

The **co-operative**
asset management

Guide to responsible investment for advisers and their clients

This document is intended for investment professionals only and its content should not be relied upon by private investors when making investment decisions.

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



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About The Co-operative Asset Management

The Co-operative Group has over 12 million customers. Over 292,000 are investors in our Unit Trust range, amounting to over £2 billion of assets under management.

The Co-operative Asset Management specialises in active UK equities and bonds and gains further insight into alternatives and overseas equities via strategic partnerships. We offer a distinctive responsible investment approach that fully integrates the consideration of financial as well as environmental, social and governance (ESG) issues, throughout the investment process.

We are the only UK fund provider to:

- apply a common core approach to responsible investment across all the funds we manage
- apply 'active engagement' across all the funds we manage
- feed valuable business insights gained from our engagement process back into the company analysis we undertake for investment purposes.

In 2002 we were the first UK investor to publish our voting record at company Annual General Meetings on our website – a practice now increasingly adopted by fund management groups that offer responsible investments.

Furthermore, our flagship fund, the Sustainable Leaders Trust, became the first ethical screened fund to top the UK All Companies sector, achieved over the 12 months prior to 30 January 2007.



This distinctive way of investing money was recognised in 2007 when we were awarded the 'Best Ethical Investment Provider' from Moneyfacts, a leading industry publication.



The Co-operative Financial Services has signed up to the internationally recognised UN Principles for Responsible Investment (PRI). The Principles reflect the increasing relevance of environmental, social and corporate governance issues to investment practices. In signing them we are publicly committed to adopting and implementing them (see page 11).



Responsible investing – the opportunity for investors

According to figures from the Ethical Investment Research Service (EIRIS), the total of funds invested within UK domiciled ‘ethical’ or ‘green’ retail funds was estimated to be £6.8 billion at the end of 2008.

This represents almost 750,000 accounts in ethical funds, more than double the 1998 figure of 304,000 when less than £2.2 billion was invested ethically. The number of vehicles available has grown from fewer than 25 to almost 100 today.

Some people refer to it as ‘green and ethical’ investment, ‘socially responsible’ investment or ‘social, ethical and environmental’ investment.

At The Co-operative Asset Management we simply call it responsible investing because that’s what it is – responsible, informed and prudent.

More and more clients are concerned with what the money they invest *does*. Does it fund companies that pollute the environment? Or that profit from child labour? Or does it help make the world a better place?

The market is no longer a niche – it’s well established and it’s worldwide. So why are so few investment professionals taking up the opportunities of responsible investing?

Doesn’t ‘responsible’ mean a lower rate of return?

It doesn’t have to. Recent studies have shown a link between companies’ social & environmental management and financial performance. It pays to be responsible and, increasingly, those who aren’t – pay.

If responsible investing excludes sectors of the market or focuses on emerging industries, doesn’t that open the fund up to greater risk?

All funds (apart from index trackers) filter out some stocks and focus on others. And there’s an excellent reason for favouring companies with good social, ethical and environmental records.

An estimated 70% of the value of top UK companies relates to ‘intangible assets’ such as ‘goodwill’ and ‘brand reputation’ⁱ. That’s value exposed to social, ethical and environmental risks. Analysis of these risks can put responsible investment funds ahead of the game.

How does The Co-operative Asset Management decide what’s ‘responsible’?

We don’t – our customers do! We ask our customers what issues they care most about and the results drive our Ethical Engagement Policy.

This Policy means that we use our influence over companies to encourage them to improve their behaviour. We put pressure on, and offer to help, the companies we invest in to change for the better.

According to The Co-operative Ethical Consumerism Report 2008, ethical consumer spend rose to £35.5 billion in 2007, up 15% on the previous yearⁱⁱ. And these consumers, according to market research firm Superbrands, are those with the most to spendⁱⁱⁱ.

Many leading Asset Managers now appear to accept that integrating ESG issues into investment decision-making is financially relevant and requires substantial effort and attention to be carried out effectively^{iv}.

Know your clients' values

The motivations for responsible investing vary. For some it's concern about the environment, for others it's religious conviction. Some are motivated by the bottom line and see a sound business case for responsible investing.

