Sector Compliance Report
2010

NBIM
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NBIM Investor Expectations on Children's Rights 2010 Sector Compliance Report

Executive Summary

This is the third report on the level of compliance with the NBIM Investor Expectations on Children's Rights, covering 527 companies in seven sectors that NBIM was invested in at the end of 2010. Each sector has been identified as having high exposure to risk related to children's rights and child labour. The sectors comprise Food & Beverage, Agriculture (Cocoa and Seed), Apparel Retail, Technology Hardware & Equipment, Steel, Mining and Toys. The assessments were based solely on publicly available information from the companies.

As with our two earlier reports, we noted great variations among the sectors. Cocoa, Hybrid Seed and Technology Hardware & Equipment showed the highest level of compliance with our expectations, while Toys and Steel had the lowest. There was no consistent trend of increasing or decreasing compliance across sectors in 2010, compared with 2009. There has been an increasing level of overall compliance over the past three years, though information provided by most companies on child labour issues or children's rights continues to be limited.

Child labour risk was also an issue among the suppliers that the companies had direct contact with, so-called tier 1 suppliers. We saw increasing transparency and awareness of the risks further up the supply chain, all the way to raw material sourcing.

In a wider context, we have seen interesting developments regarding increased disclosure on social issues. There have been several initiatives by stock exchanges, banks and national and international standard-setters, for example, to increase transparency by issuing requirements and guidelines on corporate reporting of social risks and impact. In the US, the Securities and Exchange Commission (SEC) has proposed rules that require reporting companies to disclose information concerning the so-called conflict minerals tantalite, tin, tungsten and gold. These minerals are used in products such as cellular phones and high heat-resistant steel alloys and may be sourced from countries known for illegal mining using forced labour and child labour. Armed groups are present at many of the mining sites and revenues from the mines go to militant groups responsible for gross violations of children's rights. The new disclosure rules stem from the Dodd-Frank Act, in which the US Congress states that conflict minerals originating from the Democratic Republic of the Congo help finance «conflict characterised by extreme violence.» Companies in various sectors producing, for example, electronic equipment, jewellery or steel alloys may be subject to the new regulation. The OECD has issued Due Diligence Guidance for the mining and minerals sector that also addresses sourcing of minerals from conflict-affected areas.

To reflect this development, we included raw material sourcing as a factor when assessing companies' supply chain management in 2010. Although we noted that social and environmental issues were being addressed further down the supply chain of companies, corporate disclosure on child labour risk and children's rights in raw material sourcing was still very low.

Introduction

The NBIM Investor Expectations on Children's Rights outlines our expectations for how companies should manage risk related to child labour and children's rights. We expect companies to prevent the worst forms of child labour and promote children's rights in their operations and supply chains. Our expectations are summarised on the last page of this report and are also available on NBIM's website, www.nbim.no.

The expectations are directed at companies that operate or have supply chains in sectors and countries where the exposure to risk related to child labour and children's rights is high. We annually assess how these companies manage such risk, measuring their performance against our expectations.

The assessments of the companies in this report were solely based on publicly available information from the companies at the end of 2010. An external analyst carried out the initial assessments, which in turn were subject to NBIM's interpretation. The assessments provide NBIM and the companies with a tool to guide improvement of corporate performance related to children's rights and serve as a basis for constructive dialogue.

Methodology

Publicly available material as of 31 December 2010 was analysed for each company against 10 indicators presented in this report. Performance related to the individual indicators was graded as either «compliant,» «non-compliant,» or «not disclosed» depending on the level of disclosure of relevant information. Transparency was a key expectation. Both «non-compliant» and «not disclosed» were rated as non-compliance by NBIM. To be considered compliant, companies must have addressed the relevant indicator in their publicly available material.

The industry sectors in this report have been identified as sectors exposed to the risk of child labour and children's rights violations. Companies within each targeted sector were selected based on a combination of their market capitalisation and NBIM's holdings in the company. This means that the sample of companies may vary from year to year.

