

ETHICAL FINANCE

Background

The global financial crisis of the last three years has resulted in bailouts and bankruptcies of major financial institutions around the world, declines in stock market values, and recessions in developed economies including the UK. As governments seek to cut back budget deficits and money becomes harder and more expensive to access, both consumers and business face significant financial pressures.

While trust in the banking sector has all but vanished, interest in sustainable alternatives is growing. Some 44% of the British public are interested in finding out about the ethical credentials of the next financial product or service that they buy¹, and ethical finance has grown to reach £19.3bn in 2009, from £5.2bn 10 years earlier².

Materiality and strategy

The Co-operative Financial Services (CFS) is the group of businesses that includes The Co-operative Bank (including **smile**), The Co-operative Insurance, The Co-operative Investments, The Co-operative Asset Management (TCAM) and, from August 2009, Britannia. CFS' core business activity is the provision of financial

services – banking, insurance and investments – to corporate, business and personal customers. In 2010, CFS had an operating profit of £208.6m and total assets at year-end of £69.4bn. Loans and advances to bank customers were £35.1bn and deposits £34.2bn³. Investments totalled £24.2bn⁴, including listed equities of £5.2bn⁵. In relation to the provision of ethical finance and investments, CFS seeks to be the leading retail bank and institutional investor in the global financial services industry.

The bank launched its Ethical Policy⁶ in 1992, and completed the most recent review in 2009. It covers all assets and liabilities held on the bank's balance sheet, (eg, retail and syndicated loans, corporate leasing, retail deposits and savings, and treasury dealings), and the investment of all retained balances. From 1 August 2009, the Ethical Policy extended to include Britannia's assets and liabilities. The Policy is currently unique in UK retail banking, in so far as it contains explicit clauses that are mandated by bank customers and that restrict the provision of financial services to certain activities and sectors. In 2011 the Ethical Policy was extended to investments underpinning The Co-operative Insurance motor and home insurance policies (page 43).

The Ethical Engagement Policy⁷ was launched in June 2005, and is implemented by TCAM on behalf of The Co-operative Investments. The Ethical Engagement Policy guides TCAM's approach to engagement with equity investees. TCAM votes on all equities held, and discloses its entire UK and overseas voting record online⁸.

Community investment

International development and human rights

Animal welfare

Diet and health

Ethical finance

Social inclusion

Inspiring young people

🎯 Targets 2010	Progress	🎯 Targets 2011
Indicator: Ethical screening		
Consider a distinctive social and ethical consumer proposition for the general insurance business.	✔ Agreement was secured to extend The Co-operative Bank Ethical Policy to the investments underpinning home and motor insurance policies (page 43).	EOP Extend ethical screening activities to the £1bn of investments underpinning the key insurance products.
Indicator: Social and environmental banking (Performance benchmarks and recognition pages 43 and 44)		
Launch a Social Banking Unit (SBU) to bring together banking services for the environmental, social and charity sectors.	✔ In 2010, the SBU was launched, bringing together corporate banking services for renewables, carbon reduction, charities, social housing and microfinance (page 44).	EOP Extend commercial lending in the area of energy efficiency and renewables to £1bn, recruiting extra resource to key business centres.
The Co-operative Bank to commit £200m to finance renewable energy projects in 2010.	✔ In 2010, total committed facilities for this area reached £398m (page 44).	EOP Help to kick-start a revolution in community-owned renewable energy generation via a combination of £1m of grants and the development of a new financial product for the public sector.
Indicator: Socially responsible investment (Performance benchmark page 49)		
The Co-operative Asset Management (TCAM) to integrate climate change impacts into fund analysis on all core equity investments.	✔ Every stock recommendation now includes an analysis of climate change impacts (page 45).	
TCAM to co-file shareholder resolutions at Royal Dutch Shell plc and BP plc regarding tar sands operations.	✔ Shareholder resolutions co-filed requesting that companies report on the investment risks associated with Canadian tar sands projects and their plans to address them (page 45).	

(continued over)

ETHICAL FINANCE

🎯 Targets 2010	Progress	Targets 2011
		EOP Where ethical screening of investments is not feasible (owing to fiduciary duties), continue to ensure that engagement with investees is the most active, assertive and transparent of UK institutional investors, and supports campaigning activities.
		Implement Group Pensions' new PACE Responsible Investment Policy and Practice Statement, including publication of summary voting records, engagement activities and compliance with UK Stewardship Code.

Assurance

Whilst many financial services organisations now produce social and environmental reports, few, if any, subject their core business activity – the provision of finance and investments – to independent scrutiny or assurance. The Sustainability Auditor, Two Tomorrows, has provided a high level of assurance (pages 124 and 125) over the bank's Ethical Policy implementation and associated data. In order to do so, they have directly investigated, at a 10% sample level, the veracity of policy implementation, reviewing case files and assuring themselves of the integrity of the process and outcome.



