

SOCIALLY RESPONSIBLE INVESTMENT

Revisiting a three-year experience



FINANCIERE DE L'ECHIQUEUR

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In this booklet, we wish to share the main lessons drawn from **three years experience** acquired in the course of over three hundred SRI interviews with listed companies.

The “stock-picking” management practised by Financière de l’Echiquier is a style of management based on conviction derived from a deep knowledge of the companies. **An analysis of non-financial criteria actively enhances our knowledge of the companies we invest in.** Consequently, it has become part of our stock selection approach.

Our experience has shown that it is essential to accept the part of subjectivity inherent to the SRI approach and involve the whole team for better investment outcomes.

Marie-Ange Verdickt
Director of Research and SRI

1 An essential tool for “stock-picking”

The company’s sustainability does not depend solely on its economic performance.



Did you know?

Broad SRI

France 2009 AuM: €250 billion⁽¹⁾

Europe 2007 AuM: €2150 billion⁽²⁾

Broad SRI involves applying ESG measures ex post to non SRI portfolio. It does not entail systematically taking into account ESG criteria into investment decision

Core SRI

France 2009 AuM: €50.7 billion⁽¹⁾

Europe 2007 AuM: €500 billion⁽²⁾

Funds managed upstream with systematic filtering of ESG criteria:

- “Best in Class” approach
- “Best Efforts” approach
- *Norm based exclusions** (normative exclusive funds)
- *Sector based exclusions** (sector exclusive funds)
- *Thematic funds **
- *Shared return funds ** (solidarity funds)

* Exclusive, thematic and shared return funds must include an ESG filter to be considered as SRI funds.

Sources:

(1) Novethic, *Les chiffres 2009 du marché français de l'ISR* (French market 2009 SRI statistics)

(2) Eurosif SRI Study, 2008

1.1 ESG criteria fine-tune our knowledge of companies

According to Financière de l'Echiquier, the quality of a corporate social responsibility directly impacts the development of companies.

Integrating ESG (Environment, Social and Governance) criteria helps to enhance our knowledge of companies by going beyond figures and examine the human resources policy, relations with stakeholders, environmental challenges, etc.

Building on three years of experience, this approach equips us with key information, namely: knowledge of new regulations, detection of new growth opportunities, improved risk assessment.

Analysis of ESG criteria enables us to build a better appraisal of the company and hence a better assessment of the risk inherent to our investments.

We have therefore decided to integrate ESG criteria in all of our funds.



Did you know?

- **NOVARTIS** was sentenced to pay **\$250 million** for sexual discrimination ⁽¹⁾.
- **TECHNIP** accepted to pay a fine of **\$338 million** for corruption in concluding a contract in Nigeria ⁽²⁾.
- **LAFARGE** was fined **€250 million** for illegally fixing prices with rivals ⁽³⁾.
- “Non-quality” has a price. **TOYOTA** thus took back over **a million cars** in the United States for brake failure. This example illustrates the need of a strong commitment upstream.
- The case of **BRITISH PETROLEUM**, held responsible for the oil spill in the Gulf of Mexico is unprecedented. Expenses already incurred amount to **€8 billion**. The cost of the fine is expected to be much higher.

Sources:

(1) Le Figaro, 19 May 2010

(2) Le Figaro, 28 June 2010

(3) Le Figaro, 17 June 2010

1.2 Non financial issues do have a financial impact!

A recent study by the firm, Accenture*, has shown that the **growing interest of companies in sustainable development is largely driven by economic reasons, such as competitive advantage and cost-cutting.**

As a result, given that environmental protection lies at the heart of its strategy, MICHELIN has been able to foresee regulatory developments on CO2 emissions by vehicles, and presently holds a leadership position with regard to “green tyres”!

Nonetheless, there is a need to take note that the overriding reason advanced by companies remains the public image risk. **Given that sustainable development has a price, negligence in the area equally has a cost that cannot be overlooked!** A typical example is the amount of fines paid for failure to comply with social and environmental regulations.