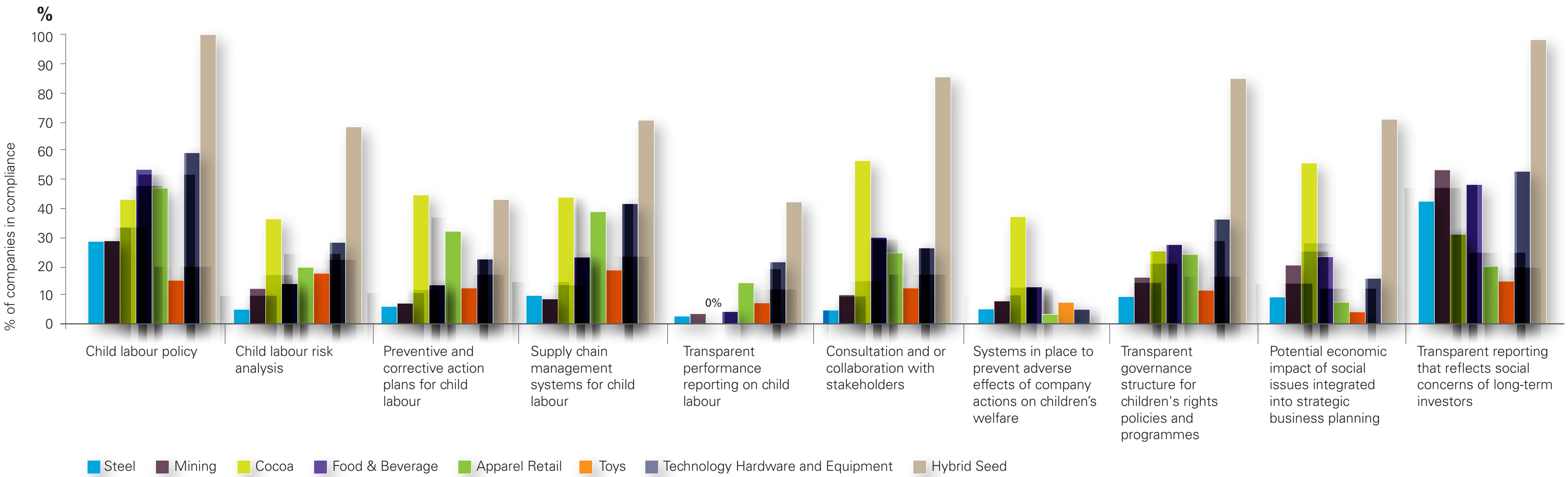
We compared data from 2008, 2009 and 2010. A total of 527 companies were assessed in the 2010 report, 427 of which were also assessed the previous year. The findings may have been influenced by companies being added to, or dropped from, the assessment sample in the three-year period.

As with the previous assessments, we focused on information disclosed on company websites, including annual reports, sustainability and corporate social responsibility reports and press releases. FTSE sector classifications were used to define the sector categories identified and assessed in 2010, as listed below. Under the Apparel Retail sector we combined the following sub-sectors: Apparel Retailers, Footwear, Clothing & Accessories and some companies with significant apparel manufacturing from the broadline retailers sector. Food & Beverage was a new sector in 2010. Although the cocoa companies are classified according to FTSE as Food & Beverage companies, we decided to continue to present the cocoa companies separately.

- **Food & Beverage:** 47 companies representing 36 percent of the sector market capitalisation in our portfolio. (With cocoa companies included, 67 companies representing 51 percent of the sector market capitalisation in our portfolio have been assessed.)
- **Agriculture (cocoa and seed):** 23 companies. As this is not a FTSE sector, the percentage of the sector market capitalisation cannot be determined.
- **Steel:** 83 companies representing 84 percent of the sector market capitalisation in our portfolio.
- **Technology Hardware & Equipment:** 60 companies representing 79 percent of the sector market capitalisation in our portfolio.
- **Mining:** 105 companies representing 62 percent of the sector market capitalisation in our portfolio (sub-sectors: gold mining, coal, general mining, platinum and precious metals, diamonds and gemstones, non-ferrous metals).
- **Apparel Retail:** 182 companies representing 93 percent of the sector market capitalisation in our portfolio.
- **Toys:** 27 companies representing 100 percent of the sector market capitalisation in our portfolio.

