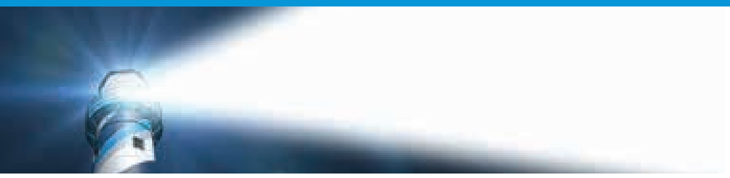
First State Investments

Colonial First State Global Asset Management

Responsible Investment Annual Report 2012

Contents

Colonial First State Global Asset Management (CFSGAM) operates as First State Investments (FSI) outside of Australia. The entire company is collectively referred to as FSI in this report.



Foreword

Welcome to our Responsible Investment (RI) Report for the 2012 calendar year. This is our sixth report demonstrating our commitment to responsible investment and to the continual improvement of our internal practices.

2012 heralded a significant change for our RI team, with two new senior appointments being made by the business. In the September quarter we welcomed Will Oulton and Pablo Berrutti to the team. Based in London, Will is our new Global Head of RI. Pablo is our Head of RI in the Asia Pacific region and is based in Sydney. Both Will and Pablo bring a wealth of experience to the business. Further, their appointments reinforce our commitment to embed responsible investment practices into the core of our investment activities globally. We firmly believe that doing so is in the best long-term interests of our clients.

Our main RI benchmark continues to be our performance relative to peers against each of the United Nations Principles for Responsible Investment (PRI). In 2012, the PRI began a process of reviewing and redefining the reporting requirements for signatories. We were active participants in this process through our membership of the PRI's Technical Committee, which had the role of advising the PRI team in its ambition to develop a stronger reporting framework for signatories. In addition, we also participated in the Pilot programme which provided valuable feedback to the PRI on the proposed reporting requirements. This process has our full support and will add further credibility to the PRI's reporting and disclosure agenda.

Maintaining the trust and confidence of our clients is critical to our long-term success as a leading world class responsible asset manager. The financial services sector continues to attract criticism from many quarters and the most recent Edelman Trust Barometer showed the financial services sector in a poor light. Maintaining our licence to operate is therefore critical to the long-term success of our business and our approach to RI plays a major part in achieving this.

In the UK, Professor John Kay's 'UK Equity Markets and Long-Term Decision Making' review was published and raised a number of key issues for the industry. Among these issues is the role of investor engagement with companies. This is an area of continuing focus for us and one which is important to strengthen, both by our own direct activities and by collaborating with other investors where appropriate and where we can add influence and add value.

The UK's Financial Reporting Council (FRC) revised the UK Stewardship Code in 2012. Additional information is now being asked of asset managers in terms of disclosing their policies on managing conflicts of interest and for stock lending. Of course both are important stewardship issues for asset managers and we maintain an active dialogue with the FRC and support its work in encouraging greater levels of disclosure from asset managers.

This report provides a number of examples of the stewardship activities of our investment teams. Engagement is central to our RI approach; as active owners of hundreds of companies in our portfolios we voted on more than 16,000 resolutions in 2012. Our ongoing communication with companies is something that we value greatly. Accordingly a significant amount of emphasis is put on ensuring that any concerns we might have are clearly articulated to company management teams to maintain the highest standards of governance and sustainability practices are maintained.

The past 12 months once again provided us with a reminder as to how our climate can impact our lives and economies. Around the globe there were many examples of extreme weather including heat waves, extensive flooding and powerful destructive storms which caused widespread damage to property and loss of life. Climate policy is a key issue for investors and our participation in climate related debates is conducted via our membership and support of the Investor Group on Climate Change. Indeed, we will look to expand our participation further in the year ahead.

Looking forward, it is our intention to increase our thought leadership work and participation in industry debates. An example of this is our involvement in the University of Cambridge Programme for Sustainability Leadership, in their newly formed 'Investment Leaders Group'.

We will also continue to seek to work with like-minded investors to promote higher standards of practice in the markets where our clients' money is invested. Industry collaborations are an important part of our work and a report of our key collaborations and activities is included in section 4 of this report.

The year ahead will see further evolution and enhancement of our global RI strategy, as well as embedding RI considerations more deeply into our business globally. Our focus will be on a number of areas including:

- Investment and product development processes
- Client relationships and management, communications and reporting practices
- The skills of our people and our influence and role in developing high quality markets where we invest our clients' money.

I look forward to providing an update on our progress in the 2013 report.

Mark Lazberger
Chief Executive Officer

About us

CFSGAM and First State Investments collectively manage over US$167 billion[1] on behalf of institutional investors, pension funds, wholesale distributors and platforms, financial planners and their client's worldwide.

We are one of the largest managers of Australian sourced funds with offices located in Sydney and Melbourne. In Asia we provide asset management services to wholesale and institutional investors across a diverse range of domestic and global asset classes with offices in Hong Kong, Singapore, Jakarta and Tokyo. Our European, Middle East and African exposure is gained through our offices in London, Paris, Frankfurt and Edinburgh. With additional offices in New York and Auckland and represented in Beijing and Shenzhen through the First State Cinda joint venture, we have aspirations to be a world-class asset management business with a global footprint.

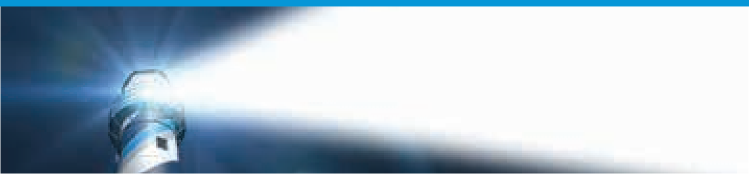
Our parent company, the Commonwealth Bank, is rated AA– by S&P[1] and is the largest Australian bank by market capitalisation (ASX code CBA). The Bank is one of Australia's leading providers of integrated financial services, including retail banking, premium banking, business banking, institutional banking, wealth management, and sharebroking products and services.

We are distinguished from our peers by our specialist investment teams. Although each team might have its own philosophy or investment processes, there's one thing all teams share: a commitment to acting in our clients' best interests and maximise portfolio performance.

Indeed our particular advantage rests in the quality of our professional teams, in our innovative solutions, and in the rigour of our investment processes.

Our ability to meet our clients' expectations while managing risk has been an important reason why we have not just survived in difficult market conditions but grown.
By adopting the United Nations Principles of Responsible Investment (UNPRI) our approach to risk management and corporate governance has evolved to the point where it now impacts positively on the companies in which we invest.

1. FUM and Ratings data is shown as at 31 December 2012.



Our approach to Responsible Investment

Progress to date

Since becoming a signatory of the United Nations PRI in 2007, FSI has made steady progress in integrating the consideration of environmental, social and corporate governance (ESG) factors into the investment processes and ownership practices in our diverse range of asset classes.

This progress has been evidenced by our improvement in the PRI's annual benchmarking results from 2008 to 2011. In 2011, we ranked among the top 25% of fund managers globally in five of the six principles. While the PRI did not release a benchmarking report for 2012, we have continued to refine our approach and practices.

As well as remaining focused on improving our RI practices throughout 2012, we also recognised a need to both deepen and globalise our responsible investment capabilities. As part of this commitment we welcomed Will Oulton to lead our global RI efforts from our London office and sought to retain our strong presence in Australia by appointing Pablo Berrutti to lead RI in the Asia Pacific region.

Principle 1
We will incorporate ESG issues into investment analysis and decision-making processes

Principle 2
We will be active owners and incorporate ESG issues into our ownership policies and practices

Principle 3
We will seek appropriate disclosure on ESG issues by the entities in which we invest

Principle 4
We will promote acceptance and implementation of the Principles within the investment industry

Principle 5
We will work together to enhance our effectiveness in implementing the Principles

Principle 6
We will each report on our activities and progress towards implementing the Principles

Our strategy

In the latter part of 2012 we took the opportunity to re-examine our existing approaches, introduce new ideas and fresh perspectives. As result of this work we have broadened the scope of our existing RI strategy.

One of the goals of our business is "to be recognised as a global leader in responsible investment by our clients, stakeholders, peers and industry". We seek to achieve this by building upon the six principles of the PRI, ensuring we employ the mindset, thinking and actions of a responsible asset manager at all levels and in all areas of our business.

In order to ensure that we focus on conducting our business in this way our strategy focuses on the following three key pillars shown in the chart below:

RI Governance

Our RI governance structure will be strengthened in 2013 by:

- The creation of a Global Responsible Investment Committee (GRIC), chaired by CEO Mark Lazberger with members drawn from across the business
- The formation of a new committee, to support and inform company engagement and to promote collaboration across investment teams
- The creation of an ESG risks committee, which will assess the exposure to ESG risks across asset classes
- Reviewing and updating our RI, proxy voting and other policies to ensure they reflect our global RI strategy.

Our approach to Responsible Investment

Engaging our people

The FSI Global Culture Council (GCC) formed in 2009 is a non-hierarchical group with staff representatives from many business units across the globe. GCC members are focused on improving and enhancing our business culture, with the objective of making FSI a positive place in which to work. The GCC is also designed to support the leadership and growth of our business globally.

The GCC has a number of current focus areas including Employee Engagement, Diversity and Inclusion, and Community. The work of the GCC and our leadership in driving responsible investment practices are intrinsically linked and mutually reinforcing.

Our RI strategy includes closer collaboration between the GCC and our RI team to promote behaviours consistent with our goal of being a leading global responsible asset manager.

In addition, our human resources team will work to ensure that employees and prospective employees are fully versed in our commitment and approach to RI. This will include:

- Clearly articulating our commitment to RI to prospective employees and recruitment agents
- Incorporating candidate interest and alignment to our RI goals as part of our assessment and requirements.

Quality of investment practices and processes

Since becoming a signatory to the PRI, we have maintained a strong focus on incorporating ESG factors into our investment processes. We have ensured that each investment team has access to value-adding ESG data and research. We also continue to be active stewards of our clients' capital, engaging with companies on their ESG performance and practices, and related risks and opportunities.

We are active investors. As such we believe that the incorporation of ESG factors into our investment processes will deliver long-term benefits to our clients.

