REPORT TO: **SUPERANNUATION INVESTMENT SUB-COMMITTEE OF THE FINANCE COMMITTEE - 19 NOVEMBER 2003**

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

REPORT BY: **DIRECTOR OF FINANCE**

REPORT NO: **768-2003**

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 2003.

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

Alliance Bernstein only began managing the Funds' assets in July 2003. Consequently there has been limited opportunity for them to put the engagement strategy into place. Their focus has previously tended to be on remuneration and overall business strategy.

8 BAILLIE GIFFORD

Baillie Gifford have continued to be heavily involved in responding to government consultations and co-ordinating institutional activity.

A summary of recent engagement activity is shown on pages 33-34 of their quarterly report.

9 FIDELITY

Fidelity prepared a position paper for its institutional clients outlining its engagement process and its approach to some of the main issues. This was circulated to members on 30 June. Fidelity's recent activity is outlined in Appendix 1.

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 continues to be scarce but it is clear that increasing pressure from a variety of sources is being applied to an increasing number of companies.

11 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.

DAVID K DORWARD
DEPUTE CHIEF EXECUTIVE (FINANCE) **11 NOVEMBER 2003**

Socially Responsible Investment Policy

- 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 risks or returns.
- 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, on behalf of our clients, we discuss these issues with the management of, primarily UK, companies in which we invest, 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.

Socially Responsible Investment (SRI)

Fidelity pursues an active policy of dialogue with UK companies on social, environmental and ethical issues. Our research is supported by independent research from EIRIS (Ethical Investment Research Service). Fidelity seeks to contact companies where there are a number of areas of concern relating to SRI. In the six months to the end of September we contacted a number of companies including Anglo American, Aviva, MMO2 and GlaxoSmithKline. Details of some of the feedback that we obtained from each is outlined below. In June, Fidelity signed up to the Extractive Industries Transparency Initiative (EITI). Details of this are also given.

Anglo American
Anglo American is a leading mining and natural resources company. Within the area of corporate social responsibility the company focuses on four main areas: Business practices & performance, Workplace, Environment and Society. Within these, Anglo American sees water, energy, health and diversity as its main priorities, risks and opportunities. We wanted to find out more about the companies progress in these key areas.

Aviva
Aviva is the world's seventh largest insurance group and the biggest in the UK. We wanted to find out more about the company's approach to corporate social responsibility because of its high ranking in several independent studies, such as the Business In The Community Corporate Responsibility Survey. We were also interested in the approach it was taking to dealing with flooding.

MMO2
MMO2 provides mobile communication services in Europe. We wanted to find out more about the company's approach to handset theft and recycling phones.

GlaxoSmithKline (GSK)
GSK is a world leading research-based pharmaceutical company. We wanted to find out more about the company's approach to stem-cell research, as well as looking at the progress it had made in its second year of reporting on Corporate Social Responsibility (CSR) issues.

Socially Responsible Investment (SRI): Anglo American

Business practices and performance: The company avoids top-down target setting as it feels that these do not work. Instead it prefers to set business-specific targets as it feels these can be more relevant to particular circumstances and communities. Its 'Good Citizenship' business principles were rolled out across the group in 22 languages. These apply to all managed operations, whilst contractors and significant suppliers are also asked to adhere to them.

Workplace: Safety: The lost-time-injury-frequency-rate, a measure of safety performance, fell by 42% from 2001 to 2002. 47 people died during the year, of these 25 were employees and 22 contractors. The main cause of fatal injuries remained the result of falls of ground, although moving machinery and transport-related incidents also posed significant problems. Anglo is taking a number of measures to improve safety. It introduced 'golden rules' that highlight the main safety risks, is undertaking further adult literacy training at South African sites and is also mechanising more processes.
Occupational Health: The company's main occupational health challenges continue to be noise and dust, as well as HIV/AIDS. In August 2002, the company announced that it would provide anti-retroviral therapy for employees with AIDS. Anglo estimates that 3,000 people will be receiving treatment within 12 months. Although providing treatment is costly, it has helped to improve morale and reduce absenteeism. The firm sees it as a very important contribution to the community and key to helping alleviate poverty. Anglo conducts a number of other initiatives, including education & prevention programmes.
Human Resources - diversity: One of the key priorities in this area is ensuring equal opportunities throughout the organisation globally. In South Africa, employment equity is being introduced in line with the empowerment charter. In 2002, 22% of the managerial employees were historically disadvantaged South Africans (HDSAs). By the end of 2007 a target of 40% needs to be reached. The company has a long-standing programme to develop HDSA managers and offers about 600 educational bursaries each year.

