Responsible investment report

For the period
01 January – 31 December 2011

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.

Contents

Foreword from the Chief Executive Officer

Welcome to the Colonial First State Global Asset Management (CFSGAM) responsible investment report for the 2011 calendar year. This is the fifth year that we have produced a responsible investment report. Previously we have reported against our progress in implementing each of the six Principles for Responsible Investment (PRI). However, we have changed the focus to report specifically on what each of the investment teams is doing across CFSGAM to implement responsible investment. This reflects that, over time, every team within CFSGAM has increased the sophistication and rigour with how environmental, social and governance (ESG) issues are assessed in the teams' investment processes, and the improvements it has made to investment stewardship practices. We have also grouped together all our activities under Principles 3, 4, 5 and 6 into one section on business-wide activities.

I am proud of our investment teams globally and the leadership they have shown when integrating ESG considerations into their investment strategies. While our quality-focused active investment styles make us well-placed to lead in our approach relative to quantitative or index strategies, I believe the rigour of our approach to responsible investment has been a contributing factor to the performance of our funds. More than 70% of our strategies have outperformed their respective benchmarks over three and five years. Our approach to responsible investment adds value to our global investment products and, while direct attribution is difficult to demonstrate, I believe the correlation is significant.

Our stewardship activities are a strength in our approach to responsible investment. In 2011, CFSGAM voted at more than 1,600 company meetings on more than 18,000 resolutions. CFSGAM will typically seek to relay concerns to company management prior to voting against a resolution. This engagement conveys to companies the rationale behind a decision not to support a resolution and can assist in improving future governance standards.

While we do not include every company engagement on ESG, the engagement examples provided in this report demonstrate the seriousness with which we take our role as a fiduciary. We firmly believe that, as a manager of other people's money, we should behave as an owner of companies, not a trader. We make a point of communicating with companies on the areas of ESG we think are important and encourage them to manage long-term risks.

CFSGAM also invests in property and infrastructure assets directly and is active on ESG issues. CFSGAM Property directly controls the management of real estate it manages on behalf of investors, and so it is in a favourable position to implement responsible investment initiatives and processes to directly affect ESG outcomes of the investments. Further, 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 protection and creation.

Two of the biggest challenges to mainstreaming responsible investment practices across our investment portfolios are the lack of consistent and comparable ESG reporting by companies and the absence of quality education on responsible investment. To help address these gaps, we were very pleased to see the ongoing success of the Integrated Reporting Initiative in 2011. We were an active participant in the dialogue through our participation in the Australian discussions and we continue to communicate our preference for fit-for-purpose ESG reporting by companies.

Similarly, we commend the Responsible Investment Academy for its development of the Responsible Investment Essentials course. While there is still some way to go before we have comprehensive responsible investment courses for investment analysts, in 2011 we enrolled more than 40 of our investment professionals across our organisation on to the Academy's course.

To manage many of the long-term environmental challenges we face, we need an effective regulatory system that starts to price externalities. As an active member of the Investor Group on Climate Change, and a significant investor in the Australian markets, we have for many years been a participant in the debate around emissions trading. We have long believed investors require a price on carbon to provide greater certainty when making long-term investment decisions. We were pleased to see the passing of legislation that will see a price on carbon in Australia and, while the Emissions Trading Scheme will be very much a soft start, it is a step in the right direction.

We continue to be a participant in the global policy debate and again signed the Investor Statement on Climate Change. In January 2012, we participated in the fourth Investor Summit on Climate Change at the UN Headquarters in New York.

I commend the United Nations Principles for Responsible Investment for its ongoing success in recruiting new signatories to the PRI and its ongoing support of signatories. To have grown to a signatory base of more than 900 international investors in a little over six years is a significant achievement. I believe the investment industry has started to think about responsible asset management on a par with responsible investment.

Ongoing financial trouble around the world is increasing the focus on the financial services sector. With public protests taking place in many of the world's major cities, the financial services sector needs to work hard to maintain its social licence to operate. As a shareholder in many large organisations, and direct owner of large property and infrastructure assets, a social licence to operate is an important part of CFSGAM's operations.

Governments and regulators around the world are starting to address perceived shortcomings through codes of stewardship, required disclosures on voting and general guidelines. We need to not only consider how we integrate ESG issues into our investment processes, but also how we develop and deliver our products to ensure that we have a continuing focus on delivering what is in the best interests of our clients.

Finally, we had built into our business's balanced scorecard the target to be top quartile across five of the six Principles of the PRI by reporting year 2011. I am pleased to say that we achieved that target a year early in reporting year 2010, due to the commitment towards investment best practice from all the people in our business.

Mark Lazberger
Chief Executive Officer

Chapter 1

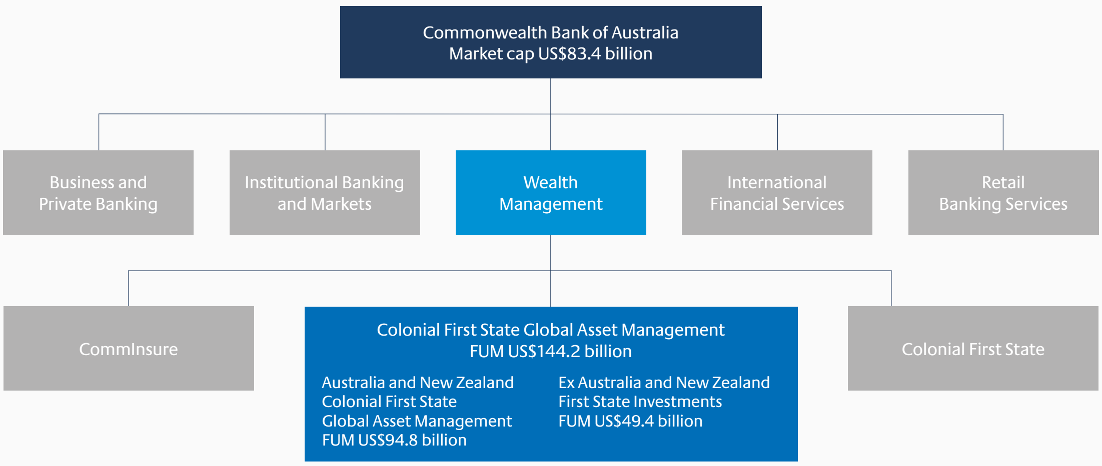
Governance, policy and strategy

Traditional blanket from Rajasthan

About Colonial First State Global Asset Management

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, direct property and direct infrastructure.

Ownership structure



Source: Colonial First State Global Asset Management as at 31 December 2011.

CFSGAM's approach to responsible investment

CFSGAM seeks 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 remains 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

Governance of the approach to responsible investment

Since signing the PRI in March 2007, a governance framework has been established to ensure there is responsibility across CFSGAM for the relevant aspects of the PRI.

A PRI Steering Committee, which is comprised of senior representatives from across the business and chaired by the Chief Executive Officer, is responsible for setting the organisation-wide responsible investment policy and strategy.

Supporting the PRI Steering Committee are sub-committees and working groups that deal with asset-class-specific ESG issues. These sub-committees ensure that tangible work is undertaken to implement the PRI into the different investment strategies across the organisation. Every investment team has a staff member allocated to ESG considerations who spends a notional 10% of their time on responsible investment-related activities. There are also asset-class-specific policies which are reported against.

Governance structure

CFSGAM Executive Committee

PRI Steering Committee

Climate Change Position Statement

Responsible Investment Policy

Annual Responsible Investment Report

Listed equities and credit and fixed interest implementation committee	Property working groups	Infrastructure working groups
Voting and engagement policy	Direct property sustainability policy	Infrastructure ESG policy
Corporate governance and engagement report	Direct property responsible investment report	Client reporting
	Listed funds reporting	

Key
Committee
Policy
Reporting

Summary of the approach to the PRI

Principle 1

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

Principle 1 is important 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.

Every investment team across CFSGAM tailors its approach to its investment process. This is reflective of the different investment strategies and styles across the global group. The objective in every case is to use ESG analysis to help make the best possible investment decision.

A number of resources are made available to support the investment teams implement Principle 1. These include 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.

Principle 2

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

Proxy voting rights are an important part of shareholder responsibility, and CFSGAM seeks to vote on all possible resolutions at company meetings. Prior to voting, the relevant investment manager and company equity analyst carefully consider each resolution, with guidance provided by CFSGAM's 'Guidelines and principles for corporate engagement on governance, environment and social issues'. Recommendations from a selection of independent corporate governance research houses are also sought. CFSGAM emphasises that its investment teams retain full control over their proxy voting decisions and do not necessarily follow the guidance provided by third party governance research houses. Data provided by third party service providers is used only as an additional source of information that investment teams use when making their voting decisions.

CFSGAM is an active shareholder through proxy voting and direct engagement 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.

Through carefully considered proxy voting and company engagement, CFSGAM seeks to ensure that the companies it invests in have high performing boards and an alignment of incentives between company management and shareholders. This is important for encouraging proper risk oversight, company strategy, and long-term company performance.

CFSGAM believes that engagement with companies, together with voting on shareholder resolutions, are key to achieving ESG improvements. 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.

CFSGAM also invests in property and infrastructure assets directly and is active on ESG issues. CFSGAM Property directly controls the management of real estate it manages on behalf of investors, and so it is in a position to implement responsible investment initiatives and processes to directly affect ESG outcomes of the investments. The CFSGAM Infrastructure investment strategy is to typically manage a large enough interest in each individual business to enable the team to add value through board and board committee representation. The team is active on ESG issues through this representation or company engagement, and seeks to ensure that there are adequate sustainability policies in place, and that reporting against these policies takes place.

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 and participating in collaborative investor-led initiatives.

CFSGAM welcomes discussions with companies and understands the challenges that companies face in trying to meet all the demands of various stakeholders. There was a large increase in this type of engagement by CFSGAM's investment teams globally in 2011.

CFSGAM also believes that corporate sustainability reporting is an area where collaborative investor engagement makes sense. Only when a critical mass of mainstream investors are consistently communicating to companies the need to report on ESG performance, will investors have access to the information required. In this spirit, CFSGAM welcomes the move to integrated reporting and collaboration across the investment supply chain.

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, most notably through the Investor Group on Climate Change, the Financial Services Council (Australia), 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 where relevant and CFSGAM encourages the wider investment 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. This included direct meetings with other investors, presenting at conferences and contributing through surveys and media dialogue.

Principle 5

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

During 2011, 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 helped CFSGAM to stay abreast of developments in the sustainability and responsible investment arena more broadly, and helps CFSGAM collaborate with like-minded investors to facilitate ongoing improvements in the industry's approach to sustainability and responsible investment.

Principle 6

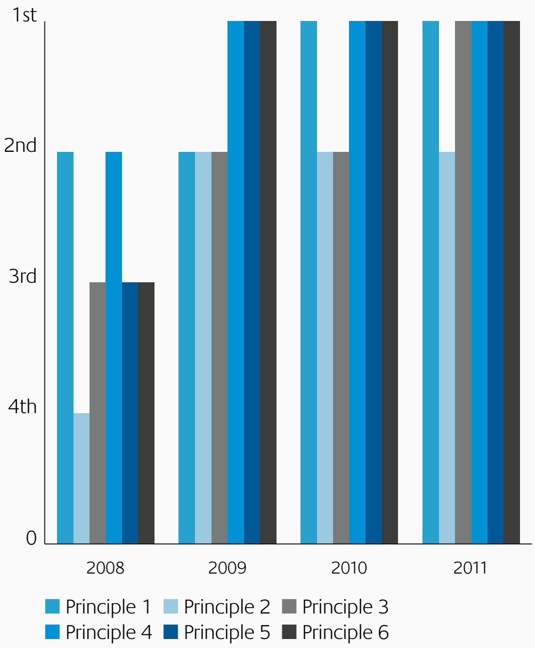
We will each report on our activities and progress towards implementing the Principles.

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 investment.

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 fifth year.

Quartile ranking against all investment managers globally

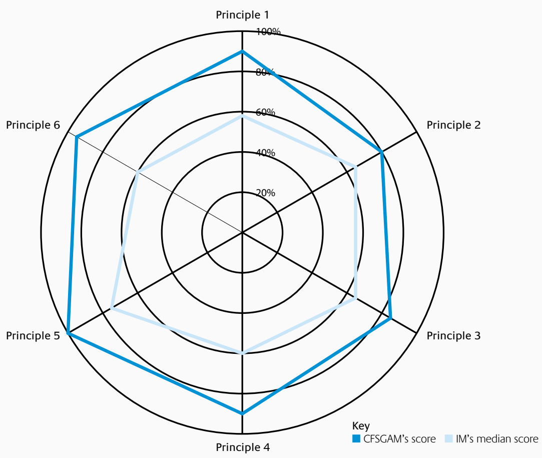


Source: PRI annual Reporting and Assessment survey 2011

CFSGAM's continued work towards global best practice in its approach to sustainability and responsible investment was recognised in the 2010–11 PRI survey results. As shown in the chart above, CFSGAM now sits in the top quartile in five of the six Principles relative to global investment managers.

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

PRI scores against all investment managers globally



Source: PRI annual Reporting and Assessment survey 2011

Balanced scorecard approach

In 2009, CFSGAM strengthened its PRI governance by embedding PRI objectives into the balanced scorecard for the business. The balanced scorecard target is that CFSGAM will be top quartile across five of the six Principles for responsible investment by the 2011 reporting year.

The successful implementation of the PRI is used to help measure CFSGAM's performance and set key performance indicators for employees. Relevant areas of the business have specific targets that help the whole business achieve the business-wide target. For example, the Chief Investment Officer has the most influence over Principles 1, 2 and 3 and so is responsible for those, while the distribution and sales functions of the business are responsible for aspects of Principles 4, 5 and 6.

CFSGAM was pleased to achieve its balanced scorecard target one year ahead of schedule, in the 2010 reporting year. CFSGAM is now working to be placed in the top quartile in all of the six Principles while developing new business objectives to help CFSGAM achieve best practice in responsible investment in the medium and long term.

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.

