REPORT TO: SUPERANNUATION INVESTMENT SUB-COMMITTEE OF THE FINANCE COMMITTEE - 15 NOVEMBER 2006

REPORT ON: SOCIALLY RESPONSIBLE INVESTMENT - SIX MONTHLY REPORT

REPORT BY: HEAD OF FINANCE

REPORT NO: 643-2006

1 PURPOSE OF REPORT

This report reviews the progress by the Fund Managers regarding the positive engagement strategy approved by the Sub-Committee on 23 February 2000.

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 30 September 2006.

3 FINANCIAL IMPLICATIONS

There are no financial implications.

4 SUSTAINABILITY POLICY IMPLICATIONS

As part of the Fund's policy on Socially Responsible Investment, its investment managers are required to engage with companies on matters of social responsibility including Sustainability and the Environment.

5 EQUAL OPPORTUNITIES IMPLICATIONS

The Fund's Socially Responsible Investment policy requires investment managers to engage with companies regarding their performance in relation to Employee Care and Human Rights.

6 INTRODUCTION

On 23 February 2000 the Sub-Committee approved a report prepared by Hymans Robertson, the Fund's consultants that the Fund should adopt a strategy of positive engagement with the companies in which it invests. The four action areas were identified as Employee Care, Human Rights, Sustainability and the Environment. This report reviews how the individual Fund Managers have implemented this.

7 ALLIANCE BERNSTEIN

Alliance Bernstein have targeted a specific issue in the banking sector. This is summarised at Appendix 1.

8 BAILLIE GIFFORD

A summary of recent engagement activity is shown at Appendix 2.

9 FIDELITY

Fidelity's policy and recent engagement activity is shown at Appendix 3.

10 OVERALL CONCLUSION

The managers have continued to demonstrate a commitment to this activity and have addressed a wide variety of issues with companies.

11 BACKGROUND PAPERS

None.

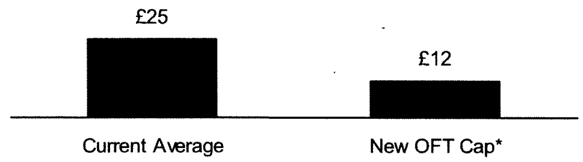
MARJORY M STEWART
HEAD OF FINANCE **7 NOVEMBER 2006**

Company Engagement

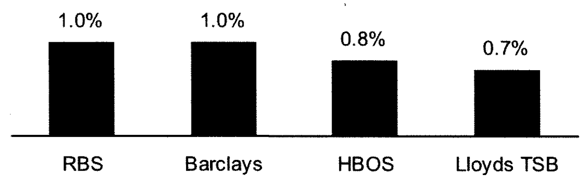
Impact of Regulatory Measures to Eliminate UK Bank Penalty Fees

- Penalty fees for late payments on credit cards were declared illegal by the Office of Fair Trading (OFT), which ordered banks to cut fees*
- Our research suggests this cap will have a low impact on the profitability of our holdings while improving price transparency for customers
- Given the low impact of this regulation on profitability, we continue to find our holdings attractive

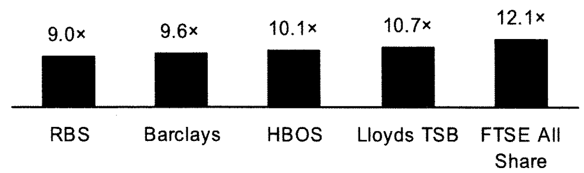
Charges For Credit Card Late Payments Per Default*



Loss As a Percentage of Profits from New OFT Cap**



Price to 2007 Earnings***



*The OFT stated that penalty fees are illegal as they breached unfair contract laws, and that in the future, banks would only be able to charge customers the underlying administration costs, such as postage and stationary
**Estimated annualised loss as a percentage of consensus estimates 2006 pre-tax profits
***Consensus estimates as at September 30, 2006

Sources: Company estimates, I/B/E/S estimates, OFT, Bernstein and Morgan Stanley

July 1, 2006 to September 30, 2006
888-08028

APPENDIX 1

BP

We spoke to Investor Relations at BP following the announcement that due to pipeline corrosion, production on the Prudhoe Bay field on the North Slope of Alaska was to be shut down. The company has endeavoured to reach an appropriate balance between the 'security of supply' pressures and minimising the environmental and safety risks. Confirming its commitment to environmental and safety integrity, BP has stated several priorities: to ensure the safety and integrity of its operating infrastructure; to minimise environmental impacts; to continue the cooperative working relationship with all of the relevant agencies; and to restore production as soon as it is safe to do so.

We will continue to speak to the company about its maintenance programme and the processes it is introducing to ensure that risks associated with pipeline maintenance are minimised.