Environment: The company has achieved ISO 14001 Environmental Management Accreditation for 51% of assets by turnover. It aims to achieve full certification by the end of 2004. Nevertheless, the total energy used in 2002 increased from 2001. The company uses water in a number of areas including its primary activities at mining and smelting operations, forest product operations and industrial minerals. At present it reports water use in aggregate. However, in the future it plans to focus on individual businesses where water issues are a priority.

Society: In 2002, Anglo spent US$28.8 million or 0.9% of pre-tax profit on corporate social investment. Its main priorities are education, health and community development. During 2002, Anglo completed its Community Engagement Guidelines, which detail its ongoing commitment to explore and undertake community projects.

Fidelity Investments

Socially Responsible Investment (SRI): Aviva

Approach to corporate social responsibility (CSR)
Aviva's CSR policy was launched at the beginning of 2002 and has been adopted by 95% of the business worldwide (by number of staff). Issues are managed locally, with the support of a central CSR group, whilst the main board has overall responsibility. The Aviva CSR policy reflects the company's commitment to eight objectives, which relate to: the environment, community, workforce, human rights, health and safety, suppliers, customers and standards of business conduct. Details of some of these are outlined below:

Environment: Launched in 1998, this programme deals with direct and indirect impacts. Areas of direct impacts are: property management, energy use, waste management, paper use and travel and transport. Examples of some of the initiatives are given below:
Energy use: In 2002, approximately 30% of electricity used in its UK operations was sourced from renewable energy.
Waste management: The total amount of business waste recycled per staff member increased by 7.9% during 2002, whilst waste generated per employee reduced worldwide.

Human rights: Aviva has developed a policy on Human Rights, which is tied to the Universal Declaration of Human Rights. This is specifically focused on purchasing, fund management and workforce-related-issues. Aviva is reviewing this area and hopes to update the policy in the Autumn of 2003.

Health & Safety: Each business is responsible for meeting and implementing the local, legal and social requirements surrounding health and safety issues. Health and safety training is often included in company induction programmes for new employees. The core businesses also provide access to occupational health services and many promote healthy living by meeting some or all of the costs of exercise activities, such as gym membership and sponsorship of employee teams.

Suppliers: The central purchasing centre includes questions on the environment in its sourcing process and will be extending this to cover other areas like human rights.

Customers: The company offers a number of green products. Norwich Union Insurance is helping to launch the Pay As You Drive™ insurance initiative. This programme, due to be piloted in 2003, provides individual premiums based on how often, when and where people use their cars. Risk assessors are encouraged to point out to clients potential environmental problems when visiting a site.

Socially Responsible Investment (SRI): MMO2

Management and reporting on Corporate Responsibility (CR): MMO2 recognises that although people want to use its services they have concerns about it. It is embedding corporate responsibility (CR) into what it does and believes it makes good business sense.

Recycling phones: MMO2 is working with environmental firm Shields Environmental to encourage users to hand in their redundant phones. The majority of old phones can be repaired and reused. Where damaged phones are scrapped, their components and precious metals are recovered with less than 2% of all material left as waste. Funds from the initiative are donated to charity. Shields Environmental is looking at the possibility of distributing some of the refurbished phones in emerging markets. However, in order to ensure that mobile waste is not simply being exported, phones will only go to countries where Shields Environmental has set up a similar end-of-life recycling scheme.

Supply Chain: During 2002/03, the company developed an ethical procurement policy. The aim of this strategy is to ensure that suppliers comply with all national and other applicable law and regulations relating to standards, health and safety, payment of living wages and the prohibition of the use of child labour. MMO2 is also specifically looking at the sourcing of mobile phones and equipment. It has entered into discussions with some of its suppliers to better understand their manufacturing process.

Handset theft : A growing proportion of crimes is associated with the theft of mobile phones. Consequently, MMO2 aims to promote crime deterrence. For example, in October 2002, MMO2 and other operators set up a scheme to allow stolen phones to be blocked by tracing a number unique to each phone. Previously, firms were only able to block SIM cards and not the phones themselves (meaning that thieves merely needed to replace the SIM card). MMO2 is also undertaking other initiatives, both by itself and with other operators. For example, MMO2 is looking at educating youths, as a high proportion of victims of handset theft are under 18 years old. In Slough, it has also opened an internet café to try and take adolescents off the street. Other initiatives include the production of a leaflet in the UK to remind people how best to use a phone in public places.

