REPORT TO: **SUPERANNUATION INVESTMENT SUB-COMMITTEE OF THE POLICY AND RESOURCES COMMITTEE - 17 MAY 2010**

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

REPORT BY: **DIRECTOR OF FINANCE**

REPORT NO: **273-2010**

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 2010.

3 BACKGROUND

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 and process is shown at Appendix 1.

5 BAILLIE GIFFORD

A summary of recent engagement activity is shown at Appendix 2. This shows the wide range of topics covered and the diversity of companies approached.

6 FIDELITY

Appendix 3, shows various examples of issues Fidelity 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.

The fund is still committed to following the United Nations Principles of Responsible Investment.

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

10 BACKGROUND PAPERS

None

MARJORY STEWART
DIRECTOR OF FINANCE **07 MAY 2010**

Our Investment Process Considers ESG Factors

- We have added a new function to our knowledge management systems which automatically alerts analysts to potential ESG issues

- Flagged ESG issues are addressed as an integral part of our research and stock selection processes

Respected External Research

- KLD
- RiskMetrics/ Innovest
- GMI

Panel from Analyst Knowledge Management System

ESG

Environment

Social

Governance

Controversial business areas

Alert

No Alert

ESG Research: DuPont and Biofuels

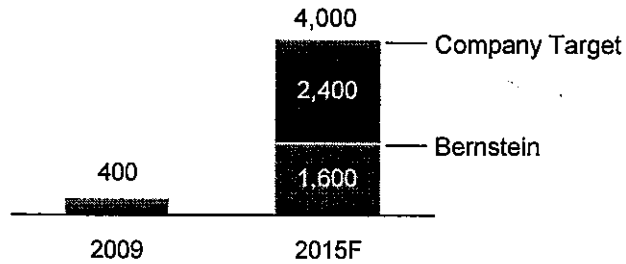
- DuPont has three attractive business segments

Opportunities

Segment	Opportunity
Specialty Chemicals	Recovery in autos and construction
Agriculture	Large, stable, growing business
Biofuels	Cellulosic ethanol and biobutanol

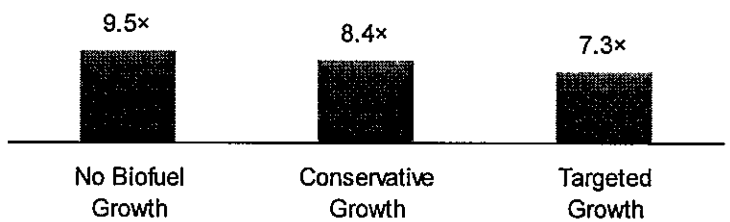
- The company's investments in biofuels should augment revenues

DuPont: Biofuel and Biomaterial Revenue (USD Millions)



- Biofuels provide promising additional upside for shares that are already attractively valued

DuPont: Price to Normalized Earnings (2015F)

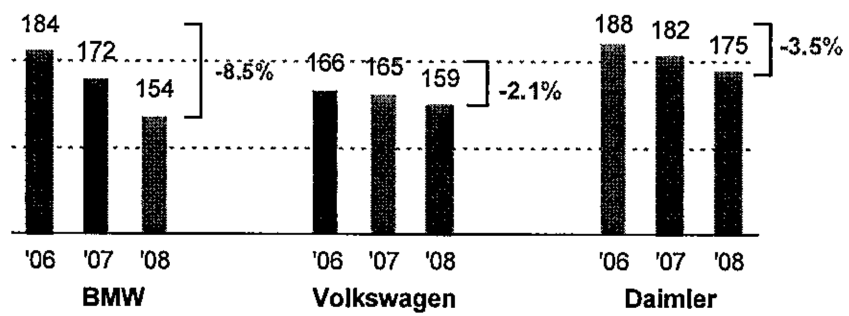


As of March 31, 2010
Source: DuPont and Bernstein; see Disclosures and Important Information.

