REPORT TO:	**SUPERANNUATION INVESTMENT SUB-COMMITTEE OF THE FINANCE COMMITTEE - 17 MAY 2006**
REPORT ON:	**SOCIALLY RESPONSIBLE INVESTMENT - SIX MONTHLY REPORT**
REPORT BY:	**DEPUTE CHIEF EXECUTIVE (FINANCE)**
REPORT NO:	**310-2006**

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 31 March 2006.

3 FINANCIAL IMPLICATIONS

There are no financial implications.

4 LOCAL AGENDA 21 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

A summary of engagement issues over the last six months is shown at Appendix 1.

8 BAILLIE GIFFORD

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

9 **FIDELITY**

Fidelity's new reporting format is shown at Appendix 3. This shows recent activity plus current issues.

10 **OVERALL CONCLUSION**

The managers continue to address a variety of issues on the Fund's behalf and the approach continues to develop.

11 **BACKGROUND PAPERS**

None.

DAVID K DORWARD
DEPUTE CHIEF EXECUTIVE (FINANCE) **9 MAY 2006**

Company Engagement

Impact of Measures to Combat Global Warming on the European Aviation Industry

The EU'S Greenhouse Gas Emissions Trading Scheme Is Likely to be Extended to Airlines by 2008

2005 | 2006 | 2007 | 2008

Jan 2005
EU Emissions Trading Scheme (ETS) sets CO_2 emissions targets for heavy industry and creates market for emissions quotas

Dec 2005
EU Council of Ministers welcomes Commission proposed to include air transport in ETS

Mid 2006
European Commission Working Group on the extension of ETS to air transport to publish report; Commission legislative proposal likely to follow

2008
Likely date for legislation extending ETS to air transport to come into force

Several Key Issues for Airlines Remain to be Resolved

- What will be the baseline year for setting emissions targets?
- Which airlines will be covered?
- Which routes will be included (e.g. intra-Europe only or also external routes)?

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BERNSTEIN
Investment Research and Management

APPENDIX 1

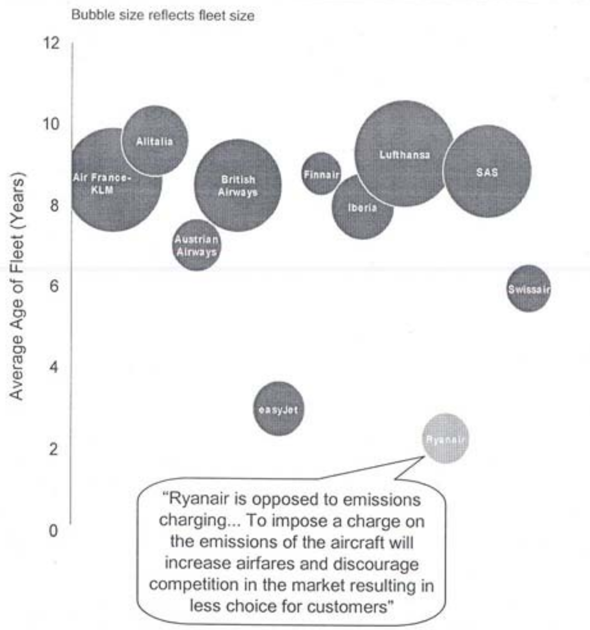
Company Engagement

Impact of Measures to Combat Global Warming on the European Aviation Industry

The Impact of Extending ETS Will Vary by Airline

- One of the major factors that determines CO_2 emission levels is the age of the plane engine: the newer the engine, the less CO_2 it emits
- An airline with a particularly old fleet may be able—at a cost—to meet emission requirements by buying newer planes with more fuel-efficient engines. This is one of the factors driving current strong sales of new civil aircraft
- An airline with a relatively young fleet (e.g. Ryanair) may be subject to less onerous CO_2 reduction targets
- High growth airlines may face higher costs from buying quota to allow expansion above their allotted emissions baseline

European Airlines: Average Age and Size of Fleet



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Sources: Company disclosures, Flight International, HSBC, Trucost and Bernstein; News Release Ryanair Website, December 2004