Finance declined

£1.2bn finance declined in line with the bank's Ethical Policy since 1992

Ethical Screening

The Co-operative Bank – screening of finance

The bank provides facilities to some 92,000 corporate, business and wholesale market customers⁹. Ethical Policy compliance is secured, in the main, via self-completion questionnaires, which are incorporated within application forms and authenticated by account opening staff. Ongoing compliance is affirmed remotely via a central screening exercise undertaken on a biannual basis.

For large relationship customers¹⁰, ethical compliance is confirmed via direct investigation by business development managers and reviewed on an annual basis. Business development managers are issued with Ethical Policy guidelines that set out the criteria to be considered in the provision of facilities, and make explicit where involvement is prohibited. High-risk sector guidelines detail corporate activities that are considered to present an elevated Ethical Policy risk (eg, the manufacture of chemicals) and where referral to the dedicated Ethical Policy Unit is mandatory.

Referrals are made to the Ethical Policy Unit by account opening staff, business development managers and credit risk managers seeking to ensure that prospective business opportunities are Policy compliant. In most cases, independent analysis is commissioned from a leading independent ethical investment research organisation¹¹. During 2010, the bank's Ethical Policy Unit reviewed 408 (2009: 441) potentially problematic financial opportunities. Of these, 40 (10%) were found to be in conflict, and the business opportunity declined (2009: 43, or 10%). In 2010, the annualised gross income foregone by the bank as a result of ethical screening was an estimated £17.5m (2009: £17.7m)¹².

Bank – ethical screening referrals and outcomes

Year	Declined	Accepted	Total
2006	29	271	300
2007	32	316	348
2008	36	320	356
2009	43	398	441
2010	40	368	408

Social responsibility

Ecological sustainability

Delivering value

Assurance

On the basis of customer confidentiality, the bank is generally unwilling to name businesses found to be in conflict with its Policy. However, all referrals to the bank's Ethical Policy Unit are subject to independent third-party scrutiny as outlined on page 42.

An Ethical Policy training programme is available to all staff via the intranet, within bank staff induction programmes, and as part of annual training reviews for customer-facing departments. In 2010, the programme was completed by 238 members of staff (2009: 682).

Performance recognition

CFS outperformed 20 financial institutions from 16 countries to win the 2011 Financial Times Sustainable Bank of the Year award (Europe). This recognises an embedded and broad approach to sustainability¹³.



Performance benchmark

In 2010, social and environmental ratings agency Oekom awarded The Co-operative Bank the highest sustainability rating of any UK high street bank¹⁴. The bank was awarded a rating of 'B', while no other high street bank received a rating higher than 'C'.

Performance benchmark

Research undertaken by the Ethical Consumer Research Association in 2009¹⁵ reviewed 28 providers of cash and current accounts in the UK and awarded 'Best Buy' status to The Co-operative Bank and **smile**, 'for their ground-breaking ethical policies'.

Performance benchmark

In 2009, an ethical finance website¹⁶ was developed by Experts in Responsible Investment Solutions (EIRIS), to provide consumers with ratings of financial institutions' green and ethical profiles. The Co-operative Bank (including **smile**) was the highest-rated financial institution, and The Co-operative Insurance was the highest-rated insurance provider¹⁷.

All business declines by issue 2010

	Estimated income foregone 2010
Ecological impact 113 finance opportunities in connection with ecological impact, of which 12 were declined. For further details, see pages 69 and 87.	£1,102,000
International development and human rights 176 finance opportunities in connection with international development and human rights, of which 16 were declined. For further details, see page 29.	£374,000
Animal welfare 68 finance opportunities in connection with animal welfare, of which six were declined. For further details, see page 36.	£168,000
Social inclusion 29 finance opportunities in connection with financial inclusion, of which six were declined. For further details, see page 53.	£397,000
Total	£2,041,000

Community investment

International development and human rights

Animal welfare

The Co-operative Insurance – screening of investments

👁️ The Co-operative Insurance provides home and motor cover to some 1.4 million customers. Customers' insurance premiums are, in general, invested in fixed income bonds, where these provide the most appropriate risk and liquidity profile to meet the costs and claims arising from the provision of an insurance service.

Unlike equities, such investments are more akin to a financing arrangement, in that they provide a return but do not confer upon the investor the rights and principles of 'ownership'. In light of this, in January 2011, the bank's Ethical Policy was extended to cover the fixed income bonds underpinning home and motor premiums. To achieve compliance, a review of all holdings was undertaken and resulted in 11 bonds being divested, worth some £75m.

