

Responsible Investment Activity Report (July – December 2008)

The Fund's responsible investment (RI) activities over the 6 months have continued to be driven by the recommendations of the 2006 RI Strategy Review and 5-year strategic plan. The main focal areas include more in-depth engagement with companies and the integration of extra-financial issues into the investment decision-making processes within the Fund.

USS continues to take its role as a long term and responsible investor very seriously. Working with internal fund managers and collaborating with pension funds and other investors from around the world, the Fund has continued to address environmental, social and governance (ESG) issues associated with its investments.

1. Integration

1.1 Non equity Assets

The Fund believes that integration of RI should not be limited to public equities and increasing attention has been paid to alternative assets (and in particular private equity), fixed income and the Fund's property portfolio.

1.1.1 Fixed Income

The Fund has developed a process to provide a score and ranking for use in the sovereign debt selection for emerging markets. The country scores are based on four indices which reflect a broad range of environmental, social and governance indicators, including (but not restricted to):

- Adult literacy and education enrolment
- Air pollution
- Biodiversity and habitat protection
- Carbon intensity
- Corruption
- Female representation
- Investment & regulatory restrictions
- Life expectancy
- Population below poverty line
- Price controls
- Private property rights
- Water accessibility and quality

The data provides the Fixed Income desk with comparisons between countries, for use in cases where the financial returns and other factors are deemed equal.

1.1.2 Private equity

In private equity, a process has been formulated to ensure that RI issues are incorporated within the due diligence process prior to investment in a private equity manager. The Fund asks questions to better understand how private equity firms assess ESG risks as part of their own due diligence before they buy an asset, how they manage the asset in relation to these issues, and how they disclose and manage communications regarding their ESG performance.

USS works with other pension funds and investor groups to share and develop best practice in the area. For example a member of the RI team presented to Australian pension funds, the Responsible Investment Association Australasia and the Australian venture capital association, AVCAL, regarding USS' work in this area in July.

In November, the Fund was profiled in [Sustainable Alternatives](#), a report published by the UK Social Investment Forum under their Sustainable Pensions Project which looks at responsible investment within alternative asset classes – see Box 1.

The Fund is a founder member of the Principles for Responsible Investment steering committee on private equity (see below).

*Box 1
Excerpt from Sustainable Alternatives, UKSIF Sustainable Pensions, November 2008*

David Russell, Universities Superannuation Scheme (USS)
USS is a recent investor in alternatives, with our allocations in this asset class only really beginning in 2007. In order to assess best RI practice in this area, the Fund sponsored Mercer to undertake research into the integration of responsible investment principles by pension funds into alternative assets. The results were disappointing. Whilst a small number of funds were taking action, and there are a large number of niche products available, there was a real lack of evidence that integration of these factors into alternative assets was occurring.

USS has since focused its RI activities in alternatives on Private Equity (PE). Whilst the fund invests some \$500+ million in low carbon related assets, and also has significant investments in timber, our main focus has been how we integrate RI into all alternative investments rather than relying on niche allocations. The challenge has been to work out the most effective way in which to do this.

As a result, USS has developed a specific PE RI due diligence process, with the RI and Alternatives teams questioning potential managers (General Partners in the parlance of private equity) prior to investments taking place. It is also clear from the work that we have been doing that many PE managers take these issues into account in their own due diligence and portfolio management processes, but their disclosure is not as institutionalised or developed as that of the quoted sector.

USS is also working with other asset owners and with General Partners to discuss how the UN Principles for Responsible Investment can be applied to PE investments. This is a sensitive process at a time when the PE sector is facing significant challenges, both in terms of operating environment and pressure from stakeholders. We believe, however, that this engagement with PE managers will ultimately lead to better long term and responsible investments in the sector.

1.1.3 Property

The Funds' property team has continued to accumulate data on the environmental performance at the majority of the Funds' properties. Targets have now been set for the reduction in energy use, water consumption, and waste production. These are important developments as very few pension funds are addressing RI in non-equity assets.

During the past six months, the RI team has worked closely with the property team during the re-tendering of the Fund's property management contracts to ensure that environmental and social issues are managed effectively at USS' portfolio properties.

Externally, the Fund is participating in the Royal Institute of Chartered Surveyors Sustainability Valuation Information Papers committee, which is developing for the first time, guidance on how property valuers should calculate the impact of extra-financial issues on assets values.

