Responsible investment strategy

FONDS DE RESERVE
POUR LES RETRAITES

Introduction

Since 2003, the Supervisory Board has demanded a firm commitment from the Fonds de Réserve pour les Retraites in the area of responsible investment[1]. As a public investor, and vector for intergenerational solidarity, the FRR wishes to set an example by factoring Environmental, Social and Governance (ESG) principles into its asset management practices. The FRR will accordingly promote best practices of responsibility, both in terms of the investments it makes but also in the service providers it appoints.

"Over the last five years, the FRR has consolidated the founding principles of its identity as a responsible investor."

The FRR has therefore gradually laid the foundations for socially responsible criteria to be integrated, across its entire portfolio, into the selection process for its asset managers and the securities in which they invest. It has also introduced a global proxy voting policy. In addition, since April 2006, the FRR is committed to applying the UN-sponsored Principles for Responsible Investment (UNPRI).

The main reason behind the FRR becoming a responsible investor lies in its primary mission and objective: to optimise returns on the funds entrusted to it, on behalf of the community, in as secure an environment as possible. As such, ESG factors need to be integrated into the FRR's management processes for it to fully understand the risks and opportunities presented by the businesses in which the FRR invests. Indeed, the FRR is convinced that these criteria can have an impact on company valuations and therefore on the returns of the fund. Failure to integrate these factors into its decision-making process could therefore be detrimental to achieving its objective.

The second reason is economic: investment yields do not depend solely on the impact of companies' financial and extra-financial strategies, but also on the externalities they generate for their industry or the economy as a whole. It is necessary, especially for a universal public investor, active in pensions, whose role it is to protect its investments over the long term, to analyse the environmental and social externalities of corporate strategies and their effects on the community.

Despite the curtailing in 2010 of its investment horizon resulting from the pension reform of that year, the long-term protection of the value of its investments remains one of the FRR's core objectives. Indeed the FRR is, by virtue of the volume of its assets, a universal investor whose constraints in terms of diversification mean that it is present in all asset classes, sectors, geographical zones, etc. It is therefore in its interest that the entire system works well over the long-term.

Over the last five years, above and beyond deploying its main strategic principles across its entire portfolio, the first SRI (Socially Responsible Investment) mandates have allowed the FRR to gain a significant level of responsible management experience. Up till now, the FRR's efforts in terms of integrating ESG factors into management processes have followed a positive so-called "best in class" approach which promotes best practices of social and environmental responsibility and have focused on large European listed companies. Management results from these SRI mandates have underlined the benefit of an approach to financial analysis that incorporates ESG information: these mandates have generated market comparable performance whilst at the same time promoting good ESG practices. By putting its benchmark values to the test of real-life fund management, but also comparing them to those of other SRI investors, the FRR has, during this initial phase, consolidated the founding principles of its identity as a responsible investor. The FRR must continue in this direction by implementing these principles in as fully operational and integrated a manner as possible.

"For 2013-2017, the responsible Investment strategy will extend the FRR's base to emerging markets and small and medium capitalisation equities."

Bringing the SRI and management teams closer together within the management companies has enabled extra-financial information to be integrated into the management process across all of the FRR's asset classes, including those that are not specifically labelled SRI. The FRR shall continue to encourage all of its managers to advance further in this direction, by increased dialogue in order for the institutional investor and management company community to progress.

Having reached the end of its first responsible investment policy for 2008-2012, the FRR is to renew its strategy for 2013-2017. Having consulted the Responsible Investment Committee and also taking into account changes in practices developed by other institutional investors, the Supervisory Board has outlined the FRR's identity as a responsible investor for the next four years (2013-2017).

While this new strategy extends the FRR's base for action beyond the traditional scope of SRI, in particular to emerging markets and provides new opportunities to exploit asset classes as yet little explored in the sphere of responsible management, such as small and medium-capitalisation companies, it remains nevertheless founded on the same principles. These will be deployed differently depending on the specific nature of each investment platform underpinned by four strategic priorities.

1. In 2003, the FRR Supervisory Board emphasised that "its investment policy should be consistent with respect for collective values that encourage balanced economic, social and environmental development and that the FRR should actively promote best practices with the aim of the management companies adopting these values in their analysis of financial assets and transparency of corporate governance".

1. Overview of the four strategic priorities and how the FRR intends to implement them over time

Priority 1: Integrating ESG factors into asset management

The purpose is to define these factors more clearly by setting an initially limited number of objective and measurable criteria for ESG aspects. These criteria shall then be measured and their progress monitored over time. The aim is therefore to broadcast the values held by the FRR with the utmost clarity and to support companies in achieving progress via constructive dialogue.

The FRR shall therefore expand its efforts towards integrating extra-financial data into its management processes by further engaging with its managers through regular exchanges on ESG issues.

The FRR shall continue to promote good ESG practices whilst at the same time seeking to reap the financial rewards from the materiality of certain SRI criteria, in other words the proven impact of social responsibility criteria on a company's performance. Concerning this point, the FRR shall focus in particular on its small and medium-capitalisation equities SRI actively managed mandates to learn any lessons that may subsequently be deployed in managing its other actively managed mandates. It shall in particular help support the economic development of these companies in pursuit of shared ESG values.

