REPORT TO: **SUPERANNUATION INVESTMENT SUB-COMMITTEE OF THE POLICY AND RESOURCES COMMITTEE - 18 MAY 2009**

REPORT ON: **SOCIALLY RESPONSIBLE INVESTMENT - SIX MONTHLY REPORT**

REPORT BY: **HEAD OF FINANCE**

REPORT NO: **258-2009**

1 PURPOSE OF REPORT

This report reviews the progress by the Fund Managers regarding the positive engagement Policy on Environmental, Social and Corporate Governance approved by the Sub-Committee on 17 November 2008.

2 RECOMMENDATIONS

The Sub-Committee is asked to note the information contained within this report with regard to the activities of the Fund Managers during the six month period ended 31 March 2009.

3 FINANCIAL IMPLICATIONS

On 17 November 2008 the Sub-Committee approved a revised Policy on Environmental, Social Governance. This policy recognises the over-riding fiduciary duties but encourages the managers to engage with companies. They are requested to summarise this engagement activity quarterly. The key areas continue to be Employee Care, Human Rights, Sustainability and the Environment.

4 ALLIANCE BERNSTEIN

Alliance Bernstein's latest activity has looked at executive compensation and is shown at Appendix 1.

5 BAILLIE GIFFORD

A summary of recent engagement activity is shown at Appendix 2(a). This shows the wide range of topics covered and the diversity of companies approached. A new policy document on engagement is also included at Appendix 2(b)

6 FIDELITY

At Appendix 3, Fidelity if process and policy is shown together with examples of issues they have considered in the last quarter.

7 OVERALL CONCLUSION

The managers have continued to develop their strategy in this area and link more closely with the long-term effect on share value.

8 POLICY IMPLICATIONS

This Report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

The Fund's policy on Socially Responsible Investment requires its investment managers to engage with companies on Sustainability and the Environment and Employee Care and Human Rights.

9 CONSULTATION

The Chief Executive, Depute Chief Executive (Finance) and Depute Chief Executive (Support Services) have been consulted in the preparation of this report.

10 BACKGROUND PAPERS

None

MARJORY STEWART
HEAD OF FINANCE **08 MAY 2009**

Taking an Active Role in Executive Compensation

Compensation Principles

- As much compensation as possible should be variable: certainly more than 50%.
- Variable compensation should be linked to the multi-year performance of the business
- Link payments to achievement of specific, quantifiable, business objectives for which audited data are in the public domain.
- Senior executives should hold company stock equivalent to a significant multiple of their annual compensation
- Remuneration committees must be demonstrably independent to ensure adequate oversight
- All compensation payments, as well as changes to remuneration structures, must take account of financial performance, and set an appropriate tone for the business
- Automatic compensation increases linked to comparator analysis are inflationary and to be avoided

Our Approach

- We vote proxies actively on our clients' behalf following these policies
- We engage with companies to understand their approach to pay, and to make our concerns clear where appropriate

UK Examples Q1 2009

- We engaged with the chairman of a UK plc in the transportation sector on planned increases of 20%+ in CEO and CFO base compensation. We considered these unnecessary and inappropriate in view of the business environment. Following our discussions, the chairman has confirmed to us that increases have been limited to 3%.
- We voted against a 35% increase in CEO salary at a UK plc in the leisure sector on similar grounds, and expressed concern that the remuneration committee was not independent
- We reviewed changes to compensation structures at a UK plc in the telecommunications sector: these complied with our principles and were approved

Amazon.com

This retail website is well known for selling competitively priced books and music but has recently been expanding its services from providing an online marketplace for third party sellers to producing its own products, including a recently launched electronic book. There is limited disclosure on its approach to management of environmental and social issues, including customer servicing, reputation management, and financial security, and we were keen to gain a better understanding of this aspect of the business management practices.

We spoke to Investor Relations who confirmed that the 'customer is king' and that all business practices operate on this basis, with the long term sustainable performance of the business in mind.