ESG Research: BMW to Retain Market Share With Greener Car Models

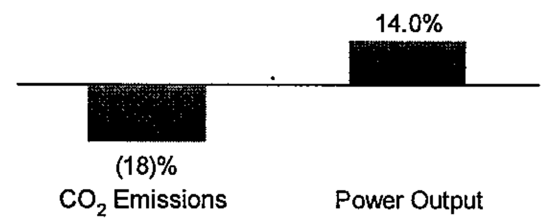
- European and US auto makers face tougher emissions standards. Although BMW started with high emissions, it has made rapid progress

CO_2 Targets: g/km



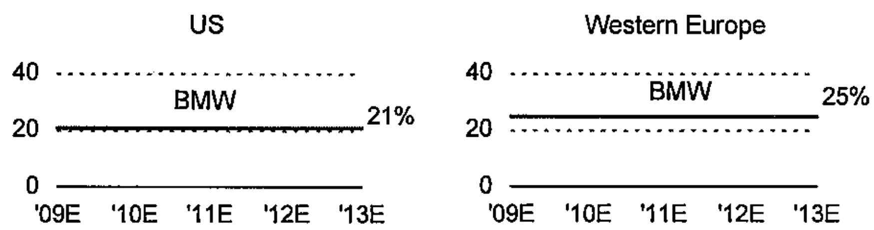
- BMW has reduced emissions in its new models while increasing power

New Model 320i Performance Relative to Predecessor



- Enhanced environmental and power performance should enable BMW to retain market share. Gains in market share would likely lead profits to exceed our forecast

Luxury Car Market Share



Source: BMW, Transport & Environment; Bernstein

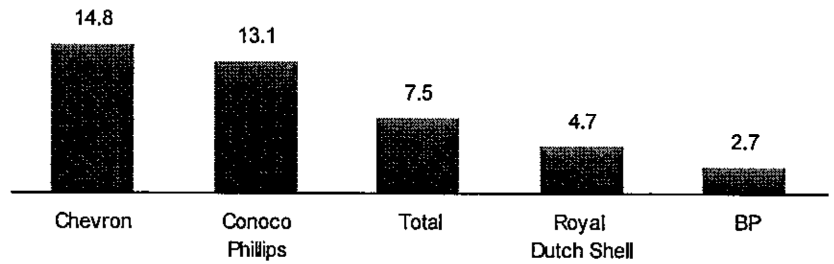
ESG Research: Chevron in Ecuador

- Chevron outperformed many of its peers from 2004 – 2008 and we trimmed/sold it in 2009

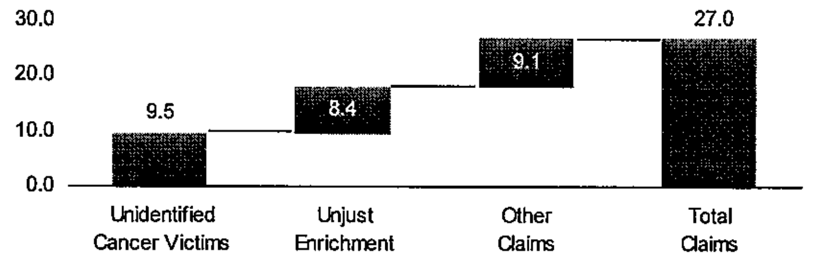
- Our trim/sell division was based on fundamentals, but included consideration of a law suit in Ecuador alleging dumped oil waste by Texaco* over 20 years

- After extensive discussion with management, we concluded that, while the award would be much smaller, newsflow would be negative and protracted

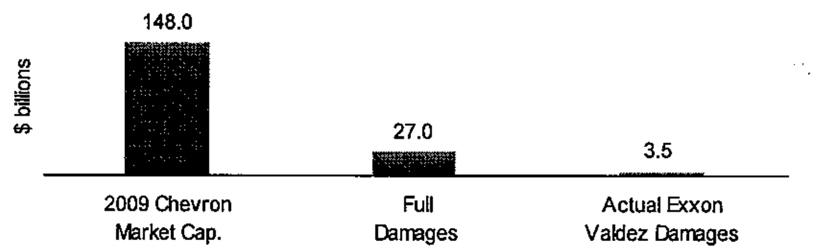
Annualized return, 2004 – 2008



Claimed Damages (USD Bil.)



USD Bil.



*Acquired by Chevron 2001
As of August 31, 2009
Source: Bernstein

APPENDIX 2

Autonomy Corporation

Autonomy specialises in developing software for the analysis of unstructured information (data which is not in spreadsheets or databases, but in e-mails, word documents, video clips, phone calls, etc). Companies are increasingly looking to extract value from the vast amount of data they accumulate, and this trend is helping to drive very strong underlying revenue growth at Autonomy. We spoke to the Company Secretary regarding the changes they are making to executives' long term incentive plans, and forthcoming changes to the board make up. We discussed the new remuneration structure in detail and believe that the two new plans have strong performance targets which are well aligned with shareholder returns and will incentivise the executives. We were also pleased to learn of the imminent appointment of two new independent non-executive directors. We have since learned that the two individuals will add expertise, skills and knowledge to the board through their financial and industry experience, and this will complement the other board members. We welcome the strengthening of the board at this growing company.

