

Report to the Methodist Conference 2013

The Methodist Church
Joint Advisory Committee
on the Ethics of Investment

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All CFB ethical investment policies and position statements are available from
www.cfbmethodistchurch.org.uk/ethics

Chair's Foreword

The Joint Advisory Committee on the Ethics of Investment (JACEI) serves the Methodist Church by providing a mechanism for tackling ethical dilemmas associated with investment, and publishing an account of its work to Conference. This Report covers the twelve months to 31 March 2013.

The Committee has taken forward several policy issues during the year, completing work on a revised Alcohol Policy, and commencing discussions that will lead to new ethical investment policies on gambling, human rights and power generation.

The 2012 London Olympics, whilst providing a focus for sporting achievement, also created opportunity for the churches to lead engagement with companies operating in the hospitality sector around their potential exposure to human trafficking.

We renewed our commitment in 2012 to encourage companies to work towards establishing Living Wage policies across their UK operations. This work is receiving renewed focus, as public debate around the benefits of the Living Wage for employees, companies and society grows. The Committee was also delighted to learn that the Central Finance Board (CFB) had become an accredited member of the London Living Wage Initiative.

We have long viewed collaboration with other Church investors as a key strength of the CFB approach to ethical investment, and during the year we welcomed continued ecumenical activity. The CFB, Church of England and other Church Investors Group (CIG) members routinely collaborate at company engagement meetings. This sends a powerful message to companies of the seriousness of our combined approach. International collaboration with faith partners is now a key focus for the CIG, as it agreed a new three-year strategy. JACEI meetings have benefited greatly from the attendance of colleagues from the Church of England, the United Reformed Church and the Methodist Church in Ireland.

We reviewed and welcomed considerable engagement activity during the year across all sectors and on many different areas of concern. For instance, the CFB led an innovative CIG meeting with house-builder Bellway on the contribution the residential construction sector is making to achieve the UK's climate change targets.

Investment in extractive industries continues to exercise much attention, and routine engagement meetings were held with all the major holdings in the CFB portfolio. These meetings serve to build and enhance the relationship the CFB has with high impact companies, whilst never shying away from asking difficult and probing questions. The year

saw many challenges including a military coup in Mali and violent industrial action in South Africa. A Senior CFB Fund Manager visited the Niger Delta to see at first hand the challenges oil companies face from working in such a volatile environment.

Climate change is one of JACEI's key concerns and we continued to challenge companies failing to respond to the Carbon Disclosure Project (CDP) survey. We encourage companies to take part, but also recognise that some go beyond the requirements of CDP, providing a legitimate reason for non-participation. We welcomed the Government's decision to introduce mandatory emissions reporting for UK companies from 2013.

Our work reviewing companies operating in Israel/Palestine continued in intensity during the year. We undertook engagement with a UK listed but Irish domiciled construction company regarding its subsidiaries in Israel/Palestine. We took close interest in discussions with Alstom and Veolia, two French companies with interests in the Jerusalem Light Rail Project (JLRP). At the end of the period under review, both companies had progressed contractual commitments to sell their equity and operating interests in the JLRP consortium, although these are yet to be completed. During the year the CFB sold its stake in Veolia on investment grounds.

We reviewed the ecumenical approach to voting and judged that it continues to work well. The Church of England led discussions to appoint a provider for a common overseas proxy voting service. Consequently, the CFB have appointed ISS to vote their European portfolio. The CFB UK portfolio will continue to be voted by PIRC, using the CIG voting template.

We commend this report to Conference as evidence of the breadth and depth of issues regularly considered by JACEI and as part of the CFB's commitment to invest ethically in accordance with Methodist teaching. We confirm on page 3 that we judge that the CFB has managed the Funds in keeping ethically with the aims of the Methodist Church.

We are always delighted to receive comments and feedback on the report itself, and on the work undertaken.

I would like to thank my colleagues who serve on JACEI for their time, commitment and contribution.

We hope you enjoy reading the report.

The Reverend John Howard
Chair JACEI

Executive Summary

Revised Policy Statement on Alcohol

The Committee developed a Revised Policy Statement on Alcohol which was subsequently approved by the CFB Council and is now available on the CFB website. The Policy replaces an earlier one dating from 2002 and reflects changes in the way alcohol is sold and consumed. (Page 4)

Position Paper on Human Rights & Conflict

During the year the Joint Public Issues Team (JPIT) began work to develop a Position Paper on Human Rights and Conflict that should lead to a CFB Policy Statement. (Page 4)

Position Paper on Gambling

The Committee began work to develop a Position Paper and CFB Policy Statement on Gambling focusing on the increasing normalisation of gambling in society, and reservations about the regulatory environment. (Page 4)

Position Paper on Power Generation

The Committee devoted much thought and time looking at the implications of the UK's ambitious climate change targets for the power generation industry. This is a challenging piece of work, which should lead to a CFB Policy Statement. (Page 4)

Carbon Disclosure Project (CDP) Engagement

The Committee supported moves by the CFB to encourage corporate 'laggards' to take part in the CDP survey and wrote to several companies during the year. (Page 5)

The Living Wage

CFB is an accredited London Living Wage employer. It continued engagement with Lloyds Banking Group during the year, pressing the company to work towards applying the Living Wage, and identified three further companies for engagement in 2013. (Page 5)

Trafficking & the Leisure Industry

The Committee welcomed CFB participation in ecumenical engagement with the leisure industry on trafficking. The 2012 London Olympics provided a focus for engagement with UK hospitality companies, particularly Whitbread and Intercontinental Hotels Group (IHG). (Page 5)