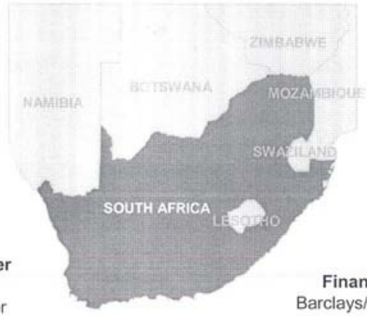
BERNSTEIN
Investment Research and Management

Company Engagement: Black Economic Empowerment

A wide-ranging programme …

- Black Economic Empowerment (BEE) is a programme launched by the South African government to increase growth by reducing inequality
- Different industries have been encouraged to draw up their own BEE charters. Charters have already been developed for several sectors including mining, agriculture and financial services
- An integral part of the programme is a codes-linked-scorecard*, which measures companies' empowerment progress in four areas:
  - Direct empowerment through ownership and control of enterprises and assets**
  - Management at a senior level
  - Human resource development and employment equity
  - Indirect empowerment through preferential procurement and enterprise development

…affecting several UK holdings



Consumer Staples
SABMiller

Finance
Barclays/ABSA

Industrial Commodities
Anglo American
BHP Billiton
Rio Tinto
Xstrata

Insert Tracking Code

*Private companies must apply the codes if they want to do business with any government enterprise – that is, to tender for business, apply for licences and concessions, enter into public-private partnerships, or buy state-owned assets.
**Each charter is tailored to suit a particular industry; however they generally stipulate a target of 25 percent black ownership over the next ten years.
Sources: Department of Trade and Industry – Republic of South Africa and Bernstein.

Company Engagement: Black Economic Empowerment

Company	Issue Addressed	Example actions
bhpbilliton	Supply Chain Management	Established Business Development Centres near BHP facilities to help suppliers achieve BEE supplier status, promote local supply opportunities to small and medium sized companies and provide enterprise development support to potential suppliers
SAB MILLER	Majority Business Ownership	Announced plans in April 2006 to sell 40 percent of its bottle-top manufacturing subsidiary to a BEE group
xstrata	Majority Business Ownership	Plan to place 15 percent of their South African business in the hands of historically disadvantaged South Africans by 2007 and 26 percent by 2012
ABSA	Financial Inclusion	Launched Mzansi low-cost bank account service as part of its initiative to provide access to full-service banking within 15km of all South Africans

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Sources: Company reports, Department of Trade and Industry – Republic of South Africa and Bernstein.

Bernstein Value Equities

Summary of Major Engagement Activity for Tayside

Baillie Gifford

Company	Area of Engagement	Main Topic	
Taylor Nelson Sofres	Corporate Governance	Board changes	A successful consultation with the company where we discussed the new CEO and potential Chairman appointees.
Royal Dutch Shell	SRI	SEE risks, Human Rights	We wrote to the company to ask about the operations in Sudan - the current policies and systems employed to promote the sustainability of the investment in the region, and ensure compliance with the company code of conduct. We received a prompt, comprehensive response and have arranged a meeting for later in the year. We are satisfied that Shell is fully aware of the SEE (social, environmental and ethical) issues and have the appropriate management systems in place.
Shaftesbury	Corporate Governance	Executive Remuneration	We participated in a remuneration consultation. Initially the performance targets were low in comparison to consensus estimates. Following our engagement the target required for 100% of the award to vest was increased. We fully expect to approve the new remuneration plan at the 2006 AGM.
Wolseley	Corporate Governance	Executive Remuneration	We spoke to the company about the lack of a financial underpin for the long term incentive plan and the earnings per share performance targets in the share option scheme. This was a successful consultation in which our concerns were addressed.
Australia and New Zealand Banking Group	Corporate Governance	Executive Remuneration	We wrote to the company informing the Company Secretary of our decision to oppose the remuneration report. The long term incentive scheme allows excessive vesting for median performance which we do not believe is in the best interests of shareholders.
Brambles (AU)	SRI	Health & Safety and other Social, Environmental and Ethical issues	We had a conference call with the Chief Financial Officer to discuss its Health and Safety (H&S) Policy and its supply chain audit and reporting process. We will continue to monitor the progress of this diverse business.