As additional detail was not readily available, we encouraged further disclosure on the management of key non-financial risks. We were informed that they are now considering this.

BHP Billiton (UK)

BHP Billiton is a broadly diversified resources company with a wide range of products. The industry has seen considerable consolidation over the last few years and this has left the major producers with strong positions in several commodities. We met the Group Manager, Governance to discuss the role of the Risk and Audit Committee (RAC) and how the non-executive directors (NEDs) develop an understanding of the business and its risk management systems.

Given the complexity of the business, the board recognised about five years ago that the challenge for the RAC was understanding the risks within the nine Customer Sector Groups (CSGs). The nine CSGs are Petroleum, Aluminium, Base Metals, Diamonds and Specialty Products, Stainless Steel Materials, Iron Ore, Manganese, Metallurgical Coal and Energy Coal. Separate RACs have therefore been set up for each CSG which is chaired by a NED from the main board. This was a conscious decision to enable NEDs to better understand what was happening on the ground. The RACs consider the financials of each business unit, internal controls (including compliance with US governance regulation, Sarbanes Oxley), fraud and illegal behaviour, and the rehabilitation of closed mines.

We also discussed the importance of board evaluation which involves an external consultant. This includes interviews with the board directors, a review of board materials, and a focus on the directors' terms of reference. The dynamics of the committees and their interaction with management are also considered. Following the most recent board evaluation, the board recognised that it would benefit from recruiting NEDs who are current serving executives with relevant mining experience. In 2008, Alan Boeckmann, an experienced engineer, and Keith Rumble, a mining executive with experience of the metal sectors, were appointed as NEDs.

The board appears to recognise the challenges faced by NEDs in understanding a diversified resources company like BHP Billiton. We therefore welcome the systems that have been introduced in recent years which appear to assist the NEDs in monitoring and managing the business risks and opportunities.

Cairn Energy

Cairn is an oil and gas exploration and production company. There are two parts to the business: Cairn India and Capricorn. Cairn India, a subsidiary, is listed in India and has interests in India and Sri Lanka. Capricorn is an exploration-led business whose core

Appendix 2(a)

assets are in Greenland, South Asia and the Mediterranean. Capricorn is a non-listed subsidiary of Cairn.

As described in the engagement note from Q1 2008; Cairn Energy has a very stable Board with a number of directors having been together for more than 9 years. We noted that this was extremely positive as it had been very successful, although we felt that from a governance perspective, for future stability there should be some form of succession plan in place. We therefore accepted the offer of a meeting with the Chairman to discuss changes to board structure.

One of the long standing independent non-executive directors has resigned, whilst the other remains on the board but has stepped down from the role of Senior Independent Director and at the 2009 AGM, will resign from the Remuneration or Nomination committees. At the request of the Audit Committee chairman, he will remain on the Audit Committee for another year to provide experience and continuity. In addition, a deputy CEO has been named and a new independent non-executive has been recruited to the board. This is extremely positive; the company is maintaining considerable experience on the board whilst refreshing the board committees with more recent board recruits. We were grateful to the Chairman for having this discussion with us.

A second point which we discussed was the proposed amendments to the executive remuneration, specifically the valuation methodology used for Capricorn. We are currently communicating with the remuneration consultant but informed the Chairman that we had some concerns with the current proposals. Our conclusion will be reflected in the way we vote at the company's AGM later this year.

Microsoft Corporation

Microsoft Corporation develops, manufactures, licenses and supports a range of software products for computing devices. As Microsoft is one of the world's largest companies, with high visibility products, we would expect it to be a leader in the fields of corporate governance, environmental sustainability, and social responsibility. We had a telephone conference with the Head of Corporate Citizenship and covered a range of issues. We are pleased with the progress the company has made in relation to the concerns we raised in 2007 and 2008 regarding internet privacy and censorship in China. Microsoft is now a signatory to the Global Network Initiative, which is multi-stakeholder group of companies, civil society organisations, investors and academics working towards protecting and advancing freedom of expression and privacy in the ICT sector. We see this as a positive step towards Microsoft recognising its responsibilities in this area.

