REPORT TO: **SUPERANNUATION INVESTMENT SUB-COMMITTEE OF THE POLICY AND RESOURCES COMMITTEE – 26 NOVEMBER 2012**

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

REPORT BY: **DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **460-2012**

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 30 September 2012.

3 BACKGROUND

On 17 November 2008 the Sub-Committee approved a revised Policy on Environmental, Social and Corporate 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 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 CONSULTATIONS

The Chief Executive and the Head of Democratic and Legal Services have been consulted in the preparation of this report.

10 BACKGROUND PAPERS

None

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES **16 NOVEMBER 2012**

APPENDIX 1

ALLIANCE BERNSTEIN – SOCIALLY RESPONSIBLE INVESTMENT UPDATE

We continue to engage actively with UK and overseas companies in your portfolio on a range of SRI issues, particularly those related to corporate governance, in order to protect clients' interests. Two prominent examples in the UK this year involved Barclays Bank and Xstrata, the mining company.

We had a number of contacts with Barclays over our continuing concerns about the company's remuneration policy. We voted against the remuneration report in April (about three quarters of shareholders voted in favour) and also against the re-election of both the Company's Chairman, Marcus Agius, and the Chair of the Remuneration Committee, Alison Carnworth. Both were re-elected but resigned from their positions in July. We continue to view the company's performance pay targets as insufficiently stretching and as failing to properly align management and shareholder interests. But at current valuations, we still find the company's shares attractive. We plan to continue to engage the company on remuneration issues.

We engaged with Xstrata's management to express our dissatisfaction with the proposed terms of the merger between Xstrata and Glencore and the associated remuneration package. We voted against the Directors' Remuneration Report in April, although this passed with 37% of shareholders voting against. We subsequently sold out of our remaining holdings in Xstrata, which we no longer found attractive given continuing uncertainties around both the terms of the deal and the likelihood of it proceeding at all.

Company	Engagement Report
Amazon.com	Amazon.com is an online retailer that sells a range of products from books and DVDs to white goods. We had a conference call with the company's Vice President and Associate General Counsel to discuss succession planning, executive remuneration, and engagement with employees. Amazon has a stable corporate governance structure with the Chairman and CEO, Jeffrey Bezos, also being the company's largest shareholder. This helps to ensure that the company is managed for the long term. It has made some positive changes to its governance structures in recent years including the introduction of majority voting (all directors require at least 50% shareholder support to be elected) and the appointment of a lead director. It has also increased disclosure on succession planning, a sign of its importance throughout the company. We welcome the proposal to consider removing the Remuneration Committee's ability to reprice share options in its Stock Incentive Plan, following a large vote against at the 2012 AGM. We look forward to further discussions with the company prior to its next AGM.
Brambles Limited	Brambles' main business is CHEP which issues, collects, repairs and reissues pallets and containers to assist manufacturers, distributors and retailers to transport their products safely and efficiently. CHEP is by far the world's largest pallet pool provider, with operations in the US, Canada, Latin America, Europe, Australia and South Africa. We had a conference call with the Chairman to discuss the recent recruitment of non-executive directors (NEDs), succession planning, management turnover including the appointment of a new CFO, and executive remuneration. The new NEDs who will be appointed at the AGM in October have a wealth of logistics, transport, supply chain and financial experience. This is particularly important as the company develops its logistics business in North America, seeks feedback from clients such as CostCo and Coca Cola, and outsources its administration functions. Each NED visits different parts of the business, receives presentations from local management, and then gives a presentation to the board on what the company could do better. The Chairman also acknowledged that as the company reviews its future business strategy, it will also likely review executive remuneration structures and the performance targets on which it expects to consult shareholders. We look forward to further discussions with the company.
Olympus Corporation	Olympus is the world's leading endoscope maker. This is a growing market driven by demographics and increased medical screening. Olympus has a strong competitive position based on loyal customers and high barriers to entry. We met the President in Tokyo in September to discuss ongoing litigation, improvements to the company's internal controls, and future capital raisings or business alliances. Since the disclosure in November 2011 of the £1 billion accounting fraud linked to investments made in the late 1980s, there have been significant changes at the company, including the appointment of a new board in April 2012. Although not delisted by the Tokyo Stock Exchange (TSE) in January 2012, the company has been classified by the TSE as a 'security on alert' and, in conjunction with the TSE, has developed a rehabilitation plan. This involves making improvements to internal audit systems covering both domestic and overseas subsidiaries. The company will submit an internal confirmation document to the TSE in January 2013, and this will be followed by a four month TSE inspection period. The target is removal from the 'security on alert' designation within one year. We have encouraged the board to put future capital raisings or business alliances to a shareholder vote. We have also asked that the board consider other options to strengthen its balance sheet, including the sale of cross shareholdings and cost cutting, which would avoid dilution to shareholders. The President understood shareholder concerns. He stressed the importance of the independent directors, who comprise a majority of the board, in ensuring that any future decisions will be in the best interests of shareholders. We will continue to engage with the company on these issues.

