June 2005.

THE FRR'S SRI INVESTMENT STRATEGY AND SRI MANDATE PHILOSOPHY

1) The SRI investment strategy of the FRR (*Fonds de réserve pour les retraites*)

The role of the FRR is to invest, on behalf of the public, the sums entrusted to it by policymakers to be used to help finance the general old age insurance plan and affiliated plans as of 2020.

Accordingly, the FRR's investment policy has a dual aim. On the one hand, it seeks to maximize investment returns over the long term and under the best possible conditions of security. Its investment policy must also be consistent with certain shared values that promote economically, socially and environmentally sustainable development.

This dual aim was forcefully affirmed by the Supervisory Board in its April 2, 2003 proceedings on the Fund's general investment policy orientations. In this same statement, the Executive Board was asked to 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's Supervisory Board and Executive Board adopted a three-pronged strategy to promote SRI investment and best corporate governance standards:

A/ An active policy of voting proxies at the shareholder meetings of corporations in which the FRR invests, via its managers, in compliance with the relevant sections of the French *décret* dated December 19, 2001. On February 10, 2005, the FRR published a set of broad proxy voting guidelines for managers under mandate.[1] In fact, mandates were awarded in part on the basis of managers to fulfill this fiduciary duty on a large scale and in compliance with client guidelines. This active proxy voting policy has been implemented.

B/ For asset managers selected by the FRR to manage European equity mandates, the enlargement of stock-research and -picking criteria to include certain extra-financial considerations (a total of just over 3 billion euros). The FRR asks that the managers selected for these mandates make a certain number of commitments :

- *A commitment to research and analysis,* integrating relevant and reliable information on the social and environmental behavior and practices of companies being considered for investment, and assessing their merits on the basis of the ten principles of the UN's Global Pact in particular (see attached document).

- *An effort to include the findings of this research in their stock-picking process;*

- *A commitment to transparency and reporting* on the way in which extra-financial criteria have been integrated and any problems encountered;

- *A commitment to exchange with the FRR* in terms of method and research.

[1] Available on the FRR website: http://www.fondsdereserve.fr

C/ The development of SRI by managing several mandates dedicated to this approach, with the dual aim of gaining a better grasp of the specific characteristics of extra-financial analysis that can be implemented in line with the Fund's philosophy and improving the ability over time to measure the value added of SRI processes in terms of investment performance. The RFP launched by the FRR on June 28, 2005 seeks to select managers for these dedicated SRI mandates.

2) The objectives assigned to the FRR's SRI management mandates.

During the preliminary organization of its SRI RFP, the FRR worked extensively with Europe's leading experts in socially responsible investment (asset managers, rating agencies, research groups, brokers, index makers, etc.). Consequently, its in-house work was enriched by contributions from numerous sources, helping to better identify and articulate the objectives that the Fund wishes to pursue by devoting a portion of its allocation to SRI assets.

From this work, the FRR has identified **five conclusions** around which its RFP is structured:

A/ The FRR considers that equities managed using an SRI process do not constitute a new asset class per se. In other words, the FRR does not view SRI as a means of enhancing the efficiency of its portfolio and does not assign this type of investment an *ex ante* investment return objective or a volatility hypothesis that is significantly different from those underlying its other equity investments.

B/ The FRR expects that a specifically SRI investment process will include extra-financial considerations in its stock analysis process, on three primary levels:

1) The first concerns the assets selected: The idea is to better apprehend the environmental, social or corporate governance threats and opportunities implicit in the business strategy and their impact on the FRR's long-term investment strategy. Indeed, while it is undeniable that these threats and opportunities exist, it remains difficult to date to prove a relationship of direct and robust causality between these factors and long-term investment value creation. As the mixed findings of the research conducted so far show, it is too early to say whether SRI investments out- or under-perform conventional investments.

2) The second is more economic in nature: The idea is to identify and, insofar as possible, to assess the impact of this strategy on other economic actors, in particular on the public domain that ultimately funds the FRR and other pension plans. In fact, it would be somewhat paradoxical if the FRR's own investment policy did not attempt to take corporate practices into account, especially those that could have a positive or negative impact on the public, which, in many cases is forced to assume the financial consequences.

3) The third is related to the nature of the FRR: The FRR was created to serve the general interest. It has a long-term investment horizon and will not make any payouts until 2020. Consequently, the Fund is in a position to be an innovative investor, to promote best practices and to enhance the objectives set for it by law and by its own Supervisory Board. Through this RFP, the FRR intends to make a methodological contribution to the development of SRI in Europe, and to support efforts in this direction by all relevant economic actors: asset management firms, businesses, rating agencies, etc.

C/ To guide potential managers in their analysis, the FRR will supply its own list of SRI principles, along with specifications, when the second phase of the RFP begins next fall. This list will change over time, as experience is gained in this area. In addition to corporate governance, for which the FRR will ask managers to ensure that the companies in which it invests comply with the FRR's own guidelines on proxy voting as a strict minimum, the chapter headings of these SRI principles may concern:

- *respect for international law and basic worker rights;*
- *job development through better management of human resources;*
- *corporate environmental responsibility;*
- *respect for consumers and fair trade practices in local markets.*

D/ Consequently, the approach is fundamentally multi-criteria. For this reason, the FRR has ruled out investment processes based on the notion of screening or excluding *a priori* certain economic sectors. The FRR prefers to encourage inclusive processes of the "Best in Class" type. Naturally, managers will be free to exclude stocks that, upon analysis, conflict with the Fund's SRI principles—independently of their market capitalization. This will ultimately depend on the degree of discretion left to managers, which will be indicated by the FRR during the second phase of the RFP process, so that it can select and eventually combine a sufficiently representative range of management processes.

E/ In line with this approach, and due to the still geographically disparate nature of extra-financial information available to managers, **the FRR has decided at least initially to center its approach on the universe of pan-European equities** (European Union, Member States of the European Economic Area and the Helvetic Confederation) covering mid and large caps.

3) In light of the foregoing considerations, the FRR has selected the following characteristics for the RFP:

- The total amount of funds available for investment in connection with this RFP is around 600 million. This amount will eventually evolve along with the FRR's resources, as changes are made to its strategic allocation, and if the Fund decides to increase the proportion of SRI mandates within its total European equity exposure.

It should be noted that, with this first step the FRR is already the top-ranking European institutional investor in SRI assets.

- A maximum of six mandates should be awarded upon completion of this RFP, including one stand-by mandate, [2] depending on the quality of the bids submitted by the candidates.

- The minimum size of the mandates awarded should be 50 million euros. The FRR reserves the right to award different amounts to each of the asset managers it selects on the basis of their investment process and the capacity thresholds that this may entail.

- The FRR would like to assess the SRI processes that it has selected over a sufficiently long time frame. Consequently, the **management mandates will be awarded for a period of five years.**

[2] Standby mandates are those for which the FRR reserves the right to activate as needed, in particular if one of its active managers is unable to perform, without saturating the management capacity of its other mandated managers.

******

Overall, the FRR intends to promote an SRI strategy that is:

- built to last and not one-off, as a short-term strategy would do a disservice to this type of asset management

- ambitious, as attested to by the amounts allocated to the RFP

- played out on several levels of pragmatic action, because SRI is still a largely experimental area for which no market standards exist, which also means that its success will depend on the ability of all relevant players to mobilize adequate human and technical resources.