*Study conducted in partnership with UN Global Compact: *A New Era of Sustainability*, June 2010



In practice

GROWTH STOCK FUNDS

Non-financial rating for each fund

ECHIQUIER MAJOR	6.9/10
ECHIQUIER AGENOR	6.4/10
ECHIQUIER JUNIOR	6.6/10

VALUE FUND

ECHIQUIER QUATUOR	5.4/10
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1.3 Growth stocks set the pace

Growth stocks are often in the vanguard in the field of corporate social responsibility.

They have a duty to take on these challenges in their strategy in order to establish their competitive advantage over the long term thereby ensuring their development. Attracting and motivating the best players and predicting developments in social and environmental regulations are key success factors for these companies.

Therefore it is no surprise that our growth stock funds prefer to invest in well rated stocks even if we did not set any ESG filter initially. **This observation has led us to embark on a SRI labelling process for Echiquier Major that is investing in leading European stocks.**

On the other hand, with regard to value funds, we are aware that companies are lagging behind on these issues. The delisting witnessed on these stocks often due to a poor management of ESG constraints. Our duty is to determine whether these difficulties will

remain over time or not. Once resolved, they may become a bullish catalyst for the stock.

2 An inevitably subjective approach

Assessing the quality of management alongside social and environmental challenges is first and foremost a matter of conviction rather than certainty.

We therefore accept the inherent part of subjectivity.



Did you know?

The Global Reporting Initiative (GRI) is a set of benchmark indicators on sustainable development. This international initiative designed for companies, NGOs and trade unions is merely optional.

Are the GRI indicators used?

A study conducted in 2008 by the firm, KPMG, revealed that 77% of CAC 40 listed companies refer to GRI standards in drawing up their sustainable development report compared with a mere 31% for SBF 120 listed companies. These figures are clearly indicative of the discrepancies witnessed in non-financial reporting, depending on the size of the companies.

* KPMG, "51 best practices to improve your sustainable development report", 2008

In 2009, the study conducted in the launching of the Gaïa Index, the first SRI index for companies with a market capitalisation of less than €2 billion, brought out the following findings:



- 80% of companies have responded to issues related to good governance, which is a great performance!
- On the down side, social and environmental issues did not record the same amount of success, as they posted a dismal response rate of 48% and 30% respectively, whereas only 6 questions were related to social and environmental issues.

These results were a good indication that published information was lacking.

2.1 There is no IFRS equivalent for ESG information

Whereas annual financial statements have been standardised and certified systematically, the same cannot be said for sustainable development. The structuring of a reliable and relevant non-financial report would make our work easier. Yet events have shown that there is a significant gap between the quality of financial reporting published and the non-financial reporting available.

For instance, **out of 50 leading European companies held in our Echiquier Major fund, hardly one out of two actually publish statistical data comparable** on a set of benchmark indicators, such as water and energy consumption, or CO2 emissions.

Still, even less companies actually publish performance indicators accompanied by measurable goals with specific deadlines. Most often their reports give an account of isolated success stories but fail to provide any figures. In the absence of any shared landmarks, it is an uphill battle to compare the performances of the different companies!

Faced with highly heterogeneous information, assessment of corporate social responsibility shall just remain an opinion.



Our 6 criteria for assessing companies

Financial rating (60% of general rating)

1. Quality of financial structure

2. Visibility on earnings into results

3. Growth prospects

4. Earning Surprise

SRI rating (40% of general rating)

5. Quality of management (core business and governance)

6. Responsibility (environmental and social aspects)

Our cases of exclusion

A very poor governance rating is a factor of exclusion.

We do not apply any sector based exclusion.

In sectors open to controversy (on-line games, alcohol, defense...), we pay special attention to the prevention policies implemented by the companies. However, we do not practice any exclusion automatically.