Via a process similar to that for bank finance, potentially problematic new investments will be referred to the Ethical Policy Unit for assessment. This approach is believed to represent the launch of the world's first ethically screened general insurance products.

Diet and health

Ethical finance

Performance benchmark

UK general public's social, environmental and ethical ranking of financial services providers¹⁸.

	2006	2007	2008	2009	2010
The Co-operative	1 (18%)	1 (14%)	1 (9%)	1 (17%)	1 (10%)
HSBC	=2 (2%)	2 (4%)	2 (6%)	2 (6%)	2 (3%)
Lloyds TSB	=2 (2%)	n/a	3 (2%)	3 (3%)	3 (2%)
Barclays	=2 (2%)	n/a	4 (2%)	4 (3%)	4 (1%)

Social inclusion

Inspiring young people

ETHICAL FINANCE

Social and environmental banking

🎯 In 2010, the bank established a dedicated Social Banking Unit (SBU) to further develop ethical commercial opportunities. The SBU operates from three offices – in Manchester, London and Glasgow – with 46 full-time employees, and brings together management and development expertise for charities, social housing, renewable energy, microfinance and credit unions.

In total, in 2010, £2.5bn of bank deposits were from social, co-operative and environmental businesses, representing 54% (2009: 52%) of total corporate and business banking liabilities. This is an increase of £496m on 2009, and reflects growth of £286m in community and charitable deposits, and £142m in public services deposits.

In 2010, £2.2bn or 27% (2009: 25%) of assets (eg loans and overdrafts) were with such businesses, an increase of £198m on 2009, including growth of £82m from the environmental and social sector and £70m from the public services sector.

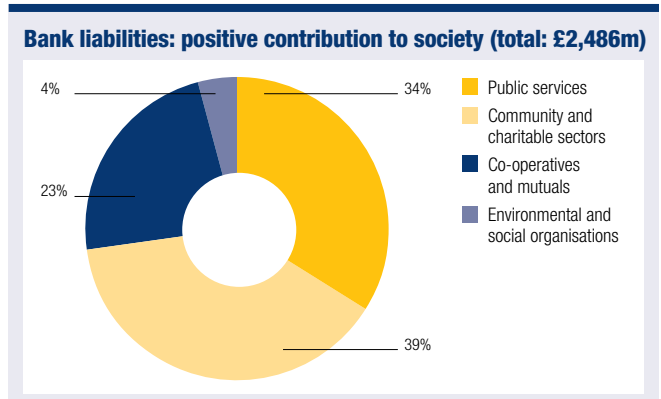
In renewable energy, the bank is considered a market leader in the provision of sub-£20m finance, where it has invested in developing expertise over a number of years. In 2007, the bank committed £400m to a fund for lending to renewable energy and energy efficiency projects. In 2010, total committed facilities for this area reached £398m, of which £187m had been drawn down. **🎯** The bank has pledged to extend its commercial lending for renewable energy and energy efficiency to £1bn by 2013.

➔ Tiree Renewable Energy Ltd

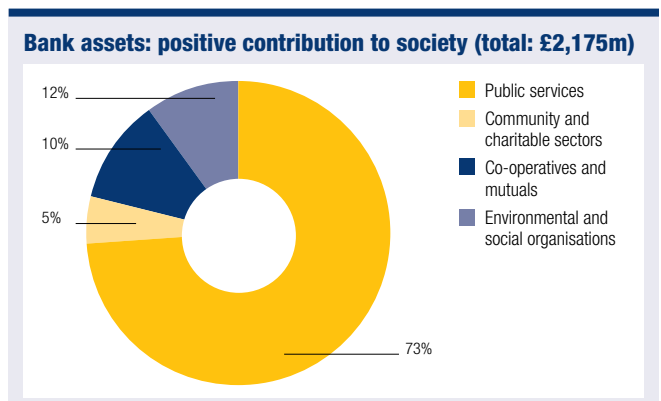
In 2009, The Co-operative Bank provided £1.2m for a community-owned wind turbine on the island of Tiree in the Inner Hebrides, where the majority of adults are members of The Co-operative. The turbine, commissioned in March 2010, is anticipated to generate returns of some £100,000 each year for the local community. The monies generated will be used to support the island's Community Development Plan, funding initiatives such as affordable housing, new school books, improved harbour facilities and youth groups.



	2008	2009	2010
Total (£m)	2,749	3,814	4,641
Positive contribution to society (£m)	1,492 (54%)	1,990 (52%) ¹⁹	2,486 (54%)



	2008	2009	2010
Total (£m)	3,450	7,785	8,030
Positive contribution to society (£m)	795 (23%)	1,977 (25%) ²⁰	2,175 (27%)



➔ Performance recognition

The Co-operative Bank was awarded 'Best Charity Account Provider' at the Business Moneyfacts Awards 2010, in recognition of the quality of products and services offered to the charity sector.

