The **co-operative**
asset management

Responsible Investments Quarterly Review

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Part of The **co-operative** financial services

Section 1 **Engagement Update**

Oil Sands Update

Since we last discussed oil sands in the previous issue, there have been two major events on the calendar. The high watermark of a two-year engagement campaign led by The Co-operative Asset Management was the 2010 Annual General Meetings (AGMs) of BP and Royal Dutch Shell respectively, where we were the lead investor in putting shareholder resolutions to the meetings, asking each board to issue a report on how they will manage the environmental, social, economic and political risks around their respective activities in oil sands.

Prior to the AGMs, The Co-operative Asset Management and a number of institutional investors, co-ordinated by the responsible investment charity Fair Pensions, had been in detailed discussions with the two companies regarding the substance of the resolutions, which were filed at the end of 2009 in order to meet the deadline for shareholder resolutions as set by the companies.

BP

The resolution received significant support at the AGM on 15 April 2010, considering that shareholder resolutions are normally treated with extreme caution by investors in UK companies. 6% of shareholders supported it while over 8% abstained, meaning that almost 15% of investors who voted declined to support management's request to reject the resolution. This is a very credible figure for a UK shareholder resolution. At the AGM The Co-operative Asset Management presented the resolution and asked the Chairman to answer our concerns that persisted over the optimistic projections that BP was using on break-even cost and carbon intensity, as well as challenging the company to become an energy company in which high-carbon fuels played a rapidly diminishing part. The Chairman stated that there were no right and wrong parties here and recommitted BP to responsible operation, though he disagreed with the arguments in the resolution.

Royal Dutch Shell

The AGM at Shell on 18 May 2010, held in The Hague, followed a similar format. The Co-operative Asset Management met privately with the Chief Executive just prior to the commencement of the AGM where the issues were discussed amicably – though Shell stood by its position. At the AGM we praised Shell for taking a markedly more thorough and open approach to engagement on the issue, though questioned the fact that the pursuit of oil sands appeared to be, by their own assessment, in direct contradiction to the more sustainable energy path they espoused.

The resolution received somewhat less support at Shell with 5.4% supporting it and 5.6% abstaining. We attribute this to the fact that Shell produced a report on the oil sands in April, which set out to acknowledge and address the concerns expressed in the shareholder resolution, and also embarked on an intensive campaign of investor engagement on the resolution.

Though defeat in terms of bald numbers was expected in both cases, the objective was to use the shareholder resolutions as a lever to prod the companies into better disclosure of the thinking behind their use of shareholder capital in this controversial way, and to set out what we regarded as the weaknesses in their arguments.

Judging by the fact that BP made its first and substantive disclosures on oil sands as a result of the resolution, that Shell devoted a whole report to it, that the shareholder resolutions were the most discussed issues in the responsible investor community in the months leading up to the AGMs and that the media coverage was extensive and positive, we deem the resolutions to have been a success. Shareholder resolutions should not be used lightly, but when well chosen and pursued effectively, they can be a powerful tool for raising the agenda of Environmental, Social and Corporate Governance (ESG) issues material to company performance. The Co-operative Asset Management will continue to monitor developments in the oil sands debate but is satisfied that our activities in the resolutions and the oil sands letter of 2009, which was backed by $3 trillion of investment, has given powerful momentum to investor engagement on this most important of issues.

Whitbread

One of our newer active holdings is hospitality group Whitbread, which operates hotels, pubs, restaurants and coffee shops in the UK. Well-known brands include Premier Inn, Beefeater and Costa Coffee. We were concerned that the company might be losing ground on sustainability and responsibility, and had meetings with the senior management to discuss this. We found ourselves pleasantly surprised. Behind the scenes, Whitbread had been preparing a relaunch of its Corporate Social Responsibility (CSR) programme, now called 'Good Together', and released its first report under this heading in the second quarter.

The approach is to embed sustainability concepts into the business through existing management structures and across six priority areas: Environment, People, Sourcing, Health, Community Investment, and Brand and Customers.

