

RESPONSIBLE INVESTMENT STRATEGY

Introduction

The role of the FRR is to invest, on behalf of the public, the sums entrusted to it by policymakers to help finance the general retirement scheme (private sector employees) and aligned plans (for salaried farm workers and skilled crafts person) as of 2020. In light of this role, the FRR is a long-term investor and an instrument for ensuring intergenerational solidarity. For this reason, when it was first set up in 2003 and in the first decisions made by the Fund's Supervisory Board, the latter stressed that *"its investment strategy should be consistent with certain shared values that promote economic, social and environmentally sustainable development"* and that *"the FRR should actively contribute to promoting best practices, thereby encouraging asset management firms to incorporate these values into their analysis of financial assets and corporate governance transparency."*

On these foundations, the FRR (i) introduced social, environmental and governance criteria into some of its investment portfolios so that the managers investing on its behalf could integrate them into their analysis of companies, and (ii) set up a global policy of voting proxies at shareholder meetings. In April 2006, the FRR formally committed to the application of the PRI (Principles for Responsible Investment), which were drafted under the auspices of the UN (see Appendix 1).

The Board conducted an assessment of the various actions undertaken based on the analysis by the Executive Board and independent consultants. On this basis, and also by taking into account the practices developed by other institutional investors in Europe in the area of responsible investment, the Board decided to build on the initiatives conducted up to now and specify the strategic pillars around which FRR's identity as a responsible investor will develop in the years to come (2008-2012).

This document describes these strategic pillars and the way in which the FRR intends to implement them over time.

1/ How do we define responsible investment?

By responsible investment, the FRR means voluntarily taking ESG (environmental, social and governance) criteria into account when making decisions related to investment and related activities (research, analysis, voting proxies and dialogue with companies in particular). This definition, which underscores the different dimensions of responsible investment, is widely accepted within the financial community. It does not address the reasons for integrating extra-financial factors nor the ways in which to do so, which may vary from one investor to another and from one investment class to another.

2/ Why does the FRR intend to be a responsible investor?

- The first reason is related to its fundamental mission and its objective, which is to optimize the return on the funds entrusted to it for investment under the best possible conditions of security. To this end, it is necessary to incorporate ESG criteria into asset management in order to fully apprehend the risks and opportunities attached to the businesses in which the FRR invests and will invest in. In fact, the FRR is convinced that these criteria can have an impact on the value of the companies and hence on the risk-adjusted return on investment. Consequently, not integrating these criteria in its investment decisions could run counter to its interests and objective.
- The second reason is economic in nature : The long-term performance of investments does not depend only on the impact of the financial and extra-financial strategy of the companies, but also on the impacts that they generate for the industry in which they operate or for the whole economy. An analysis of these externalities , positive or negative, and therefore of the environmental and social sustainability of corporate strategies and their implications for the community, is necessary, in particular for an investor whose resources are provided by the public and intended for investment over the long term in a vast number of companies.
- The third is related to the role of the FRR as a public, long-term investor. As such, the FRR is expected to identify and track the risks that some of these investments may pose to its own reputation. The FRR must also promote best investment practices within and with respect to the financial community.

3/ What are the main drivers of FRR's responsible investment strategy?

The new strategy builds on orientations and guidelines that were decided on five years ago, and also defines new catalysts for actions that will be developed over the period. It is based more specifically on adherence to the ten principles of the UN's Global Compact (see appendix 2), which is a shared framework, recognized worldwide and sufficiently broad to take different geographic realities into account while also clearly making reference to the fundamental standards recognized by the ILO (International Labour Organisation).

FRR's responsible investment strategy will be deployed along 5 principal lines:

- Make further efforts to incorporate ESG considerations into investment portfolio management

The first efforts on the part of the FRR to incorporate ESG issues into the asset management process were part of a positive approach that seeks to give preference to best ESG practices, focused on ESG and concentrated on publicly-listed companies in Europe (both conventional and SRI mandates). These efforts have paid off. Traditional managers have in fact made serious efforts to gradually integrate extra-financial research into portfolio management. Similarly, the initial assessment on the management of specialized SRI mandates confirmed the utility of this initial approach on an experimental basis, which led to a yearly performance in line with that of the market so far. The FRR will therefore continue to encourage its managers to make progress in this direction, will step up its dialogue with the latter and the financial community, and will take inspiration from the best practices in this area from its peers.

The FRR now wishes to expand this approach by extending it to all asset classes in its portfolio: all will be reviewed beforehand to determine to what extent it is possible to integrate ESG criteria into decisions related to investment and the selection of managers and/or funds. If this approach is systematized, its practical implications will be variable and adapted to each asset class.

- Improve extra-financial risk prevention

As of 2008, the FRR will acquire a system that will enable it to track and prevent extra-financial risks that may have an impact on the reputation of the Fund. The image risk for the FRR can arise from the failure on the part of businesses in which it invests to comply with basic standards reflected in the international conventions ratified by France, in particular the eight fundamental conventions of the ILO. This particular system, which applies to FRR's entire portfolio, will thus strengthen the vigilance that managers already exercise.