In sectors with a high environmental impact (road transport, building materials, chemicals, etc...), we give priority to the “Best in class” and “Best efforts” approach. Additionally, we would encourage companies with a forward-looking approach.

2.2 Lack of information does not imply lack of commitment!

In many cases, our experience has shown that lack of written information is not necessarily indicative of the quality of commitment. For instance, the company, 1000 Mercis, does not publish any information in its annual report nor on its website. Nevertheless, it has an employee turnover next to 0, done its carbon audit and taken plenty of initiatives to cut down its carbon footprint. Hence the overriding need for a direct meeting...

2.3 Our experience in assessing management has equipped us to develop tools for analysing ESG criteria

Since 1991, the quality of management has been a fundamental criteria of Financière de l'Echiquier's stock selection approach.

Twenty years of meetings with business leaders have equipped us to develop benchmarks in an essentially subjective field.

The skills acquired have enabled us to draw up our own ESG assessment grid. In practical terms, we rate companies based on 6 criteria, two of which are non-financial, namely quality of management, and social and environmental responsibility. **Both criteria account for 40% of the final rating scored by the companies.**

3 An approach conducted in-house

Financière de l'Echiquier manages its funds with conviction. This approach cannot be outsourced, including for SRI.



Our SRI methodology

RESEARCH

Analysis of annual report and/or sustainable development report.

Search for external information (NGO reports, brokers, etc...).

INTERVIEWS

Direct contact with a diversity of partners (SD manager, HR Director, Technical Director, IR...).

Interview guide using 9 key questions.

Production of a report outlining the goals to be met and areas where progress has been made.

RATING

Risk assessment

Rating in tandem with manager

FOLLOW-UP INTERVIEWS

Performed at least every two years.

Follow-up of achievements and progress.

Where needed, amendment of the rating

3.1 Involvement of the management team is essential

Who knows the company better than the manager or analyst who drew up the investment plan and subsequently made the decision to invest? His/her deep insight into the history of the company, its leaders, its shareholders and its activity is simply invaluable. This enables him/her to read between the lines of a non-financial reporting systematically presented in a positive light. Hence our decision to involve the entire management team in the non-financial research process. **Managers cannot outsource their thoughts and insight to an external partner.**

3.2 We do not turn to rating agencies

Rating agencies only provide a partial coverage of our investment territory by globally giving preference to large caps. **Financière de l'Echiquier's approach involves all fund stocks, regardless of the size of the market capitalisation.**

Unlike rating agencies, we do not systematically penalise a company for lack of information. Most often, the public nature of their analyses and ratings oblige the agencies to confine themselves to published information, which is sometimes far removed from realities on the field. **A hands-on approach we have always opted for at Financière de l'Echiquier.**



Our interview tools



9 questions for responsible companies

▸ Governance

- Who can veto your decisions within the Company?
- Why are you listed?
- What risks other than financial have you identified?

▸ Human Resources

- How do you develop staff loyalty?
- How do you help your employees progress?

▸ Environment

- How does the environment impact the running of your business?
- How can we keep track of your actions in that area?

▸ Other Stakeholders

- What is your definition of a community minded/responsible company?
- What actions within your Company meet that definition?



www.fin-echiquier.fr

3.3 Nothing better than meeting!

Given that very little information on corporate social responsibility has been formalised so far, there is definitely an added value for those who conduct research on the field.

The meeting is a crucial moment. To prepare for it in a proper manner, we actually conduct research obtained not only from data published by companies, but equally from external sources, such as studies by brokers, NGO reports, press articles, etc.