APPENDIX 2

Diageo	Corporate Governance	Executive Remuneration	We discussed aspects of the executive remuneration policy with the executive reward committee. We fully expect our views to be forwarded to the Remuneration Committee and have suggested that we meet with the company to discuss the remuneration policy and performance targets prior to next year's AGM.
Glaxosmithkline	SRI	New product development, sustainability, environment, health & safety and the harmonisation of benchmark standards	We met with management to discuss its eco-design tool kit, and the international harmonisation of clinical trials and benchmark standards. The eco-design tool kit has been developed to support new product development and product transfer, and integrates sustainability principles into this core business process. The objective is to take products to the market more cost effectively, having evaluated and mitigated potential environmental, health and safety issues during the early stages of development. The international harmonisation of benchmark standards is particularly relevant for a company such as GSK due to the extent of their operations and the range of drugs they manufacture. The company has set the harmonisation of codes as an objective and we will review their progress made against this target in 2006.
Persimmon	Corporate Governance	Executive Remuneration	We were consulted by the Remuneration Committee about its proposed Synergy Savings Plan, which will be put to the shareholder vote at its EGM in January 2006. Following extensive dialogue and concessions by management, we have informed the Remuneration Committee that we are supportive of the Scheme: the synergy targets have been toughened and the retention period has been increased to four years.
Royal Bank of Scotland Group	SRI & Corporate Governance	Key performance indicators for SEE issues and the arrangement with Bank of China	We met the head of Corporate Responsibility (CR) to discuss RBS's recent CR developments and to gain further understanding about their investment in the Bank of China. The company's disclosure has significantly increased since the publication of the 2003 CR Report and includes an extensive list of the progress made in 2004 and targets set for 2005/06.
Total SA	SRI	SEE risks, Human Rights	We spoke to the Vice President Investor Relations about the resumption of its oil and gas operations in Sudan. Concerns about human rights and civil conflict, in particular, mean that this region is politically very sensitive. We have a further meeting organised to discuss these issues in more detail, specifically the relationships with its stakeholders and international non-governmental organisations (NGOs).

Company	SRI Topic	
Carnival	Environmental risk management	We had a conference call with the Chief Operating Officer to discuss how, as a global cruise company, its environmental management systems (EMS) operate. In 2005, Carnival published its first environmental management report and set a target of complying with ISO 14001, an environmental management standard, by August 2006. Importantly, the development of its EMS will allow the company to set environmental targets and measure its performance. Doing so will also enable it to respond to the Carbon Disclosure Project, which is a request from institutional investors for disclosure of information on Greenhouse Gas Emissions. We welcome Carnival's increased disclosure on environmental issues and will continue to monitor its progress.
GlaxoSmithKline	Human rights, sustainability, and stakeholder management	We visited the company's research and development site in Belgium to discuss vaccine development and scientific trials in the developing world. Since drug trials must be conducted in the region affected, building effective relationships with the local community is of paramount importance. For example, local interpreters are employed, drugs are issued at lower prices to charities via tiered pricing, and it liaises with UNICEF and WHO, who have developed systems to distribute the vaccines. The meeting provided us with a valuable insight into the company's approach to stakeholder engagement, which we believe is in accordance with best practice.
Northgate	Employee care (health and safety) and environmental risk management	We met the Company Secretary of Northgate, a van and car hire company, to discuss how it manages health, safety and environmental (HSE) issues. It has recently carried out an extensive risk review of all issues, including financial and HSE risks. It also plans to implement ISO 14001, a company wide environmental management system. Although the company is compliant with HSE regulations and employees receive HSE training, currently its disclosure on HSE issues is limited. Following the risk review, we expect there to be more information on HSE issues disclosed in the 2006 annual report.