Other issues discussed were Microsoft's approach to managing the environmental risks associated with the business and its exposure to ongoing anti-trust filings and regulatory risks. Among the environmental issues were the level of resources Microsoft is allocating to building more energy -efficient data centres, the company's decision to market existing programmes such as Live Meeting as 'environmentally friendly', and developing software products designed to manage environmental issues such as energy usage and power management.

Rightmove

Rightmove is the leading web-based property portal in the UK, a market which is seeing a structural shift in the method of property advertising from print to online. The company should be a winner in the long term thanks to its strong brand, as well as its first mover and scale advantages. In the current economic climate, and given the current sensitivities around executive remuneration, it is particularly important that companies design remuneration policies which incentivise management to focus on long term shareholder value and sustainable business practices.

As large shareholders in the company, we were consulted in January on a remuneration proposal to award options, up to a £2 million individual annual limit, to the executive board directors. This was the first review of its executive remuneration policy since Rightmove's IPO in 2006. The company's remuneration policy is based on the provision of a competitive package, comprising a low base salary and high variable long term incentive opportunities such as options. This helps to ensure that management are focused on long term strategy rather than short term returns.

However, given the continued volatility and uncertainty in the property market, the outstanding IPO options which were granted in 2006 offered little incentive to management since they are essentially worthless at current market prices. We therefore questioned the rationale and incentive value of granting further options to executives at this time, and also queried the performance targets attached to the options. Also, importantly, granting a significant number of options to executives at a low point in the market could send out the wrong message to the market and undermine the board's alignment with its long term shareholders.

Following the shareholder feedback from the consultation, the remuneration committee has decided not to grant options to executives and will withdraw the resolution at this year's AGM. Nevertheless, it will investigate alternative remuneration structures for senior executives for this year and ensure they remain consistent with its current policy, which will be outlined in the 2009 annual report. We welcome the remuneration committee's decision and expect to be consulted on its future remuneration structures.

Samsung Electronics Co

Samsung Electronics is one of the strongest companies in the global electronics industry. It has invested heavily in its brand to the extent that it now charges premium prices above those of many Japanese competitors, and should be able to weather the current downturn relatively well. We met with the company's Investor Relations Manager to discuss the company's 2009 AGM agenda, corporate governance and its supply chain audit.

Given the current economic climate, the company has reduced its final dividend to shareholders and directors have taken a 20% pay cut. There have also been significant changes to the board in the last 12 months. Three of the four executive directors being elected at the AGM are new to the board, and have been appointed due to their breadth of skills, diversified knowledge and backgrounds. Although it is difficult in South Korea to find suitably experienced independent non-executive directors, who don't have business connections with the company, a majority of the board has been independent since 2000. This has instilled an ethic within the boardroom of openness and transparency on key issues. For example, the decision to publish quarterly consolidated financial statements was suggested by the independent directors.

We also discussed how the company is placing increasing importance on managing and auditing its supply chain in emerging markets. The Investor Relations Manager highlighted a recent case where they sacked four suppliers for not complying with the Electronic Industry Citizenship Coalition's (EICC) code of conduct, specifically that they breached guidelines regarding child labour. Given the importance of Samsung Electronics' brand, any suppliers failing to adhere to the EICC code pose a significant reputational risk to the business, and will therefore be replaced. Since the company's next ESG report is due to be published in September, we will review their progress and future goals with interest.

Standard Chartered

Standard Chartered is an International bank with branches in Asia Pacific, Africa, The Middle East, Europe and The Americas and it is a company which we identified several years ago as being best in sector from an ESG perspective. Since then it has continued to develop its policy implementation programmes, culminating this month (March 2009) with the publication of sector standards on subjects such as: Forestry and Palm Oil, Mining and Metals, Nuclear Energy, and Ship Broking. There are two reasons for the emphasis. The first is to equip Relationship Managers in the Wholesale and SME banking services to have the 'right' conversations with their clients to help implement ESG policies. In addition, and more importantly, the aim is to reduce the risk associated with its lending programmes.