BHP Billiton (UK)

The current Chairman of BHP Billiton, Don Argus, is retiring at the end of March 2010. The company took the opportunity to introduce the new Chairman Jac Nasser to its shareholders, and to discuss future strategy plans as well as current operational challenges.

The message in terms of strategy is that there will be no change. Having been on the board since 2006, Nasser is well versed in the company's strategic positioning and current projects.

The minimisation of injuries and fatalities is a relevant issue for all heavy-industrial companies but, at the moment, BHP Billiton's safety record is poorer than the majority of its peers in the mining sector. The Chairmen were both keen to emphasise that safety is an important issue for the executive management as well as the board, and that steps had been taken to lessen the causes. The first step was the acknowledgement that most injuries and fatalities are suffered by contractors - the solution being to bring the contractor operations back in-house. The result is that BHP has greater operational control, owns the machinery and equipment and is therefore directly responsible for training personnel, and for maintaining and servicing the equipment. They expect the safety statistics to improve as a result of this action.

Finally, we discussed progress on the Olympic Dam project, a copper, gold and uranium mine. It is currently going through the feasibility study phase. The environmental concerns include energy usage, water, emissions, land disturbance, spillages, flora and fauna, and major storage dams. The social concerns include all aspects of health and safety, local community and broader stakeholder relations, including NGOs and indigenous populations, as well as concerns about exposure to radiation. The company is taking a cautious approach, and is focused on ensuring that they cover all issues; a short delay to the project now is acceptable if it means that all operational, environmental and social risks will be actively managed and minimised when it starts to operate at full capacity.

Provident Financial

Provident Financial is the market leader in home credit in the UK and Ireland. It extends small cash loans to those without access to banking finance, and collects interest payments through agents. In the Q2 2009 engagement report, we commented on our meeting with the Chairman of the Remuneration Committee (Remcom) at which we discussed our concerns regarding remuneration and the voting down of its remuneration report at the 2009 AGM, as well as encouraging full consultation with shareholders in future.

The Remcom wrote to us in December 2009, and in January we spoke to the Company Secretary regarding the remuneration proposals for 2010. We are pleased that the Remcom has made several positive changes which include more stringent performance targets in the annual bonus and long-term incentive plans, and a scaled back annual bonus opportunity. In addition, salaries have been frozen for 2010. In particular, the Remcom has increased the focus on long-term remuneration: at least two-thirds of executives' remuneration will be based on long-term share price and earnings performance, and executives will be required to make a personal investment in the company's shares.

Given the heightened sensitivity around remuneration issues, particularly in the financial sector, we are encouraged by the Remcom's response, particularly given our high regard for the company's executive management. Nevertheless, we will continue to monitor the performance targets for future awards.

ABB

ABB is a Swiss engineering company, which supplies equipment designed to enable its customers around the world to use electrical power effectively and to increase industrial productivity in a sustainable way. It places emphasis on ensuring its operations are energy efficient and its supply chains, especially those in the emerging market countries, operate within minimum environmental, health & safety (EHS) standards.

When we last spoke to this company in 2007, it was complying with best practice standards. Since then, it has significantly increased its presence in the emerging markets, particularly India and China. As a result, its exposure to environmental, health & safety, human rights and security risks has increased. We were pleased to learn from the Head of Sustainability that, as the significance of the EHS risks has increased, so has the company's focus on these issues. They are now incorporated into areas such as ABB's Enterprise Risk Mapping System, its supplier selection procedure (in the emerging market countries as well as developed markets) and the M&A due diligence process.

We continue to believe that ABB's approach to sustainability, and to the broad range of environmental, health & safety, human rights and security risks it faces, is aligned with best practice.