UK Banks

The Committee received a briefing paper prepared by the CFB on ethical issues relating to banking, which reviewed the scandals that have engulfed the sector since 2008. JACEI welcomed significant CFB contact with Barclays and Standard Chartered during the year probing into the circumstances that led to punitive fines being handed down by regulators. (Page 6)

Tax Justice

2012 saw growing debate on tax avoidance and companies which, although profitably operating in the UK, appear to pay little or no corporation tax. The Committee received a briefing paper which recognised that this is a complex area affecting several actors including national and intra-national governments. JACEI also noted the work undertaken by Christian Aid and expects to return to this as time and resources allow. (Page 6)

Investment in Israel/Palestine

The Committee committed considerable time during the year reviewing engagement with Veolia and Alstom around their involvement in Israel/Palestine. The holding in Veolia was disposed of towards the end of 2012 on investment grounds. CFB also engaged with buildings' materials company, CRH over the supply of cement in Israel and the Occupied Territories by a subsidiary of a company in which it has a minority 25% interest. (Page 6)

Investment in Burma

The Committee received a briefing note on investment in Burma, which concluded that in spite of hopeful signs of a move towards greater democracy, it was still too early to recommend that investment by the CFB was appropriate. (Page 7)

CFB Voting and the UK Stewardship Code

The Committee monitors CFB proxy voting decisions at every meeting, placing high importance on the CFB exercising its shareholder stewardship. The Committee noted that the CFB had revised its UK Stewardship Code Statement during the year. The CFB takes a robust position on excessive remuneration, voting to oppose executive remuneration that fails to deliver superior performance or is deemed to be excessive. (Page 7)

The Church Investors Group (CIG)

The Committee continues to view CFB collaboration with the ecumenical CIG as making an important contribution to the impact of faith-based investment in the UK and Ireland. 2012 saw a series of landmark events including a speech by former US Vice President, Al Gore, in St Paul's Cathedral. CIG approved a new three-year strategy that will seek to develop international partnerships to facilitate better engagement with multi-national companies. (Page 7)

Conclusion

The Committee judges that the CFB has managed the funds under its control according to an ethical stance which is in accordance with the aims of the Methodist Church.

In arriving at this conclusion the Committee scrutinised compliance with CFB ethical policies through the:

- voting record of the CFB;
- ethically excluded lists of UK and European companies;
- monthly ethics meeting minutes of the CFB;
- company engagement record of the CFB;
- Trucost and EIRIS reviews of the CFB UK portfolio carbon footprint;
- participation of the CFB in the **Church Investors Group (CIG)** (page 7); the **Institutional Investors Group on Climate Change (IIGCC)**; the **Carbon Disclosure Project (CDP)** (page 5); the **UN Principles for Responsible Investment (UN-PRI)** and the **Extractives Industry Transparency Scheme (EITI)** (page 10)
- collaboration with the **General Board of Pensions and Health Benefits (GBOPHB)** of the United Methodist Church

Resolution

The Methodist Conference adopted the following Resolution on 10 July 2013:

The Conference receives the report of the Joint Advisory Committee on the Ethics of Investment for the year to 31 March 2013.

Significant Issues

Revised Policy Statement on Alcohol

A new Position Paper on investment in alcohol-related companies was agreed. This reflects changes in the way alcohol is bought and consumed, recognises that concern has grown in respect of the impact on children, and changes to the CFB's engagement process.

A Policy Statement was subsequently drafted by the Committee and approved by the CFB Council. Both the Position Paper and Policy Statement are available on the CFB website:

Policy

- The CFB will continue to avoid investment in companies on the grounds of its exposure to the production and sale of alcohol;
- The CFB will continue to avoid companies which control licensed premises whose commercial success is mainly linked to increased or excessive 'volume' drinking;
- Previous CFB decisions to disinvest from companies with material exposure to alcohol remain important precedents;
- Exposure to alcohol is not considered in isolation from other product lines which raise ethical concerns, such as tobacco, pornography and gambling;
- The CFB will continue to be increasingly concerned with maintaining an investment in a company whose exposure to alcohol is material and growing;
- Where applicable, companies exposed to high alcohol content products such as spirits, liqueurs and premium beers will be looked on less favourably than those involved with wine and beer with lower alcohol content;
- Investment in hotels or restaurants where alcohol is served as an ancillary activity may be viewed as generally acceptable, whilst public houses, off-licenses and licensed bars where it is the primary activity, may not;
- Engagement with large food retailers for whom alcohol is a significant, but not major, part of the business, is particularly required to ensure the criteria below are satisfactorily observed;
- Products, such as 'alcopops', designed to encourage drinking by the young, under-aged and vulnerable are to be discouraged;
- The CFB will continue to focus its proactive engagement with companies on business behaviour and responsible drinking practices, particularly:
 - Supporting public and industry health awareness campaigns
 - Supporting responsible drinking and awareness

- Ensuring advertising and marketing, including labelling, meets regulatory and responsibility 'best practice'
- Retailing alcohol in a responsible way that does not encourage excessive consumption
- Not targeting sales, advertising and offers at the young, under-aged or vulnerable

Position Paper on Human Rights & Conflict

During the year the Joint Public Issues Team (JPIT) began to develop a Position Paper on Human Rights and Conflict that will lead, in time, to a Policy Statement on investment issues related to human rights.

This is a challenging subject that is beginning to impact corporate behaviour and thinking as business operations increasingly globalise. The scope of the Paper has been to look at company human rights responsibilities in theatres of conflict, although JACEI is well aware that the business context for human rights encompasses many other aspects of business operations, such as supply chain or land rights.

