Schroders
Socially Responsible Investment Review

2005 Annual Report

In this booklet we provide general information on our asset management services.

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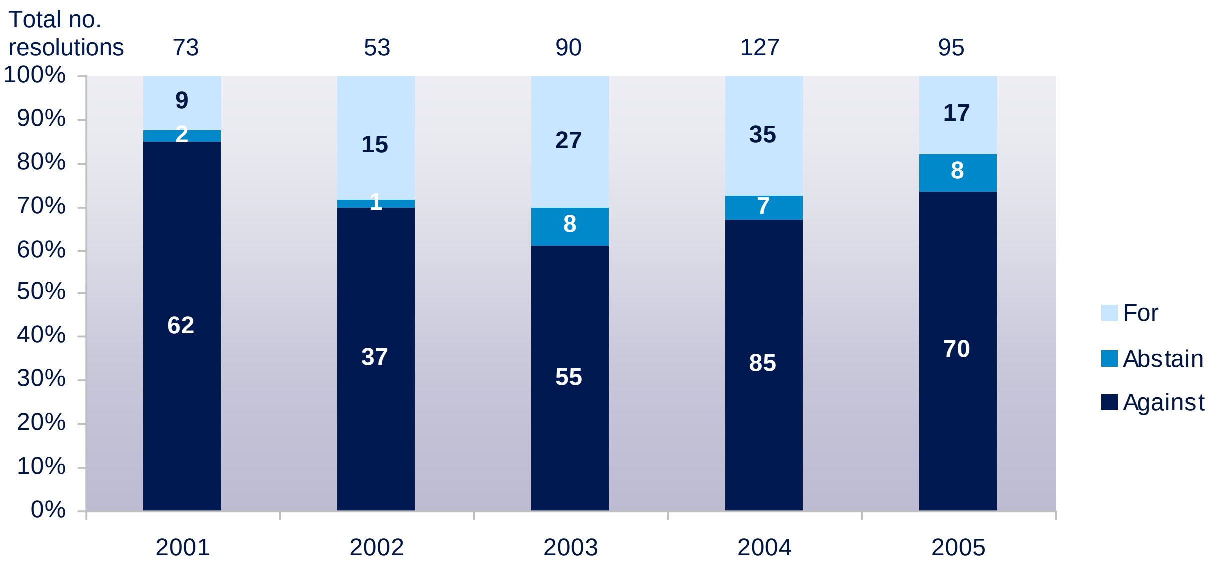
Section 1
Shareholder Resolutions Review

The number of shareholder resolutions of a social, ethical or environmental (SEE) nature that we have voted on during the year has decreased from 127 in 2004 to 95 in 2005. This still represents the second highest number of SEE shareholder resolutions that we have had to vote on. The decrease has been driven by the number of resolutions tabled at Japanese companies' AGMs dropping from 21 in 2004 to 4 in 2005. Shareholder resolutions continue to be driven by the trend for issues to be raised with US companies through resolutions as opposed to engagement.



Graph 1: Schroders 5-yr International voting record on SRI shareholder resolutions (please note the figures in the columns are the absolute number of shares voted, not percentage of votes)

Graph 1 shows that the number of resolutions which we supported during 2005 decreased from 28% in 2004 to 18% of our overall votes. Whilst there could be many reasons for this (e.g. poorly worded resolutions) we have noticed that the quality of corporate responsibility disclosure by US companies has improved making a lot of the resolutions redundant.

Table 1 (overleaf) provides an indication of the trends that shareholder resolutions have followed since 2001 (it does not cover all issues that have been the subject of shareholder resolutions). In collating the information for this table, we have selected resolutions which focus on a broad theme but it is acknowledged that the individual resolutions may be more specific than the topic they are categorised under. For example:

- Weapons includes resolutions focusing on military sales, space based weapons, cluster bombs and mines
- Tobacco resolutions vary in focus from advertising restrictions, labelling and smuggling
- Equal opportunities covers resolutions focusing on board minority representation, glass ceiling, sexual orientation and diversity reports

- Labour standards includes those resolutions which focused on The China principles, the Macbride Principles, the International Labour Organisation core conventions, vendor standards, human rights and company codes of conduct[1]

Whilst there are some trends that can be identified from Table 1 (overleaf), it should also be recognised that trends will be influenced by our stock holding decisions which affects our exposure to companies that may be the targets of shareholder resolutions. Animal testing and welfare shows a sharp increase on previous years' data, which is likely to be the result of a pressure group using shareholder resolutions as a method for lobbying companies. Nuclear power shows a decline over the last three years (the spike in 2003 was driven by concerns from Japanese investors following the temporary shut down of 13 nuclear power plants in Japan as a result of two companies admitting, or being found, to have doctored safety and inspection records). It is interesting to note that there has been a decline in Equal Opportunity related resolutions over the past six years whilst the percentage of resolutions focusing on labour standards has remained fairly constant. The drug pricing/access issue tends to be driven by concerns about American national health care policies as opposed to global concerns about affordable access to medicines in the developing world, in 2005 the majority of resolutions on this topic were focusing on the policies of US pharmaceutical companies to prevent the importation of their products from Canada into America.

[1] China Principles - US Business Principles for Human Rights of Workers in China (http://www.globalexchange.org/campaigns/sweatshops/china/principles.html); Macbride Principles (http://www1.umn.edu/humanrts/links/macbride.html) and the ILO Core Conventions (http://www.ilo.org/ilolex/english/convdisp1.htm)

Issues		**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Ethical	*Animal Testing/Welfare*	0	0	0	1	3	19
	Genetically Modified Organisms	8	7	9	2	4	6
	Weapons	5	4	0	4	6	4
	Tobacco	0	5	4	8	6	4
Environmental	*Greenhouse Gases & Climate Change*	0	3	4	7	10	5
	Renewable Energies	3	5	6	6	2	0
	Nuclear Power	3	5	6	11	9	3
	Protected Areas	5	3	6	0	2	2
	Old Growth Forests	0	3	0	2	1	1
Social	*Equal Opportunities*	14	12	10	10	7	5
	Labour Standards	16	10	12	18	10	17
	HIV/AIDS	0	0	2	2	6	4
	Pay	0	0	0	2	3	3
	Drug Pricing/Access	11	7	6	1	3	7
Total number of resolutions voted on		37	73	50	90	127	95

Table 1: Trend analysis of SEE voting issues since 2000 (figures are shown in percentages except for 'Total number of resolutions voted on' which is absolute data)

Section 2
Engagement Review

This year there has been substantial discussion within the SRI community about the definition of engagement. In the latter part of 2005 Schroders was represented on the panel of an industry workshop at the UK Social Investment Forum's AGM to present our views on our definition of engagement. As a fund management house our fund managers, financial analysts, corporate governance analysts and SRI analysts regularly engage with companies. However for the purpose of this review the term 'engagement' will refer to SRI engagement only.

Essentially we use engagement with companies to:

- Monitor the ongoing CR performance of a company
- Fill in gaps in our analysis (fact finding)
- Make suggestions for change if a company's corporate responsibility performance is below acceptable standards

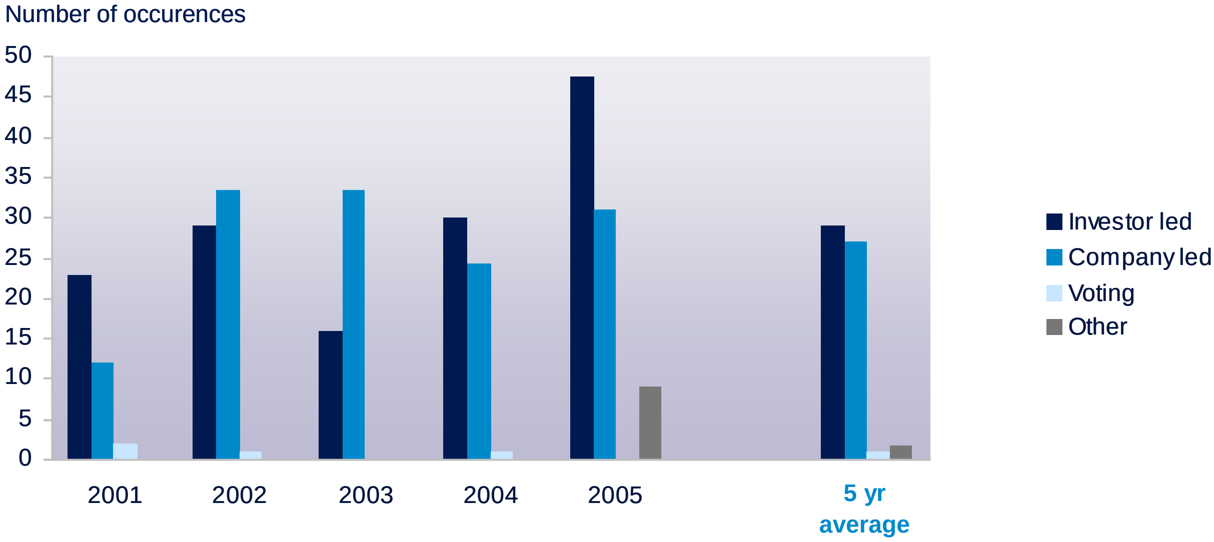
Ongoing monitoring and discussions with companies to improve our analysis are essential elements of engagement, both of which serve to demonstrate to the company our interest in aspects of their corporate responsibility (CR) performance and hence act as a means of encouraging a company to continue its CR programmes[2]. We make suggestions for change where we feel this will either help to improve stakeholder understanding of company performance or where it will decrease the long-term risk to our shareholdings in the company.

Year	Companies engaged with	Suggestions for change (absolute)	Suggestions for change (%)
2001	37	18	49
2002	63	13	21
2003	49	13	27
2004	55	17	31
2005	87	38	44
5-yr average	**44**	**20**	**35**

Table 2: A 5 year review of suggestions for change

Table 2 provides an overview of the number of instances where we have engaged with a company and made a suggestion for change. The initial high proportion in 2001 is due to the fact that corporate disclosure on SEE performance was poor at the time and a lot of suggestions focused on encouraging companies to become more transparent on their SEE policies, management systems and performance. Companies have now improved their performance in this area and as a result our understanding of what issues may have the most material impact on shareholder value has improved. The upwards trend in suggestions for change since 2002 reflects the improved understanding of what specific issues or data we would look for disclosure on, and a focus on companies to provide this information. It is also driven by the on-going sector analysis programme, the additional SRI resource at Schroders and the implementation of our Pan-European SRI policy this year which will mean engagement with wider range of companies, which was not possible beforehand.

