FONDS DE RESERVE POUR LES RETRAITES

THE FRR AND RESPONSIBLE INVESTING

2008
2009
2010
2011
2012

FONDS DE RÉSERVE POUR LES RETRAITES

RESPONSIBLE INVESTMENT: MID-TERM ASSESSMENT OF THE 2008-2012 STRATEGY

Contents

Message from the Chairmen of the Supervisory and Executive Boards

From its inception in 2003, the FRR showed a willingness to embrace and fully assume its identity as a public, long-term investor that takes extra-financial or ESG (environmental, social and corporate governance) factors into account in the management of its investments. As a responsible investor, the Fund has made efforts to incorporate ESG issues into portfolio management and implement an original policy for voting its proxies: systematic exercise on the basis of a public benchmark of its own construction that is updated annually by the Supervisory Board.

After these first steps were taken, the FRR reinforced this approach by adopting a five-year responsible investor strategy in the spring of 2008.

First of all, this multi-year strategy explains the underlying rationale: fully apprehend the threats and opportunities that are attached to the businesses in which the FRR is invested in order to optimize the return on the funds entrusted to its care; take into account the external factors, both positive and negative, that businesses exert on the whole economy in which a universal investor like the FRR is present; identify and monitor the risks that certain investments may represent for its reputation and for the relationship of trust it has established with the nation's citizens.

«... five principles that the FRR intends to implement by giving preference to establishing and maintaining a transparent and pragmatic dialogue with all stakeholders.»

Raoul Briet
Chairman of the Supervisory Board

Augustin de Romanet
Chairman of the Executive Board

It is further broken down into five pillars that the FRR intends to implement, primarily through dialogue, with all stakeholders, in partnership with other investors and by demanding both pragmatism and transparency.

This report provides information about how this strategy has been implemented over the past two years. It shows the ground covered, tangible achievements, problems to be overcome and avenues for reflection. At the end of the day, it attests to the living and dynamic character of an approach initiated well before the crisis, which recent developments in the financial arena have rendered more necessary and timely than ever.

Key figures

33.3 billion €
FRR assets
(through 12/31/2009)

2/3
of the asset managers
working for the FRR
have signed the PRI

85%
of the market capitalization
of the issuers in the investment portfolio is covered by the extra-financial analysis

The FRR **votes at annual meetings of**
+90%
of the companies
in its portfolio

Founding member of the PRI of the UN and **signatory to the CDP and the EITI***

The FRR is in **dialogue** with 10 companies **with regard to extra-financial risks**

In 2008, the FRR formed its **Responsible Investment Committee**

The FRR has **excluded** 8 companies **from its investment universe**

The principles of the UN's Global Compact, the fundamental conventions of the ILO and the international conventions against controversial weapons are the FRR's **benchmark principles**

* *Principles for Responsible Investment, Carbon Disclosure Project, Extractive Industries Transparency Initiative.*

The FRR's annual report for 2009 is available on the Fund's website www.fondsdereserve.fr

The FRR in brief

Founded in the early 2000's, the FRR *(Fonds de réserve pour les retraites)* is a public agency that was set up in the service of the long-term survival of the French retirement pension system. Through the optimal management of the resources that have been entrusted to its care by the people of France, its role is to cover, as of 2020, a significant portion of the financing needs of the basic retirement plans covering private sector employees, self-employed tradesmen and small retailers.

The Supervisory Board, whose members represent either public policymakers (French Parliament and Ministries) or labor-management stakeholders, or are individuals with recognized credentials in fields relevant to the Fund's mission, defines the broad outlines of the investment strategy and, to this end, also defines the orientations of the responsible investment policy. The Executive Board is responsible for executing these decisions and reporting to the Supervisory Boar on management performance. The Supervisory Board has formed several committees since the Fund's inception, including a Responsible Investment Committee (in 2008). It is a key element in the organization of the FRR's responsible investment function (see appendix 1).

Members of the Responsible Investment Committee
From left to right: Jean Claude Javillier, Raoul Briet, Philippe Le Clézio, Daniel Lebègue.

The responsible investment strategy

Ratified on April 15, 2008 by the Supervisory Board, the responsible investment strategy (appendix 2) summarizes the reasoning that led the FRR to develop a responsible investment policy from the time of the Fund's inception in 2003, setting out the basic priorities of this policy for the five following years (2008-2012).

Rationale

Since it began investing, the FRR has strived to exemplify the attitudes and behaviors of a responsible investor for three principal reasons. First of all, these attitudes and behaviors are linked to an objective of optimizing return while taking certain risk constraints into account: environmental, social and governance (ESG) factors must be included to fully apprehend the threats and opportunities that are attached to the investment decisions that the FRR may make. For the FRR, being a responsible investor means fully assuming its fiduciary duties. These attitudes and behaviors also obey an economic rationale: for a universal investor—i.e., an investor whose portfolio is representative of a portion of the global economy, the long-term return on investment is closely tied to economic growth and thus depends on external factors – both positive and negative – engendered by the companies that it invests in. Finally, as a public investor, the FRR is expected to identify and monitor the risks that some of its investments may pose to its own reputation and, insofar as possible, must exhibit exemplary behavior as an investor. In view of these different motives, the recent financial crisis only reinforced the wisdom of the FRR's commitment to the practice of responsible investment.

A FEW KEY CONCEPTS

- **Responsible investment (also referred to as socially responsible investment):** actively taking ESG (environmental, social and corporate governance) factors into account when making investment decisions or conducting related activities (in particular, research, analysis, voting and dialogue with businesses).
- **Fiduciary duty:** responsibilities that are incumbent on any person who exercises discretionary power on behalf of another person under circumstances that generate a relationship based on trust and confidence—both objective and subjective (this is the definition that was proposed by UNEP FI and Freshfields, Bruckhaus, Deringer in 2005). In the field of finance, these duties encompass the duty of care and the duty of loyalty on the part of professionals with regard to those whose investments they handle, which means providing the due diligence and expertise that it is reasonable to expect of them.
- **Universal investor:** an investor whose diversified portfolio corresponds to a representative sample of the entire economy and who consequently receives a return on investment that is linked to global economic growth over the long term. When the universal investor constructs its portfolio, it is obliged to pay attention not only to the return provided by each one of the assets that make up the portfolio taken separately, but also to the interactions that exist between the returns on these various assets (external economic factors).

milestones

2009

- Further development of responsible investment within asset classes (credit, real estate, and infrastructure).
- Launch of activity related to commitment to dialogue with corporations.
- Second report on the extra-financial risks of the portfolio*.
- Exclusion from portfolio of companies potentially involved in the production of cluster bombs.
- Report on factoring environmental impacts into the investment strategy.
- Support for EITI (Extractive Industries Transparency Initiative).

2008

- Adoption of the Responsible Investment Strategy for 2008-2012 by the Supervisory Board.
- Formation of the Responsible Investment Committee.
- Deployment of responsible investment for all new mandates and across asset classes.
- Support for the FIR *(Forum pour l'Investissement Responsable)* award promoting research.

2007

- First assessment of the SRI strategy.
- Results of the first year of PRI.
- Issuance of the first reports on the portfolio's extra-financial risks*.
- Calculation of the portfolio's environmental footprint*.
- Exclusion of companies potentially involved in the production of anti-personnel mines.
- Launch of the Sustainable Finance and Responsible Investment Chair, for which the FRR is among the founders.

2006

- 5 SRI mandates for a total of 600 million awarded.
- Elaboration of the FRR's SRI principles.
- Launch of the signature of the PRI (Principles for Responsible Investment) and participation in its board of directors ever since.

2005

- Adoption by the Supervisory Board of the Proxy Voting Guidelines.
- First exercise of proxy votes.
- Selection of three agencies specializing in the analysis of extra-financial data.
- Signature of and support for the CDP (Carbon Disclosure Project).
- Launch of an SRI management RFP.

2004

- First SRI elements appear in the traditional mandate specifications (Active management-large cap equities in Europe).

2003

- Deliberation of the Supervisory Board on voting proxies.
- First deliberation of the Supervisory Board on the general orientations of the FRR's investment policy, consistent with *"certain shared values that promote economic, social and environmentally sustainable development."*

* *With the assistance of three specialized agencies, respectively: EIRIS in 2009, VIGEO and EIRIS in 2007, and TRUCOST for the environmental footprint.*

NB : The support for national and international initiatives, while ongoing, is mentioned only under the first year of membership.

«An investment policy (...) consistent with respect for certain shared values that promote balanced economic, social and environmental development.»

