPA Victoria, the Responsible Investment Association of Australia (RIAA) and Cbus (as David Atkin in the co-chair of the PRI) have formed a PRI Australian Country Network. The aim of this group is to develop and deliver a consistent approach to providing advice and support to PRI signatories in Australia.

A representative from CFSGAM's Responsible Investment team was involved to present at the inaugural meetings of the network on the activities CFSGAM has undertaken in Australian equities and CFSGAM continues to be engaged in the network.

Hong Kong roundtable on carbon finance

CFSGAM was invited to participate in a roundtable on clean infrastructure which was hosted by the Asian Development Bank and the UK Government's development arm, DFID. The purpose of the roundtable was to discuss how development institutions may facilitate a larger flow of capital into clean infrastructure in Asia. Specifically, how funds should be structured, how risks can be managed and which fund managers may be willing to work with the development banks. The Head of Infrastructure Investment represented CFSGAM at the roundtable.

NABERS tool development

CFSGAM has trialled and piloted the new tools developed by the NSW Department of Environment, Climate Change and Waste (DECCW) for Indoor Environment and Waste. In the case of NABERS Indoor Environment, CFSGAM was able to assist by providing feedback and examples which assisted DECCW to change the protocol. This resulted in an improved tool for the property industry to adopt.

With regard to the NABERS Waste tool, CFSGAM has provided direct feedback and assistance to DECCW to help it understand the practical limitations of the current tool. CFSGAM has offered further assistance to change the protocol to be more industry meaningful and easily adopted.

Challenges to implementation

The biggest challenge to Principle 5 is finding the time to participate in all the various initiatives and prioritising those that are the most important. It is clear that executives from across the group spend considerable time on ESG initiatives. For many of these initiatives to be successful there needs to be greater participation from across the industry. In 2011, CFSGAM will be undertaking a review of all of the collaborative initiatives it participates in to ensure maximum possible value is added.

Principle 6

We will each report on our activities and progress towards implementing the Principles

CFSGAM seeks to be fully transparent in its approach to implementing the PRI. It is important to keep stakeholders informed on progress and CFSGAM has undertaken a number of steps to raise awareness of ESG initiatives. All current policies and reports are publicly available on the company website, and mainstream communications now feature CFSGAM's approach to sustainability and responsible investments.

42. Responsible investment report

In 2010, CFSGAM was pleased to announce the release of its third annual responsible investment report, for the calendar year 1 January to 31 December 2009. CFSGAM produces this report to encourage discussion with stakeholders, increase awareness of challenges and opportunities and to provide transparency on the processes taken to implement the PRI.

43. Direct property reporting

The Commonwealth Property Office Fund (CPA) and CFS Retail Property Trust (CFX) annual reports cover the responsible property investment and sustainability initiatives taking place across CPA's and CFX's property portfolios. Both CPA and CFX report on how they have performed and what the benefits to investors have been in undertaking sustainability and environmental initiatives.

The reports outline how the funds' daily operations and approach to business help drive long-term sustainable value. The key philosophies underpinning the engagement in sustainability practices are consistent with CFSGAM's membership of the PRI. The sustainability component of the report demonstrates how the funds have upheld the PRI and monitored its impacts on the environment and developed relationships with stakeholders.

CPA and CFX incorporated their ESG reporting into the annual report, rather than producing a standalone sustainability report. This is an important step towards the mainstreaming of ESG issues as they should not be viewed by investors in isolation from more traditional financial measures and reporting.

Direct Property Investment Fund sustainability report

The Direct Property Investment Fund (DPIF) released its third sustainability report to investors on the sustainability initiatives undertaken in the 2009–10 financial year and its plans for the future. While this is only the third official report to investors on these activities, DPIF has been actively focused on managing ESG issues for many years.

DPIF is committed to promoting change within the industry and to facilitating further advances in sustainability initiatives not just within the fund's portfolio, but by the broader property industry and its stakeholders. DPIF will continue to drive operating efficiencies within its properties, while increasing the focus on improving tenant engagement and fostering improved tenant/landlord partnerships.

44. Listed property reporting initiatives

Australian SAM Sustainability Index

Australian SAM Sustainability Index (AuSSI) tracks the performance of Australian companies that lead their industry in terms of corporate sustainability. Based on a thorough assessment of economic, environmental and social criteria, the AuSSI comprises the top sustainability driven companies from 21 industry clusters covering the entire Australian economy. CPA was recognised as the leader for the Real Estate Investment Trusts Cluster by AuSSI. CPA and CFX have been listed on this index since 2005.

Carbon Disclosure Leadership Index

In 2010, CPA was pleased to announce that it was a member of the Carbon Disclosure Leadership Index (CDLI) 2010. The CDLI represents companies with the clearest consideration of business-specific risks and opportunities and the best internal data management practices for understanding greenhouse gas emissions and energy use. CPA and CFX have been listed on this index since 2006.

CPA is also the only real estate entity to be identified as a leader in the new Carbon Performance Leaders category. Being the only real estate entity named as a Carbon Performance Leader is a significant achievement for the Fund and recognises CPA's long-term commitment to sustainability and responsible investment.

Dow Jones Sustainability Index
The Dow Jones Sustainability Index (DJSI) tracks the financial performance of the leading sustainability-driven companies worldwide. Currently 70 DJSI licences are held by asset managers in 16 countries to manage a variety of financial products including active and passive funds, certificates and segregated accounts. CPA and CFX have been listed on this index since 2003 and 2004 respectively.