The Committee will continue to develop its thinking around our expectations of companies operating in theatres of conflict; what companies must do to mitigate risk of being complicit in human rights abuses; the issues around which the CFB would expect to engage; and in what circumstances disinvestment may be appropriate.

Position Paper on Gambling

JACEI gave thought to a paper that is intended to lead to the publication of a Position Paper and Policy Statement related to Gambling. Discussion focused on the 'normalisation' of gambling and the concern that the regulatory framework is insufficiently robust, allowing gambling to expand further into 'normal' everyday situations.

Thinking will include issues such as spread betting as part of any overarching Policy, whilst 'softer' forms of gambling activity, such as lotteries and Bingo will also be addressed.

Position Paper on Power Generation

The UK government's ambitious target to cut greenhouse gas emissions by 80% by 2050, which is supported by the Methodist Church, raises compelling issues for sectors, such as power generation. Our 2012 report to Conference noted that as part of our ongoing work related to investment in fossil fuel companies, a specific paper on power generation was required. During the year, JACEI received a paper outlining some initial thinking on the current UK energy mix and what it may need to look like in the future if these targets are to be met. JACEI is alive to the controversial decisions that may have to be taken, in relation to new coal fire generation and new nuclear capacity in any future UK energy policy. Implications for investment in the sector are equally

problematic and JACEI needs thoroughly to explore the issues before it will be able to advise the CFB on an appropriate Policy.

Carbon Disclosure Project (CDP) Engagement

Much thought and time is devoted to how the CFB engages with companies on their climate change and wider environmental impacts.

The Carbon Disclosure Project, which now represents 655 global investors with combined assets of US\$78 trillion, surveys 6,000 of the world's largest companies asking them to report on their climate strategies, energy use and emissions. The Committee believes climate change presents an acute risk for carbon intensive businesses and CDP offers a robust methodology and mechanism for managing and reducing climate change impact. It strongly supports CFB initiatives in engaging directly with high impact companies that have not responded or declined to participate in CDP.

It was pleasing to note that **Go Ahead Group** which had not taken part in the 2011 survey request has now reversed this decision and provided a full response to the 2012 survey. Transport is among the material risk groups for emissions and it is gratifying to see one of the UK's largest integrated transport groups providing detailed information.

Engagement with **ITV** and **Aggreko** revealed companies that, whilst declining to participate, nevertheless had robust processes for measurement and disclosure in place. Whilst we believe CDP provides the most consistent methodology for disclosure, we respect the business decision not to take part when companies provide at least equivalent levels of disclosure.

We have engaged for several years with engineering company **Cookson Group** with only limited results. During the year we were able to meet the company and explore with them their approach to managing climate risk and the reasons for their modest disclosure. It became apparent that the company did not collect data in such a way as to allow full disclosure. Later in the year Cookson demerged into two separate businesses one of which the CFB subsequently sold on investment grounds.

As part of the 2012 process, three companies were selected for engagement; **Capita Group**, **Elementis** and **Spirent Communications**. Both Capita Group and Elementis demonstrated very strong performance which we welcomed. Engagement with Spirent continues.

CFB is also a signatory to the **CDP Water Survey**, and since its merger with CDP, the **Forest Footprint Initiative**, which targets leading companies with exposure to forestry, either directly or via the supply chain in the areas of bio-fuels, soy, palm, beef and timber.

The Living Wage

The Committee welcomed CFB efforts to engage with **Lloyds Banking Group** on implementing the Living Wage. Several of the UK banks have taken steps to apply Living Wage

standards recognising that it can help lift the most vulnerable out of poverty. Whilst Lloyds has extensive employment policies that we view positively, it has so far declined to go further. The CFB therefore continues to press the company to undertake a full cost benefit analysis for applying the Living Wage in the UK. JACEI also monitored **HSBC's** progress in becoming Living Wage compliant.

We welcomed news following engagement that hospitality group **Intercontinental Hotels Group** had announced it would be introducing the Living Wage at its managed estate in London. We view this as a particularly positive step for those working in the hospitality industry. We continue to engage with the company with a view to their extending its introduction not only to its managed hotels outside London, but also to the franchised operations.

CFB works with ShareAction (formerly Fair Pensions) on the Living Wage campaign and have agreed with them primary targets for focused engagement in 2013. As well as continuing our work on Lloyds Banking Group, CFB will seek to engage with **Land Securities**, **Whitbread** and **AstraZeneca**.

The Committee commended the CFB's decision to become an accredited London Living Wage employer during the year.

Trafficking and the Leisure Industry

The Committee has welcomed continued CFB participation in ecumenical engagement with the leisure industry on trafficking. The 2012 London Olympics provided a focus for engagement with UK hospitality companies, particularly **Whitbread** and **Intercontinental Hotels Group (IHG)**.

This work, originally launched by US investors during the 2010 World Cup, recognised that the hospitality industry was particularly exposed to trafficking risks unless detailed policies and processes were put in place. A coalition of 39 US and UK based faith investors continued to partner this work by raising awareness and business risk among a targeted group of companies.

Letters were sent to 20 Olympic sponsors and 13 hospitality groups calling for training and monitoring for trafficking. The response was gratifying; 11 hospitality companies told us that they would be training staff in this area, and over 80% of sponsors had dedicated human rights training in place. JACEI welcomed the strong progress that had been made. Nevertheless, the coalition concluded more work was needed specifically on trafficking as part of human rights awareness, and this continues.

The Committee welcomed progress made by **Whitbread** to conduct training in those parts of its business potentially affected by trafficking, noting that the company had taken considerable action since the issue was first raised with them.