Barclays

We met the Corporate Responsibility (CR) Director to discuss the key CR issues that are integrated into Barclays' business strategy. This includes financial inclusion, which involves supporting community finance organisations and financial capability initiatives for young people in the UK, as well as microfinance initiatives in less developed markets. Additionally, Barclays was one of the original banks involved in the development of the Equator Principles (the incorporation of environmental and social credit risk in project finance) and it has continued to be at the forefront of their implementation. Barclays has welcomed the introduction of the revised Principles commencing July 2006.

Diageo

We met the Performance & Reward Director to discuss the company's executive remuneration policy and the role of the Remuneration Committee (RemCom). In 2005, the RemCom completed a self-review of its performance, which is recommended in the Combined Code, and has implemented several changes to its procedures that will improve decision-making. We also discussed our vote against the Remuneration Report in 2005 because we believed that the performance targets in the share options scheme are insufficiently challenging. Encouragingly, the RemCom will discuss our views at its next meeting and will incorporate this into its forthcoming review. This was a useful meeting which enabled us to gain an insight into the RemCom's strategy. We look forward to receiving a response from the RemCom regarding the performance targets following its next meeting in December.

Linear Technology Corporation

We wrote to the Vice President in August following the company's announcement that it was subject to an investigation by the Securities and Exchange Commission (SEC) about the timing of its option grants to management. The SEC is currently investigating whether some US companies deliberately manipulated the options date in order to maximise the gains to the scheme participants, a practice which fails to align the interests of management and shareholders. In our discussions with the company, it has denied any wrongdoing: options were always granted at the board's quarterly meetings, prior to the earnings announcements. Since the dates for the meetings are set years in advance it is impossible for the board to grant options at a time when it is most advantageous to participants. Nevertheless, the company is cooperating fully with the SEC, is conducting an internal audit of its option grants, and will advise us in due course on the SEC's findings. We are satisfied with the progress to date and will continue to monitor developments.

Royal Bank of Scotland Group

We met the Head of Corporate Responsibility (CR) and Investor Relations following the publication of the bank's 2005 CR Report. The company's disclosure has increased since the publication of the 2004 report, this year setting out a comprehensive list of priorities including qualitative and quantitative targets covering issues from fraud and financial crime to responsible lending and climate change initiatives. RBS has also started to audit its suppliers against the UN Global Compact Principles which cover human rights, labour rights, the environment and bribery and corruption.

The increased disclosure will enable us to review performance for the different international businesses and the increasingly global supply chain.

Standard Chartered

We met the CEO of Standard Chartered Wholesale Bank to discuss the social and environmental risks faced by the bank. Since a large percentage of Standard Chartered's project finance work comes from the emerging markets of China, SE Asia, India, Middle East and Africa, consideration for social and environmental issues can be very important. We discussed how environmental and social risk management factors are embedded into the Banks sustainable lending policies. Three examples include: helping customers to recognise and address environmental risks; extensive employee training; and clear policies for high impact projects in the timber and the extractive industries. We believe the company has implemented effective environmental and social management systems to address complex emerging markets projects, demonstrating its leadership in this area.

Total SA

We met the Head of Investor Relations to discuss its current policies and mitigation strategies for carbon dioxide (CO_2) emissions and climate change. Total has an increasing exposure to CO_2 and climate change risk through the heavy-oils component of its reserves portfolio. Heavy-oils have a high carbon content relative to other hydrocarbon energy sources. Total has an extensive research and development programme which, among other things, aims to enhance production efficiency and includes a CO_2 capture and sequestration (storage) project in South of France. We believe these are significant projects for Total and will continue to communicate with the company and follow its progress towards the goal of minimising CO_2 emissions.

Vodafone Group

We met the Director of Corporate Responsibility to discuss the introduction of Vodafone's new socially inclusive products. It has committed to introduce three products by 2010 with features that reduce social exclusion. The products currently being trialled include an 'accessible blackberry' which allows deaf and hard-of-hearing people to communicate more easily and a microfinance initiative for developing countries. The 'accessible blackberry' is compatible with hearing aids and incorporates enhanced keypad and text features. The microfinance initiative involves an arrangement with a local bank that allows customers to access virtual loan accounts through their mobile phones by following text message instructions.

These are examples of where corporate responsibility and social inclusiveness can be of direct commercial benefit to the company and we look forward to the introduction of these products in the relevant markets.

Appendix Corporate Social Responsibility Report - Q3 2006

Fidelity's policy on Corporate Social Responsibility

- 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 as long as the potential for financial return is not reduced. We favour companies committed to high standards of CSR and to the principles of sustainable development.
- 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 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 attitudes. We strongly believe that this is the most effective way to improve the attitude of business towards CSR.