We continue to consider Standard Chartered one of the most proactive companies in terms of its commitment to the integration of ESG into its business. The business rationale is three-fold: to enhance client relationships, protect and develop its global reputation, and minimise risk.

eBay

As a well known brand on the internet for people to visit to buy and sell goods, eBay is almost unique, although it is similar to many US companies in its lack of disclosure on the management of intangible risks.

Our conversation with the VP of Global Citizenship and the Deputy General Counsel & Assistant Secretary revealed that the company spends considerable time and resources in identifying and mitigating its non-financial risks such as product quality, timeliness, financial security, trust and privacy which are important components of brand reputation. Risk management generally is the responsibility of the Audit Committee who gain input from throughout the business and the issues raised are integral to the competitive sustainability of the business.

In addition, the company is proactive in its measures to work with public law enforcement agencies around the world to tackle fraud whilst at the same time providing customers with the best practice privacy options. eBay will address its lack of disclosure when it publishes its first Corporate Responsibility report later this year; we look forward to reviewing the document and following up on our initial engagement meeting.

BAILLIE GIFFORD

BG Environmental, Social and Governance Policy

Introduction

Baillie Gifford recognises that owning a company's shares on behalf of clients confers certain rights and responsibilities. At the same time, environmental, social and governance (ESG) issues, and the management thereof, are integral to the sustainability of a business. For this reason, Baillie Gifford considers ESG issues when analysing and reviewing a company, and there is a dedicated Corporate Governance Team who also take on the share-ownership responsibilities for our clients.

As active managers, a key part of our investment strategy is to assess the quality of company management, in particular, management attitudes to shareholders. When combined with financial information, non-financial business information can provide valuable insight into the overall quality of management. Given that significant ESG issues play-out over the medium to longer term and that our clients are invested for the longer term, it is important that companies' approaches to ESG issues are considered on a case by case basis.

Approach

Our investment approach aims to add value for our clients through the use of proprietary, fundamental research, building up an in-depth knowledge of individual companies in order to develop a view on their prospects. As part of this investment process we endeavour to identify the issues, financial and ESG, within companies that we believe could have a material impact on shareholder value.

Our approach to the social and environmental aspects of share ownership is based on engagement and dialogue rather than exclusion. Using in-house and external research, we identify key issues relating to our clients' shareholdings and discuss them with the companies concerned. In this way, we encourage companies to monitor and address the material social and environmental risks and opportunities facing their businesses. We believe that this process can contribute to the long term value of our clients' investments.

The Corporate Governance Team analyses all companies in which we are invested at least once a year. We then use a rating system so that we engage with the right companies on the right issues, thereby concentrating our efforts where they can be most effective. Companies whose ESG performance or disclosure is not up to standard are identified as engagement priorities. Following identification, further analysis is undertaken which makes use of all publicly available company documents, previous research pieces published on the Baillie Gifford Research Library, and analysis provided by ESG research providers and various brokers.

Engagement Themes

The ESG issues we focus on vary between geographic region, industry sector and between companies, and are dependant on the emphasis of a company's core business activities.

Key ESG issues

The following list is neither exhaustive nor exclusive, but is representative of our detailed expectations of companies on specific ESG issues.

Governance

- Board-level responsibility for significant ESG issues
- Appropriate systems for assessment of risks and opportunities
- Formal policies and systems for implementation and subsequent monitoring of effectiveness
- Dialogues with stakeholders and disclosure of the above in publicly available reports
- Incorporation of relevant ESG issues into long term executive compensation

Environment

- Have an understanding of significant environmental challenges facing the business directly or indirectly, for example through the supply chain
- Support a precautionary approach to manage and mitigate environmental impacts
- Specific environmental issues considered include:
  - pollution impacts and liabilities
  - climate change (see below)
  - water management
  - resource consumption
  - impacts on biodiversity
  - market opportunities for new products or services