With a largely franchised operating model **IHG** was not so well advanced, although meetings held with the company indicated more would be disclosed as part of the 2012 corporate responsibility report. Engagement suggests there

has been progress in 2012 with IHG holding pre-Olympic training sessions on human rights and attending industry meetings on the risks arising from trafficking. We expect the company to disclose more in its 2013 Report.

UK Banks

The UK banking sector continued to arouse controversy during the year. The LIBOR rate rigging scandal perhaps represented a new low point that directly led to the Barclays Chief Executive, Bob Diamond, resigning. The Committee commended the CFB's work on banking, noting the production of a paper, *Ethical Issues Arising from Banking* (see CFB website), that examined the various ethical failures and outlined possible improvements. This has proved a useful tool for closer engagement with companies.

Barclays has come under particular scrutiny for its role in the LIBOR scandal. JACEI welcomed the way CIG members worked together to hold Barclays to account on this and other matters. The CFB, participated at a meeting arranged by the Church of England with the senior independent director and Deputy Chairman, Sir Michael Rake, to express concerns about the bank's corporate governance and business culture. The CFB was also part of the CIG meeting with the new Chairman, Sir David Walker, soon after his appointment, to stress the need for cultural and behavioural change. This was followed by a CIG submission to the independent Salz Review on Barclays' business practices. JACEI recognises that the appointment of the new Chairman and Chief Executive represents the beginning of a process to restore trust and ethical probity through a change of culture at Barclays. It is expected that further meetings will be held with the company to monitor progress.

CFB engaged with **Standard Chartered** following the handing down of a significant fine by New York regulators in respect of 'rogue' transactions that fell foul of US sanctions governance. The bank presented a very full and candid account of the circumstances that led to the fine, from which it was apparent that the penalty may have been somewhat disproportionate to the offence committed. We welcomed the clarity and openness with which the bank discussed the issues.

CFB met with **HSBC** in the light of revelations of money laundering at its Mexican subsidiary which resulted in a record fine being handed down. It was reassuring to learn of the changes enacted to avoid similar events being repeated.

JACEI noted a Memorial to Conference on ethical banking calling on the Methodist Connexion to review its banking arrangements and to consider the ethical stance of their current providers.

Tax Justice

JACEI noted a Memorial to Conference concerning Tax Justice and the work undertaken by Christian Aid and others on the subject.

Subsequently, the Committee received a discussion paper on tax justice prepared by the Joint Policy Issues Team (JPIT),

which it is hoped will ultimately lead to a Position Paper and CFB Policy Statement.

Work conducted by the Church of England in developing a specific investment policy on tax was also noted.

2012 saw growing debate in the media and wider society on tax avoidance, and companies which, although profitably operating in the UK, appear to pay little or no corporation tax. The Committee recognises that this is a complex area affecting several actors including national and intra-national governments. Government has to provide a competitive environment for business to invest, whilst also outlawing the most aggressive forms of avoidance which companies are able to exploit.

The Committee expects to return to this as time and resources allow.

Investment in Israel/Palestine

The Committee noted that its Report to the 2012 Conference had been taken out of en bloc business specifically to discuss Israel/Palestine. Considerable time was spent during 2012/13 reviewing investment in companies operating in Israel and Palestine.

Principal engagement during the year continued to be with **Veolia** and **Alstom**, two French companies held by the CFB. Both companies have been involved in a consortium building and operating a fixed line tramway linking West Jerusalem with Israeli settlements in East Jerusalem and the West Bank, which allegedly contravene international law.

During the year there was extensive engagement with Veolia. Worryingly, whilst the company had promised not to renew contracts for some bus routes running through settlement areas, it had subsequently bid for contracts for others. Apparently this had been done without reference to the Paris Head Office. Given the risks involved, we welcomed the subsequent commitment to establish stronger central management oversight of all Israeli contracts. Dialogue has continued throughout the year and JACEI was pleased with Veolia's continued willingness to engage at length. JACEI was also thankful for the exchange of information with colleagues in the Church of England who are conducting their own engagement process with Veolia.

Towards the end of 2012, Veolia fell out of the Index upon which the CFB's European portfolio is based. Consequently, for investment reasons the stock was sold. The engagement process resulted in a number of changes following pressure from investors. Veolia has offered to maintain contact with CFB on a courtesy basis.

Both Veolia and Alstom are committed to selling their stakes in the Jerusalem City Pass Consortium, although both have encountered continuing legal obstacles. At the close of 2012 **Alstom** confirmed that it had signed contracts to sell its stake in the consortium, but the legal process to complete is ongoing. Alstom will continue to have maintenance obligations as the builder of the train units, but will no longer be a partner in the project.

Following a request by the Methodist Church in Ireland, CFB wrote to **CRH** an Irish domiciled but London listed cement and buildings' materials company. CRH holds a 25% stake in Mashev Group, which in turn owns Neshor Israel Cement Ltd, a company responsible for supplying much of Israel's cement, including cement for the construction of the separation wall. CRH indicated that its minority stake allowed no day to day management of Mashev, and that Neshor supplies cement and other materials across the region to all communities without discrimination.

The company indicated that it takes a 'thoughtful and considered' approach to human rights issues, and JACEI asked the CFB to engage further with the company to find out how this is effected in practice. This work is on-going.

The Committee noted that the 2012 Conference adopted a Notice of Motion calling on the UK government to ban the import of illegal settlement goods.

