First State Investments

Colonial First State
Global Asset Management

Responsible Investment and Stewardship
Annual Report 2013

First State Investments operates as Colonial First State Global Asset Management in Australia. The entire company is collectively referred to as First State Investments in this report.

Contents

Foreword

Welcome to our seventh annual Responsible Investment and Stewardship (RI) report for calendar year 2013. This report provides you with examples of our stewardship activities and illustrates how we continue to execute upon our RI commitments across our global investment business and within our investment teams.

We believe it's important to share with our clients and the industry how we are attempting to address the many RI challenges and shades of grey that arise in our day-to-day activities. It is through this reporting, and that of our peers, that we hope our industry can move forward together to enhance the effectiveness of RI implementation for the ultimate benefit of our clients.

In last year's report, we shared the key components of our revised RI strategy, which is based on the three pillars of Quality, Stewardship and Engagement. This approach is designed to embed RI into the core and culture of our investment business globally.

Over the year we have made good progress against our strategic goals. For example, we have strengthened our governance structure with the formation of a Global Responsible Investment Committee, which has members drawn from our investment, distribution, product and business functions globally. Engaging our senior colleagues to support our endeavours is critical for our long-term goal of successfully integrating RI across our global business.

We have a number of investment teams, across a wide range of asset classes and geographies, who each have their own unique investment process. The common thread which exists between them all is a commitment to achieving the highest standards of stewardship. All our investment teams seek to understand and integrate ESG factors into their unique investment processes to enhance the quality of their investment decisions. This is not only in the long-term interests of our clients, but also important for the long-term sustainability of our business.

We have seen the development of a number of stewardship codes emerge across the world since the publication of the UK Stewardship Code in 2010. Since its launch, it has enjoyed explicit support from large international asset owners such as CalPERS, Ontario Teachers and the Swedish fund AP3. More recently we have seen the emergence of a stewardship code in Japan and we expect to see a similar code in Australia in the near future. In response to this, we decided to formalise our global position on stewardship and, in November 2013, we published our Global Stewardship Principles.

These Principles detail our approach to stewardship across our entire investment business. As part of our internal discussions in creating the Principles, we also took time to remind ourselves as to the fundamental purpose of our business which I believe is worth sharing:

- We are managers and stewards of our clients' assets.
- We have responsibilities, as well as ownership rights, in relation to the companies in which we invest. In addition, we play a significant role in maintaining the integrity and quality of the markets in which we operate, and have a responsibility to allocate capital to productive purposes. We discharge these responsibilities prudently.
- We aim to protect our clients' capital and, through sound judgement and detailed analysis, deliver the best risk-adjusted returns for them over the long-term.
- We never allow the pursuit of personal gain to take precedence over our clients' interests.

The ownership obligations that we execute on behalf of our clients rest upon these fundamental principles.

Research published in 2013 by the CFA Institute shows that trust in the financial services industry continues to be low. As a professional investor this concerns me, because the foundations of our industry are built on trust. I believe that our commitment to RI and stewardship plays an important role in earning and maintaining our clients' trust in the work we do on their behalf.

Last year our firm was honoured to be invited to join the first meeting of the Investment Leaders Group (ILG). The ILG is a three-year project designed to understand how investors can realise environmental, social and economic outcomes alongside long-term investment returns. In June the inaugural meeting in London took place with representatives from our peers including; Natixis Asset Management, Allianz Global Investors, Aviva Investors, Nordea Life and Pension, PensionDenmark, PIMCO, Retraites Populaires, and Zurich Investments. Facilitated by the University of Cambridge Programme for Sustainability Leadership (CPSL), and hosted by HRH The Prince of Wales, the ILG has been tasked to work together to address what the investment industry can do to help shift the flow of capital towards responsible, long-term value creation, such that economic, social and environmental sustainability is delivered as an outcome of the investment management process. We will report on the progress of the group both collectively and individually.

In 2013 we participated in a review of fiduciary duty undertaken by the UK Law Commission as a result of the Kay review of UK Equity Markets and Long-Term Decision Making. Although the results of the review are yet to be published, I believe that the concept of fiduciary duty lies at the heart of responsible asset management. There needs to be clarity around the responsibilities and duties of fiduciaries, including investment managers who are serving the people who entrust their pensions and savings to them. It is important that RI practice is recognised as being wholly consistent with the long-term interests of savers and investors.

Last year we continued to focus on enhancing the environmental, social and corporate governance (ESG) information and resources available to all of our investment teams. We have made significant progress with the appointment of two new independent ESG research providers. This new level of research and information enables us to more closely monitor our ESG exposure across our business. Importantly, it will also help to enhance the quality of the information that we are able to provide to our clients on our stewardship activities.

Active engagement with companies is a fundamental part of our stewardship approach. It is critical to aid our understanding of the financial quality and sustainability of the companies in which we invest our clients' capital. During the year our investment teams held several thousand company meetings and voted on more than 15,000 resolutions.

Over the course of the year we have made significant progress to improve our RI practices across the group. Some of these include:

- strengthening our governance structure and processes with the introduction of a Global Responsible Investment Committee (GRIC) with members drawn from across our global employee base
- introducing Global Stewardship Principles and a Cluster Munitions Policy
- enhancing the quality of ESG information available to our investment teams
- six investment teams actively collaborating with peers on a range of ESG engagement programmes; and
- playing a leading role in the Investment Leaders Group formed in 2013 specifically on long-term mandates.

Further details of these and our other activities can be found in this report along with our priorities for 2014 which include embedding our stewardship principles into our product management processes and completing our ESG information management plan. We will also continue to share our experiences through case studies and collaborative engagements as well as playing a leading role in the Investment Leaders Group.

This report provides a team by team overview of our stewardship activities which we hope you find useful. We value your feedback and look forward to working together to meet our RI challenges and opportunities in the coming year.

Mark Lazberger
Chief Executive Officer

About Us

First State Investments (known as Colonial First State Global Asset Management in Australia) is the consolidated asset management division of the Commonwealth Bank of Australia. The Commonwealth Bank is rated AA- by Standard & Poor's and is the largest Australian bank by market capitalisation and one of Australia's leading financial services providers.

We are a growing global asset management business with experience across a range of asset classes and specialist investment sectors. We manage USD 163 billion of assets on behalf of institutional investors, pension funds, wholesale distributors and platforms, financial advisers and their clients worldwide.

We employ teams of investors who are specialists in their respective fields and set their own investment style. Each investment team is structured so that managers and analysts have a strong sense of portfolio ownership. Incentive structures are directly aligned to the results they deliver for clients.

Whilst each team might have its own distinct philosophy or investment process, they share a commitment to responsible investment and stewardship.

Assets under stewardship

TOTAL ASSETS UNDER STEWARDSHIP	163.2
As at 31 December 2013 / USD billion	
Australian Equities	22.3
Global Emerging Markets*	55.6
Global Resources	2.7
Global Equities	1.3
Property Securities	2.8
Listed Infrastructure Securities	3.6
Total equities	88.3
Fixed Income and Credit	20.1
Emerging Markets Debt	1.1
Short Term Investments	36.7
Total debt	57.9
Listed and Direct Property**	13.8
Direct Infrastructure	3.2
Total alternatives	17.0

* Includes a range of Asia Pacific, global emerging market equity and worldwide equity strategies.

** Following the internalisation of management of Kiwi Income Property Fund (December 2013) and CFS Retail Property Trust Group (March 2014), together with the compulsory acquisition of Commonwealth Property Office Fund (April 2014), these businesses will no longer be part of FSI.

Our Approach to Responsible Investment and Stewardship

We became a signatory to the UN Principles for Responsible Investment (PRI) in 2007 and since that time we have systematically and progressively improved our responsible investment (RI) practices across our investment teams globally.

In 2013 we reviewed our progress to date and developed a strategy aimed at taking us towards global leadership in RI over the coming years. The strategy, which we described in this report last year, is based upon three strategic pillars of Quality, Stewardship and Engagement, as illustrated in the diagram below.

The strategy is underpinned by a strong governance framework and is supported by our RI team. The RI team engage the entire business to deliver the strategy, which is overseen by the Global Responsible Investment Committee (GRIC), whose role it is to monitor and direct the responsible investment practices across the business.

Each of our investment teams has an RI representative who co-ordinates information flows across their respective teams. The RI representatives also sit on an Environmental, Social and Governance (ESG) Committee which plays a key governance role by representing their teams, reporting on team progress, contributing to thought leadership and looking at new approaches to addressing current and emerging ESG risks and opportunities. The ESG Committee is an important part of ensuring that we have the highest quality of ESG integration embedded within our investment processes.

Responsible investment in practice

On pages 14 to 31 you will find a 'snapshot' for each of our investment teams. While each team has incorporated an approach to RI which complements their investment philosophy, at an organisational level we are able to draw out some commonalities which are based on our policies, particularly our Global Stewardship Principles.

ESG integration

Each team has a process for identifying and assessing the relevance and materiality of ESG issues for their respective asset classes. For all active equity teams company engagement is a key source of insights on these risks and opportunities.

These insights, coupled with the best available third party ESG research, are assessed by the relevant company analyst and incorporated into stock notes or reviews. Some teams assign specific ESG scores, while others incorporate the assessment into broader views of company management and business quality. All active equity teams hold regular team meetings to discuss company assessments including on ESG factors.

Our Approach to Responsible Investment and Stewardship

Our fixed income teams have an assessment process which flows into their view of a particular security, whether through the six factor model used by the Emerging Markets Debt Team or the ESG score and internal credit rating used by the Fixed Income and Credit Team.

For all teams, responsibility and accountability for analysis and integration of ESG factors, investee company engagement and proxy voting rests within each team. Integration and engagement are mutually reinforcing with analysis driving engagement and engagement outcomes influencing the analysis. This is why we have chosen not to separate proxy voting, engagement or ESG research into a specialised function.

For our Direct Infrastructure team a much more specific approach is possible. This team has developed separate and detailed policies and assessment frameworks while still adhering to the organisation-wide approach.

Company engagement

Engagement with company management is a fundamental part of our teams' investment processes. Through company engagement, we seek to highlight areas for potential improvement and risk reduction, encourage improved disclosure on ESG issues, and commend companies that are making progress in this area. We have guidelines and principles for corporate engagement, which are publicly available on our website.

Engagement is more difficult for fixed income investors. We have, however, effectively engaged with counterparties and semi-government issuers.

For Direct Infrastructure our seats on company boards allow more direct oversight.

Given the varying nature of the asset classes we manage, the geographies in which they operate and the size of our holdings, each of our investment teams' engagement approaches are tailored to individual companies and the specific issues in question.

When engagement is unsuccessful

On occasions where our engagement activities with company management are unsuccessful, we may escalate the issue, for example by writing to, or meeting with, the chairperson or lead independent director, voting against directors who we believe are not providing appropriate oversight, or collaborating on further engagement with other like-minded investors. Ultimately we may choose to sell down holdings in companies where we lose confidence in the management of the business following unsuccessful attempts to engage.

Proxy voting

Proxy voting rights are an important part of shareholder responsibility and we seek to vote on all possible resolutions at company meetings. Prior to voting, the relevant investment manager and analyst carefully consider each resolution, with guidance provided by our 'Guidelines and principles for corporate engagement on governance, environment and social issues'.

Recommendations from a selection of independent corporate governance research providers are also sought. Our investment teams retain full control over their proxy voting decisions, however, and do not necessarily follow the guidance provided by third party governance research providers.

All teams have an approval and escalation process for proxy votes and maintain records when they vote against management or against the recommendations of the proxy voting adviser.

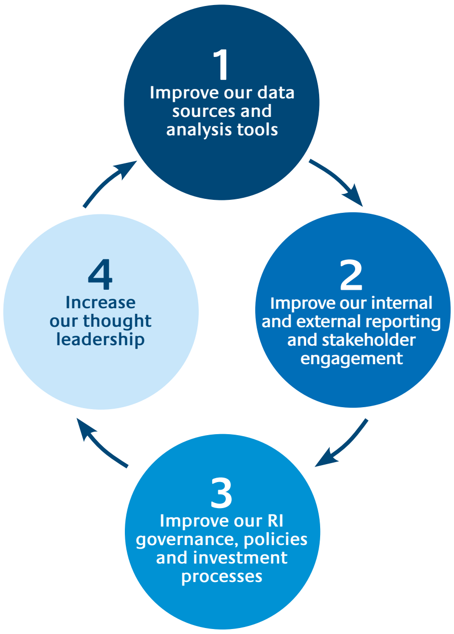
Teams are responsible for their own voting and from time to time different teams may vote in different ways on the same issue. To manage this while maintaining team independence we encourage and are developing forums where teams who are voting on the same company can discuss any issues (while always complying with regulatory requirements related to collusion or takeover provisions).