[2] We acknowledge that we are not the sole targets of company CR reporting and that other stakeholder interests are also taken into account in putting together CR reports and implementing CR programmes.



Graph 2: A 5 year review of Pan-European SRI engagement activity

The data in Graph 2 provides a reflection of how active Schroders has been within its SRI programme. 'Investor led' data refers to instances where we have initiated the engagement with a company, whilst 'company led' data refers to those where a company has approached us or has been presenting it's CR performance to the market (either directly or with the aid of brokerage houses). 'Voting' reflects any instance where there has been a shareholder resolution placed at the AGM of a company we invest in. In the UK (and now Pan-Europe) we will endeavour to engage with both the company and proponents before taking a decision on how we vote, the vote will convey to the company whether we support its approach to the issue addressed by the resolution or not. However shareholder resolutions in the UK, and Pan-Europe, are infrequent. This year we have also incorporated an 'Other' set of data which refers to conferences we have attended at which companies were presenting and which we used to improve our analysis and understanding of the company and their sector. .

Graph 2 also demonstrates the increase since 2003 of investor led engagement, reflecting the success of the sector analysis programme and also the recruitment of an additional SRI analyst this year. In addition we have started to monitor the impact of our pan-European engagement programme which shows that 31% (27 engagements) were with continental European companies. Taking this into account our data shows us that UK company engagement increased from 55 instances in 2004 to 61 instances in 2005, demonstrating that the application of a Pan-European SRI policy has not had a detrimental affect on our UK SRI programme.

Section 3
Company Engagement Report

Company	Engagement Activity
Resources	
Mining	
Lonmin	We had a meeting with the Chief Executive, the Vice President for Safety, Health and the Environment and the Vice President of Investor Relations. The meeting was intended to introduce the new Chief Executive and for him to outline Lonmin's corporate responsibility approach. It is clear that the CE is very committed to making sure that Lonmin's CR strategy is correctly developed and implemented and whilst this may have resulted in some backwards steps initially, it should allow the programme to proceed with success. We were able to ask various questions on waste management, human capital, health and safety and community relations to which Lonmin has responded. The company has also addressed the concerns that we raised last year regarding a policy for the use of security forces, linkage of executive remuneration to corporate responsibility performance and measuring the costs of health and safety incidents.
Rio TInto	We attended the annual up-date of Rio Tinto's corporate responsibility performance which was given by the Chairman, the Head of Communications and Sustainable Development and the Head of Health Safety and the Environment. The presentation reinforced Rio Tinto's ranking as one of the leaders in the sector with regards to Corporate Responsibility. The reporting on operational performance is firmly established and the company is now increasing its disclosure on long term strategic issues (we have written to the company to encourage greater reporting on this in the future). RT demonstrates its long term strategic thinking in its understanding of the impacts of climate change on future global energy mixes and their product portfolio (the company mines both coal and uranium), its water management programmes (which we see as a key issue as water resources become depleted and competition for them between local communities and the corporate increase) and product life cycle assessments. Rio Tinto has a very good health and safety performance out performing industry averages for Australia, Canada and the US. We had questioned the company on the costs of H&S incidents versus the expenditure on H&S RT said that they are working with consultants on this topic. We also asked if there was a risk that by linking executive remuneration to absolute health and safety targets there was a risk of driving the reporting of incidents underground - the company stated that they are confident that their H&S culture has developed beyond this being a risk
BHP BIlliton	We attended a BHP presentation to the SRI industry. The presentation demonstrated a high level of senior management commitment, comprehensive policies, robust internal accountability structures and high standards of practice. The company uses this dedication to corporate responsibility (CR) to establish superior quality relationships with host governments. They believe this improves their reputation relative to their competitors, presents governments with superior value-added proposals and reduces the risk of working in countries which are politically sensitive. Their aim is to make themselves indispensable to government and the local community (through the design and implementation of economic development programmes) and to work to their own high standards. A distinction between BHP and other major companies is that they integrate their community standards with other health, safety and environment standards. Financial Institutions such as the International Finance Corporation (IFC) have commended BHP for their excellent project management and world-class standards of operation.
Oil & Gas	
BP	We met with two Investor Relations Managers to discuss and understand how BP is integrating CR issues into business planning and project management. Nearly 100% of all 'major sites' are certified to ISO 14001. However, it's not clear from the report what proportion of operations are covered by Health and Safety (H&S) issues and which areas are certified. The company has recently published a Code of Ethics, which is mandatory to all employees and incorporates all group standards. This year BP has suffered the worst H&S accident in America since 1990, with multiple fatalities at Texas City. Reports by independent government bodies of negligence and evident short-cuts are not providing empirical support for BP's apparently high Health and Safety standards. BP could also improve its relationships with NGOs by becoming more aware of campaigns against them and cooperating with the information they require. We encouraged more open disclosure of how the company's projects and subsidiaries are accountable to the Group's

Company	Engagement Activity
	standards. In particular, it would be interesting to see evidence of a compliance program implemented throughout the group, which measures compliance to group standards at major operational sites. We also toured the BP Grangemouth refinery (which has subsequently been sold to a private investor) to understand more about how refineries work and the corporate responsibility issues associated with them. The refinery was the site of three major accidents in 2000 and triggered a review of BP's H&S policies and the stimulus for a £1.3bn upgrade to the site. Fifty percent of maintenance expenditure is on inspection (assets are measured against legal, manufacturers' and internal standards to determine replacement rates), and the expenditure is benchmarked against the industry. The site manager was not concerned about the impact of decreasing staff on H&S and believed there had been a shift in the operational culture of the workforce. We also asked about how the company copes when there is a skills shortage in the work pool due to demand from other basic industries. The company has focused its social programmes on this problem, through educational initiatives in local schools and communities and young enterprise initiatives. However there is still the challenge of ensuring a supply of sufficiently qualified/skilled people. Some demand can be met by planning for jobs and through outsourcing to international contractors.
BG Group	We met the CFO, the Executive Vice President of Policy and Corporate Affairs, the Head of Health and Safety, Security and the Environment and the Head of Corporate Responsibility Policy who presented on BG's CSR performance. Once again the company gave a very thorough presentation of its activities. Despite an obvious effort to improve its H&S performance there were, sadly, 6 fatalities in the first quarter. The company did show improvements in it's risk management approach to new projects and regions and the setting of environmental performance targets. We have written to the company to re-emphasise our support for the setting of longer term targets (which would demonstrate greater strategic thinking by the company) and to follow up some questions on the issue of contractor supply shortage in the sector and what implications this has for performance and health and safety.
Tullow Oil	Combined financial and SRI analyst meeting - We met with the CEO and CFO. The company intends to produce a stand alone Environmental, Health and Safety Report next year. They carry out environmental and social impact assessments for all their sites, as a matter of course, before commencing commercial extraction, although they do not disclose the results of these assessments. We encouraged them to do so. Furthermore, they have recently set up a Risk Committee which is still in its embryonic stages but will be monitoring and managing the company's exposure to environmental and social risks in the future. This year we met with the Head of HSE from Tullow Oil, who has responsibility for implementing all EHS policy and activities. The group has recently developed a clearer CR agenda and has set up a CR committee, with dedicated funding and responsibility for CR matters. However, a major function of this committee is to allocate philanthropic donations for investment in the communities in which it operates. All UK operations are certified to ISO 14001, and the aim is to extend this to overseas operations in forthcoming years. In terms of Health and Safety, Tullow ensures UK operations conform to OSHA 18001 health and safety standards; in addition its own internal standards meet this level of quality and therefore overseas operations also work to these standards. Tullow reports on Lost Time Incidents (LTI), and the frequency of these incidents (LTIFR); the latter has dropped below the industry average. It has established a new central crisis and energy management team to proactively manage risks to the business. We hope to see improved reporting in the area of human capital management in the future as the company does not currently report in this area. We expect to see improved disclosure on the breakdown of EMS emissions and resource consumption and evidence of the inclusion of biodiversity into EMS systems in the future.
Wood Group	Wood Group is a construction design company for the oil and gas industry. We met with the Director of Health, Safety and the Environment (HSE) and reviewed the company's current approach and commitment to CSR. The Group has a strong commitment to safety policies and operational standards but certification to these standards is still embryonic. Some operations are certified to H&S standards but given that safety performance and standards are a pre-requisite to gaining contracts with many of their clients, not as many as might be expected. Wood Group is taking action to reduce the frequency of incidents and fatalities, which whilst rare, are still occurring. We encouraged progression towards a more