Investment in Burma

2012 saw Burma begin to emerge from a half century of military oppression and political isolation. US and EU sanctions were eased as a result of the civilian government moving swiftly to improve Burma's human rights record. As remarkable as these changes were, JACEI noted the danger of increasing economic activity without strong guarantees that the reforms are irreversible. Continuing ethnic violence was also disturbing. The CFB prepared a paper on Burma, concluding that it was still too early to allow investment. JACEI agreed with this approach, noting that the easing of sanctions had been applied for a limited time whilst the situation was monitored. As a result the French oil major **Total** will continue to be avoided.

CFB Voting and the UK Stewardship Code

The CFB is a signatory to the UK Stewardship Code, and during the year the Financial Reporting Council reviewed its provisions and made several amendments. The CFB reviewed its own disclosure in the light of these changes and published a revised Statement of compliance in February 2013, which is available on the website.

The Committee reviews the CFB UK and European voting reports (available on CFB website) at every meeting, placing high importance on the CFB exercising its shareholder stewardship.

Voting is carried out collaboratively with church investor partners with a view to building a critical mass of consistent faith investor opinion in the exercise of proxy voting. The CFB uses the CIG template and employs the proxy voting services of PIRC to carry it out in the UK. European voting was undertaken on our behalf by Glass Lewis & Co, but from spring 2013, following a joint tender exercise with the Church of England, this will be carried out by ISS.

The CFB takes a robust position on excessive or poorly structured executive remuneration packages. During the calendar year 2012, the CFB voted at 200 UK meetings, opposing 89 remuneration reports and recorded abstentions

on a further 46 out of a total of 161 UK company remuneration reports.

Notable examples of companies in which remuneration was opposed included **HSBC, Barclays, and Standard Chartered, Unilever, Pearson, BG Group, BP, BT Group, Tesco, National Grid, Rio Tinto and Marks & Spencer**. Where remuneration is viewed as especially poor in terms of structure, CFB also opposes all members of the Remuneration Committee. Such instances included **AstraZeneca, Schroders and Reckitt Benckiser**.

Shareholders are given a binding vote to approve Long Term Incentive Plans and during 2012, 14 new schemes put to shareholders were opposed or abstained by the CFB.

In Europe, the main issues leading to votes being cast against Board resolutions were shareholder capital and board balance concerns. During the year the CFB voted at 222 European meetings, comprising 2,817 resolutions. CFB opposed or abstained in 11% of cases.

The Church Investors Group (CIG)

The Committee continues to view CFB collaboration with the ecumenical CIG as making an important contribution to the impact of faith-based investment in the UK and Ireland. 2012 saw several important milestones, including an event staged in St Paul's Cathedral, with former US Vice President Al Gore speaking about sustainable capitalism. CIG welcomes its growing collaboration with the St Paul's Institute.

CIG developed and approved a new three-year strategy for the period 2013-2015 focused on developing international partnerships and on UK engagement.

The CIG also:

- Received sustainability presentations from **AstraZeneca** and **G4S**
- Continued a programme of engagement on climate change based on the CDP Survey results
- Organised meetings with **Whitbread, IHG, Xstrata, Barclays, Rio Tinto, Tate & Lyle** and **J Sainsbury** and continued its focused engagement with **BP**
- Hosted an expert seminar with house-builder **Bellway** on the contribution new build is making to sustainable development
- Used its contacts in South Africa to keep a watching brief on events affecting **Lonmin** and **Anglo American**
- Continued to review and monitor the ecumenical voting policy adopted in 2009, and modified the voting template for use in 2012-13

The Chief Executive of the CFB serves as the Vice-Chair of CIG.

Regular Reporting Items

Alcohol and Tobacco

The Committee noted the UK Government's decision to introduce per unit minimum pricing of alcohol in England and Wales following a consultation. JACEI noted this was expected to be set at a level lower than that recommended in Scotland.

New laws governing the display of tobacco products in large retail outlets came into force during the year and were also noted.

During the year one European alcohol stock entered the Index and was excluded from the CFB portfolio: **Campari**.

Armaments

The Committee considered a CFB note on **Diploma**, an international distributor of specialised technical products and services. Diploma has a small exposure to defence via its specialist cables which are used in military aircraft as well as having civilian applications. Sales were noted as being less than 3%, and as a distributor, rather than manufacturer, JACEI was comfortable that the stock did not breach CFB Policy on armaments.

During the year one European defence stock entered the Index and was excluded from the portfolio: **Finmeccanica**.

Corporate Governance and Business Ethics

Executive remuneration continued to dominate public debate, not least with the so called 'shareholder spring' that claimed the positions of several leading Chief Executives. JACEI noted government plans to introduce a mandatory vote on pay, which is welcomed. However, it is disappointing that such a vote will only be offered every three years, with little indication as yet, what will happen in the intervening 'fallow' years.

During the year the Committee received regular news reports and updates on corporate governance and executive pay, and noted engagement by the CFB with several companies specifically on levels of pay, including **Barclays** and **HSBC**.

In deciding how to vote, the CFB considers the quality of disclosure, how stretching performance hurdles are and the potential for excess. CFB declined to support retention packages which the Board of **Xstrata** wished to commend as part of the merger deal with **Glencore**. The rejection of these by shareholders whilst approving the merger itself saw the resignation of Xstrata's Chair, Sir John Bond.

CFB attended several high-profile events during the year linked to future models of capitalism and building better, more sustainable businesses. Of particular note was the *Blueprint for Better Business* Conference called by the Archbishop of Westminster.

Environment

House builders are well placed to make a material contribution to the government's climate change targets. Given the lively debate on the need for new housing, the sector has the opportunity to apply cutting edge energy and water saving technologies within the residential sector so as to make a real and prolonged impact on sustainable living. The Committee welcomed the results contained in the 2012 Next Generation Survey of house-builders. This benchmarks the house building sector from a sustainability point of view. It showed that several CFB holdings, and in particular **Berkeley Group** and **Taylor Wimpey**, scored well against their peers.