Responsible Investment and Stewardship – Our Progress

Four areas of focus

In 2013 we committed to building on our existing platform so we could:

- improve our data sources and analysis tools
- improve our internal and external reporting and stakeholder engagement
- improve our RI governance, policies and investment processes, and
- increase our thought leadership.



Enhancing the quality of our investment processes

We believe that the evaluation of ESG factors and the exercising of our stewardship responsibilities should be completely integrated with our evaluation of financial and business quality.

We believe that the quality of our investment processes and decision making is improved by our ESG integration work and that this is in the long-term interests of our clients.

During 2013 our key achievements were:

Enhancing the quality of ESG information

During 2013 we reviewed our ESG research service providers and conducted a comprehensive tender process. The purpose of the tender was two-fold. Firstly, it was to provide our investment analysts with the best available third party research and analysis of ESG factors for investee companies and sovereign issuers. And secondly, to acquire data for portfolio level reporting and risk assessments, which can be used by our portfolio managers and senior management to better understand the ESG risks, impacts and performance of our portfolios.

Following this process we appointed two leading global ESG service providers; Sustainalytics and GMI Ratings. We are currently working on integrating these new providers into our investment teams' work flows including through data platforms like Bloomberg and our proprietary research systems.

This project has resulted in the development of a broader ESG information management plan that will involve the complete redesign of our intranet site.

The new site will aid investment professionals in accessing information on all of our different research providers, on key ESG themes and will connect them with experts who can further assist them. This redesign will make relevant and credible ESG information easier to identify and access for use in each team's individual processes.

Our work in this area has the ultimate goal of ensuring that we can provide the same level of internal governance over ESG performance as we do for financial performance. Over time we expect that this will also lead to improvements in our client and public reporting.

2013 goals disclosed in the 2012 RI report	Progress
Establish the GRIC	Established. Chaired by our CEO with members drawn from across the business.
Review of policies and position statements	Stewardship principles and cluster munitions policy approved by the GRIC. Broader policy review is underway.
Enhance ESG data services and IT infrastructure	A tender process was conducted and two new ESG research providers (Sustainalytics and GMI Ratings) were appointed in November 2013.
Integrate RI into product development process	While yet to be formally integrated into the product development process, following the launch of our Worldwide Sustainability Fund, a number of thematic product ideas have been suggested from across the group.
Contribute to Cambridge University Investment Leaders Group	The first meeting was held in May 2013 and we are involved in a number of initiatives stemming from the programme which we believe will enhance our internal processes. We are leading a workstream on "investment timeframes and long-term mandates".

Responsible Investment and Stewardship – Our Progress

Internal reporting on RI and stewardship practices

Our investment teams are accountable to the GRIC for the delivery of our RI and stewardship obligations and commitments. Investment teams are expected to provide detail on their approach to integrating ESG considerations in their investment decision-making and provide evidence of their stewardship activities.

The teams' reports have a strong focus on risk identification and assessment, engagement and stewardship. There is a rolling programme of teams reporting to the GRIC.

Evaluating the risks from "stranded assets"

During the year the ESG Committee discussed the emerging debate regarding the issue of risks associated with potential stranded carbon intensive assets as identified in the "Unburnable Carbon 2013: Wasted Capital and Stranded Assets" report issued by the Carbon Tracker initiative.

To ensure that we can properly assess the potential investment implications for our clients, a sub group of the ESG Committee was formed to address the issue in detail.

(See the case study on page 34 for more details)

Increasing our ESG knowledge

Over the course of 2013 we held a number of briefings where industry experts were invited to present and discuss various subjects to our staff, including investment teams. Such briefings included:

- The Australian Council of Superannuation Investors' (ACSI's) Executive Manager of Institutional Investments and Policy, Paul Murphy, discussed ACSI's latest proxy voting guidelines and engagement following the recent Board Confidence Index.
- Towers Watson and MSCI Sustainable Investment adviser Roger Urwin presented his views on recent and future trends in RI and Sustainable Investment.
- Leading Australian proxy voting advisers Ownership Matters reviewed the 2013 annual general meeting season and discussed the Board Confidence Index results.
- The HSBC Climate Change team presented to our London based colleagues on their latest research on climate risk including their new report on water risks.
- Leading Macquarie University safety researcher Sharron O'Neil discussed her latest research on Australian companies and issues with the current reporting of safety statistics.

Engaging colleagues across our organisation

Human Resources and Culture Plan

During the year we assessed the degree to which RI principles are embedded in our human capital management processes. The assessment was performed by our Human Resources (HR) team who, with the support of the GRIC, are now developing an HR and Culture plan which covers recruitment, talent and management development, incentives and culture.

Among a broad range of activities, some of the initiatives to be undertaken include:

- ensuring our commitment to RI features on all position descriptions and advertisements
- enhancing interviewing skills training to ensure that we employ people with strong alignment to our RI and stewardship principles
- inclusion of RI in on-boarding and training processes, including leadership training.

Responsible Investment and Stewardship – Our Progress

Global Stewardship Principles

In November 2013 we published our Global Stewardship Principles. These Principles outline our approach to ensuring that clients' interests are at the core of our investment processes. The Principles include our approach to managing conflicts of interest, monitoring and engaging with investee companies, executing voting rights and collaborating with other investors. The Principles direct how these stewardship activities will be monitored, assured and reported on.

The Global Stewardship Principles were developed and endorsed by the GRIC, who will review them annually. Compliance with the Principles will be subjected to an annual assurance process. The Principles can be downloaded from our website.

Improving our governance framework

Across our organisation we have 13 investment teams investing in a range of asset classes around the world. Each team has their own unique investment process with RI practices applied in a way which complements their investment approach. Our Global Stewardship Principles and RI Policies are common threads that tie our diverse investment capabilities together.

Through collaboration and learning from each other's approaches, we believe our investment teams have a competitive advantage in their incorporation of ESG factors. Therefore we see the diversity of approaches employed as a key strength of our business.

This strength through diversity nonetheless comes with its own set of challenges. In order to maintain the highest standards across the organisation, it was essential to establish a strong governance framework and organisational culture around RI. This governance framework was enhanced in 2013 with the formation of the GRIC and the ESG Committee. The members of both of these Committees are detailed in Appendix 3.

Global Responsible Investment Committee

The GRIC is chaired by the CEO and includes senior leaders from across the organisation, including the Chief Investment Officers for both equities and fixed income & credit, senior investment professionals, as well as representatives from sales and distribution, product, HR and our regional business heads.

The GRIC met twice in 2013 and approved several important initiatives including the creation of our Global Stewardship Principles. The principles have been critical in making explicit the ways in which our different teams with their unique investment philosophies are united by common values and standards.

The GRIC also initiated reviews on how we can improve our practices in several key areas including client reporting, human resources and communications. As part of its investment oversight function, the GRIC received presentations from a number of investment teams on their approach to RI and stewardship and discussed strategic issues, for example the implications for our business from the UK's Kay Review.

ESG committee

The ESG committee reports to the GRIC and is chaired by an associate director from the Direct Infrastructure team and includes representatives from each investment team.

The ESG committee's responsibilities include monitoring ESG risks and opportunities, coordinating cross-team collaborations and driving improvements in our RI practices. During the year the committee met four times and delivered the following key initiatives:

- oversaw the tender process which led to the appointment of new ESG research providers GMI and Sustainalytics,
- the establishment of a stranded assets working group (see page 34), and
- the development of a reporting structure for investment teams to use when presenting to the GRIC.

Responsible Investment and Stewardship – Our Progress

Transparency and stakeholder engagement

We see transparency and engagement with a broad range of stakeholders as critical to our success. In addition to this report we also issue an annual proxy voting and engagement update, participate in various industry initiatives, meet regularly with civil society and other groups and report to our clients and the PRI on our progress.

This year we are completing the new PRI reporting framework for the first time and will be making our full report publicly available.

Our engagement with stakeholders from clients, to industry peers, to civil society is evolving over time and we see our participation in the Investment Leaders Group (ILG) as a key example of this. A full list of the industry and other initiatives we participated in during 2013 can be found on page 36.

Release of the 2013 Proxy Voting and Engagement Update

In November 2013, we published our annual Proxy Voting and Engagement Update. This report highlights the proxy voting and engagement activities of our listed equity teams.

It provides a number of examples and statistics which we feel highlight the key focus areas and issues when our investment teams assess proxy voting resolutions. For example we report on how often the teams vote against company and proxy adviser recommendations and include regional or sectoral breakdowns of votes against.

For the first time we also published how we voted on all company meetings globally on a team-by-team basis in an easy-to-use Microsoft Excel format. The report and Excel spreadsheet with our full proxy record can be downloaded from the Reports section of our website.

Responsible Investment and Stewardship – Our Progress

Investment Leaders Group

UNIVERSITY OF CAMBRIDGE
25 YEARS
PROGRAMME FOR SUSTAINABILITY LEADERSHIP

The Investment Leaders Group (ILG) is a three year project with the goal of helping to shift the investment chain towards responsible, long-term value creation, such that ESG and economic issues are delivered as an outcome of the investment process alongside robust, sustainable investment returns. We are a founder member of the ILG along with 11 other institutions from the pension fund and asset management industry.

The ILG is supported by world class academics from the UK's Cambridge University's Judge Business School and Faculty of Economics. The premise of the ILG is that responsibility should be at the heart of the investment process in order to best serve the needs of clients and beneficiaries over the long-term. The ILG's maxim is to lead by example.

The ILG is delivering its objectives through a series of work streams, the first two being;

1. The Value of Responsible Investment: RI has the capability to influence positively beyond the investors immediate asset base into the wider economy, environment and society. This work involves the development of an intellectual model of how this process works in order to strengthen its adoption by investors.
2. Reporting Investment Impact: the goal of this work stream is to develop a model and methodology for reporting on the impact of investment processes on the real economy and wider society. This will enable investors to better assess and communicate the impacts of their investments to clients, beneficiaries and wider civil society.

We will report on the ILG's progress each year as well as how we are adopting the outcomes from the group into our investment practices.

Goals and Outlook for 2014

2014 goals

As reported last year, we had historically used the PRI Benchmark Report as the basis for our goal setting. However, since the change in the PRI's reporting framework, benchmarking information has not been available. For this reason, in 2013 and 2014 we set goals based on the achievement of specific milestones.

Should the new PRI reporting framework (which we completed for the first time in February 2014) include a benchmarking element, we will disclose this information in next year's RI Report. We will also continue to disclose our milestone-based goals to show the steps we are taking to improve our RI practices.

2014 is the second year in our three-year strategy rollout. We will continue our efforts to implement the RI strategy by working on the four focus areas outlined earlier. Our goals for 2014 include:

- Complete an RI policy review and update.
- Incorporate RI principles into the new product development process.
- Finalise HR and Culture plan and implement plan to agree and set short-term targets.
- Finalise and implement ESG Information management plan which will include:
  - Integration of ESG research services with Bloomberg, Capital IQ and proprietary research systems.
  - Enhancement of intranet site to become an ESG information hub for investment professionals.
- Enhance systems and processes to better capture company engagements from across equity teams in a consistent and reliable format.
- Continue our involvement and support of the Cambridge Investment Leaders Programme. Lead workstream on investment timeframes and long-term mandates.
- Complete a strategic review of current collaborative initiatives.

Responsible Investment and Stewardship In Practice

Investment teams not included in this report

The following investment teams are not included in this report:

- Direct Property
- Short-Term Investments (cash)
- Multi-Asset Solutions; and
- Real Index (fundamental indexing)

In the case of Direct Property, this is because following the internalisation of management of Kiwi Income Property Fund (December 2013) and CFS Retail Property Trust Group (March 2014), together with the compulsory acquisition of Commonwealth Property Office Fund (April 2014), these businesses will no longer be part of FSI.