Company	**Engagement Activity**
	comprehensive and quantitative environmental management systems (EMS), increased H&S disclosure and amalgamation of this information at group level.
Statoil	We met with the Manager of Investor Relations. The meeting covered management of upstream environmental and social impacts from oil and gas exploration and production. The company has the majority of its operations on the Norwegian Continental Shelf, in deep water. The Norwegian authorities are strict on environmental performance and Statoil is therefore used to operating in a stringent regulatory environment. The company states that internal CSR standards now uphold operations to the same standards internationally, where ever they are operating, including Brazil, Gulf of Mexico, China, Algeria. Its international operations are growing rapidly, as planned, and the challenge the company faces is to maintain it's above average H&SE performance. To this end, they have encountered more unusual weather hazards, platforms which are below their quality standards and contractors with less than appropriate attitudes for HSE compliance. These have been tackled with programmes to educate contractors abroad (e.g. 30,000 employees in Iran), investments to upgrade (e.g. Venezuela) and rigorous country risk assessment programmes to prepare for unforeseen weather events, political risks and other social-conflict risks. The majority of its operations are offshore, reducing exposure to onshore community risks. The company shows clear evidence of practicing what it preaches and although unable to isolate these costs alone, can highlight delays and the monetary repercussions in production and operations, whilst these standards have been met.
Norsk Hydro	We met with the Director of CSR and discussed the integration of CR policies and programs into business planning operations in the oil and gas division. Currently Norsk operates a set of Business Principles and Steering Documents which lay down the environmental and social standards and parameters that it operates within. The group historically has always had strict environmental management standards, as a result of working in the tight regulatory environment off Norway. However, as a result of expanding operations across the world it is extending its social standards. This includes social standards on human rights, corruption and transparency, facilitation payments and stakeholder engagement processes. Currently it is drawing up a system to incorporate these standards into the contracts drawn up with contractors (alongside HSE requirements), and to integrate them with procurement operations at group and project level. When working with business partners the company promotes its own standards and usually finds that it is fairly proactive in this area and can offer support to other national companies. The guidelines used by the super-majors are fairly similar. We encouraged the company to continue upgrading its social standards as it described, but otherwise were fairly satisfied with the risk management policies in place.
Royal Dutch Shell	We met with the Head of Investor Relations to discuss Shell's approach the integration of CR standards and processes into business planning in upstream operations. The company has internal policies on environmental impact assessment (EIA) and social impact assessment (SIA), biodiversity, ship quality standards, but some assurance is required as to how well it is implementing these standards overseas where regulatory frameworks are less stringent. In some cases Shell's policies are clearly mandatory (e.g. HS), in other cases, it's possible they are more or less used as guidelines (e.g. biodiversity and stakeholder engagement policies). The company monitors its performance against 12 performance indicators. Currently it focuses mainly on H&S and EMS systems and we have encouraged the company to develop other indicators also related to project standards. On a separate occasion we met with the Head of Exploration to discuss Shell's future strategy towards exploration and development of upstream reserves. The company has made several project blunders due to over aggressive targets in frontier projects, insufficient due diligence at the scoping stage of projects and inadequate provisions and margins for error. We emphasised that this focus on growth should not compromise the EIA and SIA process or other internal quality standards. While Shell needs to fast forward its project management process, it must also carry out this process to ever increasing higher standards, due to the frontier nature of the projects it is embarking on.
Cairn Energy	We met with the Head of Health and Safety and Head of Corporate Planning to discuss Cairn Energy's approach to CSR and its producing assets which are located in India and Bangladesh. The company has an ambitious policy to leave a 'net social impact' in all areas that it operates in. To this end, it carries out EIAs and SIAs to identify community and environmental baseline standards and to note where its operations might adversely and positively affect the site. Biodiversity assessment tools are being developed and further incorporated into their EMS over the next year. Water use and effluent production as well as greenhouse-gases (GHG) gases have increased, as the company has expanded and we have encouraged them to work harder to break this trend. All of Cairn's operations are certified to the International Standards Organisation (ISO) 14001, but none appear to be specifically certified to international HSE standards, so it is more

Company	**Engagement Activity**
	difficult to be certain of performance, although we are assured that Cairn's standards are very similar. Its health and safety records, whilst not outstanding, are within the Oil and Gas Producer's Association average. The company has made significant contributions to local community infrastructure and certain areas of high value biodiversity in the areas it operates but it is not clear if there is a 'net social impact'. We encouraged the company to use independent assurance to verify their contributions here.
Premier Energy	We met with the Director of CSR, and Head of Corporate Affairs and discussed Premier's CSR strategy and its ambitious policy to deliver net-positive social and environmental impact. Around 66% of the company's operations are located in Pakistan and Indonesia and operated by national oil companies. Despite this, Premier maintains that it adheres to its internal standards across all operations and that its CSR policies and activities differentiate it from other oil companies and facilitates government relationships. It has been awarded Occupational Health and Safety Administration (OSHA) 18001 and ISO 14001 for all drilling operations. Premier also uses a HSE system for producing operations which 'embraces' the same standards. It is currently working towards these standards in Indonesia (ISO 14001 has already been awarded). Its EIA and SIA processes are conducted in accordance with World Bank Standards. The company is developing an environmental cost programme which will record costs from EIAs, monitoring costs and base-line surveys for the end of 2006. The company does appear to have a good HSE record with zero fatalities for the last three years. We have encouraged them to produce a regular annual CSR report, the previous one was in 2002, and to improve reporting of CSR performance and initiatives.
Basic Industries	
Chemicals	
Ciba Chemicals	During a financials meeting with the Financial Director and the Head of Investor Relations we discussed the impact of the incoming Registration, Evaluation and Authorisation of Chemicals (REACH) legislation. Over the next 10-11 years this legislation is expected to impact about 10% of their product base. What exposure this equates to in terms of the revenue structure of the company remains unclear. The impact of REACH is expected to affect the whole business fairly evenly, not just one business segment. The company indicated that the threat was the potential competitive erosion from companies importing similar products from outside from the EU (and therefore not subject to REACH requirements). There is a high level of opposition to the regulation as a result of this amongst the industry.
Givaudan	We met the Head of Finance and CEO with financial analysts and asked about the implications of the REACH legislation. The company is a specialist in the perfumes and flavourings industry. Most products are used in minute quantities; therefore REACH is unlikely to have significant impact in the first few years. However, the company was unclear about its commitment to ascertaining the implications of REACH.
BASF	We met with the Directors of the Sustainability Centre and Investor Relations. BASF has a reputation as a leading light in the chemicals industry. Certainly, it has a good governance structure (e.g. the Sustainability Centre), it also has a new eco-efficiency tool which evaluates the environmental impact of its products and good internal targets for eco-efficiency and improvement. Nonetheless BASF has not isolated the monetary benefits of its internal eco-efficiency projects to date, which have been conducted over a number of decades to create a highly efficient integrated production system. This kind of integration is exemplary in the industry and has created process synergies and material cost benefits. The company also emphasises its customer orientation and its ability to create value for customers through eco-efficient processes. However, whilst BASF offer a service which calculates the environmental impact of customer products (the eco-efficiency audit) there are very few products which have been designed to create environmental and cost synergies for customers. The drive for this type of eco-efficient product comes from the company as norm, rather than from the customer. This means that BASF it facing the challenge of educating its customers before it can sell its ideas and reap potential gains from these projects.
Linde	We met with the Head of Corporate Responsibility and the Head of Corporate Quality, Safety and the Environment. The company was presenting its first corporate responsibility report. The company was clearly able to demonstrate that it has put in suitable governance structures for the management of its corporate responsibility programme and that relevant key performance indicators (KPI) targets will be developed during 2006. One of the clear drivers behind this was the increasing customer demand for quality, safety and environmental performance, which led to operations being certified to international

Company	**Engagement Activity**
	standards. The products of the company are well aligned with the concepts of sustainable development, it is developing technologies in carbon capture, desulphurisation and hydrogen storage and logistics; though this has been driven by client demands and the company could do well to demonstrate a greater awareness of how environmental challenges are shaping its research and development (R&D) activities. An interesting area was the development of its pharmaceutical gases, which is growing rapidly and offers alternatives to long hospital stays and other pharmaceutical products. The company has set in place a good basis for its approach to Corporate responsibility and its product range aligns well with the concepts of corporate responsibility.
Johnson Matthey	We met with CSR Consulting to discuss Johnson Matthey's recent CSR report. The company has demonstrated progress in its recent CR report with greater attention to quantitative details in the section on human capital management, good clear presentation in the report, and a welcome addition of product information indicating which products are more 'inherently' sustainable and eco-efficient. For future CR reporting, we consider that the company could identify its key business risks around a clear governance structure, align its EMS target setting and reporting procedures, in particular the metrics used; report more on human capital indicators explain the company's interest in psychosocial hazards and give greater weight in the report to the indirect impacts of its products, such as safety in the environment and product regulatory standards.
Construction and Building Materials	
Aggregate Industires	Schroders attended a building and construction conference at which the Group Environmental Manager was presenting on the how the Group's approach to Corporate Responsibility (CR) and building relations with key stakeholders enables it to build a good reputation and help it gain access to land. It was very encouraging to see the company's development since Q1 2000, when the quality of their CR was poor, to being able to demonstrate how effective good CR practices are in securing long term business.
Taylor Woodrow	Schroders attended a building and construction conference at which the Health and Safety manager Health and Safety manager provided an extremely good presentation on TW's H&S management system, demonstrating how performance is measured across the group and how it is linked into employee remuneration. He was also able to demonstrate that projects undertaken by the company which had good H&S performance records were also those that performed well financially.
Travis Perkins	Schroders attended a building and construction conference at which the Group Planning Director was presenting on the challenge of securing sustainable timber. We had previously met with TP in Q3 2003 to discuss this issue at which time TP had stopped sourcing Timber from Indonesia as they were unable to guarantee its legality. TP was able to demonstrate that it has been able to put in place a thorough supply chain management system to ensure the sustainability of its timber. One area we questioned the company on in 2003 was regarding customer education regarding sustainable timber. TP has produced a customer leaflet, and feedback from this served to demonstrate that the majority of their customers would be more likely to buy certified timber having read the leaflet. TP had also found that the number of customers buying wood because it was certified had increased from 5 to 26% over two years. It was encouraging to see the success of TP's approach to sourcing sustainable timber, and to hear that customer education initiative is beginning to deliver results.

Company	Engagement Activity
General Industries & Cyclical Consumer Goods	
Aerospace & Defence	
BAE	We met with the Director for Corporate Responsibility and the Head of Investor Relations to discuss BAE's annual corporate responsibility performance. The company's corporate responsibility programme has developed a long way since 2002 when we first met the company. A Corporate Social Responsibility Committee is to be established during 2005 which will be chaired by a NED and will report directly to the board. The company now provides quantitative data for its operational issues, though sadly the company has failed to develop any corporate level targets for these indicators, with targets still being set at a operating company level. We have written to the company to encourage them to develop these targets over 2005. We again took the opportunity to question the company on efforts to attract the best technology engineers to an industry that people may avoid on moral issues; the company says that its approach to CSR has helped to attract some candidates, it is going a little further and analysing its employees in its US business to establish what it was that attracted them to the firm. Much of the negative comment that the company receives is due to the lack of transparency associated with selling its product, we have encouraged the company to explore avenues, at an industry level, of disclosure relating to offset payments to governments and other methods for improving transparency. We have also encouraged the company to explore the possibility of increased disclosure on political lobbying (though this is something that will be very challenging) and initiatives to increase public understanding about the nature of their product versus that of small arms.
Non-Cyclical Consumer Goods	
Beverages	
Scottish and Newcastle	We met with the Head of Public Affairs and the Group Environment Manager, at the company's brewery in Edinburgh, who were presenting on the environmental performance of the company and the steps the company has taken to implement a responsible drinking approach across the business. With regards to the environmental performance it was encouraging to hear a company talk about not only the direct impacts on its operations (e.g. need to improve energy use and decrease emissions) but also about the longer term implications on its supply chain (e.g. disruption to agricultural growth patterns) and the impacts on its consumer base (e.g. drinking patterns). However it wasn't able to then indicate that it was developing a strategy for dealing with these longer term issues. The company then covered its approach to responsible drinking, detailing the steps it has taken to improve the public image of some of its products and to increase the responsible drinking message through its advertising, as well as its close work with national and regional governments on the issue.
Food Producers & Processors	
Nestle	We attended a presentation by the Zone Head for Asia, Oceania and Africa on Nestlé's commitment to Africa. The meeting provided an in depth focus on the companies operations focusing on HIV/AIDS (the company was able to develop a good management programme to dealing with HIV/AIDS within the workforce but has yet to assess the impacts of the disease on its future markets); water (Nestle is starting to focus on the use of water in its operations and as a product); employees (Nestle stated that it's employees in Africa receive better salaries than the averages for countries in which they work, it wasn't clear if these met living wages but salaries have increased faster then industry averages in the relevant regions; Nestle is also investing in training to improve literacy within its workforce to help in internal recruitment and performance_ and compliance with the World Health Organisations International Code of Marketing Breast Milk Substitutes.
Cadbury Schweppes	We met with the Corporate Social Responsibility Manager and the Investor Relations Manager as part of our research into the Food Production sector. The company reports on its CR performance on a two-year cycle, so this meeting was used to fill in some gaps from our previous meeting in Q3 2004. It is encouraging to see that the company is still developing its Governance structures and has recruited dedicated Health and Safety and Ethical Trading professionals. Amongst other topics that were discussed were HIV/AIDS (the company is very aware of the impact it will have on their local markets), Climate change (risks and opportunities - the company appeared more focused on the opportunities then the risks), water management programmes, energy efficiency and supply chain issues. Cadbury Schweppes has a good grasp of what the operational issues are that it faces and we look forward to increased disclosure on its long term strategic issues.
Dairy Crest	We met with the Investor Relations Manager to discuss Dairy Crest's approach to CSR.