Main pillars of the strategy

On the basis of the experience accumulated over the first years of the Fund's investment activity, the Supervisory Board identified the five major pillars of responsible investment policy, to be deployed over five years:

1. Make further efforts to incorporate ESG considerations into investment portfolio management,
2. Improve extra-financial risk prevention,
3. Continue to exercise proxy voting rights in companies to improve their governance,
4. Analyze more precisely the impact of environmental issues on the FRR's investment strategy,
5. Participate actively in French and international research efforts in the area of responsible investment.

As part of this progress report, each one of these pillars is explored in a separate chapter: for each pillar, the key actions undertaken since the strategy was adopted are presented, as well as the first results obtains and the avenues for future development in the years ahead.

The broad outlines of the strategy

The strategy also sets forth the basic principles that underlie its implementation: dialogue with all stakeholders, and collaboration, partnership and pragmatism as well as transparency and regular assessment. This mid-term report reflects the commitment to transparency and regular assessment. And in spite of the methodological difficulties that this may engender, the report includes the indicators linked to the various activities undertaken in accordance with the different pillars of the strategy (see table 1); moreover, to the extent that it was possible and relevant, quantified estimates have been provided for the period 2010-2011.

The strategy also defines the major external benchmarks that have framed the FRR's own policy of responsible investment: these principles include those set forth in the UN's Global Compact, which itself is inspired by the content of the major international conventions with universal scope, including the Universal Declaration of Human Rights, the Basic Conventions of the International Labour Organisation, and key statements pertaining to environmental protection (the Rio Declaration on Environment and Development) and the fight against corruption (the UN Convention against Corruption). In addition to these universal principles, certain conventions banning the use of some weapons (biological, bacteriological and chemical weapons, anti-personnel mines, cluster bombs) and, in terms of good governance, the guidelines for the exercise of proxy votes that the FRR has developed.

Lastly, it is important to note that the responsible investment strategy adopted by the FRR is also fully consistent with the Principles for Responsible Investment (the UN PRI), which were ratified in 2006 under the auspices of the United Nations. In addition, this report also includes a correspondence table in the appendix, which links each section of the report to each related principle (appendix 4). As a recognized responsible investor, the FRR was also an active contributor to the adoption of the PRI and is very involved in this organization. In addition to having a seat on its Board of Directors, the FRR participates in its working groups.

Table 1: **Indicators used to monitor the implementation of the responsible investment strategy**

ACTION	INDICATOR
PILLAR: INTEGRATION	
ESG INTEGRATION	Amount of equity mandates with RI provisions
	% of equity / active management portfolios
	Percentage of managers having signed the PRI (as a % of the total number of managers and a % of managed assets)
SRI PROCESS	Amount of SRI mandates
	% of equity / active management portfolios
PILLAR: PREVENTION OF REPUTATION/IMAGE RISKS	
ACTION	**INDICATOR**
RISK ASSESSMENT	Number of companies covered by the extra-financial analysis
	% companies covered by the extra-financial analysis (as a % of the number of companies in the portfolio)
	Market capitalization of companies covered by the extra-financial analysis
	% of companies covered by the extra-financial analysis (as a % of equity market capitalizations)
DIALOGUE	Number of companies with which the FRR is in dialogue
	Number of companies excluded
	Number of collaborative initiatives in which the FRR participates
PILLAR: VOTING PROXIES	
ACTION	**INDICATOR**
VOTES	Number of annual meetings to vote in
	Number of annual meetings voted in
	% (Annual meetings to vote in/number voted in)
	Total number of resolutions
	Votes FOR
	% total number of resolutions voted on
	Votes AGAINST
	% total number of resolutions voted on
	Abstentions
	% total number of resolutions voted on

First pillar: integration

Historical overview: Results and assessment of incorporation into European equity mandates (2004) and SRI mandates (2006)

Incorporation (or integration) can be defined as taking ESG factors into account in the analysis and /or the management of a portfolio of invested assets. As soon as it began investing, the FRR sought to promote this integration into the management mandates it awarded. Before the adoption de the Strategy in April 2008, a considerable portion of the European equity portfolio was being integrated in this fashion, which took two distinct forms. First of all, for active management mandates for European large caps that were awarded in 2004, the FRR laid down four obligations for managers related to ESG aspects: a research and analysis obligation, an integration obligation, a transparency obligation and an obligation to exchange information with the FRR. These obligations were formulated with sufficient flexibility to be acceptable to all managers and compatible with all active management processes. Secondly, the FRR awarded specifically SRI mandates for the same universe in 2006: as part of this framework, managers promised to implement management processes that would take the FRR's benchmark principles into account and also to report specifically and in detailed fashion on this implementation and its results. In this SRI allocation, managers are free in their choice of process, provided that it obeys a positive logic that leads to the selection of companies that are the best in class or that make the best effort from an extra-financial perspective.

These two approaches have proven to be extremely fruitful. The first approach, which is ambitious, flexible and compatible with a gradual accumulation of resources and expertise on the part of managers, was embraced by the asset management industry. The second approach, which is more specialized and appropriate for managers with prior experience in SRI management, has also provided a wealth of information. Three years after it was first implemented, we can see that SRI mandates have provided financial performances that are very comparable with those of traditional mandates: while there have been no significant outperformance, on the other hand there have not been any major underperformances on the part of these mandates, a finding that tends to refute the notion that SRI management is necessarily less remunerative than conventional management. In addition, like conventional mandates, SRI mandates turn in heterogeneous performances, as some management processes turn out to be more effective than others under certain market conditions. Even if the measurement of extra-financial performance is a delicate exercise, some managers are able to show the contribution of SRI management techniques at this level (for example, the portfolio outranks the benchmark, extra-financial impacts measured by job creations or improved carbon emission levels). Lastly, if SRI managers are free to choose their management processes, then they end up with portfolios that may very substantially and that are more or less similar to their benchmark index.

Results obtained by extending the integration policy to the entire portfolio

On the basis of this positive outcome, the Investment Strategy for 2008 suggested that a larger role be granted to the integration approach by applying it not only to all equities in the portfolio (beyond the European universes) but also to all asset classes (bonds, private equity, commodities, etc.). In terms of actions related to this first pillar, these entail asking questions concerning the most appropriate way to integrate ESG criteria into management – while ensuring that the specific features of each asset class and characteristics of the management style (active, passive) are respected – whenever a new mandate is granted, or whenever a fund is selected or an existing mandate is being renewed – based on the analyses done, the selection processes and the mandates must be adapted to permit this integration.

From this perspective, the years 2008 and 2009 were eventful—not just because many mandates were renewed as the FRR's first mandates arrived at their term, but also because of the gradual investment in new asset classes as a result of the implementation of the strategic asset allocation decisions (commodities, infrastructures).

The principal ESG provisions contained in the mandates or in fund bylaws are summarized in table 2 below. For example, for every actively managed equity mandate

Table 2 : **Principal ESG provisions inscribed in mandates or in the FRR's fund bylaws**

	TRADITIONAL EQUITY MANDATES		FIXED INCOME MANDATES	PRIVATE EQUITY	
	ACTIVE MANAGEMENT	PASSIVE MANAGEMENT	CREDIT (2009)	PRIVATE EQUITY (2006)	INFRASTRUCTURES (2009)
1. Voting rights	Yes	Yes	Not applicable	Not applicable	Not applicable
2.Extra-financial research and analysis	Yes	No	Yes	No	Yes
3. ESG reporting	Yes	Yes (G)	Yes	No– Under consideration	Yes
4. Incorporation of ESG criteria into the management process	Yes, possibly	No	Yes, possibly	No	Yes, possibly
5. Exclusion	Yes (2008)	Yes (2008)	Yes	Yes (restrictions on investment)	Not applicable
6. Assistance with engagement	Yes (2008)	Yes (2008)	Not applicable	To be defined	To be defined

awarded since April 2008, managers are required to conduct an extra-financial analysis and are asked to take relevant extra-financial aspects on board when they make management decisions. In addition, they must vote proxies for all investment securities in the portfolio and are expected to report on this exercise of proxies as well as on the ESG aspects of their analyses and management decisions. Last but not least, as part of the policy aimed at preventing reputation and image risks with regard to the FRR (see chapter 3), they must assist the FRR using the means they have available for this purpose. These requirements can be relaxed to some extent under passive management mandates, as a way of taking into account the greater financial constraints that these managers face (the decisive nature of the benchmark, the size of the portfolio, resources allocated).