2. Engagement & Voting

Over the past six months in depth research and meetings have been undertaken on targeted companies in the food retail, general retail, banking, oil and gas, pharmaceutical, aerospace & defence, mining, transport, food producers, industrials and consumer services sectors. The companies include Tesco, HSBC, Smiths Group, Millennium & Cophorne, Agrium, Panmure Gordon, UBS, Arcelor Mittal, Marks & Spencer, Total, Exxon, UTI Worldwide, BP, Chang Hwa, Aviva, GSK, BAE Systems.

The extra-financial issues covered within the meeting included (but were not restricted to):

- Protection of minority shareholder rights
- Board succession planning
- Remuneration
- Adoption of majority voting in the US
- Adoption of a say on pay resolution in the US
- Structure of boards, in particular the combined role of a chair and CEO
- Oil sands production
- Mining in India and other countries with extractive mining techniques
- Strategic and operational issues
- Operations in emerging markets
- Adaptation to climate change and carbon trading
- Health and safety records
- Engagement with the Banking industries regarding recapitalisations
- Corporate responses to campaigns or legal proceedings.
- Shareholder access to and quality of independent non-executive directors

2.1 Vedanta Resources

In conjunction with other large pension funds, USS met with senior management of global mining company, Vedanta Resources, to discuss the company's operations in Orissa, India, where the company has been accused of failing to consult with indigenous communities.

2.2 Arcelor Mittal

The Fund also met with global steel company Arcelor Mittal focusing on their management of Health and Safety issues in developing markets and the integration of procedures across their global operations.

2.3 Chang Hwa

Our engagement with the Taiwanese bank, Chang Hwa continued, with USS sending a representative to attend and vote at the Annual General Meeting. This is the first time USS has been personally represented at a Taiwanese shareholder general meeting. Our attendance ensured USS was able to vote on the full proposed meeting agenda which would not be possible remotely. To address such shortcomings, the Fund will continue with work at a market-wide level to protect and enhance minority and overseas shareholder representation within Taiwan.

3. Market Wide Activities

The Fund has also continued its significant involvement in a number of key projects which aim to maximise the potential impact of RI activities in creating long-term value for the Fund.

3.1 Pharmaceuticals

A third phase of the [Pharma Futures](#) project was co-convened by USS which explored the challenges and opportunities of emerging markets. Two workshops were held during the year in London and Mumbai which involved pharmaceuticals executives and institutional investors. The report is due in early 2009.

3.2 Regional Corporate Governance

3.2.1 United States

USS has continued its extensive involvement in US corporate governance (in addition to US company-specific engagements) on issues such as majority vote standards, enhanced disclosure on director candidates and a vote on executive remuneration.

The Fund has sought to highlight the key legislative changes required from new Obama-led administration focussing on overseas investors' expectations and a shareholder vote on remuneration (say on pay). A member of the RI team presented on say on pay in December to a [Shareholder Forum meeting](#) in New York which was reported by the [Harvard Law School Forum on Corporate Governance](#) and an article on USS' perspective on the issue was published in [Governance magazine](#) in November.

The Fund has also worked on the development of a [Director Candidate Information Request questionnaire](#) to provide supplementary proxy disclosures on the qualities and competencies of director candidates prior to voting. Linked to this, USS co-sponsored an International Roundtable on Executive Remuneration and Director Engagement in Chicago in October to provide feedback on the questionnaire, director-shareholder communications and say on pay. The forum was attended by investors, corporate directors and academics.

3.2.2 Germany

USS, in conjunction with other investors, flagged serious concerns regarding minority shareholder protection with the German Finance Minister and BaFin, the German regulator, further to shortcoming in the disclosure rules relating to the holding of financial instruments. Following the introduction of new requirements earlier this year, companies are not obliged to disclose positions where derivatives are settled into cash rather than shares. This enabled Porsche in October to significantly increase its stake in Volkswagen to over 74 percent without disclosure to the market.

3.2.3 Japan

The Fund contributed to the Asian Corporate Governance Association's policy document highlighting corporate governance issues in Japan. The [ACGA White Paper on Japan](#) makes six recommendations for improvements to corporate governance in Japan. The paper was published in May and formed the basis for engagement with regulatory and investor bodies and Japanese listed companies throughout the year. Subsequent to the launch of the white paper, the Tokyo Stock Exchange (TSE) released a questionnaire asking investors opinions on improvements to the governance of listed companies in Japan. The responses to the questionnaire are to be used by the TSE to review their policy on corporate

governance of listed companies. [USS responded to the TSE questionnaire](#) in July, drawing upon recommendations made in the ACGA White Paper.