Company	Engagement Report
BHP Billiton	BHP is a broadly-diversified resources company with a wide range of products. We took up the invitation to meet senior management to discuss executive remuneration ahead of their AGM in October. This type of invite has not been unusual this year, as many overseas and UK companies have sought shareholder input. BHP Billiton explained its remuneration strategy review process, and the plan to make no significant changes. We are satisfied that the outcome is the right one, and we are pleased that the CEO has waived his annual bonus this year in light of the recently acquired shale gas assets being written down. However, we were disappointed that the committee has not yet disclosed whether the level of award under the Long Term Incentive Plan will also be scaled back. We will continue to monitor the committee's use of its discretion in both the short-term and long-term awards.

ENVIRONMENTAL, SOCIAL & GOVERNANCE REPORT (ESG)

OVERVIEW - Q3 2012

FIL has a well established approach to responsible investment which is integral to the research process. FIL's integrated approach incorporates environmental, social, and governance ("ESG") issues into its investment process when ESG-related issues may have a material impact on either investment risk or return. This role is facilitated by our ESG Specialist, who acts as a focal point within FIL globally for environmental, social, and governance related activities. The ESG Specialist works within the framework as outlined in our Principles of Ownership:

> FIL believes that high standards of corporate responsibility will generally make good business sense and have the potential to protect and enhance investment returns. Consequently, our investment process takes environmental, social, and governance ("ESG") issues into account when, in our view, these have a material impact on either investment risk or return. ESG best practice should be encouraged provided they enhance long term financial return.
> We do not screen out companies from our investment universe purely on the grounds of poor ESG performance but rather 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 corporate responsibility.

Below are highlights of potential issues, dialogue and company engagement noted by our investment teams in the last quarter:

ENVIRONMENTAL

Subject - Arctic Drilling - Royal Dutch Shell ("Shell")

Background / Investment Case -

Although the oil and gas industry has been operating in the Arctic for almost a century, the recent concession given to Shell by the US government to start preparation drilling work in the Chukchi Sea highlights the increasing interest in the area for oil and gas operators.

The region has so far been responsible for 10% of the world's discovered conventional resources and there is much more potential for production in the region. But with this opportunity comes risks such as stringent regulations which may increase costs and cause production delays; court litigation potentially delaying drilling; territorial issues and internal politics; reputational risk of exploiting climate change; significant technical challenges resulting from oil spills; harsh weather conditions affecting machinery and health & safety procedures.

Recent Update –

- The U.S. Department of Interior approved Shell's preparatory operations in non-oil-bearing zones in the Chukchi Sea
- The Environmental Protection Agency approved interim air pollution limits to ensure that the company meets mandated air quality standards under the Clean Air Act.
- Approval from the US Coast Guard in relation to suitability of the company's containment vessels is still outstanding and further regulatory permits to drill in the area need to be approved.
- The matter of encroaching sea ice in the area being drilled is a concern and the company has recently halted its operations due to this climatic issue.
- Our Oils & Gas analyst continues to monitor Shell's operations in the Arctic Region and also monitors the activities of Shell's peers operating in the same area.

Other Companies affected -

- BP plc who in July 2012 confirmed the suspension of its operations in Alaska due to the stricter regulations and
- ENI S.p.A. who earlier in the year entered into an agreement with the Russian company Rosneft Oil Company OJSC to explore jointly several offshore sites in the Arctic Region.

Subject - Renewable Energy

Background / Investment Case -

FIL's utilities analyst continues to monitor the introduction and impact of new legislation and regulations in relation to renewable energy.

Recent Updates –

- During the quarter, Japan announced plans to end their dependence on atomic power by the end of the 2030s, bowing to public pressure after the Fukushima nuclear disaster. Japan joins Germany in its plans to reduce its dependence on nuclear power. Germany has begun decommissioning old plants and also speaks of weaning itself off it altogether by the 2020s.
- Germany's nuclear exit plan is causing billions of Euros worth of write-down's, large asset sales and job cuts at utility companies.