Our goal is to seek to understand and measure the corporate governance quality and the environmental and social efficiency of our portfolios so that our investment managers and our clients can understand the extra-financial drivers of portfolio performance. We will be striving to achieve this goal during 2013 and beyond.

Stewardship

Our main areas of focus going forward will include participating to a greater degree in industry debates regarding the sustainability of financial markets and the investor role in improving the governance of markets. In addition to individual efforts to raise and debate issues of significance to our clients and our industry by researching, writing, and participating in a variety of forums and projects, we will also be working with the University of Cambridge Programme for Sustainability Leadership and their new Investment Leadership Group. This relationship will allow us to contribute to, and learn from, other leading institutional investors and academics on a range of important market issues and how future ESG issues may impact and influence our investment performance.

We will continue to actively support a range of industry and other initiatives related to RI, as well as focus on greater collaboration between industry groups. This work should help identify gaps in addressing key issues and support other industry groups in the pursuit of common interests.

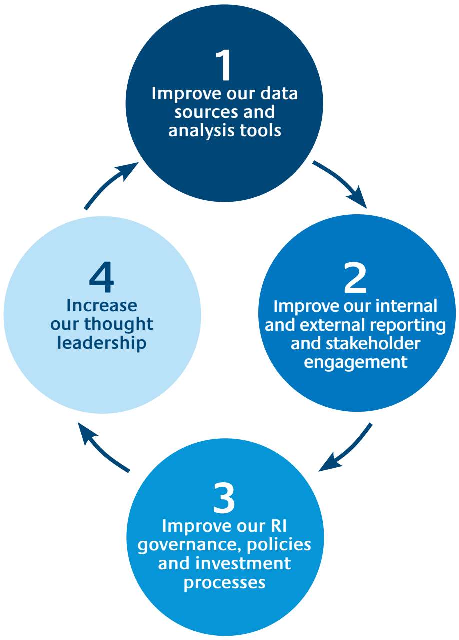
Our approach to RI will also influence our product development and management processes. As our clients increasingly take an interest in our approach to RI and our assessment and evaluation of ESG factors, we will aim to consider the effect of these factors when assessing the performance of existing products and in the development of new products.

We will aim to adopt the highest standards of stewardship on behalf of our clients' interests globally and be at the forefront of emerging best practice in this area.

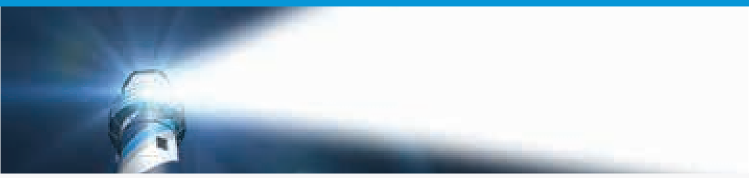
Our goals for 2013

In order to measure our progress towards implementing our strategy over the following three years we have set ourselves a number of goals for 2013. We will confirm our achievements of these goals on our website as they occur and will describe how their implementation has enhanced our business in next year's RI Report.

Strategic pillars – focused on good governance, engagement, quality and stewardship – guide our goal setting and prioritisation. By building on our existing platform we are committed to delivering changes in 2013 which will:



Goal	How will this contribute to our strategic priorities?
Establish the Global Responsible Investment Committee	Improve our RI governance, policies and investment processes
Review of policies and position statements	Improve our RI governance, policies and investment processes
Enhance our ESG data services and IT infrastructure	Improve our data sources and analysis tools Improve our internal and external reporting and stakeholder engagement Improve our RI governance, policies and investment processes
Integrate RI into product development process	Improve our RI governance, policies and investment processes
Contribute to Cambridge University Investment Leaders Group	Increase our thought leadership and RI brand



Integration team highlights

In the following pages you will find an RI 'snapshot' for each of our investment teams[2]. While the integration of ESG factors into our investment decision-making and ownership practices is the responsibility of everyone in the investment team, each team has an RI Representative. These individuals act as the main contact for the RI team, representing their team on the ESG risk committee, and communicating policy and other changes within the broader business or the industry. They are also responsible for reporting their team's progress to the Global RI Committee.

Our focus for the snapshots section this year has been to demystify RI by providing practical, process descriptions of how each team considers ESG risks and opportunities. In addition we have sought to provide examples and describe the issues which each team expects to be prevalent in 2013.

Each snapshot highlights:

The team

- Its size and location
- Its investment strategies
- Its investment head and RI representative

The team's approach to integrating ESG factors

- Approach and process for considering ESG factors
- ESG integration example where an ESG issues has altered a buy/sell/hold decision

The team's approach to company engagement

- Approach and process for engagement
- ESG engagement example

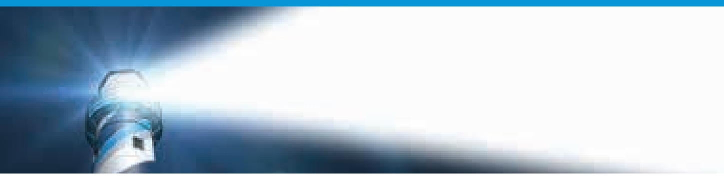
The team's approach to proxy voting (for equity teams only)

- Approach and process for proxy voting
- Proxy voting example
- Team proxy voting statistics on key issues

Key Issues for 2013

- The key ESG issues the teams will focus on in 2013

2. Real Index, Emerging Market Debt, Multi-Asset Solutions and Indonesian Equities have recently been introduced to the RI process. A case study on the Emerging Market Debt team's progress is provided in this report.



First State Stewart

> AUM	> Inception Date	> Team	> Location
US$52.6bn	1988	30	Edinburgh, Hong Kong, Singapore

Strategies:
Asia Pacific ex Japan, Emerging Markets, Frontier, Greater China, India, Latin America, Worldwide, Worldwide Sustainability

Managing Partner – First State Stewart
Stuart Paul

RI Representative
David Gait

KEY ISSUES FOR 2013

- Circular economy
- New measures of growth
- Tax avoidance by multi-national corporations
- Supply chain exploitation

First State Stewart is a trading name of First State Investment Management (UK) Limited, First State Investments International Limited and First State Investments (UK) Limited ("First State Stewart").

The First State Stewart team manages a range of Asia Pacific, Global Emerging Market and Worldwide Equity funds.

The team's approach to integrating ESG factors

Since the launch of First State Stewart's first product in 1988, sustainable investment has always been an integral part of the team's investment philosophy and stock-picking process. Our investment process and consideration of ESG issues continues to evolve but at its heart includes the following components:

- When assessing companies for investment the team performs a detailed assessment of the quality of management, financials and the franchise. We see a company's approach to ESG issues as a good proxy for all of these factors.
- We also have a strong focus on the sustainable positioning of company as we believe it plays an important role in determining long-term shareholder returns for all companies in emerging economies.
- The entire First State Stewart team meet regularly and thoroughly test each other's investment ideas during these meetings. This includes ESG issues for particular companies.
- We also have explicit sustainability strategies that have a greater focus on sustainable development themes. While offering their own discrete funds, the views and stock ideas of the Sustainability team are fully integrated across the whole First State Stewart team.

ESG integration example: GIANT

Listing: Taiwan

Market Cap: USD 2 billion

Shareholders since: February 2012

Company description: Established in 1972, Giant is one of the world's largest bike manufacturers in terms of revenue. The company has the number one position in China and is one of the top three brands in Europe and the US. Giant operates manufacturing bases in Taiwan, China and the Netherlands. The company manufactures under the Giant brand but also manufactures for Trek and Specialized.

Investment rationale: Excellent track record of execution both in the original equipment manufacturer (OEM) business and development of its own brand, there is a good history of paying dividends and the company has the long-term backing of the Liu family. The long-term stewardship approach of the family gives us confidence in the quality of management. We also see long-term sustainability tailwinds for a company that manufactures bikes as people opt for healthier lifestyles and commuting (Giant is also leading in the development of Electric Bikes). This gives us confidence in the ESG credentials of the franchise.

Risks: Raw material costs are outside the company's control and these are driven by sustainability factors globally. However saying that, Giant has done a good job of growing operating margins over the years despite the volatility. This gives us greater confidence in the quality of the financials.

Engagement issues: We have asked Giant to improve its ESG reporting and transparency. We seek to understand the impacts of recyclability requirements and collaborative consumption i.e. how people sharing and renting bikes is likely to impact the company's growth.

The team's approach to company engagement

We engage on a wide range of issues including strategy, governance, alignment of interests and reputation. We engage for two reasons:

1. We believe that the purchase of a share in a business comes with both rights and responsibilities. Should one of our companies fail to meet international best practices on the environment, human rights or social issues, we believe we have a responsibility, as part owners of the business, to engage with senior management to persuade them to address the issue, rather than to walk away from the problem.
2. We see ESG issues as investment issues. Positive engagement on ESG issues becomes a powerful tool in driving shareholder value and protecting and enhancing the value of our portfolios.

Our engagement takes many different forms, from face-to-face meetings to informal emails to formal written correspondence. In total we make direct contact with over 1,000 companies per year.

We find it much more productive to engage with management teams with whom we already have a good relationship. As a result, perhaps the most important part of our engagement process is to establish rapport with management teams ahead of any engagement. One of the best ways we have found of doing this is to write thank you letters after our meetings, reiterating our appreciation for the meeting and reminding management of our long-term approach and expectations as shareholders.

Fundamentally the engagement always needs to be two-way. It's critical that we listen to companies and truly understand the challenges they are facing, as well as effectively communicating our expectations as investors.

ESG engagement example:

An area we engaged on during the year was the use of toxic chemicals in personal care products. We read some rather alarming articles about links to all kinds of nasty health impacts of substances with unpronounceable names like Diethanolamine, Imidazolidinyl, Monoethanolamine and Triethanolamine.

We wrote to Amore Pacific (Korea), Natura (Brazil) and Beiersdorf (Germany) to try and get a better understanding of their approach and also encourage transparency and dialogue with consumers. As is often the case, the quality of the response was telling. Natura was by far the most impressive in its demonstration of consideration and leadership on these issues. The company provided extensive detail, but one specific example it outlined was in relation to Triclosan (an antibacterial ingredient that is widely used in personal care products). Natura acted proactively by eliminating its use from its new formulations since 2008 because of the potentially harmful effects on the environment and human health.