Fidelity's four-stage process for CSR analysis & engagement

1. CSR Analyst identifies engagement priorities, typically focused on companies where we perceive that environmental, social and ethical issues could have a material impact on shareholder value. These engagement priorities are discussed with the relevant research analysts.
2. Background research is undertaken on specific issues through dialogue with brokers and other interested parties (such as non-governmental organisations).
3. CSR Analyst holds dedicated CSR meetings with companies.
4. The findings from the meeting are reviewed by the CSR Analyst and research analyst and future engagement objectives agreed.

Recent company engagement Note: We have been in contact with the companies listed below to discuss environmental, social and ethical issues, either through face-to-face meetings, by teleconference or in writing.

Company	Country	Corporate Responsibility Strategy	Environmental Management & Climate Change	Responsible Product Stewardship	Workplace	Human Rights
Agcert	Ireland		♦	♦	♦	
BMW	Germany	♦	♦	♦	♦	
BP	UK		♦	♦	♦	
Camco International	UK		♦	♦		
China Methane Recovery	UK		♦			
EcoSecurities	UK		♦	♦		
Eurofins	France		♦	♦		
Holcim	Switz	♦	♦	♦	♦	

Company	Country	Corporate Responsibility Strategy	Environmental Management & Climate Change	Responsible Product Stewardship	Workplace	Human Rights
Lafarge	France	♦	♦	♦	♦	
Michelin	France	♦	♦	♦	♦	
Saft Batteries	France		♦	♦		
Seche Environnement	France		♦	♦		
Schneider Electric	France		♦	♦		
Total	France		♦			♦
XStrata	UK	♦	♦	♦	♦	♦

Appendix Corporate Social Responsibility Report - Q3 2006

Issue: Ongoing CSR Themes

Background
Fidelity International's investment process takes social, environmental and ethical issues into account when, in our view, these have material impact on either investment risk or return. Our CSR Analyst this quarter continued this focus in relation to:

(i) Re-engaging with companies and/or sectors where there are concerns in relation to CSR performance.

Company Engagement
CSR - an important performance indicator for the Oil & Gas industry

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 use the information gathered during these meetings to add weight to investment decisions and also to encourage company management to improve procedures and attitudes. This is particularly important in the Oil & Gas sector, as much of the new reserves are located in non-OECD countries, where projects are potentially lucrative but more complex in terms of social, environmental & political risks.

Our CSR Analyst requested a meeting with **Total** this quarter to discuss its Yadana Project in Myanmar (formerly Burma), specifically to review its management of human rights issues surrounding its operation in that country. Although there are currently no EU or UN economic sanctions applied to Myanmar, it is internationally regarded as a repressive regime. Total presented to us on why its decision to stay in Myanmar does not signal approval of this regime, but instead reflects the Group's belief that economic and human rights progress go hand-in-hand. We emphasised our ongoing review of the company's management of this issue going forward, specifically looking for 'proof of performance' in relation to its commitment to enhance human rights.

We also met with **BP** because of our concern that recent incidences represented a worrying pattern in the company's management of environmental, health and safety (EHS) issues. The company presented to us on the shutdown of its Prudhoe Bay oil field in Alaska after discovering severe corrosion on its pipeline which allowed a 200,000 gallon oil leakage. The US Environmental Agency is conducting a criminal probe into this incident. The EPA is also investigating whether BP was criminally at fault for an explosion last year at its Texas City refinery that killed 15 and injured 170. The company presented on its responsible approach in ordering the shutdown of the entire Prudhoe Bay field, though subsequent testing showed the western part to be safe. Going forward, we will continue our ongoing dialogue with BP around the robustness of its policies & procedures for EHS.

Banks called to Account
Fidelity's CSR Analyst works with the investment team to identify key social and environmental risks and opportunities relevant to a business or a sector. However, these elements can also be identified within the financial analysis process. A recent industry review presented by Fidelity's UK Banks Analyst to the investment team highlighted social issues such as over-indebtedness and irresponsible business practices as key risks that could lead to significant earnings downgrades. Allegations of irresponsible business practices increase the rise of regulatory action. As investors, it is in our interest to understand any business practices of the banks that might prompt such scrutiny. The equity analyst again noted the risk for his stock coverage when the Office of Fair Trading recently announced its plans to investigate the appropriateness of fees charged by UK Banks for customers missing a payment or exceeding an overdraft.

Cement makers tackling emissions
The cement industry is a heavy producer of CO2 – approximately 5% of global emissions. The manufacture of any given amount of cement produces a nearly equal quantity of carbon dioxide, of which 80% is due to (i) chemical reactions in the production process and (ii) the combustion of fossil fuels. We requested meetings with two large European cementmakers to review how the industry is tackling these emissions.