Climate Change

- Encourage effective management of climate change risks and opportunities
- Reduce direct and indirect greenhouse gas emissions and integrate climate change policies into business strategies
- Develop corporate reporting and disclosure on climate change so that investors can properly assess associated investment risks and opportunities

Labour

- Adopt a code of conduct based on the International Labour Organization's Declaration on Fundamental Principles and Rights at Work and develop management systems to implement this code
- Monitor effectiveness of the code and take action to improve standards where risks and weaknesses are identified
- Focus on health and safety management systems and performance, particularly in high-risk sectors (e.g. oil & gas) and with business associates and contractors
- Manage employee skills base

Supply Chain

- Manage exposure to all social and environmental risks up and down the supply chain
- Proactively develop risk mitigation and business opportunities within the supply chain

Bribery & Corruption

- Work against corruption in all its forms including extortion and bribery
- For companies in extractive industries (such as oil, gas and minerals), support and actively participate in the Extractive Industries Transparency Initiative
- Support employees in appropriate ethical conduct through training and reporting procedures such as whistle-blowing hotlines
- Enforce robust governance and internal control systems

Stakeholder Relationships

- Consider stakeholder relationships including employees, suppliers, customers, shareholders, regulators etc.

Corporate Disclosure

Currently levels of disclosure vary between sectors and between countries. Baillie Gifford endeavours to engage with all the companies in which it is invested on corporate governance, environmental and social issues where disclosure is either limited or not aligned with best practice. Best practice is specific to the sector and the country the company is incorporated in and these differences are taken into consideration when analysing and engaging with a company.

Issues material to investors should be set out succinctly in the annual report. Disclosure should contain a policy element, description of company wide implementation plans, indication of recent performance, and targets against which future performance will be evaluated.

In accordance with the ABI's (Association of British Insurers) revised Guidelines on Responsible Investment Disclosure, Baillie Gifford believes that: ESG risks should be reported in the context of the whole range of risks and opportunities faced by the company; that the ESG-related reporting should contain an outlook; and that it should describe Board actions to reduce risks. We also fully endorse the International Corporate Governance Network's (ICGN) Statement and Guidance on Non-financial Business Reporting.

Evaluating the effectiveness of our intervention

When engaging with companies on ESG, we set clear objectives. Our underlying aim is to develop a good understanding of a company's policies, systems and performance. We encourage improvements where we believe these do not meet an appropriate standard and are not in our clients' best interests.

We monitor companies' progress and follow up on any meetings we have with companies when necessary. We actively consider whether or not the objectives we set at the time of our meeting with the company have been met.

Industry Groups

We build and maintain strong connections with other shareholders to increase the influence we can bring to bear on our clients' behalf. We do this through formal and informal means. In 2007 we became a signatory to the UN Principles for Responsible Investment (UNPRI). The UNPRI are a set of principles which encourage the incorporation of ESG issues into mainstream investment decision-making and ownership practices. Having analysed and engaged with companies on ESG issues for a number of years, becoming a signatory was a natural progression towards greater transparency and accountability to our clients on ESG issues.

Less formally we often meet and network with ESG peers and when appropriate arrange joint meetings with company representatives.

In addition, we have significant input into UKSIF, the UK Sustainable Investment and Finance association, and therefore the UK's ESG agenda, through our participation in the UKSIF Advisory Group. Baillie Gifford has also been a signatory to the Carbon Disclosure Project (CDP) since its inception in 2000. It provides a secretariat for the world's largest institutional investor collaboration on the business implications of climate change. We are also members of the Extractive Industries Transparency Initiative.

Client requirements and servicing

In addition to our normal engagement process, our Corporate Governance Team can communicate our clients' concerns to companies on request. We also have several clients for whom we avoid investment in specific companies or sectors. Our clients receive quarterly reports on corporate engagement, summarising our activities and conclusions from meetings with senior management at the companies in which we invest. We are transparent and accountable on ESG issues.