Sector Comparison 2010

Reporting Indicators 2010

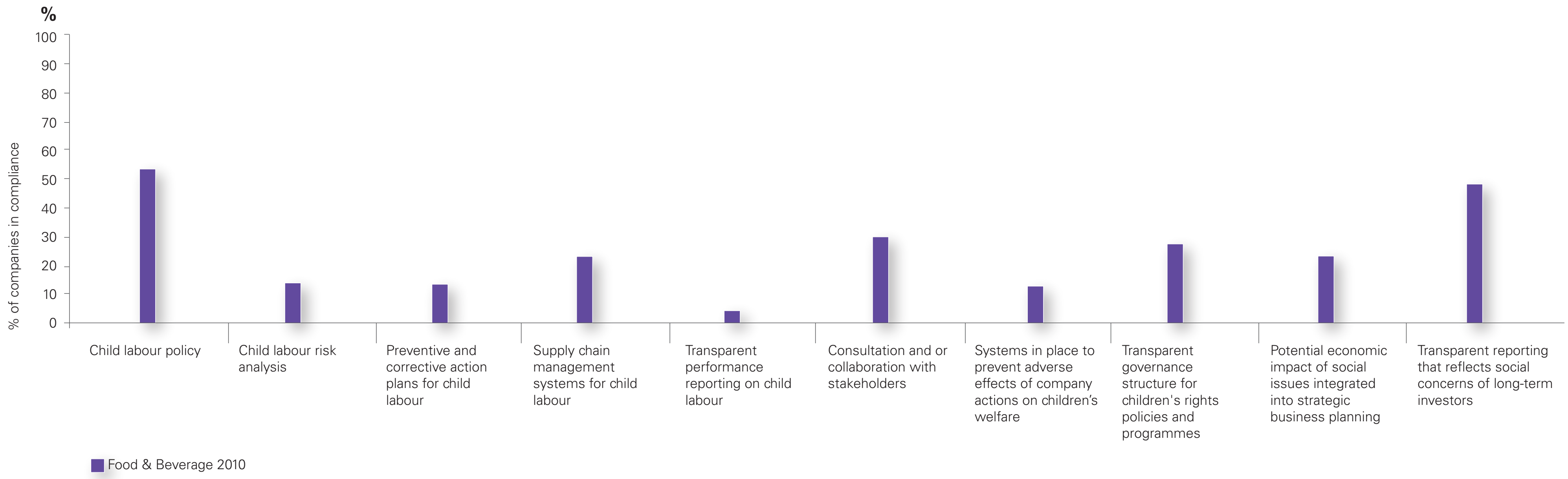


There were great variations in the level of compliance between the sectors. The two Agricultural sectors, Cocoa and Hybrid Seed, showed a high level of compliance across all indicators compared to the other industry sectors. Toys and Steel were the sectors with the lowest level of overall compliance.

Compared with the 2009 assessment, there were no significant increases or decreases in overall compliance. When we looked at the data for the sectors assessed over three consecutive years – Steel, Mining, Apparel Retail and Cocoa – we saw a positive trend in the level of compliance and a significant rise in the level of reporting of social issues that concern long-term investors.

Food & Beverage Sector

Compliance with the Expectations

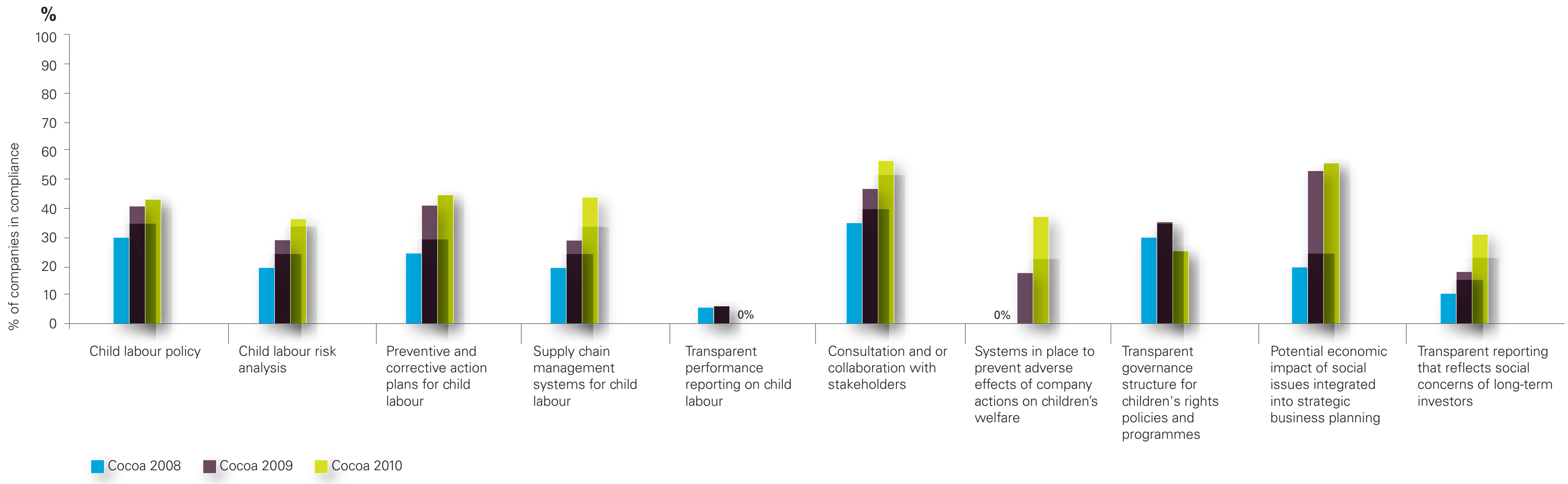


This was the first time we assessed a larger selection of companies in the Food & Beverage sector. Companies in this sector face risk exposure to child labour in the agricultural supply chain. Compared with other sectors examined in this report, a high number of companies in the Food & Beverage sector publicly disclosed a child labour policy in 2010. However, reporting on action plans and supply-chain management systems put in place by companies to implement child labour policy was low.