Holcim and **Lafarge** outlined to us initiatives to displace carbon-intensive energy processes with less-intensive ones, for example displacing 'clinker' (a cement compound) with substitution materials such as slag and fly ash, which are waste produced by the steel sector and energy plants. In 2005, Holcim consumed 16 million tonnes of these alternative materials, thereby reducing its CO2 emissions. Substituting fossil fuels that fire the kiln with biomass is another successful solution that the industry is pursuing. Indeed, Michelin and Lafarge are leading a project which helps to dispose of Britain's used tyres by using them to fuel cement kilns. Due to the high heat level of the clinkerisation process, scrap tyres are totally consumed leaving no waste, smell or smoke.

Both Holcim and Lafarge have voluntarily committed to cut CO2 levels by 20% by 2010, recognising the long-term threat it represents to their business.

Appendix Corporate Social Responsibility Report - Q3 2006

(ii) Our continuing review and evaluation of investment opportunities that address environmental and social issues.

Company Engagement

Sustainable Transport – on the road to environmental improvements

According to the projections of the World Business Council for Sustainable Development (WBCSD – Mobility 2030), the number of road vehicles throughout the world will double in the next two decades, primarily due to increased mobility in developing countries. A key issue for the transport sector is that energy efficiency gains due to the use of new technologies are being more than offset by increasing transport volumes. The corresponding sharp increase in emissions are in turn offsetting the successes achieved in other sectors in reducing greenhouse gas emissions related to Climate Change.

The solution to sustainable transport must be developed in a partnership that not just includes automakers, but also the sector's technology suppliers and energy providers. **Michelin** outlined to us how improving the rolling resistance of a vehicle's tyres can reduce both fuel consumption and carbon dioxide. This is a cornerstone of the company's research and development programmes, as it claims that tyres account for 20 percent of a modern car's fuel consumption, and more than 30 percent of that of a heavy truck. It is seeking to develop a competitive advantage in this area with the promotion of its Green tyres for passenger cars and the Energy range for trucks. Michelin is advocating the implementation of a new method of classification of tyres, as it claims that the energy efficiency of the different brands available on the market may vary by 50% for the same vehicle.

Displacing carbon-intensive energy sources with less-intensive ones is also an important solution for the transport sector. **Total** and **BP** presented to us on their strategy for developing and delivering advanced biofuels ('2nd generation'), which will help to accelerate the move to renewable transportation fuels. **Saft Batteries** sees good growth potential in supplying innovative power-storage technologies for environmentally-friendly vehicles. The company provided an overview of its new joint venture to supply advanced-technology batteries for current-and-future generation hybrid cars.

Sustainable Energy – that doesn't cost the Earth
Energy efficiency is a swift, economical and efficient way of reducing energy consumption and carbon dioxide emissions. Buildings are major consumers of energy; EU research indicates that by improving energy efficiency, carbon emissions from buildings could be reduced by more than 20%. This will help the EU to meet its climate change objective under the Kyoto Protocol, with the EU Directive on the Energy Performance of Buildings aiming to deliver reductions of 35-45 million tonnes of carbon dioxide per year within the EU by 2010.

Schneider Electric is positioning itself as a pioneer in this area, developing a new generation of solutions for remote management, diagnosis of inefficiencies and maintenance of energy. The company presented to us on a new service offering which it views as one of its growth areas; 'guaranteed energy performance contracts' for buildings, for which it makes the claim that the savings generated by improved energy efficiency pay for the initial investment.

ETS – investment links to Kyoto emission reduction projects outside the EU

A linking directive under the EU Emissions Trading Scheme (ETS) allows European companies to reduce emissions by purchasing Kyoto offset 'carbon credits' from emerging market countries, using UN-approved methodology. The underlying principle is that the benefit to the environment is the same, wherever the emissions reduction action takes place in the world. This initiative also helps to transfer environmental technologies to countries such Brazil, India and China.

Our CSR Analyst provides ongoing input to the investment opportunities arising from this emerging, global carbon market, evaluating the potential for projects to reduce emissions and sell-on the surplus credits. For example, **Agcert** builds animal waste management systems that enable CO_2 reduction in agriculture in Brazil and Mexico, with the potential to generate around 90-120 million carbon credits for sale to signatories of the Kyoto Protocol. Both **Camco International** and **EcoSecurities** work with industrial companies and utilities to identify and develop greenhouse gas emissions projects in China and Russia, helping to maximise the volume of credits produced and facilitate their placement with purchasers in Europe and Japan.

Our CSR research on Climate Change has assisted with our understanding of equity plays related to the emerging carbon market, a growing investment opportunity which has not previously been a well understood arena for equity investors.