Highlights include Whitbread now rolling out lessons learned from a trial green hotel at Tamworth, which achieved an 81% reduction in operational carbon emissions and a 66% reduction in water footprint in its first year. Whitbread has also recently announced that it will invest £7.3 million this financial year to introduce a package of measures to help the company reduce its carbon emissions and conserve water across its existing estate.

This programme will contribute significantly to helping the business deliver against its targets of a 26% reduction in energy consumption and a 20% reduction in water use by 2020. Annual energy cost savings of £1.5 million are anticipated in LED lighting alone.

Sourcing is also an area of significant activity. From June 2010, all Costa Coffee sold in the UK (and almost all internationally) has been Rainforest Alliance Certified™. The company is methodically reviewing its raw materials and supply chains to determine priority areas for further responsible sourcing developments. The raw materials its businesses rely upon include timber, coffee, tea, fabrics and plastics (which require oil) to name but a few.

All of these commodities are, or will become, 'stressed' within the supply chain in the next couple of decades. This process will help Whitbread understand how it can manage these dependencies better and improve its reputation for doing so.

The strong improvement and programmes now in place reassured us on a number of fronts. Over time we anticipate significant business benefits to flow, including margin improvements from cost savings and greater staff motivation and productivity, as well as an enhanced reputation with customers.

Whitbread is actively incorporating biodiversity risk and deforestation into its analysis and, following our discussions, is considering future participation in the Forest Footprint Disclosure. They are also looking across the property portfolio for ways to help bees and provide nests, as they already do with bats.

Whitbread's CSR programme is still gaining traction and we will be seeking to ensure that it continues to be a priority following the arrival of a new Chief Executive later in the year. As part of our ongoing programme of engagement, we will also seek to better understand the company's approach to improving gender balance.

Bayer

Bayer is a global chemicals business based in Germany and focussing on health, crops and high-tech materials. Among its portfolio of businesses it has a world-leading position in the supply of neonicotinoid based pesticides, including imidacloprid and clothianidin.

One of the critical biodiversity challenges for the agricultural sector is the global decline in pollinators, including bees. While the science is not yet clear, new forms of pesticides have been cited as a possible reason for the collapse in bee numbers.

Following an exploratory meeting with Bayer in December 2009 and a subsequent assessment of the scientific position, we wrote to Bayer in the second quarter of 2010 outlining a number of steps that could reduce potential risks to bees from neonicotinoids. The company recently responded to our letter and we are now considering how to best develop the dialogue further.

Unilever

As one of the world's largest fast-moving consumer goods companies with a premium offering, Unilever's operations intersect with a large number of environmental and social issues as well as governance. The company's reputation on these is crucial. While Unilever won the Company of the Year for Business in the Community's Awards for Excellence 2010, we nevertheless pressed for improvement on a number of fronts. This included governance, when, following an upsurge in 'golden hello' awards in this year's proxy season, The Co-operative Asset Management went public on appointments at Unilever. On recruitment, the new Finance Director received a 'golden welcome' of £680,000 in cash and a restricted share award with a value of £2.6 million, neither of which were contingent upon corporate performance.

We are unable to support awards that provide no link to company objectives: they have the combined effect of undermining the retentive and incentive effect of standard long-term share grants and embed bad practice concerning recruitment negotiations in the market. The Co-operative Asset Management spoke on BBC Radio 4 the morning of the AGM, where the level of shareholder dissent eventually reached 12% of votes cast. Unilever has, however, shown progress in other areas. This includes labour relations, where most of the issues relating to temporary contracts and the closure of tea packaging facilities in Pakistan now appear to be resolved. We challenged the company on how its processes have been improved to ensure that the board is more proactive in reputation risks relating to labour ahead of significant changes in the supply chain.

Another item on the engagement agenda is the use of Bisphenol A in food cans. This is a hazardous chemical used in baby bottles, food cans and in paint on boats. While opinions vary as to what levels might be safe for humans, there have been a number of moves by legislators to reduce exposure to the chemical, particularly for babies. We are encouraging Unilever to invest in alternative ways of lining its cans as competitors have done.