Chapter 2

Investment team activities

Embroidered Mayan cloth, Mexico

Equities

CFSGAM's equity investment teams are located in various regions around the world and provide investors with exposure to a wide range of equity investments.

About CFSGAM's equities capability

As well as offering equity solutions in traditional developed and emerging markets, specialist teams offer investors access to niche areas of global equity markets including listed property securities, listed infrastructure securities and listed resources securities.

Equity investing forms a key part of our global business, with more than half of our assets under management invested in global equity markets.

As a major shareholder in global equities and as a signatory to the PRI, CFSGAM encourages all companies to pursue best practice in ESG issues, in the belief that companies which do so will generate superior returns for shareholders over the long term.

Equity investment teams' 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 'Behavioural change or research process' column in the 'Engagement examples' table denotes whether the engagement is attempting to achieve a change in company actions or whether it is part of informing the research and investment process only.

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

Asia Pacific and Global Emerging Markets

US**$40.6** billion
FUM as at 31 December 2011

Inception date of asset class 1988

Team size 28
Location Edinburgh, Hong Kong and Singapore

The team's approach

Since the launch of the Asia Pacific and Global Emerging Markets (APGEM) team's first product in 1988, sustainable investment has always been an integral part of the team's investment philosophy and stock-picking process. At the heart of this philosophy is the principle of stewardship. The team believes its job is to entrust clients' capital to good quality companies with strong management teams and sound long-term growth prospects. Each investment is a decision to purchase, on behalf of our clients and the team, not a piece of paper or an electronic Bloomberg ticker, but part of a real business with all the rights and responsibilities that go with this 'share' of the ownership of the company. The team takes these rights and responsibilities seriously. The team also believes that the way it behaves as an investor, and the role it plays in the broader industry, are important for its own sustainability.

ESG analysis is a fundamental part of the research and portfolio construction process. 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 better investment decisions. The team believes that governance in particular is a vital consideration when investing in emerging markets companies.

Short-termism in the investment industry remains a material challenge for the APGEM team. For example, out of more than 50 investment banks covering Indian companies, the team has yet to find one which incentivises its analysts on greater than 12 month performance. It is therefore very difficult to use its research effectively to help drive long-term returns and ESG integration. The team looks to try and influence the industry through pushing down its own supply chain to put pressure on the investment banks to not be involved in listing companies with questionable practices, and also produce quality ESG research. The team also participates in policy debate and supports industry associations like the Asian Socially Responsible Investment Association (ASRIA) and the Asian Corporate Governance Association.

Incorporation of ESG considerations into the investment process

Focus on quality

The team looks to invest only in good quality companies. Quality is measured through the lenses of management quality, financial quality and franchise quality. By analysing the sustainability performance of companies, the team can better measure less tangible elements of quality and identify hidden risks.

The team has an absolute returns mindset. That is, risk is defined as losing money for clients, rather than in terms of deviation from any benchmark index. The team's focus is as much on the potential downside of investment decisions as on the anticipated upside. The identification of long-term sustainability risks thus becomes an extremely important way of managing risk. In addition, the team's willingness to differ substantially from index weightings, both by country and company, means there is no obligation to be invested anywhere where there are particular sustainability concerns.

Research

The APGEM team has been constantly exploring new sources of information and data providers. For example, the team engaged with non-governmental organisations such as the World Wildlife Fund prior to a trip to South Africa. The team also hired a research provider to look at US company management from an alignment and governance perspective. The team is also increasingly integrating Glass Lewis proxy voting research into the investment process where it provides useful information. The team also supported a student project investigating corporate governance in South Africa, with resources, advice and guidance from the team provided in return for access to the findings.

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.

The APGEM team is finding ESG questions increasingly useful to differentiate between good and bad quality companies in developed markets. The team has found that many management teams are unable to answer simple ESG questions and RepRisk has been valuable for providing material for discussion. Poor governance and short-term remuneration policies are a significant area of focus in the recently-launched World Wide Fund. The team has also started to analyse the pay differential between the highest and lowest paid employees in US firms.

The majority of clients' commission is allocated for access to management which, in turn, is about gaining ESG insights. The team continues to support Responsible Research and specific ESG analysts at major sell-side houses.

Engagement example

Over recent years, engagement has started to run the risk of becoming a box ticking exercise to see who can collect the greatest number of engagement cases. The team was reminded of this recently, when a fellow participant in a collaborative engagement project on palm oil pulled out because it was unable to lay direct claim in public to the specific, very worthwhile engagement cases being undertaken by the group. The team engages with companies on ESG issues for two reasons. Firstly, because the team has a responsibility as a part-owner in the business to address any ESG issues that may arise. Secondly, because if the team can help to address these issues satisfactorily, it is able to add value and reduce risk to portfolios. The engagement approach is far from perfect and continues to evolve over time. Below is a brief description of the team's experience over the past five years with the investment in Anglo Gold Ashanti. It is a good example of why company engagement is a marathon, not a sprint.

Anglo Gold Ashanti

Anglo Gold Ashanti is a large gold miner with more than 20 operations spread across Africa, Australia, South America and North America. It employs around 60,000 people and produces approximately five million ounces of gold each year. The team's engagement with management dates back to September 2007, when a letter was written to the Chairman of Anglo Gold, expressing the team's concern with the company's lack of progress in addressing its environmental and social problems.

The letter explained that our investment rationale for buying shares in the company was, to a large degree, predicated on an improvement in the company's poor environmental and safety performance. If the company was able to deliver on this, we saw huge benefits in terms of its ability to generate long-term cash flows from existing mines, earn the social and environmental licence to bid for, and operate, new mines and ultimately reduce its cost of capital. Less than one week later, a new CEO was appointed with a specific mandate to clean up the company. Given the timing, it is safe to say the team was not instrumental in this appointment.

Over the following five years, 12 members of the team have met with at least eight different members of the new management team of Anglo Gold over a total of 17 meetings in Johannesburg, Bogota, London and Edinburgh. In each meeting, safety performance has been a key topic. At least three formal written engagement letters have been sent, as have numerous emails on environmental and safety issues. The team has also helped external ESG specialists engage with senior management. ESG issues raised over that period included environmental licence procurement, river pollution allegations, relationships with local communities, use of private security contractors, management of silicosis, seismic safety threats, tax, royalties, diversity, post-apartheid reparations and perverse safety incentives.

Has any of this engagement worked? There is never a clear cut answer to this question. On the one hand, the company has delivered a solid improvement in its ESG performance. Most significantly, fatalities have fallen 59%, while the all-injury frequency rates have fallen by 45%. Progress has been made across a number of other health outcomes, from the improved provision of HIV clinics to malaria, tuberculosis and noise-related injuries. Environmental performance is harder to assess. The number of environmental accidents has fallen. Cyanide certification has risen significantly. The reporting of ESG performance has dramatically improved. The company is now commendably transparent and bares itself for all to see. This is no easy thing to do, given the challenges still facing the business. From what we can tell, the culture of the company has also changed for the better. To management's credit it is often held up as a rare example of a mining company which is transparent about the royalties and taxes it makes at a country level. This is crucial, given the importance of ensuring mining proceeds are used to fund long-term development.

However, to claim that the team played a direct role in any of these improvements would be misleading. At the most, management may have been provided with some external support in order to tackle these issues head on. Very occasionally, engagement may have encouraged action on a particular issue. We will never know.

Not only is it difficult to lay direct claim as a minority investor to any improvements, it is also too early to argue that any transformation has been successful. Many challenges still remain. Fifteen fatalities occurred last year. Progress on silicosis remains far too slow. Too many allegations of water pollution and environmental damage still persist, while the company currently faces major protests from communities and MPs in Colombia concerned about the proposed mine's environmental impact. As a minority shareholder, it is almost impossible to build up a complete picture of these specific issues. For example, according to the company, 7,000 people recently marched in Colombia in support of the proposed mine. Meanwhile, 38 Colombian MPs have reportedly just written a letter to the company outlining their concerns about the mine. Gaining a genuine social licence to operate any mine today is a complex procedure. Our aim is to reassures ourselves that the company goes about this in the right way, and is willing to walk away if the social licence is not forthcoming.

There is no such thing as the perfect company in which we can invest our clients' and our own capital. At the final assessment, it is the trend that matters. If a company continues to progress and steadily improve its safety and environmental performance, then all stakeholders will benefit. If we can play a role, however modest, as a minority shareholder, then the engagement will be time well spent. If progress starts to slow and reverse, a company will very quickly lose its licence to operate and all stakeholders will suffer. For now, we remain convinced that Anglo Gold Ashanti is still heading in the right direction.

Engagement example summary

Sector	Country	Engagement issue
Agriculture	India	Health and safety
Banking	Singapore	Corporate governance
FMCG	India	Food safety standards
Logistics	China	Failure to submit audited financial statements
Mining	South Africa	Safety and community relations
Oil and gas	PNG	Community relations
Retail	UK	Palm oil usage
Technology	Taiwan	Financial transactions
Telecoms	Australasia	Remuneration package
Transport	Sri Lanka	Low attendance at board meetings by director
Utility	India	Water usage and weapons
Various	Hong Kong	Issue of shares without pre-emptive rights

Australian Equities, Growth

US$10.1 billion
FUM as at 31 December 2011

Inception date of asset class 1989

Team size 18
Location Sydney

The team's approach

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 analysis[1] to focus on areas of competitive advantage and areas of potential threats. ESG analysis is used to provide insights into company management, which then feeds in to the broader view of assessing the quality of company management. Bespoke ESG analysis from sell-side brokers is also commissioned to support our research and company engagement.

Each stock and industry review includes a discussion on ESG issues and the implications for the company. During the past year, we have covered a range of issues including carbon pricing and the valuation implications for company assets (including team-developed carbon modelling) for a utility business, board experience and the diversity and abilities of directors on the board of a construction company, and the ongoing environmental performance of a chemical company.

ESG considerations are key to the team's ownership practices. Through direct engagement with management, chairpersons and other board directors, together with proxy voting, the team sends an important message to companies that they must take ESG issues seriously.

Actioning proxy voting is a very important part of the Growth team process. Core to what the team does is representing investors, engaging with companies invested in, and meeting the requirements of the PRI. Over 2011, the team has worked hard to meet with chairpersons and CEOs to address voting agenda items and voice the team's opinions.

To embed ESG considerations across the team, part of the investment analysts' key performance indicators is 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. In addition, the team has pushed broker research to include some specific details about ESG issues which it raised. The team also encourages brokers to devote resources to ESG by specifically allocating brokerage to ESG research.

Engagement examples

During the second half of the year, the team extended its engagement to the small cap component of its investment funds. For example, the small cap team has worked to identify a formal list of issues within the smaller industrial and mining companies it will investigate further and, where applicable, take up with boards and management.

International gold miner

The team was concerned about conflicting views coming from management and the board around the company's tenement rights and the timeframes. After conducting independent research the team concluded that the share price exceeded the valuation given the risks and exited the stock.

Woodside Petroleum

Woodside Petroleum is considering a liquefied natural gas (LNG) development at James Price Point in the Kimberleys, Western Australia, that has attracted significant attention due to the indigenous community concerns and environmental impacts. It is unclear why Woodside Petroleum is looking to pursue the development from a long-term financial perspective. Whilst it may be good for short-term net present value (NPV), if the project was to run over, which it may well do given the ongoing concerns from stakeholders, the project would not be as economically attractive.

The team requested a meeting with the Chairman of Woodside Petroleum to better understand how, and to what extent, the board considered the potential NPV benefits of the James Price Point project in the context of the risks around environmental approvals, indigenous community concerns and broad reputational risk to the company. In that context we were also keen to understand why the James Price Point processing plant was chosen over other potential processing options (for example, off-shore processing and piping to Browse for processing).

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.

Small cap education provider

The small caps team engaged the board of an education provider following allegations of impropriety by the Chairman. The team requested a written explanation and assurance from the board that allegations were false. The board followed through with this request, which was subsequently supported by a court ruling. No further engagement was required.

Property fund manager

The team engaged with a property fund manager and developer representing the interests of minority shareholders after offshore hedge funds approached to break up the company. Portfolio managers met with the disgruntled equity holders to discuss their views. However, the team's independent research found that their proposal would not unlock value and would not, therefore, be in the best interests of investors. The team met with the Chairman to discuss its views and the preferred strategic direction of the company.

Engagement examples summary

Sector	Country	Engagement issue	Complete/ ongoing	Behavioural change/ research process
Property	Australia	Governance, fees, independence	Ongoing	Both
Mining	Australia	Helicopter accident	Complete	Research process
Oil and gas	Australia	Coal seam gas issues	Ongoing	Research process
Coal companies	Australia	Government approval process and environmental impact statement sign-offs	Ongoing	Research process
Mining	Australia	Director suitability	Complete	Research process
Clothing	Australia	Second strike on pay in proxy voting	Complete	Both
Media	Australia	Remuneration of CEO	Complete	Both
Financial services	Australia	Remuneration of CEO	Ongoing	Both
Retailer	Australia	Annual report disclosure	Complete	Both
Aviation	Australia	Carbon tax and union discussions	Ongoing	Research process
Mining	Australia	Review of rare earths plant	Ongoing	Research process
Coal companies	Australia	Impact of carbon tax	Ongoing	Research process
Oil and gas	Australia	Coal seam gas project – effects on the water table	Ongoing	Research process
Media	Australia	Management/Board discussion on debt	Ongoing	Both
Clothing	Australia	Second strike pay discussions – low hurdle	Ongoing	Behavioural change
Childcare	Australia	Chairperson implicated in Premium Income Fund scandal and reputational risk	Complete	Both
Childcare	Australia	Singapore asset purchase delay	Ongoing	Both
Mining	Australia	Accessing resources from Western Sahara	Ongoing	Behavioural change
Mining	Australia	Indigenous rock art at Abydos	Complete	Research process
Packaging	Australia	Alternative packaging materials	Complete	Research process

Australian Equities, Core

US$8.6 billion
FUM as at 31 December 2011

Inception date of asset class 1993

Team size 19
Location Sydney

The team's approach

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 commitments under the PRI, has enabled the team to formalise this approach.