Socially responsible investment

The Co-operative Asset Management (TCAM) – investment strategy

TCAM employs a focused, active investment approach, and recognises that a company’s corporate governance and the way it manages its social, ethical and environmental (SEE) risks are important indicators of the long-term value of the company. For this reason, every stock recommendation produced by investment analysts contains, along with analysis of financial performance and prospects, an overview of the quality of corporate governance and SEE risk management evident at the company.

🎯 An analysis of climate change impacts is now included in every stock recommendation, detailing whether company responses to climate change were likely to have a positive or negative impact on long-term business performance.

Since 2008, TCAM has screened out from across all investments the sovereign debt of those countries where human rights are most severely curtailed²¹.

📄 The Ethical Engagement Policy can be viewed online, together with TCAM’s UK and overseas voting record.

TCAM – approach to engagement

In accordance with the Ethical Engagement Policy, TCAM’s engagement activity focuses on corporate governance and SEE issues. Corporate governance activism is primarily driven via voting at the general meetings of investee companies (as summarised in the tables on UK voting and overseas voting on pages 46 and 47 respectively). Engagement on specific areas of corporate governance concern (for example, short-termism in remuneration policy) is undertaken on a case-by-case basis, following voting outcomes. For reporting purposes, ‘engagement’ is restricted to instances where TCAM has pressed a point of difference with a company or where it has lent weight to a significant positive initiative. Engagement is not taken to cover endorsements of corporate behaviour that are essentially the sector norm, or close to it. Research, letters of enquiry and seminar attendance are not reported upon as engagement.

Ethics and sustainability engagement 2010		
Concern	Companies	Push for change
Climate change (unconventional oils) Increasing investment by oil and gas companies in unconventional fossil fuels, such as Canadian oil sands and US oil shales, risks dangerously increasing atmospheric CO ₂ levels and causing local ecological destruction.	Oil and gas – BP plc and Royal Dutch Shell plc	🎯 Engagement commenced in 2008. In 2010 TCAM co-filed shareholder resolutions requesting companies report on the investment risks associated with Canadian tar sands projects and their plans to address them (page 71).
Biodiversity The use of pesticide products containing neonicotinoids is considered to be a possible contributory factor in the decline in bee numbers across the world (see pages 86 and 89).	Chemicals – Bayer AG	In 2010, company urged to significantly scale back its marketing for the use of neonicotinoid pesticides on plants where bees are known to forage.
Water The Carbon Disclosure Project (CDP) recently launched the Water Disclosure Project, requesting water-related data from some 300 of the world’s largest corporations in water-intensive sectors.	Non-respondents to Water Disclosure Project – Apple Inc; BG Group plc; The Coca Cola Company; E.ON AG; EDF Energy plc; Lafarge SA; Royal Dutch Shell plc; Scottish & Southern Energy plc; Talisman Energy Inc; Total SA	Companies urged to participate in CDP Water Disclosure Project and to disclose data on total water use and recycling, exposure to water-stressed areas and future water use goals (page 79).

UK votes cast 2010

419

UK votes cast in opposition to management (10%)
2009: **417 (11%)**

TCAM – UK voting

At year-end 2010, 66% of equity holdings by value were listed on the UK stock exchange (2008: 67%). A UK Corporate Governance and Voting Policy sets out positions with respect to voting outcomes²², stating that TCAM will vote against a resolution where it ‘is inconsistent with its guidelines, does not accord with best practice, and is not in shareholders’ long-term interests’. However, in the first instance, and where the issue is not considered fundamental, an abstention will tend to be registered, and a vote against a company only registered when it has not responded to previous engagements. Abstentions will also be registered where performance falls short of best practice, but is not considered to be significantly material. Where there are plans not to support a company’s board, the affected company is informed of concerns in writing, in advance.

In 2010, 203 notifications were issued detailing an intention to vote against, or to abstain on, a management resolution, or to support or abstain on a shareholder resolution (2009: 207). In 15 instances (2009: 10), a response from the company was forthcoming and, in 14 cases (2009: three), this resulted in a change to the proposed vote.

In 2010, TCAM voted on 4,074 UK resolutions tabled by management (2009: 3,882), and was represented at five annual general meetings²³ (2009: four). Opposition to management voting (whereby votes were cast against a resolution or an abstention was cast) accounted for 419 of the votes cast, or 10% (2009: 417, or 11%), and confirmed TCAM’s status as one of the most active and assertive institutional investors in the UK. The major areas of opposition are executive remuneration, executive incentives and board independence.