Corporate Social Responsibility (CSR) Report - Q1 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
Camco International	UK		♦			
Carbon Trust	UK		♦			
CMR Fuel Cells	UK		♦	♦		
EU Environment DG	EU		♦			
European Climate Exchange	UK		♦			
First Choice	UK			♦		
Green Spirit Fuels	UK		♦	♦		
Health & Safety Commission	UK				♦	
HTC Purenergy	UK		♦	♦		
Losonoco	UK		♦	♦		
LowCVP	UK		♦	♦		

Company	Country	Corporate Responsibility Strategy	Environmental Management & Climate Change	Responsible Product Stewardship	Workplace	Human Rights
Lloyds TSB	UK	♦		♦	♦	
Novera Energy	UK		♦	♦		
Philips	The Netherlands	♦	♦	♦		
Point Carbon	Norway		♦			
PPC	Greece		♦	♦		
QuestAir Technologies	UK		♦	♦		
Royal Bank of Scotland	UK	♦		♦	♦	
SolarWorld	Germany		♦	♦		
Suez	France		♦	♦		
VRB Power	UK		♦	♦		

Issue: Sustainable Transport

Background

Road transport is one of the main causes of pollutant growth, representing 28% of total UK emissions. Progress towards stabilising and ultimately reducing emissions from the sector is essential. The Renewable Transport Fuels Obligation (RTFO), implemented late last year, is a positive development to promote lower carbon fuels. The RTFO mandates that 5% of all the petrol and diesel sold in the UK in 2010 will comprise a biofuel. In the budget, the Chancellor confirmed incentives to fuel suppliers to get biofuels on to the market, with the total potential support for biofuels doubling to 35p per litre (comprising a 15p per litre buy-out price to be paid by suppliers who fail to meet the mix obligation, plus an extension of the 20p per litre duty incentive to 2008/9). Our engagement objective was to review sustainability issues that might impact the investment case of this energy source.

Company Engagement

The Low Carbon Vehicle Partnership (LowCVP) is a partnership of the automotive and fuel industries, Government, academia, non-government organisations (NGOs) and other stakeholders to accelerate the shift to clean low carbon vehicles and fuels in the UK. We learned from a presentation of its research that, on a life-cycle basis ('farm-to-filling' station analysis), the net greenhouse gas (GHG) emissions reductions vary widely depending upon the biofuel crop and the way it is grown and processed. The study focused on bioethanol produced from wheat and showed that life-cycle GHG benefits vary from 7% to 77%, depending on the means used to produce and process the fuel. Green Spirit Fuels launched in June 2005 by Wessex Grain, noted that the industry recognises the importance of retaining political and public support for the emerging biofuels market, as well as the risks from unsustainable production of fuels which deliver little by way of greenhouse gas savings. Indeed, the LowCVP has ongoing programmes of work to prepare a carbon certification methodology through which GHG savings of biofuels can be calculated, which are anticipated to provide the basis for RTFO reporting. Losonoco builds and operates refineries that re-cycle agricultural, municipal and commercial waste streams into fuel ethanol. Its focus is on biomass rather than crops, providing an environmentally friendly, high value-added alternative to existing waste management options. These 'second-generation' biofuel producers offer the potential advantage that the cultivation process (if any) could be less environmentally intensive than for ordinary agricultural crops. Plant biotechnology companies are researching a corn with a higher starch content to accelerate the fermentation process used to make ethanol. Another avenue is to produce genetically-enhanced enzymes, yeasts and bacteria capable of producing ethanol from virtually any plant, tree or agricultural waste. We attended a briefing by a specialist consulting firm to the agricultural industry on the development of non-food GM crops for renewable resources and energy production, offering the potential for relatively small land mass in comparison to typical broad acre crops. Of course, climate concerns are not the only environmental issue when we are considering the sustainability of the potential rapid growth in the market for biofuels. There are concerns about the impacts on biodiversity and the displacement of traditional agricultural patterns. We were encouraged that the RTFO noted the importance of wider sustainability assurances, and we also learned from an official at the EU DG Transport and Enterprise that options are under review for a required sustainability certificate for biofuels, which would include environmental and social standards.

Future Engagement Objective

Carbon performance and the wider environmental sustainability of biofuels will be an important evaluation criteria as we review any potential investments in this area going forward.

