CORPORATE SOCIAL ISSUES REPORTER

Impartial Research on Companies and Shareholders Worldwide *April 2008*

One in Five Large Firms Set Labor Supplier Standards

A fifth of all large cap companies have codes addressing their suppliers' compliance with labor standards, RiskMetrics Group found as part of its first global study of these types of policies. Moreover, most of these address core labor rights issues including child and forced labor, freedom of association and equal employment opportunity. The findings come from a year-long pilot project assessing more than 1,800 global companies—the S&P 500, the Toronto Stock Exchange 300 and the Morgan Stanley EAFE index excluding Japan—on more than 200 policy and performance indicators, including more than 60 on supplier labor standards.

While this was the first year RiskMetrics looked at non-U.S. firms' policies and practices in this area, it represented the third time RiskMetrics has looked at the supplier labor codes of the S&P 500. This cohort appears to be adopting codes at an accelerating rate. The percentage of companies in the S&P 500 with standards addressing their suppliers' treatment of employees leapt three percentage points between 2005 and 2006 and six between 2006 and 2007.

Core Labor Issues

The labor issues most frequently addressed by companies in their supplier codes were child and forced labor and workplace discrimination; 15 percent of all the companies surveyed set standards for their suppliers on these points. The next most common provisions in supplier codes were freedom of association (12 percent) and harassment, health and safety and wages (all tied for 10 percent). However, far fewer companies set standards for their suppliers on these labor issues that were as stringent as the corresponding core conventions of the International Labor Organization (ILO). (See the box about the ILO core conventions and Table 1.)

> *While 20 percent of the surveyed companies set labor standards of some kind for their suppliers, only 14 percent mentioned that they actually monitored their suppliers for compliance.*

Child labor: The ILO's Minimum Age Convention (No. 138) bans child labor, stipulating that the minimum age for admission to employment shall not be less than the age of 15 or completion of compulsory schooling, whichever is higher, while making exceptions for a few designated developing countries. While 15 percent of the companies had policies barring their suppliers from using child labor, only 9 percent set a minimum age in line with this standard. Similarly, the ILO's Worst Forms of Child Labor Convention (No. 182) forbids the most intolerable and dangerous types of child labor such as slavery, prostitution, mining, deep-sea fishing and certain types of manufacturing for those under the age of 18. However, only 6 percent of the companies RiskMetrics analyzed met this requirement by setting a minimum age for work of 18 or outlining the types of safe work those between the ages of 15 and 18 can undertake.

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Investor Achieve Record Number of Withdrawals –With some final decisions, the Securities and Exchange Commission staff has tied up most of the remaining loose ends of the spring social issues proxy season. In addition, this year's surge of withdrawal agreements should be close to the end now, since most of the companies with pending shareholder proposals have issued their proxy statements. Proponents have now withdrawn 122 resolutions this year – a record. 12

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Forced labor: The ILO's Forced Labor Convention (No. 29) and Abolition of Forced Labor Convention (No. 105) ban the use of any form of compulsory labor as a means of political coercion or education, punishment for the expression of political or ideological views, work force mobilization, labor discipline, punishment for participation in strikes, or discrimination.

Although 15 percent of firms banned their suppliers from employing forced labor, only 10 percent barred the use of prison and other forms of compulsory labor that equal the protections of these ILO conventions.

Freedom of association and the right to organize: The ILO's Freedom of Association and Protection of the Right to Organize Convention (87) establishes the right of all workers and employees to form and join organizations of their own choosing without prior authorization, and lays out a series of guarantees for the free functioning of organizations without interference by the public authorities, while Right to Organize and Collective Bargaining Convention (98) provides for protection against anti-union discrimination, for protection of workers' and employers' organizations against acts of interference by each other, and for measures to promote collective bargaining.

All told, 12 percent of the companies guaranteed freedom of association in their supplier codes, but only 10 percent met the letter of the ILO's requirements for its core conventions on these topics. In most cases the companies embraced freedom of association but declined to mention the right to organize. However, many, to their credit, acknowledged their business ties to China and mentioned that suppliers only needed to guarantee freedom of association or the right to organize where it is legal to do so and encouraged worker councils and other forms of communication between management and employees as a substitute elsewhere.

Discrimination: The ILO's Equal Remuneration Convention (No. 100) calls for equal pay and benefits for men and women for work of equal value. At the same time, Discrimination (Employment and Occupation) Convention (111) requires the elimination of discrimination in access to employment, training and working conditions, on grounds of race, color, sex, religion, political opinion, national extraction or social origin and to promote equality of opportunity and treatment.

While 15 percent of the companies RiskMetrics analyzed had anti-discrimination policies, only 3 percent met the standards outlined in ILO conventions 100 and 111. Most fell short of ILO 100 by not specifically stating in their supplier EEO policy that it applies to pay. On ILO 111, those disqualified for meeting this standard did not include all of the classifications listed in the convention.

The ILO and its Core Conventions

Created in 1919 as a specialized agency of the United Nations, the ILO is made up of government, business and union representatives from 175 member states. Over the years, the ILO has adopted 184 lengthy and legalistic labor "conventions"—the world's most comprehensive body of international labor standards. Of these, the ILO has identified eight "core" conventions it considers so basic as to constitute fundamental human rights. They cover child and forced labor, equal treatment and freedom of association. To underscore the importance of these standards, the ILO adopted in 1998 the Declaration on Fundamental Principles and Rights at Work, which incorporate these core conventions. The core conventions appear below.

Child labor
- No. 138, Minimum Age Convention (1973)
- No. 182, Worst Forms of Child Labor Conventions (1999)

Forced labor
- No. 29, Forced Labor Convention (1930)
- No. 105, Abolition of Forced Labor Convention (1957)

Freedom of association
- No. 87, Freedom of Association and Protection of the Right to Organize Convention (1948)
- No. 98, Right to Organize and Collective Bargaining Convention (1949)

Equal treatment
- No. 100, Equal Remuneration Convention (1951)
- No. 111, Discrimination (Employment and Occupation) Convention (1958)

Monitoring and Enforcement

Similarly, while 20 percent of the surveyed companies set labor standards of some kind for their suppliers, only 14 percent mentioned that they actually monitored their suppliers for compliance. Even fewer—12 percent—outlined consequences for suppliers found in violation, or whether they would engage the facilities in implementing corrective actions (11 percent). Meanwhile, fewer than half of the companies with

Table 1 - Supplier Labor Policies of Large Cap Firms	
% with supplier labor code:	20
% with supplier code that discusses:	
Child Labor	15
ILO 138	9
ILO 182	6
Forced Labor	15
ILO 29 and 105	10
Freedom of Association	12
ILO 87 and 98	10
Discrimination	15
ILO 100	3
ILO 111	5
Harassment	10
Health and Safety	10
Hazardous Materials	2
Working Hours	8
Working Hours Limit	4
Wages	10
Living Wage	2
Monitoring	14
Enforcement	12
Corrective Action	11
Hotline	6
Training	7
Reporting	4
Source: RiskMetrics Group	

supplier codes acknowledged training workers on these policies and programs (7 percent) or reporting on the findings from these efforts (4 percent). Likewise, 10 percent of the firms had supplier codes with a health and safety statement, but only 2 percent addressed workers' contact with hazardous chemicals.