The team believes that, by systematically considering all the sustainability issues for the companies invested in, the team is better aligning with the long-term interests of its clients. As a fiduciary, considering sustainability issues is in line with the team's investment philosophy. Through the active engagement undertaken with the companies in which the team invests, best practice corporate governance behaviours are encouraged across the Australian market. This is in the best long- term interests of clients.

The team also looks to influence the investment industry and encourage brokers and other research firms to provide ESG research and views on stocks. The team has made ESG capabilities part of the overall sell-side research review process and broker panel structure.

Incorporation of ESG considerations into the investment process

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 one of the six factors in the research process. The other factors are management, industry/company position, valuation, market factors and financials. The following table describes the considerations under each of these factors. Where ESG factors are determined to have an impact on revenues and/or costs, they are quantified and implied in all other factors, most directly to the valuation and financial assessment of the company. The integration of ESG into the investment process has proved helpful in making informed investment decisions, in particular in the assessment of company strategy and management of ESG risks.

Management	Industry/ Company position	Valuation
– Experience – relevant – Ability to execute – Shareholder focus	– Industry structure – changes – Pricing power/ margins – Competitive advantage	– Triangulation – Relevant to sector and peers – Consistency
Market factors	**Financials**	**Sustainability**
– Index movements – Market 'themes' – Corporate activity	– Balance sheet – Cash flow generation – Earnings transparency	– Social policies – Environmental policies – Management commitment and disclosure

The team's primary sources of ESG information are through company engagement and by access to publicly available information from either company reports or media. The team generally meets with the management of companies in which it invests at least twice per year, along with site visits and collaboration with other industry participants. The team typically engages with companies on sustainability concerns and encourages 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.

The team keeps track of all of its engagement activities in CFSGAM's proprietary investment database.

Engagement examples

Oil Search

A company's management of many and varied stakeholder interests is often most important when investments require both governmental and community approvals. Investor attention tends to be focused on these risks and on company behaviour during periods of development or expansion. However, insufficient focus on governance and sustainability issues over the longer term can result in delays, cost blow-outs and, in some cases, jeopardise the start and the completion of projects.

The LNG project being developed by Oil Search, and operated by partner ExxonMobil in Papua New Guinea (PNG), is a good example of the need for a company to have a long-term focus on sustainability issues to ensure a social licence to operate. The construction of the project began in March 2010 and is expected to be completed in 2014 at a cost in excess of US$15 billion.

The development will unlock an energy reserve which is the equivalent of more than 500 million barrels of oil. Oil Search has been operating in PNG for many years and successfully managed the political and landowner environment to enable the profitable export of oil. This long-term relationship and community involvement is integral to the current project.

As an active investor in the company, the Australian Equities, Core team has spent considerable time with the Oil Search management team, including several visits to the operations in PNG. It is important that the team maintains a level of comfort that the project will be delivered both on time and profitably.

As well as being constructed on geographically challenging terrain, the 700 kilometre pipeline passes through villages of differing landowner groups. The financial and social benefits flowing to the PNG landowners have been an increasing focus for Oil Search, which is trying to balance stakeholders, and aims for an equitable distribution of the financial rewards of the project to the communities of PNG. The team believes that the management of Oil Search has a focus on the sustainability of its business in PNG. Oil Search has won the practical and financial support of global health and wildlife organisations because of its programs in the community. The progress of the LNG project relies on continuing good relationships with stakeholders and the successful management of any conflicts arising. Monitoring the risks associated with the project, as well as the progress of the construction itself, is a key part of the team's dialogue with Oil Search management.

Australian-listed healthcare company

Members of the Australian Equities, Core team engaged with management of an Australian listed healthcare company to better understand its engagement and sustainability processes. The team noticed this company had a high standard of safety and corporate governance ratings, attested by external industry research reports as well as company process and statistics. Despite this, the company does little in the way of disclosure and does not produce a sustainability report. Given the relative performance on key environmental and safety measurements, the team encouraged the company to promote and disclose this key differentiation, as this is viewed as a competitive advantage in the industry and is relatively under-appreciated by the market.

Engagement examples summary

Sector	Country	Engagement issue	Complete/ ongoing	Behavioural change/ research process
Mining	Australia	Safety and environmental incidences	Ongoing	Behavioural change
Mining	Australia	Environment issues management	Ongoing	Research process
Medical	Australia	Governance and stakeholder governance management	Ongoing	Research process
Oil and gas	Australia	Landowner, stakeholder, community, legislative risk	Ongoing	Research process
Healthcare	Australia	Healthcare reform legislative risk	Ongoing	Research process
Energy	Australia	Industry and manpower management	Ongoing	Research process
Property	Australia	Community engagement	Ongoing	Research process
Oil and gas	Australia	Coal seam gas issues, staffing and wages risk	Ongoing	Research process
Retail	Australia	Supply chain and remuneration discussions	Ongoing	Research process
Agriculture	Australia	Remuneration and board level engagement on governance	Ongoing	Behavioural change
Gaming	Australia	Legislative risk to gaming/remuneration	Ongoing	Research process
Clothing	Australia	Governance/remuneration	Ongoing	Behavioural change
Media	Australia	Governance	Ongoing	Behavioural change
Coal	Australia	Local stakeholders/safety	Complete	Research process
Banking	Australia	Offshore staffing hubs	Ongoing	Research process
Gaming	Australia	Risks and management of gaming	Ongoing	Research process
Engineering	Australia	Safety and indigenous skills training	Ongoing	Research process
Steel	Australia	Carbon tax – negotiations and management of risks	Ongoing	Research process
Retail	Australia	Staff engagement – flood response	Complete	Research process
Oil and gas	Australia	Management team discussion and tour of operations – assessment of sustainability management	Ongoing	Research process

Global Resources

US$4.2 billion
FUM as at 31 December 2011

Inception date of asset class 1997

Team size 10
Location Sydney, London

The team's approach

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 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.

Engagement examples

International oil exploration and production

One of the most significant issues faced by oil companies that purchase assets previously managed by state run enterprises are the potential social and environmental liabilities that are inherited.

One such example is an international oil and gas exploration and production company focused on developing oil reserves in Eastern Europe. It is the country's largest petroleum producer, responsible for approximately 60% of the country's total output. As with all investments, the team engaged the company with regard to its environmental and social responsibilities within the country. The company has shown in its reporting, and as witnessed on a site visit, the desire to improve the environment and local health and safety beyond that obligated by its operating licence. This provides an investment opportunity where ESG issues are clearly being managed in a way that mitigates ESG risk and improves the overall risk profile of the company.

The company acquired its operating assets from a state run entity that had shown little regard for the local environment and community by walking away from its production wells, storage and pipelines once their economic value was exhausted. The company has spent considerable time and over US$70 million since taking over operations engaging and working with local communities to clean up decaying wellheads and equipment, surface oil and associated drilling fluids and remediate what would be considered, in western countries, an environmental disaster. At the same time, the company is educating and training local companies that it engages with to operate in a safe and environmentally-friendly manner.

In undertaking engagement with the company, the team has supported the company's approach and encouraged it to continue with its focus.

Canadian forestry

A Canadian listed company with forestry lease holdings in China was accused of being fraudulent by an independent research firm which also questioned the company's accounting practices and asset ownership.

The team met with management in Hong Kong, to get an understanding of how the company would respond to these allegations. The team walked away from the meeting with concerns that it would not be able to provide all the information to the market that would be required to clear itself and that it would take quite a bit of time for the independent committee to conduct its review and provide the findings to the market. In the meantime, investors would be provided with very little information.

The team took that the view that the corporate governance risks were too great and exited the position in the company.

Since the team exited its position, the company has been investigated by the Ontario Securities Exchange and was placed in a trading halt. The CEO has voluntarily resigned and three other employees have been placed on administrative leave and relieved of their duties. The company's unaudited second quarter results, released in mid-August 2011, highlighted that gross profit margins from its plantation operations had halved from the second quarter 2010, and the company indicated the margin 'is more representative of our expected average gross profit margin for future sales'.

Corporate governance issue

A Singapore-listed agricultural holding company announced that it had plans to raise capital by listing one of its Indonesian subsidiaries during the quarter. The Global Resources team met with management to engage with them around the purpose of the capital raising, given the company did not appear to need cash for capital projects. In the team's view, the company was unable to clearly articulate the reasons why it needed additional capital nor what the capital would be used for. It appeared that the controlling shareholder interests were not aligned with minority shareholders and the team subsequently sold its position. The Indonesian subsidiary was listed, albeit at a significant discount given market conditions were quite negative, which subsequently impacted the holding company's valuation.

Coal seam gas

A recent site visit to Queensland to meet with landholders and community groups highlighted some potentially serious issues for oil and gas companies which are involved in coal seam gas developments in the region. In response, the Global Resources team conducted a follow-up site visit and engaged with the relevant companies over a series of meetings. These meetings focused on the company's efforts to address the environmental and social issues that had been raised, and provided significant comfort to the Global Resources team that senior management were taking these issues seriously and responding appropriately.

The CFSGAM Global Resources team continues to closely monitor the environmental and social issues related to coal seam gas development and encourages companies to manage the ESG risks. The team has monitored research and also attended events relating to the concerns raised by key stakeholders.

Gold company

Ten people were killed after a helicopter, chartered by a major gold producer, crashed in Indonesia. The Global Resources team met with the gold company's management and asked them what was being done about this incident. Management assured the team that a full investigation was being carried out, with results expected in three weeks. At the time of the incident, workers were called to put tools down for one hour the next day, and all safety processes/policies were reconfirmed. The team was satisfied with management's response, and will await the outcome of the investigation.

Australia-based steel makers and suppliers

There was a great deal of attention in the first half of 2011 on the proposed introduction of a carbon price in Australia. A carbon price will have implications for a wide range of Australian companies, particularly those in the energy, mining and manufacturing sectors. For some time, political uncertainty made it difficult to ascertain the likely impact of the new tax on individual companies.

Investment teams across CFSGAM have closely assessed the earnings implications of the tax on individual companies, as well as the likelihood of exemptions and assistance packages offered by the Australian Government. Teams across CFSGAM have had ongoing dialogue with a number of steel companies to keep abreast of the concessions which are being negotiated. Steel companies are expected to qualify for substantial exemptions from the tax, but the earnings impact on other companies could be much greater, affecting the viability of some business models.

Engagement examples summary

Sector	Country	Engagement issue	Complete/ ongoing	Behavioural change/ research process
Diversified mining	International	A variety of ESG concerns	Ongoing	Research process
Gold	Indonesia	Social (health and safety incident)	Ongoing	Research process
Agriculture: supply chain	Indonesia	Local stakeholders/safety	Ongoing	Research process
Gold	Australia/ Turkey	Corporate governance	Complete	Research process
International oil and gas	Australia	Environment (water impact concerns) and social (compensation, landholder rights)	Ongoing	Both
Forestry	China	Corporate governance	Complete	Research process
International oil and gas	Canada	Managing inherited environmental liabilities in Albania	Ongoing	Research process
Agriculture: plantations	Singapore/ Indonesia	Apparent preferential treatment of Indo v Singapore shareholders	Complete	Behavioural change
Diversified mining	Global	Discussion of issues: community development, environmental responsibility, issues in Zimbabwe, governance in India, the future of Jabiluka	Ongoing	Research process
International oil and gas	Egypt assets	Treatment and support of local and expat workers during the Egyptian uprising	Complete	Research process
International oil and gas	Canada	Concerns over training and safety	Complete	Behavioural change
International oil and gas	Australia	Environment (water impact concerns) and social (compensation, landholder rights)	Ongoing	Research process

Listed Property Securities

US$3.3 billion
FUM as at 31 December 2011

Inception date of asset class 1991

Team size 11
Location Sydney, London, Hong Kong, New York

The team's approach

ESG continues to be included as a 'Quality Factor' to be assessed when analysing a company and is incorporated in the research process. The team believes that companies with stronger ESG ratings are better placed to achieve strong long-term returns for shareholders. A main challenge continues to be the lack of consistent reporting from companies.

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 gathering information 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.

ESG 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.

Another issue is the impact a minority shareholder can have on influencing the behaviour of a company. The team does not own shares in every listed company and therefore is only entitled to vote at Annual General Meetings for companies that it invests in. When the team challenges companies it doesn't invest in, companies invariably respond with statements such as, 'our shareholders approved it at the last AGM'.

Engagement examples

Remuneration in Australia

Remuneration has been a major talking point in 2011 as the 'two strike' rule came into effect and many remuneration reports were voted down for a first strike across the market. The team met with a number of boards over the AGM season to express concerns with remuneration policies within the listed property sector. One of the concerns is using market capitalisation as a suitable peer group measure to base remuneration, without considering other measures such as the return on equity. The return on equity needs to be in-line if market capitalisation is to be used as an effective benchmark.

Furthermore, companies have been encouraged to clearly state the performance hurdles set for management. The team has welcomed changes to remuneration policies by Stockland Group and Mirvac Group. The team believes that management should be remunerated to reward good work, but there needs to be a clear set of hurdles that encourage long-term performance without excessive risk taking. The team's process includes assessments of management's ability to deliver on strategy and the best use of capital. Appropriate remuneration and KPIs are key to this assessment.

Deutsche Euroshop

There was a material change to the company's performance-based pay structure which was then implemented. A long-term incentive scheme was introduced based on positive change in market capitalisation. The team actively questioned and disputed this change and the lack of alignment with shareholders.

The team has been a shareholder in the company for some time and has since exited its position. While it exited its position based on relative value, the change in remuneration structure was also considered in the investment decision-making process.

Eurocommercial Properties

The team met with the senior management of Eurocommercial Properties and followed this up with a site visit to its Swedish shopping centre portfolio, as part of the ongoing research process. A discussion was had on the company's understanding of how environmental considerations applied to its business. The company discussed how the planning framework in countries determined building quality and components. Sweden is quite strict when it comes to the environmental standards of buildings and, given the extreme weather, issues like heating and insulation are embedded in the design process. Meanwhile, the planning system in France is increasing its focus on environmental issues, whilst the company's third largest market, Italy, lagged behind.