Issue: Banks called to account

Background

The focus of our meeting with two banks this quarter was on their approach to the 'treating customers fairly' (TCF) initiative introduced by the Financial Services Authority(FSA). Under the FSA's principles-based approach to the TCF project, the onus is on banks to be able to demonstrate that consideration of customer needs is embedded at every stage of their business processes. For the UK banks with significant retail operations (i.e. selling direct to individual consumers), customer satisfaction and trust will be crucial to future success. Allegations of irresponsible business practices increase the risk of regulatory action that could restrict the banks. As investors it is in our interest to understand any business practices of the banks that might prompt such scrutiny.

Company Engagement

The FSA is becoming increasingly agitated by sales driven remuneration that places an emphasis on earning commission rather than providing products best suited to the customers. 'No particular remuneration structure is inherently unacceptable. However, all …will impact upon staff behaviours and it is important…to have appropriate controls in place to protect against these risks'. Lloyds TSB outlined to us its quantifiable alignment between employee satisfaction (measured via overtime, work climate, staff turnover and staffing adequacy) and customer satisfaction levels. Similarly Royal Bank of Scotland(RBS) noted that, while front-line staff have sales targets included in their bonus, remuneration is linked to customer satisfaction and bonuses are reduced for any compliance failures. All sales staff incentive schemes are checked by Group Compliance to check for product bias. However, it is clear that firms' thinking on how to factor TCF into the remuneration process must continue to evolve, as the emphasis for sales people is still on volume.

Another area that has drawn regulatory attention is TCF in product design. 'Where firms use consumer research it often focuses on who would want to buy a product and how to market it better rather than assessing who the product is suitable for'. In line with this, concerns have been raised about Payment Protection Insurance (PPI), which is designed to cover borrowers' loan payments if they lose their job or cannot work because of an accident or ill-health. Critics including MPs and consumer groups contend that, in many cases, consumers are wasting their money, as PPI is expensive and full of complex restrictions about employment status and common medical conditions.

Lloyds TSB noted that it has protected itself with an 'opt-in' rather than an 'opt-out' product selection, which puts the onus on staff to explain the benefits and risks in relation to coverage. However, given that PPI accounts for 14% of Lloyds TSB's profits, if the regulator decides that PPI should be sold separately from the underlying loan, there is a risk that competitors may erode its market share. RBS highlighted its compliance with FSA Guidelines in relation to PPI and noted that it is not a disproportionate part of their business.

The Office of Fair Trading (OFT) ruled in July that penalty fees for late payment and/or credit limit breaches on credit cards are too high, while MPs and the financial regulator have expressed concern that consumer indebtedness is at an all time high. Banks have been accused by consumer groups of lending irresponsibly to people who cannot afford to repay, contributing to financial hardship and stress. In response, both Lloyds TSB and RBS noted that they will be participating, under the aegis of the British Bankers' Association, in a plan to improve data sharing to identify those customers who are (or are approaching) unsustainable levels of debt.

Future Engagement Objectives

We will continue to engage with banks regarding embedding TCF principles into their business processes.

Issue: Identifying Low-Carbon Investment Opportunities

Background
A continuing objective of our CSR engagement is to add value to our mainstream equity research process, identifying investment opportunities that are being developed as part of the solution to climate change.