Activists say these discrepancies are evidence of companies using codes as public relations ploys to deflect criticisms, instead of implementing meaningful compliance programs. On the contrary, companies say, the proliferation of a multitude of company, industry and collective codes have muddied the debate and made it difficult to set exact standards pleasing all stakeholders. Both point to a confusing landscape for workers and shareholders trying to understand the issue and the steps companies are taking to eradicate sweatshop labor. Still, many companies (22 percent) acknowledge that their supply chains present material risks to their businesses and by extension, their shareholders.

Risk Exposure

RiskMetrics assessed the inherent risks in each industry sector by evaluating the following factors:

- The pervasiveness and severity of sweatshop labor abuses in the supply chain within the industry as documented by governments and multilateral institutions.
- The number of intermediaries typically found between the publicly traded companies in the industry and the offending suppliers.
- The extent to which governments have cut off supplies of products to the sector from particular countries due to endemic child or forced labor problems.
- The frequency to which activists have targeted companies in the industry for contracting with supplier sweatshop labor.
- The degree to which groups have sued companies in the industry for damages related to labor abuses perpetrated by suppliers.

High risk: Based on these criteria, RiskMetrics categorized retailers, consumer durables, apparel and footwear manufacturers, household and personal products makers and food, beverage and tobacco companies as at high risk for supplier labor abuses. Sweatshop labor has been well documented in all of these sectors' supply chains. In fact, apparel was the first to be targeted by the anti-sweatshop movement during the 1990s with allegations of Kathie Lee Gifford's licensed goods being tied to sweatshops in Central America and Guess's products implicated in a forced labor operation in the suburbs of Los Angeles.

Despite progress in implementing codes and monitoring them, problems persist in these industries. For example, **Gap** was found doing business with a supplier that had employed children in India in the manufacture of clothes for the Gap Kids brand as recently as October last year. Gap responded quickly by working with local groups to transition the children from the factory into schools and to pull the product from its stores, and it won praise for this response and its rigorous code and associated monitoring and reporting programs. However, the incident was a clear reminder of how common these types of abuses are in the industry.

Similarly, RiskMetrics rated restaurants, food manufacturers and others purchasing agricultural commodities as high risk, because suppliers of agricultural commodities have exhibited some of the worst labor abuses globally. According to the International Labor Organization, two-thirds of the 218 million child laborers worldwide work in agriculture. Activists continue to target companies purchasing cocoa and tobacco from growers in West Africa for the widespread use of child and forced labor on these farms and have filed lawsuits against firms in both industries for their alleged complicity in the abuses.

Out of these sectors, retailers were the most likely to have adopted a supplier code and won the distinction of exhibiting the highest rate of code adoption among all industries. Roughly half of all retailers RiskMetrics analyzed had codes, and the group also was the most likely to address all of the core labor rights areas identified by the ILO and monitor suppliers for compliance.

Industry	% With Supplier Labor Code	% With Supplier Code That Discusses:					
		Child Labor	Forced Labor	Freedom of Association	EEO	Health and Safety	Monitoring
High Risk							
Retailing	52	49	49	34	48	32	40
Food and Staples Retailing	48	39	36	33	42	21	39
Consumer Durables and Apparel	41	33	33	30	38	22	31
Household & Personal Products	43	43	36	43	36	43	36
Food, Beverage & Tobacco	34	28	25	23	24	13	25
Medium Risk							
Automobiles & Components	50	45	45	27	41	9	23
Technology Hardware	35	31	27	27	29	21	27
Media	22	18	15	10	16	7	10
Capital Goods	21	12	13	9	12	8	11
Materials	20	15	15	13	12	11	13
Semiconductors & Related Equipment	14	9	9	12	12	14	12
Healthcare Equipment & Services	12	5	4	3	7	0	3
Low Risk							
Telecommunication Services	33	23	23	23	28	20	18
Utilities	24	13	12	9	19	12	13
Commercial Services & Supplies	18	14	16	14	16	5	11
Pharmaceuticals & Biotechnology	15	9	8	9	11	11	12
Banks	14	13	11	10	10	4	9
Transportation	12	7	7	7	7	3	6
Consumer Services	11	11	11	7	11	7	11
Diversified Financials	11	8	8	4	8	6	6
Insurance	10	8	7	5	4	3	3
Energy	7	5	4	4	4	3	3
Real Estate	3	1	2	0	0	1	3
Software & Services	8	5	5	5	7	5	4
All Industries	**20**	**15**	**15**	**12**	**15**	**10**	**14**

Table 2 – Supplier Labor Policies of Large Cap Firms, by Industry

Note: RiskMetrics analyzed its sustainability research results using the Global Industry Classification Standard (GICS) developed by Morgan Stanley and Standard & Poor's, which has 10 economic sectors, 24 industry groups, 67 industries and 147 sub-industries. The "GICS 4" or 24 industry groups are analyzed in this table.

Medium risk: Albeit to a lesser extent than their high-risk counterparts, the sectors designated as medium risk, too, have been dogged by activists' campaigns in recent years. In December 2006, four major automakers—**DaimlerChrysler**, **Ford Motor**, **General Motors** and **Honda** Manufacturing of America—and three of their major suppliers—**Exel**, **Johnson Controls** and **Yazaki**—announced that they would be working through the Automotive Industry Action Group, an industry association with more than 1,500 members worldwide, to tackle labor abuses. The group, like other collaborative efforts, was born out of controversy in the face of stiff shareholder and other activist pressure. Several of the automakers had been tied to a producer of pig iron that purchased charcoal from a slave labor camp in Brazil.