For the Short-Term Investments team ESG research and engagement is conducted by the fixed income and credit team. This is particularly relevant for counter-party reviews where ESG factors form a key part of the review.

For the Multi-Asset Solutions and Real Index teams the integration of ESG factors into their investment processes is still at an early stage.

The Real Index team is represented on the ESG Committee and is testing the new ESG research provider's datasets for possible use within their process. They have also looked at the development of passive ESG themed products.

The Multi-Asset Solutions team holds the majority of its assets through other FSI funds and so these obligations are for the most part carried out by the underlying fund team.

Both teams vote all proxy votes either through the underlying fund manager (as is the case for Multi-Asset) or by voting in line with CGI Glass Lewis (for Real Index).

A brief description of each team is below:

Short-Term Investments

Our Short-Term Investment team is one of the largest managers of cash funds in Australia. The team invests in overnight cash deposits, bank bills, negotiable certificates of deposit, commercial paper and floating rate, corporate and asset-back securities. They boast one of the largest number of dedicated portfolio managers of cash funds in Australia, with a long-term and solid track record of outperformance.

Multi-Asset Solutions

The Multi-Asset Solutions team provides a range of services to institutional clients around the world in the fields of portfolio management, asset allocation, asset/liability management, portfolio construction and risk management. They advise on and design bespoke investment solutions and implement these solutions in the form of tailored risk managed multi-asset mandates.

Real Index investment philosophy

The Real Index Funds use a fundamental index methodology in the construction of its portfolios. This approach is based on the belief that markets are not perfectly efficient and that pricing errors can lead to a performance drag for traditional market cap-weighted index funds.

In Real Index funds, stocks are selected and weighted using fundamental measures of firm size, including cash flow, sales, book value and dividends. The Real Index funds aim to enhance this process by adding factors such as quality of earnings and debt coverage. In addition, the weights are adjusted periodically throughout the year rather than once per year.

The Real Index team are a small passive investment team with many hundreds of companies in their portfolios. As a result, Real Index currently have a separate proxy voting policy and vote in line with CGI Glass Lewis recommendations.

Team Snapshots

In the following pages you will find a snapshot for each investment team. In this year's snapshots we have brought the engagement and proxy voting sections together as the proxy voting process is consistent across equity teams and we believe the two processes are highly related. We have also included an 'RI and Stewardship in Practice' case study for each team which demonstrates the way in which analysis, engagement and (for equity teams) proxy voting work together to enhance the quality of our investment processes.

Each snapshot highlights:

The investment team:

- Its investment strategies and location
- Its investment head and RI representative

The team's approach to ESG integration:

- Areas for development
- Key Issues for 2013
- The team's approach to integrating ESG factors
- ESG integration example where an ESG issue has influenced a buy/sell/hold decision

The team's approach to asset stewardship:

- Approach and process for engagement
- ESG engagement example
- Proxy voting

An example of RI & Stewardship in practice:

- Example of how integration, engagement and proxy voting combine.

Proxy Voting Statistics

- Votes for and against in total and on key issues
- Votes against the recommendation of our proxy adviser or management.

First State Stewart

> Inception Date 1988 > Location Edinburgh, Hong Kong, Singapore

Strategies

Asia Pacific ex Japan, Emerging Markets, Frontier, Greater China, India, Latin America, Worldwide, Sustainability (Asia, Emerging Markets and Worldwide)

GRIC and ESG Committee Members from First State Stewart

David Gait, GRIC Member
Gokce Bulut, ESG Committee Member

AREAS FOR DEVELOPMENT

We are always looking for ways to deepen our understanding of ESG issues. We find the best way to do this is through meetings and researching companies. We also commission external research by experts; some recent examples include a Shipping report by Sustainalytics on Industry Emissions and Steel and Aluminium Sector reports by Trucost.

KEY AREAS OF FOCUS

- Tax avoidance
- Executive Remuneration
- Environmental externalities, particularly in China
- Energy supply chain

How ESG factors affect the team's investment decisions

How relevant issues are identified

ESG issues are identified through a bottom-up company research process. When we consider the quality of management, financials and franchise, we think about the impact ESG could have on the business and how management is addressing risks and opportunities. The primary source of ESG related information is one-on-one meetings with senior management. We are particularly interested in companies which embrace the underlying spirit of ESG, rather than simply taking a compliance driven, box-ticking approach.

How issues are assessed

The assessment of ESG issues is incorporated as part of the bottom-up research process.

How material issues are incorporated into investment decision making

Sustainable investment has always been an integral part of the First State Stewart team's investment philosophy and stock picking process. ESG analysis is used as a qualitative tool to assess the risks and/or opportunities a company might face. A company's approach to ESG issues is often a proxy for its quality in other areas, for example, franchise quality is impacted by operational efficiency and the environmental efficiency provided by its products.

We are fortunate enough to be able to make the decision to not own a company because of its approach to governance or sustainability issues, as we do not consider or reference the benchmark when constructing portfolios.

Our sustainability strategies take the process one step further by focusing on long-term sustainability themes as a key driver of the investment process. We classify potential investment opportunities into one of three 'sustainability sectors': sustainable goods and services, responsible finance and required infrastructure.

ESG integration example:

Simplo Technology

A consideration of ESG issues is part of every company report completed across the First State Stewart team. One example of where the thinking on ESG helped the investment case is Simplo Technology, which is held across many of the First State Stewart strategies.

Simplo Technology manufactures and sells battery packs for computers, handsets and electrical vehicle battery packaging.

Simplo Technology sits in an interesting place in the supply chain for batteries. The company does not manufacture the cells itself rather "packs" the batteries (so it doesn't have the liabilities for the cells). Its business model is acting as a very resilient barrier to integrated competitors. The competitive advantage it has is flexibility: any problems in cell manufacturing and it can switch supplier. This position in the value chain alongside leading technology is why we think its position will be sustainable. There is also an interesting opportunity in storage especially in solar. The company has demonstrated adaptability with its gradual move away from being dependent on the notebook market.

Stewardship through engagement and proxy voting

What proportion of companies are engaged with

We do not keep a count of the number of engagements. However, we ensure that we meet with and engage on materially important issues with at least the top ten holdings of the funds.

How issues for engagement are identified

We engage on a wide range of issues including strategy, governance, alignment of interests and reputation. Engagement issues are identified through the research process and through alerts received from RepRisk.

We engage for two primary reasons. First, the belief that the purchase of a share in a business comes with both rights and responsibilities. Should one of the companies fail to meet international best practices on the environment, human rights or social issues,we believe that we have a responsibility to engage with senior management to persuade them to address the issue, rather than to walk away from the problem.

Second, ESG issues are investment issues. Positive engagement on ESG issues becomes a powerful tool in driving shareholder value and protecting and enhancing the long-term value of portfolios. Engagement takes place through face-to-face meetings, informal emails and formal written correspondence. In order to facilitate effective engagement the team spend a great deal of time building relationships with company management.

How engagement activities influence investment/proxy voting decisions

As long-term shareholders, we are active owners of the companies in which we invest; and aim to vote on all resolutions at annual and extraordinary general meetings. The types of things that we find ourselves voting against most frequently include:

- Executive remuneration packages where there is a lack of alignment or the incentives are too short-term;
- Directors' elections when the candidate does not have the right character or skills for the board, or they have not been turning up to board meetings;
- Resolutions that give the board totally unfettered rights.

We rarely see environmental or social issues appear on the ballot papers in emerging markets.

Stewardship in practice

DIA

DIA, a Spanish food retailer, was 'spun out' of Carrefour in late-2011. Given the newly-empowered management team and its 'blank sheet', we identified an opportunity to help the company shape its approach to sustainability reporting and to establish a lead over peers.

Our view was in part based on the fact that DIA was already well positioned from a sustainability point of view. For example, the company operates small convenience stores, which, unlike supermarkets, are more immune to the impact of internet shopping, sell primarily fresh food on discount and do not stock cigarettes.

Following a meeting with management it was observed that there was a lack of awareness with regard to sustainability reporting; management was planning to use the Global Reporting Initiative as a framework which we did not regard as particularly meaningful.

As such, an engagement with the aim of encouraging the company to develop a more integrated approach to sustainability reporting was initiated. There are already signs of progress: we were pleased to see in 2013, that it had included sustainability metrics in its 2012 annual report. Whilst the metrics were not perfect it was good to see them at least being considered alongside the traditional financial ones.

Engagement with DIA is ongoing. In particular we are looking to influence management to make the sustainability metrics DIA-specific and link them to management's key performance indicators which should result in greater ownership behind them.

Engagement and proxy voting examples:

Engagement example – Marico

The company was asked to review its approach to advertising deodorants (with their acquisition of a brand from Reckitt Benckiser) to ensure cultural sensitivity and a shift from the chauvinistic advertising carried out by Reckitt. Specifically we were concerned that the campaign "Just Zatak her" was particularity inappropriate given social tensions in India. Subsequently Marico dropped the campaign and launched a new one with not a scantily clad woman in sight.

Voting example – United Natural Foods

The company requested that we vote against a shareholder proposal to eliminate supermajority voting requirements. We believe that supermajority voting provisions, which include any vote standard that requires a greater than simple majority vote, do not serve the best interests of shareholders. A simple majority vote is appropriate to approve all matters presented to shareholders and would be an improvement to the company's corporate governance principles, hence the vote in favour of the shareholder proposal and against the board in this instance.

Voting example – Shree Cement

We raised concerns about a proposal to increase one executive's remuneration by 60% and another by almost 200%. The company has agreed to amend this proposal at its next meeting and for both the concerned executives remuneration will now be limited to a 30% increase per annum.

Proxy Voting Statistics

The table below shows the team's proxy voting statistics for calendar year 2013.

In addition to the traditional statistics on voting decisions, we have also included the percentage of resolutions where after detailed evaluation, the team voted against both management and proxy adviser recommendations.

First State Stewart	Total Resolutions	Voted for %	Voted against %	Vote abstained %	Voted against management %	Voted against Proxy Adviser %	Voted against management and Proxy Adviser %
All	8654	93%	6%	0%	7%	11%	1%
Director elections	3427	96%	3%	1%	4%	14%	0%
Compensation related resolutions (executive)	868	94%	6%	0%	6%	11%	1%
Shareholder proposals	147	42%	56%	2%	39%	25%	14%

Direct Infrastructure

> Inception Date 1994 **> Location** Sydney, Melbourne, London, Paris

Strategies

Unlisted Infrastructure

Head of Global Infrastructure
Perry Clausen


Mark Rogers, ESG Committee Chair
Niall Mills, GRIC member

AREAS FOR DEVELOPMENT

- A review of the business's ESG policy has been undertaken and the policy updated to incorporate a new ESG risk and opportunity assessment framework (the Infrastructure Sustainability Council of Australia's IS tool framework)
- At the investee company level, ESG key performance indicators continue to be reset to new performance benchmarks each year as part of the annual business planning cycle. This provides a ratchet effect on ESG outcomes within each business.

KEY AREAS OF FOCUS

- Investments which contain a particularly large carbon risk have been difficult to justify in the past year and, in the absence of clearly defined and effectively functioning carbon markets, difficult to price.

How ESG factors affect the team's investment decisions

How relevant issues are identified

Relevant ESG issues will be typically identified as part of our rigorous due diligence process.

A risk and opportunity assessment-based approach is embedded in the responsibilities of a number of individuals across the infrastructure investment team to ensure a broad and continuous focus on the ESG issues. This also facilitates a sharing of knowledge and ideas across the broader group and across asset responsibilities. Internal staff are also trained on ESG issue identification to ensure appropriate ownership of ESG issues is embedded in the internal investment team.

How issues are assessed

The typical due diligence process associated with a large infrastructure investment will involve environmental and technical advisers assessing environment impacts and asset condition. Additional advice may be sought on legal liability issues or on social licence to operate issues should they be relevant to the particular asset.