The team's approach to proxy voting

As long-term shareholders, we are also active owners of the companies in which we invest on behalf of our clients. We therefore aim to vote on all resolutions at annual and extraordinary general meetings. The majority of resolutions we vote against relate to management remuneration, minority shareholder rights and board directorships. We rarely see environmental or social issues appear on the ballot papers.

All resolutions are reviewed with recommendations made by the relevant analyst. Each portfolio manager has ultimate discretion on voting decisions for their portfolios with controversial issues discussed at regular team meetings.

Proxy voting example:

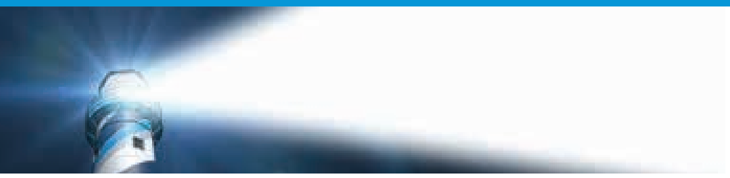
Retrospectively shifting the goal posts to improve the outcomes of executive remuneration is starting to emerge as a serious concern for the team. In 2012 we witnessed one company change accounting treatment and another removed the impact of a product recall in the calculation of performance for the purposes of remuneration payments.

In both instances we engaged the Board but failed to convince them to change their minds, at least this time. This then influenced how we voted on the resolutions relating to remuneration.

In our view it is the board's role to ensure there is alignment with shareholders over the long-term and that management share in both the up and the down times for the company. Too often the sharing only seems to be on the way up! While it is sometimes challenging to engage companies on remuneration, given it is potentially perceived as a personal attack on management, we believe we need to have these harder conversations on behalf of our clients.

Team Proxy Voting Statistics

	Total Resolutions	Voted in favour %	Voted against %	Votes Abstained %
All	6,030	91.7%	8.2%	0.1%
Director elections	1,996	94.5%	5.4%	0.1%
Compensation Related resolutions (executive)	139	86.3%	13.7%	0.0%
Shareholder proposals	28	35.7%	64.3%	0.0%



Global Listed Infrastructure Securities

> AUM	> Inception Date	> Team	> Location
US$1.5bn	2007	8	Sydney

Strategies
Global Listed Infrastructure Securities

Head of Global Listed Infrastructure Securities
Peter Meany

RI Representative
Rebecca Sherlock

KEY ISSUES FOR 2013

- In a low interest rate environment there is increased pressure on regulators to reduce the returns provided to utilities. Companies that can demonstrate strong customer satisfaction and continued improvement in operating statistics are more likely to be treated leniently than companies requesting rate increases while delivering inadequate service levels.
- In an environment of low organic growth, low interest rates and deleveraged balance sheets, we believe that capital discipline will be a key issue to watch in 2013. We want management teams to remain disciplined in their approach to M&A, maintaining shareholder value as their primary focus.

The team's approach to integrating ESG factors

ESG analysis is integrated into our investment process through the team's quality ranking model. The quality ranking model consists of 25 criteria that influence stock returns in general and infrastructure securities in particular. A score is assigned to each criterion, with ESG issues accounting for 20% of the overall quality score. A lower quality score makes it less likely that a stock would be included within the overall portfolio.

When assessing ESG factors we consider a wide range of information, based primarily on the analyst's due diligence and then on external sources of information. In determining the quality score, various statistics will be considered such as independence of the board, executive compensation, carbon intensity of integrated utilities etc.

ESG integration example:

SP Ausnet, an Australian regulated utility, has an external management structure between itself and SPI Management Services. We believe that this structure is not appropriate since SPI Management Services is a wholly owned subsidiary of SP Ausnet's largest shareholder, Singapore Power Limited.

While this structure has previously been common among infrastructure securities, the externalised management structure used by SP Ausnet has progressively been abandoned due to the difficulty in managing inherent conflicts of interest brought about by related party transactions, and the structure's poor record of value delivery for shareholders.

We penalised the company for this structure through the governance section of our quality score and we have written to the board to express our view as active shareholders.

The team's approach to company engagement

Company engagement on ESG issues is primarily carried out on a direct basis with company management, and indirectly via the team's proxy voting process.

We engage companies on material issues to achieve specific outcomes; namely to ensure good ESG practices and thereby protect investor interests.

ESG engagement example:

Italian toll road operator Atlantia SpA has recently announced its intention to merge with Rome airport owner Gemina SpA. We believe that elements of this process, notably Atlantia's public disclosure that it was looking at a listed company, were not conducted with the best interests of Atlantia's shareholders at heart. We have decided to take action and will be formally voicing our objections in writing to Atlantia's Board.

The team's approach to proxy voting

Proxy votes are initially assessed by the relevant analyst.

Analysts draw on their own experience of the company along with advice from CGI Glass Lewis.

Proxy votes are than signed off by the Head of Global Listed Infrastructure Securities, or the senior portfolio manager.

We log reasons for all instances where we vote against management or against proxy advisors, CGI Glass Lewis' recommendations.

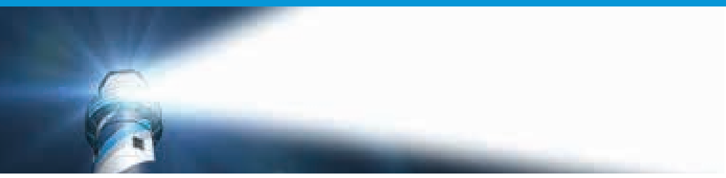
Contentious issues are discussed within the team and with the RI team. In some instances we will seek to engage with clients, our proxy advisors and other shareholders to better inform our views.

Proxy voting examples

We recently voted against the election of the Chairman of Atmos Energy, a US regulated utility. The Chairman is the ex CEO who, while in office, had a joint CEO/Chairman role and acquired other regulated assets at premium valuations which added little to shareholder value.

Team Proxy Voting Statistics

	Total Resolutions	Voted in favour %	Voted against %	Votes Abstained %
All	627	82.3%	17.7%	0.0%
Director elections	347	80.1%	19.9%	0.0%
Compensation Related resolutions (executive)	32	75.0%	25.0%	0.0%
Shareholder proposals	33	69.7%	30.3%	0.0%



Global Equities

> AUM	> Inception Date	> Team	> Location
US$2.7bn	2004	10	London

Strategies
Global Equities, Global Equities Market Neutral (long/short), Concentrated Global Equities and EAFE Equities.

Head of Global Equities
Habib Subjally

RI Representative
Benjamin Yeoh

KEY ISSUES FOR 2013

We expect the following issues to feature and intend to focus on these in our engagement activities:

- Corporate governance, reporting on key indicators and executive remuneration and workforce incentives. Ensuring that senior management's compensation programmes are aligned with the long-term interests of shareholders.
- Bribery and corruption due to the UK bribery laws and US regulations especially for companies doing business in emerging markets.
- For many companies supply chain auditing and concerns, especially in consumer orientated businesses.

The team's approach to integrating ESG factors

We maintain a bottom up approach to identifying key ESG risks, primarily using internal analysis supplemented by external research.

The team is made up of seven industry specialists that have extensive expertise in their chosen fields. We believe that this makes them better at identifying and evaluating ESG risks.

Our industry experts assess company performance based on peer comparison of key performance indicators for the sector, the achievement of stated targets and an assessment of management and corporate governance.

We rate management and ESG on a 1 to 5 scale from excellent to poor. A score of 4 or 5 means the company is deemed uninvestable. A high score adds positively to the overall company assessment.

We both positively and negatively screen the investment universe for high and poor ESG performers. This identifies companies which might be good investments and prompts us to engage or re-assess companies we own which might have concerns.

ESG integration example:

A consumer retail company with a global footprint was assessed as having excessive and inappropriate executive remuneration. We also held concerns over management structures and the company's operational execution.

Our discussions with the company and assessment of its failure to employ best practice management incentives and structures (in particular there is no strong lead independent director to challenge the CEO/Chairman role) led us to believe that the company was not being managed as effectively as it could be.

Execution failures and below average ESG disclosures prompted us to divest the shareholding in this company.

The team's approach to company engagement

We engage with all companies we are invested in on material ESG issues. These are identified through our consideration of ESG risks from our own analysis and screens using external data.

We try to gain comfort that the company's senior management and board are aware of, and accountable for, material issues.

Our first port of call will generally be to raise our concerns with management and, potentially, other directors.

Where we feel material issues are not being appropriately addressed, we will work with the RI team to develop an engagement strategy for the issue. This can flow into our proxy voting and investment decisions.

ESG engagement example:

We were concerned at merger talks between two large, global resource companies and the management incentive package being proposed.

These incentives were not appropriately linked to performance and were to be awarded in cash. We met with the CEOs of the two businesses and one of the Chairmen in three separate face-to-face meetings to discuss the merger terms and communicate our objections to the proposed management remuneration/ retention package.

Ultimately, the Board partially amended this incentive scheme. More than 78% of one of the company's voting shareholders voted against the proposed retention packages.

The team's approach to proxy voting

All proxy votes are initially assessed by the relevant industry specialist. We examine stock option programmes and executive remuneration as part of this analysis.

Industry specialists draw on their own experience of the company along with advice from CGI Glass Lewis.

Votes against management or CGI Glass Lewis are discussed with the Head of Global Equities or the RI representative.

We log reasons for all instances where we vote against management or against CGI Glass Lewis' recommendations.