Media firms licensing their trademarks also have been cast in an undesirable spotlight, Disney being the most notable. On March 10, 2008, the *Los Angeles Times* reported that a licensee had duped **Disney** into placing production into a factory the company had banned from its supplier list because of well-documented patterns of violating wage and hour laws. Over the past decade, activist groups have highlighted violations of Disney's code of conduct and Chinese labor law at dozens of factories. Reports have ranged from allegations of forced overtime and wage violations to routine verbal

Country/Region	% With Supplier Labor Code	% With Supplier Code That Discusses:					
		Child Labor	Forced Labor	Freedom of Association	EEO	Health and Safety	Monitoring
European Union	35	29	28	25	26	17	23
Other Europe	22	16	15	14	14	9	15
United States	17	12	12	8	14	8	10
Austral-Asia	10	6	6	4	6	4	5
Other Americas	8	4	5	3	6	2	4
All Countries	**20**	**15**	**15**	**12**	**15**	**10**	**14**

Table 3 – Supplier Labor Policies of Large Cap Firms, by Country/Region

Source: RiskMetrics Group

abuse and beatings. Air quality at some of the factories was reported to be so toxic that workers frequently vomited at their work stations. (See box on problems plaguing Disney's collaborative initiative with **McDonald's** in China.)

It is important to note, however, that these sectors are further removed from the problems than companies in higher risk industries. For example, most of the vehicle manufacturers implicated in the slave labor case determined that the pig iron company purchasing charcoal from the slave labor camp was a fifth or sixth tier supplier. Similarly, Disney has agreements with 6,000 licensees that make their own production contracts with tens of thousands of factories. Many of those relationships end up being subcontractor arrangements beyond Disney's knowledge.

Still, under scrutiny, automobile manufacturers and their suppliers stepped up by adopting supplier codes on a wider basis than even many of their counterparts in higher risk industries. More than half of them had codes, and most of those codes addressed core labor rights issues, although they incorporate health and safety standards and monitoring programs at lower rates than apparel and other high risk companies. From RiskMetrics' analysis, this standard for supplier compliance appears to be driven largely at an industry level, which might be the reason for its wider adoption. Electronics manufactuers, too, have an industry-wide code that has received broad acceptance. The sector also was the most likely among all to mention supply chain risks as material to financial performance to investors in annual reports and securities filings.

The healthcare sector's low marks relative to its medium risk designation is somewhat misleading, because it encompases both healthcare equipment manufacturers and health service providers. Activists have accused healthcare equipment manufacturers of sourcing from suppliers with child and other labor rights abuses—with the manufacture of surgical equipment by children in Pakistan receiving the most attention. Service providers, such as hospitals and health management organizations, are not exposed to the same risks. The two are lumped together, however, in the statistics in Table 2, which in part explains the sector's poor performance in comparison to others in the medium risk category.

Low risk: Even when looking at firms deemed to have a low risk for supplier workplace abuses, a significant minority of companies seems to be trying to address the issue of supplier labor abuses. For example, communications firms buy equipment from mainstream manufacturers, which have come under fire from labor rights groups for the health and safety conditions and working hours of their suppliers. This might explain why a third of these firms have supplier codes and close to a fifth try to monitor adherence to these requirements.

Regional Differences

As shown in Table 3, European firms eclipsed their American counterparts in their willingness to adopt and monitor codes of conduct addressing labor standards for their suppliers. No notable industry bias explains the difference, opening a debate as to whether European firms are under more pressure to adopt these types of measures or if they have realized economic benefits from setting labor standards that their competitors have not. Both the United States and the European Union ban imports made with forced labor, but enforcement has been lax on both sides of the Atlantic.

To an even greater extent than U.S. firms, Austral-Asian firms are concentrated in industry sectors with high or medium risk for supplier labor problems, but they are less likely than U.S. firms to have codes to address these shortcomings. However, firms hailing from this region were more likely to be found in medium rather than high risk sectors. For example, most of the retailers RiskMetrics analyzed were of U.S. or European origin, while Austral-Asian companies were more likely to be involved in automobile or electronics

Problem Factory Delays Project Kaleidoscope Final Report

The *Los Angeles Times* reported on March 10 that delays in releasing a progress report on Project Kaleidoscope—a collaborative effort involving **Disney**, **McDonald's**, As You Sow Foundation, members of the Interfaith Center on Corporate Responsibility and the Connecticut state treasurer's office to address recurring labor abuses in factories—are tied to a problem factory. Advocates of responsible workplace practices have been anticipating the report's debut, as many hope it holds evidence that encouraging better workplace practices at suppliers improves worker productivity, product quality, on-time delivery and overall financial performance.

History

In 2000, Disney joined with McDonald's, also under scrutiny at the time for conditions in its toy suppliers' factories in China, and a group of faith-based and socially responsible institutional investors to examine the effectiveness of monitoring. The National Labor Committee and other labor and human rights groups had alleged that the companies had engaged sweatshops in China to make toys for McDonald's "Happy Meals" using Disney characters, which are marketed to children at its restaurants. Disney and McDonald's, at the time, were involved in a joint marketing arrangement.

In 2002, the working group had conceptualized what it dubbed a sustained compliance model to improve the effectiveness of monitoring programs in improving labor standards and preventing violations at factories from recurring. However, it wasn't until August 2004 that it released the first, limited details on the project. At the time, the working group said it would tap the collective expertise and experience of Disney, McDonald's, the investor and other organizations to be identified to create a different approach to bring about sustained compliance.

The project's working group issued its first interim report in January 2005. In it, the participants said they planned to test its new methods in 10 factories in China that produce toys, footwear and apparel and represent a broad range in size. In particular, the group sought to develop factory-based systems to pinpoint the source of chronic compliance issues with the objective of resolving them and preventing them from recurring. The factories' performance would be evaluated according to standards covering wages, working hours, workplace safety, child labor and other issues identified by the working group based on commonly accepted principles. The group also pledged at that time to report by the end of 2005 on its findings, but three years later its members remain silent on the project's progress.

Delay

"People familiar with the situation" told the *Los Angeles Times* that the report was delayed in part because of what happened at a pilot plant— Hengli Factory in China's southern Guangdong province—that was producing toys for McDonald's based on Disney characters. The paper reported that a clash between security guards and a worker, who allegedly had been fired for planning a strike, triggered a riot in July 2006 in which 1,000 workers vandalized the factory.

Li Qiang, executive director of China Labor Watch, told the paper that workers had complained of the sort of chronic workplace abuses Project Kaleidoscope was intended to address. He said that employees had recounted for the project's researchers 11 to 12 hour working days and beatings from security guards. However, Li said a follow-up investigation last summer showed that conditions at Hengli only slightly improved. "Workers do not have to work as much overtime as before, the food quality is improved a little bit and management became less strict," Li said. "But still I wouldn't say it's a good factory."

Disney and other Project Kaleidoscope participants declined to comment to the *Los Angeles Times* and to RiskMetrics Group on the explanation for the delay in reporting discussed in this story, citing confidentiality agreements, although one participant told RiskMetrics that a final report from the group is imminent.

—Peter DeSimone

manufacturing.

Finally, the "Other Americas" category was weighted more heavily than other regions with extractive firms, which overall had adopted supplier labor codes at a lower rate.