The CFB undertook very useful engagement with **Bellway** over its apparent poor showing in the survey. This led to the company offering to give an expert seminar to CIG members on sustainability and the contribution the sector is making to energy and water efficient housing, as well as rehabilitating former industrial brown field sites. This was a first for the CIG, and was well received.

During 2012 CFB maintained close contact with **BP** as it continued to rebuild confidence following the Deepwater Horizon tragedy in the Gulf of Mexico. JACEI continued to support the commitment of resources to engage with BP as part of an investor coalition working for an improved safety regime and improved shareholder communications.

The Committee also noted on-going engagement with **Royal Dutch Shell** on a range of operational issues. A senior member of CFB staff joined an investor group hosted by Shell in the Niger Delta. This afforded the opportunity to see at first hand the deeply challenging environment that Shell operates in, and the progress that is being made. The CFB also participated in a sustainability day for responsible investors where the Group results on environment and safety were presented. At the end of the period covered by this report, CFB and JACEI were following the progress of Shell's stricken oil rig in the Alaskan Arctic which had run aground, and noted the company's decision to suspend all further drilling activity in the Arctic for the remainder of 2013.

Prior to the **Rio Tinto** AGM in April, the Committee noted a CFB meeting with activists from the USA and Mongolia who were in London to engage with investors about the company's operations. The matters raised formed the basis of a detailed meeting with Rio Tinto later in the year which covered operations in these locations, and elsewhere. CFB also engaged with **Anglo American** and **Rio Tinto** on a proposed new copper and gold mine in the Bristol Bay area of Alaska that would be sited close to the State's premier fresh salmon fishing areas. Although at an early stage of development, the proposed Pebble Mine project has already attracted considerable opposition and a possible objection by the US Environmental Protection Agency.

A meeting was also held with an investor coalition calling for the US oil company **Chevron** to account for environmental damage in Ecuador. We are following the lead of our US partners, the General Board of Pensions of the United Methodist Church, on the subject.

The Committee reviewed engagement meetings with **BHP Billiton** and **Randgold Resources**, which covered environmental performance.

Ecumenical engagement with **Glencore** continued, as it moved closer to pursuing its goal of merging with **Xstrata**. The latter is a CFB holding. Early appraisal of company sustainability information, coupled with disturbing exposure of environmental and human rights failures by the BBC programme *Panorama*, led CFB to oppose the merger on ethical grounds.

The subsequent approval of the merger by shareholders (but rejection of the Xstrata retention packages) led CFB to conduct a detailed review of the combined entity. This work is continuing with a further meeting with Glencore required before JACEI will be in a position to advise on its ethical suitability for investment.

During the year two European mining stocks were excluded from the portfolio: **Boliden** and **Eramet**.

Gambling

The CFB excludes companies principally involved in betting and gambling. As outlined earlier, JACEI has begun work that will look at the changing nature of how consumers gamble with a view to developing a Position Paper and Policy Statement.

During the year one UK (**Playtech**) and two European (**Lottomatica** and **OPAP**) gambling stocks were excluded from the portfolio.

Medical and Food Safety Issues

The continued need for greater transparency in the food supply chain was noted following the 'horsemeat scandal'. JACEI welcomed the CFB becoming involved in two new initiatives focused on food nutrition, well-being and animal welfare. CFB became a signatory to **the Access to Nutrition Index** modelled on the Access to Medicines Index. This will assess the nutrition policies, practices and performance of the world's largest food and beverage manufacturers and how they manage nutrition related risks and opportunities. Both malnutrition (in the developing world) and obesity (in the developed) pose considerable challenges for global food companies. The Index is predicated on the belief that those companies that best manage the growing wellness and health agenda, will be better placed to enjoy long-term sustainable growth, as well as delivering better products for the consumer.

A further initiative JACEI was pleased to note was the **Business Benchmark on Farm Animal Welfare**, which represents the first global standard seeking to assess farm

animal welfare in the supply chain. The CFB formed part of the investor consultation group that helped define the criteria, and made recommendations for widening the scope of the Benchmark to include companies such as **Genus**, which specialises in non-food animal products.

2012 saw the pharmaceutical industry come under scrutiny that led to several substantial fines being imposed by regulators. JACEI noted engagement with several pharmaceutical companies in the US, including **Johnson & Johnson** undertaken by the CFB's US partner, Wespath, whilst in the UK, CFB was in correspondence with **GSK** over its \$3bn fine for illegally targeting an anti-depressant at children. GSK assured us that these were legacy issues, and that sweeping changes to the way sales teams are incentivised had now been made.

The CIG meeting in June received a presentation by **AstraZeneca** on its corporate responsibility programmes. CFB noted that in the 2012 biennial **Access to Medicines Index**, the company had fallen from 7th to 16th position (out of 20 companies). Engagement with the company was initiated given the Index survey concluded that AstraZeneca is significantly under-performing its peers.

JACEI noted news reports that industry continued to be divided over the best means of using labelling to inform consumers about the health impacts of food. Whilst some such as **J Sainsbury**, adhered to the Food Standards Agency recommended method of a traffic light system, others, such as **Tesco** had maintained a preference for GDAs (Guideline Daily Amounts). With the CFB now involved with the Access to Nutrition Index, this is an area JACEI will continue to monitor.