Naspers

Naspers is an electronic and print media company with operations in South Africa and, to a lesser extent, in sub-Saharan Africa, China, Russia, Eastern Europe, India and Brazil. At first sight, the media sector does not appear to have significant environmental or social risks associated with it. From an environmental perspective, there are matters to manage rather than significant risks to minimise, but socially the concerns are more significant and include parental controls, accessibility, adult content, data protection, and responsible gambling and gaming. If mismanaged, these social issues could impact the company's reputation with customers. We had a conference call with the Head of Investor Relations and Head of Sustainability to discuss those topics in the list above which are not given much consideration in the company's publicly available documents. Apparently, we were the first investment manager to address this issue.

The company is aware of the concerns and assured us it is managing its risks. In addition, it is working towards complying with King III - the third edition of the South African corporate governance guidelines that comes into effect for the 2010/11 reporting year and incorporates sustainability criteria. We expect Naspers' disclosure on its management of the relevant social and reputational risks to improve over the next 15 months and look forward to reviewing its first King III compliant Annual Report.

Samsung Electronics Co

Samsung Electronics is one of the strongest companies in the global electronics industry. It has benefited from significant through-the-cycle investment in technology and branding, which has improved its long-term growth prospects and brand recognition.

We had a conference call with the Investor Relations Manager to discuss the company's 2010 AGM agenda, corporate governance and risk management. The company has recently strengthened its audit committee by appointing a non-executive director (NED) who has significant financial, risk management and credit rating experience; he is a former CEO of Shinhan Financial Group and Shinhan Bank.

Over the past two years, the company has focused on improving its risk management by developing new risk guidelines and integrating these into the business. This covers several areas including legal, customer and supplier risks, although risk criteria on related parties are still being developed. Each area of the business has a task force which oversees and benchmarks the progress of the company's risk management procedures. It expects to use future reports to disclose more information on risk management to shareholders.

With regard to reputational risks, the company has a team of 100 people in its Global Marketing Office who are responsible for looking after the Samsung brand. Brand recognition is an increasingly important part of the business: the value of its brand has increased significantly since 2003 and was recently rated better than Sony in an electronics marketing survey. Any threats to its brand are taken seriously by the board. For example, a recent fault with some of its refrigerators prompted a quick response via product recalls.

This was a useful discussion and we will continue to monitor the development of Samsung's risk management procedures.

Whole Foods Market

Whole Foods Market was founded in 1980 and has grown steadily to be America's largest retailer of natural and organic foods. Natural and organic produce represents around 2% of overall US food sales and we believe that Whole Foods has the scope to increase its market share over the long term as consumers strive to buy healthier products. We spoke to the Vice President of Investor Relations and discussed the shareholder resolutions that had been put forward at their AGM in March, along with other governance and social aspects that could impact on the company in the future.

Two shareholder resolutions were passed at the AGM this year, and we were pleased to learn that the board will look to (a) reduce the supermajority vote to a majority vote, and (b) amend their bylaws to remove a mechanism intended to slow a hostile anti takeover process. We firmly believe that, by enacting these proposals, the company will enhance shareholder rights.

In addition, we are pleased that the company has committed to provide additional information in relation to the director biographies, which do not currently provide adequate information about non-executives' skills, knowledge or experience.

Finally, we spoke at length about the importance of the company maintaining its culture and ethos as it continues to grow. This is particularly important for Whole Foods, as its culture, as much as its products, appeals to customers and is therefore integral to the future business success and growth strategy.

Appendix Corporate Social Responsibility Report - Q1 2010

General Meetings/Activities on CSR issues

1. The Impact of Regulation

- The Carbon Market:

(i) Carbon Emission Reductions

The EU Emissions Trading Scheme (ETS) was approved in 2008. The ETS limits the carbon dioxide (CO_2) emissions of certain industries and requires companies seeking to emit above those limits to purchase the requisite amount of credits/allowances, creating a secondary market. We continue to monitor how EU limitations on emissions under the ETS affect companies in which we invest. In our view, companies that can reduce their direct and indirect CO_2 emissions are potentially at a competitive advantage in markets where there are limits on carbon emissions.

Fidelity's UK utilities analyst has identified the regulatory efforts relating to carbon reduction as a catalyst for utility companies to transition their portfolio of energy production assets away from coal-based power stations towards those that are less polluting. During the quarter, Fidelity discussed the potential risks of future additional CO_2 limitation in the UK with Drax, Scottish & Southern Energy and Centrica. UK government initiatives may include subsidies for low-carbon power generation or greater limitations on carbon emissions. The nature and extent of these subsidies will become clearer following May's UK general election.