Galliford Try

Galliford Try is a housebuilder and construction company. As part of a general review of CSR reporting at the company we held a conference call with management and gave detailed feedback on its approach so far. Galliford Try has taken significant steps in terms of disclosure and we wished to indicate ways in which it could evolve its programme from managing risks to integrating sustainability into the core of its business. We look forward to continued strong progress at the company on the carbon intensity of operations and the properties it builds, as well as improving the diversification of the talent pool – the employee base in the industry is ageing and very male dominated.

We have also encouraged Galliford Try to consider issues relating to raw materials supply and how emphasising biodiversity in building design and construction (e.g. biodiversity action plans at each site focussing on assisting species of all sorts; also local growing space and green roofs/walls) could enhance sales performance. Laws and regulations are tightening here with all planning now having regard to biodiversity, so this is a potential area of competitive advantage over time with respect to bidding for contracts.

Annual Report Voting

We maintained our stance on voting on the Annual Report in relation to the level of disclosure on Environmental, Social and Governance issues as outlined in the previous review. Accordingly we wrote, as indicated in the following table in chronological order, to 39 companies in the second quarter of 2010.

Company	Vote	Topics addressed
Low & Bonar	Abstain	Climate, Gender, KPIs, Management
Telecity	Abstain	Climate, Gender, KPIs, Management
BP	Abstain	Climate, Gender, Forests
PACE	Abstain	Climate, Gender, POPs, KPIs
Carnival	Against	Gender, Donations, Governance
Reed Elsevier	Against	Donations
SDL	Abstain	Climate, Gender, KPIs
Admiral	For	Climate, Customers
Aggreko	Abstain	Climate, Gender
Oxford Biomedica	Against	Climate, Gender, KPIs, Governance
Fidessa	Against	Climate, Gender, KPIs
Royal Bank of Scotland	Abstain	Climate, Gender, Management
Colt Telecom	Against	Gender, Governance
Johnston Press	For	Climate, Gender
Jardine Lloyd Thompson	Abstain	Climate, Gender
Novae	Abstain	Climate, Gender
Partygaming	Abstain	Climate, Gender
Forth Ports	Abstain	Climate, Gender
Rightmove	Abstain	Climate, Gender, KPIs, Management
Spirent Communications	Against	Climate, Gender, POPs, KPIs, Management
Development Securities	Abstain	Climate, Gender, Forests, KPIs
William Hill	Abstain	Climate, Gender, Forests, POPs
AstraZeneca	Against	Governance
Schroders	Against	Governance
Royal Dutch Shell	Abstain	Climate, Gender, Forests
Weir	Abstain	Climate, Gender
United Business Media	Against	Climate, Gender
Camco	Against	Governance
Vitec	Abstain	Climate, Gender, POPs
Galiform	Abstain	Climate, Gender, POPs
Spectris	Against	Climate, KPIs
Tribal	Abstain	Climate, Gender, KPIs
Wolfson Microelectronics	Abstain	Climate, Gender, POPs, KPIs
John Menzies	Abstain	Climate, Gender
Dignity	Abstain	Climate, Gender
Mears Group	Abstain	Climate, Gender, KPIs, Management
Hiscox	Abstain	Climate, Gender
Headlam	Against	Climate, Gender, KPIs
Capital and Regional	Abstain	Climate, Gender

Climate – refers primarily to reporting of Greenhouse Gas emissions.
Gender – refers to gender balance throughout the company and at board level.
KPIs – refers to whether the company discloses Key Performance Indicators that enable performance on an issue to be assessed.
POPs – refers to Persistent Organic Pollutants and whether the company is taking steps to manage them out of operations or the supply chain.
Management – refers to the structures the company is using to manage Social, Environmental and Ethical (SEE) risks and find opportunities.
Donations – refers to whether a company makes political donations.
Governance – indicates those situations where the AR vote has been used to express disapproval of board composition overall.

Section 2 **Corporate Governance**

UK Corporate Governance Code

The Code replaces the existing Combined Code on Corporate Governance for reporting years starting on or after 29 June 2010, and applies to all companies with a premium listing on the London Stock Exchange regardless of where the company is incorporated.