S&P 500 Trends

Breaking out the S&P 500 posed a unique opportunity for RiskMetrics Group to present trends in this issue area, as it has been researching S&P 500 firms' approaches to supplier labor compliance for the past three years. Movement in

Table 4 - Supplier Labor Policies of the S&P 500 2005 – 2007			
	2007	2006	2005
% with supplier labor code	22	16	13
% with supplier code that discusses:			
Child Labor	17	12	10
ILO 138	11	6	5
ILO 182	5	5	3
Forced Labor	16	12	10
ILO 29 and 105	12	9	7
Freedom of Association	11	8	6
ILO 87 and 98	10	5	4
Discrimination	18	10	8
ILO 100	6	6	3
ILO 111	3	3	1
Harassment	13	9	7
Health and Safety	12	13	11
Hazardous Materials	3	NA	NA
Working Hours	11	10	8
Working Hours Limit	6	6	4
Wages	14	10	8
Living Wage	1	1	0
Monitoring	13	11	8
Enforcement	15	10	7
Corrective Action	14	NA	NA
Hotline	8	NA	NA
Training	13	NA	NA
Reporting	6	3	3

Note: Some firms dropped out of the S&P 500 index during the data collection period and were not included for analysis in this table, while others are listed on other indices in our study because of cross listings on foreign exchanges. This explains the differences in percentages between tables 3 and 4.

this area appears to be accelerating As recently as 2005, RiskMetrics counted only 13 percent of the S&P 500 had supplier labor policies. In 2007, nearly double—22 percent—had these types of standards in place.

To a lesser extent but at a similar rate of growth, S&P 500 companies are monitoring and enforcing these policies, another encouraging observations for advocates of these practices.

However, as S&P companies have adopted policies they have been more inclined to stray from international standards promulgated by the ILO. While the growth in codes in this area leapt six percentage points in the past year, those codes meeting the standards outlined in core ILO convention 182, addressing the worst forms of child labor, remained flat at 5 percent. Similarly, the percentages of codes meeting the requirements of ILO convention 100 on equal pay for equal work for men and women and ILO convention 111 barring discrimination based on race, color, sex, religion, political opinion, and national and social origin remained the same between 2006 and 2007.

Still, the ranks of companies barring the use of child labor in line with ILO convention 138—the higher of the age of 15 or completion of compulsory education, with limited exceptions for designated developing countries—kept pace with the overall trend in embracing codes during all years.

Progress on freedom of association: In addition, firms with supplier codes guaranteeing freedom of association increased from 8 to 11 percent, and those also promising the right to organize where legal without fear of reprisal in line with ILO convention 87 and 98 doubled between 2006 and 2007—issues on which firms had been the most reluctant to weigh in with standards in the past.

—Peter DeSimone

Genocide Screens at Fidelity Funds Gain Support

Proposals seeking to ensure that **Fidelity Investments** screens out holdings in companies that contribute to genocide lost in a second round of voting April 16, but again drew an unusual amount of shareholder support.

High Votes

A month after more than 25 percent of the holders at two other Fidelity mutual funds returned "yes" votes on the same resolution, ballots cast in favor at four more funds fell short of a majority but showed strong backing for the proposal. As in March, several of the funds' votes failed to reach the required 50 percent quorum level and were adjourned for another round of voting on May 14.

Fidelity has advised shareholders to vote against the genocide-free investment proposal, submitted by an activist group called Investors Against Genocide.

Proposals on the four Fidelity funds that achieved a quorum this month again each captured about a quarter of their shareholders' support. For the Mid-Cap Stock Fund, with $12.3 billion in assets under management as of March 31, according to Fidelity's website, the activists' proposal received 25 percent of its vote; at the $4.4 billion Canada Fund it garnered 23 percent; at the $12.5 billion International Discovery

fund, 21 percent; and for the $8.5 billion Overseas fund, 22 percent. A Fidelity spokesman confirmed the voting percentages. Shareholder proposals must gain a majority of shareholder votes to win approval.

Some of the Fidelity funds that will vote again in May because they didn't reach a quorum in one or both of the last two months' voting are larger in terms of assets and number of shareholders. They are the Contrafund, with $71.5 billion in assets as of March 31, according to the Fidelity website; the Diversified International fund, with $50.3 billion; the Magellan Fund, $38.4 billion; the Low-Priced Stock fund, $30.5 billion; and the Puritan fund, $22.5 billion. Three—the Contrafund, the Low-Priced Stock Fund and the Puritan fund—were rolled over for lack of quorum from March to the April 16 voting. An additional six funds deferred from earlier voting will also be polled for the May meeting.

'Productive Discussion'

Eric Cohen, chair of Investors Against Genocide, a nonprofit organization created to persuade mutual fund firms to avoid complicity in genocide through their investing, said he was heartened by the discussion and more active participation by Fidelity managers and trustees at the April 16 meeting.

"It felt different to me," Cohen told RiskMetrics' Social Issues Service. "We had what felt like a productive discussion, which was missing from the last meeting. Many trustees said they wanted to listen to shareholders. Trustee Cornelia Small said multiple times that the board was discussing and grappling with the issue."

Investors Against Genocide is changing its tack slightly as ordinary Fidelity mutual fund investors become more familiar with its unprecedented shareholder campaign. At this month's meeting Cohen asked the Fidelity Board of Trustees to shift its opposing stance on the proxy ballot to a neutral one. "…Fidelity has actively opposed it and is using its control of the machinery of proxy balloting to tilt the vote against the proposal," he said in a press release after the shareholders meeting in Boston.

Cohen said Fidelity officials at the April meeting didn't deny a connection between the controversial Chinese oil company **Petrochina**, some of whose H shares it holds in the Hong Kong stock market, and indirect funding of genocide in Darfur through Petrochina's connections to the Sudanese government. They also didn't argue that Petrochina holdings were necessary for Fidelity to earn high returns for its investors, he said.

Instead, Fidelity officials focused on the legality of their funds' right to hold Petrochina shares or any others, and the importance of not sacrificing to a shareholder proposal the flexibility among assets that the company must maintain as it makes investment choices, Cohen said.

"None of the funds in the last two meetings where there have been [shareholder] votes held Petrochina or other stocks being talked about" in connection with genocide, Ben Loporchia, a spokesman for Fidelity, told RiskMetrics' Social Issues Service.

New Approach

The genocide-free investing proxy campaign adopts a new approach to socially responsible investing, one that targets several widely held U.S. mutual funds' stockholdings rather than companies themselves. The strength of the backing that the genocide-free investing proposal has received so far on six of 21 Fidelity fund ballots where it's been placed means the resolution will be allowed to reappear on at least those six funds' proxy ballots again next year.