How material issues are incorporated into investment decision making

Internal staff make the final recommendation to the Infrastructure Investment Committee on investments, but will take a range of advice in forming that recommendation including external advice on environmental and social issues associated with an investment opportunity.

ESG integration examples:

Long-term viability of coal-related investments

Coal export terminals in Australia have become available for investment recently and the team's ESG integration work has focused on the future of coal markets in the world, the sovereign policy approach to carbon management and the credibility of the long-term coal market.

Climate change considerations on investment opportunity

A recent due diligence on a greenfields investment opportunity in an existing brownfields investment looked at sea levels, storm surges and flood events associated with the asset's location on the coast. We looked at whether additional measures may need to be taken to protect the future operation of that asset to protect it from more frequent and severe events and sea-level rise in the future.

Stewardship through engagement and proxy voting

What proportion of companies are engaged with

We acquire direct holdings in all infrastructure businesses, seeking at least one board seat at the holding company (controlling) level.

This allows direct involvement in the governance of the business, the structure of the performance incentive mechanisms and the creation of an appropriate culture around each business's approach to ESG risks and opportunities.

How issues for engagement are identified

Issues for engagement are identified as part of our ongoing direct management of the investee companies at board level.

How engagements are recorded

Monthly and quarterly reporting from the investee company management teams contains ESG dashboard performance measures and board minutes reflect ESG resolutions from the board.

What follow up occurs after company meetings

Due to the scale of the direct holding and the involvement of team members at board level on all investment companies, follow up occurs primarily through board discussion, reporting and decision making.

How engagement activities influence investment decisions

Our approach is to incorporate the consideration of ESG factors when making an investment decision and actively managing investments. We seek to ensure that appropriate policies, management key performance indicators, and reporting of ESG factors are embedded into the investee company governance regimes and are continually improved. By doing so we influence the investment decisions of the investee company.

Stewardship in practice

Anglian Water

Predicted changes in weather patterns, rising sea levels and meeting the needs of a growing population means that Anglian Water is one of the most exposed UK water companies to the effects of climate change.

To mitigate against this, and to provide sustainable water and wastewater services to a growing population, goals have been set by the board and the management team to reduce both embodied[1] and operational carbon emissions. Firstly, the company has committed to halve the embodied carbon contained in assets built in 2015 from a 2010 baseline. Secondly, the company has committed to reduce operational carbon by 10% in real terms by 2015 from a 2010 baseline.

With measurement and management of carbon now fully integrated into the delivery of all capital schemes, the company has strong evidence of the correlation between embodied carbon and capital expenditure and operational carbon and operational expenditure. The reductions in embodied carbon through design not only save costs, but also reduce the use of irreplaceable finite materials and help with the provision of more sustainable assets for the future.

The programme has already succeeded in reducing embodied carbon by 39% in 2013, delivered cost savings and reduced the use of finite materials across their capital programme. In addition to the tangible benefits delivered, Anglian Water has also successfully aligned the value chain, with suppliers, designers and contractors responding to the challenge and delivering innovative low carbon low cost solutions

As a result of these outcomes, reducing embodied carbon has become an integral part of our investment decision making process for other assets across the portfolio. We believe that using the knowledge and experience gained through our close monitoring of assets allows us to continuously improve our investment process in ways which provide tangible benefits to clients.

1 Embodied carbon is a measure of the carbon dioxide (and other greenhouse gases) emitted into the atmosphere in order to produce goods and services purchased by Anglian Water.

Global Listed Infrastructure Securities

> **Inception Date** 2007 > **Location** Sydney, London

Strategies

Global Listed Infrastructure

Head of Global Listed Infrastructure
Peter Meany

ESG Committee member
Rebecca Sherlock

AREAS FOR DEVELOPMENT

We believe that 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. To support the team's existing ESG process we use various external sources including, but not limited to, two recently purchased service providers, GMI and Sustainalytics. A key focus in 2014 is to work with these providers to better understand the information they provide and how it can be used for company analysis.

KEY AREAS OF FOCUS

Executive remuneration remains a concern, with some companies having incentives that are either easy to achieve, linked to a single financial metric and/or a limited consideration of total shareholder return. Given the nature of infrastructure companies it is felt that it is also important for remuneration to be linked to the safe operation of assets.

How ESG factors affect the team's investment decisions

How relevant issues are identified

Environmental issues are key drivers for some infrastructure companies, specifically electric utilities, energy infrastructure and railways. Social issues are important too as infrastructure companies have obligations to the communities to which they provide essential services and governance issues are pertinent to all infrastructure stocks.

How issues are assessed

Assessment of ESG factors is based on a wide range of information, primarily the analyst's due diligence and then on external sources of information.

How material issues are incorporated into investment decision making

ESG analysis is integrated into our investment process through a quality ranking model. This consists of 25 criteria that 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.

The ESG factors include independence of the board, executive compensation, carbon intensity of integrated utilities and poison pills. Board composition and alignment of interests are deemed especially important.

We believe consideration of sustainability issues reduces risks and improves returns. Risk can be reduced if sustainability issues are identified, analysed and quantified, while a focus on sustainability helps in identifying value-adding opportunities and avoiding value-destroying situations.

Company engagement on ESG issues is primarily carried out on a direct basis with company management and indirectly via the team's proxy voting process.

ESG integration example:

Atlantia SpA

Italian toll road operator Atlantia SpA announced earlier in 2013 its intention to merge with Rome airport owner Gemina SpA. We believe that elements of this process, notably Atlantia's public disclosure that it was looking at a listed company, were not conducted with the best interests of Atlantia's shareholders at heart. We have formally voiced our objections to Atlantia's board.

Stewardship through engagement and proxy voting

How engagement activities influence investment/proxy voting decisions

Active ownership and engagement are among our top priorities as a fiduciary, because of our conviction in the correlation between good governance about the practices and strong, sustainable shareholder returns. Consequently, we look to positively influence companies towards ESG best-practice to ultimately benefit clients.

We will only engage companies on material issues to achieve specific outcomes, namely to ensure good ESG practices and thereby protect investor interests. In instances where management does not respond adequately to engagement, the company's quality assessment is likely to be negatively impacted and could result in divesting ownership.

Engagement and proxy voting examples:

Atmos Energy

We voted against the short and long-term incentives proposed since they were based on EPS targets rather than a variety of measures including total shareholder return. It is believed that this kind of remuneration can lead to behaviour by management that is ultimately not in the best long-term interests of clients.

Norfolk Southern

We voted against the reappointment of the auditor since there has been no change in 44 years which can compromise independence.

Stewardship in practice

SP Ausnet

SP Ausnet is an Australian regulated utility which has an external management structure between itself and SPI Management Services. We believe that this structure is not appropriate since SPI Management Services is a wholly owned subsidiary of one of SP Ausnet's largest shareholders, Singapore Power Limited.

Whilst this structure has previously been common among infrastructure securities, the externalised management structure used by SP Ausnet has progressively been abandoned due to the difficulty in managing inherent conflicts of interest brought about by related party transactions, and the structure's poor record of value delivery for shareholders.

We have written to the board to express our view and have had multiple meetings with management.

Since these meetings there have been some developments with China State Grid receiving approval to take a 19.9% stake in the company. This will lead to a change in the board composition and the expectation is that internalisation will follow.

Proxy Voting Statistics

The table below shows the team's proxy voting statistics for calendar year 2013.

In addition to the traditional statistics on voting decisions, we have also included the percentage of resolutions where after detailed evaluation, the team voted against both management and proxy adviser's recommendations.

Global Listed Infrastructure	Total Resolutions	Voted for %	Voted against %	Vote abstained %	Voted against management %	Voted against Proxy Adviser %	Voted against management and Proxy Adviser %
All	550	86%	14%	0%	13%	11%	7%
Director elections	283	89%	11%	0%	11%	13%	9%
Compensation related resolutions (executive)	57	84%	14%	2%	16%	14%	9%
Shareholder proposals	24	33%	67%	0%	33%	4%	0%

Global Property Securities

> Inception Date 1994 **> Location** Sydney, New York, London, Singapore, Amsterdam

Strategies

Global portfolios hedged into AUD, GBP (unhedged) and USD (unhedged); Asia Pacific portfolios unhedged into GBP and USD; Australian REITs.

Head of Global Listed Property Securities
Stephen Hayes

ESG Committee member
Joseph Daguio

AREAS FOR DEVELOPMENT

- During 2014 we will be focusing on integrating the new ESG research providers, Sustainalytics and GMI, into the team's workflow.
- We have established a company engagement log which now captures all engagements on ESG issues and is shared across the team.

KEY AREAS OF FOCUS

- High standards of corporate governance are consistently important and we will maintain a disciplined and focused approach to this issue.
- In the face of concern about climate change and associated regulation, property companies are designing and constructing increasingly environmentally friendly buildings; a trend which we believe is set to continue.

How ESG factors affect the team's investment decisions

How relevant issues are identified

Corporate governance is a particular focus, where boards' independence as well as shareholder rights are of paramount importance.

We also consider any specific sustainability initiatives implemented by the company as well as the environmental impact of existing assets and developments. A company's history as a good corporate citizen is taken into account as well as evidence of any meaningful contributions it might have made which benefit society as a whole.

How issues are assessed

Material issues are incorporated into the initial screening stage of the investment process where an ESG rating is assigned to each company.

How material issues are incorporated into investment decision making

A low score (in combination with low scores on other factors) can lead to a stock being excluded from the investment universe and ineligible to be considered for inclusion within our portfolios.

ESG factors are also considered in the Capital Asset Pricing Model (CAPM) in the valuation stage of the investment process. A company's ESG profile is included as one of the variables used in determining its beta. This means that the higher the team rates a company's ESG profile, the more likely we are to invest in the stock.

ESG integration example:

Australian REIT initial public offerings (IPOs)

A recent spate of Australian REIT IPOs did not make it through the team's rigorous stock screen. They did not meet the required rating needed to be included in the investable universe on the basis of poor governance and other ESG factors as well as poor sustainability of cash flows and the quality of their assets.

Stewardship through engagement and proxy voting

What proportion of companies are engaged with

We are active investors and seek to engage with all companies that we invest in. We are firm believers in investor rights and take a proactive stance on any issues of concern, including ESG issues and especially with regard to corporate governance.

How issues for engagement are identified

During REIT/Company meetings an agenda item is any changes to the REIT's/company's ESG performance. We will relay back views on how the REIT/company rates versus its peers. In abnormal circumstances where ESG considerations are materially below par we will take a pro-active stance in directly attempting to influence change.

How engagements are recorded

The team has established a company engagement log. ESG engagement details are now recorded so that team members can easily access a comprehensive list of our ESG-related engagement issues and responses on a company-by-company basis. This will facilitate increased awareness of issues raised over time, and promote a consistent and diligent engagement approach.

How engagement activities influence investment/proxy voting decisions

The Global Head of Property Securities and each analyst are responsible for the review of proxy votes and the decision. Many factors influence the decision, including those gleaned from engagement activities. The decision will be ultimately based on what is in the best interest of clients.

Engagement and proxy voting example:

Voting for share issues without pre-emptive rights

We voted for a number of share issues without pre-emptive rights where we believed they benefited minority shareholders and were in-line with market practice. Companies included Hang Lung Properties, Henderson Land Development, Wharf (Holdings) Limited, Sun Hung Kai Properties and Kerry Properties.

Stewardship in practice

Arena REIT

Arena REIT announced a proposed merger with Sydney Health Care Trust. The terms of merger benefited Sydney Health Care Trust shareholders more than Arena REIT shareholders.

As an Arena REIT shareholder the team initially met with management to gain clarity about the reasoning of a deal structure. Disapproval of the deal was communicated back to management and the intention not to vote to support the transaction. This led to a second engagement with management and board members of Arena where a detailed outline of the merger proposal was given and background to why certain deal metrics were chosen. The management and the board communicated why this deal was in the best interest of both groups and that this was the best possible outcome for Arena REIT.

After this engagement we became comfortable with the merger structure and pricing metrics. After understanding the extensive due diligence that management had undertaken and that the deal was well thought out and had strategic merit even at current pricing, we subsequently voted for the merger to be approved.

Proxy Voting Statistics

The table below shows our proxy voting statistics for calendar year 2013.