ENVIRONMENTAL, SOCIAL & GOVERNANCE REPORT (ESG)

- In 2002 The U.K. Department of Energy & Climate Change ("DECC") placed a mandatory requirement on licensed UK electricity suppliers to source a specified proportion of electricity they supply to customers from eligible renewable sources or to pay a penalty. This requirement is referred to as the "Renewables Obligation". During this quarter, DECC approved new "Renewables Obligation Certificates" (ROC) levels which would result in reduction in subsidy levels for a number of technologies.
- Due to an energy sector overhaul in Spain, the Spanish Government this quarter released proposals for a range of measures to decrease their electricity system tariff deficit to zero by 2013. These measures include a 6% levy on Spanish power generation, implementation of a generation tax affecting all technologies and a transferral of funding costs linked to the remaining tariff deficit to the Treasury. This energy reform still needs Parliamentary approval.

Companies affected -

- In reaction to the downturn in nuclear power in Germany, this quarter RWE AG announced plans for job cuts in the area but at the same time has become well-positioned in the market due to its proactive renewable energy development strategy with strong focus on offshore wind power, investing heavily in offshore wind farms including several off the British coast. This allows the company to capitalise on various incentives within Europe that make renewable power generation attractive.
- This quarter, the U.K. Government has given the go-ahead for two large offshore wind farms off the Norfolk coast with a combined investment of approximately £3bn. Centrica Plc and Warwick Energy are currently developing these particular projects.
- The new ROC subsidy levels introduced by the DECC are a positive outcome for many companies, such as Drax Group Plc since the new ROC level is sufficient for them to proceed with coal to biomass conversion in 3 out of 6 of their units.
- Iberian utility companies affected by the new regulatory claw-backs under discussion in Spain include Iberdrola, S.A., EDP Energias de Portugal, and Enel S.p.A.

SOCIAL

Subject - Nutrition

Background / Investment Case –

Recent issues such as rising attention from NGOs, growing interest around "fat taxes" globally and rising publicity on food and health will materially impact earning growth in packaged food industry and may see a strong positioning on health as critical driver of continued growth in mature markets.

Recent Update –

- Nutrition Index to be launched to evaluate and rate 25 of the world's largest food and beverage companies in relation to under nutrition and obesity.
- Cholesterol levels in U.S. children improved in the past two decades as makers of cookies, crackers and French fries are responding to public concern that trans-fats used in their products may be harmful to health.
- This quarter, McDonalds Corp announced it will begin posting calorie information on menu boards at its U.S. stores as it works to stem criticism that its food causes obesity.

Companies affected -

Nestle SA, Unilever Plc, Danone, Kerry, Glanbia, Aryzta

Subject - Shipping

Background / Investment Case -

EU governments have agreed draft legislation to reduce emissions from ships which they contend will have a beneficial impact on human health. The European Commission has said that this could cost the shipping industry up to €11billion but is outweighed by the public health savings of approx €30 billion.

Recent Update –

- SO2 emissions, which cause acid rain and can harm human, health, have dropped by 66% from ships in EU ports since a new policy on shipping fuel began in 2010.
- Research shows that there is a correlation between SO2 and chemical elements typically emitted from ship stacks, demonstrating that ships were the main source of sulphur dioxide in the harbours.
- Shipping firms are threatening to fight EU emissions proposal as they fear it would have a negative effect on a number of businesses

Companies affected -

Wartsila, Alfa Laval AB, P&O Ferries

ENVIRONMENTAL, SOCIAL & GOVERNANCE REPORT (ESG)

GOVERNANCE

Subject - Board Diversity

Background / Investment Case -

Over the last year, there has been increased interest in board diversity and in particular, women representation on executive boards. There has been growing recognition of the importance of including more women in decision-making roles and the benefits that would be gained by businesses in doing so.

In the UK, the Lord Davies report (released in 2011) outlined a roadmap guiding businesses to achieve 25% female representation on boards by 2015. A more recent report released in March 2012 outlined how progress had been made due to an increasing number of women on FTSE company boards since 2011.

Recent Update –

- In Italy, a new law was passed in August 2012 which amended the Italian Consolidated Law on Finance to enact a quota system of gender diversity on the board of directors and board of statutory auditors in Italian companies. The law requires that at least 33% of the board be composed of female directors by 2016.
- FIL's Italian-based Portfolio Manager continues to monitor the progress made in Italy.
- This quarter, press reports claim that the EU could introduce boardroom quotas forcing companies to hire more female directors as early as 2020.
- Under the current EU proposal, Europe's listed companies could face fines if they do not allocate at least 40% of their non-executive director seats to women. Companies with €50m in revenues or more than 250 employees would have to report on the gender composition of their board, and if they don't meet the requirements, they could be subject to fines or sanctions.
- France, Italy, Spain and the Netherlands have already introduced national quotas, but the UK is opposed to such measures.