The proposal also has been filed at other Fidelity mutual funds and for funds managed by other large investment companies whose shareholder meetings have yet to be scheduled, including T. Rowe Price, Barclays, Vanguard and Franklin Templeton.

In March's voting, the two Fidelity funds that achieved a quorum were the Capital & Income Portfolio fund, with $9.3 billion in assets under management as of March 31, according to Fidelity, and votes from 27 percent of its shareholders; and the Select Health Care Portfolio fund, which manages $1.8 billion in assets.

In response to questions from Investors Against Genocide, Fidelity provided more detailed preliminary information about the breakdown of votes recorded as being against the proposal for these two funds. Cohen said the numbers showed that abstentions and so-called broker non-votes together could comprise more than 30 percent of votes tallied as opposing their proposal.

Although that method of proxy vote counting is typical for U.S. public companies, it could prove to be "an empowering message" to individual Fidelity mutual fund holders once they see what final proportion of "against" votes were in fact cast actively in support of Fidelity's opposition to the resolution, said Susan Morgan, director of communications for the proponent group.

—*Jane Meacham*

Capuchins Withdraw Proposal at Boeing

A shareholder proposal asking Boeing to toughen its human rights policy, especially in China where it earned nearly $3 billion in revenue last year, was withdrawn after the aircraft maker took steps to meet the proponent's demands.

The Capuchin Province of St. Joseph, an order of Catholic priests based in Milwaukee, on March 23 sent a letter to Boeing withdrawing its proxy proposal calling for the company to adopt International Labor Organization standards beyond its existing human rights policy and to engage third-party monitors for compliance in trouble spots where it has operations.

Rev. Michael Crosby, corporate responsibility agent for the Capuchin Order, told RiskMetrics that he "reluctantly" sent the request for Boeing to withdraw the shareholder proposal, which would have come up for a vote at Boeing's annual meeting in Chicago on April 28. This shareholder proposal will still appear as Item 5 on Boeing's proxy statement because the withdrawal occurred after ballots were printed.

Core Concern Addressed

The Capuchins dropped their campaign "because, technically speaking, Boeing has endorsed human rights principles and structured these into a programmatic," Crosby said. "They did create something that addresses our core concern."

Boeing confirmed it received Crosby's letter about the withdrawn proposal in late March but declined to comment further on the matter.

On April 2, Boeing posted the new "Company Code of Basic Working Conditions and Human Rights" on its corporate website—a document that was shaped by ongoing negotiations with Crosby after he and his group filed shareholder proposals over the last five years requesting that Boeing adopt a comprehensive human rights policy. These proposals garnered 25 percent of the vote in both of the last years. The lowest vote, in 2004, was 17.4 percent.

Boeing explains in introducing the human rights plan that "the concepts in this code are generally derived from Boeing policies and practices already in place, but which have not previously been summarized in a single document." The company says that while parts of the code reflect human rights concepts advanced by groups such as the ILO and the Universal Declaration of Human Rights, "this code represents Boeing's statement of its own standards on these subjects, rather than those of a third party."

The code sets out broad company policy on freedom of association; nondiscrimination and harassment in the workplace; environment, health and safety; expectations for supplier compliance; and forced and child labor, among other topics.

China Operations

The aircraft and defense systems company since the mid-1970s has run significant operations in China. Last year it reported revenue from that country alone of $2.85 billion, or 4 percent of its $66.39 billion total revenue. China has become one of the highest-growth travel markets in recent years, making its airlines big players in aircraft orders and purchasing. Boeing projected in 2005 that between that year and 2024, China will need 2,600 jetliners, valued at about $213 billion, making it the second largest market for commercial planes after the United States during that span of time. Boeing says on its website that it has about 430 employees in China.

The proponent's resolution said tens of thousands of people in China continue to be detained or imprisoned in violation of their rights to freedom of expression and association, quoting a 2006 Amnesty International report. Others risk torture or ill treatment for free expression there, including Christians of various denominations. Thousands of people have been sentenced to death or executed in China, according to the Amnesty International study they cite.

The proponent stated that, despite having longtime operations in China, Boeing has been unable to influence the Chinese government to respect fundamental human rights. Indeed, as Amnesty International and other groups monitoring human rights violations have reported, despite rapid economic growth and the expansion of Western-based companies operating there, no parallel increase in human rights has occurred in China. The Capuchins also appealed to other Boeing shareholders for their support of outside monitoring of Boeing's shored-up human rights code, especially in China. In his withdrawal letter to Boeing, Crosby said, "The sticky issue is still dealing with some kind of more thorough outside monitoring."

Implementation

Crosby separately expressed concern about whether Boeing would implement the new, more rigorous standards laid out in its Code of Basic Working Conditions, repeating a sentiment expressed in his group's proposal that "some critical past promises made by the company that haven't been realized."

As examples of these, the shareholder proposal mentioned a series of

delays, denied at first, in production of Boeing's new jet model, the 787 "Dreamliner." It also referred to a November 2007 *New York Times* story that said Boeing was "all too willing to make promises it ultimately could not keep" while under contract with the U.S. government to build a new generation of spy satellites worth about $4 billion. This huge "Future Imagery Architecture" project that Boeing won collapsed and was eventually killed by the government in September 2005.

—Jane Meacham

Del Monte Found Liable for Supplier Wage Violations

In March, a federal court ruled that multinational food purveyor **Fresh Del Monte Produce** (ticker FDP) could be held responsible for back wages its contractor allegedly owes farm workers. (The company, which uses Del Monte Fresh Produce as its commercial name, is a legally separate entity from Del Monte Foods Co., the packaged foods company.)

The Southern Poverty Law Center (SPLC) filed the suit resulting in the order in April 2006 on behalf of foreign guest workers and domestic migrant farm workers who were recruited to work on farms for Del Monte Southeast in Wheeler and Telfair counties west of Savannah in southeast Georgia. About 500 field and factory workers in Del Monte's sweet onion operation there were allegedly badly underpaid for planting, harvesting and packaging onions.

Using Middlemen

"This decision is particularly significant because it provides a roadblock to a disturbing trend by large corporate growers that import workers," Mary Bauer, director of the SPLC's Immigrant Justice Project, told RiskMetrics. "Increasingly, those corporations attempt to evade responsibility for their workers by having middlemen—generally penniless crew leaders—submit the applications for H-2A workers, instead of the wealthy corporations doing so themselves."

The SLPC says that at various times between 2003 and 2006, Del Monte Southeast, the owner of the farms, employed about 500 migrant workers to plant, harvest and pack sweet onions in its fields. Some of these laborers were U.S. migrant workers, and some were brought in from Mexico under the U.S. guest worker program on special H-2A visas that permitted them to work only for the employer who requested them—in this case Del Monte Southeast's labor contractor. The workers lived in labor camps operated by Del Monte, worked in Del Monte's fields and used Del Monte's equipment. In addition, the SLPC says, Del Monte employees supervised the workers daily.