ETHICAL FINANCE

UK voting									
Category	Resolutions tabled by management			Voted against resolution and management			Abstained on resolution and against management		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Report and accounts	392	293	293	26	15	18	50	39	40
Board independence: director election	1,568	1,138	1,284	53	60	80	142	61	71
Remuneration report: executive	371	303	247	74	73	65	110	79	64
Shares: executive incentives	137	80	100	26	20	18	42	22	17
Political donations	95	83	93	1	1	0	2	0	0
Other governance	2,736	1,985	2,057	12	14	14	32	33	32
Total	5,299	3,882	4,074	192	183	195	378	234	224

Annual Reporting TCAM votes against accepting the report and accounts of UK-listed companies that fail completely in respect of SEE risk disclosure²⁴, and that operate in sectors deemed to be medium or high SEE risk. Where there is limited disclosure (or no disclosure in low-risk sectors) abstentions are registered. For the poorest-performing companies²⁵ within medium- and high-risk SEE categories TCAM will, as part of its considerations, factor current SEE risk disclosure, previous voting history and engagement on SEE issues into voting decisions. During 2010, TCAM extended its policy on abstentions to companies that do not disclose greenhouse gas emissions, regardless of size or impact, unless there is significant positive momentum in climate change disclosure.

In 2010, TCAM voted on the acceptance of UK company report and accounts on 293 occasions (2009: 293) and, in 58 instances, voted against, or abstained on, their acceptance (2009: 54). Of these 58 votes, 18 related to instances where a vote against was registered, of which nine²⁶ related to SEE matters (2009: six); and 40 related to instances where a vote to abstain was appropriate, of which 38 related to SEE matters (2009: 27). Voting rationale continues to be publicly disclosed online following each AGM²⁷.

Votes in 'opposition' to acceptance of report and accounts on basis of poor social, ethical and environmental risk reporting

	2006	2007	2008	2009	2010
Votes against	40	31	12	6  ²⁸	9
Abstentions	38	62	45	27	38

Of the six companies voted against for SEE reasons in 2009, improvements in SEE reporting progressed at three, meaning that an abstention rather than a vote against was considered appropriate (Domino Printing Sciences plc, Royal Bank of Scotland Group plc, Micro Focus International plc). However, in three instances (Carnival plc, Headlam Group plc, Umeco plc), persistent SEE concerns meant that votes continued to be registered against these companies' report and accounts in 2010. In the cases of Carnival plc and Umeco plc, this represented the sixth consecutive year that such a vote had been registered.

Of the 27 companies where abstentions were registered in 2009, 10 improved their disclosure sufficiently for TCAM to subsequently support the resolution to receive their report and accounts, whereas four did not make any improvements, and a vote against was registered in 2010. In the remaining 13 instances, votes continued to be registered in abstention.

Executive remuneration In 2010, the remuneration resolution was voted against in 65 cases (2009: 73) and, in 64 cases, an abstention was registered (2009: 79). Whereas in 2009, five UK companies' remuneration resolutions were defeated by shareholders, in 2010 only three resolutions were defeated, and the average vote against remuneration resolutions fell from 17.5% back to 6%²⁹, in line with pre-financial crisis levels.

Board independence In line with the Combined Code on Corporate Governance, TCAM considers that, generally, at least half the board, excluding the Chair, should comprise independent non-executive directors (NEDs) – except for smaller companies, where it is thought there should be at least two independent NEDs, with the Chair being independent upon appointment. Votes against were registered in 80 cases (2009: 60) and votes to abstain registered in 71 cases (2008: 61). In the majority of instances, oppositional voting was driven by a lack of NED independence and unsatisfactory board meeting attendance.

TCAM – overseas voting

At year-end 2010, 34% of equity holdings were listed outside the UK; principally in the United States, continental Europe and Japan (2009: 33%). During 2010, TCAM voted against, or abstained on, 4,437 overseas resolutions tabled by management (2009: 4,941). Voting continues to be publicly disclosed online following each AGM³⁰.

Independent shareholder resolutions

In the UK, it is uncommon for shareholders to table independent resolutions, owing to the large number of shares required and a general aversion amongst large UK institutional investors to such practices. In 2010 TCAM was faced with only two such resolutions, which concerned BP plc and Royal Dutch Shell plc, both of which were co-filed and supported by TCAM (page 71).