Company Engagement
We attended the New Energy Markets Day at the London Stock Exchange for presentations from companies listed on the Alternative Investment Market (AIM); this provided us with insights on innovative low-carbon technologies. For the power generation sector, HTC Purenergy has developed commercially available technology to capture and store CO2 emissions released from coal and gas power stations. QuestAir Technologies are also participating in the development of cleaner fuels, supplying gas purification systems for use in oil refinery and industrial applications. Novera Energy is focused on wind and landfill gas power generation, and is currently pioneering a project (with the support of the Department for Environment) in East London that will convert household waste to electricity.
We met with Germany's SolarWorld for a briefing on its acquisition of Shell Solar, which has propelled the company into the position of the US's largest solar manufacturer and distributor. Although solar market currently supplies only a tiny fraction of the world's energy needs, this is expected to increase as demand is strong for solar panels as they harness energy from the sun and so provide electricity without emitting carbon.
Meteorological unpredictability is often an obstacle to the widespread use of renewable energy as the generation of electricity requires adequate weather (sun and wind) conditions. VRB Power has developed its Energy Storage System as a response to this challenge, using technology that it claims will enable generated electricity to be stored for later use.
Energy efficiency is also at the forefront of today's innovation. CMR Fuel Cells presented its current project to develop a methanol fuel stack for portable electronics that has the potential to supply power for four to five times longer than that currently available from more conventional sources. The company expects to deliver a full prototype of the fuel stack by the end of 2007. However, a paradigm technology shift is not necessary to achieve improvements in energy efficiency. Philips outlined to us the work it is undertaking to improve the environmental performance of its products. Consumers contribute to global warming by using electrical and electronic equipment. Philips' EcoDesign activities reduce the power consumption of its products, including minimal energy use in standby mode, a feature of TVs and electrical white goods.
Finally, we attended a presentation by the Chief Scientific Advisor to the UK Government who, because of its zero emissions, is a proponent of nuclear energy in relation to climate change. We also met with a detractor of this energy source, a former Special Advisor to three Secretaries of State for the Environment, who questioned the economics of nuclear as an investment choice, and outlined the issues that must be addressed in relation to the disposal of high-grade hazardous waste from nuclear plants.

Future Engagement Objective
We will monitor the progress and investment potential of these companies, and continue our ongoing review of low-carbon technologies.

Issue: Review of CSR third-party research & ratings services

Background
As part of our engagement process, we encourage companies to install effective management systems that enable them to provide detailed data on their social and environmental performance. This facilitates better constructive engagement between companies and their shareholders. Third- party research and ratings companies are a potentially valuable resource in this process as they gather publicly disclosed CSR information from across the investment universe and organise it into a research analysis tool. This quarter, we undertook an extensive review of CSR research providers to assess how they can enhance our CSR engagement. We undertook discussions with Asset 4, Corporate Health & Safety Index (CHaSPI), Corporate Responsibility Exchange (CRE), Eiris, Future Value, Innovest and Trucost. We also reviewed the FTSE4Good and Dow Jones Sustainability Index.

Company Engagement
Our review identified a variety of different available products. The FTSE4Good and Dow Jones Sustainability Index are indices that rate companies on specific social and environmental factors, with the inclusion criteria evolving gradually. For example, in the past few years, all companies listed on the FTSE4Good were given notice of a new requirement for having an environmental management system (EMS) in place. The rating is carried out by these organisations, with the disadvantage that the information held on individual companies is not directly available.
We met with the UK Health & Safety Commission to review its plans for CHaSPI, the H&S index it is developing to provide an online facility for companies to disclose information on their performance in this area. We provided feedback on our needs as users of this information, for example reviewing safety data on constructions companies, or the impact of occupational stress in relation to absenteeism. Similarly, The London Stock Exchange has developed the CRE in order to provide a web-based portal for companies to enter information relating to social, environmental and governance-related issues, and for review by investors. However, as both of these initiatives are at the early stage of development and inclusion is voluntary, company coverage is still quite limited.
The remaining commercial systems we reviewed input social and performance data on a large number of European companies, using publicly available information from CSR websites and reports. Trucost is a specialised provider of quantitative analysis of a company's environmental footprint. Asset 4 provides 'raw' data without analysis on an extensive selection of economic, social, environmental and governance-related issues, together with scoring, ranking and peer comparison functionality for the user to customise a CSR engagement portfolio. Innovest and EIRIS use the social and environmental data to develop company and sector profiles. Innovest further undertakes follow-up meetings with each company in order to seek out information that has not been disclosed by companies, but is considered by their analysts to be material.

Future Engagement Objectives
We were encouraged by the increasing number and improving quality of CSR third-party research providers. We will continue to be an active participant in relation to communicating our research needs to these companies as they are an important resource that enables us to evaluate CSR performance better and identify key issues for company engagement. Fidelity currently subscribes to the Innovest and Trucost research services.