Management also mentioned how the differing attitudes of retailers (local vs international, franchise vs owner) to environmental issues impacted how successfully it was able to introduce various schemes, such as waste recycling and automated lighting. In most cases, the common denominator was the impact these actions would have on the tenant's bottom line, which is most noticeable through the impact on the level of service charge.

US-based REIT

Prior to purchasing the stock the investment team met with the company's CEO. It expressed concern about the company's poor capital allocation, but left the meeting convinced that the company would take more aggressive actions to improve its share price. Based on this assessment, and the fact that the shares were then trading at a 30% discount from net asset value (NAV), the team added a position in the company at that time.

Within weeks, the board took the positive step of replacing the company's CEO and CFO. Subsequently, the team spoke with the new CEO. The team agreed with the new CEO's strategy to increase cash earnings per share by selling non-income generating assets (primarily developments and land), increasing portfolio occupancy, and refinancing expensive preferred equity on the balance sheet.

Engagement examples summary

Company	Country	Engagement issue	Complete/ ongoing	Behavioural change/ research process
Diverse property	Australia	Discussed remuneration report and company strategy. Voted against remuneration report	Ongoing	Behavioural change
Diverse property	Australia	Discussed remuneration report and company strategy. Voted against remuneration report	Ongoing	Behavioural change
Property investment	Netherlands	Discussed environmental impacts of developments	Complete	Both
REIT	Singapore	Discussion of estimated cost savings from energy and water efficient refurbishments that were recently completed	Complete	Behavioural change
REIT	HK	Site visit to see recently upgraded green building features	Complete	Research process
REIT	Australia	Continuing to engage on corporate governance issues within the listed REITs	Ongoing	Behavioural change
REIT	US	The team was concerned that the company had often raised equity at a significant discount to its NAV. It spoke with the CEO and advised him that the team believed the share price was being depressed by concerns about further dilutive equity raises. In answer to the questions, the CEO indicated in an earnings call that the company would not raise equity below NAV. This had a positive impact on the share price, and the team believes it is an important discipline for the company going forward	Complete	Behavioural change
Retail	Netherlands	Corporate governance and merger	Ongoing	Both
REIT (IPO)	Germany	Corporate governance	Complete	Both
REIT (IPO)	Turkey	Board independence	Ongoing	Both
REIT	Singapore	Discussion with management about Singapore Government incentives offered for green building developments	Complete	Behavioural change

Global Equities

US$2.8 billion
FUM as at 31 December 2011

Inception date of asset class 1997

Team size 10
Location London

Integration of responsible investment into the investment process

The Global Equities team believes that companies with a strong Competitive Dynamic create long-term value for shareholders. These are companies that have a winning business model, abundant growth opportunities and a strong management team. The team is uncompromising in its appraisal and will only invest where strong Competitive Dynamics are identified.

The symptoms of ESG issues can directly impact any of the favourable attributes, but it is considered that the causes rest with management. Consequently, ESG work forms a key part of the team's management appraisal. This is a critical part of the research process, as a negative view on management will lead to the automatic exclusion of the investment opportunity from consideration.

The team believes that the best way to identify Competitive Dynamics is by industry, which is why it is comprised of highly experienced industry specialists. Each specialist will use this experience to frame the key ESG issues that pertain to their particular industry. Providers such as RepRisk and ASSET4 are used to provide data on the key ESG issues for each investment opportunity under consideration, together with those of their competitors. The team seeks to understand the reasons behind poor data and whether it is indicative of poor operational or risk management by the company. The team has a policy of never investing without having spoken with the company and, where relevant, the team will engage management teams on the background and reasons for poor ESG performance.

A good ESG appraisal will likely be reflected in a positive judgement on management. A poor ESG appraisal will not only impact that judgement negatively, but could also lead to our judgement of the business model or growth opportunities being negatively impacted. This would have a direct consequence on our expectation of the company's valuation.

The team is always looking to find ways of improving its processes and so it is introducing a quantitative and qualitative ESG template score. This will be used to evaluate every company reviewed to capture both risks and benefits from ESG factors. The data is powered by ASSET4 and Bloomberg and covers governance concerns, executive pay, social and environmental concerns and management factors such as employee turnover. This ESG score, in turn, will influence the judgement of a company's Competitive Dynamics and hence the valuation expectation. This will directly influence stock selection in the portfolio and ensure that ESG is fully embedded in the process. It will be a natural next step to develop a further portfolio of 'sustainable' winners utilising this process.

Engagement examples

The team continues to support four of the most active ESG research teams on the sell side; UBS, Goldman Sachs, Merrill Lynch and Citi. The team has attended several events and meetings offered by these teams, including a useful meeting on 'How to avoid the next BP' by Citi in January 2011, an 'SRI & Sustainability' conference hosted by Merrill Lynch in March 2011, and a meeting on 'Water Risk to Business' by UBS in May 2011. In addition, the team has had several interactions with the Goldman Sachs Sustain team during the year as it continues to examine ways the team could collaborate and link their data and framework to parts of the team's investment process. A team member attended Bloomberg's initiation into the responsible investment space and team members continue to collaborate with other PRI signatories as well as other ESG analytics such as Trucost.

Mining company

The Global Equities team closely examined the initial public offering (IPO) documents of a leading miner and trader of commodities. Although the company met several elements of the team's investment criteria; for example, good current and future competitive advantage scores, on other criteria, such as the ability to gain share, valuation, and end market growth/potential cyclical market peak, the stock fell short of an investment grade. In addition, the team had a very vigorous debate regarding the quality of management and the questionable environmental and social track record of the founder/CEO as well as the risk of governance issues like market manipulation. Based on the totality of the information, and taking into account these ESG considerations, the team decided not to participate in the IPO.

China Yurun Food

The team discussed quality control procedures with this Hong Kong listed meat producer. In addition it was noted how non-disclosure of environmental and labour policies was leading to a low ESG score. Investor relations said it was aware of this and was working on drafting a public document to address this need. The team was invested for a short time, but it became increasingly obvious that there were further quality control and governance accounting issues and the stock was disinvested.

Hawaiian Electric Industries

The Global Equities team discussed the outlook for nuclear power following the Japanese earthquake and the likely environmental implications given the growing power needs of the world. In Hawaii, this means more wind power. Hawaii is one of the few places where wind power is cost effective and doesn't require subsidies. The regulatory outlook was key for our investment and our positive view was confirmed by the regulator.

Retail property investment

This company has a majority shareholder which occupies a number of board seats. These board members receive a travel allowance of €600,000 for travel expenses to attend board meetings. This allowance is not extended to other board members and is deemed excessive. The Global Equities team actively engaged with the company to have this travel allowance reduced.

Engagement examples summary

Company	Country	Engagement issue	Complete/ ongoing	Behavioural change/ research process
Pharmaceutical	Brazil	Governance – bonus KPI, use of cash	Complete	Research process
Pharmaceutical	Brazil	Governance – use of cash, incentive structure	Complete	Research process
Agriculture	Norway	Discussion of sustainable fish farming techniques and concerns over adequate regulation and use of antibiotics within the Chilean fish farming industry	Complete	Research process
Technology	USA	Enquired about management compensation and retention	Complete	Research process
Automotive	Germany	Brief discussion of the relevance of electric vehicles to consumers' lives and the engineering challenges they bring	Complete	Behavioural change
Engineering and construction	Canada	Discussion around operations in Libya, particularly around safety of personnel	Complete	Research process
Automotive	Germany	Brief discussion on the limitations of electric vehicle propulsion systems and the company's strategy for participating in the move to new energy sources	Ongoing	Behavioural change
Aerospace and defence	USA	Discussed management succession plan, as the CEO is 62 and CFO is 65. Board has a plan in place	Complete	Research process
Food producer	Brazil	Discussed quality control systems and in particular the reporting lines within the company	Complete	Behavioural change
Retailer	Great Britain	Discussed the implications of fraudulent claims of child labour alleged in a television program four years ago, since retracted	Complete	Behavioural change
REIT	Singapore	Discussion with management about shareholder misconceptions caused by Chairman speaking interchangeably about the company's operations and his private investments	Complete	Behavioural change
Office fund	Australia	The company took over as Responsible Entity of another office fund. The team gave feedback on change to management fee	Complete	Behavioural change

Global Listed Infrastructure

US$1.1 billion
FUM as at 31 December 2011

Inception date of asset class 2007

Team size 7
Location Sydney, Hong Kong

The team's approach

ESG issues are fundamental to infrastructure companies, given they have significant service obligations and social accountability to the communities in which they operate. Mismanagement of these issues can clearly impact sentiment towards a company, but may also have a direct impact on profits through customer losses, regulatory outcomes or political intervention.

For example, environmental issues present risks for coal-fired power stations but present opportunities for electricity transmission extending to renewable energies. Social awareness can maintain customer satisfaction for utilities and reduce political risk in regulatory outcomes. Governance is critical in protecting minority shareholders.

The team believes that ESG issues can impact infrastructure stock performance and should be fully integrated into an investment process. Companies are not screened on ESG criteria, but rather the risks are understood and captured in a proprietary quality ranking. In practice, the team requires a higher return for companies that fall short. This process has proved valuable as infrastructure companies which have ranked higher on ESG criteria have typically been more defensive.

Incorporation of ESG considerations into the investment process

The Global Listed Infrastructure Securities team integrates its ESG analysis into stock selection through its quality ranking model. The quality ranking model consists of 25 criteria that the team believes influence stock returns in general, and infrastructure securities in particular. A score is assigned to each criterion, with ESG issues accounting for 20% of the overall quality score.

Environmental issues are key drivers for some infrastructure companies, specifically electric utilities, energy infrastructure (oil and gas pipelines and storage) and railways. Key environmental issues considered when scoring infrastructure companies include:

- 30%-40% of the world's carbon emissions are from electricity generation and around half of electricity generation is from high carbon producing fuels like coal and oil
- the transport sector is second largest contributor to global carbon emissions
- the historic environmental safety record
- toxic emissions/waste disposal
- protection of existing environment
- operations in sensitive wilderness areas, and
- public leadership on environmental issues.

Social issues are important to infrastructure companies as they have obligations to the communities to which they provide essential services. Key social issues for infrastructure companies include:

- employee relations and understanding the internal culture (employee turnover, safety record, management KPIs)
- customer and supplier relationships
- community relationships
- dealing with indigenous populations
- public leadership on social issues, and
- operations or business dealing with rogue governments.

Governance issues are important performance drivers of all infrastructure stocks. Board composition and alignment of interests are so important they are rated separately in the ESG scoring process. The key governance issues focused on for the governance aspect of the score are:

- structure, composition and skill set of the board and its members
- degree of political interference (especially where the government is a major shareholder)
- dominant shareholders and protection of minority interests
- externally managed vehicles
- related party transactions
- total shareholder return and return on capital employed as management KPIs, and
- constitution (eg poison pills).

The scores are subject to robust debate within the team and peer review to maintain consistency across sectors and regions.

In determining the score for each category, a range of internal and external tools are used. The team believes the most important source of research is internally generated through regular meetings with senior management and other stakeholders including suppliers, competitors, regulators and industry bodies. Given the investment experience across the team, companies' and markets are understood intimately and the team believes it is best positioned to form a view on the companies' approach to ESG and the materiality of ESG issues.

To supplement the team's own research, various external ESG research and services are employed.

The Quality Rating combined with the Value Rating, which seeks to rank stocks in the focus list according to their relative mispricing, provides an overall ranking of the securities on the focus list. This overall ranking is the focus of stock selection and portfolio construction process.

Engagement examples

The following examples detail specific key engagement examples on ESG specific issues.

Transurban

As part of the engagement with the senior management team of Transurban, the team challenged it on the hurdles set for bonus remuneration. The belief was that the hurdles set were within reach without accelerated efforts from management. The management team was also challenged on the use of EBITDA as a key performance indicator for remuneration since this actively promotes acquisitions and short-term time horizons. Since this discussion, it was observed that the remuneration targets have been changed to address this concern.

Vopak

The team challenged Vopak's ability to issue cumulative preference shares to avoid a hostile takeover. These shares, which are issued at the discretion of Stichting Vopak (a controlled entity of Vopak), could lead to a significant premium takeover being dismissed without shareholder consultation. Management continues to believe that this defence mechanism is needed in order to remain independent. Whilst this argument has merit, the team views this unfavourably as it reduces governance rights as shareholders. The team continues to raise it with management and the team's opinion is reflected in the quality score that is assigned to governance. The team's active approach led to an invitation to present to the board of Vopak on key issues for the company and its management.

PG&E Corporation

As part of the ongoing research into environmental factors for utilities globally, the team continues to engage with PG&E to better understand its gas pipeline operations, including the reasons around the gas pipeline explosion that occurred in the San Bruno area of California, and the regulatory implications for the company and other pipeline operators both domestically and internationally. Utilities continue to come under increasing pressure regarding safety and reliability, and this will drive significant capital expenditure in the years to come.

Engagement examples summary

Company	Country	Engagement issue	Complete/ ongoing	Behavioural change/ research process
Integrated utilities	US	Environmental – nuclear strategy	On-going	Research process
Regulated utilities	US	Environmental legislation	On-going	Research process
Independent power producer	India	Governance	On-going	Research process
Ports	Netherlands	Governance – anti takeover devices	On-going	Research process
Integrated utilities	US	Environmental – nuclear strategy	On-going	Research process
Integrated utilities	UK	Environmental – UK environment for coal plants	On-going	Research process
Regulated utilities	Australia	Social strategy for rising power prices	On-going	Research process
Rail	Australia	Governance – senior management remuneration	On-going	Research process
Integrated utilities	China	Environmental – coal industry	On-going	Research process
Integrated utilities	UK	Environmental strategy – clean energy	On-going	Research process
Regulated utilities	US	Environmental strategy – nuclear	On-going	Research process
Water and waste	UK	Environmental – UK renewable energy policy with regard to energy from waste	On-going	Research process
Communications infrastructure	Luxembourg	Governance – remuneration	On-going	Research process
Regulator	US	Environmental – energy policy and regulation	On-going	Research process
Industry association	US	Environmental – pipeline safety	On-going	Research process
Rail	Australia	Environmental – Queensland floods	On-going	Research process
Rail	Australia	Governance – remuneration	On-going	Research process
Communications infrastructure	France	Governance – shareholder structure	On-going	Research process

Indonesian Equities

US$283 million
FUM as at 31 December 2011

Inception date of asset class 2005

Team size 6
Location Jakarta

The team's approach

The Indonesian Equities team has acknowledged the importance of ESG in investment processes and procedures. The team has not formally undertaken detailed ESG research for individual companies; however, it has incorporated ESG issues into its discussions during company visits. Our analysts will alert fund managers whenever they foresee any potential ESG issues, and a short review on the potential short-term/long-term impact of the stock will be provided.