As responsible investors The Co-operative Asset Management welcomed the opportunity to input into the consultation as detailed in our last Quarterly Review.

Our response called for action to get more qualified women on to company boards, as well as strongly supporting the annual re-election of all directors. In addition, our response centred on the notion that more should be done to promote board compositions with different backgrounds and viewpoints – noting that gender balance is key. Women make up slightly more than half of the population containing great innate talent, yet only 8.8% of FTSE 350 directors are women, as our study in August 2009 highlighted.

The updated Code was published by the Financial Reporting Council (FRC) on 28 May 2010. We welcomed the strong update of the Code, especially the move to annual board re-election and inclusion of gender as a consideration in board composition.

This is a significant change to corporate governance in the UK and in line with The Co-operative Asset Management's long-term position of supporting annual re-election of directors.

The FRC published a new Stewardship Code at the beginning of July 2010, dealing with relations between companies and their institutional investors. We previously fed into this consultation. In addition, the Higgs Guidance on non-executive directors is being revised by the Institute of Chartered Secretaries and Administrators. Both will lead to further changes to the Code.

Annual General Meetings (AGM) Season

The second quarter is always the busiest time of year as a large number of companies hold their AGM in this period. During this time we sent 115 letters to companies to explain why we were unable to support a resolution, further to the one regarding receiving and adopting the report and accounts as referenced in the table in the Engagement Update (previous page) and to open the door for engagement. Following on from last year's trend the response rate to these letters has increased dramatically. Eighteen companies responded to us and we engaged on the concerns that triggered our inability to support particular votes.

We believe it is important for institutional investors to remain consistent in their approach to principled engagement, whether in the midst of a bull-run or facing significant losses during bearish conditions.

After record levels of shareholder activism in response to the financial crisis during 2009, the early signs in 2010 were that this would continue.

In the first quarter of 2010 we witnessed a remuneration vote defeat at Grainger and near misses at St Modwen Properties and Debenhams. Therefore, moving into the second quarter after a relative return to market confidence it was important for effective stewardship and accountability to continue.

The quarter was kicked off by Xstrata where The Co-operative Asset Management has opposed the remuneration report since 2003 due to what we consider egregious practices. This year shareholders ramped up pressure on the company with 32% of votes cast against the remuneration report. The significance of the vote should not be underestimated given that controlling shareholder Glencore holds approximately 35% of the company's shares.

At Rightmove, for the second consecutive year share awards were granted under the 'exceptional circumstances' clause. Shareholders, including The Co-operative Asset Management, took exception to the decision and registered a 28% vote against. At Reckitt Benckiser where The Co-operative Asset Management has consistently viewed executive pay as excessive, voting against the remuneration since 2003, we were dismayed by the company's proposals for the year. In the context of perhaps the most excessive range of awards in the UK market, we were surprised that other investors were not orchestrated in reflecting widely understood concerns. At the meeting 16% of the shares voted against management on the report.

The Sheffield-based SIG had decided to award a substantial salary increase to their CEO in a year in which the company struggled and the share price dropped substantially. Reflecting what we viewed as disparity between pay and performance we decided to oppose the remuneration report. Other shareholders agreed, with eventually 66% voting against management at the AGM. Consequently the resolution was not passed, although remuneration votes are currently only advisory meaning it is more of a signal to boards that reform is required.

At Ladbrokes, the company unconventionally bolted an Extraordinary General Meeting (EGM) on to the end of the AGM and included highly contentious pay proposals revolving around the newly appointed Chief Executive. Firstly, our concerns related to overall excessiveness; the one-off award at 10 times the CEO's starting salary came in addition to existing award schemes and his recruitment grant of 1,177,000 shares. Secondly, the scheme only requires the CEO to maintain a 30 consecutive day share price within the five-year performance window. Perversely, therefore, even if the target was hit within the first six months or so, if the share price then plummeted over the next five years the CEO would still be awarded 10 times his salary.

For example, the shares could be awarded off the back of a month-long bout of acquisition speculation rather than genuine upturn in sentiment. We view this as contrary to long-term sustainable value creation and the concept of risk-adjusted pay.