A May 2010 report from the International Labour Organization (ILO) suggested that 60 percent of child labour is found within agriculture, involving about 129 million girls and boys aged five to 17 years old. Child labour in the agricultural sector is hard to tackle, and not all labour qualifies as work to be eliminated under the ILO conventions on minimum age (138) or the worst forms of child labour (182). The large number of child labourers, the hazardous nature of the work, denial of education and lack of regulation are reasons why the ILO says agriculture should be a priority sector for the elimination of child labour. The development of systems and programmes for assessing risk exposure and monitoring hazardous and exploitative child labour in agricultural supply chains is currently at an early stage, which may also explain the very low level of performance reporting. There is reason to believe, however, that increased focus on traceability of raw material will also enable better systems for monitoring working conditions on supplier farms. The large multinational companies purchase a significant share of the global harvest and need to promote sustainable production to ensure stable future supplies of raw materials.

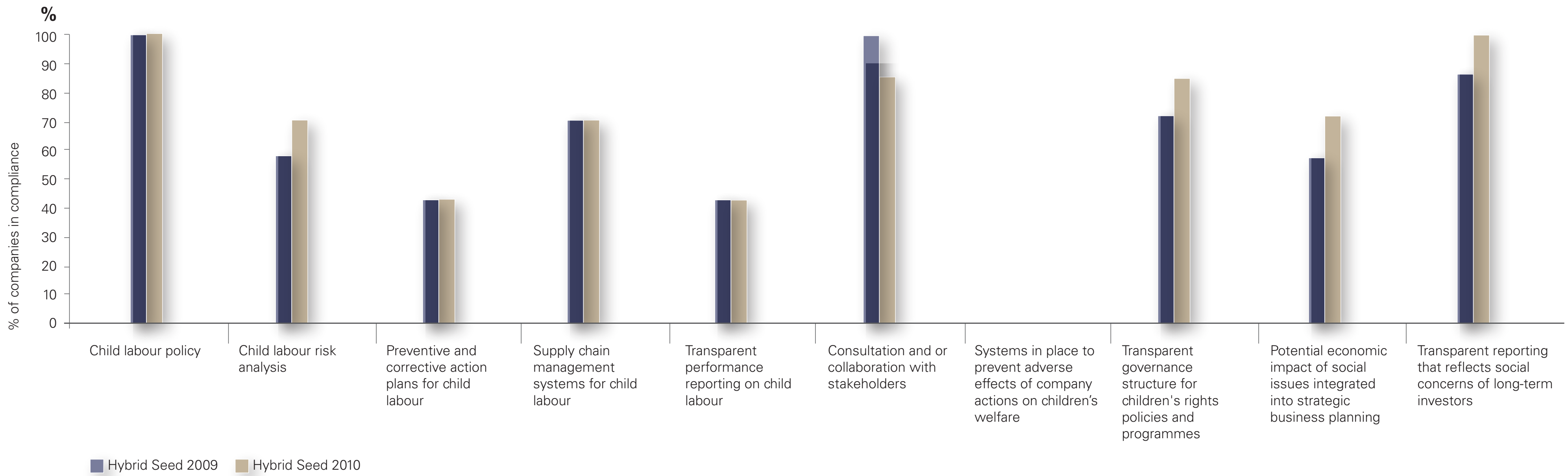
Agriculture Sector

Cocoa Sector – Compliance with the Expectations



Companies in the Cocoa sector are cocoa suppliers and chocolate manufacturers. This is the third consecutive year we have assessed companies in this sector. The level of compliance with our expectations was relatively high compared to the other sectors in 2010. Compared to 2009 we saw an increasing level of disclosure on most indicators related to how companies address the social conditions under which the cocoa that they source is grown. Child labour is prevalent in cocoa farming and the industry recognises that a joint effort toward the elimination of the worst forms of child labour and toward sustainable farming is necessary. In September 2010, a new partnership between the chocolate and cocoa industry, the US Department of Labor and the governments of Ghana and the Ivory Coast was launched to achieve a «significant reduction of the worst forms of child labour in the cocoa-growing areas.» Although there have been improvements in regard to developing and disclosing action plans to monitor and combat child labour in companies' operations and supply chains, there is limited information on how policies and systems are implemented and whether they work – the performance reporting on child labour dropped to zero in 2010. We hope the new industry initiative will result in improved performance reporting, with clear targets and key performance indicators over the coming years.