Company	Engagement Activity
	The discussion covered Governance, the environment (the company responded to our questions about annual targets saying that some long term key performance indicators would be developed, such as Energy use per product tonne). With regards to Human Capital the company acknowledged our concerns that there was very little data on human capital management and said that this was an increasing area of focus for the company. We asked about the use of Gang masters - Dairy Crest only employs from within the EU and all labourers receive above the UK minimum wage. We then focused on Dairy Crest's supply chain and the impact of Food Retailers on the prices that the company can pay to it's suppliers. With regards to animal husbandry in the supply chain, Dairy Crest has a team of 30 that monitors its 1,4000 direct suppliers and ensuring that conditions meet the demands of its suppliers.
Personal Care & Household Products	
Henkel	We were asked by Henkel to provide feedback on their corporate responsibility performance. We stated that we were very impressed with Henkel's reported evidence demonstrating its success in decreasing its environmental impacts whilst increasing production. We suggested that the company should provide quantifiable employee and H&S data to support it's statements and to provide some discussion on its supply chain management practices. We also encouraged the company to set overall quantifiable targets against benchmark data. However the quality and scope of the report was impressive and we commented on this to the company. Henkel has said that it was already discussing some of the issues we raised and would take the others on-board and agreed to keep us informed of future progress.
Pharmaceutical & Household Care	
Glaxosmithkline	We were invited to a company presentation day on CSR which was attended by its Head of CSR, Company Secretary, Head of HR and other managers responsible for ethical codes of conduct, research and development and environmental management. We engaged with management to identify what social, ethical and environmental risks they thought were of concern to the company. The key reputation concerns we identified included concern over appropriate treatment of pricing policies in developing versus developed countries; advertising and promotional policies in the US (and other countries) where laxer controls can allow the promotion of products without full disclosure of the side effects and the use of a code of ethics in sales teams to ensure appropriate integral sales practices. We will be monitoring the company to see how it manages these risks in the future. There are also signs that the company is beginning to embrace an investment strategy which looks for eco-efficiency opportunities in its products and operations at the research and development stage. The company is expected to prepare position statements on pharmaceuticals in the environment, use of chemicals and climate change in 2006.
Novartis	We attended a meeting with the IR Manager and the Corporate Citizenship Manager. The company is strongly committed to the Global Compact. Company values are analogous to those of the Compact, a code of ethics implements these values and the compact principles themselves have been implemented through policies, supporting guidelines and a corporate citizenship committee. Whilst the ethical commitment of company management was undisputed, its internal structures don't support a company specific Novartis CSR strategy and there is lack of clarity over what its CSR priorities and objectives are, what programs they implement and how the company really uses CSR to support its business operations. Product safety was recognised as a key priority, but was someway down the list of its 'material challenges' and current standards do not seem to go beyond 'Fair Marketing Practice'. It wasn't clear if its internal standards adequately mitigate against the risk of increasingly stringent regulation. Nonetheless, from proof of concept to launch of product, around 1/3 of products are successful and this is higher than most companies in the sector. Other important risks for the company include bio-ethics and clinical transparency. Novartis also views access to medicine, fair marketing practices, third-party compliance, living wages, human rights and HSE as key CR material challenges.
Tobacco	
BAT	Together with other stakeholders we met with the International Regulatory and Trade Affairs Manager, the Head of Science and Regulation and the Director of Corporate and Regulatory Affairs. The meeting was designed to provide stakeholders with the opportunity to discuss the impact of a potential public smoking ban on cigarette sales in the UK. Our concerns were whether this was a global trend developing and how the company's CR strategy was helping to minimise the impact. We also suggested that in BAT's economic analysis of the impact of the smoking ban in Ireland they may want to consider putting in the reduced number of healthcare cases. BAT acknowledged this but said that this sort of data was much longer term in nature then they intended to capture in their report.

Company	**Engagement Activity**
Cyclical Services	
General Retailers	
Dixons	We met with the Company Secretary and the Head of Public Affairs and CSR to discuss. This was the first time that Dixons had presented to a group of investors on their CSR performance. There were three main topics for the meeting, supply chain management, the impact of the Waste Electrical and Electronic Equipment Directive and Employee issues. We asked what the company does in educating customers about environmental sourcing and supply chain management. The customer says that they do provide some information on this but due to the infrequency of customer visits to the store they are unlikely to notice any differences. We also asked the company if it was intending to publish information on employee indicators (e.g. turnover, absenteeism, sick days) which are useful indicators of staff morale. The company said that they are still collecting data and are unsure if they would disclose this data. However in follow up to the meeting the company has said that they are committed to publishing employment statistics in their Annual Report 2004/05 which would include age, gender and ethnicity data and the CSR committee is considering other indicators including staff retention.
Marks & Spencer	We attended a presentation by M&S's CSR managers. The presentation covered M&S's overall CSR performance during the year. The key areas covered by the presentations were CR Governance, customers, Global Sourcing Principals (M&S provided an in depth review of it's supply chain management practices in 2003), Fairtrade and organics. M&S continue to demonstrate a good approach to CSR both at an operational level and a long term strategic level.
WH Smiths	As a result of our review of our engagement log, we contacted the Corporate Responsibility manager regarding our recommendation that the company increase its disclosure on human capital management. The company now includes some more data (diversity) but acknowledges that this can be improved. It has set up a Diversity Action Group to look at issues of diversity across the group and we have been assured that it will increase its focus on human capital data over the next year.
Support Services	
Brambles	We participated in a conference call hosted by the CFO, the Senior VP for Human Resources, the Director for Global Safety and Risk Management and the Director of Sourcing. This was the second time that the company had presented its performance, and it was clear that it is making great efforts to address its corporate responsibility demands. The company has announced that it is selling off a large part of its business to concentrate on CHEP (pallets) and Recall (information management). What was clear from the presentation is that the company does recognise the benefits to its business (though has yet to measure it) of an integrated approach to corporate responsibility. It has seen safety improvements not only reduce costs, through the reduction of lost time injuries but also serve as competitive differentiators in winning contracts. There is a clear focus on human capital, with the company putting in place development, training and recruitment programmes during 2006 and an increased focus on supply chain management as well. Brambles provided clear evidence of seeing the advantages of its CR programme and with a less diverse business it will be able to implement its programmes more effectively.
Transport	
ABP	We met with the CSR manager, and two members of the CSR committee to provide our views on what constitutes good CR practice and reporting, and how we integrated these considerations into the investment process. Whilst ABP publishes detailed information on its CR performance one area we stressed they could improve was identifying longer term strategic issues which may impact their business. ABP have provided Schroders with a report of the impacts of climate change on their business which was a topic we discussed with them in Q1 2004.

Company	**Engagement Activity**
BAA	We met with the Finance Director to discuss the financial performance of the company. However we used the opportunity to ask the company's views on the impacts of charges/taxes, as a response to the climate change impact of aviation, on customer demand and to discuss the shareholder resolution relating to the Stanstead Airport runway expansion. We also met with the Head of Investor Relations and the Group Sustainability Manager to discuss the company's CSR strategy. BAA is a recognised leader in the development of corporate responsibility. BAA has recognised the necessity of getting the aviation industry engaged in the global warming debate and has led a drive to get aviation integrated into the EU emissions trading scheme. The restrictions to growth around BAA's airports are caused by breaching noise limits and local air pollution levels. There are currently no penalties for these breaches but they will be a factor in determining future expansion plans, however BAA was able to demonstrate that it was fully engaged with these topics as well.
Non-Cyclical Services	
Food & Drug Retailers	
Tesco	We attended a store visit and met with various representatives of Tesco including the company chairman, the CSR manager and the CSR Director. The visit focused on supply chain management, recruitment and training and Tesco's involvement in the local communities. The discussion regarding supply chain management covered the willingness of suppliers to speak out on prices paid for their produce (Tesco uses an anonymous survey to obtain feedback from it's suppliers), how the company applies the DTI's Supplier Code of Practice to its international suppliers (Tesco currently applies the Code to all suppliers of UK outlets, but not to local suppliers of international outlets). We questioned the company about why it did not have long term targets for its CR programmes and whether it intended to do so in order to demonstrate a longer term strategic thinking (Tesco's said this was unlikely - though it does have some long term targets and is involved in several initiatives regarding long term sustainability of products (e.g. the Marine Stewardship Council and The Forest Stewardship Council) and if the company would be extending its current CSR policies to its International Operations (Tesco's hopes to do so by 2008). In Q2 we spoke to the Public Affairs Manager about the potential financial impacts of the Waste Electrical and Electronic Equipment legislation to the company's electronic equipment business. As with other companies we have spoken Tesco said that it was awaiting clarity before they could fully assess the costs to their business, but as a retailer and an own-brand seller it will face higher costs then other retailers. We also had a second, one-on-one, meeting with the Corporate Responsibility and Government Affairs Director and the Public Affairs manager to discuss the company's recent CSR report, Tesco's performance and feedback from any action that Tesco may have taken following our meeting with the company in Q1. We discussed the long term impacts of climate change on product sourcing. Tesco acknowledged the challenge of trying to source locally whist meeting customer expectations on price, quality and availability and that this is likely to increase with the deconstruction of the Common Agricultural Policy. As in Q1 we again raised the issue of developing long term globally applicable targets. In 2006 the company expects to have key performance indicators for each country, based on a set of core indicators. The company acknowledged that there is a case for developing long term targets. We have reiterated our comments from Q1, that the company needs to develop some long term performance targets and a globally applicable policy in order to provide investors with greater clarity about the strategic direction of the company and its performance in getting there. However the company is clearly making efforts to integrate sustainability into its business and is exploring the concept with projects such as the Nature's choice range.