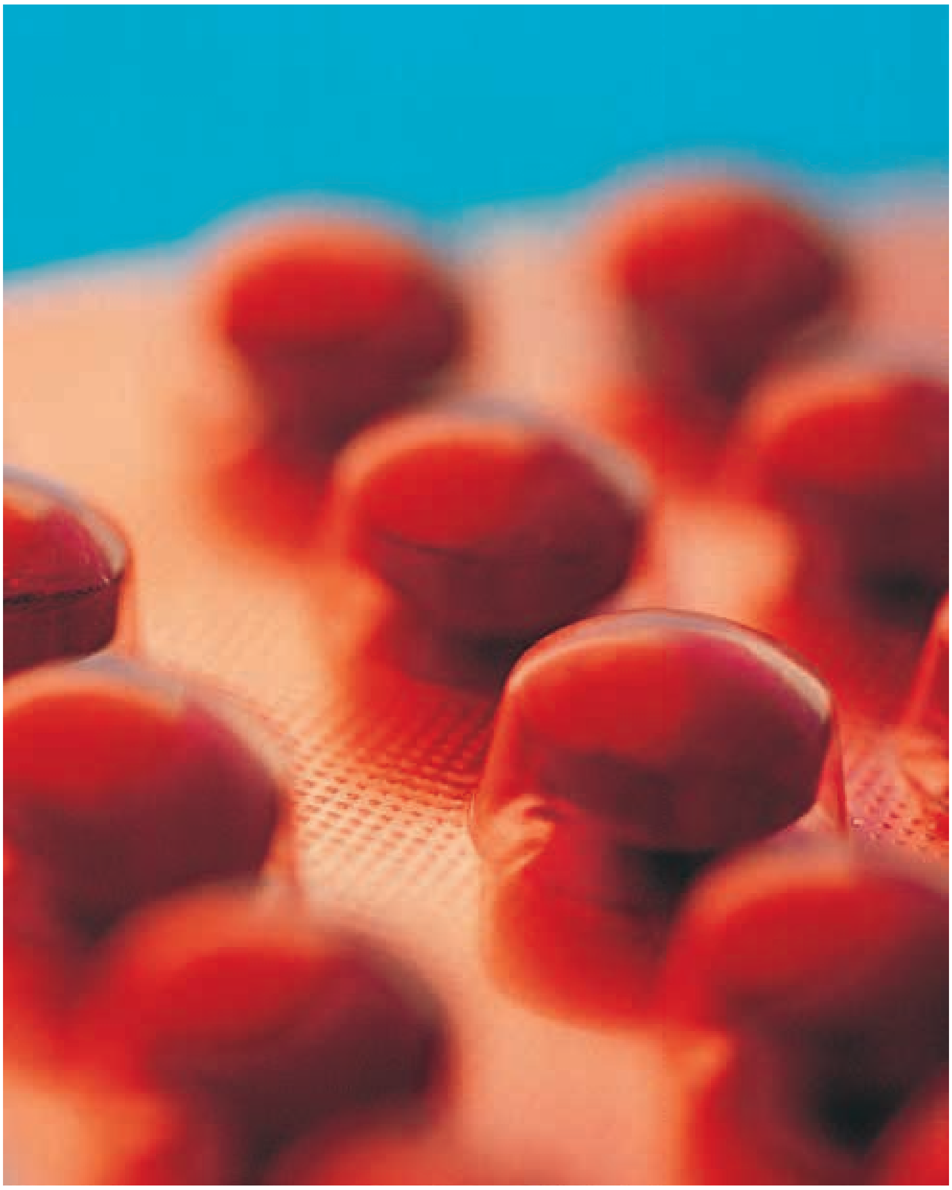
Contentious issues are discussed within the team. When not readily agreed upon, we engage with the RI team.

In some instances we will seek to engage with clients, our proxy advisors and other shareholders to better inform our views.

Proxy voting examples

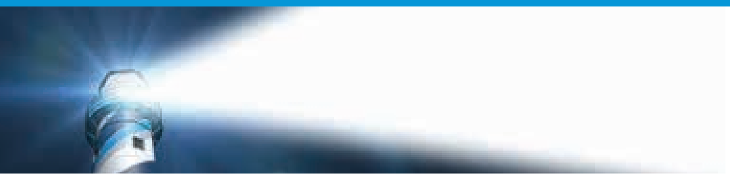
For Incyte, a pharmaceutical manufacturer, we voted for the stock incentive programme, despite CGI Glass Lewis advising an 'against' vote. We did this because the CGI Glass Lewis calculations were not as complete as our own and had not accounted for relevant biotechnology peers. The company also had been very successful in having its lead product approved and has very low staff turnover; the stock incentive being a key reason for the low staff turnover rate. We did not believe the plan was excessive.

We voted against the remuneration report for Abercrombie & Fitch. The incentive plan was poor and we believed the CEO remuneration was excessive, particularly considering recent management performance.



Team Proxy Voting Statistics

	Total Resolutions	Voted in favour %	Voted against %	Votes Abstained %
All	1,895	92.8%	7.1%	0.2%
Director elections	1,035	95.7%	4.3%	0.0%
Compensation Related resolutions (executive)	156	89.7%	10.3%	0.0%
Shareholder proposals	76	44.7%	53.9	1.3%



Global Listed Property Securities

> AUM	> Inception Date	> Team	> Location
US$3.6bn	1994	11	Sydney, New York, London, Hong Kong, Amsterdam

Strategies

Global portfolios hedged into AUD, GBP and USD, Asia Pacific portfolios hedged into GBP and USD, Australian REITs, Australian REITs Opportunities, European REITs.

Head of Global Listed Property Securities
Stephen Hayes

RI Representative
Joseph Daguio

KEY ISSUES FOR 2013

- High standards of corporate governance are consistently important to the team and we will maintain a disciplined and focused approach to this issue.
- In the face of concern about climate change, property companies are designing and constructing increasingly environmentally-friendly buildings; a trend which we believe is set to continue.

The team's approach to integrating ESG factors

The initial screening stage of the investment process contains an ESG rating. This is where a company's ESG policies are considered. Corporate governance is a particular focus, where boards' independence as well as shareholder rights are of paramount importance.

We also consider any specific sustainability initiatives implemented by the company as well as the environmental impact of existing assets and developments. We take into account a company's history as a good corporate citizen and look for evidence of any meaningful contributions it might have made which benefit society as a whole.

A low score (in combination with low scores on other factors) can lead to a stock being excluded from the investment universe and hence ineligible to be considered for inclusion within our portfolios.

ESG factors are considered in the Capital Asset Pricing Model (CAPM) in the valuation stage of the investment process. A company's ESG profile is included as one of the variables used in determining its beta. This means that the higher the team rates a company's ESG profile, the more likely we are to invest in the stock.

ESG integration example:

We have held concerns regarding poor corporate governance at Citycon Oyj, where there is a lack of independent directors on the board. We believe that this issue of board quality constitutes a significant risk for our clients. This resulted in Citycon being awarded the lowest possible ESG rating under our stock screening process. The company currently fails to meet the minimum score required to be included in our defined screen and thus falls outside our investable universe.

The team's approach to company engagement

The team is a firm believer in investor rights and takes a proactive stance on ESG issues, especially with regard to corporate governance.

Communication with CEOs and boards of directors are undertaken where it is deemed appropriate in order to influence and to enforce change.

ESG engagement example:

Primaris, a retail real estate investment trust, received a C$26 per share unsolicited cash buyout by KingSett Capital in December 2012. The Primaris board initiated a formal sale process and in January 2013 entered into an agreement with another party, H&R, to sell itself for $26.80 on a script and part cash basis. The merger agreement included a large break fee to H&R.

We were disappointed that the board entered into a merger agreement with a large break fee and accepted an offer at such a small premium to KingSett's original, all cash offer.

The team engaged the Board and management, meeting with them privately to outline our concerns of the merger agreement and the poor corporate governance shown by the group.

Following this meeting we were unsatisfied with management's justification of its decision and began selling down our portfolios' holdings in the stock. Subsequently, H&R increased its bid under the merger agreement.

The team's approach to proxy voting

The Global Head of Property Securities and each analyst are responsible for the review of proxy votes and the decision.

Third party research providers are used to guide the decision, but we are not obliged to follow the underlying recommendation.

The Global Head of Property Securities and each analyst will base their decision on what is in the best interest of our investors.

If the team decides to vote against third party recommendations, a detailed explanation of the reasons for this must be provided and documented.

The same process is followed when dealing with contentious issues.

Proxy voting example:

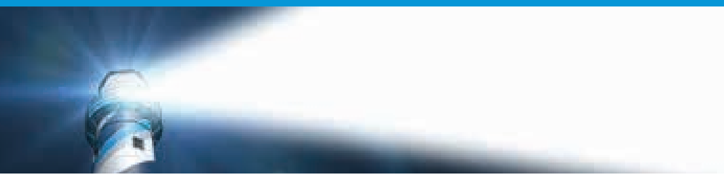
We voted 'against' the re-election of James MacKenzie as the Chairman of Mirvac Group, a view which was inconsistent with the recommendation of CGI Glass Lewis.

We have had concerns about Mr MacKenzie's independence. At times, we believe he has exerted control over management which was beyond the scope of his duties. This has affected the overall independence of the Board.

In spite of our vote, the resolution was ultimately passed and Mr MacKenzie was re-elected as Chairman.

Team Proxy Voting Statistics

	Total Resolutions	Voted in favour %	Voted against %	Votes Abstained %
All	1,258	87.8%	11.7%	0.5%
Director elections	546	88.8%	10.8%	0.4%
Compensation Related resolutions (executive)	76	82.9%	17.1%	0.0%
Shareholder proposals	1	0.0%	100.0%	0.0%



Australian Equities Growth

> AUM	> Inception Date	> Team	> Location
US$11.2bn	1989	13	Sydney

Strategies
Australian Equities, Growth, Imputation, Long Short, Small-mid Cap, Micro-Cap

Head of Australian Equities, Growth
Marcus Fanning

RI Representative
Sheridan Knott

KEY ISSUES FOR 2013

- We expect environmental issues regarding coal seam gas and liquefied natural gas projects to be a continuing area of focus in 2013.
- There will continue to be a broad level of focus on board governance; particularly with respect to remuneration, environmental scrutiny, and social issues in the area of employment.

The team's approach to integrating ESG factors

Our process uses a fundamental, bottom-up analytical framework, developed internally with proprietary analysis templates to assess the investment universe. ESG risks are used predominantly as factors that may place business value at risk.

Companies at risk are identified using both external providers and our own internally driven research, which is based on a rigorous company meeting programme.

Identified risk factors are used to assist in developing the quantitative and qualitative assumptions used by analysts in their assessment of industries and stocks.

Analysis is vigorously stress tested and screened under a peer review process. This process seeks to highlight the analyst and team's conviction in the target price and recommendation.