Del Monte had argued that it wasn't responsible for any alleged wage violations, because its labor contractor—and not Del Monte—employed the workers. However, the SLPC pointed out during the trial that the labor contractor cited in Del Monte's case was a ninth-grade dropout who was 18 and had no particular experience in the field when the arrangement with Del Monte began. She handled the recruiting of the workers, the SLPC says, but it was clear that Del Monte was the real employer. In the end, the federal judge ruled that the hundreds of migrant workers, as well as the labor contractor, all were Del Monte Southeast employees.

"Rather than paying its workers directly, Del Monte contracted with a grossly undercapitalized labor contractor to be the supposed boss of the workers while Del Monte gave all the orders," said Kristi Graunke, an SPLC attorney handling the case. "This is a common tactic by corporations—leaving somebody without assets holding the bag for their wage violations," she said.

Legal Responsibility

The ruling in *Luna v. Del Monte Fresh Produce* means that Del Monte Southeast is legally on the hook for any violations. There has been no final ruling on whether the wage violations occurred, but the case could eventually include up to 500 migrant workers. The plaintiffs complain that the hourly rate quoted on their paystubs was often incorrect, and that the pay stubs frequently reflected many fewer hours than they actually had worked.

"The folks at Del Monte should be ashamed of themselves," Bauer said. "A Fortune 600 company certainly has enough money to make sure everyone working for them receives the legal wages due them."

Fresh Del Monte Produce did not return calls asking for comment on the lawsuit for this story.

—Peter DeSimone

Investors Achieve Record Number of Withdrawals

With some final decisions, the Securities and Exchange Commission staff has tied up most of the remaining loose ends of the spring social issues proxy season, although its reasoning on whether particular resolutions may be omitted has often been opaque. In addition, this year's surge of withdrawal agreements continued in late March and early April, but should be close to the end now, since most of the companies with pending shareholder proposals have issued their proxy statements. Proponents have now withdrawn 122 social policy resolutions so far this year, a total that has already comfortably surpassed the record for 113 set in 2005; last year's withdrawal total for the whole year was 111.

SEC Decisions

Rail security: The last of the Teamsters' five resolutions on rail security was omitted in March, so there will be no votes on that issue this year. The SEC staff reversed an earlier decision and told **Kansas City Southern** that it can rely on the shareholder proposal rule's "ordinary business" exclusion to omit the proposal asking for a report on information "relevant to the company's efforts to safeguard the security of their operations" arising from terrorist attacks or homeland security incidents. The staff in January had told Kansas City and three other companies that they had to include the resolution, which was a revision of a proposal that had gotten caught in the ordinary business exclusion last year. But a fifth target, Union Pacific, later challenged anyhow, arguing that while parts of the proposal raised a significant social policy issue, other parts dealt with mundane matters, which makes the whole proposal excludable. The SEC staff agreed.

At that point, Kansas City Southern asked for reconsideration of its earlier no-action decision, citing the Union Pacific letter and arguing that "Terrorist attacks may be extraordinary events, but the tasks carried out by the management to prevent these attacks are part of the ordinary day-to-day operation of the company." The SEC staff, in a rare reversal, issued a no-action letter March 14 advising Kansas City that it could omit the resolution after all. Two of the companies that had been told they could not omit the proposal back in January had negotiated withdrawal agreements in the meantime. (For more on all this, see the March issue of the *Reporter*.)

Country selection guidelines: The SEC staff has cited two key reasons for allowing companies to omit shareholder resolutions this year on ordinary business grounds:

- that they entailed evaluation of internal risks that the company faces, and
- that they addressed routine business matters even if they also raised significant policy issues.

Both of these elements came into play in the decisions on the Teamsters' rail security resolutions, and the question of a mix of routine and significant policy issues was the crux of the surprise February decision to allow Apache Oil to omit a resolution on the Equality anti-discrimination principles. (See the story on p. 13.)

But **Chevron** was unsuccessful in raising both these points to try to convince the SEC staff that it could omit two resolutions. One of those was a new proposal from the Teamsters and United Steelworkers asking the board to develop guidelines on withdrawing from countries where the government is illegitimate, there is a systematic violation of human rights and there is a call for economic sanctions from democracy advocates; the resolution was inspired especially by Chevron's acquisition of Unocal along with its involvement in Burma. The second proposal was a repeat of a proposal filed by Trillium Asset Management last year, and this year filed by New York City pension funds and the New York State Common Retirement Fund; it asks Chevron to describe the policies that guide its assessment of whether host country laws are adequate to protect human health, the environment and the company's reputation. The SEC's letters are dated March 21 and March 18; as usual, neither gives any inkling as to why the staff rejected the company's arguments.

Animal welfare: As discussed in earlier issues of the *Reporter*, a number of resolutions, including some in a new product safety campaign, have been excluded this year on ordinary business grounds because they deal with retailers' sales of particular products. Another proposal, on animal welfare issues, has now been omitted for that reason. The SEC staff agreed with **Wal-Mart** that it didn't have to publish a proposal asking for a report on the viability of extending the policy of its UK subsidiary to sell only eggs from cage-free hens to the United States.

Also omitted is an animal welfare proposal from People for the Ethical Treatment of Animals to **eBay,** which asked the company to enact a policy prohibiting the sale of dogs and cats on the company's affiliated Chinese website. EBay argued that the proposal was impossible to effectuate (the i-6 exclusion under the shareholder proposal rule) because it owned

(continued on p. 14)

New York, Apache Sue Over Shareholder Proposal

New York City pension funds are involved in complicated litigation with Apache Oil over the company's decision to exclude New York's shareholder resolution asking it to adopt the "Equality principles" from its proxy statement. The Securities and Exchange Commission staff had told Apache it would not recommend enforcement action if the company omitted the proposal on grounds that it dealt with mundane "ordinary business" issues that were for management, not shareholders, to decide. Although the SEC staff in 2007 had not allowed exclusion of an Equality principles proposal as ordinary business, the company in question had made a different argument from the one Apache made this year.

The Equality Principles

The Equality principles deal with discrimination against homosexuals and transgendered people in the workplace. They stipulate that the company will prohibit discrimination based on sexual orientation and gender identity, but they also go further to suggest various steps a company might implement to counter discrimination against transgendered and gay employees. Among those are avoiding the use of negative stereotypes in corporate advertising and outlawing corporate policies barring corporate charitable contributions based on sexual orientation or gender identity.

New York City has long pursued a campaign to get companies to add sexual orientation nondiscrimination to their EEO statements, but in 2006 it largely switched to an effort to get companies to go further and implement measures along the lines of the Equality principles, and they began emphasizing transgendered persons as well as homosexuals.