A member of the RI team visiting Japan met with the Ministry of Environment, Japanese pension funds, fund managers and other investment service providers to help raise the profile of RI and improve understanding around fiduciary responsibility and engagement.

3.2.4 Other countries

In conjunction with the relevant portfolio managers, the Fund has also sent letters to regulatory bodies in Brazil, Singapore, Taiwan, Australia, UK and the European Commission regarding corporate governance standards, minority shareholder rights, listing rules, access to company meetings and corporate disclosure.

3.3 Principles for Responsible Investment

USS continues to play an active role in the [Principles for Responsible Investment \(PRI\)](#) sitting on the PRI board and various work-streams.

USS is an active participant in the [PRI Private Equity Steering Committee](#). The committee has sought to bring together investors (LP's) and private equity houses (GP's) to raise awareness on environmental, social and governance issues in private equity. The committee has engaged with the Private Equity Council in the USA, the representative body of a number of the largest private equity funds in the world.

USS participates in the PRI's [Sudan Engagement Group](#) (SEG) which is looking at companies with operations in, or exposure to, Sudan. The SEG is engaging with selected companies operating in Sudan to encourage them to disclose more information on their activities in the country, act responsibly and respect the UN Global Compact Principles.

In October 2008 the [Enhanced Analytics Initiative joined forces with PRI](#) to launch the [PRI Enhanced Research Portal](#). Since the EAI's launch in 2004, institutional investors have witnessed a substantial increase in the provision of extra-financial research. The new portal broadens the work of the EAI, taking it to a global audience via the PRI signatory base. USS played a lead role in ensuring a smooth transition of the EAI to a project of the PRI and the Fund will continue to provide its pro-bono support for the EAI accounts.

3.4 Climate Change

USS undertook an evaluation to assess the Fund's carbon exposure. The aim was to understand how the Fund compared to its benchmark with respect to the amount of carbon embedded in its equity portfolio. At the time of the assessment, USS was underweight (i.e. less carbon intensive) compared to the benchmark.

The Fund continues its participation in the Institutional Investor Group on Climate Change (IIGCC) and [P8](#), a convention of large global pensions funds convened under the auspices of the Prince of Wales, to discuss the role that large asset owners can play in addressing climate change.

USS participated in an IIGCC collaboration with the US-based Investor Network on Climate Risk, INCR, and the Australia/New Zealand IGCC in 2008. Timed to coincide with COP14 in Poznan, the group issued a [Statement](#) calling upon world leaders to negotiate a strong and binding successor to the

Kyoto Protocol to ensure that investors receive the market signals critical to funding the transition to a low-carbon economy. The Statement was signed by some 150 investors with over \$9 trillion in assets.

USS participates in the IIGCC property working group which has produced [“A Changing Climate for Property Investments: A Trustee’s Guide”](#). The report is aimed at helping trustees to understand the importance that the physical impacts of climate change and policy responses hold for property investments, and how property investments themselves contribute to climate change. It sets out the questions that trustees might ask of their property fund managers and their consultant actuarial advisors in relation to climate change.

The Fund also contributed to the IIGCC’s [2008 Investor Statement on Climate Change - Progress Report](#) and continue to have a place on the IIGCC board and workstreams.

3.5 Other activities

3.5.1 Global Reporting Initiative (GRI)

The RI team is participating in a project with the GRI to develop guidelines on ESG for inclusion in a company’s annual report. The project will examine how companies can frame ESG disclosures to ensure consistent, material, and reliable information on sustainability performance is available to the financial markets, drawing upon consultations with companies and investors, including USS.

3.5.2 Class Actions

As reported in the Jan – Jun 2007 RI Activity Report, USS are party to the collaborative settlement proposal between European shareholders and Royal Dutch Shell. In November 2008 a representative from USS attended the hearing at the Court of Justice in to demonstrate support from investors. A member of the RI team presented to investors on USS’s experiences in shareholder litigation in September.

3.5.3 Conferences

Fund personnel have spoken on RI at conferences in markets all around the world including China, Taiwan, Canada, the USA, Australia and continental Europe. The Fund seeks to share best practice, facilitate collaboration with other pension funds and raise awareness on the integration of RI and long-term investing.

