

SOCIALLY RESPONSIBLE AND SUSTAINABLE INVESTMENT REPORT
REPORT FOR PERIOD JANUARY – MARCH 2003

1 Decisions required and recommendations for approval

- 1.1 Prioritisation for 2003: Building on the SRSI Strategy and the LIO Learning Review, the SRSI team has prioritised activities for 2003. The projects selected include some from 2002 (e.g. Pharmaceutical and Oil & Gas sectors and climate change). New areas include the finance sector (particularly insurance), the Competition & 21st Century Investment Project, reviewing the effectiveness of voting; and creating more effective pension fund alliances on corporate governance issues. It is recommended that USS Ltd should: endorse this prioritisation of SRSI activities (Appendix A).
- 1.2 TUC survey of fund manager activism: The TUC has written to the UK's 50 largest fund managers to ask them to report on how they voted on the most controversial AGM issues of 2002. This mirrors the approach adopted in the US. It could promote some false assumptions (namely that voting equals engagement and that controversial votes are the most important ones). Nevertheless, it would be in USS members' interest for there to be greater activism by more institutional investors and more transparency is likely to encourage this. Although the majority of fund managers may refuse, on grounds that it is up to clients to disclose, some fund managers have responded positively. It is recommended that USS Ltd should: respond to this survey but also work with like-minded schemes to find an approach to disclosure which is more durable and which gives a more rounded picture of active ownership. This might be a system of disclosure by fund managers (so addressing concerns about their clients' views) to a trade association or commercial service provider (e.g. an auditor) who then publishes the information in an anonymised format. Interested trustees and investment consultants could then ask their own fund manager to reveal their (relative) performance.
- 1.3 Responsible shareholding: The new Statement of Investment Principles refers to "responsible shareholding" (or "responsible investing"). This term now covers USS's corporate governance activism and SRI engagement activities. It is recommended that: USS Ltd should develop and implement a communication strategy for informing its members and other stakeholders about this change.

2 Key External Developments (Appendix B)

- 2.1 This briefing covers latest developments with the debate on the Higgs report on UK corporate governance (where there has been vocal opposition to its recommendations), the publication of the UK government's energy white paper (which appears to have little investor relevance), and the debate on excessive executive remuneration (which again has made the headlines).

3 New Projects

New projects are covered in item 1.1

4 Activity Report

- 4.1 US corporate governance: Having undertaken a consultation in both countries which was largely positive, the team is now organising a ‘corporate governance summit’ in the States in September aimed at US and non-US corporate governance activists who would like to see better coordinated action. The objectives of this meeting will be to: 1) develop a framework of best practice for non-US investors to use in their dealings with US companies as there does not currently exist an American equivalent of the UK’s Combined Code; and 2) forge closer alliances between the two investment communities (Appendix C).
- 4.2 Learning review of external fund managers: Building on the LIO learning review, USS has developed its understanding of best practice and now assessed how its external manager are performing against these standards. The methodology is well-defined and consistent and shows that 4 of USS’s 7 fund managers have the basic foundations in place. The managers have been asked to outline their plans for further development both in response to this learning review and to the Institutional Shareholder’s Committee’s Principles on engagement (as previously agreed by the IC). USS will assess each manager’s position again at the end of the scheme year, focusing on those managers and those issues where there is greatest opportunity for movement towards best practice. When managers are being considered for (re) appointment, their performance can be assessed (and compared) against the requirements of the SIP. Thus, any requirements for change can be made clear during the contracting stage (Appendix D).
- 4.3 Climate change: USS Ltd has stepped up its leadership and management role in the IIGCC. The main focus of activities in this period has been to increase the Group’s membership (with a particular focus on other pension funds, i.e. the clients of interested fund managers) and to boost the activity of the workstreams (Appendix E).
- 4.4 Oil & gas sector: In collaboration with other fund managers, USS Ltd met with: ExxonMobil (to discuss the shareholder resolutions that the company will face in the 2003 annual general meeting in May); BP (regarding the Health & Safety and maintenance of the company’s Alaskan operations and its proposed development of a pipeline between Azerbaijan and Turkey); and Statoil (on the company’s management of CSR issues). The SRSI team is also partnering with a Norwegian consultancy, ECON, to develop a tool to enable the systematic assessment and benchmarking of the CSR performance of oil & gas companies (Appendix F).
- 4.5 Pharmaceutical companies and the public health crisis in emerging markets: The framework, designed to evaluate how pharmaceutical companies are responding to the risks related to the public health crises in emerging markets, was launched in March. USS and ISIS, the co-founders of this project, have now been joined by several other mainstream investors including L&G, Morley and PGGM. The

project has received considerable media attention and will now lead into company-specific engagement work (Appendix G).

- 4.6 Property portfolio: The internal property and SRSI teams have reviewed the reports produced by Upstream and decided on some appropriate issues for initial attention. Management responsibilities have been allocated and work with USS's agents is about to begin (Appendix H).
- 4.7 The Competition: USS Ltd, in collaboration with Hewitt Bacon Woodrow and with the support of PGGM and Ontario Teachers Pension Plan, have now launched the competition to encourage new thinking about how mandates should be formulated to best encourage long-term outperformance and a mainstream approach to corporate responsibility. The competition has been actively supported by the Financial Times and has received extensive coverage the trade press as well. Over 170 enquiries have been made and 3 entries submitted already, the closing date being 31st May (Appendix I).
- 4.8 Ethics for USS's campaign on dams: Ethics for USS have initiated a campaign to generate member pressure on USS to adopt a policy on the construction of dams and engage with the relevant companies. USS has explained why this issue has not been prioritised (appendix J).
- 4.9 Other activities: (Appendix K).
- 4.10 Public presentations and media coverage: (Appendix L).

5. Corporate Events 2002

No of events voted	UK Month	Overseas Month	Total Month	Total Year date to	No @ variance with policy *
Jan	53			53	
Feb	47			100	
Mar	43	1		144	
Apr					
May					
Jun					
July					
Aug					
Sep					
Oct					
Nov					
Dec					

* Any variances to policy are reported separately (request appendix M)