A responsible investment committee of the Supervisory Board is created to this end. Composed of its Chairman, its two vice-chairmen, and two qualified independent members, the committee will use regular reports from specialized agencies and the recommendations of the Executive Board to assess cases of non-compliance with these fundamental standards and decide on appropriate measures. After analysis of specific cases, in liaison with FRR's asset managers and peers, the committee will have a range of possible actions—from dialogue with the businesses concerned to the ultimate recourse of divesting from the business in question in case of repeated violations without any remedial efforts.

- Continue to exercise proxy voting rights to improve corporate governance

In 2005, the Board indicated that *"it is in the interest of the FRR to participate actively in effort to improve corporate governance in the companies it invests in. Indeed, it seeks to promote clarity and balance of powers in executive leadership of companies as well as in the*

information disclosed to shareholders, respect for their rights and the integrity of their votes. Consequently, it is one of the factors that make a strong contribution to the durability of the community of businesses, to the continuity of their strategy, to the way in which they exercise their responsibilities to all of their partners. All of these factors contribute directly to their future valuation.”

Efforts in the area of exercising proxy voting duties will be pursued, once again with a concern for corporate dialogue. The Fund’s proxy voting guidelines, communicated to managers, will be reviewed each year and adjusted to regulations and FRR’s priorities.

- Analyze more precisely the impact of environmental issues on FRR’s investment strategy

Environmental concerns and, in particular, the impact of global warming on the world economy and its various sectors poses numerous questions that a long-term investor cannot afford to ignore when determining its global investment strategy. The FRR’s objective between now and end of 2009 is to specify them and analyze the various categories of possible impacts on its investment policy in order to consider possible actions.

- Participate actively in French and international research efforts in the area of responsible investment

Research can play a decisive role in shaping discussion on how to incorporate extra-financial considerations into finance in general and asset management in particular. The FRR already actively supports the Sustainable Finance and Responsible Investment endowed chair developed by the French investment community and PRI working groups. It will continue to do so and will also join other promising initiatives.

4/ How to roll out these strategic pillars?

The following principles will be rolled out:

- **Dialogue with all stakeholders:** The learning curve in responsible investment is steep because the issues are complex. Accordingly, the FRR wishes to reinforce its exchanges with all stakeholders in the investment chain, in particular asset managers, other institutional investors that face the same challenges, and businesses that it encourages to pursue their efforts to publish ESG data.
- **Collaboration and partnership:** The FRR is convinced that the promotion of responsible investment is more effective when it is shared by several players. Accordingly, each time it is possible and its interests converge with those of other institutional investors, the FRR may consider collaborating with the latter.

- **Regular assessment:** As the strategy is gradually rolled out, it will be regularly enhanced by the observations and lessons that the FRR will gain from its own experience and that of its peers. It may also be reviewed by external experts.
- **Pragmatism:** The incorporation of extra-financial considerations in the management of the portfolio will be adapted to the characteristics of each asset class
- **Transparency:** The FRR will regularly report publicly on the progress and conclusions that it obtains in the rollout of this strategy.

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Overall, in the continuity of the orientations taken in 2003, the responsible investment strategy for 2008-2012 will be both ambitious as attested to by the different levers, and realistic as witnessed by the pragmatic and progressive nature of its implementation. It corresponds to the fundamental mission of the FRR, which is to manage assets entrusted to it by the nation as efficiently as possible in the interest of its future beneficiaries.

APPENDIX 1

The UN's six Principles for Responsible Investment (PRI) Signed by the FRR in 2006

The Principles for Responsible Investment were drawn up by an international group of institutional investors to address the growing importance of environmental, social and corporate governance issues for investment practice. This process was instituted by the Secretary General of the United Nations (www.unpri.org).

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognize that applying these Principles may better align investors with broader objectives of society.

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5: We will work together to enhance our effectiveness in implementing the Principles.

Principle 6: We will each report on our activities and progress towards implementing the Principles..

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

We encourage other investors to adopt the Principles

APPENDIX 2

TEN PRINCIPLES of the UN GLOBAL COMPACT

The GLOBAL COMPACT commits corporate leaders to "embrace, promote and ensure compliance with" a set of fundamental values in the area of human rights, labor, the environment and the fight against corruption.

These ten principles are inspired by the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

HUMAN RIGHTS

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and

Principle 2: make sure that they are not complicit in human rights abuses.

LABOUR STANDARDS

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labor;

Principle 5: the effective abolition of child labor; and

Principle 6: the elimination of discrimination in respect of employment and occupation.

ENVIRONMENT

Principle 7: Businesses should support a precautionary approach to environmental challenges;

Principle 8: undertake initiatives to promote greater environmental responsibility; and

Principle 9: encourage the development and diffusion of environmentally friendly technologies.

ANTI-CORRUPTION

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.