Indonesian companies are not accustomed to providing ESG details yet, thus the team is not able to get sufficient data to undertake detailed ESG research. We put more focus on corporate governance as it is the biggest issue in a developing market. Environment and social issues are tracked through news-flow and analysed accordingly.

The Indonesian Equities team believes that putting more effort into understanding companies' ESG challenges and opportunities will provide a better risk-return and less portfolio volatility in the longer term. The team is determined to improve ESG research by incorporating more ESG-related data into its research reports. We will also seek to educate companies that, by disclosing more ESG-related data, they will change the way investors may consider the companies in the long term.

Engagement examples

Coking coal producer

The team subscribed to this coal producer's IPO in 2010 in the belief that the company offered strong production growth, high quality coking coal, good margin and a clean balance sheet.

In September 2011, the company's major shareholder planned to acquire a 23% stake in an Indonesian coal producer for US$1 billion at a 46% premium over the trading price. The team was against this plan due to the following reasons. Firstly, the complex organisational structure in the target company was never going to benefit minority shareholders. Secondly, at the time of acquisition, the target company was experiencing a substantial loss due to its complex derivatives position. This meant that the acquiring company would not receive a dividend for the next few years. Lastly, following acquisition, the target company would be highly leveraged, which could pressure margins and affect capex plans to develop other mines.

The team took that the view that the corporate governance risks were too great and sold off its holdings. Post the announcement, the stock price plunged by 37% and has not recovered. Indonesian regulator, Bapepam, postponed the company's shareholder meeting in December 2011, and asked the company to provide more clarity.

Large coal producer

This company is one of Indonesia's largest coal producing companies, producing around 67 million tonnes per year, or around a fifth of total national coal production.

In 2009, the company signed an expensive loan of US$1.9 billion to refinance its convertible bonds and bank loans to various lenders. The loan would be repaid in three tranches, starting with US$600 million, in 2013 and 2014, and US$700 million in 2015. The loan significantly burdened the company's margin and cash flow.

However, the management decided to make early repayments for all the tranches with another refinancing. Based on the team's calculations, the new refinancing won't significantly improve the company's cash flow and margin, because it must pay a penalty, plus an upfront fee at over 2%. Following early repayment, the team estimates that the company will end up having a new loan larger than US$1.9 billion.

Although the company owned remarkable assets, questionable corporate governance and potential financial engineering made the team reluctant to invest in the company despite its significant weighting in the index. Nonetheless, the team remains well informed on the progress of any news related to the company.

Semen Gresik (SMGR)

A powerful earthquake hit West Sumatra in September 2009 and destroyed most of the properties in the city of Padang. Fortunately, all the plants, mills, buildings and houses in Semen Padang's area were not destroyed and only experienced minor damage, as the centre of the earthquake was quite far from the area. However, the operation had to be stopped for a week because there was no electricity from the electricity state company and the inland transportation infrastructure had been badly damaged.

The company had proper procedures in place for dealing with disaster and so all the physical assets, such as plants, properties and employees, were handled appropriately. No major injuries were reported and the plants were able to operate immediately. However, the infrastructure problems, particularly the damaged inland transportation, were beyond the company's capacity.

During the event, the company was proactively updating investors about the conditions and the recovery progress, and management was very reactive to investor enquiries. The team views the proper procedures in place, together with proactive management, as an added value to invest in the company.

Large mining contractor

In August 2009, this company undertook a rights issue with the intention to buy one of the second-largest mining contractors in Indonesia. During the rights issue, the management of the company clearly stated that there would not be any other major corporate actions by the company for the next 12 months.

In early March 2010, there was a rumour that the company was planning to undertake another rights issue to buy a coal mining company. The team talked to the company to clarify the issues and it said that the company was being offered, but there was no plan for such action. In late March 2010, the rumour was getting intense and the company was asked again, and surprisingly, it said that the company was looking at the offer and it will buy it if the price is right, using a rights issue for the funding. To make things worse, the coal mining company that was being offered was related to a group which was broadly known for its bad corporate governance.

The team saw this as a major violation of good corporate governance practices and decided to reduce the investment in the company. The share price was down by more than 50% during the event.

Global Credit and Fixed Interest

US$25.3 billion
FUM as at 31 December 2011

Inception date of asset class 1986

Team size 29
Location Sydney, Hong Kong, Singapore, Jakarta

The team's approach

The fixed interest and credit asset class faces 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 fixed interest and credit investments. This is partly because fixed interest and credit investments mature, with potentially many different maturity dates for securities issued by any one entity, whereas equity investments are perpetual securities. In other words, fixed interest and credit investments are exposed to duration and credit risk, as opposed to valuation risk.

Corporate governance is the most important ESG issue for fixed interest and credit investors. Corporate collapses can seriously impact a fixed interest and credit portfolio's performance and such events usually occur as a direct result of poor corporate governance. Therefore, the Global Fixed Interest and Credit team has vigilantly incorporated corporate governance risks within its disciplined investment process, which has a strong focus on managing default risks. This is taken into account within the internal credit rating (ICR) assigned to each issuer, where quality of management and the business plan is a factor. It is also incorporated into the Information Quality Score (IQS), which measures the potential for 'credit surprises'. Assessments are conducted based on the quality and transparency of the information provided as well as the overall standard of governance.

The team's credit analysts also assess other elements of ESG risk as part of the overall investment process, accessing ESG research through providers such as ASSET4, RepRisk, Glass Lewis Research and Responsible Research, in addition to the support provided by CFSGAM's Responsible Investment team. Environmental and social risks can point to weaknesses in standards of governance and highlight potential issues with risk management. The team has also developed a sector framework for assessing the relevancy of RepRisk news as part of the enhancement to our overall ESG assessment process.

The Responsible Investment team continues 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 Global Fixed Interest and Credit team continues 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 previous service providers to ASSET4, the team cross-referenced and tested scores from the existing service providers 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.

In addition to the credit research ratings process, the team has recently enhanced its process of selecting intermediaries with whom they transact by including ESG considerations into counterparty evaluations. Counterparties are now assessed, in part, on a weighted range of ESG indicators using data from ASSET4. Results are provided to counterparties and include examples of areas which can be improved based on the analysis. The review process has been completed in 2012

Incorporation of ESG considerations

The Global Credit and Fixed Interest team met with the four major Australian banks to discuss how they manage and monitor ESG risk within their lending portfolio. In the team's view, the banks appear to have appropriate ESG policies and processes in place, and are also continuing to strengthen their culture to recognise and assess ESG risks. However, there remains an inherent need to strike a balance between business performance and reputational risk so as to manage low probability and high consequence events.

The Global Fixed Interest and Credit team also reviewed several credits where material corporate governance issues were identified. In particular, concerns over the scale of government ownership, the ability to influence the board composition and nominations, and key strategic decisions were considered key risks. High profile Asian companies, such as Sino Forest and NTPC, were two examples where our ICR and/or IQS was reviewed to take into account poor corporate governance practices, and thus, elevated default risk.

Furthermore, the team also reviewed several credits where material environmental and social issues were identified. In particular, concerns over the safety levels and production processes were highlighted as key risks. High profile Asian companies, such as CNOOC and Fosun International were two examples where our ESG assessment was reviewed to take into account weak environmental policies and procedures surrounding key plants and factories.

Engagement examples summary

Company	Country	Engagement issue	Complete/ ongoing	Behavioural change/ research process
Toronto-Dominion Bank	Canada	Counterparty review process	Complete	Both
Royal Bank of Canada	Canada	Counterparty review process	Complete	Both
BNP Paribas	France	Counterparty review process	Complete	Both
NAB	Australia	Counterparty review process	Complete	Both
ASB Bank	Australia	Counterparty review process	Complete	Both
Credit Suisse	Switzerland	Counterparty review process	Complete	Both
Bank of America Corporation	United States	Counterparty review process	Complete	Both
NAB	Australia	ESG risk management in financing	Ongoing	Both
Brisbane Airport	Australia	Climate change impact	Complete	Research process
Westpac	Australia	ESG risk management in financing	Ongoing	Both
NAB	Australia	ESG risk management in financing	Ongoing	Both
KfW	Germany	ESG risk management in financing	Complete	Research process
AfDB	Tunisia	ESG risk management in financing	Complete	Research process
IFC	United States	ESG risk management in financing	Complete	Research process
ANZ	Australia	ESG risk management in financing	Ongoing	Both

Direct Infrastructure

US$2.8 billion
FUM as at 31 December 2011

Inception date of asset class 1994

Team size 26
Location Sydney, Melbourne, London, Paris

The team's approach

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 protection and creation.

As well as running individual mandates for clients, CFSGAM has three distinct infrastructure vehicles:

- the European Direct Infrastructure Fund
- the Global Diversified Infrastructure Fund, and
- the Wholesale Income Infrastructure Fund.

The CFSGAM Infrastructure investment strategy is to typically manage a large enough interest in each individual business to enable the team to add value through board and board committee representation. The team is active on ESG issues through this representation or company engagement and seeks to ensure that there are adequate sustainability policies in place, and that reporting against these policies takes place. If CFSGAM Infrastructure does not have a board seat, it will seek to add value and influence management decisions by actively exercising shareholder rights.

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

With a long track record, the process of dealing with ESG issues has been in itself an evolutionary process. The team has consistently developed and refined its commitment to ESG and today recognises it as being a fundamental part of its investment process.

CFSGAM Infrastructure is also very active in the broader industry, seeking ways through collaboration to advance the consideration of ESG issues in the infrastructure space. The team was the first investor signatory to the Australian Green Infrastructure Council (AGIC) and also became the first Deputy Chair of this organisation. AGIC's objective is to develop a sustainability rating tool for infrastructure assets. Such a tool will be very valuable for direct infrastructure investors in identifying ESG risk factors and opportunities. AGIC had many successes during 2011, with the ongoing development of the tool, hosting its second major conference in conjunction with the World Congress on Engineering Asset Management, hosting three master classes on sustainability in procurement in the infrastructure sector and growing its membership base to now represent more than 82 institutions. More information on AGIC can be found at www.agic.net.au.

In 2011, the team also increased its research effort on ESG issues. Most notably, a detailed research piece was produced on climate change, titled 'Carbon regulation and infrastructure: risk or opportunity?'. The paper outlines that climate change is an important theme for investors, with infrastructure assets at the forefront of society's transformation to a low-carbon economy. Investors need to be aware that, in most instances, the underlying demand for infrastructure services is expected to remain robust.

What will change is the technological or modal mix through which services are delivered to the community. Energy infrastructure, in particular generation, is likely to be most impacted, with a wide range of outcomes possible across the sector. Water utilities are also highly exposed due to the interdependence between energy and water. Transportation infrastructure will be affected indirectly, via the impact of carbon. The full paper is available on the CFSGAM website.

Incorporation of ESG considerations into the investment process

A consideration of sustainability issues is embedded in the life cycle of the direct infrastructure investment process. ESG issues are considered in following way:

Step 1: Initial due diligence

Prior to an investment being made in an asset, the team looks to consider all the relevant ESG issues for the asset. No checklist can appropriately cover all the possible issues, so considerations are made on a case by case basis. To support this process, 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.

The team does not screen any particular asset or sectors, rather it looks to do the ESG analysis to support the investment decision-making process and ensure the right price is paid for an asset.

Additionally, once completed, the AGIC rating tool will provide a useful process to assist in the identification of key risk issues and opportunities for all infrastructure acquisition opportunities.

Step 2: Ongoing asset management

Once an acquisition is made, the team undertakes ongoing active asset management as part of a continuous improvement process to value-add to asset performance and effectively manage risk. This is done through the active asset management strategy.

CFSGAM Infrastructure specialist fund managers and asset managers meet regularly with infrastructure business management teams to discuss various matters, including ESG issues. They also visit business sites in their capacity as shareholder, board member and/or board committee member. To add value, CFSGAM Infrastructure actively seeks to build relationships at various management levels within the business during the life cycle of the investment. Such relationships provide the opportunity for the open exchange of information and constructive debate of risks and opportunities including ESG issues which materially impact on the value of the investment.

In addition, CFSGAM Infrastructure seeks to ensure that management provides an appropriate level of information to the board to ensure the approach management takes in managing potential risks and realising opportunities is understood by the board. Examples of the types of reporting requested include:

- Environmental and social risks impacting materially on earnings, including contingent liabilities.
- Governance policies and procedures for assuring compliance with internal ESG policies, improving performance and mitigating risks across operations, the supply chain and products and services.
- Human capital processes including:
  - retention programs
  - workplace health and safety performance
  - staff turnover
  - succession planning, and
  - training and development programs.
  - Performance reporting on measurable environmental factors, for example:
    - energy use
    - water use, and
    - greenhouse gas emissions.

Step 3: Valuations

Appropriate management of ESG considerations is undertaken as part of the ongoing valuation of assets and is a consideration in decisions whether to divest an investment. Notably in the appointment of a valuation panel, its ability to include ESG factors into valuations is a key consideration.

Step 4: Ongoing research and industry collaboration

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

Engagement examples

Anglian Water

Anglian Water Group (AWG) serves more than six million domestic and business customers in the east of England. It is the largest water and wastewater utility in England and Wales by geographic area and fourth-largest by regulated asset base size. CFSGAM owns 33.3% of AWG through the European Direct Infrastructure Fund and the Global Diversified Infrastructure Fund as well as client mandates. This level of shareholder provides CFSGAM with two board seats.