Conclusion

Our ESG engagement policy is consistent with Baillie Gifford's overall aims, which are to provide good long-term performance to our clients, and place principal importance on our clients' interests. When considering ESG issues, our main objective has always been to add value for our clients by engaging with company management and developing an understanding of how companies' approach to ESG issues impacts investment returns. Having a separate Corporate Governance Team has facilitated this. Through our ESG engagement process, we aim to ensure the companies we invest in are well managed and are taking all material risks and opportunities into consideration. We believe this improves the returns for our clients.

Further Information

Carbon Disclosure Project: *http://www.cdproject.net*

Extractive Industries Transparency Initiative: *http://eitransparency.org*

Guidelines on Responsible Investment Disclosure: *http://www.abi.org.uk*

ICGN Statement and Guidance on Non-financial Business Reporting: *http://www.icgn.org/news/releases/ICGN_Statement_NFBR.pdf*

International Labour Organization's Declaration on Fundamental Principles and Rights at Work: *http://www.ilo.org/declaration/lang--en/index.htm*

OECD Guidelines for Multinational Enterprises: *http://www.oecd.org*

The Rio Declaration on Environment and Development: *http://www.un.org/esa/sustdev/documents/agenda21/index.htm*

UK sustainable investment and finance association: *http://www.uksif.org/uksif*

UN Convention Against Corruption: *http://www.unodc.org/unodc/en/treaties/CAC/index.html*

UN Global Compact: *http://www.unglobalcompact.org*

UN Principles for Responsible Investment: *http://www.unpri.org*

UN Universal Declaration of Human Rights: *http://www.un.org/Overview/rights.html*

Appendix Corporate Social Responsibility Report - Q1 2009

FIL's policy on Corporate Social Responsibility (CSR)

- Fidelity believes that high standards of corporate social responsibility (CSR) make good business sense and have the potential to protect and enhance investment returns. Consequently, our investment process takes social, environmental and ethical issues into account when, in our view, these have a material impact on either investment risk or return.
- We recognise and support the view that social, environmental and ethical best practice should be encouraged and can often enhance long term financial return.
- We do not screen out companies from our investment universe purely on the grounds of poor social, environmental or ethical performance. Instead, we adopt a positive engagement approach whereby we discuss these issues with the management of the companies in which we invest or consider investing on behalf of our clients. We use the information gathered during these meetings both to inform our investment decisions and also to encourage company management to improve procedures and policies. We strongly believe that this is the most effective way to improve the attitude of business towards CSR.

FIL's process for CSR Analysis & Engagement

- Our approach involves active engagement because we believe that the best way to have a positive impact on a company's CSR profile is to engage in dialogue. Our experience over the years supports this approach.
- In Europe, we are progressing towards a model where CSR issues become embedded in the core evaluation process and thus investment analysts may consider how these issues relate to the investment prospects of the companies they cover. This analysis is part of the process of understanding the sustainability of certain business models and identifying company growth opportunities.
- The investment analysts engage with companies where we perceive that environmental, social and ethical issues could have a material impact on shareholder value.

General Meetings/Activities on CSR issues

1. The Impact of Regulation

- **The Carbon Market:**

Power generation - costs and opportunities:

In 2008 the EU approved additional limitations on emissions under its Emissions Trading Scheme (ETS). The ETS limits the carbon dioxide (CO2) emissions allowed by certain industries and requires companies seeking to emit above those limits to purchase the requisite amount of credits. From 2013, the ETS limits on power generation companies, among others, will become more stringent. Companies that can reduce their CO2 emissions are potentially at a competitive advantage in markets where there are restraints on carbon emissions.

During Q1, Fidelity held discussions with RWE and CEZ on the developing carbon market and its implications for these companies. Fidelity analysts highlighted that reduced economic activity as a result of the global downturn, has resulted in lower carbon emissions across Europe. This has depressed the price of carbon credits thereby aiding companies with the largest carbon emissions. Our discussions also focused on the RWE's and CEZ'a long-term renewable investment programmes which largely centre around the construction of wind parks.