For infrastructures, a new asset class in which the FRR only began to invest in 2009, integration required a preliminary analysis of the principal issues linked to these investments and a survey of existing practices and discussion in the area of responsible investment in infrastructures. A specific questionnaire on ESG issues was built on the basis of this work and in-person meetings on the basis of the responses were carried out (due diligence) in connection with the fund selection process. With regard to the funds it did select, the FRR reiterated its attachment to the principles of responsible investment and asked managers to produce reports on ESG issues.

The integration of ESG factors also varies as a function of the context and the emergence of new extra-financial issues. As an illustration, after the crisis arose, questions and provisions related to the financial integrity of managers were considerably reinforced (see inset box).

THE QUESTIONS AND PROVISIONS RELATED TO THE FINANCIAL STRENGTH AND INTEGRITY OF ASSET MANAGERS

QUESTIONS:

- **Indicators of the financial strength of the candidate**
- **Impact of the crisis**
- **Ethics**
- **Anti-money laundering systems**
- **Presence of tax havens**
- **Governance of the asset management firm**
- **Pay structures**

PROVISIONS:

- **Obligation to act honestly, loyally and professionally while serving the interests of the FRR to the best of the manager's ability;**
- **Obligation to act in compliance with the highest standards of prudence and diligence, and to comply with the firm's code of ethics;**
- **Obligation to respect and obey all of the FRR's rules with regard to management, risk control and reporting;**
- **Promise to comply with all applicable laws and regulations;**
- **Formal policy for managing conflicts of interest and resolution of all cases of conflict of interest within the deadlines and in the best interest of the FRR.**

« Expand this approach [integration] by extending it to all asset classes in its portfolio. »

First pillar: Results for 2008-2009 and outlook for 2010-2012

The crisis has made it more difficult to analyze the indicators that have been selected. It is important to note that the data for 2008 show a clean break with that from other years due to the direct impact of the financial crisis on the valuation of equities, but also due to its indirect impact. When the crisis unfolded, the FRR decided to modify its strategic asset allocation and to defer renewal of some of its equity mandates that had arrived at their term (for the serious equity mandates with RI provisions).

But apart from the break in 2008, implementation of the strategy resulted in a substantial increase in the percentage of equities subject to responsible investment criteria (from 36% in 2008 to 85% in 2009).

As the end of the implementation of the strategy approaches, it seems important to further extend the integration with an increase in the percentage of assets that are subject to an RI approach. When mandates come up for renewal and in light of portfolio diversification, this percentage should increase significantly. A second area for further development is the constructive dialogue with our managers on ESG questions and issues. Indeed, it is interesting to note that about two-thirds of the asset managers selected by the FRR have signed the PRI (they also represent nearly two-thirds of total assets under management) and, consequently, are particularly open to this kind of dialogue.

Table 3 : **2008-2009 results for the integration pillar**
In millions of euros or %

PILLAR: INTEGRATION	EQUITIES	2004	2005	2006	2007	2008	2009
Integration of ESG criteria	Amount allocated to equity mandates with RI requirements	1 280	4 277	5 850	6 243	1 872	3 168
	% equity / active management portfolios	60%	48%	53%	55%	36%	85%
SRI process	Amount allocated to SRI mandates	0	0	656	678	374	505
	% of equity / active management portfolio	0%	0%	6%	6%	7%	13%

NB: The voting rights that are specifically monitored in the context of one of the other pillars of the strategy, i.e. provisions on the exercise of proxy voting (which exist for all equity mandates), are not taken into account here.

Second pillar: the prevention of reputation/image risks

Monitoring and prevention: the central role played by the Responsible Investment Committee

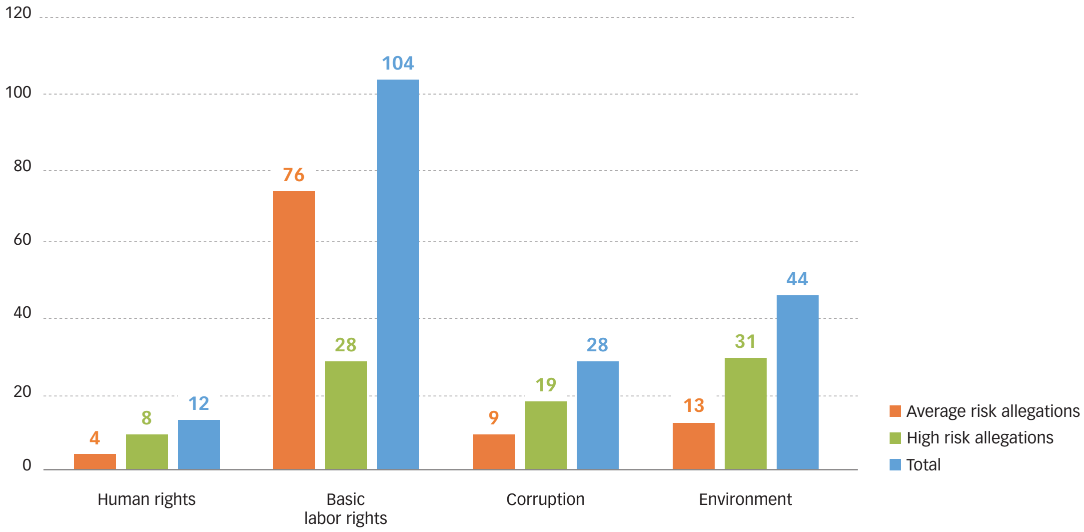
The FRR wanted to set up a system that would enable it to optimally and preventively manage the risks of image or reputation to which its deployment of the investment policy ineluctably exposes it. These risks can be defined as events that could cause the image of the FRR to deteriorate, that is, durably threaten the relationship of trust that a public institutional investor serving the public good and inter-generational solidarity must conserve and maintain with its principal stakeholders (public policymakers and social partners), represented on the Supervisory Board. The issue is not to guarantee ex ante that the FRR's investment policy is compatible at all times with ethical principles, but rather to set up a safety net that is able to best capture the deficient actions and behaviors of companies that threaten to impair the very core of shared values.

At the heart of this system lies the Responsible Investment Committee. The Responsible Investment Committee is a sub-committee of the Supervisory Board. It is chaired by the Chairman of the Supervisory Board and made up of 5 members (including two qualified individuals from outside the Fund). Its stated mission is to define a framework for detecting and preventing extra-financial risks; to regularly assess the extra-financial risks to which the FRR is exposed, as identified by this framework; and to suggest measures that will prevent the occurrence of these risks or limit their impact.

As for the general framework of this system, the Strategy is explicit. The shared values of which the Committee must be mindful are set forth in the major international conventions ratified by France and most of the world's States. In this regard, as for the rest of the FRR's responsible investment policy, the principles of the Global Compact serve as the main frame of reference in this system; they are supplemented by the international conventions on banned weapons. In the course of its first projects, the Committee specified what was meant by extra-financial risks: they are risks that correspond to serious, avowed and repeated violations of these fundamental principles. They are not the result of a one-off incident, whether deliberate or sustained by the company and outside its control, provided that such an incident is accompanied by the rollout of specific mechanisms that are designed to guarantee non-recurrence.

For its evaluation of the FRR's portfolio, the Responsible Investment Committee has recourse to the analyses done by a specialized rating agency. This agency assesses all companies whose securities – equities and bonds – are included in the FRR's portfolio (in other words, more than 2,500 companies) in terms of their compliance with the principles of the Global Compact and conventions on banned weapons. Each year, the agency submits a full report to the Responsible Investment Committee which details the allegations made with respect to certain companies, evaluating their degree of seriousness and offering recommendations for action. The agency also issues monthly warnings on new

Number of allegations by theme and level of risk, year-end 2009



Source: Eiris.

The economic sectors that are the most impacted are manufacturing, consumer goods, oil and natural gas, base materials and consumer services. These sectors tend to be those which have the greatest social and environmental impacts and which operate in regions deemed at risk.

allegations. The agency that was chosen after a selection process launched in 2008 is EIRIS (Experts in Responsible Investment Solutions), a UK-based agency.