AWG has a strong approach to sustainability, fully supported by CFSGAM Infrastructure. As part of its carbon mitigation strategy, AWG management has set some challenging targets, including:

- Stabilising operational carbon emissions by 2015. Under a business-as-usual scenario, AWG's operational carbon emissions are expected to increase by 10% from 2010 to 2015, driven by population growth and tighter water quality standards. AWG is aiming to achieve a reduction of 10% in real terms (or zero-growth nominally).
- Halving embodied carbon in the hard assets for all capital expenditure by 2015. This is relative to comparable assets AWG has built prior to 2010, and applies to both new-build and maintenance projects.
- Halving total annual greenhouse gas (GHG) emissions by 2035. A long-term aspirational target, which will rely on other stakeholders taking action to reduce emissions.

In order to meet these goals, AWG is taking a proactive and pragmatic approach to carbon emissions management.

In addition, when evaluating a project, AWG's design engineers integrate carbon emissions estimates into the design phase. From questioning whether the project's goals can be achieved using existing infrastructure to thinking of ways to minimise and/or reuse materials, engineers are challenged to think innovatively in order to reduce embodied, as well as operational, carbon emissions. To help them do this, tools such as AWG's carbon modeller have been developed, allowing them to 'optioneer' different designs and select the least carbon-intensive option.

A good example of the potential benefits of such an approach is the Bedford Growth scheme, which involved increasing wastewater treatment capacity for an additional 30,000 people. From the original designs, AWG was able to reduce embodied carbon by 67%, or 4,833 tonnes of $C0_2$. Project capex was also reduced by 25%, or £5 million, illustrating the tangible financial benefits that focusing on sustainability can bring.

AWG also seeks to drive the regulatory agenda through its membership of industry and government bodies. By being proactive rather than reactive, AWG seeks to minimise the risk of adverse regulatory changes being imposed on the business.

As a long-term investor in AWG, the team is supportive of these initiatives as it is believed they help 'future proof' the asset against future regulatory changes and increases in direct and indirect carbon costs. The benefits of such an approach are clear: a focus on sustainability leads to lower costs, higher returns and lower risks.

Brisbane Airport

CFSGAM was a foundation investor in Brisbane Airport Corporation (BAC). Brisbane Airport is Australia's third largest airport by passenger movements. In 2011, BAC had nearly 20 million passengers through its terminals and there are 420 businesses and nearly 17,000 people who work on Brisbane Airport every day. The vital role BAC plays in the Queensland economy means environmental and community issues are critical to its future growth.

Through a long-term shareholding and representation on the Board, the team has always looked to support BAC's activities as they relate to sustainability. In the first CFSGAM responsible investment report (2008) there was a case study outlining the achievements of BAC in relation to a significant water saving initiative. In 2011, the team is pleased to report the following ESG achievements at Brisbane Airport:

- **Climate change:** The long-term impacts of climate change are a key consideration at Brisbane Airport. For example, Brisbane Airport's infrastructure is being planned and constructed in accordance with long-term sea level rise forecasts. The 1 in 100 flood event in January 2011 saw BAC infrastructure unaffected by rising flood waters, with operations continuing at all stages throughout the flood event, proving the resilience of the BAC's critical infrastructure under extreme conditions. Additionally, the new parallel runway planning process (and specifically the height the runway will be constructed to) has involved consideration of changing storm surge levels and flood frequencies as well as rising sea levels.
- **Water:** As outlined above, Brisbane Airport has achieved a circa 85% reduction to date in potable water consumption across the airport. Initiatives include leak monitoring technology, rainwater tanks, water harvesting design, water restriction devices, freshwater lakes and recycled waste water network including Australia's first on-airport recycled water treatment plant.
- **Biodiversity:** Extensive flora and fauna studies provided the foundation for BAC to formulate a Biodiversity Management Strategy, including a 285 hectare conservation zone comprising habitats of the higher biodiversity values on the airport.
- **Carbon footprint:** Brisbane Airport management is also currently undertaking an energy saving study. This initiative, similar to the water saving strategy, should lower Brisbane Airport's carbon footprint and reduce the cost of electricity use across the airport site.

Direct Property

US$18.1 billion
FUM as at 31 December 2011

Inception date of asset class 1994

Team size 20
Location Australia and New Zealand

The team's approach

As CFSGAM Property directly controls the management of real estate it manages on behalf of investors, it is in a favourable position to implement responsible property investment initiatives and processes to directly affect ESG outcomes of the investments. These often have immediate and enduring financial benefits to our investors, particularly in areas of energy and resource, and tenancy demand. In this way, responsible property investment makes good business sense as it positively impacts investment performance and assists in future-proofing properties to ensure they will continue to provide strong returns for investors.

CFSGAM Property manages three listed real estate investment trusts (REITs) along with a suite of wholesale property funds and direct property mandates valued at A$18 billion. Each of these investment products is managed through substantial asset and development management capability, and each with an RPI overlay.

The team is committed to best practice standards in environmental management, social incorporation, corporate governance and risk management. The team takes a leadership role in working with industry bodies to guide government direction and regulation, and consistently reviews and improves the way it services and supports all stakeholders.

In 2011, the team increased the amount of research it undertakes on ESG issues. Most notably, the team publicly released a detailed research paper on the effects of carbon regulation on property: 'Australian commercial property sector well positioned for carbon regulation'. The paper found the commercial property market is unlikely to be materially impacted by the introduction of a Carbon Price Mechanism (CPM).
A CPM may be a positive development for the industry, helping to future-proof commercial property against further increases in electricity costs. This could be achieved by accelerating the adoption of energy efficient technologies and through complimentary measures to assist the sector in the transition to a reduced carbon economy.

The Responsible Property Investment team has five key objectives, incorporating:

- **Fiduciary duty:** To protect and enhance returns
- **Value proposition:** To include RPI within the investment process and business philosophy
- **Communication:** Articulate the value proposition of RPI, and collaborate with others
- **Operational process:** Ratings and performance to be maintained and improved across assets and portfolios, taking all stakeholders and communities into account
- **Reporting:** Stakeholders to be kept advised of RPI developments and progress.

The team's proactive management approach to environmental and social considerations in building design and operation demonstrates leadership capabilities in the marketplace. By successfully engaging stakeholders, the team can mitigate risks to its strategy. Further, by implementing market-leading governance practices, the team can provide investors with assurance that their investments are managed prudently and within the appropriate fiduciary framework. This robust approach to incorporation of ESG into all areas of management in direct property has resulted in a number of international awards and recognition.

Incorporation of ESG considerations into the investment process

We incorporate RPI at all stages of ownership management and development:

Invest: Each asset acquired is reviewed through a responsible investment checklist as part of the standard due diligence process. This process investigates the environmental and physical aspects relating to a property (land and buildings), in both its construction and ongoing operation. Social aspects are investigated in relation to how a building is integrated within its local community. In relation to governance, the asset is reviewed for compliance with regulatory controls. These RPI aspects are investigated not as a screening process, but as part of risk identification and mitigation.

Manage: The team sets performance targets to improve its assets over time. The day-to-day management of a building is closely guided through the Operational Performance Strategy. This strategy is focused on setting and achieving performance targets for the operation of a building based on an appropriate benchmark for the class and use of each particular building. Once a benchmark is set, the team then actively monitors, manages, analyses and reports on the actual achievement of these targets, and institutes continual improvement. To drive sustained asset performance the team:

- trains operations staff to manage properties more efficiently
- considers life cycle analysis in the replacement of plant and equipment
- considers the needs of a building's occupiers, and
- has a detailed Tenant Engagement Strategy, including a Green Lease Strategy (which includes a green lease schedule, a tenant fit-out guide and house rules, governing the operation of the asset).

Enhance: The team seeks to refurbish or redevelop to a high environmental standard when undertaking development works. When undertaking refurbishment or redevelopment works, the team aims to improve the environmental standard of its assets. The team targets a minimum of 5-star Green Star ratings and 5-star NABERS Energy ratings on new developments. The team also takes into account the effects on communities and ensures the buildings are integrated into the social community, and provides the appropriate infrastructure. The procurement policy takes into account ESG in dealing with suppliers.

Create value: The team focuses on the sustainability of its assets because it is good business practice: improving the efficiency of assets reduces operational costs. From an owner's perspective, a more sustainable building will typically attract higher income. As such, responsible property investment is a key factor in maintaining property valuations over time, which is aligned with fiduciary responsibility and the long-term interests of unitholders. The responsible property investment program results in real efficiencies being achieved across many of the assets managed on behalf of investors. For example, in the listed Commonwealth Property Office Fund, the team has been recording results for some time. Since 2006, properties in this fund are 29% more energy efficient, 26% more water efficient, and emit 30% less emissions per square metre. On one particular asset $3.2 million was spent over a four-year period, replacing equipment with more efficient plant, retrofitting, and introducing a number of management efficiency measures, resulting in a 48.5% reduction in $C0_2$ and a return of over 14% per annum.

Engage: CFSGAM Property takes a leadership role in working with industry bodies to consistently review and improve the way ESG is practised within the property sphere in Australia and globally. The team assists in providing feedback and guidance to proposed regulation. Memberships and partnerships include:

- Signatory to the United Nations Principles of Responsible Investment (PRI) through CFSGAM
- Member of the Investor Group on Climate Change (IGCC), through CFSGAM, and member of the Property Working Group
- Board member of the Green Building Council of Australia (GBCA)
- Co-chairman of the UNEP-FI Property Working Group
- Membership of and National president of the Property Council of Australia (PCA)
- National sustainability and divisional sustainability representation (NSW and VIC) on the PCA
- Board representation on, and corporate donor to the Property Industry Foundation
- Melbourne 1,200 Buildings Partnership with Melbourne City Council, and
- Signatory membership to the Better Building Partnership between owners and the City of Sydney.

Through its parent body, CFSGAM Property is also a signatory to the UN Global Compact.

Operational Performance Strategy

CFSGAM Property's Operational Performance Strategy (OPS) covers the management and operation of property assets by specifying practices to implement ESG considerations in each building under management.

The OPS serves to embed efficiency improvements throughout the assets' operations, for the benefit of all stakeholders. This approach seeks to maintain and enhance asset value, mitigate operational and legislative risk, achieve full operational potential and provide quality accommodation for tenants in conjunction with social and financial objectives, to achieve a balanced outcome. The ESG principles underlying the OPS are to:

- benchmark the environmental footprint of the funds which hold the assets, and the individual properties managed
- responsibly improve the operational performance and efficiency of all assets over time by setting measurable short and long-term targets as appropriate
- explore and implement as appropriate, the adoption of management and design practices, systems and technologies which promote innovative performance solutions
- understand and influence the associated supply chain activities
- influence, direct and educate key stakeholders to act in a sustainable manner, and
- report and disclose performance in a format that is tailored to suit the information user (transparent, consistent, relevant and inclusive).

Centres creating communities

The shopping centres that CFSGAM Property manages form an integral part of communities in which they are located and so have the ability to interact with these communities. They are more than just an attractive place for customers to shop and retailers to operate; they help create better communities, by being vibrant focal points for their communities. In this regard, RPI means collaborating to achieve the best outcomes for all stakeholders of the centres. CFSGAM Property provides space, facilities and funds to local community organisations, charities and schools.

Direct property life cycle analysis

CFSGAM Property's life cycle 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 life cycle analysis model assesses whether the owners will realise a return if additional capital is spent 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.

Life cycle 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.

Tenant Engagement Strategy

CFSGAM Property has produced a green leasing strategy for office buildings, which forms part of our overall social focus, with particular regard to tenant engagement. All new leases from July 2011 have a green lease schedule, with commitments by the owner and opportunity for the tenant to collaborate to improve the environmental outcomes of the premises.

Chapter 3

CFSGAM activities

Traditional Ikkat fabric from Lombok, Indonesia

Engagement through voting

With more than US$70.6 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.

A key development in Australia during 2011 was the introduction of the 'two-strikes' rule on executive remuneration. CFSGAM expects this to enhance communication and understanding between companies and shareholders on the topic of executive remuneration, and strengthen the link between pay and performance.

Europe continues to focus on harmonisation of corporate governance practices, while emerging markets continue to develop their corporate governance frameworks, with varying degrees of success.

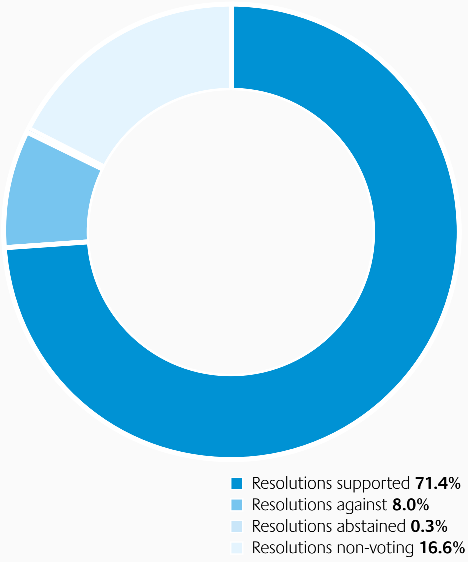
Given the focus on executive remuneration, it is likely that legislation will only increase in this area. Setting limits on executive remuneration, increasing alignment between performance and pay, and giving shareholders greater input on remuneration packages are some of the likely themes surrounding new legislation globally.

The 'comply or explain' approach is gaining traction, especially in Europe, Australia and the US. The UK's strong corporate governance framework is built around the 'comply or explain' principle, which requires companies to disclose their compliance against set criteria and justify any deviations from best practice. The US is gradually adopting the 'comply or explain' approach, while in Europe it is providing a flexible framework which allows for harmonisation of corporate governance regulation across borders.

An issue noted by CFSGAM's investment teams globally, including in emerging markets, was an increasing number of capital raising resolutions without shareholder approval.

Shareholder resolutions voted on during 2011

In 2011, CFSGAM voted at 1,619 company meetings, voted on 18,427 resolutions and voted against management 8.0% of the time.