The CFB continues to be represented as part of the **FTSE4Good** consultation process on breast milk substitutes. A member of the CFB team sits on the FTSE4Good Expert Committee on Breast Milk Substitutes which met twice during the year. The Expert Committee reviews adherence by companies to the WHO Code on Breast Milk Substitutes and FTSE criteria, conducts a verification process and makes recommendations to the FTSE Policy Committee. Ultimately it can recommend inclusion or expulsion from the Index. **Nestlé** are the first company with involvement in the marketing of Infant Formula to be included in the FTSE4Good Index. FTSE4Good undertook a verification exercise of Nestlé's performance on Breast Milk Substitute marketing in Laos and Morocco over the past year. Our engagement with Nestlé on this subject continues including participation in a stakeholders' meeting convened by the company in October 2012 to help inform and develop their approach to a range of ethical issues.

Human Rights

2012 saw JACEI commence work that will ultimately lead to a specific Position Statement and Policy on human rights and conflict during 2013 (page 4). This is a challenge given the breadth of issues that human rights risk covers, and so initially your thinking will focus on business and conflict.

However, much of the engagement work undertaken by CFB has a business and wider human rights context. Meetings with **Anglo American** and **Rio Tinto** always review the impact of mining operations on community human rights such as land loss, access to sacred sites, indigenous peoples' rights, or the impact of water stress on neighbouring communities.

2012 has been particularly challenging owing to the volatile political situation in Mali where **Randgold Resources** principally operates, and in South Africa where the fatal shootings by police officers affected the operations of **Lonmin** and **Anglo American**. The CFB met with Lonmin and the Committee considered a CFB briefing note on the social and environmental difficulties facing South African platinum mining companies. Our ecumenical partners in South Africa (CIG SA) have provided invaluable help and support during a very difficult year, including holding a meeting in London with CFB staff. JACEI particularly acknowledges the extraordinary reconciliation work undertaken by Bishop Joe Seoka of Pretoria, in bringing people together when so much mistrust was in evidence.

Much of our focused work on Israel/Palestine is also in support of human rights. This work is outlined elsewhere in the report (page 6), but we noted in September that the United Church of Canada voted to boycott some Israeli products. The Presbyterian Church, in a much closer vote, decided not to disinvest from companies supplying equipment to Israel. The situation in Israel/Palestine remains fluid and volatile and we have concentrated our efforts in 2012 engaging with **Veolia**, **Alstom** and **CRH**.

The easing of sanctions against **Burma** has resulted in much renewed investment interest. JACEI reviewed a CFB paper considering options as human rights appear to improve, and Burma is courted by international business. We agreed with the CFB that whilst ethnic and community violence, together with the persecution of minorities continues, it would be inappropriate to recommend investment in Burma. **Total** will therefore remain excluded from the European portfolio.

Media

JACEI noted that the Church of England national investment bodies disinvested from **News Corporation** after a lengthy period of engagement and in light of the phone-hacking scandal. A year on from the crisis, the Ethical Investment Advisory Group of the Church of England had not been satisfied that News Corporation showed the necessary willingness to effect pronounced corporate governance change.

JACEI welcomed new child protection controls introduced by **BSkyB** across all its media platforms. These will include enhanced PIN protection, parental control default, 'hiding' whole genres from the electronic satellite platform and filtering out adult content at 16,000 Wi-Fi locations. Sky is also working on a 'whole home' solution in which access controls can be correlated across all media platforms within the home. This was followed by a decision by **BT** to remove all pay per view pornography from the BT Vision service. JACEI viewed these developments as very positive and will

put pressure on other providers, such as **Vodafone** to take similar steps.

Networking

The Committee was delighted with the continued development of reciprocal observer status with the Church of England Ethical Investment Advisory Group (EIAG) with its Secretary attending all of the JACEI meetings covered by this report.

The Committee was also delighted to welcome Mr Richard Nunn to the June 2012 meeting as the regular URC observer, succeeding Mr Frank Kantor. Mr Nunn is also Chair of the CIG.

The CFB is actively involved in a number of industry and partner SRI initiatives on which JACEI receives regular reports:

- The **Institutional Investors Group on Climate Change**; CFB attended several meetings of IIGCC and takes part in its climate risk working group
- The **Extractives Industry Transparency Initiative**; CFB took part in all of the investor teleconferences during 2012, and noted that the number of candidate countries included in the revenue transparency initiative was growing impressively
- The merger of the CDP with **Forest Footprint** means for the first time CFB will be a signatory to this growing coalition of investors focused on preventing illegal deforestation. The survey, backed by \$7trillion in assets assesses material business risk in five areas connected to either business operations or through the supply chain in bio-fuels, soy, palm, beef and timber
- **CDP Water Survey** focuses on water scarcity, and is targeted at the largest global 500 companies. The CDP Water Survey is seeking to become a global standard for water reporting and practice
- **UK Sustainable Investment & Finance**; UKSIF, the SRI industry trade body, hosted seminars and opportunities for engagement throughout the year attended by CFB staff. These included a briefing on the climate change talks, 'Rio+20', and an expert seminar with the **World Gold Council** on the development of an industrywide conflict free gold standard
- CFB are signatories to the **UN Principles of Responsible Investment**, and JACEI receives reports of UN-PRI events and initiatives from time to time
- The CFB UK Equity Fund portfolio carbon footprint is measured annually by **EIRIS** and **Trucost**. It was pleasing to record that the portfolio was significantly lower than the FTSE All Share, largely owing to stock selection.

Other contacts include the Ecumenical Council for Corporate Responsibility (**ECCR**) where a Connexional Team member sits on the Board. JACEI welcomed the appointment of a new executive Director in 2012.

