

Responsible Investment Activity Report (January - June 2009)

The fund's focus for 2009 remains on ensuring that USS takes account of material corporate governance, environmental and social factors in investment decisions where relevant, across all markets and asset classes.

The financial crisis has reinforced the importance of ensuring that responsible investment (RI) does not operate as a silo function but is embedded within the organisation's investment culture and processes. The Fund will continue to strive towards the integration of RI, share best practice and to convey the importance of this message to government and regulators.

1. Investment Integration and Engagement

The RI team works closely with USS internal portfolio managers to provide integrated extra financial research and advice on environmental, social and governance issues. The Fund seeks to integrate RI across different asset classes. Key activities over the six months, January to June 2009, include:

1.1 Private Equity

USS has worked with other pension funds and investor groups to share and develop best practice in the integration of environmental, social and governance (ESG) factors into private equity. In May 2009, the British Venture Capital Association announced the creation of their [Responsible Investment Advisory Board](#) to provide strategic guidance on ESG matters. The Board includes representation from USS and includes investors, intermediaries and sustainability /responsible investment practitioners.

The Fund also actively participates in the [workstream on private equity](#) convened under the UN Principles for Responsible Investment and contributed to a recent publication for private equity investors by the [Institutional Investor Group on Climate Change](#) – see below.

1.2 Equities

In the past six months, the Fund has undertaken engagement with both management and non-executive directors across many key markets addressing a wide variety of issues including:

- Operations in emerging markets
- Strategic and operational issues
- Appointments to the board
- Extractives projects in India
- Succession planning
- Remuneration
- Operating in Sudan
- Oil sands
- Political contributions
- Minority shareholder protection
- Legal investigations
- Health and safety concerns

The emphasis is on quality in-depth engagements rather than quantity. Where useful and possible, USS works in collaboration with other investors – inviting participation from institutional investors across the globe. Noteworthy engagements include:

1.2.1 Cintra

The Fund led a joint engagement to protect our interests as a minority investor in the Spanish company Cintra following the proposed offer for a merger with its largest shareholder Ferrovial. With other investors, the Fund coordinated a [joint shareholder agreement](#) and publicly outlined its' concerns in a submission to the Spanish regulators. Subsequently, the offer to shareholders was increased. However, the fund has continued to engage with the regulator to encourage the strengthening of minority shareholder protection in Spain.

1.2.2 Porsche

USS was represented at the Porsche AGM in January, following concern about the lack of transparency around trades in Volkswagen (VW) shares and other derivatives which increased Porsche's stake in VW to more than 70% in October 2008. The resultant squeeze on short positions triggered severe share price fluctuations and concern was raised around the integrity of the transaction and the robustness of German securities regulation.

The Fund issued a statement to the press in advance of the AGM stating "As a long-term and responsible investor in Porsche and the German market, USS is concerned about recent revelations at Porsche and is critical of the market system which allowed for this undisclosed trading to take place in VW's shares. USS, along with other overseas shareholders, is appealing to the supervisory board of Porsche and the German market regulatory body to address this issue as a matter of urgency. This is not only essential for effective risk management control at the company level but to restore the reputation of Germany as a key financial centre". Following the statement, USS also engaged with the German regulator regarding this issue.

The Fund also raised concern regarding remuneration practices at Porsche.

1.2.3 Royal Dutch Shell

In conjunction with another large European pension fund, USS has met with Shell to discuss its oil sands operations in Alberta, Canada. The fund seeks to gain a better understanding of the complexities of the environmental, political and social issues associated with tar-sands extraction.

The Fund has also met with Shell in relation to its remuneration during the year and has encouraged the company to continue to ensure that sustainable development concerns are integrated into the remuneration of executives at the company.

2. Market Wide Activities

2.1 Walker Review

In February, the UK Government announced a review into measures to improve the corporate governance of UK banks, particularly with regard to risk management, chaired by Sir David Walker. The [Walker Review](#) will examine board management of risk, incentives to manage risk in bank remuneration policies, the competences needed on bank boards, board practices and structures, and the role played by institutional shareholders.

