

2002 quarter 2 voting reports

The SRSI team produce quarterly reports for the Investment Committee on which the following is based.

Socially Responsible and Sustainable Investment Activities

Quarter 2, 2002

Review of external events

This quarter has seen a significant drop in share and fund values globally. Whilst global political and economic events have been significant factors, so too has been the drop in investor confidence as a result of corporate governance failures and major doubts about the accuracy of corporate financial reporting.

The UK government's consultation on activism has continued to stimulate a debate amongst investment managers about what constitutes good practice. Other inputs into this debate have been a survey of SRI undertaken by Deloitte and Touche that concluded that *"Fund managers appear, on balance, persuaded as to the merits of SRI but will only take it beyond its niche position when there is sufficient client demand"*. The survey also noted that the fund managers thought that *"pension fund trustees had little real interest in SRI from a performance or moral perspective, but were primarily interested in protecting their own reputations and deflecting criticism"*. In addition, a study undertaken by the NGO consortium, **Just Pensions** (see also section 8 of this report), concluded that *"most pension funds have failed to translate these changes into action two years after key changes were made to legislation. ... [and] ... reputations of both the employing company or organisation and of the trustees individually are at risk."*

The quarter has also seen a marked divergence in the number of CSR related shareholder resolutions facing UK and US companies, with only one significant resolution in the UK but with a significant increase in resolutions in the US. In addition, ISS, the mainstream proxy agency, recommended voting in favour of some CSR shareholder resolutions (ie against management) for the first time in its history.

1 Burma (Myanmar)

The Institutional Investors Group on Myanmar (Burma) has undertaken a six month review of its activities. In total, letters were written to sixty-eight companies. Disappointingly, responses were received from only fifteen companies, twelve of which were European companies (a response rate of 44%) and three were North American companies (14%). Only one Asian company responded. This response highlights the impact shareholders have in influencing companies where they have significant shareholdings. A further seven companies responded to the International Coalition of Free Trade Unions (ICFTU), a coalition of trade unions that also wrote to companies highlighting the risks of operating in Burma and three have indicated that they are closing their operations in Burma.

The Group held meetings with a number of companies which have large installed bases in Burma and in which the Group members had significant shareholdings. The purpose of these meetings was threefold: to understand what steps the companies were taking to ensure social and environmental risks were being managed well; to encourage clear public disclosure on activities; and to emphasise the reputational risks and therefore investment risk of operating in Burma. These meetings were constructive and the Group has agreed to continue dialogue with these companies.

The political landscape in Burma has altered significantly with the release of the democratically elected leader, Aung San Suu Kyi, from house arrest. Whilst this is a significant step, the UK and US governments have been quick to point out that her release should not be viewed as a major breakthrough for democracy. What is clear is that her release presents all parties with a window of opportunity that the country desperately needs.

The IIGM will continue to engage with the companies with a large installed base and high risk exposure in the country and where there are also significant shareholdings. Their engagement will focus on encouraging good practice standards of CSR and risk management, and understanding how companies can best contribute to political and economic liberalisation in Burma and thus investment stability.

2 Climate change

USS Ltd has continued to play an active role in the Institutional Investors Group on Climate Change (IIGCC). Whilst the full group met once in the period of this report, the four workstreams (company engagement, property engagement, public policy engagement, and investor engagement) have become more active with, for example, the company engagement workstream arranging meetings with companies from the water and retails sectors, and the property workstream beginning planning for an autumn seminar with other property investors.

USS Ltd is active in three workstreams (company engagement, property engagement and public policy engagement). In addition, USS Ltd was elected to the seven-member IIGCC Steering Committee. This committee has taken over the management activities of the IIGCC, and has made a recommendation for funding of the Group that is currently being considered by member institutions.

USS Ltd participated in the Carbon Disclosure Project, an independent initiative to write to the 500 largest global companies requesting data on carbon emissions and management. These data will then be analysed enabling benchmarking of corporate performance in this area. USS Ltd believes that encouraging companies to disclose investor-relevant environmental information will drive improved management of these issues.

The SRSI team has also fed into United Nations Environmental Programme Financial Initiative project on climate change and its implications for investors. This research, undertaken by Innovest, will be reported at the United Nations Earth Summit in Johannesburg.

The SRSI team also participated in research being undertaken by the Association for the Conservation of Energy into the implications of climate change and global warming for properties and construction.

3 Investment related advice

3.1 FocusWickes Initial Public Offering

A member of the SRSI team took part in a meeting between LIO and the company's brokers to discuss the IPO of FocusWickes, the UK DIY retail chain. The IPO did not go ahead.

4 Learning review

Following completion of the learning review, the SRSI team evaluated the report and made recommendations for how to take SRSI forward over the next 18 months. The recommendations covered the fund's SRSI vision, project priorities and risk management systems. These recommendations were accepted by the Investment Committee in May 2002 and focused on; improvements to the engagement process; building the capacity of the SRSI team; improved communications; integration of SRSI into the investment process; establishing objectives to enable the evaluation of progress in addressing these issues; and improvement to risk management processes.