Environmental Real Estate Index
CPA and CFX ranked third and fourth respectively on the Environmental Real Estate Index (EREI) for the top Australian listed property companies. This index measures the environmental performance of the commercial real estate sector globally. The EREI produced its inaugural report in 2009.

FTSE4Good Index
The FTSE4Good Index measures the performance of companies that meet globally recognised corporate responsibility standards and facilitates investment in those companies. Both CPA and CFX are listed on the FTSE4Good Index. CPA and CFX have been listed on this index since 2005 and 2001 (inception) respectively.

Corporate governance reporting updates
As one of Australia's largest asset managers, CFSGAM is an active representative of major shareholders in many Australian listed companies. CFSGAM uses its influence to encourage best practice corporate governance in the companies in which we invest and produces a twice-yearly report to provide an update on our corporate governance practices and activity. The corporate governance update outlines how we voted on key issues such as director elections/re-elections, executive remuneration and non-executive remuneration and provides case studies of engagement.

Client questionnaires
In 2010, there was a marked increase in focus on ESG issues and considerations in investor communications which reflects the importance that funds and investors now place on sustainability and responsible investment. A number of Requests for Information were completed specifically in relation to ESG practices and the PRI survey.

Responsible investment website
CFSGAM's responsible investment website includes information on our commitment to sustainability, links to all current policies and reports, latest news and research on sustainability and responsible investment in the business and profiles of the responsible investment team. CFSGAM's responsible investment website can be accessed at www.cfsgam.com.au/RI.aspx.

Appendix A

Supporting policies, reports and statements

Responsible investment policy statement

First State Investments stewardship statement

CMIL corporate governance report, June 2010 – unlisted property funds

CFSAMAL guidelines and principles for corporate engagement on governance, environment and social issues

CFSMPL and its corporate governance practices – unlisted funds

Climate change position statement

CMIL and its corporate governance practices – listed funds: CFX and CPA

Direct property sustainability policy

Direct infrastructure corporate engagement guidelines summary

Appendix B

The six Principles for Responsible Investment

Principle 1

We will incorporate ESG issues into investment analysis and decision-making processes.

Possible actions	Reference*
Address ESG issues in investment policy statements	1
Support development of ESG-related tools, metric, and analyses	2, 3, 4
Assess the capabilities of internal investment managers to incorporate ESG issues	11, 12 ,13
Assess the capabilities of external investment managers to incorporate ESG issues	N/A
Ask investment service providers (such as financial analysts, consultants, brokers, research firms or rating companies) to integrate ESG factors into evolving research and analysis	7, 9
Encourage academic and other research on this theme	5, 6, 8
Advocate ESG training for investment professionals	10

Principle 2

We will be active owners and incorporate ESG issues into our ownership policies and practices.

Possible actions	Reference*
Develop and disclose an active ownership policy consistent with the Principles	1
Exercise voting rights or monitor compliance with voting policy (if outsourced)	18
Develop an engagement capability (either directly or through outsourcing)	15
Participate in the development of policy, regulation and standard setting (such as promoting and protecting shareholder rights)	27, 29, 32-37
File shareholder resolutions consistent with long-term ESG considerations	18
Engage with companies on ESG issues	16, 19
Participate in collaborative engagement initiatives	17
Ask investment managers to undertake and report on ESG-related engagement	N/A

Principle 3

We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Possible actions	Reference*
Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)	21, 24-28
Ask for ESG issues to be integrated within annual financial reports	21, 27
Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)	21, 29
Support shareholder initiatives and resolutions promoting ESG disclosure	23–31

* 'Possible actions' are taken from guidance provided by the PRI to help signatories fulfil their fiduciary obligations under the PRI. Where actions have been addressed by CFSGAM, they are referenced by a number before the sub-section heading.

Principle 4

We will promote acceptance and implementation of the Principles within the investment industry.

Possible actions	Reference*
Include Principles-related requirements in requests for proposals (RFPs)	N/A
Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)	39
Communicate ESG expectations to investment service providers	38
Revisit relationships with service providers that fail to meet ESG expectations	32
Support the development of tools for benchmarking ESG integration	32
Support regulatory or policy developments that enable implementation of the Principles	33–37

Principle 5

We will work together to enhance our effectiveness in implementing the Principles.

Possible actions	Reference*
Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning	40
Collectively address relevant emerging issues	41
Develop or support appropriate collaborative initiatives	41

Principle 6

We will each report on our activities and progress towards implementing the Principles.

Possible actions	Reference*
Disclose how ESG issues are integrated within investment practices	42–44
Disclose active ownership activities (voting, engagement, and/or policy dialogue)	42–44
Disclose what is required from service providers in relation to the Principles	42–44
Communicate with beneficiaries about ESG issues and the Principles	42–44
Report on progress and/or achievements relating to the Principles using a 'Comply or Explain'[1] approach	42–44
Seek to determine the impact of the Principles	42–44
Make use of reporting to raise awareness among a broader group of stakeholders	42–44

Note:

1. The Comply or Explain approach requires signatories to report on how they implement the Principles, or provide an explanation where they do not comply with them.

* 'Possible actions' are taken from guidance provided by the PRI to help signatories fulfil their fiduciary obligations under the PRI. Where actions have been addressed by CFSGAM, they are referenced by a number before the sub-section heading.

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