Similar to Reckitt Benckiser, where we had comparable levels of concern, we were again surprised by the lack of opposition amongst the investment community. At the EGM, combining opposing votes and abstentions the aggregate protest vote came in at 32%. The Co-operative Asset Management will continue engagement with Ladbrokes given the high risk-profile of the award scheme.

Wolfson Microelectronics also employs a similar pay plan; only in their case large awards can vest simply for maintaining a level of share price appreciation over five days. As with Ladbrokes the nature of the target fails to necessitate sustained performance and may be subject to perverse outcomes. It has been reported that 40% of shareholders voted against the remuneration report.

Coming towards the end of the quarter, despite positive engagement discussions with Bloomsbury Publishing we decided to take a stand against the bonuses awarded during the year. In the prevailing context of revenue down 12%, adjusted profit before tax down 35% and Earnings Before Share (EBS) down 37% we came to the conclusion that the awarding of bonuses at 100% of salary was unjustified and inappropriate. At the AGM some 20% of shareholders agreed with us and opposed.

We will continue in dialogue with the company to address board composition issues as well as the link between performance and pay.

However, despite the prevalence of the poor remuneration practices there are some examples of progress. For instance, whilst AstraZeneca's remuneration package raised a number of insurmountable concerns, and led us to vote against, it did raise the bar by including two big steps in the right direction:

a) if used, the holding periods of shares awarded under a new bonus scheme of up to eight years is one of the longest holding periods in the FTSE helping align reward with long-term performance; and
b) a strong clawback clause enabling AstraZeneca to take back shares granted if either the underlying performance of the company, or the occurrence of an event that causes or is very likely to cause reputational damage to it, or serious misconduct by the participant, warrants this.

Lobbying for Electronic Proxy Voting in Brazil

We co-signed a letter to the largest companies listed in Brazil to encourage them to adopt electronic voting practices at their AGMs. Presently only a handful of companies are set up for electronic voting, which presents a barrier for shareholders, especially overseas investors, to execute their votes. Consequently this inhibits shareholders' ability to hold boards accountable for performance. At the current time obstacles include attendance requirements for shareholder meetings, incomplete pre-meeting reporting and overly demanding requirements that investors obtain or renew signed, paper power of attorney statements on an annual basis. We hope this letter, co-signed by a significant number of institutional investors, encourages companies to work towards the adoption of electronic voting and to keep investors informed about their position on this important governance issue.

Section 3 **Tough Questions on Investing in BP**

What is The Co-operative Asset Management's view on the Gulf of Mexico oil spill?

The oil spill is threatening to be the largest the world has ever seen in peacetime and a catastrophe on a human and environmental scale. Eleven people lost their lives and the spill will have lasting implications for the local environment and the oil and gas industry. There will have to be a long-term clean-up operation and studies of its impact.

There will have to be compensation for those whose lives and livelihoods have been turned upside down. For the industry, we'll see much tighter regulation in the US and Europe with drilling in deep water and other difficult or sensitive areas restricted. Bans are not out of the question.

The wider impact is that the tragedy has caused people of all political stripes and beliefs to pause and question whether our addiction to oil is worth the extreme lengths we go to get it, and whether politicians and regulators have been asleep on the job or too close to the companies. It may even strengthen the hand of the US administration in trying to move the country to a more sustainable energy mix in the future.

Why did it happen?

The immediate reason is that the blow-out preventer, a failsafe, *failed*. The statistical likelihood of the event happening was tiny but, given the magnitude of the consequences, once is too often and clearly something was not right – something future tough safety rules will have to address.

The reason the impact has been as bad as it has, and the flow not been staunched much quicker, is because we are dealing in an extreme environment of deep water. As 'easy oil' diminishes, international oil companies are forced to go further afield into more challenging physical and political environments to maintain production levels, needing increasingly exotic technology to tease the oil out, such as in the oil sands or the Arctic. This inevitably ups the risk of an accident, and that accident is then more difficult to control and clean up.

Whose fault is it?