The FRR shall also help to finance companies the corporate mission of which is to preserve the environment or are beneficial to society. This is a new approach for the FRR. Indeed, it enables it to be exposed to themes such as water, eco-technology, waste treatment and management, renewable energy via a selection of investment funds run by dedicated managers.

> "The FRR will help to finance companies the corporate mission of which is to preserve the environment or are beneficial to society."

The FRR hopes that these new SRI thematic fund mandates will provide scope for the FRR to experiment on these themes enabling it to better identify, understand and follow sectors the contributions of which will be crucial for sustainable development.

Priority 2: Conducting social responsibility

This priority focuses on two areas of action: the first concerns the activities of the companies in which the FRR invests and the manner in which such companies conduct their activities; the second concerns the inevitable impact of State taxation practices.

Since 2008, the FRR has had in place a system enabling it to monitor and prevent extra-financial risks that may have an impact not only on its investments but also its reputation. Indeed, risks for the FRR may arise from failure by a company in which it invests to observe universally recognised principles, such as those of the United Nations Global Compact and good governance, but also the international treaties ratified by France, in particular the Ottawa[2] and the Oslo[3] Treaties. The FRR will pursue this approach by extending it to new asset classes, geographical areas and sizes of market capitalisation. This system will continue to operate transversally across the FRR's entire portfolio alongside the vigilance the managers should already be exercising in these areas.

Such monitoring falls, in particular, within the remit of the Responsible Investment Committee established in 2008, on which sit the Chairman of the Supervisory Board, a member of the college representing employee trade unions, a member of the college representing employer trade unions and two external qualified individuals. The Responsible Investment Committee relies on regular analysis provided by specialist agencies and on proposals of the Executive Board to assess cases of failure to observe the FRR's principles and decides what action to take. If an allegation is proven, the Responsible Investment Committee may take a number of possible measures ranging from dialogue with the company in question to, as a last resort, in the case of repeated breaches to which the company has refused to put an end, a decision to register it on the list of companies banned from investment by the FRR.

Also, to avoid legal and regulatory risks, money-laundering risks and reputational risks arising from the FRR's exposure to various financial centres classified in some cases as "tax havens", the FRR has decided that it should not invest in any sovereign bond or company in a State where such risks exist, or contract with any third party whose registered office is located in such a place. The FRR shall pursue the process that it has begun on defining the scope of these restrictions in association with the work being conducted by the public authorities (French Government and Parliament) and international organisations.

For this new period and in order to prepare itself for widening the range of its asset classes, the FRR shall select SRI research providers with wide coverage of its investment zones (emerging countries, small capitalisations, in particular). It shall consult these managers regularly on these matters. Indeed, ESG issues should, in its opinion, be integrated with care and prudence into the heart of its day-to-day management.

2. Convention on the prohibition of the use, stockpiling, production and transfer of anti-personnel mines and on their destruction.
3. Convention on the prohibition of the use, stockpiling, production and transfer of cluster munitions and on their destruction.

Priority 3: Exercise of the FRR's voting rights

In 2005, the Supervisory Board stated that "it is in the interests of the FRR to actively participate in improving the governance of the companies in which it invests. The aim is to promote clarity and balance in the powers exercised by the management bodies of such companies and also the quality of the information provided to shareholders, respect for their rights and integrity of the voting process. It is therefore one of the factors that contributes significantly to the longevity of the corporate community, the continuity of the strategy they pursue and the manner in which they fulfil their responsibilities towards all of their partners. All of these factors contribute directly to their healthy future valuation". The Supervisory Board established a number of principles in relation to exercise of the FRR's voting rights, pursuant to which the FRR's rights as a shareholder at general meetings must be exercised without fail, by each of the managers, in line with the guiding principles set by the FRR. All positions in the name of the Fund are taken in its sole interests and with complete independence.

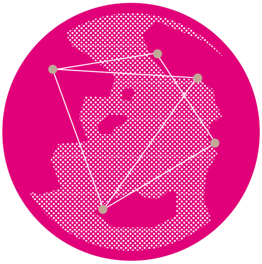
> "The FRR will continue to vote at general meetings of all companies which it invests, whatever the size of its shareholding in the capital."

These guiding principles, established by the Executive Board, were made public after their adoption by the Supervisory Board on 26 January 2005. They are updated each year and are available on the FRR's website: www.fondsdereserve.fr.

Following the 2005 campaign, during which a system was implemented giving very wide discretion to the companies responsible for managing the FRR's portfolios, the FRR planned as from 2006 to gradually introduce greater coordination between itself and its managers in the exercise of voting rights where the managers' voting intentions in respect of one same resolution in one same company differed. The FRR established an internal proxy voting monitoring committee to supervise this coordination process.

The FRR's guidelines for the exercise of voting rights are re-examined each year and adjusted in line with regulatory changes and the FRR's concerns.