In addition to the traditional statistics on voting decisions, we have also included the percentage of resolutions where, after detailed evaluation, we voted against both management and proxy adviser's recommendations.

Global Listed Property Securities	Total Resolutions	Voted for %	Voted against %	Vote abstained %	Voted against management %	Voted against Proxy Adviser %	Voted against management and Proxy Adviser %
All	1068	93%	5%	2%	7%	9%	1%
Director elections	561	95%	3%	2%	5%	12%	1%
Compensation related resolutions (executive)	122	89%	10%	2%	11%	6%	2%
Shareholder proposals	1	0%	100%	0%	0%	0%	0%

Global Resources

> Inception Date 1997 **> Location** Sydney, London

Strategies

Global Resources

Head of Global Resources
Dr. Joanne Warner

ESG Committee member
Tal Lomnitzer

AREAS FOR DEVELOPMENT

Embed and fully utilise the capabilities of new ESG service providers GMI and Sustainalytics for aggregate portfolio comparison and benchmarking.

The team is involved in an ongoing project with the Principles of Responsible Investment (PRI) looking at the integration of ESG issues into executive remuneration.

KEY AREAS OF FOCUS

The team continues to focus engagement activities on executive remuneration (specifically ensuring alignment with shareholders' interests), environmental practices, safety, corporate governance and community engagement.

'Stranded Carbon' is an issue that is getting increased attention, specifically, the potential for long-term carbon reserves to become "stranded" or commercially impaired as a result of government regulation to combat climate change. We aim to better understand the carbon reserve risk of the companies that we are invested or may invest in. See page 34 for more information.

How ESG factors affect the team's investment decisions

How relevant issues are identified

ESG issues are particularly pertinent for natural resources companies due to the nature of the industry and the countries in which they operate. We believe that a consideration of ESG issues leads to better risk/return outcomes and improved long-term returns for clients.

We have developed a tailored ESG framework that is an integral part of the company review process. The framework is focused on safety, industrial relations, community, environmental performance, board structure, compensation and ownership. Primary research is supplemented with externally-sourced databases to ensure broad coverage. Each company held by the funds is formally reviewed annually with more frequent informal reviews through the year.

How issues are assessed

Site visits and management meetings are a key component in understanding the exposure and management of ESG risks and companies' ESG practices. These include environmental, safety and corporate governance practices as well as local community engagement. A social licence is as important as both the operating and environmental licences, to achieve a sustainable financial return.

How material issues are incorporated into investment decision making

We avoid investing in companies which cannot demonstrate that they meet appropriate standards or who are not making clear progress towards meeting them in the context of their operating environment.

If issues are identified we will approach the company directly to seek clarification and discuss remedies. Generally we find constructive discussions directly with senior executives or board members in a one-on-one setting to be productive and this helps build a stronger long-term relationship. Formal letters to the board are used where an informal approach has failed.

ESG integration example:

Stillwater – US Precious Metals Mining

We identified a number of governance issues within the operations of the company and its board, including a lack of transparency and sub-optimal expenditure practices. After unsatisfactory discussions with the CEO, we wrote directly to the board expressing our views. At the AGM we joined other investors to vote for new board members. The board and senior executive team have since been restructured. We continue to engage with the new CEO, who has already made significant improvements, and will be visiting the operations in March 2014 to make a first-hand assessment of the operations under the new management.

Stewardship through engagement and proxy voting

What proportion of companies are engaged with

The team engages on material ESG issues with all companies we are invested in. Material issues are identified via company meetings, site visits, sell-side research and by external ESG service providers. Questions about safety and environmental standards are part of the discussion, as well as work place culture, staff turnover and interaction with the local community.

How issues for engagement are identified

Engagement with companies is primarily carried out directly in meetings with management as well as indirectly via proxy voting. The process involves highlighting areas for potential improvement, encouraging disclosure on ESG issues, and commending companies that are making progress.

Where management does not respond adequately to engagement it may impact negatively on the assessment of the stock and could result in the team divesting its ownership.

How engagement activities influence investment/proxy voting decisions

Contentious issues are discussed within the team and with the Responsible Investment team. In some instances we will seek to engage with companies and external subject matter experts, proxy advisers and other shareholders to better inform our views. Analysts draw on their own experience of the company along with advice from CGI Glass Lewis. The final decision is made in consultation with the portfolio manager. Reasons for all instances are logged where the team vote against management or against CGI Glass Lewis's recommendations.

Engagement and proxy voting example:

Barrick – Canadian Gold Mining

Internal analysis raised concerns over high levels of remuneration for board members, including in one instance a significant sign-on bonus. We were also concerned with what was regarded as undue influence by the Chairman and low levels of independence amongst the board. Following a period of very poor performance and a major share issue to reduce debt, these concerns were raised during a corporate meeting and provided comments to a company adviser. We understand that many shareholders shared this view and also brought pressure to bear. Shortly afterwards the Chairman resigned and several new board members have been elected. We still have some reservations about the independence of the board and will continue to engage with the company.

Proxy voting examples:

HESS – US Energy

Having identified several governance issues we voted against management in favour of various shareholder resolutions at the last AGM. Specifically we voted in favour of the nomination of an independent director as Chairman. An independent Chairman is better able to oversee the executives of a company and set a pro-shareholder agenda. We also voted in favour of the elimination of supermajority voting requirements which can impede shareholders' ability to approve ballot items that are in their interests. We believe that certain entrenchment provisions such as supermajority vote standards are negatively correlated with firm value and can act as impediments to takeover proposals.

CF Industries – US Agriculture

We voted against management in favour of several shareholder proposals. The first was a proposal for a Political Spending Report in the belief that increased disclosure allows shareholders to more fully assess risks presented by the company's political spending. The second was a proposal in favour of publishing a sustainability report. In line with our requirements under the PRI, we encouraged the company to produce an annual sustainability report. The production of a comprehensive sustainability report should provide shareholders with valuable information regarding the risks and opportunities associated with the company's operations.

Stewardship in practice

GlencoreXstrata

GlencoreXstrata is one of the largest mining companies in the world with an extensive portfolio of assets, including some located in complex socio-political countries such as the Democratic Republic of the Congo, Zambia and Kazakhstan.

When Glencore announced the merger proposal with Xstrata we had meetings with the Chairmen of both companies to express views on the proposed transaction and to make the case for an increased bid for Xstrata. Despite the initial bid being recommended by the Xstrata board, the team and other shareholders were ultimately successful in achieving a higher price for shares.

Subsequent to the deal closing the team met with the CEO, organised a conference call with the head of ESG and most recently we met with members of the board and management following publication of the first group Sustainability Report. At each of these meetings the team discussed governance practices, safety performance and environmental standards building on the extensive internal fundamental research. It was concluded that the company is improving standards in these difficult jurisdictions, albeit from a low base in some instances, and has credible plans in place to improve further in the future. First-hand site visits undertaken over recent years in Africa and Kazakhstan have confirmed positive progress.

Proxy Voting Statistics

The table below shows the team's proxy voting statistics for calendar year 2013.

In addition to the traditional statistics on voting decisions, we have also included the percentage of resolutions where after detailed evaluation, the team voted against both management and proxy adviser's recommendations.

Global Resources	Total Resolutions	Voted for %	Voted against %	Vote abstained %	Voted against management %	Voted against Proxy Adviser %	Voted against management and Proxy Adviser %
All	2379	96%	3%	2%	4%	8%	0%
Director elections	1484	97%	1%	2%	4%	10%	0%
Compensation related resolutions (executive)	252	94%	5%	0%	6%	7%	1%
Shareholder proposals	38	37%	63%	0%	39%	11%	8%

Global Fixed Income and Credit

> Inception Date 1986 **> Location** Sydney, Singapore, Hong Kong, Jakarta

Strategies

Asian Fixed Income, Australian Credit, Global Credit (A$ floating rate return basis), Global Credit (benchmark return comparison), High Yield Credit, Australian Sovereign, Diversified Fixed Interest, Global Sovereign, Inflation-Linked Bonds and Emerging Market Fixed Interest

Head of Global Fixed Income and Credit
Tony Adams

ESG Committee member
Yen Wong

AREAS FOR DEVELOPMENT

Integration of new ESG research providers into credit research work flow and team training

- Development of an ESG framework for sovereign issuers
- Commitment to participate in the United Nations Environment Programme Finance Initiative and Global Footprint Network's second phase of Environmental Risk in Sovereign Credits (E-RISC) research to assess the materiality of natural resource related risks in the context of sovereign credit risk analysis

KEY AREAS OF FOCUS

- An increased awareness from emerging market regulators of the impact of a variety of ESG factors has increased the likelihood of negative impacts on credit quality. For example in China, increased awareness of the negative impacts of poor governance and environmental practices on the economy has driven regulatory changes that are having a negative impact on some companies.

How ESG factors affect the team's investment decisions

How relevant issues are identified

To identify key ESG risks the team use customised ESG rankings as a starting point for assessments. Analysts consider these alongside their own research with reference to a variety of other external sources.

How material issues are incorporated into investment decision making

The team assigns a proprietary internal credit rating (ICR) to every bond it invests in. The ICR is a forward looking measure of default risk and one of the key outputs of our credit research process. It reflects all risks relevant for that issuer including ESG risks. The ICR is on the same scale as ratings assigned by the rating agencies but is often materially different for individual issuers.

The ICR is used by all the credit portfolio managers when making their decision to buy or sell bonds, and to determine position size for the funds we manage. The Head of Credit Research is responsible for ensuring the quality of ESG inputs into the credit research process.

ICRs are also used by the passive funds when making decisions to invest in bonds ensuring that, even in the team's passive funds, ESG issues are integrated.

How issues are assessed (Fixed Income – Government)

We are still at an initial stage of incorporating ESG issues into assessments for sovereign issuers. Many of the indicators and the data used to arrive at the assessment of ESG risks for corporates do not apply for certain sovereign issuers.

For instance, country or corporate criteria for assessing ESG risks do not apply for supranationals. These issuers have a social or sustainable policy objective but there is limited reporting on their ESG performance to enable bond investors to assess and monitor these risks. The challenge is to find the appropriate data in order to assess the risks for a range of sovereign issuers and to understand how ESG risks impact the risk of default for these issuers.

ESG integration examples:

Bumi Resources

In 2009 we reviewed Bumi Resources and because of ESG concerns, did not rate (or invest) in the credit. The main concern related to the owner, Bakrie Group. Bakrie Group defaulted on its USD2.5bn debt during the Asian financial crisis in 1997 and it took over two years to restructure the debt. There was also the issue of the mudflow incident in East Java. Bakrie Group controls PT Lapindo Brantas, the operator responsible for the mudflow incident (Aug 2006).

Since that time, further problems came to light through 2012-2013 which means the bond now trades at 66c, i.e. a 43% loss from the security we declined to invest in.

Adani Abbot Point Terminal (AAPT)

In 4Q13, we reviewed Adani Abbot Point Terminal (AAPT) and assigned an internal rating of 'bb-', which meant we did not invest in the issue. The note from the analyst stated:

- Credit metrics are sub-investment grade (Debt/Capital 74%, Debt/EBITDA 8.6x, EBITDA/Interest 1.5x), and equate broadly to the bb-rating level. Also, there is no operating history to gauge any trends or volatility in the credit profile over time.
- EDF of parent/controlling entity (Adani Enterprises Ltd) is 3.34% (B-), and was 12% (CCC-) in mid-2012.
- Complex corporate structure – became even more so after recent restructure (which saw introduction of Caymans domiciled shell entities).
- Significant ESG issues (across all pillars, i.e., Environmental, Social, and Governance).

Stewardship through engagement and proxy voting

What proportion of companies are engaged with

The team's key engagement is with banks and counterparties to understand their ESG risks and their approach to managing those risks. For example, climate change and other environmental risks relating to the bank's loan book and financing, and aspects of their lending policies.

We do not engage systematically with issuers as this continues to be a challenging area for debt investors. However, we are increasingly conducting targeted engagements and recently undertook a pilot study to engage with semi-government bond issuers in Australia, including conducting its own research to assess the ESG risks faced (see case study on page 35). This assessment is an input to investment decisions.

How engagements are recorded

All engagements are recorded in the team's counterparty review records.