Additionally, we assess how companies are managing ESG issues and encourage the entities in which we invest to improve their ESG performance and disclosure.

ESG integration example:

Intrepid Mines is a precious metals development and exploration company with operations largely based in Indonesia. The company's main project is operated in what we now know is a very complicated alliance.

This stock was held in one of our Small Companies portfolios at a share price of $1.50.

Our regular company contact revealed a potential governance issue that was exposed through separate discussions with the Chairman and CEO. Their disparate views on the timeframe for development and details of the tenements raised some red flags.

We engaged the RI team to conduct independent research, which concluded that the company was likely to experience issues with the ownership of the mining license and its alliance partner. Adjusting our valuation for this risk, the share price exceeded the valuation and we exited the stock. These issues continue to pervade the stock and other governance issues have since arisen. The stock now trades at around $0.20.

The team's approach to company engagement

The Australian Equities, Growth team has active direct dialogues with many Chairpersons and/or company management on material ESG issues which we identify through our consideration of ESG risks.

We try to gain comfort that the company's senior management and board are aware of, and accountable for, the management of material issues.

Where we feel material issues are not being appropriately addressed we will work with the RI team to develop an engagement strategy for the issue. This can flow into our proxy voting and investment decisions.

ESG engagement example:

We were concerned about the base level of remuneration of the MD/executives at a listed media company given the size of the company. The team engaged the Chairman in remuneration discussions and followed up with a meeting with the Head of the Remuneration Committee on the Board to discuss the establishment of new guidelines for performance hurdles for the FY14 year.

Key issues for discussion included:

- Instigation of performance gateways for performance
- Return On Equity/Return On Assets targets as well as Total Shareholder Return metrics
- Greater focus on Long Term Incentives as the business is being restructured.

Following this consultation the company established a remuneration structure that ensured a focus on long-term outcomes for shareholders.

The team's approach to proxy voting

The Head of Australian Equities, Growth is responsible for ensuring that all company resolutions are reviewed and an appropriate recommendation is made in line with the corporate governance guidelines and principles.

The team votes on all issues at company meetings where we have the authority to do so. The exercising of the voting rights is always in the best interests of our investors and clients.

Responsibility for voting rests with analysts, who pass on the information to portfolio managers. Where the analyst opinion differs from that of our third party proxy voting consultants, the analyst is required to document their view and consult the Head of Australian Equities, Growth and the Chief Investment Officer.

In cases where the resolution may be contentious in nature, a more detailed explanation as to the reasons for the voting intention is to be outlined. Examples of contentious issues are executive remuneration packages or the appointment of non-independent directors.

Proxy voting examples

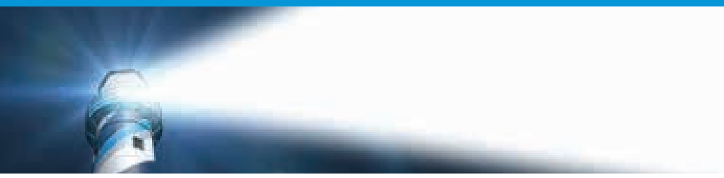
Billabong International – We voted 'against' the election of directors and remuneration. We do not believe the directors in question have acted in the best interest of shareholders and are not independent. Poor performance of the group and relative size of the business does not reflect the size of the remuneration being solicited.

Fairfax Media – We voted in line with CGI Glass Lewis' 'for' recommendation on remuneration, despite originally considering the base remuneration excessive for a company of this size. However, after discussion with the Chairman this decision was reviewed given the turnaround the company was trying to deliver in a tough advertising environment.

Woolworths – We voted 'against' the shareholder proposal regarding electronic gaming, which was raised at the EGM. We are satisfied that the company has implemented certain measures aimed at mitigating risk to problem gamblers and any further imposition would place the company at a significant competitive disadvantage.

Team Proxy Voting Statistics

	Total Resolutions	Voted in favour %	Voted against %	Votes Abstained %
All	959	92.1%	7.8%	0.1%
Director elections	436	93.1%	6.9%	0.0%
Compensation Related resolutions (executive)	273	91.9%	8.1%	0.0%
Shareholder proposals	5	60.0%	40.0%	0.0%



Australian Equities Core

> AUM	> Inception Date	> Team	> Location
US$10.0bn	1993	19	Sydney

Strategies
Australian Equities, Long Short, Tax Aware, Equity Income, Geared, Indexed, Small Companies, Small Companies Long Short

Head of Australian Equities, Core
Matthew Reynolds

RI Representative
Jewel Bennett

KEY ISSUES FOR 2013

We expect the following issues to feature and intend to focus on these in our engagement activities:

- Executive remuneration
- Corporate governance
- Issues relating to staffing and safety
- Supply chain as related to social and environmental issues.

The team's approach to integrating ESG factors

The Australian Equities, Core team has adopted a bottom up approach to identifying key ESG risks. Our own internal analysis is supplemented by company disclosures, media and external research.

A consideration of a company's sustainability and governance policies and practices is an explicit part of the stock research process. This research feeds into the team's overall view of the company in a similar way to traditional financial analysis.

Australian Equities, Core analysts consider ESG and sustainability issues as one of the six factors in the stock research and selection process. The other factors are Management, Industry Position, Valuation, Market Factors and Financials.

Where ESG and sustainability factors are determined to have an impact on profitability, they are quantified and implied in all other factors, most directly in the valuation and financials of the stock.

ESG integration example:

Maintaining the right board structure and an appropriate mix of skills and experience among executives is crucial for a company to achieve its strategic objectives. It is therefore imperative for boards to develop and maintain well-considered succession plans for key individuals to avoid disruption due to unexpected departures of board members, executives or employees in other senior operational management roles.

Our ongoing dialogue with one particular company during 2012 suggested that the board was not preparing thoroughly enough for a possible change in a key executive position. In this case we were concerned that changes on the board could divert attention from delivering on the company's stated objectives. Investment in this company was subsequently reduced across our range of Australian Equities, Core portfolios. This move reflected concerns that the changes could affect the company's performance and, ultimately, impede shareholder returns.

The team's approach to company engagement

Consideration of ESG issues and engagement on material issues is undertaken with all companies within the investment universe.

We typically complete more than 2,000 company visits annually. We therefore have ample opportunity to engage companies on key issues and follow up where required.

As part of our stock research process, analysts attempt to gain comfort in the ability of a company's board, as well as its executive and operational management teams. The company's awareness and accountability around ESG risks and opportunities forms a key part of this assessment.

Where we feel material issues are not being appropriately addressed by a company, we will discuss these issues with management and board members as the first element of the engagement strategy. Subsequent engagement with companies may involve the specialist RI team.

The outcomes of our engagement with companies flows through to proxy voting and, ultimately, to investment decisions.

ESG engagement example:

An energy company in which Australian Equities, Core funds invest acquired a brown coal-fired power station during the year. This acquisition increased the company's carbon intensity and resulted in some adverse press coverage and concern among investors. As part of our ongoing engagement with management, we visited the company to discuss and assess implications of this move.

Rather than consider the acquisition purely on environmental grounds, we were interested in assessing whether management was fully aware of, and able to manage the associated risks of the move. Potential financial implications of future changes in carbon pricing were also discussed in detail.

This particular company is aware of the implications of a carbon pricing scheme. The company remains committed to investing in renewable energy solutions. Open dialogue and engagement with the company during this potentially challenging period enabled us to fully assess the risks associated with the acquisition. Ultimately we were satisfied that management would be able to appropriately manage the risks associated with the acquisition and investment in the company was maintained.

The team's approach to proxy voting

The Head of Australian Equities, Core delegates the assessment of issues surrounding the voting of a company's resolutions to the analyst responsible for coverage of the stock.

In making this assessment, analysts follow FSI's voting guidelines, draw on their own experience of the company and take into consideration comments from proxy advisers CGI Glass Lewis and Ownership Matters.

Proxy votes are approved by the Head of Australian Equities, Core.

All instances where we do not vote in line with the Board's recommendation are recorded. We will also comment where we do not agree with the recommendation of the proxy advisers.

Contentious issues are discussed within the team and with the RI team. In some instances we will seek to engage with clients, our proxy advisors and other shareholders to better inform our views.

Proxy voting example:

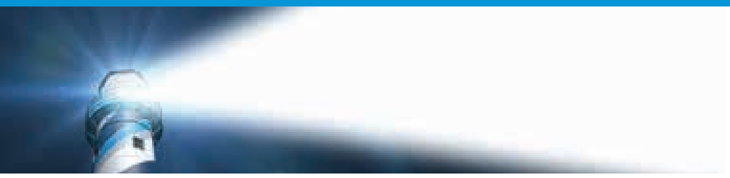
We believe boards that have a majority of independent directors tend to act in the best interests of minority shareholders. As a result, we do not favour board structures which do not have sufficient independent representation and will formally express our views through proxy voting where this is not the case.

During 2012 we voted against the re-election of three Directors at Southern Cross Media Group, including the Non-Executive Chairman. These Board members are affiliated Directors on a Board that is not majority independent.

Two of the Directors are also members of the company's remuneration and nomination committee and one served on the audit committee. We note that neither of these committees are majority independent.

Team Proxy Voting Statistics

	Total Resolutions	Voted in favour %	Voted against %	Votes Abstained %
All	398	95.2%	4.8%	0.0%
Director elections	197	96.4%	3.6%	0.0%
Compensation Related resolutions (executive)	107	95.3%	4.7%	0.0%
Shareholder proposals	5	40.0%	60.0%	0.0%



Global Resources

> AUM	> Inception Date	> Team	> Location
US$3.5bn	1997	11	Sydney, London

Strategies
Global Resources, Global Resources Long/Short, Global Soft Commodities

Head of Global Resources
Dr. Joanne Warner

RI Representative
Rupert Cole

KEY ISSUES FOR 2013

We will continue to focus our engagement activities on:

- Executive remuneration (ensuring it is aligned with shareholders' interests)
- Environmental practices
- Safety
- Corporate governance
- Community engagement.

The team's approach to integrating ESG factors

ESG issues are particularly pertinent for natural resources companies due to the nature of the industry and the countries in which they operate.