The FRR votes at general meetings of companies in all countries where it invests whatever its percentage shareholding in the capital of such companies.



Priority 4: Contribution to research on Responsible Investment and support for international initiatives

The FRR's objective here is to increase awareness on responsible investment, share its work as widely as possible and spread good practices amongst the companies the most in need.

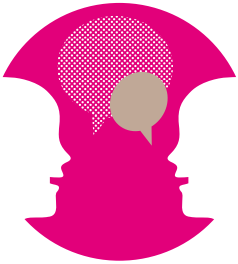
Research plays a decisive role for investors in terms of the benefit of incorporating extra-financial factors into finance in general and asset management in particular. With this in mind, the FRR actively supports the "sustainable finance and responsible investment" chair established by the Paris Market and will continue supporting academic research throughout the period 2013-2017.

Due to the sizeable percentage that bonds represent in its asset allocation, the FRR is naturally promoting SRI research on bond assets during this next period. It shall in parallel focus specifically on analysing small and medium-sized companies.

Furthermore, the FRR shall actively continue to participate in the following initiatives with the aim of promoting good practices as widely as possible amongst investors and issuers: Principles for Responsible Investment (PRI), Carbon Disclosure Project (CDP), CDP Water, Extractive Industries Transparency Initiative (EITI), and International Corporate Governance Network (ICGN).

> **"The FRR will continue to support the research on Responsible Investment, in particular on bond assets."**

2. Principles for implementation of strategic priorities



Dialogue with asset managers and companies

The process of adoption within traditional management of the ESG approach is by nature a gradual one. This is why the FRR wishes to continue its efforts to ensure that its managers develop even further their analysis of extra-financial data. Also, within its responsible investment laboratory, the FRR shall strive to deepen its exchanges with SRI managers especially those managing European small and medium capitalisation equities mandates. The FRR shall promote dialogue with companies via its managers to take advantage of the intrinsic leverage gained from its managers' globally managed assets and also their research capabilities.

Continue exploring ESG issues within the SRI laboratory

Two environment-themed management mandates investing in a selection of funds managed by dedicated fund managers will be launched in the first half of 2013. These mandates will require specific SRI reporting to enable the impact of the FRR's investments to be quantified.

"Through specific criteria, the FRR will properly assess the link between economic performance and corporate social responsibility."

Concerning the "SRI European small and medium capitalisation equities" actively managed mandates, the main objective assigned to the managers appointed at the end of 2012 shall be to bring the materiality principle to the fore by generating performance in line with or above that of the European equities markets by selecting companies that have introduced, or are planning to introduce an ESG approach. With this mandate, the FRR wishes to explore the social responsibility challenges facing small and medium sized companies.

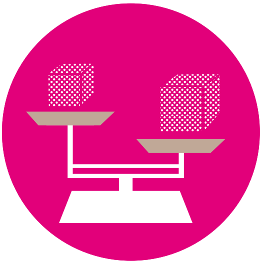
The FRR has, in this regard, given guidance to its managers by defining precise criteria to be taken into account and monitored over time . The simplicity of these indicators should enable some of them to properly assess the link between economic performance and corporate social responsibility, but also to measure how well this market segment integrates good ESG practices over time. The FRR also wishes to allow its managers a degree of flexibility in how they interpret these criteria and enable them to put forward others.

When it has gained the necessary perspective, the FRR shall consider whether it is appropriate to merge the applied criteria to form a common standard or conversely allow them to diverge, if it believes that the process of assessing the social responsibility of small and medium sized companies has not fully matured. It shall also be considered whether to extend this detailed approach to monitoring the FRR's assets as a whole.

4. In particular, consumption and management of energy, employee turnover rate, absenteeism rate, employee percentage profit-sharing rate, composition of the board (male/female parity, number of independent directors), multiplicity of corporate functions (chairman/chief executive).

Regularly evaluating its portfolio

The FRR has to outsource its asset management. This is why, since 2005, it has hoped to be in a position to assess its exposure to extra-financial risks by appointing SRI research providers to analyse its portfolio. To maintain its ability to analyse its investments, the FRR in June 2013 launched a new ESG research provider selection process. It shall continue to evaluate its investments by reference to the principles of the Global Compact and good governance and in light of the Ottawa and Oslo Treaties.



Acting with discernment

The integration into its portfolio management of extra-financial aspects shall be adapted to the characteristics of each asset class, geographical zone and size of capitalisation. For example, the FRR has decided, on the recommendation of the Responsible Investment Committee and as a precaution in the area of commodities investment, not to invest in agricultural commodities.

Working in transparency

The FRR shall report publicly on a regular basis on its progress and the conclusions that it has drawn in implementing this strategy.

Conclusion

Following on from the strategic directions taken in 2003, re-affirmed in 2008, the 2013-2017 responsible investment strategy is both ambitious, as its various priorities demonstrate, but also realistic, given the discernment with which it shall be implemented. It reflects its primary mission as a universal investor managing the assets entrusted to it by the community as effectively as possible, without compromising the future value of its investments whose horizon extends beyond that of its liabilities.

Design and layout: **avant**garde

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