What follow up occurs after company meetings

Where we have engaged with counterparties, a note of the meeting outcomes is recorded in the following year's counterparty review, along with our updated assessment. This forms part of the following year's discussion so that we can monitor progress over time.

Stewardship in practice

We assigned HSBC a "B-" score on ESG. While the company rates well on environmental factors, the level of desired reporting is lacking with the bank focused on reporting their own environmental footprint, neglecting the risks investors need to know about. These risks relate to the bank's exposure to climate change and other environmental risks through its loan book and financing activities. In the assessment report we encouraged more meaningful reporting on environmental risk exposures and risk management, and have welcomed further discussion regarding how environmental risks are identified and managed by HSBC.

In response to the assessment, HSBC requested a meeting to discuss how sustainability issues are being managed specifically in relation to their lending practices. The team met with two HSBC representatives who described their framework for assessing sustainability risk and policies covering certain sensitive sectors; however it was not clear how this is applied within group. We also expressed concerns following the recent money laundering and bribery allegations, given only limited information was available regarding the settlement and how the company was addressing the issue internally.

We recently sent out our 2014 counterparty review and HSBC has again been proactive in engaging to request a meeting. We see this as positive and look forward to seeing how these matters have progressed since last year.

Emerging Markets Debt

> Inception Date 2011 **> Location** London

Strategies

Emerging Markets Sovereign and Corporate Debt

Head of Emerging Markets Debt
Helene Williamson

ESG Committee member
Manuel Cañas

AREAS FOR DEVELOPMENT

We have added a corporate debt specialist to the team. As a result this will enable us to increase our focus on this area and develop the team's ESG analysis in relation to corporate debt.

We aim to gain systematic access to data regarding investment restrictions put in place by national and supranational entities, including national foreign policy measures and UN sanctions among others.

KEY AREAS OF FOCUS

– Politics and social unrest

– Management of natural resources

How ESG factors affect the team's investment decisions

How relevant issues are identified

Issues are identified and considered in the course of the team's investment analysis. At the core of the process is a Key Factor Model (KFM). The KFM is comprised of six factors, or angles, from which we approach the analysis of the issuers in our investment universe. Three of these factors are intimately related to RI and stewardship: fiscal policy, politics, and structural reform.

We observe that investment restrictions put in place by the national and supranational entities relevant to their investment vehicles: national foreign policy measures, United Nations sanctions, European investment restrictions, among others.

The majority of information needed in order to analyse sovereign issuers is publicly available through National Statistics Offices. However, it is important for the analysts to spend time on the ground and observe country conditions first-hand to verify whether the statistics or the news is giving the full picture. This time spent on the ground can include meetings with government officials, but a great deal can also be gauged simply by observing the surrounding environment.

How issues are assessed for materiality

We have found that certain governance indicators regularly produced by the World Bank are relevant and statistically robust variables (in multivariate time-regression analysis) in determining a key measure of sovereign risk: the spread over US Treasuries.

As part of the investment process, the team conduct a valuation exercise that gives a broad estimate of where one key variable like country sovereign spreads should be at any given point in time. It is a purely statistical tool that looks at time-series of a number of variables and feeds a model that estimates the spread. Among the variables used, the World Bank Government Effectiveness index, is one of their Government Indicators. We have tested a number of variables for relevance and robustness, and this one in particular, in combination with the other three variables, seems to work best as a predictor of country spreads.

How material issues are incorporated into investment decision making

ESG issues are complex and while the issues of fiscal policy, politics and structural reform are systematically assessed through the KFM, the approach to incorporating ESG factors is still evolving.

Incorporating ESG into investment decision making

Areas where we recognise the relevance and are working to incorporate ESG factors into our investment process include:

Managing natural resources

For example, many countries in the emerging world rely heavily on their natural resources to keep their finances in good condition. Poor decision-making in managing those resources, like calibrating sustainable harvest ratios for fisheries, or the adequate replenishment of soil nutrients in agriculture, or proper reinvestment in exploration for non-renewables, could potentially undermine a country's export output and, ultimately, their ability to source the hard currency needed to service their debt.

Social issues

Likewise, social issues could reflect on the scores of the KFM's politics and structural reform. It is not uncommon for elections in emerging countries to be highly polarised. The political spectrum can be quite broad, and so is the range of possible outcomes when key elections are held. In this context, we try to gauge social cohesion, to ensure that whatever the election outcome, the government will enjoy a broad and diverse base of support. To the extent that it may not be the case, the willingness to pay by the incoming government could be challenged or questioned.

Structural reform

Structural reform, the third factor in the KFM that is relevant for RI principles, can also have an impact on a country's social issues. Consider a country where, in order to unleash the productive potential of certain economic sectors, the power amassed by labour unions over decades may be challenged. What at first sight may seem as a clear positive for the issuer's ability to service their debt may turn out to be a destabilizing social factor with negative consequences that may dominate the better prospects for the economic outlook. A sustainable balance between labour and capital is vital to sustaining minimum levels of political stability.

Country examples:

Venezuela – social unrest

The situation in Venezuela is currently deeply concerning. Widespread riots in the capital city of Caracas have resulted in deaths, yet they have received little media coverage. The underlying problem is that the country's foreign exchange reserves are falling. This is a major problem for a country in which the majority of food, and many other staple goods, is imported. A significant rise in the country's Scarcity Index indicated that supplies of basic and essential items were becoming stressed. Unless the government can address this it seems certain that social unrest will persist and political stability be compromised as opposition to the government intensifies. This in turn will have a potentially negative impact for the country's government bonds.

Argentina – governance concerns

Argentina has over recent years persistently understated inflation levels. In fact this issue dates back to 2007, when just as a sharp increase in inflation due to medical insurance was widely anticipated, data was unexpectedly withheld and the Board of the National Statistics Office replaced overnight; in itself raising clear governance concerns. During visits to the country it has become abundantly clear to us that inflation is being considerably understated. As a result we have applied a higher risk premium to Argentinian debt securities.

Australian Equities Core

> Inception Date 1993 **> Location** Sydney

Strategies

Australian Equities, Long Short, Tax Aware, Equity Income, Geared, Indexed, Small Companies, Small Companies Long Short

Head of Australian Equities, Core
Matthew Reynolds

ESG Committee member
Robin Balcomb

AREAS FOR DEVELOPMENT

We are:

- Developing ESG dashboards for each company to support analysis,
- Improving the portfolio level monitoring of ESG risks,
- Increasing engagement activities and follow-up with companies on issues impacting on sustainability of earnings such as unburnable carbon.

KEY AREAS OF FOCUS

- Corporate governance focus areas are likely to include executive remuneration and board structure.
- Management of environmental and social issues in supply chains will also be a focus area following a series of significant incidents in the last few years.
- The potential risk of assets becoming 'stranded' flowing from both the physical impacts of climate change and enforcement of a carbon 'budget'. See page 34 for more information.

How ESG factors affect the team's investment decisions

How relevant issues are identified

The Australian Equities, Core team has adopted a bottom-up approach to identifying key ESG risks. Our internal analysis is supplemented by company disclosures, media and external research.

How issues are assessed

Analysts consider ESG and sustainability issues as one of six factors in the stock research and selection process. A consideration of a company's sustainability and governance policies and practices is therefore an explicit part of the stock research process.

How material issues are incorporated into investment decision making

Where ESG and sustainability factors are determined to have a material impact on profitability, they are quantified and implied in all other factors; most directly in the valuation and financials of the stock.

ESG integration example:

Origin Energy

Safety does not feature prominently or regularly in presentations to the market. This contributed to concerns about safety and risk management in the analyst's overall stock recommendation. Subsequently safety and risk management issues have been tabled for ongoing discussion in meetings with management.

Stewardship through engagement and proxy voting

What proportion of companies are engaged with

We engage with all companies held in our portfolios and many others in the investment universe and beyond. We collectively completed more than 2,000 company visits during 2013.

How issues for engagement are identified

Issues for engagement are identified through the detailed company research and analysis described above and have been an explicit component of the Australian Equities, Core investment process since 2007.

How engagements are recorded

All company visits are recorded in a centralised database available to all team members. ESG comments are included as a separate field and are easily identified.

What follow up occurs after company meetings

Progress on ESG issues is monitored by analysts through a review of the company visits historical record. Subsequent meetings with management provide opportunities to monitor progress on particular topics of concern.

How engagement activities influence investment/proxy voting decisions

Engagement activities are designed to improve our understanding of the policies and practices of companies and assess their effectiveness in managing ESG risks. The outcomes of our engagement with companies flows through to proxy voting decisions and, ultimately, investment decisions.

Engagement and proxy voting examples:

Leighton Holdings

We engaged the company on the implementation of a new employee KPI system for the entire group, facilitated by the appointment of a new Chief Human Resources Officer. This is expected to have a positive impact on the company culture and the quality of new work being won, although we expect this will take time to flow through to financial results.

Fortescue Metals Group

We voted against the appointment of a nominee to the board of directors, as their principal experience was as an employee of Macquarie Bank. As Fortescue paid material fees to Macquarie Bank in the period we did not believe the nominee was sufficiently independent to safeguard minority shareholder interests. More broadly, we believe that Fortescue Metals Group have a director independence issue and have raised this with management.

Stewardship in practice

BHP Billiton

BHP Billiton's sustainability rating was downgraded from a positive to neutral reflecting concerns on a number of sustainability issues, including community relations at the Cerro Matoso nickel operations in Columbia; a concentrate spill at zinc and copper mine Antamina in Peru; an ongoing US Department of Justice corruption investigation; and the Papua New Guinean Parliament revisiting the Ok Tedi agreement, which grants BHP immunity from legal action for environmental damage caused by the mine's operations.

Although BHP Billiton has good corporate policies and reporting in place for environmental and social issues, the frequency of recent incidents is of concern to the team. A number of recent sustainability related issues raised concerns that BHP Billiton will be increasingly exposed to negative media, which could damage its image and reputation.

Increased activity in onshore drilling in shale wells in Texas, US, further exposes BHP Billiton to negative public relations issues due to heightened public concern around the negative environmental and social impacts from "fracking"[2]. These will be monitored closely. While Texas is a very oil and gas friendly jurisdiction, suggesting these issues will not materially affect operations, meetings were nevertheless arranged to discuss these issues with the company and dialogue is ongoing.

Proxy Voting Statistics

The table below shows the team's proxy voting statistics for calendar year 2013.

In addition to the traditional statistics on voting decisions, we have also included the percentage of resolutions where after detailed evaluation, the team voted against both management and proxy advisers' recommendations.

Australian Equities Core	Total Resolutions	Voted for %	Voted against %	Vote abstained %	Voted against management %	Voted against Proxy Adviser %	Voted against management and Proxy Adviser %
All	1523	92%	8%	0%	7%	6%	3%
Director elections	689	93%	7%	0%	7%	6%	2%
Compensation related resolutions (executive)	517	90%	10%	0%	10%	8%	5%
Shareholder proposals	3	33%	67%	0%	33%	33%	0%

2 Fracking or hydraulic fracturing is the forcing open of fissures in subterranean rocks by introducing liquid at high pressure in order to extract oil or gas.

Australian Equities Growth

> **Inception Date** 1989 > **Location** Sydney

Strategies

Australian Equities, Growth, Imputation, Long Short, Small-mid Cap, Micro Cap

Head of Australian Equities, Growth
Marcus Fanning

ESG Committee member
Alex Gallard

AREAS FOR DEVELOPMENT

We are:

- Ensuring each stock covered in the coming months will have its valuation summary page include ESG ratings to provide a flag for low ESG ratings so portfolio managers and analysts can easily review without having to access the company reports manually.
- In the process of streamlining our proxy voting system by moving from a manual to an automated process.

KEY AREAS OF FOCUS

- Board governance, particularly with respect to remuneration, environmental issues and diversity are likely to be a key issue for Australian-listed companies in 2014.
- We expect the key issues to be similar to previous years. Our focus will remain on board and management incentives and our alignment with clients' interests.

How ESG factors affect the team's investment decisions

How relevant issues are identified

ESG risks are primarily identified by the team's own internally-driven research, which is based on a rigorous company engagement programme. Analysts assess how companies are managing ESG issues and encourage the entities in which they invest to improve their ESG performance and disclosure.