Company	**Engagement Activity**
Carrefour	We met with the Director General of Quality and Sustainable Development and the Head of Investor Relations. This was the first time that we met the company and we used the opportunity to learn about the company's approach to CR. The company was able to provide reassurance that it has a suitable governance structure in place which ensures that a global approach to CSR is implemented, though the reporting had a bias towards there French operations. The company sees the benefit from its approach to CR as a tool for maintaining customer trust and loyalty. The company was able to demonstrate that it has a risk management programme in place to monitor suppliers, and that audits are undertaken which shows it is improving its relations with suppliers and which it has previously had a bad reputation for. The company is developing its response to concerns over nutritional standards and has a sound approach to food safety (and even sees this as a source for competitive differentiation in markets where consumers have previously had little choice over the quality of food bought). We will be looking more closely at this sector in the near future, and this meeting has served to provide an understanding of performance levels in the sector.
Telecommuication Services	
Telecom Italia	Together with other investors we met the CFO, the Head of Corporate Development and Investor Relations, the Investor Relations and SRI manager and the Head of the company's sustainability team. This was the first time that the company had presented their CSR performance and it was very impressive. The company is currently trying to identify key performance indicators that link back to financial performance from its list of 316 key performance indicators. The company uses a measure of customer satisfaction to link into the remuneration for Board members. The company does not report to a great extent on Electro Magnetic Radiation though in the presentation they gave more evidence of how they are addressing this long term risk. We asked whether TI would be reporting on their global performance data and whether they would be developing long term targets, which they are looking to do over the next year. The company does not disclose on how it manages risks of bribery and corruption, however they were able to reassure us that there is a model in place for managing the issue. In conclusion the company has a very obvious commitment to CSR and has developed and is developing suitable management systems to manage its non-financial risk exposure.
Vodafone	We met with the Director of Corporate Responsibility, a Corporate Responsibility Adviser and a Investor Relations representative. The meeting was to discuss Vodafone's annual Corporate Responsibility progress. It was good to see that the company had made progress on areas where we had raised concerns last year (e.g. adult content protection and electronic identity registers) however it has still has not improved its Human Capital reporting and we have stressed that this needs to be improved especially as there is evidence of increasing staff turnover and dissatisfaction within employees. Apart from this the company continues to demonstrate that it is maintaining the high standards of corporate responsibility that it established in 2002. The company appears to be on top of issues such as public concerns about Electro Magnetic Radiation, limiting children's access to internet content and monitoring chat rooms. Particularly impressive was Vodafone's report on the beneficial impacts of mobile communications on socio-economic development in Africa
Colt Telecom	Following the review of our engagement log and its effectiveness, we have written to the company chairman to follow up on our recommendations for increased disclosure. We have been more specific in our recommendations suggesting that the company increase its disclosure on human capital management, customer focus and on energy efficiency. We also highlighted that these may be issues the company would like to consider for incorporation into its Operational and Financial Review in 2006, though the legislative framework for this has now been withdrawn by government.

Company	**Engagement Activity**
Utilities	
Electricity	
Scottish & Southern Energy	We met with the Head of Sustainable Development, the Head of Renewables and the Director of Corporate Communications to discuss Corporate Responsibility, though the focus of the meeting was on the company's approach to renewable energy. SSE states that climate change is the main issue that it faces and that it has to address the challenges of 'keeping the lights on' whilst reducing its climate change impacts. It states that it can do this through investment in low carbon (or renewable) energy technologies and energy efficiency programmes (through its customers). The company was clearly able to demonstrate significant investments in renewable technologies (exploring many of the technologies currently available) though when questioned about its work on energy efficiency it was clear that this was not an area of focus. It would require a shift in management thinking to transform the company from an energy supply company to an energy services company. In our feedback to the company we highlighted this focus on renewables as an indicator of the company's response to climate change, but also stated that greater disclosure on governance structures and human capital management would be useful.
Scottish Power	We met with the Group Director of corporate communications, the Director of energy Wholesale and the Renewables Director. The focus of the discussion was on Scottish Power's commitment to renewable energy development. It appeared that there has been a slight shift in direction from previous meetings with the company, away from energy efficiency programmes towards increasing its renewable energy mix in its portfolio, this may be because the increase in demand for green energy is coming from commercial customers (who have their own obligations) and not domestic customers who do not want to pay a premium for green electricity. This may have been caused by the commitment of the Scottish Parliament to have 40% of its electricity produced from renewable sources by 2020, with the current non-compliance by some other electricity providers this makes the economics of producing renewable electricity better due to the renewable obligation certificates that non-compliers have to buy. It was encouraging to see that the company has also recruited a full time ecologist, which should facilitate the company's ability to develop further wind farms. In our feedback to the firm we recommended that Scottish Power improve their disclosure on employee morale indicators (e.g. turnover, absenteeism and sick leave).
Utilities Other	
United Utilities	We met with the CSR manager and the Investor relations manager who presented on the company's CR performance. The presentation covered governance, employees, waste management, land management and supply chain and procurement which helped to demonstrate the improvements that the company has made in monitoring and managing it's non-financial impacts since we met the company in 2002. UU has found that it's approach to CR has helped it win business (UU provided an example from their Infrastructure Management Solutions business) and realise operational cost savings. We asked the company how it managed to integrate long term targets into project development given the regulatory time frame of 5 years, they acknowledged that this was a problem that they were looking to address. Additionally we encouraged the company to provide information on long term strategic issues that may affect its business (e.g. rainfall patterns and climate change), to set targets on a global basis against a benchmark year and to provide more discussion on scenario planning (e.g. Urban development, climate change and population growth).

Company	Engagement Activity
Financials	
Banks	
Alliance & Leicester	We met the Director of Corporate Communications and the Head of Investor Relations to add to the research for our banking sector report and to become more familiar with the companies practices. Alliance and Leicester prepared their third CSR report this year. We were impressed by the clarity of their report, a trend throughout their literature and products which they emphasise to ensure customers can understand and relate to their services as much as possible. A good customer orientated approach. We were also impressed by their dedication to environmental management, specifically their energy savings programmes and initiatives, conducted by their energy manager. In terms of their lending practices and their exposure to environmental concerns, they have a lease book and operate a very small level of corporate lending. Their exposure, therefore, to environmental risk through their lending practices seemed negligible. They made reference to the Treating Customers Fairly Initiative in their report and to customer service, advertising, product design and remuneration in this context. Their enthusiasm and commitment to this issue seemed very high and we have encouraged them to report more on their activities in this area, particularly to develop more indicators. They have a strong community relationships and a policy not to offshore call centres. They also report on H&S data and on staff absenteeism, turnover and investment. Their existing policies and practices seem to be in proportion to their environmental and social risk exposure.
Standard Chartered	We met with the CSR Manager to add to the research of a banking sector report and to become more familiar with the companies practices. This year's CSR report was their first. Historically Standard Chartered has prepared environmental reports. Therefore, this years report represented an improvement on last year in that it provided greater focus on customer service and other indirect impacts of banking than previous years. Their relative strength remains the reporting of their direct environmental impacts, although their performance indicators here are not normalised or indexed and we suggested this as an area for improvement. The report was felt to be a good start and basis for broader CSR reporting. In particular we were impressed with their Customer Outserve programme, which they are currently deploying as part of a new strategy to ensure the business has a more customer focussed approach. We look forward to seeing performance indicators from this new business model which we hope will provide greater insight into the company's ability to sustain a growing customer base. We also suggested some reporting on Health and Safety data, which was notably missing and reporting on staff turnover. We look forward to seeing these improvements in the report next year.
Barclays	We met with Barclays to add to the research for our banking sector report and to become more familiar with the companies practices. This meeting was extremely well attended by Barclays and an impressive performance. Attendance included their Employee Relations Director, Head of Product Compliance, two managers from Investor Relations, the Group Regulatory Compliance Director, their Head of Public Issues and their Environmental Risk Manager. This year's CSR report represented a more condensed version than last years, whilst also being more comprehensive, taking into consideration their indirect environmental and social impacts. There was reference in the report to indirect impacts such as the Treating Customers Fairly (TCF) Initiative and the incorporation of environmental criteria into SME and corporate lending practices. However, whilst their level of commitment seemed high there was less evidence in practice of a) their commitment to TCF beyond FSA regulatory requirements and b) an extension of their approach to environmental lending beyond that of ensuring regulatory compliance and reputational management. The latter, nonetheless, still represents leading sector practice in terms of UK banks. They are currently conducting a 'gap analysis' of their business to identify areas where they are not meeting FSA TCF principles. We expressed an interest in the results of this analysis. We also expressed an interest in further disclosure of customer related performance indicators regarding customer satisfaction, understanding, retention and complaints and on the key indicators of employee absenteeism and turnover. They have an exemplary outsourcing policy. Their website further supplements the report with additional information, for example it contains a detailed environmental policy and environmental lending policy. On the whole the report was of a high calibre. Environmental reporting was comprehensive with appropriate targets, normalisation and benchmarks.