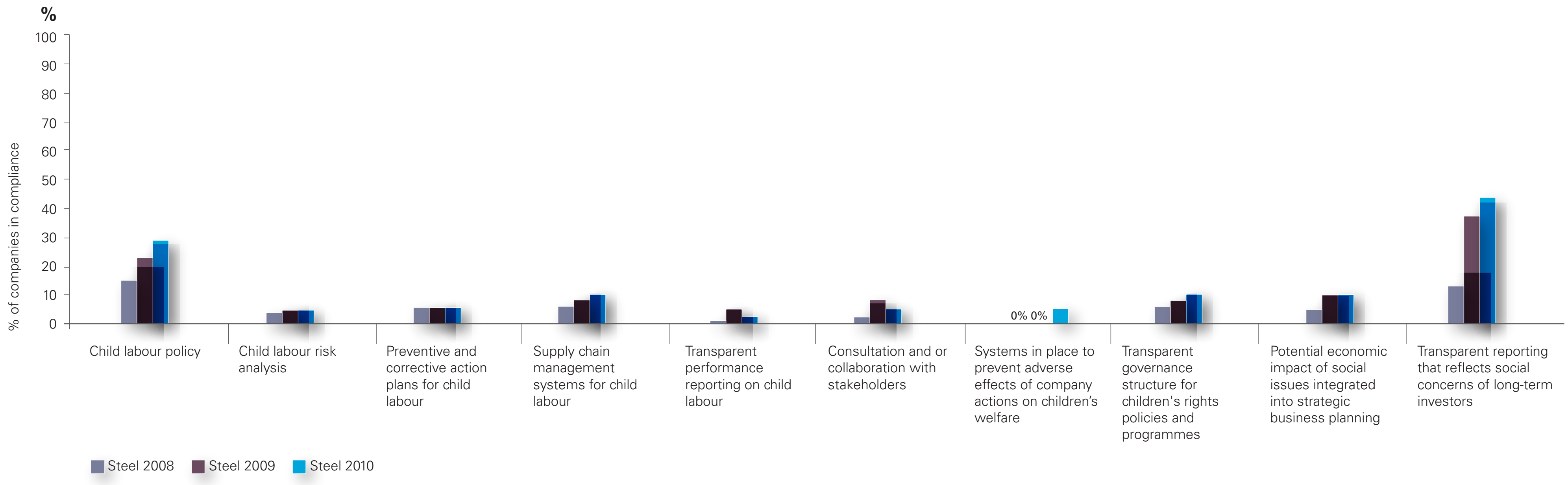
Hybrid Seed Sector – Compliance with the Expectations



The companies in this sector are also involved in the production of hybrid seed. In the cultivation of hybrid cottonseed in particular, production is very labour-intensive as cross-pollination has to be done manually and there is a high risk of child labour. As in the three previous years the Hybrid Seed sector had the highest level of compliance in 2010. All companies in this sector had a child labour policy and there was also an industry-level effort to combat exploitative child labour in the supply chain. Crop Life International, a global federation representing the plant science industry, said in 2009 that leading multinational seed producers would work together against the use of child labour in seed-growing operations. The progress in implementing the common approach varies among the companies. This is also confirmed in the dialogue we have with the companies: Some have just launched programmes for cotton hybrid seed production in India, while other companies are rolling out their programmes to other geographic areas, other types of seed or other business activities. There are also other indications that progress is being made. According to social scientist Davuluri Venkateswarlu's report «Seeds of Child Labour – Signs of Hope,» published in 2010, initiatives by Monsanto and Bayer «have had a positive impact such that the proportion of child labour to the total workforce on the farms producing seeds for these companies has dropped from nearly 53 percent in 2003–04 to less than 3 percent in 2009–10.» As in previous years, though, we saw limited reporting in 2010 on how the companies managed children's rights beyond the worst forms of child labour. Disclosure on stakeholder relations dropped compared with 2009, while information on corporate activity regarding the indicator of prevention of adverse effects of company actions on children's welfare remained at zero.

