REPORT TO: SUPERANNUATION INVESTMENT SUB-COMMITTEE OF THE FINANCE COMMITTEE – 20 NOVEMBER 2002

REPORT ON: SOCIALLY RESPONSIBLE INVESTMENT - SIX MONTHLY REPORT

REPORT BY: DIRECTOR OF FINANCE

REPORT NO: 807-2002

1 PURPOSE OF REPORT

This report reviews the implementation by the Fund Managers of 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 2002.

3 FINANCIAL IMPLICATIONS

There are no financial implications.

4 LOCAL AGENDA 21 IMPLICATIONS

There are no Local Agenda 21 implications.

5 EQUAL OPPORTUNITIES IMPLICATIONS

There are no Equal Opportunities implications.

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 SCHRODER INVESTMENT MANAGEMENT LIMITED

Schroder have implemented a policy of specific investigation into particular issues of concern. An example is the consideration of the telecoms sector industry shown at page 18 of their Investment Report.

A summary of Schroders recent engagement activity is also shown at pages 19 to 20 of their Investment Report. This covers an increasing range of issues.

8 BAILLIE GIFFORD

A summary of recent engagement activity is shown on page 45-46 of their quarterly report.

Baillie Gifford have begun to address very specific issues at individual companies and are combining this with questions over corporate governance.

9 FIDELITY

Fidelity have prepared a document for its institutional clients which outlines its position on shareholder activism. Its attitude to Socially Responsible Investment is shown at Appendix A. This affirms Fidelity's view that financial return is the first priority but positive engagement with companies can improve procedures and attitudes.

10 OVERALL CONCLUSION

The submissions by the Fund Managers continue to show that they are devoting significant resources to this area and by allowing each to use its own means of targeting companies the Fund has been able to address a wide range of issues.

Evidence of direct contribution to positive outcomes is scarce but it is clear that increasing pressure from a variety of sources continues to be applied to companies.

DAVID K DORWARD
DIRECTOR OF FINANCE **20 NOVEMBER 2002**

BACKGROUND PAPERS
No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above Report.

7. Socially Responsible Investment in the UK: Our Perspective and Approach

Introduction

UK pension fund trustees are currently required to specify in their Statement of Investment Principles their stance on Socially Responsible Investment (SRI) in accordance with the Pensions Act 1995.

Fidelity's primary objective is to produce superior financial returns for our clients. SRI does not change this, but factors into the process the additional aim of encouraging UK companies to develop responsible attitudes to their environment, employees, stakeholders and society as a whole.

This section outlines the main factors involved in SRI and Fidelity's perspective and approach to them.

Background

Under the Pensions Act 1995, the Government issued a regulation requiring pension fund trustees to state their stance on social, environmental and ethical investment and how they exercise their rights as shareholders. SRI is the collective term commonly attached to these issues. The regulation states:

"The following items are required to be included in all statements of investment principles (SIPs) under section 35(3)(f) of the Pensions Act 1995.

(a) The extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments, and

(b) The policy (if any) directing the exercise of the rights (including voting rights) attaching to investments."

The Government does not compel pension fund trustees to have an active policy on SRI. However, it is keen to encourage pension funds to use their rights as shareholders, through investment policies and voting, to lead companies to adopt more socially responsible practices.

Importantly, SRI does not remove the fiduciary responsibility of trustees to look after the "best interests" of their members. However, social, environmental and ethical best practice can form part of these "best interests" so long as financial returns and diversification are not negatively impacted.

Essentially, SRI seeks to combine pension funds' financial objectives with social, environmental and ethical issues.

SRI Within Fidelity's Investment Process

Fidelity's investment process will take social, environmental and ethical issues into account when, in our view, these have a material impact on either investment risk or return.

A consistent aspect of our process is the in-depth analysis of companies. From this we construct our own forecasts to identify those companies whose financial potential is greater than that implied by their share price. At the heart of this lies an intensive programme of visits and contacts undertaken by Fidelity research analysts. A considerable amount of information is collected on the companies analysed, including social, environmental and ethical factors. These issues can have a major influence on the financial potential of companies.

The most obvious, but by no means only, examples of SRI considerations are environmental harm and potential subsequent financial liabilities. Many industries have legal responsibility to take remedial action for damage caused to the environment. Fidelity takes this and any poor publicity surrounding pollution incidents into account within its investment process. Extreme bad publicity can have a materially negative impact on revenues and as a result, share prices. Consequently, customers and investors may decide not to buy services or shares of the companies involved.

Fidelity supports the premise that, over the long term, sound social, environmental and ethical policies make good business sense.

An Active Engagement Approach

There are two main ways in which investors can use their shareholding power to influence the social, environmental and ethical operations of companies:

i Screening: Excluding from investment lists, companies that fail to meet particular ethical standards, or picking stocks with the best ethical record in each industry.

ii Engagement: Engaging in dialogue with corporate management on the issues in question and applying pressure on them in order to improve their procedures and attitudes.

Screening tends to reduce the investment universe from which holdings are chosen and this can introduce imprudent additional risk and potentially harm financial returns. Fidelity believes that engagement is more effective because it doesn't limit investment opportunities. In the UK, we operate an active policy of dialogue with UK companies on social, environmental and ethical issues.

We strongly believe that this is the most effective way to improve the attitude of business towards corporate social responsibility.

We subscribe to research provided by the Ethical Investment Research Service (EIRIS) to help identify those issues that are of direct concern to the UK companies in which we invest. EIRIS is an independent ethical research service that has been operating since 1983 and its coverage includes all constituents of the FTSE All-Share Index. We focus our attention on those UK companies identified by EIRIS as having concerns on issues such as the environment, labour practices, equal opportunities and political donations.

Regular company meetings, which are central to our investment process, provide an opportunity for SRI engagement. At these meetings our analysts and fund managers have the chance to raise any concerns Fidelity has and find out what the companies are doing to improve their ethical approach. We also enter into regular dialogue, purely on the topic of SRI engagement, outside these meetings and attend SRI-related seminars. The results of these various inputs are recorded and are re-examined during subsequent engagement.

Ethics Inside Fidelity's Own Business

Fidelity's mission statement begins "*To become the world's pre-eminent money manager by being in a class of our own in terms of investment performance, client service and business ethics.*"

Fidelity's Code of Ethics and Insider Dealing Policy are designed to control potential conflicts of interest and the release of confidential client information. This allows us to meet fully the requirements of applicable laws, regulations and industry standards.

Summary of Fidelity's Approach

Our approach can be summarised as follows:

Fidelity's primary objective is to produce the best financial returns for our clients.

Fidelity recognises and supports the view that social, environmental and ethical best practice should be encouraged as long as the potential for financial return is not reduced. Fidelity believes that, over the long term, sound social, environmental and ethical policies make good business sense.

Fidelity's 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.

Fidelity does not screen out companies from our investment universe purely on the grounds of poor social, environmental or ethical records. Instead, we adopt a positive "engagement" approach, whereby we discuss these issues with the management of, primarily UK, companies in which we invest, on behalf of our clients with the aim of improving procedures and attitudes.

Fidelity has an active corporate governance policy that seeks to protect the financial interests of our clients and, for UK investments, takes into account the recommendations of the Combined Code of the Hampel Committee.