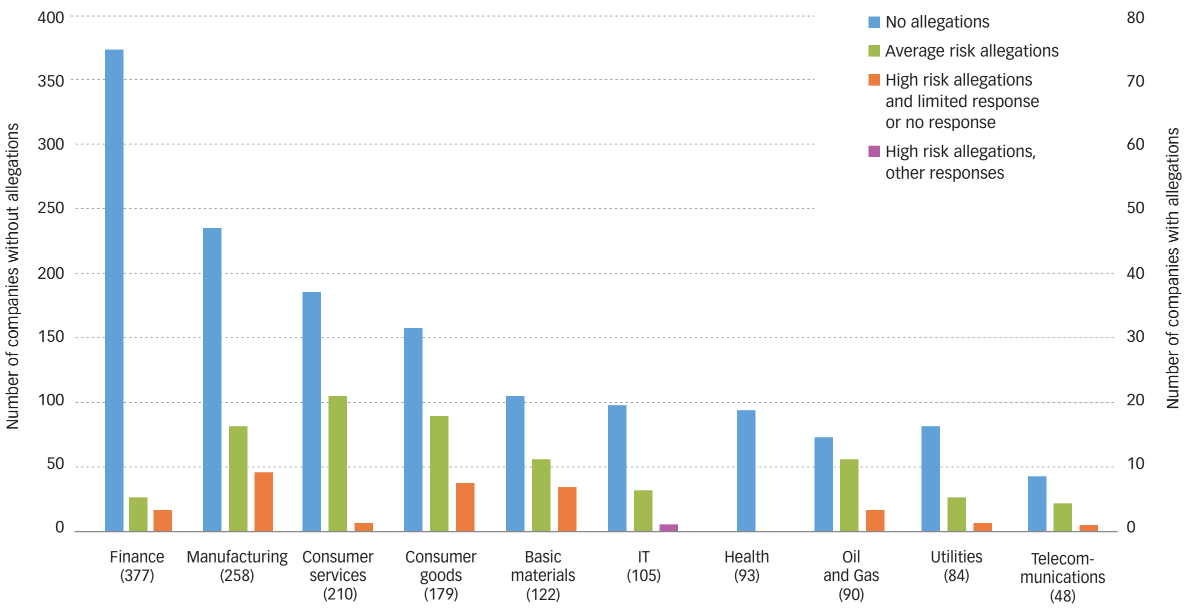
On the basis of this information, but also using other sources (published reports and surveys, information received from other investors or from managers working for the FRR), the Responsible Investment Committee draws up a list of companies that may generate an image/reputation risk for the Fund. This list is then used to recommend specific actions. These actions run the gamut from a simple request for additional information to an engagement of dialogue with the companies in question. Only rarely and as a last resort will the Committee exercise the option of recommending that a company be excluded from the portfolio.

The exposure of the FRR's portfolio to reputation/image risks

Based on the portfolio at year-end 2009 (analysis of 94% of all equity investments and 60% of the fixed income investments in the FRR's portfolio), it appears that a limited number of companies (around 6% of the equity portfolio in terms of the number of companies and around 9% of the bond portfolio) are concerned by one or more allegations – without distinction in terms of their weight in the portfolio. Using only those allegations that may be qualified as serious and with respect to which the company in question took no action or only limited measures, in the final analysis only about thirty companies are concerned (out of the more than 2,500 in the portfolio, which is less than 2%). In addition to these companies, there are a few that could potentially be involved in the production of cluster bombs.

Most of the allegations identified concern the failure to comply with fundamental labor principles, but with the majority of these allegations classified as representing an average risk. Conversely, the allegations concerning human rights violations, serious environmental impairment and corruption are less numerous, but they generally present a higher level of risk and, in the case of human rights violations, these serious allegations are generally not resolved in a satisfactory manner.

Number of allegations per sector



Source : Eiris.

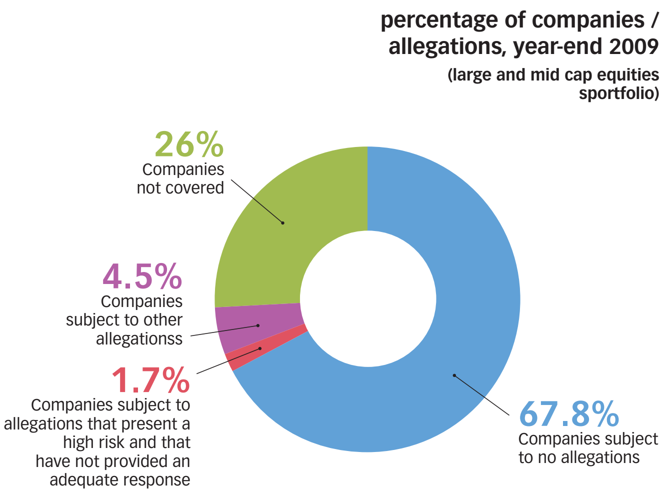
Lastly, North America has the greatest number of companies that are suspected of violating international standards, but it is in Asia that the largest proportion of companies included in the portfolio were identified as presenting a high risk and flagged.

On the basis of these results, the Responsible Investment Committee examined in detail the thirty or so most controversial cases, and selected those that corresponded with its approach to reputation risk. The Committee then drew up a list of companies that the FRR should engage in dialogue.

Rolling out a policy of dialogue

A policy of dialogue covers two main types of action: the dialogue can be forged with businesses individually, either with other investors or in isolated fashion. It can also be set up within a collaborative framework. In the latter case, a group of investors contacts a group of companies or even market regulators, with regard to a specific issue.

The dialogue of an institutional investor with the management of a company in which the former is a shareholder remains a practice that is under development but still relatively rare in continental Europe. However, in the interest of good governance and risk management, a shareholder is fully justified in its efforts to learn more about the company and exercise its duties as a shareholder. From this perspective, engagement is closely tied to the active exercise of voting rights (see chapter 5). This active involvement on the part of an investor is not synonymous with activism: the goal is not to single out the company's executive leadership for blame, but only to ensure that it is acting in the best interests of its own shareholders. From the perspective of responsible investment, the objective is more precisely to ensure that the company's executive leadership is aware of and factors in all of the threats and opportunities linked to the business.



Source : Eiris.

The FRR gives preference to a positive approach positive, and dialogue is an important element of its responsible investment policy: the FRR prefers to allow the companies it invests in to respond to the allegations that concern it – by offering additional information or by committing to measures that will allow them to resolve the problem and reduce the likelihood of another violation in the future.

But the dialogue with companies is an activity that takes a lot of time, and that may not produce measurable results for many years. As part of its pragmatic approach to responsible investment and because of its limited resources, the FRR has opted to focus its program of commitments on a pre-selected group of around ten priority companies. At the end of 2009, these companies were contacted by the FRR and informed of the questions the Fund was asking about their activities. It is still too early to provide a summary in this report of the results obtained.

Less targeted, but nonetheless allowing investors to pool their resources and acquire greater clout, dialogue within a collaborative framework takes the form of international initiatives. They may be formal (under the auspices of an international organization, such as the PRI) or informal. Already a participant in several major initiatives (UN PRI since inception, Carbon Disclosure Project since 2007), the FRR also joined ITIE in 2009, since the adoption of the Strategy (see appendix 3 and inset). In addition, the FRR has opted to take part in a one-off initiative – the so-called Seoul initiative in 2008 – whereby around fifty major institutional investors that had already signed the PRI sent a letter to approximately 9,000 businesses worldwide, asking them to join the Global Compact. And in 2009, the FRR signed an investor statement addressing public policymakers, urging support for the conclusion of an ambitious agreement at the International Copenhagen Conference (see chapter 4).

> «The FRR acquired a system enabling it to track and prevent extra-financial risks that may have an impact on the reputation of the Fund.»

Action of the last resort: exclusion

In cases were dialogue produces no tangible results, and when the reputation risk is deemed to be too high, the Responsible Investment Committee may recommend excluding the related securities from its investment universe. The FRR gives preference to a positive approach that seeks progress on the part of the offending companies, and hence only excludes them in cases where no other solution is available. This targeted policy of exclusion was launched in 2008. As of December 31, 2009, a total of 8 companies have been excluded from the FRR's portfolio due to their possible involvement in the manufacture of anti-personnel

EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (EITI)

Launched in 2002 by the British government to coincide with the World Summit on Sustainable Development in Johannesburg, this initiative is supported by French policymakers. It is based on the belief that, with good governance, the exploitation of resources such as oil, gas and minerals can generate substantial revenues that contribute to economic growth and the reduction of poverty. Conversely, when governance is weak or ineffective, this type of resource can lead to poverty, corruption and conflict.