'No-Action' Letter

The SEC staff issued the "no-action" letter to Apache March 5, accepting the company's argument that it could omit the resolution because some of the principles, especially those relating to advertising and contributions, dealt with ordinary business questions rather than significant social issues. According to a brief filed by Apache, the company heard nothing more about the issue until April 4—after it had printed its proxy statement without the resolution—when New York City published a release on the Controller's website saying the funds were exploring the option of filing a lawsuit against Apache.

Turning to the Courts

At that point, on April 8, the Houston-based company filed suit in U.S. District Court for the Southern District of Texas, seeking a temporary restraining order and preliminary injunction against the New York City funds to block any effort that would force Apache to reschedule its annual meeting or mail supplemental proxy materials containing the Equality principles proposal.

The company accused the funds of "laying in wait for over a month," and asserted that the "cookie-cutter resolution" had not been motivated by any evidence of discrimination on Apache's part. It argued, among other things, that postponing the meeting would "result in negative speculation in the marketplace that could be interpreted by many stockholders and potential investors in Apache to mean that Apache is experiencing an extraordinary event (such as a takeover attempt or a serious financial problem)" and cost as much as $600,000.

The New York City funds then quickly counterfiled in the U.S. District Court for the Southern District of New York requesting an injunction to force Apache to make a supplemental mailing to solicit proxies on their Equality principles proposal. The funds argued that they would be "irreparably harmed" if they missed their "once annual opportunity to communicate with other stockholders."

For the funds, a key point was that in 2007 the SEC staff had told Armor Holdings that it could not omit an Equality principles resolution on ordinary business grounds.

In its filing, Apache countered that while Armor had argued ordinary business, it had failed to make its argument by discussing the ways in which the Equality principles crossed the line into ordinary business territory. In its own suit, it cited a number of SEC staff rulings allowing companies to omit resolutions that related to the marketing and advertising of products and asserted that "Apache's shareholders could not effectively oversee whether the company's corporate advertising and marketing policy is impacted by sexual orientation or gender identity."

(continued from p. 12)
less than 50 percent of the website in question and did not have operating control, and the SEC staff agreed.

PetSmart has been allowed to omit its animal welfare proposal under yet another part of the shareholder proposal rule—section (i-10), which provides for exclusion of proposals that have been judged moot. The SEC staff agreed with the company that PETA's proposal asking for a plan to "resolve the lack of adequate and proper care of sick and/or injured animals received by and housed in PetSmart stores" was mooted by step-by-step procedures that "have been in place for many years."

Sustainable paper purchasing: Best Buy was allowed to omit a resolution from Domini Social Investments asking it to report on sustainable paper purchasing practices on grounds that "decisions concerning the paper stock used by the company" were routine, ordinary business questions.

Recent Withdrawals

While decisions at the SEC this year have knocked about 60 social issues proposals off proxy statements, more than twice as many resolutions have been withdrawn by their proponents, usually after some concessions by target companies.

Global warming: Ford has reached agreements with the proponents of two climate change resolutions, which negotiated with the company as a group. The company received a second-year resolution from the Sisters of St. Dominic and a number of co-filers asking it to adopt quantitative goals for reducing total greenhouse emissions; the other proposal was a new resolution from the Connecticut Retirement and Trust Funds asking for an assessment of actions to prepare for regulations that focus on promotion of conservation and efficiency. The shareholder proponents agreed to withdraw the proposals on the basis of commitments Ford has given to:

(i) adopt and publish in its annual Sustainability Report quantitative goals for reducing GHG emissions;
(ii) discuss in the Sustainability Report the steps Ford is taking to meet new fuel economy and GHG emission standards; and
(iii) continue the dialogue with the proponents on this issue.

Ford discussed the agreement in its proxy statement, calling it "further demonstrable evidence of Ford's commitment to the important objective of reducing greenhouse gas emissions." Management also noted that the shareholder proponents of the withdrawn proposals believe that Ford's transparency on its planned steps to achieve its emissions reduction targets by 2020 makes the company "an industry leader that should be modeled in other companies and industries."

The resolution from the Connecticut funds was technically omitted before the withdrawal, because the SEC staff had agreed that it was substantially duplicative of the quantitative goals proposal, which had been filed first. But Connecticut continued meeting with the company and other proponents and was pleased with the company's commitments at end of the process.

Sustainability: Seven more resolutions asking companies to issue sustainability reports have now been withdrawn after the targets agreed to do the reporting. This means that 23 of this year's 30 sustainability resolutions have been withdrawn, an unusually high percentage even for this issue, which is more amenable to agreement than many. In 2007, 21 of 41 sustainability proposals were withdrawn, and eight of 20 were withdrawn in 2006.

The recent withdrawals involved sustainability report requests from the New York City pension funds to **Allegheny Technologies, Hartford Insurance** and **Norfolk Southern**; a resolution from The Calvert Group to **JetBlue**; Christian Brothers' proposal at **Dillard's** and Methodist pension board proposals to **Comcast** and **UAL**.

Sexual orientation nondiscrimination: Three more resolutions asking companies to develop policies for nondiscrimination against homosexual and transgendered employees have been withdrawn after the companies agreed to the requests. The new withdrawals involve a Calvert Group proposal asking **Superior Energy** to amend its nondiscrimination statement, the same Trillium Asset Management proposal at **Pentair** and three of New York City's broader resolutions asking **Frontier Oil, Fidelity National** and **Tesoro** to adopt the "Equality principles." The proportion of withdrawals for these proposals is down this year; 16 of 32 have now been withdrawn, compared with 15 of 24 in 2008.

Forest protection policy: Domini Social Investments has withdrawn its resolution asking **Home Depot** for a report on progress toward implementing the company's 1999 wood purchasing policy, which was adopted at the time of the withdrawal of an earlier shareholder resolution. A Domini representative told RiskMetrics:

> Home Depot has agreed to publish a progress report (on its website) documenting progress in implementing its wood purchasing policy. The report will cover qualitative and quantitative indicators, including quantification of FSC [Forest Stewardship Council]-certified wood sales.

Human rights: The Capuchins withdrew their resolution asking **Boeing** to adopt International Labor Organization standards after the company released a new human rights policy. The withdrawal came after the

company had published its proxy statement. (See the story on p. 10.)