USS contributed a [formal submission to the Walker Review](#) setting out key recommendations on remuneration, board independence, board effectiveness, accounting standards and other impediments to investors providing robust oversight for companies. USS also met with Sir David and Lord Myners to discuss the fund's submission.

2.2 FTSE350 Remuneration

In light of the economic situation which developed in the second half of 2008, USS undertook a review of its voting policy on remuneration in anticipation of the potential changes companies may choose to put forward. A letter was sent to companies in the FTSE 350 detailing USS's expectations in terms of disclosure in their remuneration report and the funds' proposed approach to voting on remuneration in 2009.

2.3 Engagement with global sell-side on ESG research

The fund co-wrote to global sell-side research firms to highlight concern about the reduced provision of integrated environmental, social and governance research by brokers in the wake of the financial sector crisis. With Dutch institutional investor, APG, the fund stressed the importance of sell-side houses continuing to provide ESG research, noting that the quality and depth of ESG coverage would continue to be taken into account in broker evaluations, commissions and research budget allocations.

2.4 Regional Corporate Governance

2.4.1 Japan

To assist with our engagement in Japan, USS has joined the [GO Japan Engagement Consortium \(JEC\)](#), a global institutional investor collaboration bringing together Japanese and international institutional shareholders. Through partnership with local investors and the involvement of Japanese based executives, the JEC hopes to allay the concerns of Japanese companies to engagement with overseas investors and provide foreign shareholders with a local perspective.

The consortium enables USS to be represented as part of a larger pool of assets when speaking to companies and regulatory bodies in Japan and builds upon the market level engagement undertaken through the Asian Corporate Governance Association last year.

In March, [USS wrote a letter to the Japanese Financial Services Agency](#) to express support for proposed corporate governance reforms in Japan. The letter reiterated the Fund's endorsement of the [Asian Corporate Governance Association's](#) May 2008 White Paper on Japan which covered concerns about takeover defences, minority shareholder protection, independent representation on boards and shareholder voting.

2.4.2 Taiwan

A portfolio manager and member of the RI team participated in groups meeting with the Taiwanese stock exchange and market regulators to call for improvements in corporate governance and market practices. The meeting was convened by the Asian Corporate Governance Association (ACGA) for overseas institutional investors in Taiwan. During the visit, the fund also presented at a seminar for major Taiwanese companies on ESG best practice, highlighting concerns regarding minority shareholder protection and providing a long term shareholders' perspective.

2.4.3 Sweden

In April, USS wrote a [letter to the Swedish Industry and Commerce Stock Exchange \(NBK\)](#) to demonstrate international investor support for more stringent rules for the equal pricing of different classes of shares in takeover situations.

2.4.4 USA

The Fund has continued to advocate market-wide reforms that will address systemic challenges to engagement in the US and allow for more open and effective dialogue with companies.

- *Enhanced Disclosure on Director Candidates*
USS has spearheaded the development of a questionnaire for director candidates through the International Roundtable on Executive Remuneration. The [model Director Candidate Information Request \(DCIR\)](#) was submitted to the SEC in a [letter to SEC Chairman, Mary Schapiro in May 2009](#) by investors, including USS, representing more than \$1 trillion under management. The DCIR was also highlighted at a Yale Governance Forum in June 2009.
- *Independent Chairman*
In January, the Fund co-wrote with Railpen, a [letter](#) to US companies to encourage the separation of the roles of Chairman and Chief Executive.

In April the Fund also wrote, in conjunction with eleven global institutional investors, to 64 Fortune-100 companies to encourage those companies to appoint an independent Chairman to the board.