As you know, it's a requirement of the FSA Conduct of Business rules to know your clients in order to give the best advice possible. Until you understand your clients and their entire individual needs you can't say you know them. Just as you'd ask a client about their risk tolerance, you should ask if they have social, ethical or environmental concerns.

In doing so, you are not only meeting your regulatory obligations, but also opening up opportunities to strengthen your client relationships and build your business.

Incorporating responsible investing into your business enables you to:

- attract new clients who are concerned with what their money does
- add value for existing clients by introducing them to responsible investing.

In fact, with more and more people expressing concern with what is done with their money, existing and new clients may well expect advice on responsible investing. And if you can't provide it, they may take their business to someone who can.

- Responsible investing is included in the new best practice standards in financial planning (ISO 22222) and the new financial adviser exams (FSSC, CII & IFS).
- Pension Funds and Child Trust Funds are now both required to have disclosure regarding social and ethical issues.



Approaches to responsible investing

There are dozens of product providers in the market and no two have exactly the same approach to responsible investing.

We believe that the most important feature of responsible investing is a process called 'engagement' in which fund management groups use their influence as shareholders to encourage the companies they invest in to adopt higher standards of governance and corporate responsibility.

Engagement is important because it proactively facilitates positive and significant changes in businesses that might not otherwise occur. You can read more about engagement in the section 'A closer look at engagement' on page 11.

In addition, there are two common approaches to responsible investment funds:

- positive selection – investing in companies because the fund supports their sector (such as clean energy), policies (such as fair trade) or products and services (such as social housing)
- negative screening – avoiding investing in companies because of their sector (such as the arms trade), policies (such as sweat shop labour) or products and services (such as pornography).

Our approach

Our ethical flagship fund, the Sustainable Leaders Trust, integrates the strongest elements of all these methods, as well as employing a 'best-in-sector' approach. First we assess how well a particular sector connects with our values.

For example, the beverages industry may offer handsome returns – but the business can have negative social and environmental impacts that need to be factored into the investment case.

Then, we look for evidence of companies that are genuinely addressing those impacts and seek to invest in the very best in the sector.

In addition, we look for crossovers between sectors that express our clients' values and sectors benefiting from changes in society (such as clean energy).

Occasionally, companies still have room for improvement, although their potential positive contribution is clear. Our pragmatic approach allows us to identify and invest in exceptional cases, and actively engage with the company to improve their performance.

From this carefully constructed universe, the Fund Manager selects investments on the basis of future growth prospects of a company.

Ethical issues at a glance

Some clients have strong views about a particular issue, such as gambling, or are passionate about a particular area, such as animal rights. Others just want to know their money is working to make a

better world. No list is exhaustive, but the issues below are those most frequently raised by investors and addressed by responsible investment funds.

These issues are often described by the umbrella term ESG (environmental, social and governance).

Environment	People	Animals	Governance	Values
Climate change	Human rights	Animal testing	Board structure	Arms trade
Habitat loss & biodiversity	Workers' rights	Fur	Excessive executive pay	Tobacco
Genetic engineering	Equal opportunities	Factory farming	Political donations & lobbying	Alcohol
Pollution & toxics	Access to medicine	-	Bribery and corruption	Pornography
Nuclear power	Health & safety	-	-	Gambling

Our Ethical Engagement Policy

The Co-operative Asset Management is the only UK fund management group to apply a customer-driven Ethical Engagement Policy across all its funds.

In 2005 we gave our customers the chance to tell us what issues they cared most about.

The results were used to create our Ethical Engagement Policy. Our customers know we are engaging companies with their concerns.

Engagement in action

During 2007, The Co-operative Asset Management challenged advertising, marketing and public relations company WPP Plc regarding irresponsible lobbying activities of some of its subsidiaries. We argued that responsible representation should be prioritised over carbon emissions. In August 2008, the company informed us of a raft of reforms that met our recommendations including embedding ethical training for employees, strengthening its Code of Conduct to address client choice and enhance the systems that ensure this Code is being observed.

Common concerns

Isn't all this 'green' and 'ethical' business a fad?

All the indicators demonstrate otherwise. The recent battle between the supermarkets for green credentials shows which way the wind's blowing:

- growing consumer and regulatory pressure on social, ethical and environmental issues increasingly benefits responsible investing
- corporate social responsibility is now seen in many sectors as crucial to brand value
- companies that contribute, and adapt, to emerging social and environmental challenges may offer superior long-term performance
- climate change will keep the environment top of the agenda.