We recognise that many resources companies actively seek to deliver community benefits such as employment, education and infrastructure while operating to the highest environmental standards. We expect a genuine commitment to these high standards. We avoid investing in companies who cannot demonstrate that they meet these standards or who are not making clear progress towards meeting them in the context of their operating environment.

Site visits and management meetings are a key component to help us understand the exposure and management of ESG risks and companies' ESG practices. These include environmental, safety and corporate governance practices and local community engagement.

The team has developed a tailored ESG framework that is part of the company review process. When an analyst reviews a resource company, an ESG review is also completed.

We supplement the primary research undertaken by our experienced analyst team with externally sourced research and data to continually monitor company performance.

For diversified mining companies we consider the overall performance of the company and consider the materiality of different issues in our overall assessment.

The Global Resources team believes the consideration of ESG issues will lead to better risk/return outcomes for our funds, which will ultimately improve long-term returns for our clients.

ESG integration example:

An Australian based gold producer with a poor safety record experienced three fatalities in October 2010.

The deaths were not disclosed to the market. As production guidance was not affected, the company asserted that the event did not qualify as a significant event requiring disclosure.

We held a one-on-one meeting with management. We did not consider management to be forthcoming on its safety record or on the changes being made to improve on-site safety.

Our analyst undertook a site visit and observed lax safety standards and poor housekeeping.

Following our site visit we chose not to invest until site safety significantly improved.

The team's approach to company engagement

We engage with all companies we are invested in on material ESG issues. The team seeks to highlight areas for potential improvement, encourage disclosure on ESG issues, and commend companies that are making progress in this area.

Company engagement on ESG issues is primarily carried out on a direct basis with company management and indirectly via our proxy voting process.

Where management does not respond adequately to engagement, it may impact negatively on our assessment of the stock and could result in the team divesting its ownership.

ESG engagement example:

The board of a large, diversified mining company recommended its shareholders accept the conditions of a proposed merger from Company B.

The merger was contingent on 50% of shareholders voting for the Management Incentive Arrangements (MIA) which included cash payments to the CEO and senior employees of the target company over three and two year periods respectively.

There were no performance hurdles attached to the cash payments.

We were unhappy with the structure of the MIA. We believe remuneration should be linked to performance and should include a stock component, to align the interests of management and shareholders.

We met with the CEO of the target company and stated our position. We considered his response unsatisfactory and arranged a meeting with the non-executive Chairman.

As a result of our meetings we voted against the remuneration package.

Our approach to proxy voting

All proxy votes are initially assessed by the relevant analyst.

Analysts draw on their own experience of the company along with advice from CGI Glass Lewis

Proxy votes are signed off by the portfolio manager.

We log reasons for all instances where we vote against management or against CGI Glass Lewis' recommendations.

Contentious issues are discussed within the team and with the RI team. In some instances we will seek to engage with external subject matter experts, our proxy advisors and other shareholders to better inform our views.

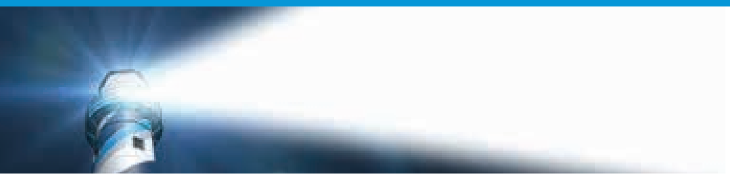
Proxy voting example:

We voted against the Remuneration Report for a particular company. The MD's high remuneration level relative to peers was a concern for us as the company has yet to establish cash flows. The MD also had a small equity position in the company, which is unusual for a small cap explorer, and indicated limited alignment with shareholders.

We voted against the Remuneration Report for another company. The company is still in an exploration/development phase and we accept that external performance measurements are currently not appropriate. Nevertheless, the Remuneration Report failed to adequately disclose the company's remuneration policies, including the relationship between company performance and remuneration. Additionally, the Remuneration Report failed to provide an adequate explanation on the short-term incentive component, including any maximums allowed.

Team Proxy Voting Statistics

	Total Resolutions	Voted in favour %	Voted against %	Votes Abstained %
All	2,828	94.2%	4.3%	1.4%
Director elections	1,633	85.3%	2.1%	0.9%
Compensation Related resolutions (executive)	191	85.3%	14.1%	0.5%
Shareholder proposals	40	37.5%	62.5%	0.0%



Direct Property

> AUM	> Inception Date	> Team	> Location
US$18.3bn	1996	950	Australia

Strategies
Direct Property

Managing Director, Property
Angus McNaughton

RI Representative
Rowan Griffin

KEY ISSUES FOR 2013

Short-term

- The role of our assets in the community
- Tenant engagement/management opportunities
- Indoor environment, occupant comfort and productivity impacts of sustainable/green buildings.

Long-term

- Moving towards integrated reporting and the ongoing analysis and addressing of stakeholder materiality issues
- Investigation of shared value as a business proposition.

The team's approach to integrating ESG factors

The philosophy is focused on long-term returns and stability; hence, ESG risks and opportunities are incorporated into all business processes and investment management decisions.

Full life-cycle consideration of ESG factors are included from asset acquisition and due diligence through active asset management, refurbishment, redevelopment and divestment.

Implementation is through the Direct Property Sustainability Policy, with a focus on:

- Environmental performance
- Social interaction, and
- Governance.

Environmental performance is benchmarked through industry tools, such as Green Star and NABERS ratings. All assets have targets set and are managed against these targets and benchmarks.

Our commitment to social outcomes is represented by our engagement with tenants, customers and the communities in which our assets are located. More formally, these are managed through our Green Lease Schedule and Tenant Engagement/Management Plans and a community framework.

Our funds are managed with a foundation of robust governance which is fundamental to protecting the long-term interests of our unitholders. We operate in a framework of various regulatory regimes which include: Managed Investment Scheme obligations, corporate law, stock exchange listing rules and the Corporate Governance Council's principles and recommendations.
We further draw on the strength of the Commonwealth Bank of Australia's (The Bank's) governance practices and regimes.

Our assets are managed according to our policies, and where managing agents are engaged they are trained in our policies and procedures.

ESG integration example

Our responsible property investment programme has resulted in real environmental efficiencies being achieved across the property portfolios we manage. In our Australian listed funds, we have achieved the following to 30 June 2012:

Commonwealth Property Office Fund (CPA)

- Saved enough energy to power 4,498 average Australian homes since FY07
- Saved enough water to fill 73 Olympic sized swimming pools since FY07
- Reduced our emissions by the equivalent of 11,747 A380 passenger trips around the world since FY07
- Diverted enough waste from landfill to fill over 865 standard metropolitan buses since FY10.

CFS Retail Property Trust Group (CFX)

- Saved enough energy to power 1,854 average Australian homes since FY08
- Reduced our emissions by the equivalent of 11,492 A380 passenger trips around the world since FY08
- Saved enough water to fill 247 Olympic-sized swimming pools since FY08
- Diverted enough waste from landfill to fill over 744 standard metropolitan buses over FY12.

The team's approach to stakeholder engagement

Engagement is represented in the continuous implementation and management of our Sustainability policy and strategy.

Internally, we are particularly focused on the environmental performance of assets we manage for our investors. Externally, we place significant emphasis on the satisfaction on our tenants and customers, ensuring that the properties we manage provide an environment that is conducive to undertaking business in a profitable and sustainable way. To assist we have a Green Lease Strategy and Green Lease Schedules in all of our office leases. This is accompanied by a Tenant Management/Engagement plan for all tenants within the office assets we manage.

We have a stakeholder engagement framework to determine the materiality of ESG issues, and we prioritise them for action. This is undertaken with regard to the AA1000 standard.

We engage with our supply chain through a Responsible Procurement Policy.

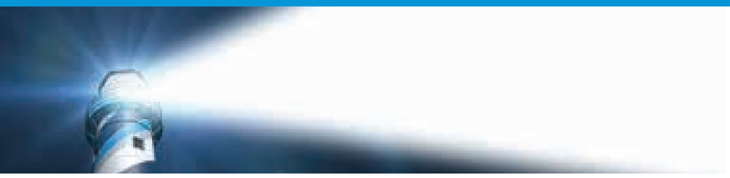
Stakeholder engagement example

In 2011, a pilot Green Lease Schedule (GLS) was developed for 201 Miller Street, North Sydney, Australia, an asset owned by the listed Commonwealth Property Office Fund (CPA) and managed within CFSGAM Property.

The GLS was designed to foster tenant engagement to improve an asset's sustainability performance. The 201 Miller Street asset was chosen to pilot the GLS because it had recently undergone major building upgrade works, had a variety of tenants and a short-term weighted average lease expiry profile.

The GLS encourages setting a NABERS Energy target for the tenant, which can vary from the owner's target, agreeing action items of the building environment management plan, and commits both landlord and tenant to a regular dialogue on concerns, difficulties, solutions and key learnings on the implementation of the GLS.

As a result of the success at 201 Miller Street, the GLS has been rolled out across the entire CPA portfolio. At 201 Miller Street, the take up rate for the GLS by tenants in new leases is now 85%.



Direct Infrastructure

> AUM	> Inception Date	> Team	> Location
US$3.3bn	1994	25	Sydney, London, Paris

Strategies
Unlisted Infrastructure

Head of Global Infrastructure
Perry Clausen

RI Representative
Mark Rogers

KEY ISSUES FOR 2013

We believe these are likely to be:

- Social licence to operate – regulated utilities, transportation and PFI projects are coming under increasing pressure and scrutiny in relation to taxation, financial structuring and the level of returns to investors. It will be critical for infrastructure investors to actively participate in discussions to ensure that the integrity of regulatory frameworks are maintained and that the public debate is balanced and informed.
- Low carbon transition – there is still considerable regulatory and political confusion around carbon schemes and carbon management in many countries. This spills over into existing renewable energy investment frameworks (ROCs, RETs etc.) and creates uncertainty that causes investors to retreat from the space.

The team's approach to integrating ESG factors

Our Unlisted Infrastructure team uses a risk and opportunity identification framework to ESG risks and opportunities in existing businesses and for potential new acquisitions.

This framework is called the Infrastructure Sustainability Rating ('ISR') Scheme, developed by the industry not-for-profit peak body – the Infrastructure Sustainability Council of Australia.