(ii) Renewable Energy – Water Use

The EU Commission has established an objective to improve energy efficiency as part of its "20-20-20" goals. The purpose of the goals is to reduce the EU's greenhouse gas emissions by 20% and to increase the use of renewable energy sources in overall energy consumption by 20% by 2020, compared to 1990 levels.

Fidelity's renewables analyst recently examined the water consumption levels of different renewable power generation technologies and visited a solar thermal plant in Spain. Power generation from solar thermal plants, such as those developed by Acciona and Abengoa, is water-intensive. In comparison, wind turbine producers Vestas Wind Systems, Gamesa and Clipper Windpower have low water usage. These considerations are material because water usage may become subject to increasing regulatory constraints in the future.

- Energy Efficiency:

Recent figures estimate that a significant amount of the EU's total energy consumption and CO_2 emissions results from daily activity in residential and commercial buildings. Current EU rules require Member States to reduce household emissions by 2020. According to commentators, these rules will provide the homebuilding sector with significant incentives to build energy-efficient homes. Also, the French Senate recently adopted a law to improve energy efficiency in residential and commercial buildings. Pursuant to this law, buildings in France will need to reduce average annual energy consumption from 2010 levels.

Fidelity has identified a potential market in the construction of energy-efficient buildings in France. During the past quarter, Fidelity continued to discuss with Nexity and Bouygues their projects for investment in buildings with low energy consumption. The UK government is currently consulting on ways to implement minimum standards for the energy performance of buildings. Fidelity's analyst has discussed the potential cost and opportunities resulting from future legislation with the homebuilders Barratt Developments and Taylor Wimpey.

- Sustainable Transport:

In December 2008, the European Parliament passed regulations limiting future emissions from automobiles. Therefore, companies that develop products reducing automobile emissions, as well as manufacturers developing cars with low emissions, are likely to benefit. Fidelity's automobile analyst has examined the different strategies companies may use to meet future emission targets, particularly those developed by BMW, such as the 'Efficient Dynamics' motors which have high fuel efficiency

2. *Brand Equity & Reputational Risks*

- Supply Chain Issues:

Negative perceptions of a Company's product supply chain can 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 (for example, due to lack of Company presence in the sourcing countries), they may be exposed to product safety risks, which could lead to product recalls, fines or lawsuits. Finally, as consumers become more sensitive to the overall sustainability and ethics of supply chains, companies that do not take account of these issues may face reputational risks.

(i) Audit Process

During the quarter, Fidelity discussed Unilever's framework to manage reputational risk through the monitoring and audit of its global supply chain.
Unilever has developed a Supplier Code of best practice which all of its suppliers are required to sign. If a supplier repeatedly contravenes the Code or fails to improve, Unilever terminates their contract.
Unilever stressed that it aims to respond immediately to ethical concerns that may affect its supply chain. For example, the company stated that a news article had alleged the use of child labour at farms producing vanilla pods in Madagascar. Although Unilever did not source directly from the farms highlighted, it launched its own investigation and wrote to all of its direct suppliers globally stressing the importance of monitoring their supply chain.

(ii) Local Communities

Fidelity's mining analyst recently discussed with Vedanta public concerns arising from the company's mining operations in Orissa, India. The company has been the subject of a number of highly critical reports with regard to environmental damage and dislocation of indigenous people. Additional scrutiny has been placed on the company following the publication of a report by Amnesty International in February 2010 urging investors to engage with the company on the risks and human rights concerns. Thus, the Amnesty report and those published by other organisations on this issue have resulted in significant negative publicity and consequently pose a reputational risk to the brand. Fidelity continues to monitor the situation at Vedanta.

(iii) Shareholder Activism & Oil Sands

During the quarter, a group of UK-based investors added proposals on oil sands extraction to both the BP and Royal Dutch Shell AGM agendas. Both proposals request the companies to report on the financial assumptions they have made to justify their oil sands extraction projects in Canada, including future carbon prices, oil price volatility and regulatory and legal risks. In addition, the proposals request information on the extent to which the companies have considered potential reputational risks that may arise from the projects as a result of possible environmental damage and/or the disruption of indigenous peoples' lands.
Fidelity met with Shell to discuss its oil sand extraction strategy in Canada; similarly, we discussed the issues with BP. We are assessing our approach to the AGM proposals and continue to monitor these issues at Shell and BP and across the industry.