Socially Responsible Investment (SRI): GlaxoSmithKline

Environment, health and safety (EHS): GSK adopts an EHS theme each year. In 2003, this aim is to reduce key EHS risks. Specific objectives include a driver safety programme, assessment of occupational chemical exposure and the enhancement of process safety focus and tools. The company chose to focus on driver safety as this was the main cause of injuries in its commercial business during 2002. Having reviewed existing initiatives, GSK developed a specific driver-safety programme, which is being rolled out in 2003. Going forward, particular focus will be given to areas of the world with the highest number of road traffic incidents.

Research & Development (R&D): GSK recognises that a lot of people have strong feelings about the use of stem cells in the development of medical treatments. However, it feels that a balanced approach is needed as this type of research could be used to cure diseases such as Alzheimers or Parkinsons. At the time we spoke to GSK they were using adult and foetal stem cells in research, but not embryonic ones. GSK is committed to publishing all meaningful trials in a timely manner, as well as presenting findings at conferences. It does not publish proprietary work due to its very nature or small-scale research as this would lack objectivity.

Access to medicines in the developing world: GSK pioneered competitively-priced Antiretrovirals (ARVs) for the treatment of HIV/AIDS. Over the past few years, the company has been able to reduce the price of drugs as it has seen improvements in manufacturing costs. Unfortunately, the company has experienced some problems where medication sold at reduced prices in the developing world has been diverted and illegally resold in Europe. GSK now uses different packaging for some of its low-cost products. Unfortunately, the groups misappropriating these products are rebranding the low cost drugs in packaging used in the developed world, allowing it to be resold. To try and resolve this GSK is considering changing the colour of the medication.

Animal Welfare & Ethics GSK seeks to achieve efficiency in animal use and adopts the 3R's, objective is to reduce, refine and replace animal testing. GSK employees often work directly with or in proximity to chemicals. To safeguard worker health, the company seeks to define occupational exposure limits, as well as taking note of hazards unique to chemicals/products. Historically, GSK has used laboratory animals to conduct occupational toxicology tests. However, the company has reduced its reliance on animals by adopting a tiered approach to toxicology assessment. As a result, GSK has reduced its use of animals for worker safety testing on each product brought to commercial development by 15-20% over the period 1999 - 2001.The security of some of GSK's employees has been threatened by animal activist groups. Although GSK wants to be open about animal testing the safety of its employees is of prime concern.

Socially Responsible Investment (SRI): Extractive Industries Transparency Initiative

In June 2003, Fidelity, as part of a group of international institutional investors, voiced its support for the Extractive Industries Transparency Initiative (EITI). The resulting "Investors' Statement on Transparency in the Extractives Sector" was supported by portfolio managers and pension funds representing £1.75 trillion in assets.

What is the Extractive Industries Transparency Initiative (EITI)

EITI is a UK-led intergovernmental effort to boost transparency standards in the oil and mining sectors of developing countries. It seeks to unite commercial & national companies, home & host governments together with other stakeholders.

Why is this an issue for investors?

Extractive companies are becoming increasingly dependent on securing contracts in developing countries. Shareholders are seeking to reduce the business risks and costs synonymous with poor governance and corruption. Legitimate payments by companies – such as taxes, royalties and signature bonuses – can, through their large size and confidential nature, be open to misuse. This can fuel corruption, poverty and conflict in developing countries, which, in turn, creates unstable and high-cost operating environments for multinational companies. This is a significant business risk especially for extractive companies. It makes them vulnerable to accusations of complicity in corrupt behaviour, impairing their local and global 'licence to operate', susceptible to risks posed by local conflicts and insecurity, and possibly compromises their long-term commercial prospects in underdeveloped markets. As a result, it is in the interest of the companies to operate in a business environment that is characterised by stability, transparency and respect for the rule of law.

What did investors propose?

The statement calls on global extractive companies to play an active role in the UK governments EITI. The group of investors ask the companies they invest in to:

Support the principles of payments disclosure developed by the EITI process;

Work proactively with host country governments and other stakeholders, including other companies, to develop and implement payments transparency agreements within those countries that sign the principles;

Become, or continue to be, active participants in the process to promote the adoption of payments - transparency agreements by host country governments that are not yet signatories to the principles.