The EITI is a coalition of is a coalition of governments, businesses, groups from civil society and three international organizations that has developed a methodology for monitoring and reconciling company payments and government revenues. They include:

- governments that are implementing (Azerbaijan, Liberia) or that are candidates (Afghanistan, Democratic Republic of Congo, Norway, etc.) and governments that support the initiative: around fifteen, including France, the United States and Great Britain
- companies: around forty from among the largest players in the field of extraction (or related businesses); investors are also among the members (Investors' Statement on Transparency in the Extractives Sector, signed by 70 to 80 investors, including Calpers, PGGM, AP1 and NBIM)
- international organizations such as the World Bank and the IMF.

To be eligible, governments and businesses must satisfy the following criteria:

- regular publication of payments (of businesses, including public and state-owned ones) and revenues (received by governments from businesses) related to extractive activities;
- payments/revenues audited by an independent auditor applying international standards;
- reconciliation of payments and revenues by an independent member of the board of directors;
- involvement of civil society in the design and control of this process;
- a detailed work plan for rolling out this process.

Table 4: **List of companies that are excluded from the portfolio of the FRR due to their possible involvement in the manufacture of anti-personnel mines or cluster bombs (as of December 31, 2009)**

COMPANY	COUNTRY
Alliant Techsystems ATK	United States
General Dynamics	United States
Goodrich	United States
Lockheed Martin	United States
L3 Communications	United States
Raytheon	United States
Singapore Technologies Engineering	Singapore
Textron	United States

mines (prohibited under the Ottawa Convention of 1997) or cluster bombs (banned by the Oslo Convention of 2009). In this second case, the FRR has taken a decidedly proactive stance, since the Oslo Convention has not yet gone into effect.

Monitoring global risks

Above and beyond the analysis of allegations concerning businesses whose stock is included in the FRR's portfolio, the Responsible Investment Committee analyzes the more global risks that an investor such as the FRR may be exposed to. For example, in both 2008 and 2009, the issue of tax havens was back on the table in the aftermath of the financial crisis and the G20 summit meeting in London. The Committee evaluated the exposure of the FRR to this risk – whether through its managers, its funds and securities portfolio. As a result, additional questions and ad hoc provisions were introduced into new mandates, and this risk is now permanently monitored.

In the course of 2008, the Responsible Investment Committee also tackled the issue of how to assess extra-financial risks in the case of government bonds. In the area of sovereign debt, the FRR's approach has consisted of using a consistent set of indices expressing the sentiment of the international community, in the terms of the opinion issued by the Responsible Investment Committee (the existence of international sanctions that target a particular State directly; inclusion on the list compiled by the GAFI (*Groupe d'Action Financière*) of non-cooperative States in connection with the fight against money laundering; lastly, the absence of diplomatic relations with France insofar as this implies a rupture of political, economic and commercial ties). The application of this opinion is useful in identifying the geographic regions that pose an excessive reputation risk for the FRR (to date, Burma, North Korea, Iran and Zimbabwe).

In the same way, when the FRR began investing in commodities the Responsible Investment Committee issued a statement against investments in derivatives related to food and agricultural commodities, as such investments cold tend to encourage purely speculative movements in basic subsistence foodstuffs. The FRR's investment strategy was adapted in consequence.

Results for 2008-2009 and outlook for 2010-2012

Adopting the strategy made it possible to develop a systematic policy for assessing risks and establishing dialogue, whereas these activities had been conducted in one-off fashion previously (for example, in 2007 three rating agencies were asked to evaluate the portfolio).

While coverage increased globally between 2008 and 2009 (in terms of the number of businesses tracked and their total market capitalization), the slight decline in the rate of coverage (in terms of the number of businesses) reflects the change in the structure of the portfolio between the two years: the decision to invest in listed real estate (which led to the addition of several less well covered real estate companies to the existing portfolio), the increase in the number of small capitalizations, and the rise in passive management (which led to a general increase in the number of securities in the portfolio) reflect this decrease. Conversely, the rate of coverage in terms of capitalization did in fact increase.

In terms of dialogue, after the Responsible Investment Committee spent a year implementing the related policy, 2009 marked the real beginnings of conducting that policy with businesses. It is still too early to report on the results of this activity, outside of the two cases in which it resulted in an exclusion (two companies potentially involved in the manufacture of cluster bombs, both of which failed to provide satisfactory responses to the questions posed by the FRR). Lastly, the FRR's participation in collaborative initiatives with institutions that are its peers, particularly in Europe – both one-off and ongoing – is growing steadily.

It is very difficult to establish defined prospects with regard to prevention and dialogue: while analysis should cover a large portion of the portfolio, this coverage is dependent on how the FRR's portfolio evolves, as well as on the coverage by the outside supplier of analytic services and human resources, which remain quite modest at this stage.

Table 5: **2008-2009 results for the prevention of extra-financial risks pillar**
In billions of euros, units or %

PILLAR: PREVENTING EXTRA-FINANCIAL RISKS	ACTIONS	2004 - 2007	2008	2009
Evaluation of risks	Number of companies covered by extra-financial analysis	0	1 451	1 731
	% of the number of companies in the portfolio	0%	75%	67%
	Amount in market capitalization of companies covered by the extra-financial analysis	0	18.5	22.6
	% capitalization of the securities of companies covered	0%	77%	85%
Dialogue	Number of companies that the FRR is engaged in dialogue with	0	0	10
	Number of companies excluded	0	6	8
	Number of collaborative initiatives (ongoing or one-off) in which the FRR participates	0	3	4

Third pillar: taking environmental issues into account

Discussion on how to factor environmental considerations into the investment strategy

Pursuant to the objective set by the Strategy and in connection with the adjustment to the strategic asset allocation in 2009, a survey was conducted with the APREC *(Association pour la Promotion de la Recherche en Economie du Carbone)* and I Care Environment, a specialist consulting firm, the aim of which was to specify and analyze the various categories that impact the FRR's investment policy – and in particular its long-term investment policy (the strategic asset allocation) – and also to determine feasible actions. The key elements of this survey were made public in a working document entitled "How should the environment be factored in to the FRR's investment policy?" It is available on the FRR's website (www.fondsdereserve.fr).

This survey concluded that climate change, the exhaustion of natural resources, the scarcity of water and the loss of biodiversity seem to be the most relevant environmental issues for a long-term investor. These issues must be considered from the perspective of both threats and opportunities, which themselves are variable over time and depend on the actions taken by various actors—in particular public policymakers. Indeed, to be effective and allow economic actors, and in particular investors, to make the right decisions, environmental policy must be stable, predictable and consistent over time.

In addition, the survey reveals that an investor can try to incorporate environmental issues and factors at various levels in its investment policy: the strategic asset allocation, choices made within asset classes, management styles, reporting and evaluation. These different levels appear to provide a complementary way of dealing with the major environmental challenges we face and also tally with the practices of major reserve funds in other countries.

In a novel manner, the survey goes into greater detail on how environmental issues might be integrated into the strategic asset allocation. Using long-term climate scenarios as a basis, it generates medium-term economic and financial scenarios that can be used to redefine the reward/risk tradeoffs of various strategic assets and, in so doing, calculate a strategic asset allocation that is dependent on climate changes and trends. The key findings demonstrate that taking climate change on board in the development of the strategic asset allocation reduces—for most of the generated scenarios—the percentage of risky assets. Out of the five economic and financial scenarios generated, only the green growth scenario makes it possible to reverse this outcome. Another avenue explored consists of completing

« Environmental concerns pose numerous questions that a long-term investor cannot afford to ignore. »

the portfolio with environmental assets, such as carbon or forest, a source of protection or return against the environmental issues chosen.

The study undertaken by the FRR was used as a basis for the discussions of the Supervisory Board during the process of adjusting the strategic asset allocation in 2009, and offers avenues that could be developed to improve the way that environmental issues could be factored into the FRR's portfolio.

Participation in a group initiative at the Copenhagen summit

Alongside this study, and in the context of preparing for the Copenhagen negotiations on climate change, the FRR decided to sign a declaration of investors in favor of an international agreement at Copenhagen. Coordinated by various global networks (Investor Network on Climate Risk, the Institutional Investors Group on Climate Change, the Investor Group on Climate Change/Australia and New Zealand and the UNEP Finance Initiative), this declaration called on public policymakers to come to an agreement on strong, credible and efficient measures to combat climate change and global warming.

Results for 2008-2009 and outlook for 2010-2012

Defining indicators related to the integration of environmental aspects into the investment strategy is in fact a delicate exercise. The FRR published a working document that it then presented on several occasions to various parties (in France and abroad).

The FRR wishes to continue exploring the various avenues for improving the integration of environmental aspects into the investment strategy and encouraging other investors, as well as consultants and specialist researchers, to pursue the discussion. The FRR also intends to continue monitoring work underway in this area.