It's too early to say exactly. What we know for sure is that BP has legal responsibility for the accident and the consequences, though there were several companies – Transocean, Cameron and Halliburton – that on BP's behalf installed the sub-sea infrastructure that failed. While BP is an understandable lightning rod for people's anger and must shoulder the greatest burden of responsibility, it will be many months, perhaps years, before we have all the facts and mete out blame and responsibility to companies, regulators and whoever else should have and could have helped prevent such an event.

Has BP's response been sufficient?

BP did the right thing in immediately accepting its legal responsibility for the spill and committing to honour all legitimate compensation claims. Judging by the amount of oil BP collected from the broken well in the weeks following the spill, it clearly massively underestimated the size of the spill, which didn't help its credibility.

Its first techniques to stop the flow failed, that's true: but an accident like this has never happened so there was no experience to fall back on. Again, BP's actions will be best judged from the vantage point of history, when we can analyse things with the benefit of hindsight and better information.

What do we think of Tony Hayward's handling of the crisis?

Beyond what we've said above, he's made some ill-considered comments and should have been more sensitive to those made vulnerable by this tragedy.

However, it's reassuring that he has never shirked or backtracked from a public commitment to fix it utterly – given that the expectation in these situations is that a company accused will deny all responsibility even in the teeth of overwhelming evidence to the contrary.

What's our view on the BP dividend?

We believe that BP's financial position was strong enough to pay the quarterly dividend as well as meet its clean-up and compensation payments, but that's not the whole issue. BP's decision to pass on the dividend for the remainder of 2010 was in the company's long-term interest when it comes to repairing relationships with the governments whose permission they depend on to operate.

Did The Co-operative Asset Management own shares in BP? Does it now? What's the position?

For a number of years those Co-operative funds able to invest in BP (i.e. our whole-of-market funds) have owned fewer shares than our competitors and less than what an investor would typically own if their portfolio reflected the large size of BP.

This is because we have historically valued the company at a lower level than many of our peers and other industry analysts, with BP's poor Environmental, Social and Governance (ESG) performance being a contributory factor in this work.

Consequently, the recent sharp fall in the share price following the oil spill has made a strong contribution to the performance of the Co-operative funds when compared to both the FTSE AllShare benchmark and many of our peers holding much bigger positions in BP. It has been particularly beneficial to the Sustainable Funds who own no BP at all because it was avoided on environmental grounds.

Should a company like The Co-operative Asset Management be investing in a company like BP at all? Is that ethical?

We have always been conscious that oil and gas companies face very high social and environmental risks. However, there are also large risks attached to, say, the pharmaceutical sector (think, if you will, about the impact of another Thalidomide) yet we need drugs and we even need oil to make drugs.

Likewise, the food sector has had big issues of its own, as the Creutzfeldt–Jakob (or 'mad cow') disease and poisoned baby milk in China scandals demonstrate.

Many of our investment customers want us to have access to a diversity of investments to avoid too much financial risk. But we know that this means we're exposed to a range of environmental and social risks. That's why for years we've been actively analysing the risks of the companies we invest in and engaging with them where we feel they are not managing the risk properly.

As mentioned earlier, we were the lead investor in a coalition that put a resolution at the BP and Shell AGMs this year on the risks around their plans to exploit oil sands in Canada. All of our assessments of our investments have ESG information built-in and when that information says there is significant risk that the company won't address, we lower the price we're prepared to pay for that company.

Ultimately, what we want to do is pay a fair price for a company, taking proper account of its risks and push it towards best practice on environmental, social and governance matters. This is what we have done and continue to do with BP.

Does this mean that there is no company which you would not buy at the right price?

No it doesn't mean that. Some companies are obviously just too risky and have an appalling track record of wilful disregard for their stakeholders. With such companies, you can never be confident that they are a good long-term investment, so they are avoided.

Though we had misgivings about certain aspects of BP before the spill it did not fall into this uninvestible category, nor does it today while the facts of who's really to blame for the spill and what it says about BP as a whole remain open to question.

Shouldn't The Co-operative be investing all its money in green companies instead?