Overseas voting														
Category	Total		Resolutions tabled by management						Resolutions tabled by independent shareholders					
			For resolution and management		Against resolution and management		Abstained on resolution and against management		For independent resolution and against management		Against independent resolution and for management		Abstained on independent resolution and against management	
	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010
Board composition and election of directors	10,179	10,039	6,653	6,891	917	1,585	2,543	1,392	42	122	6	34	18	15
Remuneration	990	832	244	175	509	438	100	76	124	134	8	4	5	5
Other governance	3,428	3,028	2,291	1,967	406	614	466	332	181	96	49	7	35	12
Political and charitable contributions	27	39	0	0	0	0	0	0	27	37	0	0	0	2
Ethics and sustainability	151	155	0	0	0	0	0	0	110	128	0	4	41	23
Total	14,775	14,093	9,188	9,033	1,832	2,637	3,109	1,800	484	517	63	49	99	57

Community investment
International development and human rights
Animal welfare

In contrast, in the United States, independent groups frequently secure the required number of shares to enable a resolution to be tabled, although these are framed as advisory resolutions, where the outcome or request is not binding on the company. When considering such resolutions the 'burden of proof' is considered to rest with companies and not independent shareholders.

In 2010, TCAM was presented with 623 overseas shareholder resolutions (2009: 646). Of these, 517 (83%) were supported (2009: 484, or 75%). In 155 cases (2009: 151), resolutions had ethical or sustainability components, of which 128 (83%) were supported (2009: 110, or 73%). Of these, 56 concerned climate change issues (page 69), 28 concerned international development and human rights issues (page 29), 10 concerned diversity issues (page 112), 10 concerned animal welfare issues (page 36), six concerned biodiversity (page 87), four concerned chemicals (page 91), four concerned public policy issues (page 123), two concerned social inclusion issues (page 53), two concerned water (page 79) and two concerned waste and packaging (page 77). A further 30 resolutions concerned other issues, including nuclear power and tobacco.

Independent shareholder resolutions 2010

128 independent shareholder resolutions on ethical and sustainability issues supported (83%)
2009: **110 (73%)**

Ethics and sustainability overseas voting by category						
Ethical Engagement Policy category	Number of resolutions		For independent resolution and against management		Against or abstain on independent resolution	
	2009	2010	2009	2010	2009	2010
Ecological sustainability (pages 69, 87, 91 and 79)	39	70	35	64	4	6
International development and human rights (page 29)	31	28	28	26	3	2
Social inclusion (page 53)	24	2	4	1	20	1
Diversity (page 112)	20	10	20	9	0	1
Animal welfare (page 36)	9	10	9	10	0	0
Public Policy (page 123)	0	4	0	2	0	2
Other	28	31	14	16	14	15
Total	151	155	110	128	41	27

Diet and health
Ethical finance
Social inclusion
Inspiring young people

ETHICAL FINANCE

▶ Performance benchmark

Research undertaken by the Ethical Consumer Research Association (ECRA)³¹ concluded The Co-operative merited a 'Best Buy' in both its Insurance and Investment sector buyers' guides³². ECRA noted that The Co-operative "is highly unusual in subjecting its engagement policy to rigorous independent scrutiny"³³.

Social private and listed equity investment

Since 2007, CFS has committed £15m of shareholder capital to social private and listed equity, of which to date £9.4m has been drawn down. Funds committed include:

- £5m committed to Bridges Ventures Community Development Ventures Fund II, a private equity fund in support of UK start-ups in deprived areas; of which £3.6m drawn down;
- £5m invested in the Impax Environmental Markets listed equity fund in support of the solar, wind and waste sectors globally;
- £3m committed to Enterprise Ventures Growth Fund private equity fund in support of small businesses in former coal-mining areas in the UK impacted by pit closures; of which £0.4m drawn down; and
- £2m committed to Bridges Sustainable Property Fund LP private equity fund in support of sustainable property, of which £0.4m drawn down.

In 2010, TCAM agreed a partnership with the private equity business Kohlberg Kravis Roberts & Co (KKR), under which TCAM will contribute funding as a Limited Partner towards projects including joint ventures and buy-outs. Through the partnership, TCAM aims to invest in companies that show leadership in environmental, social and governance (ESG) issues or where there is an opportunity to enhance ESG standards.

The Co-operative Group Pension Scheme (PACE)

The Co-operative's pension arrangements are regarded as an important part of the rewards package for employees and a key element in the attraction and retention of employees. As a result of recent mergers and acquisitions, a number of Defined Benefit (final salary and career average) and Defined Contribution schemes are operated. The majority of pension scheme members belong to a Group-wide defined benefit scheme based on career average earnings (PACE). In September 2010, the Board of Trustees of the PACE scheme approved a revised Responsible Investment Policy and Practice Statement³⁴ (the 'Policy') to better define the Scheme's approach to ESG issues. The Policy provides for the trustees to: instruct investment managers in relation to specific ESG issues; to engage with investee companies; and to direct investment managers to exercise voting rights on its behalf, wherever practicable to do so. It also creates greater requirement for public disclosure on: voting records; engagement activities; and compliance with The UK Stewardship Code.