WHAT EMERGED FROM COPENHAGEN?

The Copenhagen Agreement recognizes the objective of limiting global warming to +2°C, but does not set out any specific binding commitments for the various countries.
The only quantified commitment concerns the level of financing the developed countries must offer to the developing ones over the 2010-2012 period (30 billion dollars) and by 2020 (100 billion dollars a year by 2020). However, no further precision is offered with regard to the sources of funding.
Two decisions concerning the two project mechanisms of the Kyoto Agreement (a mechanism for clean development and its joint implementation) call for the simplification and standardization of procedures. A decision on "deforestation avoided" asks the developing countries to roll out systems that will make it possible to estimate the emissions of their forests, which is a first step toward monetary accounting.
The results that emerged from Copenhagen were a disappointment given the magnitude of the climate change issue and the expectations of economic agents – investors in particular – who need a stable and predictable regulatory framework over the long term so that they can adapt their own actions as effectively as possible.

Fourth pillar: exercising proxies

The FRR's strategy in the area of voting rights

During its debates, the Supervisory Board agreed on a number of principles pertaining to the exercise of voting rights on behalf of the FRR: the rights of the Fund should be systematically exercised on its behalf by managers during shareholder meetings, and managers should act in alignment with the guidelines set forth by the FRR, insofar as positions taken in the name of the Fund are taken in its interest only and in strict independence of other considerations or interests.

These guidelines, proposed by the Executive Board, were made public after ratification by the Supervisory Board on January 26, 2005. They were ratified by the Board at its meeting on February 28, 2006 and were transmitted to managers so they could vote proxies for the FRR. They are amended annually, and are in the public domain. They are available at the FRR's website (www.fondsdereserve.fr).

After the 2005 season, which saw the implementation of a system that left wide latitude to the companies managing the portfolios of the FRR, the gradual adoption of coordinated exercise of votes between the Fund and its managers began to be envisioned in 2006, to cover cases where managers had voting intentions that diverged with respect to the same resolution. An in-house committee was formed by the FRR to monitor votes and supervise the implementation of this coordinated approach.

« Continue to exercise the FRR's voting rights by proxy contributing there by to improved corporate governance. »

The exercise of proxies by the FRR's managers in 2009

The year 2009 was an eventful one in terms of the exercise of proxies for the FRR by its managers. In fact, 12 equity mandates expired or were terminated, and 17 new equity mandates were activated. As a result of this situation, some managers were not able to vote at certain meetings due to the deadlines in force for meeting registration in some countries. Accordingly, although the FRR was able to participate via its managers in more meetings in 2009[1] (5,420 as opposed to 3,623 in 2008), the average attendance rate for the portfolio was slightly lower (93% versus 96% in 2008).

1/ Several of the FRR's managers may hold securities in the same company and hence vote at the same shareholders' meeting.

This substantial increase in the number of shareholder meetings is due essentially to the pursuit in 2009 of the implementation of passive management in the FRR's portfolio, with the awarding of more mandates index-managed mandates than was previously the case.

During this campaign, 61,082 resolutions were examined and voted on, resulting in the following breakdown: 52,030 votes FOR (85.18%), 8,113 votes AGAINST (13.28%) and 939 ABSTENTIONS (1.54%). These results are different from those obtained in 2008, showing an increase in FOR votes and a marked decline in abstentions (see table tracking votes).

The scope of issuers that are the subject of coordination by the FRR has widened. This scope was determined on the basis of the payout ratio by issuer (in principle, companies that have a payout ratio of above 0.25%), issuer nationality, and the interest of the company. In the final analysis, 104 shareholder meetings (versus 80 in 2008) were followed.

« The FRR has expanded the scope of issuers with which it has adopted a coordinated approach. »

The principal subjects of debate

As is the case each year, certain subjects become items for debate between issuers and their investors; at the same time, it should be noted that a higher quality dialogue has opened up among stakeholders, which has led to the modification of some resolutions or to the presentation at meetings of the changes accepted by the issuer.

Executive compensation

So-called deferred compensation (severance pay and umbrella retirement plans for executives), which under French law must be stipulated under a regulated agreement, has been highly contested by shareholders. This year, the level of dissent was even more visible, forcing companies to amend contracts and agreements related to severance pay and special retirement guarantees, aligning them with the terms of the directives contained in the AFEP – MEDEF Code of October 2008.

The following issues led to votes against resolutions on the part of FRR managers:

- the company's negative earnings versus the severance and retirement packages offered;
- excessive sums paid to executives in the event of severance or under umbrella retirement plans;
- the absence of demanding performance criteria;
- the validation of a global package of free allotments of shares or stock options, where no specification was given as to the breakdown between employees and executives.

Capital increases

Investors have long objected to capital increases with shareholders' preferential rights waived. Once again, they showed a great deal of opposition last year, particularly in cases where the company's demand concerned a significant percentage of its stated capital.

Managers voted against capital increases with preferential subscription rights waived and without a prescribed and guaranteed period of priority in cases where the capital increase involved more than 20% of the company's stated capital.

Capital increases reserved for employees were also contested by shareholders. The FRR's own policy is that capital increases reserved for employees are positive; accordingly, in most cases its managers voted in favor of such resolutions.

Anti-takeover provisions

Resolutions that allow the company to buy back its own shares were contested on the part of some shareholders, particularly if this action is permitted in the event of a takeover bid via the company's stock. These resolutions passed, but often with only a slight majority. Stock warrants grants representing an excessive percentage of the company's share capital (more than 25/30%) were also contested or even voted against.

Adjustments to the benchmark for 2010

Most of the precisions that the Board decided to enact this year pertain to (i) the need to ensure that the provisions concerning the audit committee are compliant with Article L823-19 of the French Commercial Code, created by the Government Order dated December 8, 2008; (ii) the modifications concerning to gender equality on boards of directors, the need for transparency with regard to compensation policy on the part of companies that are subject to the recommendations that came out of Pittsburgh; and (iii) lastly, a precision on the information to be provided when stock options or free stock allotments are granted to executive officers.

Table 6: **Table tracking manager activity in the area of voting proxies**

	2005	2006	2007	2008	2009
Number of annual meetings to vote in	567	1 917	2 221	3 770	5 842
Number of annual meetings voted in[1]	395	1 726	2 107	3 623	5 420
As a % of annual meetings to vote in	*70%*	*90%*	*95%*	*96%*	*93%*
Total number of resolutions	7 598	14 734	23 289	34 637	61 082
Votes FOR	6 802	12 744	19 582	29 114	52 030
As a % of total number of resolutions voted on	*89%*	*86%*	*84%*	*84%*	*85%*
Votes AGAINST	683	1 481	2 829	4 392	8 113
As a % of total number of resolutions voted on	*10%*	*10%*	*12%*	*13%*	*13%*
ABSTENTIONS	47	509	878	1 135	939
As a % of total number of resolutions voted on	*1%*	*3%*	*4%*	*3%*	*2%*

Source: legal department

1/ Several of the FRR's managers may hold securities in the same company and hence vote at the same shareholders' meeting.

Fifth pillar: support for research

Research on the extra-financial aspects of investment is crucial for the development of responsible investment; however, academic exploration of this field remains relatively scant. For this reason, the FRR is an active supporter of the Sustainable Finance and Responsible Investment Chair developed by the financial marketplace of Paris. Since 2008, it has brought together researchers (*École Polytechnique, Institut d'Économie Industrielle de l'Université de Toulouse*) and professionals (investors, managers) alike. The support provided by the FRR includes financial support for the Chair, representation in its office and a seat on its orientation board, plus an active role in its various work groups. Work done since the chair was initially endowed has focused on defining what a socially responsible corporation or project is. Other subjects of study include the links between taking extra-financial considerations on board, the economic performance of companies, and the financial performance of funds that are invested on the basis of responsible considerations. The motives of various players (business and investors) have also been the subject of discussion, as has the lessons of the financial crisis in terms of issues related to corporate governance.

In both 2008 and 2009, the FRR was also a member of the jury for the French Social Investment Forum (FIR – *Forum de l'Investissement Responsable*) Award, which each year recognizes research work done in Europe and devoted to issues related to responsible investment (under four categories: articles, theses, dissertations and dissertation projects). The jury is made up of both researchers and practitioners, and the awards reflect the broad diversity on the discussions underway on this subject.