The results of the review, and what USS Ltd had decided to do in response, were reported to the London Investment Office, the fund's external managers, and the management committee. The results were also reported to external stakeholders at a meeting chaired by Helen Wildsmith, Director, UKSIF. Those attending the meeting included:

ASH	Campaign Against the Arms Trade	Centre for Corporate Accountability
Cornerhouse	Corporation of London	ECCR
Ethics for USS	Friends of the Earth	Just Pensions
Greenpeace	Health and Safety Executive (HSE)	SCF (International)
Oxfam	Saferworld	WWF
TUC	UKSIF	

These meetings, which took place during May-June, were to both inform stakeholders of the results of the learning review, and to obtain input into future strategic priority goals for the SRSI team.

5 Oil & gas sector

In line with the priorities set in the SRSI strategy, the team has continued to focus on this sector and on those issues that could have greatest significant shareholder or governance implications. These are:

5.1 Climate change

The SRSI team completed the development of the risk assessment framework for evaluating the exposure of the oil and gas sector to reputational risks associated with responding to climate change. This framework was circulated to a number of companies and others for comment, edited to reflect concerns or issues, and then applied to ExxonMobil. This company was chosen as the first to be assessed against the framework as the results of the assessment could feed into the decision making process for some of the shareholder resolutions that the company faced at its 2002 AGM

In May the completed assessment was sent to the company in draft form and after comments, the report, *The Reputation Risk to the Oil and Gas Sector from the Climate Change Debate - An Investor's Perspective: the ExxonMobil Corporation* was sent to the company and named institutional investors.

5.2 BP

As indicated in the last report to the IC, BP faced a shareholder resolution for its April AGM that requested the disclosure of risk assessment information associated with access to protected areas. Following engagement with the company and other interested parties, USS voted with the company. For information, a total of just over 11% of shareholders voted for the resolution, and these were thought to be predominately US investors concerned about the company's potential activities in Alaska.

5.3 ExxonMobil

This company faced eight shareholder resolutions at its May 2002 annual general meeting questioning its corporate social responsibility, with the primary focus on its approach to climate change and human rights.

Following the publication of the company's proxy papers, USS Ltd hosted a meeting between the company and other institutional investors to evaluate the resolutions the company was facing and its responses to them. ExxonMobil were represented by three vice presidents and two senior staff members. In addition to USS Ltd, there were thirteen other institutional investors present. This meeting enabled a frank and open discussion between the investors and the company on the CSR challenges it faces on a wide range of issues, indicated by the broad range of CSR based shareholder resolutions it was facing. All participants were positive about the meeting, whilst accepting that there were differences on a number of the issues discussed. The company expressed a desire to continue to engage with UK investors.

The majority of those who met with the company also attended another meeting hosted by USS Ltd with CampaignExxonMobil, the lead NGO on a number of the resolution facing the company. This meeting was also attended by Mark Mansley of Claros Consulting, who presented his report on the financial and investment implications of ExxonMobil's position on climate change. Members of the SRSI team also met with representatives of the Tri-State Coalition for Responsible Investment and US PIRG, both organisations having submitted shareholder resolutions against the company.

Following these engagements, and further discussions with the company, USS Ltd decided to vote against the company on five out of eight shareholder

resolutions namely Resolutions No. 5 (on Human Rights), No. 6 (on Executive Compensation and CSR performance), No. 8 (on Renewables), No. 9 (on Equal Employment Opportunities) and No. 10 (on Poison Pills) and with the company on the remaining three.

5.4 TotalFinaElf

The SRSI team has written to the company seeking responses to questions raised during our engagement with the company earlier in the year.

5.5 Analyst meetings

In conjunction with Americas' Portfolio Manager, a member of the SRSI team met with an oil analyst to discuss how climate change and other CSR risks were being taken into account in company evaluations.

6 Pharmaceutical sector

In view of a forthcoming NGO project on the same topic as the proposed Friends, Ivory & Sime and USS Ltd benchmarking study, the focus for this project is being evaluated.

7 Property portfolio

The project assessing the SRSI position of the USS property portfolio continues, with a member of the team meeting with LaSalle Investment Management / JonesLangLaSalle in July to discuss the implementation of the recommendations made in the Health and Safety assessment completed earlier in the year.

The environment component of this assessment is now well underway. Environmental Governance, the consultants commissioned to undertake the assessment, have interviewed USS Ltd and LaSalle Investment Management / JonesLangLaSalle. The final part of the data gathering phase, scheduled for July, is to undertake a detailed evaluation of the environmental performance of a sample of USS properties. The SRSI team expects to be able to report back on this project at IC meeting in October 2002.

Sustainable property indicators

The SRSI Team is part of a DTI-funded Partners in Innovation project for the development of sustainability indicators for investment properties. This project, a partnership between investors, property companies, valuation companies, and the IPD, led by Kingston University, will deliver over the next two years a set of indicators to enable properties to be benchmarked on their sustainability performance. The aim is that these data will then be linked to financial aspects of a property's performance in the IPD index, enabling comparisons between individual properties to occur.