Types of issues voted on: all votes	Number of votes	Per cent of total votes
Non-voting	2,696	14.6
Director election	6,770	36.7
Executive remuneration	596	3.2
Non-executive remuneration	511	2.8
Issue of new shares	319	1.7
Remuneration report	804	4.4
Financial scheme/reconstruction of capital	65	0.4
Constitution/articles of association change	704	3.8
Appoint/Reappoint auditor	881	4.8
Takeover or merger acquisition	121	0.7
Shareholders proposals (SHP)	103	0.6
SHP – Environment	24	0.1
SHP – Social	47	0.3
All other proposals	4,786	26.0
Total	**18,427**	**100.0**

Types of issues voted on: against votes only	Number of votes	Per cent of votes against
Non-voting	0	0
Director election	601	8.9
Executive remuneration	91	15.3
Non-executive remuneration	26	5.1
Issue of new shares	35	11.0
Remuneration report	158	19.7
Financial scheme/reconstruction of capital	4	6.2
Constitution/articles of association change	181	25.7
Appoint/Reappoint auditor	46	5.2
Takeover or merger acquisition	16	13.2
SHP	35	34.0
SHP – Environment	5	20.8
SHP – Social	7	14.9
All other proposals	839	17.5
Total	**2,044**	**11.1**

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 Academy

The Responsible Investment Academy (an initiative of the Responsible Investment Association of Australia) has developed a course aimed at educating investment professions in a more formal way on responsible investment. While many in CFSGAM's investment teams are experienced in responsible investment, there is significant interest across our broader business. CFSGAM has enrolled 40 executives from across the business to complete the Certificate for Responsible Investment.

Responsible investment sessions

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 2011 and the topics they covered.

PRI Academic Network

During 2011, CFSGAM continued to work closely with educational institutions to develop education materials and course content. We also participated in global collaborations, most notably through being a member of the Award Panel for the PRI Academic Network Research Awards and participating in the Academic Network Conference. We believe this project was particularly important given the need to see rigorous academic research produced to support the investment industry in its approach towards responsible investment.

Name	Title	Company	Topic	Brief description of topic
Adam Horler	President	LOHAS Asia	Responsible Investment Briefing: Can Asian consumers save us all?	Adam Horler from LOHAS, a specialist sustainability-focused market research firm in Asia, discussed whether Asian purchasers can begin to consume more responsibly and how companies have risen to the challenge of producing less resource and energy-intensive goods and services.
KT Rabin	CEO	Glass Lewis & Co.	Update on global corporate governance issues	The CEO of one of CFSGAM's service providers – KT Rabin from Glass Lewis & Co. – provided an update on current corporate governance issues globally. Specific issues discussed included corporate governance in the eurozone, US regulatory changes and emerging trends among pension funds worldwide.
Nathan Fabian	CEO	Investor Group on Climate Change	Ongoing political debate of climate change and emissions trading	Emissions trading and the Government's proposed carbon tax remained close to the top of the Australian political agenda throughout 2011. Nathan Fabian, CEO of the Investor Group on Climate Change, provided a comprehensive summary of his views regarding the ongoing debate between politicians, listed companies and environmental groups.

Name	Title	Company	Topic	Brief description of topic
Benjamin McCarron and Claire Veuthey	Head of Research	Responsible Research	Overview of the responsible investment ecosystem in Asia and dominant trends	Benjamin McCarron and Claire Veuthey from research firm Responsible Research provided an overview of the current responsible investment landscape in Asia, including the increasing number of UN PRI signatories and sustainability disclosure among listed companies. A number of case studies from China and India were discussed, specifically in the food, water and energy sectors.
Aimee Kaye	ESG Analyst and Economist	Macquarie Securities	Employee engagement in Australia	Companies often suggest that people are their most important asset. There appears to be a growing body of evidence to support this claim, with the latest international research suggesting that company performance can be linked to employee engagement. Aimee Kaye, an ESG analyst from Macquarie Securities, provided an analysis of employee engagement trends in Australia, including human capital measurables such as staff turnover, remuneration, productivity and absenteeism and how these factors can be linked to share price performance.
Richard Boele	Founder and Managing Director	Banarra	Global Reporting Initiative (GRI) providing a framework for company reporting	In order to make informed investment decisions, portfolio managers require companies to provide accurate and relevant reporting on ESG issues. The Global Reporting Initiative (GRI) provides a framework for companies to follow when publishing these reports. Richard Boele, Founder and Managing Director of Banarra, outlined some of the most important issues to consider in the assessment of ESG factors and whether the GRI adequately meets the information requirements of investors.
Dr Nils Kok	Associate Professor, Executive Director	Maastricht University (Netherlands), Global Real Estate Sustainability Benchmark (GRESB) Foundation	Building better returns through sustainability initiatives	Dr Nils Kok, co-founder of the Global Real Estate Sustainability Benchmark (GRESB) Foundation, provided insightful sessions to external analysts and internal employees, focusing on the correlation between responsible investment and returns from property, and how asset owners can employ sustainability initiatives in order to help generate superior long-term returns.

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

- Management Committee 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 Greenhouse and Energy reporting (including Carbon Disclosure Project) Working Group
- Member of the Research Working Group
- Member of the Property Working Group

Property Council of Australia (PCA)

- 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
- Member of the 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

Association of Superannuation Funds of Australia Investment Policy Sub Committee

- Committee Member

Other collaborative initiatives that CFSGAM participated in, or continued to be a member of, during 2011 included:

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

Carbon Disclosure Project and Water Disclosure Project

CFSGAM again accepted the invitation to become a signatory to the Water Disclosure Project. CFSGAM was one of the first signatories to sign in 2010.

Like the Carbon Disclosure Project, the Water Disclosure Project will survey 302 of the world's largest companies in sectors that are water-intensive or face particular water-related risk. A total of 354 signatories representing US$43 trillion are signatories and 408 companies in the Global 500, the South Africa (JSE) 100 and the Australia (ASX) 100 that operate in water-intensive or water-sensitive industry sectors were surveyed.

The Water Disclosure Project requests information on the risks and opportunities companies face in relation to water; on water usage and exposure to water stress in companies' own operations and in their supply chains; and on companies' water management plans and governance. This information can then be used to inform investor signatories on potential investment risk and commercial opportunity.

In 2011, CFSGAM was again a signatory to the CDP. On 1 February 2011, 551 signatories representing US$71 trillion in assets requested information on carbon emissions and climate change from the chairmen/CEOs of over 6,000 of the world's largest companies. CFSGAM's Direct Property division is also a respondent to the CDP.

Stewardship code

As reported in the 2010 Responsible Investment report, after careful review CFSGAM took the decision to not sign the UK Stewardship Code.

Representatives from CFSGAM met with the CEO of the Financial Reporting Council UK (FRC) to discuss the UK Stewardship Code. CFSGAM discussed its alignment with the principles behind the Code and our active engagement as investors. Direct dialogue with companies is a key way for CFSGAM to assess management quality and the risks and opportunities of the companies invested in. CFSGAM, exercises its voting rights thoughtfully, with diligence and care. CFSGAM is a signatory to the PRI, which provides a framework and forum for better engagement, and CFSGAM believes that there is little, if any, obligation in the Code that is not covered by the PRI.

In addition, CFSGAM expressed to the FRC its concern about the strength of the Code and the ability for it to make genuine improvements to real stewardship by investors. Concerns were raised that the combination of no review mechanism and the speed and number of signatories to the Code will lead to many signatories failing to fulfil the intention of the Code. CFSGAM gave the example that a review of signatories to the Code highlighted that there are some investor signatories which have a very different view on investor stewardship to CFSGAM.

ASX Corporate Governance Council Corporate Governance Principles and Recommendations Roundtable

CFSGAM participated in a roundtable to review Principle 7 of the ASX Corporate Governance Principles and Recommendations. The roundtable included non-executive directors, governance advisers, institutional investors, proxy advisory firms, company secretaries and risk officers. The group discussed a range of issues related to how companies manage and report their material business risks and focus on the reporting of ESG issues and what role and possible approach the Principles and Recommendations could play in this area going forward. This is consistent with the Financial Service Council work on an ESG Reporting Guide for Australian Companies and will provide better exposure and support for the Financial Services Council (FSC) initiative.

Financial Services Council working group

The FSC working group was formed in 2010 and CFSGAM has been an active participant since inception. In 2011, the FSC worked collaboratively with the Australian Council of Superannuation Investors (ACSI) to develop and release an ESG Reporting Guide for Australian Companies. The guide is aimed at ASX 200 companies which are not reporting on ESG issues, and provides some guidance on how to report, including key themes under the environmental, social and governance pillars. References are provided to standard reporting frameworks and norms for each theme and some example indicators and best practice reporters are referenced. The guide can be accessed on the CFSGAM website.

The working group also wrote to the ASX as part of its review of listing rules for additional reporting on mining and exploration activities. The working group encouraged the ASX to consider payment transparency by companies to sovereigns, consistent with the Extractive Industries Transparency Initiative which is supported by the Australian Government. Similarly, in July 2010, the United States passed the Dodd-Frank Financial Reform Act which requires companies engaged in extractive industries, and registered with the US Securities and Exchange Commission, to publicly disclose any payments they make to governments, country by country and project by project.

Emerging Market Disclosure Project, Indonesia

The Emerging Market Disclosure Project (EMDP), a PRI initiative aimed at increasing disclosure by emerging markets companies, is focusing on Indonesia this year. Given CFSGAM's presence in Indonesia, CFSGAM participated in a study that looks to understand how ESG issues are factored in lending and investment decision processes by asset managers, pension funds, development banks and commercial banks in Indonesia.

Cluster Munitions Working Group

CFSGAM has participated in a Cluster Munitions Working Group of investors who are all signatories to the PRI. This Group is made up of eight institutional investors.

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 2010 or the Ottawa Treaty. The Convention on Cluster Munitions and the Ottawa Treaty prohibit the use, production, stockpiling and transfer of cluster munitions and anti-personnel mines.

The ultimate aim of the 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.

The Group wrote to US-based companies linked to the defence sector which are not involved in cluster munitions to commend them for their policy and encourage them to consider making a formal, public statement regarding their policy toward cluster munitions. The Group acknowledged the leadership of these companies and outlined the risks involved in the manufacture of such weapons.

ESG Research Australia

CFSGAM was again an active member of ESG Research Australia. CFSGAM had a representative on the Management Committee and chaired the Research Evaluation Committee. In doing so, CFSGAM coordinated the responses from all signatory members on their views of ESG research across the Australian market and facilitated the roundtable discussions that led to the summary report and award event. The summary report on ESG research in Australia can be found on the ESG Research Australia website.

Forest Footprint Disclosure (FFD) project

In support of the FFD, CFSGAM joined 19 other investors to endorse a letter to encourage non-disclosing companies to respond to the project. These letters went to numerous companies across the forest supply chain and emphasised many causes of deforestation and the contribution to climate change, as well as the risks to companies and investors.

Integrated reporting

CFSGAM is very supportive and engaged in the regional discussions on integrated reporting. The concept of integrated reporting is effectively that companies should combine their traditional financial reporting and sustainability reporting in a way that articulates how ESG issues are relevant to strategy, risk management and financial performance. Integrated reporting should also encourage integrated thinking.

CFSGAM has always articulated to companies that is has a preference for such reporting; however, it seems the industry has now reached a tipping point in the recognition of the need for integrated reporting. Driven mostly in the UK by the Prince of Wales' Accounting for Sustainability Project, and the Global Reporting Initiative, there is a critical mass of large companies, accounting firms, regulators and investors now collaborating on the frameworks for integrated reporting. CFSGAM is providing input into that process through the Australian forum coordinated by KPMG and the Society for Knowledge Economics.

The initial paper coordinated by the working group on investors' perspectives outlined that, as more investors commit to a mainstream consideration of ESG issues in their investment selection processes, they face a number of challenges relating to information flows that include a lack of:

- usable information on a company's ESG performance; sustainability reports are typically targeted at stakeholders other than investors
- information from many medium-sized and smaller companies
- consistent data year on year (in content and approach) and lack of consistency in definition across the sector
- candour and relevance in disclosure; sustainability reports are presented in a marketing style, and do not necessarily address the key issues that are the most material to the company and investors, and
- complex metrics with a lack of standardised methodologies for calculation and setting of boundaries, for example regulatory requirements which focus on local boundaries for companies with international operations.

By looking at ESG performance, investors will also be looking for insight into the efficiency of operations. Ideally, investors would have access to reporting that disclosed:

- 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 time frame of any potential impact
- the governance process in place for managing ESG issues, for example which ESG issues are managed by risk, strategy, the Board or operational management
- information on whether and how externalities are identified and 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, for example energy use and safety performance
- a discussion around materiality and how ESG issues are being managed
- forward-looking discussion on how ESG issues are going to be managed and how that impacts the traditional forward-looking statements of the company
- whether a company identifies future ESG regulatory risks which could impact the balance sheet (eg through asset impairment)
- a simple concise summary of the key ESG issues without the marketing gloss.

During the period, CFSGAM provided stakeholder feedback on the paper Towards Integrated Reporting: Communicating Value in the 21st Century. This paper is the first output of the Global Steering Committee. CFSGAM's feedback is focused on the fact that:

- the framework needed to put a greater focus on risk management and financial performance
- there needed to be an articulation of the investor need for comparability of ESG data, and
- the principle of accuracy and no spin needed to be stronger, as this should not be a marketing exercise.

CFSGAM believes that the strongest aspects of the report are the articulation of the five different 'capitals' (manufactured, human, intellectual, natural and social capitals) and the investor's perspectives. While there is still not a template and a 'how to' guide for companies, the paper provides good context and a business case for companies moving towards integrated reporting.

In CFSGAM's engagement with companies, it increasingly raises the opportunity of moving towards integrated reporting.

Cross team engagement

While most engagement is driven by the investment teams, on some more technical issues company engagement is supported by the Responsible Investment team. Examples of such engagement in 2011 are given below.

Palm oil

The sustainability, or otherwise, of the palm oil industry continues to challenge investors globally. It was alleged that a Singapore-listed agricultural company commissioned over 700 paramilitaries to attack an indigenous community in Indonesia. Apparently 40 people went missing as a result of the attack, which was intended to clear land for palm oil cultivation. One man was allegedly shot in the back several times by the paramilitaries. CFSGAM contacted the company to ask for its response to these allegations. CFSGAM also contacted possible customers of the company to understand their response to the allegations.