Renewable sources of power generation:

EU targets require that a significant amount of power generation come from renewable energy sources. During the quarter, Fidelity held discussions with power utility companies which have made long-term investments in renewable energy generation. Our analysts have identified that these investments may be positive for shareholder returns and position companies at a competitive advantage. Investments in renewable energy generation may help companies reduce their exposure to volatile commodity prices. For example, Drax Power, which operates the largest coal plant in Europe, is currently attempting to diversify away from using coal to using bio-mass sources to generate power. Similarly, EDP, the Portuguese utility, is making considerable investments in new hydro- and wind-power generation.

- **Energy Efficiency:**

Energy-intensive industries, which are large customers of the power utilities, are also secondarily affected by EU emissions regulation. Companies in these sectors which become more energy efficient may be at a long-term advantage in markets where there are restraints on carbon emissions. For example, in the cement production industry electricity costs may account for 10-20% of total costs. Fidelity analysts have monitored companies such as Holcim, CRH, Lafarge, Buzzi Unichem, and Italcementi, which have made substantial progress over the past few years in reducing electricity consumption.

Recent figures estimate that a significant amount of the EU's total energy consumption and CO2 emissions result from daily activity in residential and commercial buildings. Current EU rules require Member State governments to reduce household emissions by 2020. According to commentators, these rules will provide the homebuilding sector with a significant opportunity to build more energy-efficient homes. Consequently, Fidelity has indentified a large potential market in the retrofitting and construction of energy efficient buildings. Companies such as Bouygues have increased spending on sustainable building projects; Skanska and Hochtief are also involved in efforts to improve the sustainability of buildings. Moreover, the EU recently passed a law prohibiting the sale of incandescent light bulbs from 2012. As a result, Philips and Siemens, which are developing energy-efficient light bulbs, may capture a larger share of this market in the future.

- **Sustainable Transport:**

According to EU figures, automobiles also contribute significantly to total European CO2 emissions. As a consequence, the European Parliament recently passed regulation limiting future emissions from automobiles. Therefore, companies that develop products that help reduce automobile emissions may benefit. In addition, railway companies may benefit secondarily from these regulations.

During the quarter, Fidelity explored strategies developed by Umicore and Johnson Matthey; both of these companies produce catalysts for cars which reduce emissions. Tyre manufactures can also contribute to reducing CO2 emissions through product innovation. In this regard, Fidelity held discussions with Nokian Tyres and Tomkins. Commentators have identified that investments in rail transportation are set to increase as a consequence of the EU automobile emission reduction targets. During the quarter Fidelity analysts have identified Ansaldo and Vossloh which produce rail equipment as companies that may benefit from such investments.

2. Brand Equity & Reputational Risks

- **Retail Supply Chain Issues:**

Negative perceptions of a company's product supply chain may affect sales and brand equity; retailers are particularly exposed to such risks. First, companies that fail to screen suppliers adequately may unknowingly encourage dangerous and/or repressive working conditions. Second, if retailers lack appropriate controls over their supply chain they may be exposed to product safety risks. Finally, as consumers become more sensitive to the overall sustainability of supply chains, companies that do not take account of these issues may face reputational risks. During Q1, Fidelity analysts engaged with Danone on sustainability issues related to its bottled water business. In the past, we have visited the factories of apparel companies to examine working conditions. In this space, commentators have identified H&M as a company which may be well positioned to benefit from growth in organically sourced and sustainable clothing.

- **Exposure to Weapons Manufacturers:**

In 2006, the Belgian government introduced a law forbidding Belgian citizens from investing in companies that produce cluster munitions; a list of companies to which the law will be applicable has not yet been finalised. Furthermore, in December 2008, 94 governments signed an agreement committing themselves to eliminate all cluster munitions by 2016. Following this move, a number of pension funds and charitable organisations have divested from companies involved in the production of cluster munitions. Continued investment in companies that are publicly excluded from large European fund portfolios for these reasons may carry reputational risks. In addition, such divestments may affect company share price. Over the next quarter, Fidelity analysts will aim to engage with companies in this sector.