Products and services

Carbon offset – products

In 2010, carbon offsetting continued as a standard feature of all The Co-operative Bank's branded mortgages and virtually all new car insurance policies (page 67).

Affinity cards

CFS offers a range of credit cards, each linked to one of 15 charity partners. A donation is made to the chosen charity when an account is opened, and further donations made in proportion to the spend on the card. In 2010, a total of £1.3m was raised.

think card

The think credit card supports ethical consumerism, whereby purchases from 16 ethical partners³⁵ attract preferential rates of interest. Upon activation of the card, the bank, in partnership with the RSPB, arranges for a third of an acre of Indonesian rainforest to be purchased and protected in the customer's name. For every £100 spent on the card, a further 25p is donated to rainforest protection. Since the launch of the partnership in December 2008, £120,445 has been raised for the RSPB, enough to help protect 2,294 acres of rainforest.



Sustainable funds

TCAM's three Sustainable unit trusts, Sustainable Leaders Trust, Sustainable Diversified Trust and Sustainable World Trust, employ, in the main, a 'best-in-class' approach to ethical investment. In addition, the funds withhold investments from certain proscribed activities: armaments, animal testing for cosmetics, nuclear power, tobacco and companies that systematically fail to uphold basic human rights.



▶ Performance benchmark

In 2009, the Sustainable Leaders Trust achieved an 'A' rating from Old Broad Street Ratings (OBSR)³⁶. The rating recognises the fund's strong research-based investment process and long-term investment approach with a focus on SEE and governance issues³⁷.

Performance benchmark

The **smile** funds supermarket³⁸ was one of two investment platforms to receive the highest rating in a 2010 UK Sustainable Investment and Finance (UKSIF) ‘mystery shopping’ exercise. UKSIF awarded the funds supermarket five stars, commenting that it “makes it easier for investors to identify green and ethical funds, providing resources that help investors understand the options available to them”.

Performance benchmark

CFS is a signatory to the United Nations Principles for Responsible Investment (PRI), a voluntary investor initiative comprising of six Principles³⁹. The current number of signatories stands at 861. In 2010, CFS ranked in the top two quartiles in all six Principles and the top quartile in three out of six (2009: four out of six)⁴⁰.

Young driver insurance

In 2011, CFS launched a new Young Driver motor insurance product for 17 to 25 year olds, which calculates premiums based on driving behaviour. The product, the first in the UK insurance market to reward safer driving, utilises a ‘Smartbox’ device to increase or decrease premiums in line with how safely the car is driven. It also gives advice on measures policyholders can take to reduce premiums. In trials, the product resulted in savings for 82% of drivers.

Influence and action

Corporate Governance

In March 2010, TCAM responded to the Financial Reporting Council (FRC) consultation on the UK Corporate Governance Code, calling for consideration to be given to the positive impact of gender diversity on company boards, and strongly supporting the annual re-election of all directors⁴¹. The updated Code was published in May 2010, and included annual election of directors as well as inclusion of gender diversity as a consideration in board appointments.

In April 2010, TCAM responded⁴² to the FRC’s Stewardship Code consultation, supporting the ‘comply or explain’ approach⁴³, and underlined its strong support for mandatory disclosure of voting records by institutional investors, a position supported consistently since 2005.

In September 2010, TCAM responded to the European Union’s Green Paper on Corporate Governance, and reiterated its support for mandatory voting disclosure and annual re-election of directors. In addition TCAM argued for a mandatory advisory (ie, non-binding) vote on directors’ remuneration as fundamental to a robust remuneration policy.

Good Companies Guide

The Observer/TCAM Good Companies Guide⁴⁴, published for the fourth year in August 2010, focuses on how FTSE350 companies might be

affected by five key sustainability issues: resource depletion, climate change, pollution, demographics and resource distribution.

Companies were ranked based on the effectiveness of their responses to these challenges and the impact these could have on their competitive positioning in the long term.