Aren't responsible investment funds exposed to greater risk?

An estimated 70% of the value of top companies relates to 'intangible assets' such as 'goodwill' and 'brand reputation'. That's value exposed to social, ethical and environmental risks.

Analysis of these risks can put responsible investment funds ahead of the game, by helping them identify companies that the market may have mis-priced.

Doesn't a restricted investment universe lead to underperformance?

All active managers filter stocks on different grounds. And recent studies have shown a link between companies' social & environmental management and financial performance^v.

Being responsible brings benefits and increasingly those who aren't pay the price.

The Co-operative Asset Management believes large companies should be required to report their greenhouse gas emissions and how they manage them.

In 2009, we began withholding support at the AGMs of high-impact companies whose climate disclosure didn't give investors enough information.

Performance with responsibility

With some product providers you and your clients may hear a lot about 'socially responsible' but not enough about 'investing'. Make sure that the providers you recommend have strong investment credentials, as well as claiming socially responsible expertise.

The Co-operative Asset Management's Sustainable Leaders Trust was the first ethical screened fund to top the UK All Companies sector, beating over 320 funds including mainstream blue-chip equity funds. This achievement is testimony to the sound investment fundamentals of the Fund.

How to evaluate funds

No two funds are the same – so here are the key issues you'll want to take into account when assessing responsible investment funds for your clients.

Performance

As with any investment, the track record of the Fund Manager – especially over the long-term – is paramount.

Values

Do the values, approaches and any no-go areas of the fund match your client's?

Transparency

Ensuring that you and your client can understand exactly what the fund does is crucial. It ensures your client understands what they are buying. And it helps you compare products. It may be wise to avoid funds whose investment and stock selection processes seem complicated, confusing or riddled with ethical jargon.

Experience

Embedding ethical issues into the investment process is notoriously difficult. Does the organisation have the necessary experience and resources? How does the Fund Manager come up with a rounded view of a company based on a balance of financial and ESG considerations?



“Responsible investing should never be an excuse for underperformance.”

Mike Fox, CIS Sustainable Leaders Trust's Fund Manager

Our commitment to transparency

At The Co-operative Asset Management, we aim to make our investment approach and fund range clear and easy to understand. The purpose and strategy of our funds are very straightforward. Our own commitment to corporate transparency is demonstrated by our being the first UK institutional investor to publish online a record of how we voted at company AGMs.

Research and risk

Investment decisions are only as good as the quality of research they're based on. How does research integrate financial considerations (e.g. balance sheets, business strategy, competitive position) and ESG issues (i.e. governance risk, impact on the environment, employee policies)? How do the research outcomes feed into stock selection? How does the Fund Manager construct a diversified portfolio and mitigate risk?

Engagement

Your client wants a fund that reflects their values. How are those values applied when selecting companies for investment?

How does the fund engage with the companies it invests in to put your client's values into practice? Can it demonstrate success in improving companies' performance?

Leadership

Does the fund provider itself show leadership in corporate social responsibility? It's as simple as putting your money where your mouth is. Research shows that ethical consumers are wary of companies jumping on the green bandwagon^{vi}.

For some clients, how the fund provider behaves is as important as financial returns.

Leadership at The Co-operative Asset Management

- The Co-operative Group is considered to be Britain's most ethical brand^{vii}.
- We were rated first in the Corporate Responsibility Index in 2007 and second in 2008^{viii}.
- Our Solar Tower Head Office in Manchester is the largest solar power project in the UK – and we've brought together 40 of the UK's biggest Plcs to share our expertise in powering business with wind power^{ix}.

Read more about how we 'walk the talk' at our website

co-operativeassetmanagement.co.uk



“Responsible investing is not something we apply to a few isolated funds, it's integral to our whole investment process. Corporate social responsibility is what our organisation was built on. In 2007, we were ranked in the highest category of the UK's leading benchmark – the Corporate Responsibility Index.”

**Paul Sharman, Managing Director and Chief Investment Officer,
The Co-operative Asset Management.**



A closer look at engagement

You and your clients may hear a lot about engagement from ethical investment product providers. Engagement is an important part of responsible investing as it involves not just evaluating companies' responsible business practices, but also actively facilitating their improvement.