Steel Sector

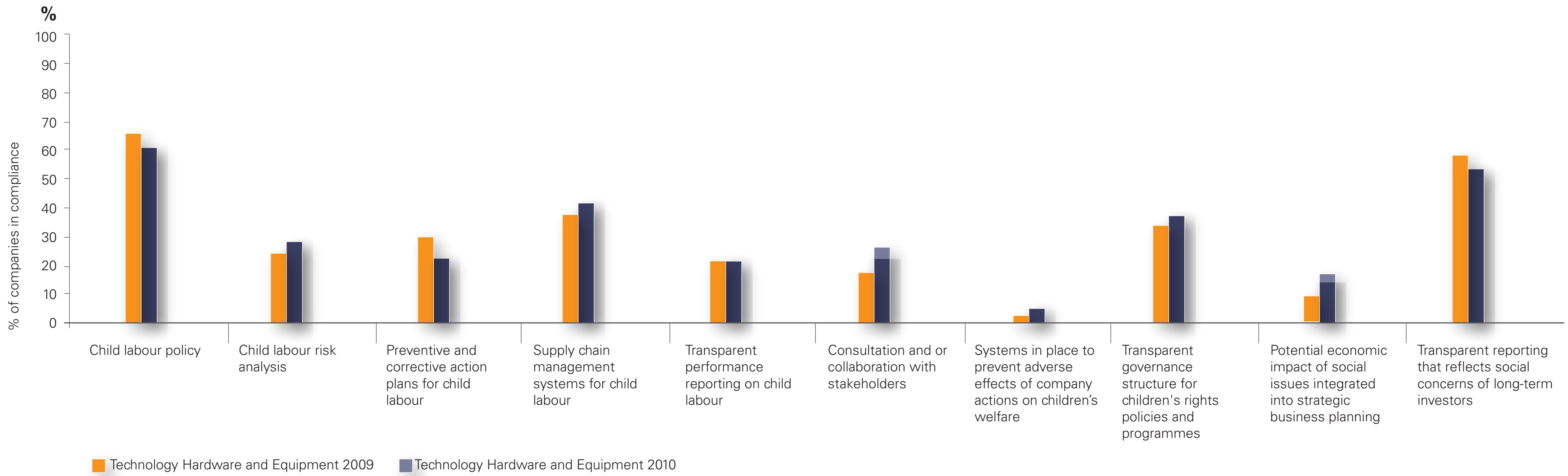
Compliance with the Expectations



The companies in the Steel sector encompass the steel industry value chain ranging from iron ore miners to steel manufacturers and distributors. The companies in this sector face exposure to risk of child labour and violations of children's rights far down in the supply chain, such as in the minerals sourcing of charcoal and pig iron. The mining activities for exploration of raw materials for steel production may also negatively affect children because of the large environmental and social impact of the mining activities on local communities. Certain varieties of steel also use minerals that fall into the definition of conflict minerals, for example tantalum and tungsten. While we saw an increasing number of companies in the Steel sector that published a child labour policy, the overall reporting on child labour risk analysis and supply chain management systems was still very low in 2010. This was true also for reporting on systems or activities for preventing adverse effects of company actions on children's welfare. Over the three years we have evaluated portfolio companies in the Steel sector, we observed a significant increase in the level of reporting on social issues that are of concern to long-term investors.

Technology Hardware & Equipment

Compliance with the Expectations

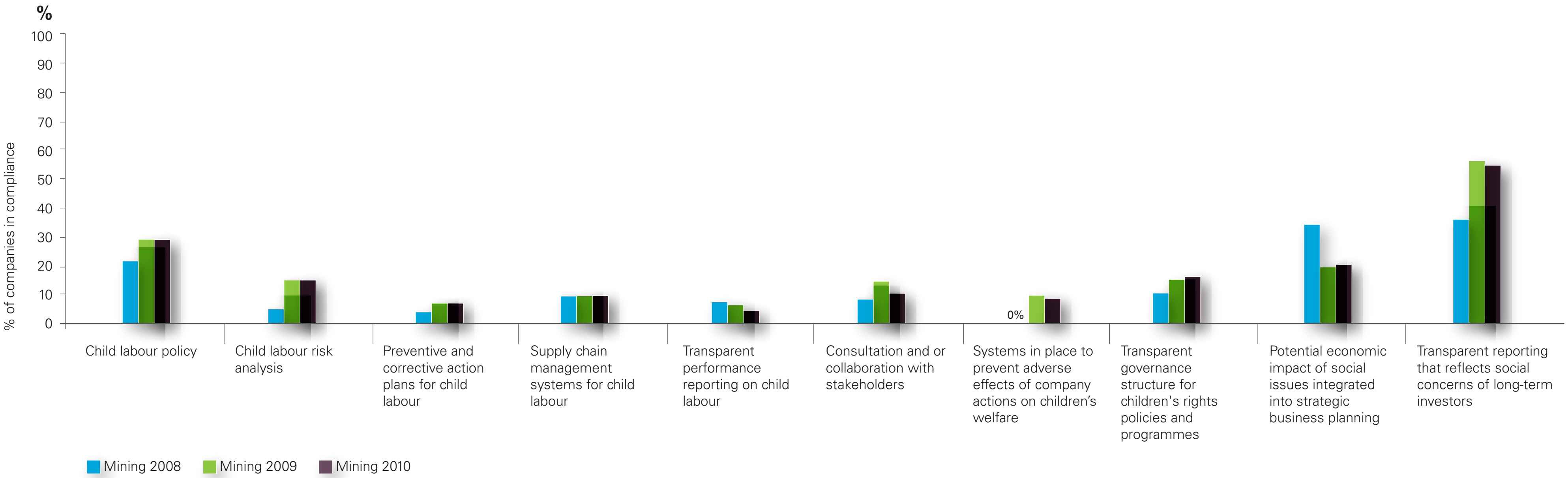


The companies in this sector are manufacturers of mobile phones, computer hardware, semiconductors and other electronic equipment. The Technology sector faces risk exposure to child labour in the supply chain, both in the factories where products are manufactured as well as in relation to the raw materials used in the products. Conflict minerals are used in products such as cellular phones and PCs. Significant amounts of these minerals are sourced from countries known for illegal mining using forced and child labour. We observed no significant change in the level of disclosure in 2010 compared with 2009. Compared to the other sectors in this report, the level of compliance with NBIM's expectations on child labour policy and supply chain management systems was relatively high.