Company	Engagement Activity
Bradford & Bingley	We met with the Group Corporate Social Responsibility Manager and the Head of Investor Relations. This year is B&B's second CSR report. The report commences with key goals for 2005 and some words from the Chief Executive. We have encouraged B&B to complement this existing text with additional background information on their CSR governance structure, the hierarchy of responsibility in CSR and relevant committees, which is currently not provided in the report. B&B's recent business strategy has been to focus on specialist high quality lending and retail financial services. They offer no unsecured lending, which means they do not have exposure to the usual banking sector environmental and social liabilities in lending operations. They also have a strong commitment to working with housing associations and financing 'social housing'. Noticeably, they have closed their own asset management business and set up a partnership with Legal and General to provide SRI products instead to take advantage of this growing market opportunity. They have decided not to certify their EMAS with ISO 14001, as the extra regulatory / administrative costs of this commitment outweigh the extra benefits this will bring to the system, which already provides reasonable reporting coverage and has done so since 2002. We have encouraged them to set targets in this area and to index and normalise this reporting information. They report on staff absenteeism, turnover and investment and also on a range of indicators which give reference to general customer satisfaction and customer complaint handling, we have encourage them to expand upon this to measures of employee productivity, customer retention etc. B&B have also engaged proactively through CSR questionnaires with all their suppliers, focussing particularly on the practices of the twenty or so suppliers which take up approximately 80% of their procurement.
Credit Suisse	We had a telephone conference with the Head of Investor Relations and the Head of CSR. The company produced a full sustainability report in 2003, but only a statistical update in 2004 with a short review of milestones and activities for the year ahead. Unfortunately, these lack sufficient strategic context and in some cases contain insufficient detail for a clear understanding of their significance to be obtained on their own. The company has a clear and concise code of conduct, with performance and ethical values. They have also identified the key social and environmental risks for business segments, though they were reluctant to discuss these issues and would not identify the key risks for each business. Whilst its impressive to hear this level of commitment, its hard to take this into account without evidence. Credit Suisse do not operate a CSR policy, preferring to keep policies specific and practical and therefore leaving them specialised in different areas. Whilst this is understandable, there does, nonetheless, need to be a 'bridge' between implementation in business segments and corporate strategy. It was not clear what this bridge was. They are demonstrating very impressive competences in environmental lending, SRI and micro finance. However, their CSR report needs to demonstrate this by taking a more performance related emphasis, with further indicators, more disclosure and a better balance between description and action. This is particularly applicable to their sections on employee and customer engagement. Nonetheless, Credit Suisse, represents a company with strong levels of integrity and very high standards of delivery. Their CSR report could reflect this better.

Company	Engagement Activity
HSBC	We met with the Senior Manager for Corporate Responsibility and Manager of Corporate Affairs. HSBC have made a huge improvement in their 2004 CSR report on previous years. This report dedicates half of its content to the 'indirect' impacts of the business, including treating customers fairly (TCF), lending policies, money laundering and financial crime. Most importantly, they demonstrate an ability to integrate CSR into core business strategy and to define the key environmental and social risks most relevant to each business segment and deal with these separately. We encouraged this approach, which is the most progressive seen in the sector so far in the 2004 reports. A number of recommendations were made including: a distinction between core values and aspirational values; a clearer integration of core values into company strategy; the measuring of progress towards their five strategic objectives (three of which could be usefully measured through extra-financial criteria through KPIs); and how to further consider CSR not just as a risk management tool but also a tool for opportunity in areas of lending and TCF. Importantly the report also showed consideration of employee performance, a good customer focus/orientation and HSE indicators. The one weakness of the report was a lack of employee and customer related indicators and a lack of clarity on how exactly they are going 'beyond compliance' in their treating customers fairly (TCF) initiative. We asked for more information in these areas and made recommendations for more indicators related to customer and employee satisfaction. More detail is required here. Despite this, the report achieves a good balance between policy and tangible initiatives as evidence of policy performance. The corporate culture of HSBC seems genuine in its ethical approach and this is apparently promoted by the CEO and prevalent amongst senior management. This emphasises the importance of 'good leadership'. All in all, I was struck by their openness and genuine interest in progressing forward in this area and their huge leap forward from last year. A fine effort. We also attended an SRI lunch with various Board level members and the Chairman. Requests were put forward for increased disclosure on diversity, talent pool training and human capital indicators. Clarification was sought on Treating Customer Fairly policies, specifically the standards HSBC applies in these areas. HSBC confirmed this was a new area and standards are currently localised because marketing policies are localised also. This area will receive more attention and disclosure in future reports. More detail was also provided on its Sustainability Toolkit, which is its environmental and social credit assessment tool and assesses corporate clients, in addition to their project finance clients (which only make up 1-2% of their balance sheet) against their environmental risk standard.
HBOS	We met with the Investor Relations Manager, the Director of Investor Relations and the Director of CSR. HBOS concentrates on its savings and retail lending market in the UK, in which it has a large market share. In this respect, the company has increased its sales force and customer service operations (by 2000 out of 40,000 staff) to improve quality of service. They do not operate any offshore centres and have stated an dis-interest in doing so. In addition, they outsource no major functions, preferring to keep all their activities under their own control. This meeting covered aspects of treating customers fairly, in which they appear to have a strong commitment to a customer focus and have been investing in this area. We have encouraged them to report on their programmes and activities, one example being there new customer 'Complaint Solver' program, which centralises complaints and ensures they are dealt with in a standardised manner. We further encouraged reporting on staff turnover and absenteeism and other employee productive indicators. The observation was made that whilst they have this operational data, they do not want to report on it unless other companies were doing so. We expressed that the same comments have been made to all banks engaged with and that some were already reporting more in this area. HBOS is about to sign up to the Equator Principles and is currently putting in place the processes to implement these standards. Their reasoning for adopting these Principles was cited to be reputational but the vast majority of their financing is to the developed world (Europe) and the Principles were felt to have limited practical utility in most cases, as regulations in these areas were felt to be sufficient to uphold projects to reasonable environmental and social standards.

Company	Engagement Activity
Lloyds TSB	We met with the Director of Investor Relations and the CSR Director to discuss their CSR report and key SRI risks and opportunities to Lloyds. The CSR report itself was disappointing. The report was more traditional with a focus on eco-efficiency, human capital management and community relations. There was little content on indirect impacts or recognition of key SRI issues to the company. In this respect, the report fell behind its peers. Discussion with Lloyds revealed an approach to CSR reporting which viewed these reports as more aligned with the needs and interests of the wider public, community and employees then SRI Analysts. They have apparently invested millions of pounds in recent years in customer relationship management software, which they believe places them ahead of their peers in the UK in terms of understanding customer needs. However, their concept of customer service was rather one way, reflecting their understanding of the customer, rather than an interest in how the customer understands them. The discussion also covered their risk management policies, which seems fairly competitive with their peers, although they do not intend to adopt the Equator Principles, as they believe this is not relevant to them. I felt there was a lack of willingness to embrace CSR issues here and rather an effort to keep them under control, for fear of further media attention and adverse publicity, which they have received much of lately. Rather than retreating, there is a need for this company to really prove that it is committed to this area.
UBS	We had a conference call with the Head of Environmental Management, the Head of Investor Relations and a CSR manager. This was our first engagement with UBS. The company excels in its approach to in-house environmental ecology and environmental risk management. It has embedded environmental criteria into its credit assessment process for SME's, corporates and project finance. Increased environmental exposure means higher risk and a poorer credit assessment and a financial product tailored to reflect this. This is an automated process and one which credit controllers are specifically trained in. The company has been operating this process for a number of years and considers it a core competence. We encouraged them to provide some more detail on this practice, but the company was reluctant to disclose anything which might harm their competitive advantage in this area. All in house environmental reporting is indexed and normalised and covers the breadth of the company's impacts. Their CSR report excels in the above areas, but falls short of providing much information on employees, customers and health and safety data. This is partly because of company re-structuring. However, we have encouraged the company to progress towards reporting on employee investment, training, surveys, morale, gender, ethnicity, age profiles and indicators on employee turnover, absenteeism and length of stay in the future. We would also expect to see reporting on consumer complaints, retention, satisfaction, turnover, etc. UBS has led us to believe that they have this information, but they have not been able to amalgamate it yet. This will change in the next year or so and we hope to see CSR reporting to reflect this.
Svenska Handelsbanken	We had a conference call with the Head of Investor Relations. The company does not have many of the CSR policies and procedures that its peers have; Svenska is an organisation with a strong ethical basis and very sharp customer focus. The bank has a decentralised structure with branch managers responsible for local branch operations, including environmental and social performance. There are no targets set out by central office and nor does it collate this information. Customer complaints information is collated but not generally reported on. Staff turnover is also collated. Remuneration structures of the sales force are based on a flat wage- there is no bonus to incentivise selling. We have encouraged Svenska to report on how such quality customer service is implemented at branch level and to see if aggregate figures can be compiled, above and beyond that currently reported on.

Company	Engagement Activity
Royal Bank of Scotland	We met with the Head of Investor Relations and the Head of Corporate Responsibility. We discussed three issues: human capital management, treating customers fairly (TCF) and the incorporation of environmental and social criteria to lending activities. RBOS are about to produce their second CSR report, in which they have increased their focus on key Corporate Social Responsibility (CSR) issues. They highlight key material issues to different stakeholders, including employee productivity and customer satisfaction. Both areas are monitored yearly and monthly, respectively, and performance data for different business segments are used to improve performance further. This year they will be reporting on key employee and customer indicators in their CSR report. The company has a strong culture of accountability, which is reflected in their attitudes to endorse the principles of TCF. They pay great attention to ensuring systems are robust enough to maintain objectivity in lending assessments of all environmental, social and financial criteria. Manual Environmental Credit Risk Assessments are applied to all corporate lending activities (over £1million). The Equator principles are implemented in full above this threshold. Credit assessments are separate to relationships management of accounts to ensure objectivity. We are encouraged by this increased focus on these key issues and look forward to seeing increased disclosure on them in the upcoming CSR report. We met, later in the year, with Investor Relations, who were conducting a road show gain feedback on their 2004 CSR report. This year's report was an overall improvement on last year and gave good coverage of key stakeholders' issues. Areas for improvement included the inclusion of a 'governance' section, with reference to strategy, policy and systems implementation; identification of key business risks to each business segment and clear discussion on how these risks are mitigated. Also noted, was a lack of consistency in terms of EMS reporting and EMS targets due to different management information systems, which have yet to be aligned. We also encouraged more human capital management indicators and customer indicators, and more detail on environmental and social credit risk assessment processes, as referenced in previous discussions. We met again with RBS, as the company was demonstrating its new head quarters in Edinburgh, which have been designed to improve staff productivity by improving the working environment. We look forward to seeing whether the new site improves employee productivity and retention.
SEB	We had a conference call with the Head of Investor Relations. Management appears quite proactive in its approach to CSR. Company risks and opportunities, for all business segments, are identified and management has set out values, policies and systems to mitigate these risks and where possible to find opportunities. The key areas we discussed were customer service, employee productivity and Social Ethical and Environmental (SEE) lending policies are amongst those also felt to be important by the company. In addition they also pay increasing attention to SRI funds. We are awaiting a fuller response to questions e-mailed to the company at its request.
DNB	We had a conference call with the Head of Investor Relations and the Manager of CSR. Engagement revealed that the company does have competitive policies and practices in human capital management, customer service and risk management in lending. The company conducts employee surveys to measure employee engagement and uses this information to inform company leadership, human capital performance and peer performance. Customer standards are increasingly being defined. Customer surveys are also conducted regularly to ascertain the product and service appeal and positioning. In terms of lending activities, DNB operates an awareness matrix which places a risk category on each client, that incorporates financial and non financial criteria. Clients in high risk categories must conduct Environmental and Social Impact Assessments. This is a process carried out for all corporate clients and some Small to Medium Enterprises. The main outcome of this meeting was to encourage improved disclosure either in the annual report or a new sustainability report. The company accepted this and we can expect further disclosure in the future in all three areas cited above.
EGG Plc	We met with the Head of Investor Relations and discussed standards of customer service, human capital management and the incorporation of environmental and social risk assessments in to its lending activities. It is clear that the company has many measures for customer service, which enables comparison with other banks via a confidential, independent, customer service performance measurement system. Egg also operates a comprehensive environmental management policy. All its lending activities are personal and retail based and social and environmental criteria are not incorporated into this process.