How issues are assessed

This analysis is vigorously stress tested and screened under a peer review process. This process seeks to highlight the analysts' and team's conviction in the target price and recommendation.

ESG considerations are used to help develop quantitative and qualitative risk assumptions in analysts' assessment of industries and stocks, and are overlayed in target price and stock recommendations.

ESG integration example:

Sims Metal Management

There were instances of poor capital allocation and value-destructive acquisitions at the company which placed the balance sheet at risk and manifested in write-downs.

We engaged in dialogue with the company board and the Chairman about concerns on the strategy and future of the company under the CEO's leadership.

The CEO was ultimately replaced, and the holding was retained in the stock as we came to the view that the management team had a renewed focus and direction.

Stewardship through engagement and proxy voting

What proportion of companies are engaged with

We undertake active engagement with many companies' senior management and boards. We take the opportunity to raise material ESG issues in these discussions.

How issues for engagement are identified

We seek to gain comfort that senior management and company boards are aware of, and accountable for, the management of material ESG issues.

Where there is concern that material issues are not being appropriately addressed, an engagement strategy is developed for the issue. This may ultimately flow into the proxy voting and investment decisions.

How engagements are recorded

Company engagements are not currently recorded. We are in the process of implementing a database of company engagements that will be available to all team members by the end of 2014.

How engagement activities influence investment/proxy voting decisions

Engagement activities are an important part of the fundamental, bottom-up, analytical framework used to assess the investment universe.

All proxy voting resolutions are reviewed, taking into account all relevant factors, and an appropriate recommendation is made in line with the corporate governance guidelines and principles. The exercising of voting rights is always executed in the belief that it is an asset of and in the best interests of investors and clients to do so.

Engagement and proxy voting example:

David Jones

The CEO unexpectedly resigned, citing personal reasons for his departure. We were concerned about the timing and nature of the resignation, and held multiple discussions with the Chairman and senior management to get a clearer understanding. Subsequently we voted against the board members at the company's Annual General Meeting, believing the board composition was sub optimal, as there was no retail experience on the board.

We did, however, vote in favour of the company's resolution concerning the Remuneration Report where some other major investors voted against in protest of the board. We carefully review each resolution on its merits, and didn't believe a vote against was in the best long-term interests of the company or clients.

Stewardship in practice

Boral

In mid-2010, Boral did not specify any hurdles for their short-term incentives (STIs), while long-term incentives (LTIs) were wholly linked to total shareholder return (TSR) relative to the ASX 100. Following the appointment of a new Chairman, STIs were wholly linked to earnings before interest and tax (EBIT) growth. LTI hurdles remained unchanged however.

In 2011, the newly-appointed CEO announced a change in strategy and made several acquisitions in a short space of time, spending more than AUD850m. The largest of these was the acquisition of 50% of the Lafarge plasterboard company in Asia for $600m at a forecast EBITDA multiple of 11.1x; a very full price which significantly increased the leverage in the business.

Throughout 2011 and 2012, we had several conversations with the Chairman around remuneration. It was the view that the lack of hurdles relating to return on funds employed (ROFE) was encouraging management behaviour to acquire at any cost, even as its core markets of Australia and the US were on a cyclical downturn.

To try and resolve the matter we wrote a letter to the board explicitly recommending that they divest the recently acquired Asian joint venture business, de-gear the company and focus on their core Australian and US franchises. We also persisted with the view that there needed to be ROFE hurdles for management.

In the 2013 remuneration report, the company altered the hurdles. LTI hurdles are now based off ROFE (33%) and relative TSR (67%). Whilst still not ideal, we believe this is a step in the right direction. In October 2013, the company sold down its 50% of the Lafarge business to USG Corporation for roughly AUD$500m at an EBITDA multiple of 10.6x. Whilst below the 11.1x that they recently paid, it de-geared the balance sheet and allowed the company to focus on its core Australian and US businesses.

While these outcomes are unlikely to be as a direct result of our engagement, we hope to have had some part to play towards achieving a positive outcome for the long-term benefit of the company and end investors.

Proxy Voting Statistics

The table below shows the team's proxy voting statistics for calendar year 2013.

In addition to the traditional statistics on voting decisions, we have also included the percentage of resolutions where after detailed evaluation, the team voted against both management and proxy advisers' recommendations.

Australian Equities Growth	Total Resolutions	Voted for %	Voted against %	Vote abstained %	Voted against management %	Voted against Proxy Adviser %	Voted against management and Proxy Adviser %
All	941	94%	6%	0%	5%	5%	0%
Director elections	407	96%	4%	0%	4%	6%	0%
Compensation Related resolutions (executive)	340	93%	7%	0%	7%	4%	1%
Shareholder proposals	6	50%	17%	33%	67%	0%	0%

Emerging Practice – Our New Frontiers

Indonesian Equities

Indonesia is a dynamic developing market where basic shareholder protections and governance practices which would be found in other developing markets are absent or fairly new. Consequently, of all our investment teams, our Indonesian equities team have faced some of the most significant challenges in implementing RI practices.

Even basic stewardship responsibilities like proxy voting are difficult in Indonesia as notice of meetings have very little information on resolutions, with shareholders expected to attend meetings and vote with almost no background information as to the issues.

In 2013 our Indonesian Equities team celebrated its 10-year anniversary. Over that time their efforts to integrate ESG factors into investment decision-making remains as unique as its all-female investment team.

The team's investment process incorporates EGS factors by:

- allocating an ESG score for large companies, and
- ensuring that the team has regular meetings with the management of smaller companies and engaging on ESG issues wherever possible.

As part of its RI development the team has undertaken to provide more detailed explanations of their ESG scores and where sufficient information is available, vote company proxies.

To support the Indonesian team, the RI team is working on providing them better access to ESG research through GMI, Sustainalytics and RepRisk, and encouraging the providers to expand coverage wherever possible. The RI team will also be helping the team improve proxy voting processes with the help of our proxy voting advisor CGI Glass Lewis. And lastly, both the Indonesian Equities team and FSI more broadly will continue to support the Asian Corporate Governance Association in its excellent work on improving corporate governance practice across Asia, including in Indonesia.

The experience of our Indonesian Equities team shows us that no matter the market, improving RI practices is possible. Over time we believe this focus and leadership in the Indonesian market will provide us an investment edge as the market inevitably recognises the impact of these factors on long-term performance.

Head of Indonesian Equities
Hazrina Dewi

Q&A with our Head of Indonesian Equities, Hazrina Dewi

1. What do you find the most challenging aspect of integrating ESG factors into your investment decisions?

Information, or the lack of it, is our main challenge. Even though some companies do issue sustainability reports, their reports usually only cover their corporate social responsibility (CSR) activities rather than addressing ESG risks and opportunities. We appreciate their effort on CSR activities, although however we do feel the disclosures are mostly cosmetic.

Companies often act as if once they have done their share in CSR their ESG responsibilities are completed. To make it worse even investor relations personnel sometimes have a lack of understanding on what ESG means (risk) and how the company they represent has carried out their ESG responsibilities. As a result we are heavily dependent on market information to make sure there are no ESG related shocks.

2. Given the difficulty in obtaining good information, what are some of the things you look for when assessing companies on their ESG performance?

Governance is our main consideration. Access to company information and investor relation responses are what we are looking for. Take two companies from the same industry for example; we would put premium valuation on the one that answers our phone calls and replies to our emails promptly. Consistency of information is also important as the communication needs to happen in both good and bad times. We usually make quarterly contact with companies whose shares we are holding.

3. Which is the most sustainable Indonesian company in your portfolio and what does this add to the investment case?

This is a very hard question for a market such as ours. Most listed companies are either family related or state owned. Astra International is a company that has been able to perform for a long period of time and transformed from a family business to become a professionally managed conglomerate. Having Jardines as majority shareholders certainly helped the company to adopt global standards of practice, at least in governance. We believe they are working hard on the other aspect of ESG as well, although having mining and plantations as one of its many businesses makes the job harder.

4. When trying to discuss ESG issues with Indonesian companies what is the general response like, and can you give an example of a company that was open to discussing their ESG performance?

Our difficulty was not caused by companies hiding their ESG problems. Rather it is their lack of understanding about ESG that was the main culprit. For example not all investor relations departments of property companies can answer our questions on their waste management policy. In fact none of the property companies we talked to know how much of their waste is recycled. Therefore we have a lot of work to do to make sure that companies integrate ESG information into their investor presentations in addition to operational and financial information. We keep asking the right questions and hoping one day they will have the answer in hand rather than telling us that they will get back to us with the information. Better yet would be to give us the information without us having to ask them!

Case Studies

Working Group – "Stranded Assets"

Background

In 2010, international governments formally set a long-term goal to limit global warming to below 2 degrees centigrade, requiring a stabilisation of the atmospheric concentration of greenhouse gas (GHG). More than 80% of the world's growing energy demand is currently met by fossil fuels; however, a significant body of scientific research states that to achieve the 2 degree goal, fossil fuel related GHG emissions will have to be significantly reduced.

According to the International Energy Agency, the world is currently on a path to raise the atmospheric concentration of GHGs to a level corresponding with warming of 3.6 degrees or more. The World Bank recently warned that there could be no certainty that adaptation to this level of climate change is possible and that a "4 degree warmer world can, and must, be avoided".

In 2009, research by the Potsdam Institute calculated that to reduce the chance of exceeding 2 degrees warming to 20%, the world should adopt a carbon budget equivalent to 565 GtCO2 emissions from 2009 and 2050. At the current rate this would be reached in approximately 16 years.

In 2013 this work was reframed in an investment context by the Carbon Tracker Initiative which found that if known fossil fuel reserves are used, humanity would exceed the carbon budget by several times. Conversely, if the carbon budget were to be implemented, there is a risk of significant write-downs to the value of these fossil fuel reserves causing them to become 'stranded'. The carbon budget approach has subsequently been endorsed in the October 2013 Intergovernmental Panel on Climate Change's fifth assessment report.

Our response

In considering this issue our Global Resources team has taken the lead by engaging with companies within its portfolios that they consider at risk. Through this process the team is collecting specific information on how companies are considering the issue and what strategies they are developing to mitigate and manage the potential business risks.

In December 2013 the ESG Committee formed a stranded assets working group to explore and better understand the investment implications of the complex issues and debates around carbon budgets and the risk of stranded assets.

The group's work will involve:

- Literature review: The group will collect and assess the available literature on the issue.
- Exposure assessment: The group will develop a framework for determining which assets may be most at risk. The framework will be used to determine the risk exposure across our global investment portfolios.
- Options assessment: The group will (at a high-level) consider the range of options investment teams can take to understand, evaluate and manage any perceived risks for the long term protection of our clients assets.

To date the literature review has been completed and the former head of Deutsche Bank Climate Change Advisors, Mark Fulton, presented at the first meeting of the group. We expect this work to be complete by the middle of 2014.

Engaging with Semi Government Bond issuers

In April 2013, the Fixed Income & Credit team established, with the support of the RI and Strategy team, a semi-government bond engagement program. This engagement team developed an approach for assessing and engaging with Australian state governments on ESG risks and opportunities.

Early on in the process the limitations of traditional ESG risks assessments for semi government issuers were recognised, including:

– how and whether individual ESG issues will impact the performance of the bonds,

– assessing how and when different risks might manifest themselves, and

– the need to take a more systems-based approach to the assessment due to the relationships between many of the issues.

As a result, rather than assessing and seeking to quantify the impact of individual issues, the team decided to explore and fully understand the governance and decision-making frameworks used by state governments. In particular we were interested in those decisions which required trade-offs between different stakeholder groups and/or between long-term and short-term outcomes.

To pilot the framework we chose to review the Australian state governments of Queensland and New South Wales. These states were chosen due to our existing good relationships with the relevant treasury departments.

Examples of ESG issues we wished to explore included:

– Mining approvals

– Social disadvantage and inequality

– Infrastructure planning

– Biodiversity loss

– Climate change adaptation

– Gaming machines

In our meetings and correspondence we met with treasury officials, corresponded with various other government departments and met with the treasurer of NSW. We found that once our purpose and objectives were explained there was a willingness and openness to discuss the issues. Whilst there were challenges along the way, for example, sourcing the most relevant information, a good platform for future engagements was established.