Recent reports about critical working conditions at factories that assemble electronic equipment raise concerns about hazardous labour conditions for young workers below the age of 18. A large part of the manufacturing and assembly of electronic equipment takes place in China. Despite a comprehensive labour law that prohibits employment under the age of 16, weak implementation and lack of child labour statistics means that the industry needs to have strong systems and adequate transparent reporting in place. Many companies in the Technology sector will most likely be subject to new regulations and guidelines with regard to conflict minerals as mentioned in the executive summary of this report. In our dialogue with the companies, we have already observed increased awareness on this issue. There are several multi-stakeholder and sector level initiatives to develop systems for tracing minerals and proper due diligence practices.

Mining Sector

Compliance with the Expectations

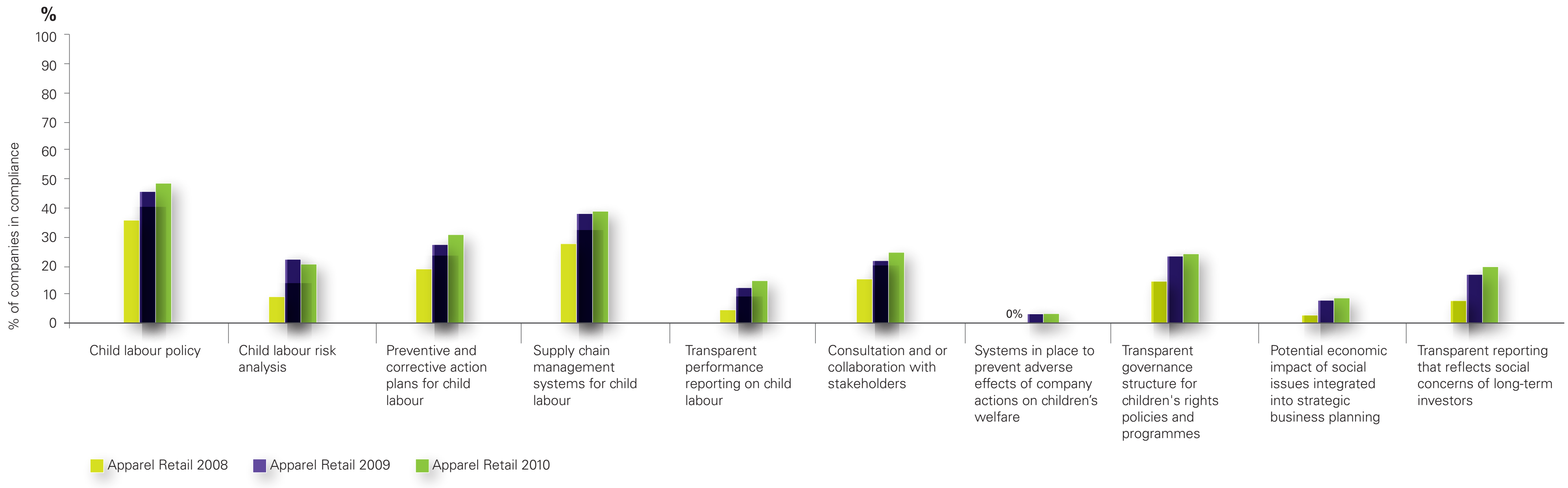


The Mining sector covers companies engaged in the exploration and production of gold, diamonds and gemstones, coal, and other minerals and precious metals. The risk exposure to child labour and violations of children's rights for companies in the Mining sector varies according to geography and business activity. Mining companies typically face child labour concerns with regard to artisanal mining. According to the ILO/IPEC, approximately 1 million children are employed in the informal mining sector and work under hazardous conditions. Mining companies can also have significant social and environmental impact on local communities and there is a risk that company activities may have an adverse impact on the basic rights of children. The sector's low level of compliance in 2010 with the indicators related to child labour and children´s rights are therefore disappointing.

Compared with the 2009 assessment, there was no consistent trend of increasing or decreasing compliance across indicators in 2010. The Mining sector displayed a fairly low level of disclosure on how it addresses issues related to children's rights compared with the other sectors assessed in this report.