Lots of our investments are based on 'green is gold'; that companies that are helping to solve our environmental problems will be increasingly profitable. But this brings us back to the issue of balancing risk and reward. Because we need a diverse investment universe, we're not at liberty to become a 'pure play' green investor: indeed, many of these companies carry high financial risk.

However, we are looking to ramp up our investment in green companies as this becomes a much larger theme in the economy in the coming years.

Section 4 **Thematics**

Investment Themes

The banking sector was a feature on buy lists across our funds in the second quarter of 2010. The key question is whether Europe's governments and regulators have done enough to restore confidence in the wake of collapsing state of public finances in Greece. So far the indications are good, though the stock market has retraced some of the strong gains it made last year.

Investment in this sector poses interesting challenges for responsible investors and we intend to keep up the pressure to ensure that governance structures are fit for the purpose of maintaining financial stability.

Another sector strongly represented in purchases was media, which should also benefit in more stable economic scenarios. At ITV significant changes and improvement in board composition are a likely catalyst for future performance, while WPP is a play on global media spend with a strong presence in emerging markets. We've had a positive impact on WPP in the past on responsible public relations though we retain concern over excessive remuneration.

One theme that has served our funds well over the quarter has been global power shortage. Our active holding in Chloride, which provides uninterruptable power supplies, was sold following a takeover battle that drove the shares far above our initial purchase price.

We also took some profits after gains at Aggreko, which sells portable generators, though we continue to maintain a significant holding.

Croda is a new holding within the Sustainable Funds. This speciality chemicals company uses renewable sources for more than 70% of its raw material supply and is a clear sector leader on this issue. It is helping its customers in personal care products to drive progress on their environmental footprints.

Other purchases included public transport company National Express, where management action has restored the company's finances following significant losses last year in the rail business.

Business and Biodiversity

This is the United Nations' International Year for Biodiversity; however, the organisation's assessment of performance against the Millennium Goal of significantly reducing the rate of biodiversity loss by 2010 is stark: "The world has missed the 2010 target for biodiversity conservation with potentially grave consequences."*

Many of the businesses we are invested in have a direct connection to the ecosystem and biodiversity, and we have stepped up engagement in this area. In our view, companies in all sectors that take measures to address the issue will increasingly benefit from enhanced reputation, reduced costs, and improved sales opportunities, as well as safeguarding their business continuity. Clear examples abound in water management. Forests help purify water, and transpiration also influences local weather patterns, both of which are mission critical in the agricultural sector.

Less well considered is the role of the forests, along with other ecosystems including mangroves, in helping to protect areas from extreme weather events. The presence (or absence) of such defences will become an increasingly important consideration in assessing where to locate assets, such as factories, across all industries.

While our search has not yet yielded companies of a sufficient size for investment, we are increasing our efforts to find those companies that focus specifically on restoring damaged habitats and alleviating the drivers of species loss.

Biodiversity was inherently linked with the engagements at BP and Shell, both at the local level in the management of potential toxic releases from oil sands and at the global level in the question of emissions driving climate change and habitat loss.

Other examples include highlighting the issue to Whitbread and Galliford Try, as well as addressing the declining bee population with Bayer (see Engagement Update above). We are also lending support to broader initiatives, including through our role as a steering committee member for the Forest Footprint Disclosure Project.

As part of our work on preserving forests, we wrote to MEPs on the environment committee of the European Parliament to express our strong support for a level playing field on imports into Europe of illegal timber. UK companies are leading the field on timber in terms of traceability and responsibility, but can lose out to undercutting by competitors that are less scrupulous in their sourcing.

The European Parliament had proposed strong legislation, subsequently weakened by the European Council. We called on the Parliament to stand firm and the Council changed position surprisingly quickly.

Finally, on 7 July 2010 the European Parliament voted in the new legislation on timber sourcing in the EU.

*http://www.un.org/millenniumgoals/pdf/MDG%20Report%202010%20En%20r15%20-low%20res%2020100615%20-.pdf

Contact broker services

0845 603 9986

co-operativeassetmanagement.co.uk

tcam@cfs.coop

Please call 08457 46 46 46 if you would like to receive this information in an alternative format such as large print, audio or Braille.

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