- *Governance Reform*
[USS co-wrote to President Obama](#) and met with congressional leaders in February 2009, conveying investor support for corporate governance reform. The letter advocated such reforms as a means of restoring investor trust in the integrity of US capital markets and public corporations. The issues raised included shareowner access to the proxy; standard majority voting for election of corporate directors; transition to independent boards with split chair/CEO roles; advisory shareholder votes on executive remuneration; repeal of the authority for brokers to vote un-instructed shares; stronger rules on compensation clawback; limits on the use of conflicted remuneration consultants and restrictions on severance payments rewarding poor performance.

2.5 Pharma Futures

The third phase of Pharma Futures, co-convened by USS, was completed with the publication of a report in February. The project explored the links between sustainable pharmaceutical business models and improved health outcomes in middle-income markets, including China, India and Brazil. [Pharma Futures 3: Emerging Opportunities](#) is based on structured dialogue between the industry, investors, entrepreneurs and global health experts. The dialogues considered how novel approaches to value creation in emerging markets might benefit both the pharmaceutical industry and society by increasing business value while improving health for millions of people who currently have little to no access to affordable, quality health care.

2.6 Climate Change

The Fund contributed to the May 2009 PRI publication [Investor Leadership on Climate Change](#) – see below and USS continues to be represented at the [P8 Summits](#) on climate change. The fund met several renewable energy funds in this half of the year.

2.6.1 Adaptation

Following the publication of [Managing the Unavoidable: Understanding the Investment Implications of adapting to Climate Change](#) in early 2008, the Fund has continued to work on adaptation in conjunction with Henderson, Insight, Railpen and Acclimatise. The group is working on the development of a framework for assessing the risks and opportunities of climate change adaptation across several industry sectors. A series of sector based reports will be published later in the year.

2.6.2 Institutional Investors Group on Climate Change (IIGCC)

The Fund continues to be actively involved with the IIGCC. A member of the RI team presented at an IIGCC trustee training seminar in Paris in June and the Fund contributed towards IIGCC's investor statements on [Non-carbon market financial mechanisms for climate change mitigation and adaptation in developing countries](#) and [Toward an effective global carbon market](#). The first statement advocates urgent action to boost the effectiveness of global carbon markets in order to leverage private sector investment in developing countries to mitigate the risks of climate change. The second proposes a number of measures which will enable carbon markets to fulfil their potential as a catalyst for investment to support a global low carbon economy including the scaling up of the Clean Development Mechanism, caps on emissions trading schemes and the provision of robust long term price signals necessary to secure long term investment in low-carbon solutions.

A member of the RI team also contributed to the development of [The IIGCC Guide on Climate Change for Private Equity Investors](#) which considers the risks and opportunities associated with climate change and related policy developments across the breadth of this alternative asset class. The Guide advises how such factors might be considered by pension funds (limited partners) when selecting their managers and by private equity fund managers, (general partners) when selecting their investments. The note provides a series of questions in four key areas, namely, awareness, measurement, adaptation and mitigation and opportunities.

The IIGCC also published the [Global Climate Disclosure Framework for Automotive Companies](#). The publication aims to improve automotive company reporting (and therefore also the management) of climate risks and opportunities by providing a sector-based disclosure framework. The framework aims to help investors to better assess climate risks and opportunities for automotive companies and engage with them on improving their climate strategies. The group worked with other investor collaborations, including the Carbon Disclosure Project, Ceres and Australia/New Zealand IGCC to ensure that the frameworks can be implemented at a global level.

2.7 Principles for Responsible Investment

The fund continues to be active participants in the UN Principles for Responsible Investment. USS completed the annual PRI survey to report on the funds' progress towards implementation of the principles and has made public the [Summary of USS Responses to 2009 PRI Survey](#) and [Assessment Results](#) on-line.

In May, PRI co-published an analysis of the global investment community's role on climate change, highlighting recent investor activity with input from a member of the USS RI team. The report [Investor leadership on climate change](#) was produced in association with the UN Global Compact and the UN Environment Programme Finance Initiative as part of the UN's Caring for Climate series.