The allegations demonstrate the ongoing persistent challenges of the industry, and it is not only the palm oil producers that are being targeted. Purchasers of palm oil are potentially exposed to even greater reputation risk.

While CFSGAM is engaging companies, it has also been looking at what collaborative initiatives it may be able to participate in with other investors. CFSGAM has agreed to join the PRI working group Sustainable Palm Oil Investor Working Group. The primary objective of the group will be to support the development of a sustainable palm oil industry through the active support of the Roundtable on Sustainable Palm Oil. The two main activities of the Group will be to get broader investor interest and also to engage companies up the supply chain. CFSGAM sees an opportunity to add value through engagement with Chinese and Indian purchasers of palm oil.

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 CFSGAM invests. 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. As well as writing in collaboration with 20 other investors to the European Union Commissioner to support enhanced disclosure for extractive companies, CFSGAM continued to engage with companies on EITI-related disclosure.

In late 2010, CFSGAM 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 continued in 2011, and representatives from CFSGAM met with many of the large companies exposed. Some companies conveyed a tendency of not wanting to participate in EITI if their host country was not yet a participant; others felt too much disclosure was risky from a competitive positioning perspective. We emphasised the general direction of regulation and encouraged companies to be more proactive.

India insight

This was my first trip to India. The thing that surprised me the most was how much companies seemed to genuinely want to grow their business in a way that was addressing the wealth gap. Either through philanthropy or growing 'responsibly', the approach was more genuine than you typically see in other global companies.

The common question I tried to ask all the people I met was, 'What are the biggest sustainable development challenges for your company and for India?' I was really struck by how much the good company leaders had thought about the issues. Particularly impressive responses were from Mr Godrej, from Godrej Industries, who said that people in India waste too much and Ms Shikha Sharma from AXIS and Sunil Duggal from Darbur who argued that inequality was the big challenge. Having more than 50% of people without access to basic financial services creates major sustainable development challenges. Mr Duggal eloquently put it that 'poverty is the biggest polluter'.

The waste aspect was interesting. Consistently, people claimed that the Indian population just wastes too much. Some of this was due to 'silly government policy' like free power to the agricultural sector: 'farmers just leave the water pumps running all night because the power is free'. The waste is also a result of a lack of awareness about the environmental impact that occurs through people's activities.

The importance of a social licence to operate in the context of land acquisition challenges was a surprise. It was a theme that cut across sectors. Even the companies with a poor approach like Jindal Steel recognised that this was the biggest challenge, but it's relevant to everyone.

I was surprised that water issues did not come up more. It was only when I asked that companies admitted that India's reserves were seriously under pressure. I suspect it's just not a priority. Gujurat seems to be taking some innovative approaches to managing salinity in the coastal rural areas that have led to some significant improvements in agricultural yield. Otherwise, there was not much from the companies in terms of innovation.

It was the opposite with energy. I suspect this is partly driven by the regulatory reporting requirements in India, which I think are some of the best in the world. With 35% of the population still without access to electricity, it seems energy conservation emerged as a major policy objective. The Energy Conservation Act was passed in September 2001 and requires large energy consumers to adhere to energy consumption norms and to report on use and efficiency gains.

The challenges at the company level were obviously broad and varied. Some of particular note and frequently mentioned include:

- bringing people along the sustainability journey and convincing them it's good business
- education and making people understand they have an impact
- lack of regulatory certainty, and
- human capital and finding skilled labour.

The other real take-out from my trip was the overwhelming sense of 'India pride'. 'Tata pride' from the staff at Taj was quite wonderful. Our guide spoke so fondly of the way the staff where treated post the terrorist attacks. Tata continued to pay its 1,500 staff, including contractors, full wages for the two years it took to rebuild the hotel. The loyalty that this fosters certainly cannot be bought.

Some of the more concerning things should be no surprise. Obvious pollution challenges. Poverty like nowhere else I have seen. Corruption. Corporate governance; how many boards are too many? All these issues create massive challenges for companies and are barriers to achieving sustainable development. More specifically, I think the multi-national corporations that are run as divisions, as opposed to even proper subsidiaries let alone public companies, could also be of concern.

In summary, I learnt more in this trip than I can possibly put down on paper and I am sure I will develop more opinions over time. There was certainly the good (Dabur, Godrej) the bad (YES Bank and Gujurat) and the ugly (Jindal and Gateway), but I suspect this is a theme across everything in India. The approach companies take to ESG issues is potentially more insightful in India than in many other markets.

Amanda McCluskey
Head of Responsible Investment

Bhutan dharma

We are sitting in a cold, brightly lit room, staring at a large pair of hairy knees. The knees belong to the CEO of the Bhutanese Stock Exchange (BSE). He is wearing his traditional dress, a knee length gho, tied at the waist and complemented by a particularly thick pair of long, woollen socks. 'Our biggest problem', he sighs, 'is that people only want to invest for the long term in Bhutan, thinking only about the dividend each year.'

To us, this seems like a nice problem to have. Most stock markets have the opposite problem. What is the point of a stock market, we ask him? Why does Bhutan, the land of Gross National Happiness (GNH), want to have a stock market? He regards this question as odd. Bhutan is not anti-growth, anti-globalisation nor anti-capitalism. The beauty of GNH is that it lacks any of the aggression, hostility or political association of these virulent 'anti' movements. It recognises the benefits of the market economy and is happy to incorporate them where appropriate. It is a successor to, rather than the antithesis of, capitalism. As such, it is less – far less – threatening and much more potent.

'Our vision is to become an integral part of the financial system and participate in the nation building. Our mission is to develop and establish a fair, orderly and transparent securities market with the objective to facilitate efficient mobilisation and allocation of capital.' In Bhutan, the stock exchange is acutely aware of its social licence to operate. It has a sense of purpose, or dharma.

Elsewhere, the reverse is true. A cursory look at how other, much larger, stock exchanges regard their role is revealing. For example, the New York Stock Exchange describes itself simply as a leading global operator of financial markets and provider of innovative trading technologies. The Hong Kong Stock Exchange states, 'as an infrastructure provider, HKEx is essentially an IT-based enterprise.' Its explicit mission statement is 'to create and operate active international public financial markets in Hong Kong.' The Mexican stock exchange aims to 'be a leader in financial markets in service, profitability and innovation in each of our segments.' There is no mention of purpose or the positive role that stock markets can play in helping savers, large and small, allocate their capital to investors for the future benefit of all. Most stock markets seem too long on innovation and too short on purpose.

We are standing in a cold, brightly lit room of a developed-market stock exchange, surrounded by anonymous computers. The brand names and specifications have been removed to avoid disclosing sensitive information amongst competing clients. Above us, metal cages hang from the ceiling, along which different coloured bunches of wires are running.

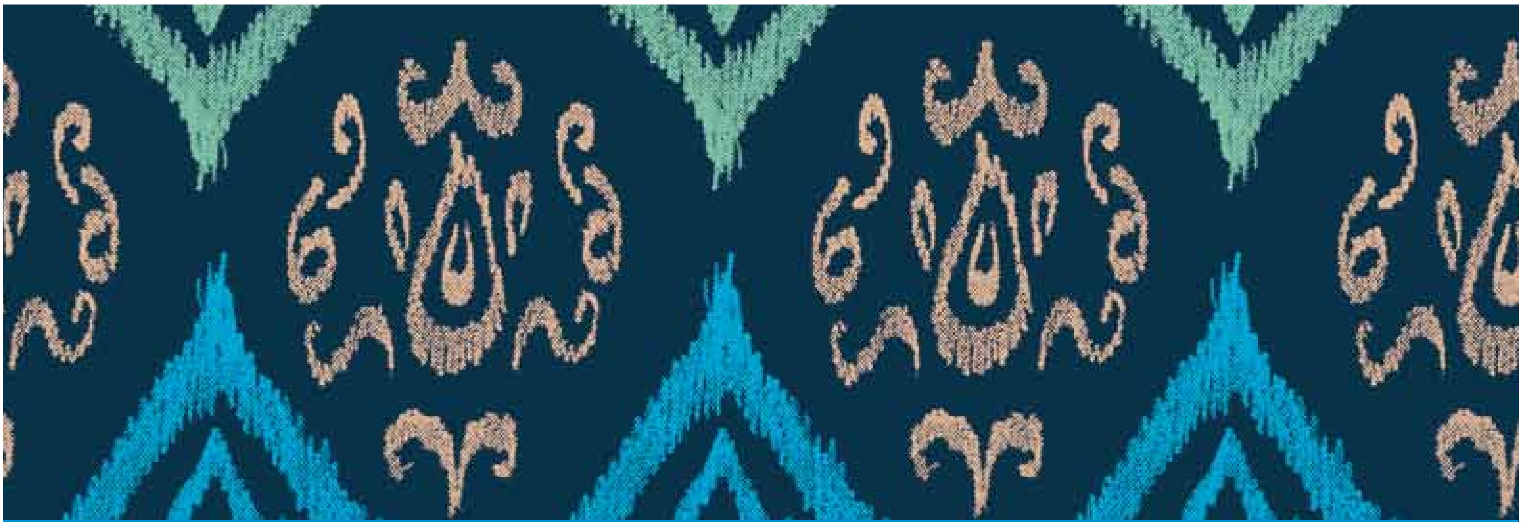
Our guide is explaining to us how this new, state-of-the-art, high frequency trading room works. "Our biggest challenge is latency. We have reduced the time between client orders and the exchange computer to around 300 microseconds, but we still have some way to go." One microsecond is one millionth of a second.

Great care is taken to ensure that computers at the far end of the room have the same length cables as those nearest the stock exchange servers. Although not all clients here are equal. This particular facility offers a tiered service. 'Gold Level' clients pay significantly more for a few extra microseconds in which to execute their trades. We wonder why these extra microseconds are so advantageous? Is it ethical? Our guide laughs at our questions. "Put it this way. So long as it remains legal we will do it. Our clients demand it."

Arguably this "so long as it's legal" mindset has been responsible for many of the less socially desirable financial market developments over the past two decades. Any search to strengthen and nurture fiduciary duty, stewardship or social purpose has been overtaken in the scramble for short-term profits. The listing of stock exchanges and fund managers has not helped.

What can be done? In Chiapas, Mexico, they talk about the importance of *preguntando caminamos*. Asking, we walk. The proliferation of ideas being put forward suggests the finance industry has finally started to ask. But it has yet to start walking. Perhaps Bhutan's greatest contribution to sustainable development is its willingness to both ask and walk. As a country it has been unafraid to experiment and put into practice what most other countries are still only talking about. It is time the investment industry did likewise and took a few, small, bold steps in a different direction.

David Gait
Senior Portfolio Manager



Chapter 4

Looking ahead

Hand-drawn African textile

Looking ahead

Since the launch of the PRI, many industry participants have made significant advances in the incorporation of longer-term ESG issues into their investment processes. However, there is always more to do. With the objective of continuing to improve the approach to responsible investment, CFSGAM has continued to reflect on the progression of sustainable development as a concept, and the role of finance markets.

CFSGAM is increasingly of the view that the financial services industry needs to ensure it broadens its focus to include Responsible Asset Management. The industry needs to find better ways to work with clients to improve the long-term focus of the industry.

A common frustration expressed by those managing leading companies and long-term capital is the short-termism of financial markets. However, the incentive structures in place throughout the investment supply chain continue to be short-term in focus. The finance markets play a major role in the allocation of capital, yet the decision-making frameworks behind them are based on incentives that are predominantly short-term in focus and rarely include environmental and social externalities.

The Occupy movement around the world is highlighting frustrations of the public with the financial sector, which regulators are acting upon; and asset managers will not remain immune. The continued short-termism and hesitancy to change the way capital is allocated jeopardise the finance sectors' own licence to operate.

To change this, the industry needs to have more honest and open debate and agree ways forward. To start this discussion, in late 2011 CFSGAM hosted a roundtable of leading thinkers from within the investment sector, and also those doing innovative work outside the sector. CFSGAM asked participants to come prepared to share their ideas for investors wishing to shift the playing field back to investing for the long-term interests of their ultimate beneficiaries, what role PRI signatories play in reclaiming the investment markets and what role they thought governments should play.

The four key areas that emerged from the discussion as potential areas of focus include:

1. Changing the way performance is measured
2. Focusing back on the individual
3. Changing remuneration structures
4. Engaging beneficiaries

These four points will involve a raft of possible initiatives, with some including: examining the focus on benchmarks, considering responsibility in our sector or a 'Financial Hippocratic Oath', looking to bring salaries back in line with the true value of what is delivered, and catalysing the long-term investor voice. CFSGAM looks forward to working with the industry to progress this discussion.

Appendix

Traditional Scottish tartan

Appendix

Investment policies 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.

Supporting policies, reports and statements include:

- Responsible investment policy statement
- First State Investments stewardship statement
- Climate change position statement
- CFSAMAL guidelines and principles for corporate engagement on governance, environment and social issues
- Direct property sustainability policy
- CMIL and its corporate governance practices – listed funds: CFX and CPA
- CFSMPL and its corporate governance practices – unlisted funds
- Direct infrastructure corporate engagement guidelines summary

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 whether companies have shown 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 a direct owner 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

Appendix
continued

The six Principles for Responsible Investment

Principle 1
We will incorporate ESG issues into investment analysis and decision-making processes.

Possible actions
- Address ESG issues in investment policy statements
- Support development of ESG-related tools, metrics, and analyses
- Assess the capabilities of internal investment managers to incorporate ESG issues
- Assess the capabilities of external investment managers to incorporate ESG issues
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms or rating companies) to integrate ESG factors into evolving research and analysis
- Encourage academic and other research on this theme
- Advocate ESG training for investment professionals

Principle 2
We will be active owners and incorporate ESG issues into our ownership policies and practices.

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

Principle 3
We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Possible actions
- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)
- Ask for ESG issues to be integrated within annual financial reports
- 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)
- Support shareholder initiatives and resolutions promoting ESG disclosure

Principle 4
We will promote acceptance and implementation of the Principles within the investment industry.

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

Principle 5
We will work together to enhance our effectiveness in implementing the Principles.

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

Principle 6
We will each report on our activities and progress towards implementing the Principles.

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

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