Company	Engagement Activity
Sao Paulo	We participated in a conference call with Sao Paulo's management on its CSR performance. The company has good reporting procedures both on a direct and indirect level. Its indirect reporting focuses on lending activities and the proportion of its loan book that is lent to environmentally sensitive sectors, with different sectors have respective risks highlighted. They are currently valuating the Equator Principles.
Nordea	We had a telephone conference with the CSR Director and Head of Investor Relations. The company has identified key social and environmental issues relevant to their business, namely: environmental (indirect and direct), human rights and money laundering. The identification of risk is both top down (from group CSR) and bottom up. However, at business level there are no key persons with responsibility for implementing CSR group level codes, strategies and projects. So its believed that implementation of their CSR strategy has some way to go. Nonetheless, they demonstrated a certain level of commitment at group level. Areas of employee productivity and customer service are monitored but methods and details were not known by the above persons. Disclosure is poor in these two areas in the annual report.
ABN Amro	We had a meeting with ABN Amro which involved an assessment of its environmental credit risk assessment (ECRA) and a review of its governance structure. The key outcomes from the meeting were that that company uses the latest modelling in ECRA and evaluates clients on a project and corporate level. Relationship managers are used to evaluate the social and environmental risk component of client assessment. This information is used in an advisory capacity. The focus of this high level client assessment is currently on the oil and gas and mining sectors. It has lending policies on the forestry, mining, tobacco, oil and gas sectors and further plans are in place to implement the Equator Principles. ABN Amro uses clear values and business principles and has clear CR governance structure. The company claims to use CR to differentiate its practices from other companies and demonstrates good senior management commitment.
Insurance	
Prudential	Schroders attended a presentation by Prudential on offshoring. The presentation was given by the head of its offshore operations to Mumbai, India. The meeting provided an in depth understanding of Prudential's approach to this large outsourcing project and how they managed initial local community, employee and customer dissatisfaction to bring about a positive end result. The case-study is purported to be a leading best-in-class example of how to conduct these operations with minimial reputational damage.

Section 4
Engagement Performance

In this section we provide an evaluation of our activities where we have made suggestions for change during our engagement activities with companies. As we noted in last year's annual review that, whilst it is possible to claim participation in the process it is not always possible to claim that any change in management practice or policy is solely down to the engagement activity of the individual stakeholder, as company Boards have to take into account the considerations of a wide group of stakeholders (e.g. employees; pressure groups; local communities and government) as well as legislative drivers and competitive change.

We also reiterate that this is a long term process and it is unreasonable to expect that any suggestions for change will be addressed within a year, as this tends to be the standard reporting period for most companies we have met with. It is for this reason that our engagement log is reviewed on an annual basis to determine whether any suggestions for change have been met.

The following subjective ratings have been used to assess the effectiveness of any suggestions for change that we have made:

- No Change – there is no obvious response to our suggestions
- Some change – the company is able to demonstrate that it has started to implement some response which would satisfy the suggestions we made
- Almost there – the response by the company has gone a long way to satisfying the suggestions that we made
- Achieved – the aim of our suggestion for change has been met

Table 3 provides a review of our performance since 2000 and provides a 5-year average.

	Purpose of meeting			Assessment of company change against suggestions for change				
Year	Voting	Fact finding	Suggestions for change	No change	Some change	Almost there	Achieved	Notes
2000	3	9	7	0 (-)	0 (↓)	0 (-)	6 (↑)	Glynwed was demerged making suggestion for change redundant
2001	2	19	18	0 (-)	3 (-)	0 (↓)	13 (↓)	Thistle has been taken over and Rank Group sold off its hotel operations.
2002	1	50	13	1 (↓)	1 (↑)	2 (↓)	8 (↑)	Enterprise Oil was taken over by Royal Dutch Shell
2003	0	36	13	1 (↓)	2 (↓)	2 (↓)	8 (↑)	
2004	1	38	17	4	4	4	8	

Table 3: UK Engagement activity since 2000 and assessment of the effectiveness of suggestions for change. The arrows (and dashes) indicate the trend on last year's data.

It is encouraging to see that the trend over last year's data shows an increase in the number of suggestions that have been rated as 'achieved' (as indicated by the upwards pointing arrows). The data for 2001 does not correspond to the data presented in 2004's annual review as a result of a reclassification of one of the engagement activities from 'change facilitation' to 'fact finding' and as a result of Rank Group selling off its hotel business to which the original suggestion for change had most relevance. Due to the fact that the figures will vary on an annual basis as company responses to requests for change are re-assessed it is not practical to produce 5-year average performance data. What the table does indicate is that our original assumption that suggestions for change could be achieved within a year may have been too presumptuous given that almost 50% of 2004's suggestions have been rated 'no change' or 'some change'. This reflects a similar trend to last year's data.

Section 5
Sector Reports

Full copies of these reports can be obtained from your Client Director

CSR Issues in the Pan-European Banking Sector

The key CSR risks and opportunities of eighteen banks have been reviewed across the UK and Scandinavia, these are: Alliance and Leicester, Barclays, Bradford and Bingley, Egg, HBOS, HSBC, Lloyds TSB, Northern Rock, Royal Bank of Scotland and Standard Chartered in the UK and Credit Suisse, Danske, DNB, Nordea, Forenings Sparken, SEB, Svenska Handlesbanken and UBS. These banks offer a range of banking services including retail and wholesale banking, private banking, project finance and asset management.

Research indicates that there are three, key CSR considerations: quality of customer service; employee productivity and the management of social and environmental risks in lending activities. These reflect increasing market pressure on banks to improve operational standards and risk management practices. In addition, the report reviews the take up of sustainable finance opportunities and the management of financial crime. For each of these CSR issues, we have looked for banks to demonstrate robust systems and procedures; a high level of commitment from senior management; appropriate culture; and a progressive attitude.

Company disclosure on the three key issues, however, is varied and can be quite poor. This is partly because companies have not focussed on the reporting of 'key CSR issues' and have, instead, reported on environmental management and community initiatives. This is partly because there are concerns of confidentiality, particularly in areas of environmental risk assessment and employee productivity. Disclosure by international banks on these issues, however, has improved greatly in 2005 and is significantly greater than the disclosure of the UK national banks and European based banks. Using this information, it has been possible to gauge senior management commitment, culture and attitudes to these CSR issues, but it has been more difficult to find hard evidence of standards, systems, procedures and performance measures. This is not to suggest these systems do not always exist: sometimes systems are not structured consistently to allow information to be amalgamated and reported at group level and sometimes, particularly in the case of customer service levels, there is no explicit recognised standard and therefore the systems and procedures to attain this standard have not been identified.

The research concluded, however, that there is evidence of activity to raise standards above current levels (which appear to be consistent with regulatory compliance) in order to ensure customer and employee satisfaction and to create competitive advantage. The recent launch of new programs or restructuring to improve complaint handling and customer satisfaction at Lloyds TSB, HBOS, Standard Chartered and Barclays is impressive as are recent programs to improve employee working conditions at call centres and to reduce turnover. Perhaps even more effective, are the obvious high ethical standards and particularly strong management commitment to customer service at HSBC, RBOS, Credit Suisse, UBS and Svenska Handelsbanken, which are designed to enforce superior customer performance. Environmental credit assessments in risk management are now applied to nearly all corporate lending practices and sometimes private, investment and even retail banking, indicating increased integration of financial and extra-financial issues. Credit Suisse and UBS are setting an example for the sector by integrating financial and environmental criteria together to enable risk and price adjusted loans. Overall, Barclays, Credit Suisse, HBOS and HSBC have scored highest in our ranking. Standard Chartered, Lloyds, RBOS and Svenska are just slightly underperforming these banks. Unlike other European banks, where disclosure is very low, Svenska Handelsbanken, SEB and Forenings Sparbanken can demonstrate strong commitment in these areas which challenge their international peers. The European based banks; SEB Forenings Sparbanken, UBS and Credit Suisse also perform very well in product innovation and SRI asset management.

Sustaining Sustenance: A review of the non-financial issues affecting the Pan-European Food Production sector

The quality and quantity of raw materials that this sector utilises are directly impacted by, and have a direct impact on, the state of the planet. This review takes into account the general CSR approaches that companies have and focus on specific environmental and social issues that have the most potential impact in the sector. It is useful to bear in mind that food production not only includes crop and livestock farming and fish harvesting but also food processing, transport, distribution, preparation and disposal and an analysis of the sector has to incorporate an awareness of these other elements of the sector.

The environmental challenges include climate change, water resource management, packaging (though this is also linked to food quality and, increasingly, customer education), land use, genetically modified organisms and sustainable agriculture, whilst the health and social issues that were focused on were supply chain management, obesity and food safety.

Whilst it is not clear the exact financial impact that these issues can have on shareholder value, it is very clear that the sustainability of raw material supply will be improved by developing strategies for handling long term environmental threats, and that short term risks such as product contamination can be much more easily controlled and rectified if a company has a good knowledge of its supply chain, averting reputational and litigation risks. It is also clear that with increasing awareness of the impacts of our diets and lifestyles on our bodies companies need to ensure that their product portfolio is able to ensure sales whilst dealing with dietary issues.