The CFB uses the specialist services of EIRIS, PIRC, Glass Lewis & Co, and Trucost.

The Committee commended the important input on a variety of subjects made by the Connexional Team at Methodist Church House.

The CFB Ethical Review

The CFB voting records (UK and European), ethical overview of UK sectors, list of ethically excluded European and UK companies (approx 8.2% of the Eurofirst 300 ex-UK Index and 15.0% of the FTSE All Share Index, respectively) and minutes of the monthly CFB ethics meeting were all noted.

The ethically adjusted index outperformed the FTSE All Share Index by 0.3% in the year to 28 February 2013, but underperformed by 0.5% pa over three years and by 0.4% over five years.

A significant number of CFB reports and reviews of individual companies were received during the year including notes of meetings with **Anglo American, Rio Tinto, BHP Billiton, Barclays, Standard Chartered, InterContinental Hotels Group, Randgold Resources, Lonmin, BP, AstraZeneca, GSK, and Xstrata/Glencore.**

Appendix - Role and Function of the Committee

Terms of Reference

The Joint Advisory Committee on the Ethics of Investment (JACEI) was established in 1983 by a Resolution of the Methodist Conference to provide a mechanism for the Methodist Church to tackle ethical dilemmas associated with investment and report annually to the Conference. Its terms of reference, which were last revised in 2001, are as follows:

The Joint Advisory Committee of the Ethics of Investment shall have a Chair appointed by the Methodist Council. The Committee shall have five members appointed by the Central Finance Board of the Methodist Church (CFB) and five members appointed by the Methodist Council. The function of the Committee shall be:

- to advise the CFB of ethical considerations relating to investment, it being accepted that the CFB legally has responsibility for making the final decision on the purchase or disposal of any share;
- to make public where appropriate any ethical policy of the CFB and in particular any investment decision taken on ethical grounds and any other advice the Committee may provide on ethical matters relating to investment;
- to report to the Conference on the workings of the Committee and in particular to comment on the performance of the CFB in managing the funds under its control according to an ethical stance which is in accordance with the aims of the Methodist Church.

SRI Reporting Requirements

In July 2000 regulations came into force obliging pension funds to consider their policy, if any, on socially responsible investment (SRI). In April 2005 similar requirements were extended to charities under the SORP guidelines. The UK Stewardship Code, published in July 2010 provides further clarity on reporting by investors. The CFB is investment manager to large pension funds that use the JACEI Conference Report as part of their assessment of CFB compliance with their SRI policies. The report should therefore enable trustee bodies to assess clearly whether the CFB has operated in a way consistent with the aims of the Methodist Church.

JACEI Procedures

The latest procedural amendments (2008) agreed that each meeting should have:

- one or two major items for debate either previously agreed by the Committee, requested by the CFB or driven by events;
- regular reporting items to keep the Committee fully informed of ethical issues relating to investment and to assist in the selection of items requiring a major debate;
- a report from the CFB on its 'ethical performance'. This would include the EIRIS screen, voting records and any disinvestment on ethical grounds.

That the Committee should:

- hold four meetings a year (in 2012/13 these took place in June, September, November and March);
- have its own identity with an address located at Methodist Church House;
- advise the CFB in relation to current Methodist Church policy;
- examine all aspects of a company's operations rather than simply focus on one particular issue;
- take responsibility, where appropriate, for making public any ethical policy of the CFB and in particular any investment decision taken on ethical grounds;
- seek ways to make the advice provided by the Committee available to the wider Methodist Church.

That Committee members should:

- feel free to contact the Secretary between meetings about issues of concern to them;
- e-mail their comments on position papers or other matters to the Secretary if unable to attend a particular meeting.

Committee Membership

The Revd John Howard is the Chair of the Committee. During the year, JACEI reviewed the Chair's appointment, and unanimously agreed to recommend to Methodist Council that his term be extended for a further six years to 2018. This was subsequently approved.

Members nominated by the Methodist Council are: Professor David Clough, Dr Brian Gennery, Ms Alison Jackson, Mr Chris Moorhouse and Ms Rachel Lampard.

Nominated by the Central Finance Board (CFB) are: Dr Keith Aldred, Mr Alan Emery, Mr Bill Seddon, Mr Roger Smith (until October 2012), Mr Terry Wynn (until June 2012) Ms Jennifer Potter (from June 2012), and Mr John Reynolds (from October 2012).

The Revd Winston Graham attends as a representative of the Trustees of the Methodist Church in Ireland.

In attendance from time to time to facilitate the workings of the Committee were: Mr Russell Sparkes, Mr Miles Askew, Mr Stephen Beer, Mr Christophe Borysiewicz, Mr Stephen Hucklesby, Mr James North, and Mr Paul Morrison.

Ms Kate McNab is the JACEI Minutes Secretary.

Mr Neville White is the JACEI Committee Secretary.
neville.white@cfbmethodistchurch.org.uk

A member of the Ethical Investment Advisory Group of the United Reformed Church attends as an observer, and Mr Richard Nunn attended from time to time in this role.

The Committee has a reciprocal arrangement with the Church of England Ethical Investment Advisory Group (EIAG) whereby representatives of JACEI and the EIAG attend as observers of each other's meetings. Mr Edward Mason, Secretary to the EIAG, and Mr James Featherby, Chair of the EIAG attend JACEI from time to time in this role, whilst Mr Seddon, Mr Sparkes and Revd John Howard attend meetings of the EIAG.

(Enquiries about the Committee's work are encouraged, with letters to be addressed to the Committee's Chair c/o 25 Marylebone Road, London NW1 5JR, or by email to: jaceichair@methodistchurch.org.uk).