With the first round of pilot discussions complete the team are now planning to:

– roll out the framework to other Australian states

– inviting other debt investors to engage with these state governments via the PRI clearing house system, and

– monitoring the issues identified for each state and incorporating annual checks in our discussion of the issues in future meetings.

More information on this engagement programme will be published during 2014.

Industry Collaboration

During 2013 we continued to support a variety of industry initiatives which promote and raise standards for responsible investors as well as help us improve our own practices. We participate in initiatives either through financial contributions, intellectual capital contributions, or both. For some we will lend our name in support of initiatives that are advocating for better practices, while for others we will take a much more active role, including in the governance of the organisation.

We are very proud and strong supporters of the initiatives we participate in, however like any other aspect of our business it is important to review our support to ensure that it remains aligned with our strategic priorities and that we are making best use of the limited resources available for this purpose.

We also are aware, and have raised concerns in the markets where we are most active, that as groups with related objectives have developed and grown over time, they have not always communicated or collaborated with each other which has resulted in either overlaps or gaps developing. This is of particular concern where there are overlapping membership bases. We have, and will continue to, encourage the groups we support to communicate more so that good coverage over what are a broad range of complex and ever-changing issues can be maintained and encouraged.

For this reason in 2014 we will perform a strategic review of collaborative initiatives while also identify any gaps which we believe need to be filled. This review will ensure we are allocating resources effectively, but most importantly allow us to engage with different groups in a more effective way. We expect this review to be completed in the second half of 2014.

Key Collaborations

Global Initiatives

PRI
- Infrastructure Steering Committee
- Clearinghouse Steering Committee
- PRI Country Network Steering Committee (Australia)
- Sustainable Palm Oil Working Group
- Reporting Framework Advisory Group

United Nations Environment Programme Finance Initiative
- Member of the Property Working Group
- Member of the Asset Management Working Group
- Member of the Supply Chain Working Group.

Investment Leaders Group
- Founder Member

Integrated Reporting
- Member of Pilot Program Investor group (UK)
- Business Reporting Leaders Forum (Aust)

Asia Pacific

Financial Services Council
- Member of the Investment Committee
- Member of the ESG Working Group

Responsible Investment Association Australasia
- Chair
- Member of Governance Committee

Infrastructure Sustainability Council of Australia
- First Deputy Chair and Director

ESG Research Australia
- Management Committee Member

Association of Superannuation Funds of Australia
- Member of ESG Working Group

Association for Sustainable and Responsible Investment in Asia

Green Building Council of Australia
- Member of the Board of Directors

Investor Group on Climate Change
- Member of the Committee of Management
- Chair of the Research Working Group
- Chair of the Property Working Group
- Member Water Working Group

Property Council of Australia (PCA)
- Member of the National Sustainability Roundtable
- Member of the PCA (NSW Division) Sustainable Development committee

Better Buildings Partnership
- Member of leadership panel

NABERS (Shopping Centres) Technical Advisory Group (TAG)
- Member

NABERS (Multi-Tool) TAG
- Member

GBCAB Greenstar Performance Technical Working Group
- Member

EMEA

Institutional Investor Group on Climate Change
- Member

UK Sustainable Investment Forum
- Board Member

EUROSIF
- Board Member

Signatory initiatives
- Carbon Disclosure Project
- Water Disclosure Project
- Extractive Industries Transparency Initiative

Responsible Investment Team Contacts

Will Oulton
Global Head, Responsible Investment

will.oulton@firststate.co.uk
+44 (0)20 7332 6529

Pablo Berrutti
Head of Responsible Investment, Asia Pacific

pablo.berrutti@colonialfirststate.com.au
+61 2 9303 0433

Elizabeth Dourof
Team Assistant, Responsible Investment

elizabeth.dourof@firststate.co.uk
+44 (0) 20 7332 6801

We welcome your comments and feedback – please email
stewardship@firststate.co.uk

Appendix 1 – Proxy Voting and Engagement Summary

	2011	2012	2013
Company meetings	1539	1547	1466
Resolutions voted on	15116	15647	15115
Resolutions supported	13374	14253	14083
Resolutions against	1497	1287	929
Resolutions abstained	93	103	103
Director election	6745	7044	6851
Executive remuneration	533	478	512
Non-executive remuneration	509	488	501
Issue of new shares	283	232	207
Remuneration Report	744	780	749
Financial scheme/reconstruction of capital	62	67	35
Constitution/articles of association change	554	578	479
Appoint/Reappoint auditor	877	933	896
Takeover or merger speculation	98	121	67
Shareholder proposals	115	139	150
Shareholder proposal - Environment	27	29	27
Shareholder proposal - Social	57	58	51
All other proposals	4512	4700	4590
Number of company meetings involving director elections / re-elections	1150	1165	1127
Number of resolutions involving director elections/re-elections	6745	7044	6851
Director elections/re-elections supported	92.4%	93.4%	95.6%
Director elections/re-elections against	6.9%	5.7%	3.6%
Director elections/re-elections abstained	0.7%	0.9%	1.0%
Number of company meetings involving remuneration reports	523	573	567
Number of resolutions involving remuneration reports	744	780	749
Remuneration reports supported	80.4%	86.7%	89.3%
Remuneration reports against	19.6%	13.1%	10.4%
Remuneration reports abstained	0.0%	0.3%	0.3%
Number of company meetings involving executive remuneration reports	223	224	226
Number of resolutions involving executive remuneration reports	533	478	512
Executive remuneration reports supported	87.2%	83.3%	93.8%
Executive remuneration reports against	12.6%	16.5%	6.3%
Executive remuneration reports abstained	0.2%	0.2%	0.0%
Number of company meetings involving non-executive remuneration reports	359	348	344
Number of resolutions involving non-executive remuneration reports	509	488	501
Non-executive remuneration reports supported	96.3%	95.3%	96.8%
Non-executive remuneration reports against	3.3%	4.3%	2.6%
Non-executive remuneration reports abstained	0.4%	0.4%	0.4%

Appendix 2 – Companies Subject to the Cluster Munitions Policy

Cluster Munitions & Anti-Personnel Mines Policy

During 2013 we launched our policy on cluster munitions and anti-personnel mines. This policy states that we will not invest our clients' money in securities, whether equity or debt, issued by companies that are involved in the manufacture of cluster munitions or anti-personnel mines. This policy is applied globally across all our asset classes, including index strategies.

The list of companies as published by the Dutch Authority for Financial Markets has been adopted as our starting point for the purposes of the exclusion policy. Companies on the exclusion list at December 2013 are:

- AFM Risico-Radar
- Aeroteh
- Alliant Tech
- Aryt Industries
- Ashot Ashkelon
- Hanwha Corporation
- Kaman Corp
- Lockheed Martin Corp
- Norinco
- Poongsan Corporation
- Singapore Technologies
- Splav State Research
- Textron

The on-going monitoring of excluded companies is undertaken by our ESG research providers and is reviewed by the GRIC and the ESG Committee on a regular basis.

Appendix 3 – GRIC and ESG Committees

Global Responsible Investment Committee members

Name	Title	Location
Mark Lazberger (Chairman)	Chief Executive Officer	Sydney
Chris Turpin	Regional Managing Director, EMEA & Global Head of Product	London
Paul Griffiths	Chief Investment Officer, Fixed Income and Credit	London
Kanesh Lakhani	Head of Distribution, EMEA & Global Consultant Relationships	London
David Dixon	Chief Investment Officer, Equities	Sydney
David Gait	Senior Portfolio Manager, First State Stewart	Edinburgh
Stephen Deane	Investment Analyst, First State Stewart	Edinburgh
Niall Mills	Head of Infrastructure Asset Management, Europe	London
Joe Fernandes	Head of Global Investment Solutions Group	Sydney
Martin Lau	Director Greater China Equities, First State Stewart	Hong Kong
Alexis Ng	Managing Director, South East Asia & Head of Distribution, Asia	Singapore
Caroline Gibson	Head of Human Resources, Asia & Japan	Hong Kong
Anneliese Diedrichs	Corporate Communications Manager	Hong Kong
Harry Moore	Head of Sales, Australia and New Zealand	Melbourne
Hario Soeprobo	President Director, Indonesian Equities	Jakarta
Toni Spencer	Head of Credit Research – Fixed Income and Credit	Sydney
Mark Rogers	Associate Director Asset Management, Direct Infrastructure	Sydney
Will Oulton	Global Head, Responsible Investment	London
Pablo Berrutti	Head of Responsible Investment, Asia Pacific	Sydney

ESG Committee members

Name	Title	Location
Joseph Daguio	Investment Analyst, Global Property Securities	Sydney
Yen Wong	Manager, Fixed Income & Credit	Sydney
Manuel Canas	Senior Portfolio Manager, Emerging Market Debt	London
Tal Lomnitzer	Portfolio Manager, Global Resources	London
Lizzie Reid	Assistant Portfolio Manager, Fixed Income & Credit	Sydney
Gokce Bulut	Investment Analyst, First State Stewart	Edinburgh
Robin Balcomb	Portfolio Manager, Structured Equities, Australian Equities Core	Sydney
Alex Gallard	Senior Investment Analyst, Australian Equities Growth	Sydney
Mark Rogers (Chairman)	Associate Director Asset Management, Direct Infrastructure	Sydney
Hazrina Dewi	Head of Equities, Indonesia	Jakarta
Rebecca Sherlock	Senior Investment Analyst, Global Listed Infrastructure Securities	London
Pablo Berrutti	Head of Responsible Investment, Asia Pacific	Sydney
Will Oulton	Global Head, Responsible Investment	London

Auckland
First State Investments
Level 3, 33–45 Hurstmere Road
Takapuna
Auckland 0622
New Zealand
Telephone: +64 9 448 4922
Facsimile: +64 9 486 7131

Edinburgh
First State Investments
23 St Andrew Square
Edinburgh EH2 1BB
United Kingdom
Telephone: +44 (0) 131 473 2200
Facsimile: +44 (0) 131 473 2222

Frankfurt
First State Investments
Westhafen Tower
Westhafenplatz 1
60327 Frankfurt a.M.
Germany
Telephone: +49 (0) 69 710456 - 302

Hong Kong
First State Investments
6th Floor
Three Exchange Square
8 Connaught Place
Central
Hong Kong
Telephone: +852 2846 7566
Facsimile: +852 2868 4742

Jakarta
First State Investments
29th Floor
Gedung Artha Graha
Sudirman Central Business District
Jl. Jend. Sudirman Kav. 52–53
Jakarta 12190
Indonesia
Telephone: +62 21 2935 3300
Facsimile: +62 21 2935 3388

London
First State Investments
3rd Floor
30 Cannon Street
London EC4M 6YQ
United Kingdom
Telephone: +44 (0) 20 7332 6500
Facsimile: +44 (0) 20 7332 6501

Melbourne
Colonial First State Global
Asset Management
Level 18, Tower One,
Collins Square
727 Collins Street
Melbourne VIC 3008
Australia
Telephone: +61 3 8628 5600
Facsimile: +61 3 8628 5608

New York
First State Investments
599 Lexington Avenue, 17th Floor
New York, New York 10022
United States of America
Telephone: +1 212 848 9200
Facsimile: +1 212 336 7725

Paris
First State Investments
14, avenue d'Eylau
75016 Paris
France
Telephone: +33 1 73 02 46 74

Singapore
First State Investments
1 Temasek Avenue
#17–01 Millenia Tower
Singapore 039192
Singapore
Telephone: +65 6538 0008
Facsimile +65 6538 0800

Sydney
Colonial First State Global
Asset Management
Ground Floor
Tower 1 Darling Park
201 Sussex Street
Sydney NSW 2000
Australia
Telephone: +61 2 9303 3000
Facsimile: +61 2 9303 3200

Tokyo
First State Investments
8th Floor,
Toranomon Waiko Building
12–1, Toranomon 5-chome
Minato-ku
Tokyo 105-0001
Japan
Telephone: +81 3 5402 4831
Facsimile: +81 3 5402 4839

www.firststateinvestments.com

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