Some companies respond to our questionnaire in writing prior to meeting with us. On some occasions, we notice a significant gap between the written answers and the answers provided during the interview! It is not uncommon for us to be tempted to assign a very good SRI rating after reading the annual report. **On more than one occasion, an interview has dampened our enthusiasm. As a matter of fact, this gap is illustrative of the “marketing” slant of some sustainable development reports.**

As signatories to the PRIs, SRI interviews are a crucial step in our commitment approach aimed at fostering the ESG approach amongst listed companies. These meetings allow us to engage a dialogue with them on positive aspects and areas where progress has been made. These aspects will be reviewed subsequently in the follow-up meetings held at least every two years.

4 Moving forward...



SRI milestones at Financière de l'Echiquier

2004,
Joint initiative:
Formation of Financière
de l'Echiquier
Foundation

Since 1991,
Assessment of the
quality of management
of companies

2008,
Signing of PRIs

2007,
Formalisation of our
SRI approach in
tandem with
Ethifinance

Start of SRI
interviews

2010,
Publication of "White paper"
Launching of laboratory funds:
"Echiquier Environnement" and
"Echiquier Valeurs Humaines"



4.1 Two initiatives to enhance the visibility of our SRI approach

Obtain the SRI label for Echiquier Major.

The good rating of Echiquier Major stocks has led us to apply for the SRI label from Novethic in 2011.

Launching of two “laboratory” funds: Echiquier Environnement and Echiquier Valeurs Humaines

Apart from taking into account ESG in all our funds, we would like to provide well-targeted answers to requests from institutional investors with regard to SRI.

Echiquier Environnement gives priority to stocks with an environmental policy we deem the most forward-looking.

Meanwhile, Echiquier Valeurs Humaines lays emphasis on stocks with a social policy we deem outstanding.

Our goal: Prove that the performance of Echiquier Environnement and Echiquier Valeurs Humaines funds taking into account an ESG filter is at least as good as that of our conventional funds.

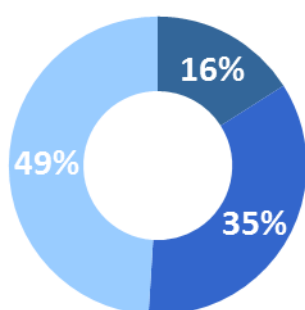


Financière de l'Echiquier: Facts and figures

1991: Inception date

4 billion euros assets under management

72 employees, including **21** managers and analysts

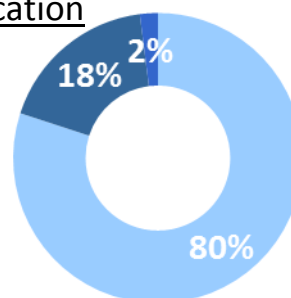


Breakdown of stocks by client category

- Private clients
- Institutional investors
- Retail investors

Breakdown of stocks by geographical location

- France
- Europe
- Others



311 companies visited in our 100% SRI interviews

72% of companies held in our funds rated based on ESG criteria

2 laboratory funds set up: Echiquier Environnement and Echiquier Valeurs Humaines

4. And what about us?

To Financière de l'Echiquier, reconciling finance and responsibility entails opting to act as a socially responsible investor.

It equally involves becoming aware of one's ecological footprint. Following the carbon balance achieved in 2008, **Financière de l'Echiquier changed the transportation and printing habits of its teams, amongst others, and went ahead to sensitise its vendors to its new approach.** The roof of its building even plays host to a new group of occupants: bees ...

Financière de l'Echiquier's social responsibility involves not only employee share ownership – 100% of the company's stock is owned by its leaders and employees – but also the individual numerous training courses offered and the quality of its working environment. These actions are assessed regularly through participation in the contest organised by the institute, "Great Place to Work": **In 2010, Financière de l'Echiquier ranks 8th amongst companies with a healthy working environment.**

Finally, **Financière de l'Echiquier set up its foundation in 2004 to work for social inclusion and education in France.** With a total endowment of over €3 million, it is responsible for implementing the company's social actions.



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www.planete-echiquier.fr

53, AVENUE D' IENA – 75116 PARIS – TEL : 01 47 23 90 90 – FAX : 01 47 23 91 91

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