Charitable contributions: Tom Strobhar withdrew his proposal asking **Ford** to list recipients of its corporate charitable contributions on its website. Strobhar has proposed resolutions opposing gifts to Planned Parenthood and organizations that support abortion in the past, with mixed success at getting them past SEC scrutiny. (See the March 2008 *Corporate Social Issues Reporter*, p. 11.) This year's resolution was more neutral sounding than Strobhar's earlier proposals, but *Christian NewsWire*, in reporting the Ford withdrawal April 9, said that the purpose of this year's resolution "was to expose the size and scope of Ford's use of shareholder money to support controversial organizations." It explained the withdrawal as follows:

> By adding a carefully worded Supporting Statement to his proposal, Strobhar was able to expose Ford's controversial contributions to organizations advocating homosexual behavior and same-sex marriage. The skillful wording was necessary to make sure Ford's expected appeal to the Securities and Exchange Commission (SEC) to omit the proposal would be denied. ...

It added that "concurrent with Strobhar's shareholder activism, the American Family Association (AFA) was conducting a consumer boycott of Ford products to convince Ford to stop its extensive support of the homosexual agenda," and that the "AFA reported over 780,000 individuals signed their petition boycotting Ford." According to the wire story, Ford "agreed to conditions that resulted in AFA suspending its two-year boycott of Ford."

Christian NewsWire quoted Strobhar as saying, "I am pleased with the recent progress at Ford even though the company is still paying Domestic Partner Benefits to employees engaged in immoral sexual relations. However, in view of Ford's recent actions, we believe it appropriate to withdraw our current shareholder proposal."

Corporate political contributions: Three more resolutions in the big campaign to get companies to disclose their political contributions have been withdrawn. The recent withdrawals came at **Avon, Duke Energy** and **eBay**. Thirteen resolutions in the contributions campaign have been withdrawn this year, compared with 22 in 2007.

Carolyn Mathiasen

ExxonMobil, Schwab Oppose Ban on Advisory Proposals

Both Charles Schwab and Exxon Mobil have decided to oppose resolutions from the conservative group Action Fund Management asking them to amend their bylaws to outlaw non-binding shareholder resolutions "unless the board of directors takes specific action to approve submission of such proposals." Most shareholder resolutions that raise social issues are nonbinding, so the proposal had the potential to knock them all out of consideration. (For background on these issues, see the March 2008 *Corporate Social Issues Reporter*, p. 14.)

The question of allowing firms to establish procedures that could outlaw nonbinding proposals came up in last fall's rulemaking on proxy access and elicited a major organized protest from shareholder activists. Companies themselves were cautious about embracing the idea, although they pushed hard for much higher resubmission levels for repeat resolutions. No more has been heard from the SEC about changing the rules on non-binding proposals since the proxy access rulemaking ended.

Schwab and ExxonMobil gave similar responses to the proposal in their proxy statements. According to ExxonMobil:

> The Board welcomes and encourages input from our shareholders. At the same time, the Board does not believe the proxy statement is the most appropriate venue for many of the issues currently raised by shareholder proposals. However, the Board also does not believe the By-Law amendment proposed by the proponent is the best way to carry out reform of the shareholder proposal process at this time.

Charles Schwab says:

> We believe that there are more effective means for stockholders to communicate with us other than through non-binding proposals. As noted in response to the first stockholder proposal above, we are concerned that some proposals are designed for purposes other than to enhance shareholder value. The cost of responding to them may exceed any benefit to our stockholders.
> However, we also believe that there may be instances where it is appropriate to submit a non-binding proposal. We are concerned that this proposal goes too far by seeking a bylaw amendment to eliminate that right, and therefore we do not support it.

The Action Fund Management proposal on outlawing non-binding resolutions is number 3 on the proxy ballots at both firms.

Cash America Faces Proposal on Payday Loans

This month, shareholders at Cash America voted on a shareholder resolution asking the company to amend its policies concerning so-called "payday loans" and to report to shareholders on the company's involvement in the short-term loan business. This resolution comes as several state legislatures are considering legislation that would restrict or ban such loans.

High Cost of Borrowing

Payday loans, also known as deferred deposit advances, are small-dollar, short-term, unsecured loans that borrowers promise to repay out of their next paycheck or regular income payment, such as a Social Security check. The Federal Deposit Insurance Corp. (FDIC) defines these loans as subprime loans. Payday loans are usually priced at a fixed fee, which represents the finance charge to the borrower. Because these loans have very short maturity terms, the cost of borrowing, expressed as an annual percentage rate (APR), is very high.

According to a report issued in November 2007 (and updated in February 2008) by the Federal Reserve Bank of New York, payday lending evolved from check cashing businesses. "Once a customer had cashed a paycheck (or assistance check) repeatedly, lending against future checks was a natural step." Other studies cited in the Federal Reserve report have shown the typical payday loan has a two-week term and is for $300. "The typical price is about $45"—that is, $15 per $100 loaned—"implying an annual percentage rate (APR) of 390 percent." The person taking out the loan writes a post-dated check to the payday lender, which the lender then cashes once the check's date arrives.

Users of these loans tend to borrow eight to 12 times per year; the Federal Reserve report states; in some cases additional instances of borrowing consist of paying the interest and fee portion of the loan and rolling over the principal (and new interest and fees) to the next pay period.

The FDIC considers the loans to be risky, because borrowers seeking payday loans generally have cash flow difficulties and no borrowing alternatives. The FDIC also says that lenders often perform only a minimal analysis of the borrower's ability to repay. For example, many simply require borrowers to present a current pay stub or proof of a regular income source and a valid checking account number. Other payday lenders use credit scoring models and consult nationwide databases that track bounced checks and persons with outstanding payday loans. However, payday lenders typically do not obtain or analyze information regarding the borrower's total level of indebtedness or information from the major national credit bureaus, according to the FDIC. Nor do they typically conduct a substantive review of the borrower's credit history.

Of particular concern to the proponent, Christian Brothers Investment Services, is that payday lenders provide this high-cost, short-term credit on a recurring basis to customers with long-term credit needs. Payday lenders engaged in predatory practices encourage multiple loan renewals, a practice known as "loan flipping," which exacerbates the accumulation of costly fees and interest.

State Regulation

Each state has its own payday loan regulations. Most Northeastern states have never permitted payday lending, and in recent years Georgia, North Carolina, Oregon, Pennsylvania and the District of Columbia have banned such loans entirely. Recent federal legislation caps interest on payday loans to members of the U.S. armed forces at 36 percent annually. The National Conference of State Legislatures reports that 29 states are considering legislation that relates to payday loans. (Among these states are many that have already effectively banned such loans.)

Tracking The Firms Involved

RiskMetrics Group's ESG Analytics department tracks companies with ties to controversial financial practices including payday lending, installment lending, pawn lending, title lending, tax refund anticipation loans, and some forms of check cashing. Payday lending is by far the most prevalent practice among such companies tracked by RMG, with all companies on RMG's "predatory lending" list engaging in payday loans. An additional 11 publicly traded companies have been identified by RMG as having ties to predatory lenders, providing loans or lines of credit to such businesses.

—Jan Fetter-Degges