Accompanying notes

- | | | | |
|----|--|----|--|
| 1 | EIRIS, www.eiris.org , November 2009 | 25 | As determined by EIRIS, who identify bottom decile performers, based on SEE risk reporting and environmental reporting, and produce a universe of companies to which the voting policy is now applied. |
| 2 | The Co-operative Bank Ethical Consumerism Report, www.goodwithmoney.co.uk/ethicalconsumerismreport | 26 | BP plc, Carnival plc, Consort Medical plc, Enterprise Inns plc, Headlam Group plc, Spectris plc, Spirent Communications plc, Umeco plc, United Business Media plc. |
| 3 | As at 31 December 2010. | 27 | www.goodwithmoney.co.uk/servelet/Satellite/1200903577492,CFSweb/Page/GoodWithMoney |
| 4 | Including investment property. | 28 | Revised from five in 2009. |
| 5 | Listed equities under management on behalf of policyholders, as at 31 December 2010. Excludes unit trust investments. | 29 | PIRC (www.pirc.co.uk), 21 December 2010. |
| 6 | www.goodwithmoney.co.uk/ethical-banking | 30 | www.goodwithmoney.co.uk/servelet/satellite/1200903577492,CFSweb/page/GoodWithMoney |
| 7 | Ibid. | 31 | www.ethicalconsumer.org |
| 8 | www.co-operativeinvestments.co.uk/servelet/Satellite/1239949742617,CFSweb/Page/Investments-UnitTrustsAndISAs | 32 | Ethical Consumer (Nov/Dec 2007), Issue 109. Ethical Consumer (Mar/Apr 2008), Issue 111. |
| 9 | Including some 10,000 Britannia customers. | 33 | Ibid. |
| 10 | Corporate banking customers with a turnover in excess of £1m. | 34 | dev.pace-pensions.co.uk/?menuId=96 |
| 11 | EIRIS, www.eiris.org | 35 | www.co-operativebank.co.uk/think |
| 12 | Relates to those potential financial opportunities foregone following referral to the Ethical Policy Unit. Figure comprises the first year of income foregone as a result of business turned away in 2010 (£2,041,000) and declines originating in the years 2000–2009 (£15,417,000), on the basis that financial services provision will have retention beyond 12 months. | 36 | www.obsr.co.uk |
| 13 | www.ftconferences.com/sustainablefinance | 37 | OBSR rates approximately 250 funds out of a universe of around 2,500 funds in the market. There are three tiers of rankings: ‘A’, ‘AA’ and ‘AAA’. OBSR stated: “any fund which receives an OBSR Fund Rating is exceptional of its type”. |
| 14 | www.oekom-research.com ; Industry Focus: Public and Regional Banks. | 38 | www.smile.co.uk/servelet/Satellite?pagename=Smile/Page/smlview&c=Page&cid=984679347389 |
| 15 | Ethical Consumer (May/June 2009), Issue 118. | 39 | The six Principles are: “1: We will incorporate ESG issues into investment analysis and decision making processes; 2: We will be active owners and incorporate ESG issues into our ownership policies and practices; 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest; 4: We will promote acceptance and implementation of the Principles within the investment industry; 5: We will work together to enhance our effectiveness in implementing the Principles; and 6: We will each report on our activities and progress towards implementing the Principles.” |
| 16 | www.yourethicalmoney.org | 40 | In 2010 CFS changed its signatory status from ‘asset owner’ to ‘investment manager’ reflecting the Financial Services Authority’s licence to operate as a stand-alone asset management company. As such, year-on-year results are not directly comparable. |
| 17 | The site rates financial institutions according to six areas: Ethical Lending/Insurance, Responsible Lending, Financial Exclusion, Environment, Carbon Neutrality and Equal Opportunities. The bank and insurance business rated as ‘good’ (the highest rating) in all categories except Responsible Lending, for which the bank rated ‘average’ and the insurance business ‘n/a’. | 41 | www.frc.org.uk/documents/pagemanager/frc/Responses_to_Dec_09_consultation/Co-Operative%20Asset%20Management.pdf |
| 18 | Source: TNS Omnibus (December 2010): Survey of GB general public’s unprompted awareness of corporate responsibility. Representative sample, all adults aged 16+. | 42 | www.frc.org.uk/documents/pagemanager/frc/ECS_comment_letters/The%20Co-operative%20Asset%20Management.pdf |
| 19 | Revised from £1,987m. £1m additional renewable energy liabilities identified. | 43 | Describes rules or recommendations which are not mandatory, but require companies to either comply with them or explain publicly why they are not. |
| 20 | Revised from £1,890m. £8m additional renewable energy assets identified. | 44 | The third Good Companies Guide was published in The Observer on Sunday 29 August 2010. |
| 21 | As defined by the EIRIS ‘Category A’ human rights list, which details 43 countries where human rights present the highest level of human rights risk for businesses. | | |
| 22 | www.goodwithmoney.co.uk/assets/Voting-guide-web-version.pdf | | |
| 23 | BP plc, ITV plc, Royal Dutch Shell plc, Tesco plc and Marks & Spencer Group Plc. | | |
| 24 | Based on Association of British Insurers (ABI) guidelines on socially responsible investment – www.ivis.co.uk/PDF/7.1_ABI_RID_guidelines.pdf | | |