4. Awards, Accolades and Appointments

4.1 Awards

The 2008 [USS/ Gresham College Farsight Award](#) was presented in September, to Credit Suisse utilities analyst Dan Eggers for his research reports *The inconvenient math* (November 2007) and *More inconvenient math* (June 2008). Research analysts Samantha Dennison, Justin Speer and Kevin Cole, led by Dan Eggers, authored the reports. The award’s objective is to honour the best individual piece of analysis by an investment research institution that integrates traditional financial analysis with longer-term issues such as climate change, scarcity, human capital and corporate governance. Criteria for the award are originality, quality, readability and clarity, sophistication and depth and financial usefulness.

USS was awarded *Pension Fund of the Year – Best Use of SRI* in 2008 by Professional Pensions.

4.2 Advisory Panels

In addition to those highlighted above, the RI team sits on a number of panels and committees.

Appointments in the past six months include:

- the Environmental Technology Committee for the [FTSE Environmental Technology Index Series](#) which measures the performance of companies globally whose core business is in environmental technologies, including renewable & alternative energy, energy efficiency, water technology and waste & pollution control.
- the newly established Non Executive Environmental Advisory Panel for Travis Perkins plc.
- the judging panel for IR Magazine's UK award for Best Narrative Reporting for UK corporates.

5. Articles & Interviews

Please click on hyperlinks to be taken through to the articles at the host publications' website.

5.1 About USS and RI

- Financial Times; [M&S faces rebellion on Rose's elevation](#), 7 July 2008
- Impressions; What can pension funds do to address climate change?, August 2008
- Scotsman; So, what misery does your pension pay for?, 16 August 2008
- Global Pensions; [Seeking to define SRI](#), 29 August 2008
- Compliance Week, Investor Questionnaire Enriches Director Elections, 9 September 2008
- Investments & Pensions Europe; [WWF report criticises Norway's oil fund on SRI](#), 30 September 2008
- Barroway Topaz Bulletin; Enhanced Analytics Initiative joins forces with UNPRI, October 2008
- Financial Times; [Pension funds can make a difference](#), 5 October 2008
- Ethical Corporation; [Institutional investors rally in UN Global Compact call](#), 28 October 2008
- UKSIF; [Sustainable Investment Opportunities for Pension Funds in Alternative Asset Classes](#), November 2008
- International Corporate Governance; Shareholder Say on Pay, November 2008
- Pensions World; Climate Change Roundtable: Time for Action, November 2008
- Harvard Law School Corporate Governance Blog, [Reconsidering "Say on Pay" Proposals](#), 6 November 2008
- Financial Times; [UK minister claims non-execs contributed to the financial crisis](#), 14 November 2008
- Financial Times; [Judgment Call: Should former executives hand back bonuses in troubled times?](#), 19 November 2008
- Global Pensions; [A growing problem](#), 26 November 2008
- European Pensions; Making your voice heard, 28 November 2008
- Responsible Investment: Profiting from Sustainable Strategies, December 2008
- Financial News; [Where were the investors?](#), 1 December 2008
- FT Mandate; Sustainable Alternatives, 1 December 2008
- Reuters; [Hard times may make nicer firms good bets](#), 9 December 2008
- Financial Times; [GSK axes political funds](#), 22 December 2008

5.2 About collaborative engagement initiatives including EAI, IIGCC, Marathon Club, PRI

- Professional Pensions; [EAI study shows scheme pressure improving EFI research coverage](#), 3 July 2008
- Financial Standard; [UN PRI enlists 400 firms](#), 28 July 2008
- The Observer; [Pension funds join to fight climate change](#), 3 August 2008
- Global Pensions; [PRI launches global network](#), 18 September 2008
- BobsGuide; [Credit Suisse's Dan Eggers recognised by Farsight Award 2008 for best long-term investment research report](#), 23 September 2008
- Financial Times; [Responsibility gains weight](#), 5 October 2008
- Global Pensions; [Responsible investment bodies team up](#), 6 October 2008
- Professional Pensions; [Responsible investment bodies join forces](#), 22 October 2008
- Professional Pensions; [PRI members urge companies to adhere to UN responsibility principles](#), 29 October 2008
- Global Pensions; [Investors call for climate change action](#), 11 November 2008