JUST ONE EXAMPLE OF WORK THAT RECEIVED AN FIR AWARD IN 2009 THE DISSERTATION OF N. KOK

A student at the University of Amsterdam, N. Kok was given an award for his paper entitled Corporate Governance and Sustainability in Global Property Markets, which among other things puts forth a method for evaluating the financial performance of green buildings.

Green buildings, built to comply with specific environmental standards and generally certified, indeed present a variety of theoretical advantages:

- some downstream costs may be reduced (energy, water, waste + insurance against future rises in the price of energy);
- an improvement in the environmental quality of the workplace can have a positive impact on employee productivity (although this may be difficult to measure financially);
- a positive impact on the image of the company that occupies the building, plus financial effects;
- a longer useful life for the building, slower depreciation in value, low price volatility and hence higher appraised value of the property.

Working from a statistical analysis of the commercial real estate sector in the United States that made it possible to compare the financial performances of certified buildings (Energy Star and LEED) versus non-certified buildings over uniform regions, it was demonstrated that green buildings offer investors better financial performance for the following reasons:

- all other factors being equal, rents 2% higher per square meter;
- actual rents (taking occupancy rate into account) 6% higher per square meter;
- prices 16% higher on resale.

Summary

The FRR's score on the PRI survey in 2009

When the Principles for Responsible Investment (PRI) were created in 2006, the board of directors decided to provide its members with a reporting tool whose aim is to evaluate their capacity to implement the Principles and also to identify best practice in this area. The participation of each signatory in the evaluation effort is mandatory (Principle 6), with failure to take part after the first year of membership leading to removal.

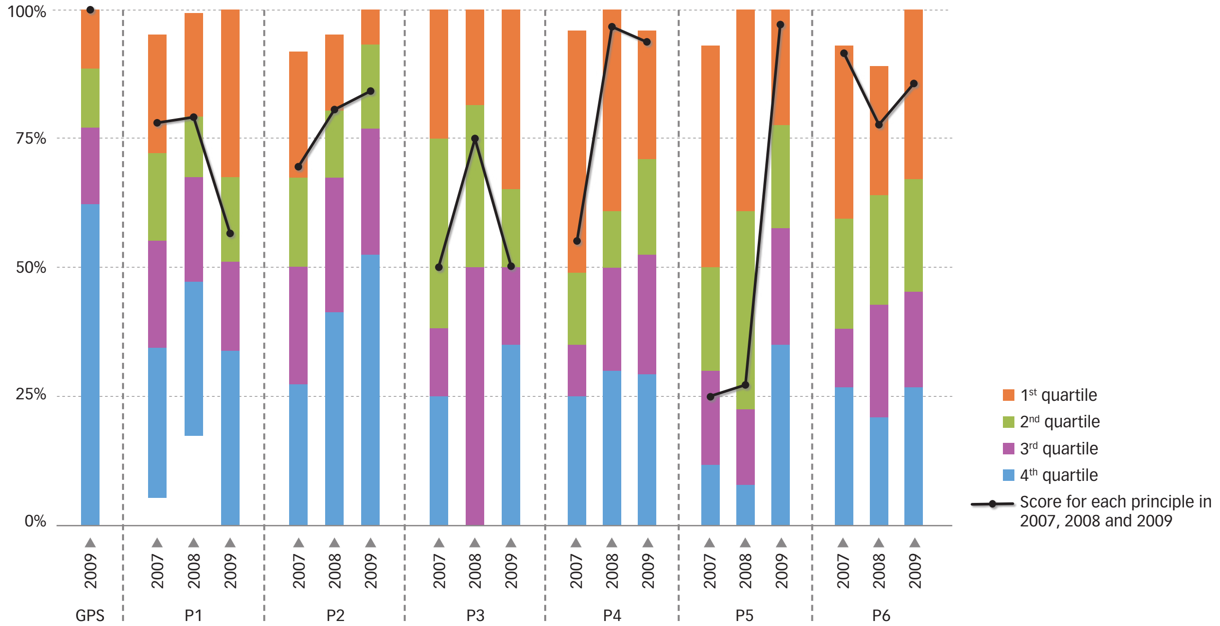
The reporting tool is an online questionnaire divided into six independent sections, each one covering one of the six principles exhaustively, which are separately scored (no global score is given). Since 2009, there is a seventh section on the internal governance practices of the signatory and its responsible investment strategy. Scores are given for each part (after compilation of all questions in the section) and are ranked by quartile, with the first quartile being the top one.

In 2009, the FRR came out either at the median level or above for each one of the principles. Compared with 2008 (the year in which the strategy was adopted), the FRR has improved its positioning with regard to three of the principles and has lost ground on two others (principle 1 and principle 3), while the change with regard to principle 4 is not considered to be significant. For the new section (GPS, governance, policy, strategy), which tackles questions about the organization and governance of the responsible investment activity, as well as the existence of a clear investment strategy in this area, the FRR got the maximal score.

- The FRR's maximal score under the GPS heading is due to the combined impact of several factors: a Fund investment policy that makes reference to responsible investment; a public responsible investment strategy; the fact that the strategy is reflected in tangible actions; at the level of governance, the Supervisory Board has ultimate responsibility for the RI strategy implemented by the Executive Board with the support of the RI Department.
- With respect to principles 1 and 2, the positioning of the FRR is attributable to the implementation of a genuine SRI policy (ESG dimension to all mandates, development of a guide for voting proxies, exercise of proxies, engagement of dialogue with companies, etc.). The decline in the score on principle 1 between 2009 and 2008 is most likely due to the shift of some questions under principle 1 to the GPS section.
- With respect to principle 3, the average positioning of the FRR is partly due to delegated management (i.e., externally managed assets), which does not lend itself to dialogue with companies on the publication of appropriate information on ESG issues or the adoption of a given standard, unless there is an ambitious and enforced policy in place.
- With respect to principles 4 and 5, the FRR's score is primarily attributable to the fact that SRI questions are systematically included in all of our requests for proposals, our promotion of the PRI in the industry, and the participation in a growing number of initiatives (PRI, Sustainable Finance Chair, the FIR award, Eurosif projects, Paris Europlace and the CDP) – all reflected in a substantial improvement in the score for principle 5.
- Lastly, the high score on the sixth principle recognizes the efforts made by the FRR in the area of communicating on its SRI strategy at the international level and its transparency.

The FRR's response to the questionnaire is public and available at the following website: http://www.unpri.org/report09/

The FRR's score compared with that of all investors



Source: UN PRI, 2009.

"Scores have been calculated based on signatories' self assessment and using the scoring methodology approved by the PRI Assessment Group. Although a limited verification exercise was undertaken with a proportion of signatories, responses have not been independently audited by the PRI Secretariat, PRI Assessment Group, or any other third party. Individual results including comparisons to the overall results (quartiles) are indicative and do not imply an endorsement of signatory activity. While this information is believed to be reliable, no representations or warranties are made as to the accuracy of information presented, and no responsibility or liability can be accepted for any error, omission or inaccuracy in this information." (UN PRI).

By adopting the strategy in April 2008, the FRR was able to pursue the deployment of its responsible investment policy around a few main priorities, fully consistent with the principles for responsible investment. The first two years were used to lay the foundations for implementation of the strategy; what remains to be done going forward is to consolidate them and extend the actions taken within this established framework.

Summary of 2008-2009 indicators
Millions of euros (unless otherwise indicated) or %

PILLAR: ESG INTEGRATION

		2008	2009
ESG integration	Amount of equity mandates with RI provisions	1 872	3 168
	% of equity / active management portfolios	*36%*	*85%*
	Percentage of managers having signed the PRI (as a % of the total number of managers)	Na	59%
	Percentage of managers having signed the PRI (as a % of assets managed)	Na	65%
SRI process	Amount of RI mandates	374	505
	% of equity / active management portfolios	*7%*	*13%*

PILLAR: PREVENTION OF EXTRA-FINANCIAL RISKS

		2008	2009
Risk assessment	Number of companies covered by the extra-financial analysis	1 451	1 731
	Number of companies covered by the extra-financial analysis (as a % of the number of companies in the portfolio)	*75%*	*67%*
	Market capitalization of companies covered by the extra-financial analysis (Billions of euros)	18.5	22.6
	Number of companies covered by the extra-financial analysis (as a % of equity market capitalizations)	*77%*	*85%*
Dialogue	Number of companies with which the FRR is in dialogue	0	10
	Number of companies excluded	6	8
	Number of collaborative initiatives in which the FRR participates	3	4

PILLAR: VOTING PROXIES

		2008	2009
	Number of annual meetings to vote in	3 770	5 842
	Number of annual meetings voted in[1]	3 623	5 420
	As a % of annual meetings to vote in	*96%*	*93%*
	Total number of resolutions	34 637	61 082
	Votes FOR	29 114	52 030
	As a % of the total number of resolutions voted on	*84%*	*85%*
	Votes AGAINST	4 392	8 113
	As a % of the total number of resolutions voted on	*13%*	*13%*
	ABSTENTIONS	1 135	939
	As a % of the total number of resolutions voted on	*3%*	*2%*

1/ Several of the FRR's managers may hold securities in the same company and hence vote at the same shareholders' meeting.
Na: not available.