8 Public presentations and media coverage

USS Ltd has made the following presentations on SRSI:

Sir Graeme Davies, Chairman of USS Ltd, gave a presentation at the European Real Estate Society (ERES) 9th annual conference on USS Ltd's approach to SRSI in general, with particular focus on our property portfolio (June 5th, 2002).

A meeting for corporate pension fund managers and CSR specialists hosted by International Business Leaders Forum (June 18th, 2002).

Peter Moon, CIO, gave a presentation to Foreign & Colonial Management, on lessons learnt about engagement (June 27th, 2002).

A meeting for senior CSR specialists from the extractive industry hosted by KPMG (11th April, 2002).

The European SRI Conference hosted by IMN for Scandinavian pension funds and fund managers on "The fiduciary dimension of SRI" (May 30, 2002).

Press and other comments on USS Ltd's work in this period include the following:

CERES, a respected US NGO, has produced a report on the implications of climate change on US institutional investors, Value at Risk: Climate Change and the Future of Governance. The report comments that: "In the United Kingdom, the Universities Superannuation Scheme (the third largest pension fund in the U.K. with \$30 billion in assets), has already staked out a singularly pro-active leadership position. It commissioned an excellent discussion paper on the implications of climate change for institutional fiduciaries, and is using its considerable "convening powers" to pull together a number of leading U.K. institutions to debate and discuss it on an ongoing basis. This gives climate change a level of visibility and credibility among U.K. institutions which it would not likely have achieved otherwise, and USS is also pressing its own portfolio companies directly to become more engaged and active on the issue."

USS Ltd receives significant coverage as an example of good practice in SRI in the recently published Just Pension report "Do UK pension funds invest responsibly? A survey of current practice on Socially Responsible Investment. Amongst other things, the report comments favourably on USS Ltd's Statement of Investment Principles (SIPs), the role of the internal auditor in the assessment of SRI performance of the internal and external investment managers, and the in-house nature of the SRSI team.

9 Miscellaneous

9.1 Health and Safety indicators

A meeting was held with the Health and Safety Executive to explore mechanisms for encouraging shareholder engagement on company H&S performance. In addition, the need for good practice examples for encouraging transmission of a good health and safety culture through the property investment and development chains was also discussed.

9.2 The London Principles

USS Ltd was invited by the Forum for the Future and the Corporation of London to support the London Principles for Sustainable Finance. This project aims to showcase UK sustainable finance initiatives at the Earth Summit in Johannesburg, and will be formally launched by the Prime Minister in late July. USS Ltd is currently considering its response to this request. [Note: following the submission of this report to the Investment Committee, USS Ltd decided to support this project].

9.3 USS Internet site

The SRSI team have worked closely with the Liverpool office to develop the SRSI section of the USS Internet site. This site now includes details of USS Ltd's voting activities, mainly for the UK but also for some international holdings, an

edited version of the SRSI report which is sent to the Investment Committee, and more details of USS Ltd policies and activities on particular projects.

10 Engagement activities and votes against management April to June 2002

10.1 General Issues

US corporate governance practices

In light of concerns about US corporate practices, including but going well beyond financial reporting, the SRSI team have worked closely with the LIO US fund managers to review risk management options. Whilst government and industry bodies are focusing on auditing and related issues, USS Ltd has decided to focus its attention on the issue of lack of independence of boards and where this is most concerning, namely where there is a joint CEO/Chairman.

A letter was sent to those corporations in which USS holds shares where the role is combined, asking the board to consider a split (see "Thematic Engagement Projects" on this website).

10.2 Company specific

The past three months have seen a high volume of voting as the major proxy season commenced. Because of this volume, USS Ltd has had to focus on voting in line with the fund's policies rather than on any detailed company engagement projects.

French Connection

EGM 4 April

Voted against share option schemes as performance criteria were not sufficiently challenging. In addition, the fund voted against directors having control of the Employee Share Ownership Trust without referral to shareholders.

Communis plc

AGM 11 April

Voted in favour of reappointment of a director with a parachute clause. Whilst this was not explained fully in the company's report and accounts, it only relates to a 12-month period. In addition, USS Ltd has suggested that the company change the composition of its Remuneration Committee.

British American Tobacco

AGM 16 April

Voted in favour of re-appointment of auditors following a satisfactory explanation from the company on the payment of non-audit fees.

10.3 Detailed report of votes

In line with previous practice, an overall summary and detailed listing of votes is attached which highlights votes by month.

Corporate Events 2002

No of events voted	UK Month	Overseas Month	Total Month	Total Year to date	No @ variance with policy *
Jan	48	0	48	48	0
Feb	46	0	46	94	0
Mar	36	1	37	131	0
Apr	140	0	140	271	0
May	224	3	227	498	0
Jun	65	1	66	564	0
July					
Aug					
Sep					
Oct					
Nov					
Dec					

* Variances to policy are reported separately in the summary to the Investment Committee