We encourage investment professionals to closely examine the way in which engagement is undertaken, as it can take many forms. Some product providers call research or gathering information 'engagement'. But this has no direct bearing on a company's direction or practices.

At The Co-operative Asset Management, when we say 'engagement' we mean tackling companies over issues of concern and championing best practice. For all our funds, engagement is rigorous, ongoing and designed to add value to decision-making in the investment process. The impact of our engagement is independently audited to ensure that it continues to set the industry standard.

Engagement in action

In 2009 we drafted and coordinated an investor letter requesting major oil companies associated with Alberta's oil sands improve shareholder disclosure and mitigate regulatory, financial and environmental risks and protect shareholder value. Oil sands are controversial because they are highly carbon intensive and have a huge impact on local water, air and land. The letter was signed by UN PRI (see page 3), institutional investors from Europe and the US with over US\$3 trillion of assets under management. The investor group will be engaging with companies over their expected responses in 2009/10.

Performance and UN Principles

In the survey of signatories to the UN PRI^x in 2007 and 2008 we scored highly for:

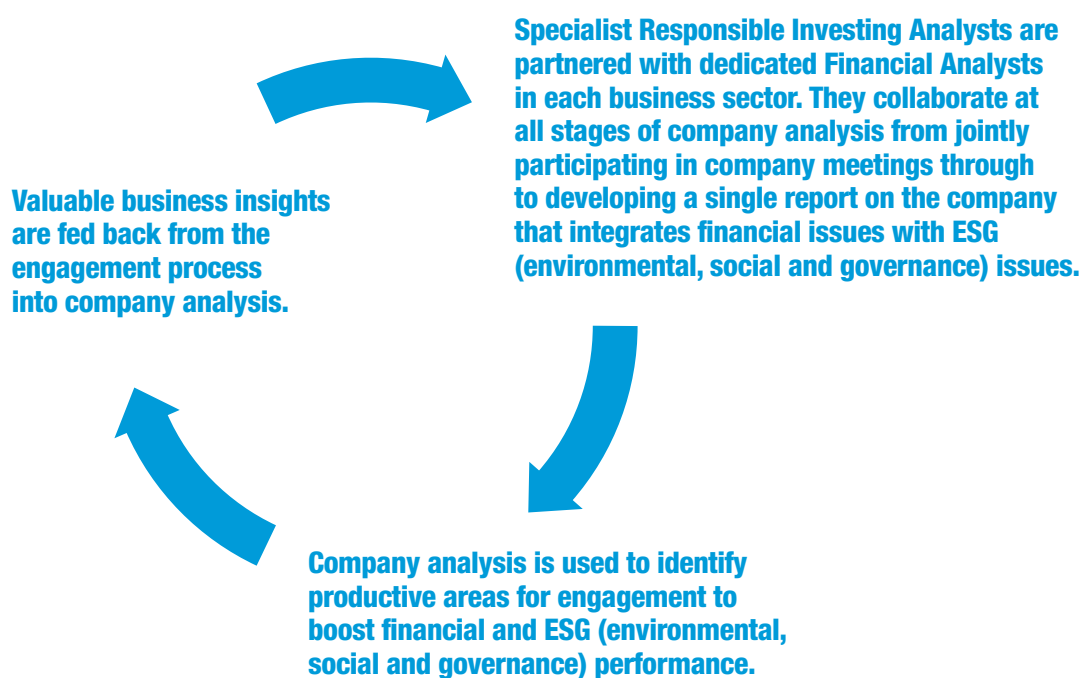
- integrating ESG issues into investment analysis and decision-making processes
- being active owners who incorporate ESG issues into ownership policies and practices.

A closer look at integration

Increasingly, responsible investment providers seek to distinguish themselves by advocating an ‘integrated’ approach. We urge investment professionals to look closely at how this is done. For example, investment managers might influence the engagement process, but without using engagement feedback in making their investment decisions.

Genuinely integrating financial analysis, engagement, and social, ethical and environmental issues – throughout the investment process – leads to a more robust, informed view of a company. And ultimately, we believe, it leads to superior investment decision-making.

At The Co-operative Asset Management, we see this approach as a one-way street. For us, integration means creating a virtuous circle.