Appendix

1. The FRR's responsible investment organization

On the recommendation of the Executive Board, the Supervisory Board defines general investment policy orientations for the Fund's assets, in accordance with the objective and timeframe for use of the Fund's resources, as well as with the prudent man and risk diversification principles. It also audits the Fund's financial performance, approves the annual financial statements and prepares an annual report on Fund management for pubic disclosure.

Accordingly, the Supervisory Board is also charged with defining the general policy orientations that govern responsible investment. Formed in 2008, the Responsible Investment Committee is a sub-committee of the Supervisory Board. It is chaired by the Chairman of the Supervisory Board and made up of 5 members (including two qualified individuals from outside the Fund). Its stated mission is to define a framework for detecting and preventing extra-financial risks; to regularly assess the extra-financial risks to which the FRR is exposed, as identified by this framework; and to suggest measures that will prevent the occurrence of these risks or limit their impact.

The Responsible Investment Committee examines the proposals submitted by the Executive Board, which is assisted by Fund personnel, in particular staff from the Responsible Investment Strategy department. Reporting to the Executive Board and providing secretarial services for the Responsible Investment Committee since it was formed, the Responsible Investment Strategy department implements the multi-year strategy for responsible investment as validated by the Supervisory Board in April 2008. In addition, the department plays a role of leadership and coordination in the area of responsible investment. In particular, the department:

- explores in-depth issues related to responsible investment with the various business areas of the FRR as well as with the asset management firms that manage its portfolio;
- is positioned to keep track of and report on sensitive issues that have an impact on the Fund's reputation;
- reinforces links with the outside world to promote research, visibility and collaboration with peers.

In order to deal effectively with the increasing workload of its various missions, the Responsible Investment Department regularly uses outside resources (consultants, interns, etc.).

2. Responsible investment strategy, 2008-2012

March 2008

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 old age insurance plan (private sector employees) and affiliated plans (self-employed retailers and trades people) 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 its various initiatives based on the analyses performed by the Executive Board and outside 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 the 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 put them in place over the long term.

How do we define responsible investment?

By responsible investment, the FRR means actively and consistently 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 either the reasons for integrating extra-financial factors or the ways in which to do so, which may be quite different from one investor to another and from one investment class to another.

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 a business 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 a business, but also on the impacts that they generate for the industry in which they operate or for the economy. An analysis of these outputs, positive or negative, and therefore of the environmental and social sustainability of corporate strategies and their implications for the public, 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.

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

The new strategy builds on the orientations and guidelines that were decided on five years ago, and also defines new levers for action 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).

The 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. The initial assessment on the management of SRI mandates confirmed the utility of this approach on an experimental basis, which led to a performance comparable to that of the market. 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 ratified by France, in particular the eight fundamental conventions of the ILO. This particular system, which applies to the FRR's entire portfolio, will thus strengthen the vigilance that managers already exhibit.

A responsible investment committee of the Supervisory Board is created to this end. Composed of the Chairman and its two vice-chairmen, the Board and two qualified outside members 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 an analysis of specific cases, in liaison with the asset managers and their counterparts, the committee will have a range of possible actions—from dialogue with businesses to the ultimate recourse of divesting from the business in question in case of repeated violations without effort to remedy.

■ **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 the FRR's priorities..

■ **Analyze more precisely the impact of environmental issues on the FRR's investment strategy**

Environmental concerns and, in particular, the impact of global warming on the world economy and its various sectors pose numerous questions that a long-term investor cannot afford to ignore when determining its global investment strategy. The FRR's objective between now and the 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 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 Paris stock market and some PRI working groups. It will continue to do so and will also join other promising initiatives.

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 counterparts. It can also be analyzed 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.

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 attested to by the pragmatic and progressive nature of its application). 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: STRATEGY

The six UN 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.

"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."

- **Principe 1**: We will incorporate ESG issues into investment analysis and decision-making processes.
- **Principe 2**: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- **Principe 3**: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- **Principe 4**: We will promote acceptance and implementation of the Principles within the investment industry.
- **Principe 5:** We will work together to enhance our effectiveness in implementing the Principles.
- **Principe 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: STRATEGY

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

- **Principe 1**: Businesses should support and respect the protection of internationally proclaimed human rights; and
- **Principe 2**: Make sure that they are not complicit in human rights abuses.

Labour standards

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

■ **Principe 4:** The elimination of all forms of forced and compulsory labor;

■ **Principe 5:** The effective abolition of child labor; and

■ **Principe 6:** The elimination of discrimination in respect of employment and occupation.

Environment

■ **Principe 7**: Businesses should support a precautionary approach to environmental challenges;

■ **Principe 8**: Undertake initiatives to promote greater environmental responsibility; and

■ **Principe 9**: Encourage the development and diffusion of environmentally friendly technologies.

Anti-corruption

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

3. Presentation of the initiatives in which the FRR participates

CDP (Carbon Disclosure Project)

Founded in 2000, the CDP gathers and publishes information pertaining to the carbon emissions of corporations around the world. In creating this extensive database, the CDP hopes to promote the use of this information in the decision-making process of investors, businesses and governments and to contribute to the prevention of climate change. The CDP is supported by more than 500 institutional investors and solicits information from more than 2,500 corporations in 60 countries.

The FRR is among the investors that support the CDP.

EITI (Extractive Industries Transparency Initiative)

The Extractive Industries Transparency Initiative (EITI) is a coalition of governments, businesses, investors and groups from civil society that seeks to promote greater transparency in the revenues and payments generated by extractive wealth. The Initiative has rolled out a framework for encouraging companies to publish what they pay and for governments to disclose what they receive. Through this framework for the transparent management of financial flows, the exploitation of extractive resources can generate substantial revenues that promote growth and diminish poverty.

The FRR is among the investors that support the EITI.

UN PRI (Principles for Responsible Investment)

An initiative of the United Nations, the UN PRI was developed under the auspices of its UNEP Finance Initiative and its Global Compact. The Principles provide an international framework for responsible investors. On a fully voluntary basis, more than 700 stakeholders – investors as well as asset managers and financial services firms – have signed the official statement containing the six principles. The signing parties undertake to report annually on how they apply these Principles. The Secretary of the PRI monitors the Initiative and offers diverse services to participating investors – in particular in the form of a thematic work group and a collaborative platform.

The FRR is a founding member of the PRI and continues to be an active one (with a seat on its Board of Directors).

4. Correspondence table between the sections of this report and the PRI (Principles for Responsible Investment)

PRI PRINCIPLE	PAGES OF THE REPORT
1. We will incorporate ESG issues into investment analysis and decision-making processes.	**Chapters 2 and 4**
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.	**Chapters 3 and 5**
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.	**Chapter 3**
4. We will promote acceptance and implementation of the Principles within the investment industry.	**Chapter 2**
5. We will work together to enhance our effectiveness in implementing the Principles.	**Chapters 3 and 6**
6. We will each report on our activities and progress towards implementing the Principles.	**The entire report, final summary**

5. Presentation of principal activities by asset class

ASSET CLASS	ACTIVITIES	STRATEGIC PILLAR
Equities	ESG questions used in the process of selecting managers and ESG provisions in the mandates	Integration
	Monitoring of risks presented by issuers with regard to the UN's Global Compact and banned weapons conventions	Prevention of reputation/image risks
	Dialogue with certain issuers	Prevention of reputation/image risks
Bonds	ESG questions used in the process of selecting managers and ESG provisions in the mandates	Integration
	Monitoring of risks presented by issuers with regard to the UN's Global Compact and banned weapons conventions	Prevention of reputation/image risks
Private equity	Reflections on the investment strategy	Integration and factoring the environment into investment strategy
	ESG questions used in the process of selecting managers and ESG provisions in the mandates	Integration
Commodities	Exclusion of agricultural commodities	Prevention of reputation/image risks

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