Apparel Retail Sector

Compliance with the Expectations

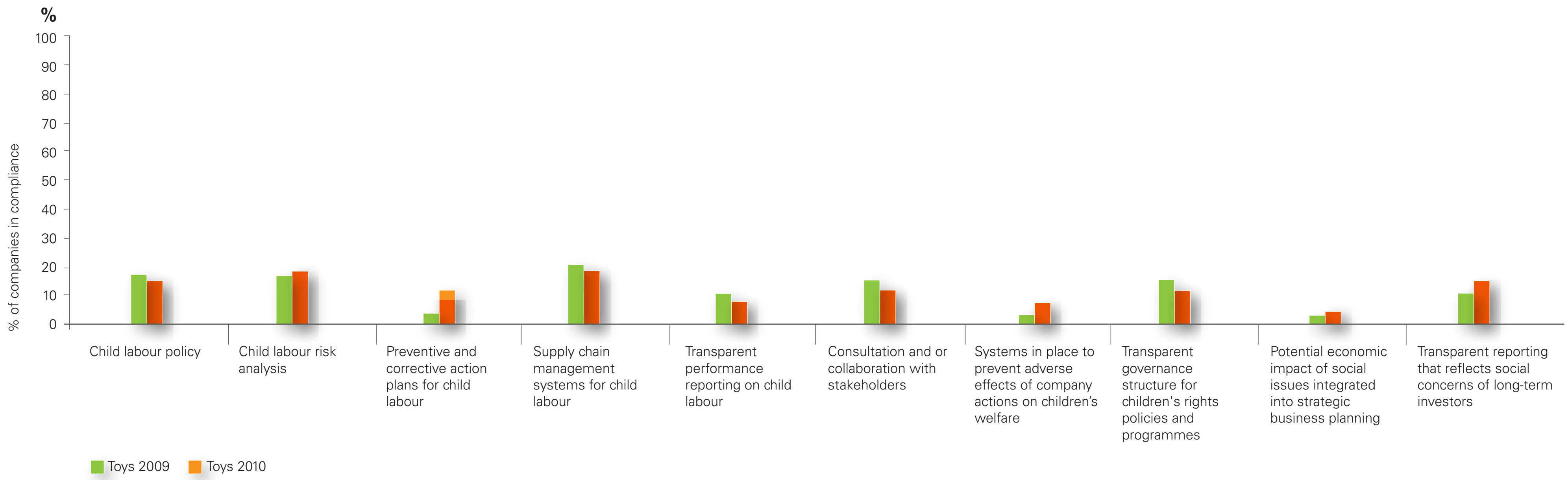


The Apparel Retail sector as defined in this report covers manufacturers of clothing, textiles, leather goods, footwear, jewellery and other accessories. The risk exposure to child labour varies with geography and business activity. The supply chains are often long and complex and the risk exposure to child labour increases with subcontracting and activities such as hand embroidery. Child labour is also prevalent in the production or exploration of some of the raw materials used in products such as cotton, silk, gold, diamonds and gemstones.

Over the three years that we have assessed this sector, we observed a positive trend of increased disclosure of child labour policies, supply chain management systems and transparent performance reporting. However, there were no significant changes in 2010 compared with 2009. Compared to the other sectors, the Apparel Retail sector scored fairly well on the indicators relating to child labour. The main risk for companies in this sector is related to child labour, but some textile industry activities also have negative environmental impacts, for example on water, that can adversely affect children's welfare. The level of compliance with the indicator «Systems in place to prevent adverse effects of company actions on children's welfare» was very low in 2010, but the companies that were assessed as compliant on this indicator typically had comprehensive environmental reporting and had carried out social impact assessments covering issues that went beyond basic labour standards. Some had, for example, identified children's rights issues related to migrant work or looked into the issue of living wages.

Toys Sector

Compliance with the Expectations



The Toys sector covers companies that design, manufacture and sell toys, computer games and accessories. Compared with the 2009 assessment, there was no consistent trend of increasing or decreasing compliance across indicators in 2010. The level of disclosure in the Toys sector was still very low compared to the other sectors. In general, US companies disclosed more relevant information about how they address child labour risk in their supply chain than Asian companies. According to the International Council of Toy Industries (ICTI), 70 percent of the world's toys are manufactured in China. The Chinese labour laws are comprehensive and the labour law prohibits employment of children under the age of 16. Lack of official child labour statistics for China and reports of weak enforcement of the laws, however, emphasise the need for robust systems to assess the risk exposure and ensure compliance with the law.

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NBIM Investor Expectations on Children's Rights

The NBIM Investor Expectations on Children's Rights outlines our expectations for how companies should manage risk related to child labour and children's rights. We expect companies to prevent the worst forms of child labour and promote children's rights in their operations and supply chains.

Our expectations are divided into four areas.

A. Prevention of the worst forms of child labour

This expectation is based on ILO Convention 182, and pertains to the working arrangements for children, encompassing hazardous and physically/mentally damaging labour.

B. Sustaining the minimum age standard

This expectation is based on ILO Convention 138. The minimum age for employment should normally not be below the age for compulsory schooling, and under normal circumstances not below 15 years. For hazardous work the age must not be below 18 years.

C. Promotion of children's welfare

This expectation is based on the UN Convention on the Rights of the Child. Large corporations should be expected, in addition to the fight against child labour, to play a role together with other stakeholders in securing the basic rights of children whose lives are affected adversely by corporate activities.

D. Governance structures

Corporations must have a corporate governance structure that facilitates realistic strategies and responses to the management of child labour and children's rights. The following elements should be considered: board-level involvement, board committee structures, management responsibilities, risk management and internal control processes, reporting lines, timelines, and internal sanctions.

Requirements:

- Child labour policy
- Continuous risk analysis
- Preventive and corrective action plans and programmes
- Supply chain management systems
- Monitoring systems
- Performance reporting
- Integration of the potential economic impact of social issues into the company's strategic business planning
- Transparent and well-functioning governance structure