Several of our investment team members are formally trained and certified in the use of the ISR Scheme.

The ISR scheme is focused on innovation and continuous improvement to ensure that ESG risks and opportunities are managed in the most efficient way. The rating scheme can cover all infrastructure sectors and allows benchmarking within and across sectors.

The issue identification tool associated with the Scheme covers a number of themes and categories (please refer to the table below).

ESG integration examples

We assess resource use in minimisation projects to find business cases that bring benefits to individual infrastructure businesses and the portfolio.

These benefits include cost benefits to the business bottom line by decreasing energy and water use, carbon risk reduction by lowering the carbon footprint, and social licence benefits associated with undertaking such initiatives.

For example, we recently brought an investment proposal to the Board of our hospital car parking business to reduce the carbon footprint of the business via a capital expenditure programme on energy efficiency initiatives.

This proposal was undertaken in conjunction with Low Carbon Australia to ensure appropriate financing was in place to make the business case investable.

In another case we invested in a regulated electricity business that has launched a pilot programme which seeks to address capacity constraints by making better use of existing network infrastructure. The pilot is being partly funded by the UK energy regulator.

The project will help to keep the costs of energy down for customers on the network, thereby providing a broader community benefit and some value to the company's social licence to operate. Another expected benefit is the savings in embedded carbon costs of infrastructure not being built. This is the equivalent to the average annual emissions of approximately 27,778 Australians (or 675,000 tCO_2e).

Themes	Categories
Management and Governance	Management Systems Procurement and Purchasing Climate Change Adaption
Using Resources	Energy and Carbon Water Materials
Emissions, Pollution and Waste	Dischargers to Air, Land and Water Land Waste
Ecology	Ecology
People and Place	Community Health, Well-being and Safety Heritage Stakeholder Participation Urban and Landscape Design
Innovation	Innovation

The team's approach to company engagement

We take direct stakes in infrastructure businesses seeking at least one board seat at the holding company (controlling) level.

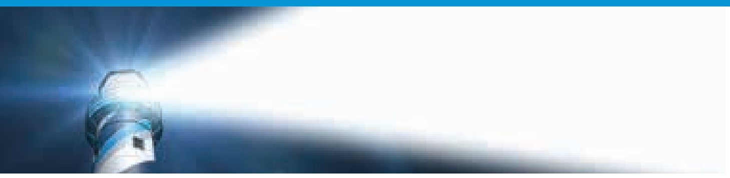
This allows direct governance of the business, the structure of the performance incentive mechanisms and the creation of an appropriate culture around each businesses approach to ESG risks and opportunities.

ESG engagement example:

Our regulated utility businesses today operates under performance scorecard systems that include key performance indicators such as gross operational carbon savings, provision of customer service levels and health and safety components. This ties executive remuneration to key ESG metrics and allows the Board to effectively set and monitor key ESG risk criteria and establish appropriate ESG culture via the remuneration structure.

Further, we actively promote that each board meeting sets aside time to discuss and assess ESG issues, risk and opportunities with the focus being on value protection and value creation within the business by better managing ESG issues.

Water management – water (abundance and scarcity) has increasingly become an important issue in the day to day operation of critical infrastructure assets. A renewed focus on water security and flood management (related to asset resilience) is expected in 2013 as companies' thoughts on these issues mature.



Global Fixed Interest and Credit

> AUM	> Inception Date	> Team	> Location
US$25.2bn	1986	25	Sydney, Singapore, Hong Kong, Jakarta

Strategies
Asian Fixed Interest, Australian Credit, Global Credit (A$ floating rate return basis), Global Credit (benchmark return comparison), High Yield Credit, Australian Sovereign, Diversified Fixed Interest, Global Sovereign, Inflation-Linked Bonds and Emerging Market Fixed Interest

Head of Global Fixed Interest and Credit
Tony Adams

RI Representative
Yen Wong

KEY ISSUES FOR 2013

- We expect environmental issues regarding coal seam gas and liquefied natural gas projects to be a continuing area of focus in 2013.
- There will continue to a broad level of focus on board governance; particularly with respect to remuneration, environmental scrutiny, and social issues in the area of employment.

The team's approach to integrating ESG factors

For credit and fixed income investments, ESG issues are very focused on downside risks. Bond investors are primarily interested in the risks of default and the ability to recover losses.

To identify key ESG risks we use customised ESG rankings as a starting point for assessments. Our analysts consider these alongside their own research with reference to a variety of other external sources.

This leads to each issuer being rated on a 1 to 5 scale, from very low to very high risks based on the adjusted rankings. This risk is factored into the internal credit rating (ICR) for every security we assess.

The weighting of ESG risks in the overall ICR is not predefined and can represent anywhere from 0% to 100% of the reason for the ICR, depending on the level of risk.

Our ICR can be significantly different to ratings by the rating agencies because it reflects risks (including ESG risks) that may not be considered by rating agencies.

The ICR is used by all portfolio managers when making their decision to buy or sell bonds, and to determine position size for the funds we manage.

Additional portfolio risk constraints, including how much of an individual security can be held, are based off the ICR. As a result, high ESG risks are both implicitly and explicitly managed throughout the investment process.

ESG integration examples

We recently assessed a Chinese railway tracks construction company as having high exposure to bribery and corruption, as well as safety issues. Our initial research and also discussion with one of FSI's equity teams indicated that the company is corrupt.

In addition, major rail projects are developed by the Ministry of Railways. This entity is also the regulator, which we believe contributes to the potential for corruption.

Despite the company's very strong government support and favourable market position, the corruption issues as well as inherent conflict of interest (company and regulator) meant that we rated the issuer substantially lower than the rating agencies and chose not to invest.

Allegations of indecent assault by the Chairman of a medium sized Chinese property developer resulted in a review of the credit in the last quarter of 2012.

The rating outlook was revised to negative on the reassessment of the company's ESG risk because of the alleged misconduct by the Chairman. The news of the Chairman's plea in court resulted in sharp drop in the company's share price and had the potential to disrupt the group's business and operations given the dual nature of the Chairman's role as CEO.

The ESG risk was previously assessed as 'High' because of governance concerns and the ICR assigned was lower than the ratings assigned by the rating agencies.

The team's approach to engagement

As bond investors we are lenders to companies, governments and other organisations, not owners of equity. Our ability to influence boards and management is constrained by not having voting rights and consequent opportunities to influence company behaviour.

Notwithstanding this we discuss ESG issues with issuers of debt wherever possible. For example:

- We conduct an annual counterparty review where an ESG scorecard is provided to each of our counterparties. We then follow up with a meeting to discuss the review and better understand their approach to managing these risks
- We have also raised ESG concerns with sovereign and semi-sovereign issuers of debt. For example we recently met with Queensland Treasury and discussed the potential for impacts of coal seam gas and the outlook for long-term tax revenue from other sectors, including agriculture.

ESG engagement example:

In a recent counterparty review with Australia and New Zealand Banking Group (ANZ), we asked the company a variety of questions on how it uses ESG factors in assessing new loans beyond its commitments to sustainable project financing through the Equator Principles. ANZ provides limited disclosure on this, but during our engagement the company has demonstrated some good risk management processes which are evolving over time.

We also had a good discussion with the company about how it is incorporating sustainability and risk management principles to build resilience into the business. The meeting provided us with good insight into the company's thinking on these issues and progress made to date.

We don't expect companies to have all the answers as management of ESG issues is an evolutionary process. However, we do expect that companies consider ESG issues and devote sufficient resources to managing material risks.

Case study

Integrating RI into a new investment team: Emerging Market Debt

FSI's Emerging Market Debt (EMD) team was established in August 2011. When new teams are established or brought into the business, it is important that they are a good cultural fit. This extends to a consideration of responsible investment practices.

The EMD team invests in fixed income securities issued mostly by sovereign countries. Fixed income investment is often considered one of the more challenging asset classes for incorporating RI principles. This is because bond investors are lenders to companies, governments and other organisations, rather than owners of equity. Indeed emerging market debt can carry an additional layer of complexity, particularly for sovereign issuers. Again, the ability to influence sovereigns is limited due to a lack of voting rights.

At the core of the team's investment process is a Key Factor Model, which is comprised of six areas of analysis. These factors are: Politics, Structural reform, Fiscal policy, Monetary policy, External and Technical.

In considering how ESG factors relate to its investment process, the team identified three of the six factors in its model which are relevant for the purpose of ESG analysis. These are Fiscal policy, Politics and Structural reform. As the team has continued to develop its process, an assessment of environmental and social issues has increasingly been embedded. Both environmental and social factors can materially affect an issuer's ability or willingness to service outstanding debt.

For example, many countries in the emerging world rely heavily on their natural resources to keep their finances in good condition. Poor stewardship and decision-making in the management of those resources could potentially undermine a country's export output and, ultimately, their ability to source the hard currency needed to service its debt. Similarly, social risks can be reflected in the scores of the Key Factor Model's Politics and Structural reform outputs.

Moving forward the team hopes to continue to enhance this assessment. As Senior Portfolio Manager, Manuel Canas says "We are actively looking to broaden the sources we use when conducting our investment research process, to include dedicated providers of indices, scores, and rankings relevant for ESG assessment. We hope to become more explicit and deepen our knowledge as to how ESG factors play a key role in strengthening our investment process."

The Emerging Markets Debt Team (from left to right) :
Philip Fielding Portfolio Manager, **Jan Markus May** Senior Portfolio Manager, **Helene Williamson** Head of Emerging Markets Debt, **Manuel Canas** Senior Portfolio Manager, **Mark Bodon** Corporate Strategist

Industry collaboration

The PRI recognises that promotion of responsible investment principles and collaboration among industry participants is essential to the broader objective of achieving sustainable financial markets and, indeed, a sustainable economy. FSI has a strong track record of supporting a variety of initiatives both financially and with our people.

Our support of these initiatives has been particularly strong in our home market of Australia. With the appointment of Will Oulton in London, the transfer of Amanda McCluskey and Nick Edgerton to Singapore and Edinburgh and our commitment to add additional resources in London and Sydney, we intend to broaden this support to these other regions. This will incorporate expanded support of integrated reporting, the PRI and the Cambridge University Initiative.