The fund has worked with PRI members to build ESG capacity amongst private equity investors. Through PRI the fund contributed to the development of the US Private Equity Council's (PEC) [Guidelines for Responsible Investment](#) in February. The guidelines call upon private equity firms to consider environmental, public health, safety, and social issues at investee companies and to work towards long-term sustainability of benefit to multiple stakeholders.

2.8 Global Reporting Initiative (GRI)

USS participated in a project with the GRI to develop guidelines on ESG matters for inclusion in a company's annual report. [Reaching investors: communicating value through ESG disclosures](#) aims to provide guidance towards more effective communication between companies and investors on material ESG issues. The report focuses on three key areas - the statements from the CEO and Chairman of the board, analysis of risks and opportunities and the provision of performance data.

2.9 Benchmarking environmental performance for commercial real estate

Together with two other large European institutional investors, APG and PGGM, USS is working with the European Centre for Corporate Engagement at Maastricht University to survey 700 listed global property companies and fund managers on their environmental performance. The survey aims to provide a benchmark for environmental performance of commercial real estate by collating data on energy and water consumption, waste collection and recycling, carbon emissions and employee training and remuneration policies.

3. Awards and accolades

USS' approach to RI was highlighted in a speech by Lord Myners to the Investment Management Association's Annual Dinner in June 2009. Many of the governance and stewardship recommendations being put forward for consideration by Lord Myners and others, such as better collaboration among investors and a focus on the qualities and competencies of independent directors, have been advocated by USS for several years.

USS received full marks in Fair Pensions [UK Occupational Pension Schemes' Responsible Investment Ranking 2009](#) and was ranked best for transparency amongst its UK peers.

4. Articles & Interviews

- Financial Times; [Voting on directors' packages urged for Germany](#), 27 January 2009
- Sued Deutsche, [Fünf Großinvestoren attackieren gemeinsam Wiedeking Porsche-Chef steht wegen der Übernahmetaktik bei Volkswagen in der Kritik](#); 30 January 2009
- Professional Pensions, [Schemes urge drugs firms over investments](#); 26 February 2009
- IPE Pension funds urge new direction in pharmaceuticals; 26 February 2009

- Reuters, [Investors urge Obama to install governance regime](#); 26 February 2009
- Financial Times, [Pensions funds warn drugs companies on future investments](#); 26 February 2009
- CSR Wire, [Emerging markets offer promise and challenge to the pharma industry](#); 27 February 2009
- Responsible Investor, [RI Round Up](#); 6 March 2009
- Reuters, [Investors oppose possible Cintra, Ferrovial merger](#); 11 March 2009
- Eleconomista.es, [Accionistas minoritarios de Cintra se rebelan ante la posible fusión con Ferrovial](#); 11 March 2009
- Trading Markets, Spanish Cintra investors oppose merger with Ferrovial; 12 March 2009
- WSJ, Cintra holders ask for hefty premium in Ferrovial merger plan; 22 April 2009
- Bloomberg, Cintra investors sign pact against Ferrovial merger; 22 April 2009
- Global Pensions, [Fair Pensions unveils scheme ESG performance](#); 27 April 2009
- NASDAQ, Major Investors call for urgent changes in global carbon market; 18 May 2009
- Professional Pensions, [IIGCC calls for urgent changes to encourage institutional investment](#); 19 May 2009
- Global Pensions, IIGCC: Urgent changes needed to promote growth in carbon markets; 19 May 2009
- The Herald Online, [Shareholder revolt over Royal Dutch Shell pay awards](#); 20 May 2009
- US Treasury Dept [Gene Sperling, Counselor to the Secretary of the Treasury, Opening Statement before the U.S. House of Representatives Committee on Financial Services](#); 11 June, 2009
- Top 1000 funds.com, [ESG progress for large funds: USS](#); 23 June 2009
- BVCA, [You're No Different: Responsible Investment and Private Equity](#); 2009