Engagement in action

Analysis from the Responsible Investing Team plays an important role in how we view UK electricity companies. The ‘stocksheets’ for each company contain analysis of the carbon intensity of their fuel mix, how they are affected by regulation, what they are doing about their environmental impact and what ‘wiggle room’ they have.

This analysis is supplemented by meetings between the Fund Manager and the Responsible Investing Team, and the executives of some of these companies, allowing us to feed the insights gained back into the investment outlook. This is an example of engagement and the virtuous circle in action.

How The Co-operative Asset Management can help you and your clients

The Co-operative Asset Management combines bottom-up stock selection with the application of carefully developed themes to construct detailed investment cases on undervalued companies.

In advocating The Co-operative Asset Management to clients, advisers can be assured that they are recommending:

- Britain's most ethical brand, The Co-operative Group^{vii}
- a responsible investment approach which fully integrates financial and ESG criteria in stock selection
- an investment process characterised by clear and informed views on why companies are undervalued and offer good long-term prospects
- an investment resource comprising experienced and committed individuals working to deliver out-performance while effecting positive change in the companies they invest in.

In early 2007, our flagship fund, the Sustainable Leaders Trust, became the first ethical screened fund to top the UK All Companies sector. The Fund Manager, Mike Fox, won the 'UK Growth Fund Manager of the Year 2007' award from Citywire. The fund also holds an 'A' rating from OBSR and a 'Superior' rating from Morningstar.

The Co-operative Asset Management's Sustainable Leaders Trust, UK Growth Trust and UK Income with Growth Trust, are available through Cofunds, Fidelity FundsNetwork and Hargreaves Lansdown Vantage platforms.

Your next step...

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- ⁱ 'Bringing "Accountability for Brands" to the Boardroom: Is that my job too?' Paper No. 20040101 - by Michele Levine, Chief Executive, Roy Morgan Research. See also: 'Brand Valuation: The financial value of brands' by Interbrand.
http://www.brandchannel.com/papers_review.asp?sp_id=357
- ⁱⁱ **<http://www.goodwithmoney.co.uk/ethical-consumerism-report-08>**
- ⁱⁱⁱ 'Business embraces its ethical future' BBC News, 1 November 2006. **<http://news.bbc.co.uk/1/hi/business/6102450.stm>**
- ^{iv} **<http://www.fairpensions.org.uk/research#FM>** Investor Responsibility? UK Fund Managers' Performance and Accountability on 'Extra-Financial' Risks, November 2008.
- ^v For example: Orlitzky, M, Schmidt, F & Rynes, S 2003, 'Corporate Social and Financial Performance: A Meta Analysis', Organization Studies, vol 24, no. 3, pp 403-11. **<http://oss.sagepub.com/cgi/content/abstract/24/3/403>** and 'A study into the influence of Environmental Governance and Financial Performance', prepared by Innovest Strategic Value Advisor Advisers November 2004.
<http://publications.environment-agency.gov.uk/pdf/GEH00904BKFE-e-e.pdf>
- ^{vi} Stephen Cheliotis, Superbrands: quoted **<http://news.bbc.co.uk/1/hi/business/6102450.stm>**
- ^{vii} An independent consumer survey carried out in 2007 and 2008 found that for both years The Co-operative was Britain's most ethical brand. The Co-operative Group (including The Co-operative Bank) was ranked number one for 2007 and 2008 with The Body Shop and Marks and Spencer ranking second and third respectively. The GFK NOP Ethics brand Survey was conducted in the US, UK, France, Germany and Spain amongst 5,000 individuals in total. The study found that consumers are increasingly choosing to buy brands which they believe to be ethical, with many willing to pay a premium for an "ethical guarantee" (GFK NOP Press Releases 2007 & 2008).
- ^{viii} **http://www.bitc.org.uk/cr_strategy_and_integration/cr_index/cr_index_2007/index.html** and
http://www.bitc.org.uk/cr_strategy_and_integration/cr_index/cr_index_2008/cr_index_08.html
- ^{ix} The Co-operative Group Sustainability Report 2005, p23.
- ^x **<http://www.unpri.org/reporting/result.php>** Scores have been calculated based on signatories' self assessment and using the scoring methodology approved by the PRI Assessment Group. Not all responses have been independently verified 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.



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