In Australia we will be focusing on encouraging increased collaboration between the various industry groups so that together we might identify and fill gaps, eliminate overlap, support each other in initiatives of shared interest, and overall increase our effectiveness as a community.

Collaborative Initiatives in 2012

PRI

- Infrastructure Steering Committee
- Clearinghouse Steering Committee
- PRI Country Network Steering Committee (Australia)
- Sustainable Palm Oil
- Reporting framework advisory group

Green Building Council of Australia

- Member of the Board of Directors

Investor Group on Climate Change

- Deputy Chair
- Chair of the Research Working Group
- Chair of the Property Working Group
- Member water Working Group

Property Council of Australia (PCA)

- Member of the National Sustainability Roundtable
- Member of the PCA (NSW Division) Sustainable Development committee

United Nations Environment Programme Finance Initiative

- Member of the Property Working Group
- Member of the Asset Management Working Group

Financial Services Council

- Member of the Investment Committee
- Member of the ESG Working Group

Australian Green Infrastructure Council

- First Deputy Chair and Director

Responsible Investment Association Australasia

- Chair
- Member of Governance Committee
- Member of Certification Committee

Association of Superannuation Funds of Australia

- Member of ESG Working Group

ESG Research Australia

- Management Committee Member

Integrated Reporting

- Member of Pilot Program Investor group (UK)
- Business Reporting Leaders Forum (Aust)

Better Buildings Partnership

- Member of leadership panel

NABERS (Shopping Centres) Technical Advisory Group (TAG)

- Member

NABERS (Multi-Tool) TAG

- Member

GBCAB Greenstar Performance Technical Working Group

- Member

UNEP FI Supply Chain Working Group.

- Member

Other collaborative initiatives that FSI participated in, or continued to be a member of include:

- Asian Corporate Governance Association
- Association for Sustainable and Responsible Investment in Asia
- Carbon Disclosure Project
- Water Disclosure Project
- Extractive Industries Transparency Initiative
- International Corporate Governance Network
- Forest Footprint Disclosure Project

Changes since last year's report are reflected below and are also shown in the above list.

- Pablo Berrutti now Chair of RIAA
- Joined ASFA ESG Working Group
- We are no longer on IGCC Low Carbon Finance Working Group
- Joined PRI Country Network Steering Committee
- Mark Rogers is now on the board of the Australian Green Infrastructure Council (AGIC).
- Will Oulton - Vice President EUROSIF
- Board Member and Chair of Nominations Committee UKSiF
- Advisory Panel Member ICCSR Nottingham University
- Member FTSE4Good Policy Committee and Environmental Markets Committee
- Member PRI Reporting Technical Committee

Our team

Will Oulton joined the business as Global Head of Responsible Investment, based in London in September 2012.

Reporting to the Managing Director EMEA and Global Head of Product, Chris Turpin, Will brings more than 20 years' experience to the role. He will be responsible for our global RI strategy, with a particular focus on investment capabilities in EMEA. Will joined the business from Mercer Investments, London where he was Head of Responsible Investment for EMEA. In this role he was responsible for leading a team that advised global asset owners and institutional investors on the development, implementation, monitoring and reporting of sustainable and responsible investment policies, approaches and strategies. Will is also the Vice President of the European Sustainable Investment Forum EUROSIF.

Pablo Berrutti was appointed to the newly created role of Head of Responsible Investment Asia Pacific based in Sydney and joined the business in July 2012. Pablo joined from Perpetual in Sydney, where he was the Head of Responsible Investment. Pablo was responsible for supporting the Australian equities, fixed income and multi-manager teams in the integration of ESG considerations, research and company engagement. Pablo is the current Chair of the Investor Group on Climate Change Research Working Group and a Director of the Responsible Investment Association of Australasia.

These two senior appointments reflect our commitment to responsible asset management as a key tenet of our stewardship responsibilities, and an essential part of protecting and enhancing our clients' long-term investment interests.

With these new appointments we also changed the reporting line for the RI team. The team now reports into Global Product, which allows us to ensure that we are embedding ESG considerations across our investment capabilities throughout the product life cycle. Every investment team continues to have an analyst responsible for integrating ESG into their investment process and we have a strong governance process in place to ensure ongoing improvements in our approach.

From left to right:
Will Oulton,
Global Head of Responsible Investment
Pablo Berrutti,
Head of Responsible Investment Asia Pacific

Appendix 1 – Global Annual Proxy Voting Statistics 2011 and 2012

	H1 2011	H2 2011	Total 2011	H1 2012	H2 2012	Total 2012
Company meetings (AGMs)	984	485	1469	977	485	1462
Resolutions voted on	11617	4577	16194	11859	4777	16636
Resolutions supported	8835	3483	12318	9433	3643	13076
Resolutions against	976	326	1302	838	298	1136
Resolutions abstained	85	10	95	83	17	100

Table 2: Director Elections/Re-Elections

	H1 2011	H2 2011	Total 2011	H1 2012	H2 2012	Total 2012
Number of company meetings involving director elections/re-elections	700	356	1056	724	384	1108
Number of resolutions involving director elections/re-elections	4429	1547	5976	4719	1636	6355
Director elections/re-elections supported	93%	93%	93%	93%	93%	93%
Director elections/re-elections against	6%	7%	6.5%	6%	6%	6%
Director elections/re-elections abstained	0%	0%	0%	1%	0%	0.5%

Table 3: Remuneration Reports

	H1 2011	H2 2011	Total 2011	H1 2012	H2 2012	Total 2012
Number of company meetings involving remuneration reports	248	215	463	294	226	520
Number of resolutions involving remuneration reports	294	309	603	333	330	663
Remuneration reports supported	81.6%	82.2%	81.9%	85.9%	90.9%	88.4%
Remuneration reports against	18.4%	17.8%	18.1%	14.1%	8.5%	11.3%
Remuneration reports abstained	0%	0%	0%	0%	0.6%	0.3%

Table 4: Executive Remuneration Reports

	H1 2011	H2 2011	Total 2011	H1 2012	H2 2012	Total 2012
Number of company meetings involving executive remuneration reports	73	113	186	55	133	188
Number of resolutions involving executive remuneration reports	127	298	425	98	304	402
Executive remuneration reports supported	86.6%	92.6%	89.6%	89.8%	87.2%	88.5%
Executive remuneration reports against	13.4%	7.4%	10.4%	10.2%	12.5%	11.4%
Executive remuneration reports abstained	0%	0%	0%	0%	0.3%	0.2%

Table 5: Non-Executive Remuneration Reports

	H1 2011	H2 2011	Total 2011	H1 2012	H2 2012	Total 2012
Number of company meetings involving non-executive remuneration report	234	110	344	246	86	332
Number of resolutions involving non-executive remuneration reports	316	163	479	290	138	428
Non-executive remuneration reports supported	95.6%	96.9%	96.3%	95.2%	96.4%	95.8%
Non-executive remuneration reports against	3.8%	3.1%	3.5%	4.1%	3.6%	3.9%
Non-executive remuneration reports abstained	0.6%	0%	0.3%	0.7%	0%	0.4%

Auckland
Kiwi Income Property Trust
Level 14, DLA Phillips Fox Tower
National Bank Centre
205–209 Queen Street
Auckland
New Zealand
Telephone: +64 9 359 4000
Facsimile: +64 9 359 3997
Web: www.kipt.co.nz

First State Investments
Level 3, 33–45 Hurstmere Road
Takapuna
Auckland 0622
New Zealand
Telephone: +64 9 448 4922
Facsimile: +64 9 486 7131

Edinburgh
First State Investments
23 St Andrew Square
Edinburgh EH2 1BB
United Kingdom
Telephone: +44 (0) 131 473 2200
Facsimile: +44 (0) 131 473 2222
Web: www.firststate.co.uk

Frankfurt
First State Investments
Westhafen Tower
Westhafenplatz 1
60327 Frankfurt a.M.
Germany
Telephone: +49 (0) 69 710456 - 302
Web: www.firststateinvestments.com

Hong Kong
First State Investments
6th Floor
Three Exchange Square
8 Connaught Place
Central
Hong Kong
Telephone: +852 2846 7555
Facsimile: +852 2868 4783
Web: www.firststateasia.com

Jakarta
First State Investments
29th Floor
Gedung Artha Graha
Sudirman Central Business District
Jl. Jend. Sudirman Kav. 52–53
Jakarta 12190
Indonesia
Telephone: +62 21 2935 3300
Facsimile: +62 21 2935 3388
Web: www.firststateasia.com

London
First State Investments
3rd Floor
30 Cannon Street
London EC4M 6YQ
United Kingdom
Telephone: +44 (0) 20 7332 6500
Facsimile: +44 (0) 20 7332 6501
Web: www.firststate.co.uk

Melbourne
Colonial First State Global
Asset Management
Chadstone Shopping Centre
1341 Dandenong Road
Chadstone VIC 3148
Australia
Telephone: +61 3 9936 1222
Facsimile: +61 3 9936 1333
Web: www.cfsgam.com.au/
assetmanagement

New York
First State Investments
599 Lexington Avenue, 17th Floor
New York, New York 10022 United
States of America
Telephone: +1 212 848 9200
Facsimile: +1 212 336 7725
Web: www.firststateinvestments.
com/us

Paris
First State Investments
14, avenue d'Eylau
75016 Paris
France
Telephone: +33 1 73 02 46 74
Web: www.firststateinvestments.com

Singapore
First State Investments
1 Temasek Avenue
#17–01 Millenia Tower
Singapore 039192
Singapore
Telephone: +65 6538 0008
Facsimile +65 6538 0800
Web: www.firststateasia.com

Sydney
Colonial First State Global
Asset Management
Ground Floor
Tower 1 Darling Park
201 Sussex Street
Sydney NSW 2000
Australia
Telephone: +61 2 9303 3000
Facsimile: +61 2 9303 3200
Web: www.cfsgam.com.au

Tokyo
First State Investments
8th Floor,
Toranomon Waiko Building
12–1, Toranomon 5-chome
Minato-ku
Tokyo 105-0001
Japan
Telephone: +81 3 5402 4831
Facsimile: +81 3 5402 4839
Web: www.firststateasia.com

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