Whilst no company is unique (differing products, geographic focus and business models) this review has attempted to provide a subjective analysis of the strategies employed by 8 European food production companies **(Associated British Foods, Cadbury Schweppes, Dairy Crest, Danone, Northern Foods, Tate and Lyle and Unilever)** for handling the above issues and on their approach to corporate responsibility in general. The companies that came out best in our assessment were:

Cadbury Schweppes, Danone and Unilever

Oil and Gas Sector Report

This report reviews the nature and scope of social and environmental risks to which oil and gas companies, BP, Shell, Norsk Hydro, Statoil, Premier Energy, Cairn Energy and Tullow Oil are exposed. An environmental and social external risk profile for each company has been determined by macro-economic factors and an internal management score used to determine the quality of a company's policies, standards and methods of operation. This analysis is used to assess how oil and gas companies are placed to face new and material environmental and social challenges this decade to grow reserves and returns from non-conventional locations, in regions with less stable and political regimes and more extreme climates. The better placed the company is to handle these challenges the more sustainable its operations.

The results of this analysis indicate that companies have very different risk profiles and management scores. The external risk profile for each company ranged as follows (from low to high risk): Statoil (10), Norsk Hydro (10.3), Shell (15.8), BP (16.3), Tullow Oil (18.6), Premier Energy (27.2), and Cairn Energy (34.55). The internal management score for those companies analysed ranges from 45-61, (the higher score, reflecting relatively poor policies and standards and increased risk to the company), as follows: Norsk Hydro (39), BP (44), Premier (46), Shell (47), Cairn Energy and Statoil (49) and Tullow Oil (61).

These results have led to the conclusion that Norsk Hydro, BP and Premier are the best placed and most sustainable companies, according to our ratings, with relatively low external risk profiles and a high quality of management. Tullow Oil and Cairn Energy have the highest internal management scores reflecting high risk in management quality and also have relatively high external risk profiles. These companies are in relatively weak positions for long-term sustainability in terms of our ratings. Statoil and Shell were positioned within these extremes.

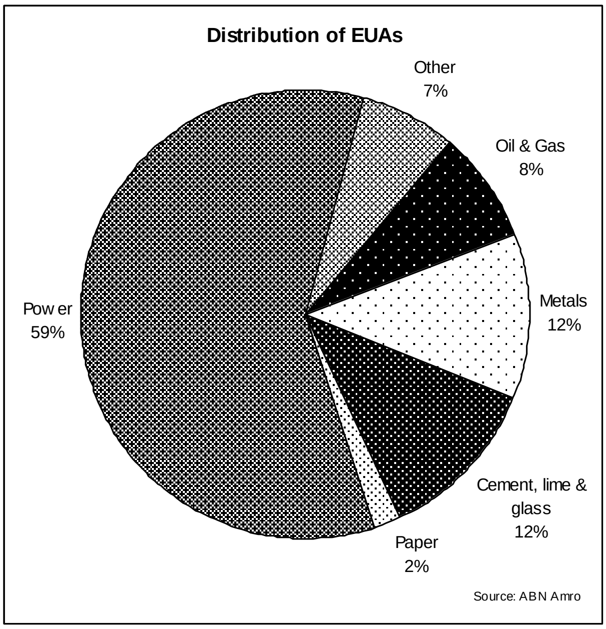
Section 6
Special Topics

EU Emissions Trading Scheme (ETS)

The EU's ETS is the first international CO_2 trading system. It is designed to facilitate the EC's Kyoto commitment of reducing Greenhouse Gas (GHG) emissions by 8% by 2012[3]. By using a market based trading system (the ETS) it is hoped that carbon dioxide reductions will be achieved with the most cost effective reduction strategies for companies. The cost effectiveness of the scheme, as measured by the EU should allow the EU to achieve its Kyoto target at a cost of between €2.9 and €3.7 billion annually, as opposed to a €6.8 billion annual cost with out it[4].

There are two phases to the ETS. Phase 1, from 2005 to 2007, requires participating companies in 25 EU member states to cut CO_2 emissions by 2-3% per year below the levels that would otherwise occur. During 2006 the scheme will be reviewed to see whether during Phase 2 (2008-2012) the scheme should be tightened (requiring participating companies to reduce their CO_2 by 10% below levels that would otherwise occur[5], and whether it should be extended to include other GHG's and other sectors not previously covered.

During Phase 1, the system will apply to 12,000 installations (owned by approximately 5000 companies) in the following sub-sectors: electricity generators; ferrous metals (iron and steel), pulp and paper, oil refineries, building materials (cement, lime, brick and tile manufacturing) and glass manufacturing[6]. Each installation must hold one tradable allowance (EUA) for every tonne of CO_2 they emit. Some member states have up to 2,500 installations covered, others less than 500. The allocation of EUA's has been distributed as illustrated in the chart below. These sectors account for 44% of the EU's GHG emissions; the major emitters not included are transport (21% of EU GHG emissions), households and small business (17%) and agriculture (10%).



Each country has a national allocation plan (NAP), through which the EU has 'grandfathered' or allocated the total permissible number of EUA's and therefore CO_2 emissions for each country and its installations. A 'cap' on the number of allowances creates the scarcity needed for the market to develop; forcing companies with excess emissions either to reduce emissions (through investment in abatement technologies or switching to less carbon-intensive energy sources), or to buy allowances at the market rate or a combination of the two. Facilities with surplus allowances are encouraged to trade them. The ETS will provide clear incentives for investment in energy efficiency and cleaner technologies at lowest cost, where this investment is cheaper than the price of the EUA's.

[3] Each of the 15 original EU member states have different reduction targets based on their 1990 GHG emission profiles. Though the 10 new members of the EU (as of May 2004) are all included in the ETS, but are not included in the EU's Kyoto target.

[4] EU @EU Emissions Trading Scheme' 2005

[5] Dresdner Kleinwort Wasserstein, 2005

[6] In addition, installations in any sector that has combustion plants of a thermal input of over 20MW, including aggregated plants on a single site, are also covered. Hospitals, Universities and large retailers may find themselves included under this provision.

The price for CO_2 tradable allowances in September 2005 is around €28. However, prices are volatile and have fluctuated in the range of €8 to €29 since the beginning of January 2005. The price of the EUA's is primarily a function of the political environment (ie. availability of allowances), fuel prices (a switch from coal to gas produces less CO_2) and the weather (which can increase or decrease fuel consumption). Current CO_2 prices are high reflecting demand for allowances by the utility companies and a shortage of supply from installations with surplus allowances.

There is concern that the ETS will financially disadvantage certain EU companies against their international competitors, whilst others believe the NAP's to be too relaxed and unable to help the EU fully achieve its Kyoto commitments (The impacts of the ETS on different industries are considered further in the full report (which is available on request from your Client Director)). Certainly the ETS is changing corporate thinking and behaviour on CO_2 emissions.

Waste Electrical and Electronic Equipment Directive (WEEE)

It is estimated that there around 6m tonnes of WEEE produced per year in the EU of this the UK produce about 915,000 tonnes, or 15%. In the UK 90% of this waste stream is disposed of through landfill or incineration, and the toxic components in this waste leak into the environment over time. It is estimated that WEEE accounts for 40% of lead in landfills and 50% of lead in incinerators. The UK Environment Agency has forecast WEEE to grow at 3-5% pa which is three times greater than municipal waste. Given this predicted growth and the current paucity of Electrical and Electronic Equipment (EEE) recycling (especially in the UK) the European Commission developed the WEEE directive.

The Directive

The WEEE directive aims to reduce the waste streams and their related pollutants and to standardise, under one directive, various national WEEE waste legislation throughout the EU. The WEEE directive will come into force in August 2005 though the UK will delay implementation until January 2006 and Germany until February 2006. Essentially the Directive aims to:

- Decrease waste to landfill
- Improve the waste management process
- Prevent hazardous substances being landfilled
- Increase recycling and resource recovery
- Increase energy recovery
- Increase the re-use of equipment and components.
- Reduce pollution caused by waste incineration

The Directive requires Member States to achieve a minimum separation rate of 4kg of separately collected WEEE per person per annum by 2006 (the UK already achieves a 7kg separation rate due to the collection of fridges under the Ozone Depleting Substances Directive and the collection of computer equipment). The French Environment and Energy Management Estimate that the typical EU household produces 13kg of WEEE pa.

Producers (manufacturers, own-brands, importers and exporters) are expected to pay for the collection, treatment, re-use, recovery, recycling and environmentally sound disposal of their products. Retailers of EEE will be classed as producers if they import EEE from outside of the EU or have their own brand of EEE. Retailers will also be asked to provide take-back facilities free of charge, or develop a collection scheme that is no more difficult then in-store take back.

The EU hopes that after the implementation of WEEE only 10-30% of the original waste material will be sent for landfill or incineration, as in order to reduce their financial exposure to WEEE producers will be aiming to reduce the weight of their products and to increase the use of recycled materials.

Alongside the WEEE Directive the EU has also introduced the Reduction of Hazardous Substances (RoHS) which aims to eliminate the use of certain hazardous substances in electrical equipment. RoHS will come into force in July 2006. The elimination of lead is one of the main aims of this legislation. Manufacturers have, to date, developed poor alternatives to using lead (which is a major component of solder), so there will be an increase in the R&D costs for manufacturers and their supply chain as a result.

The directive is going to have financial impacts on producers and retailers as R&D costs will increase as producers develop different production techniques. Producers will have to pay for the disposal of WEEE and retailers for some form of collection scheme. Due to a lack of political clarity over implementation of the directives it is still unclear as to the exact extent of these costs. However Schroders has engaged with W **H Smiths, Kingfisher, Carphone Warehouse, Dixons** and **Tescos** to understand what the financial impacts maybe and how prepared these companies are for the legislation, and will be raising this issue in our discussions with other affected companies such as GUS, Kesa, Nokia, Electrolux.

The Equator Principles

The Equator Principles are a set of policies and procedures for assessing, managing and monitoring environmental and social risk in project finance lending[7].The Principles are based on the policies and guidelines of the International Finance Corporation (IFC), the private sector arm of the World Bank Group, since June 2003. They have been adopted voluntarily by mainstream financial institutions where they provide credible guidelines for the mitigation of environmental and social risk when financing development projects over $50 million. There are now 27 financial institutions that are committed to using the Equator Principles; they represent at least 75% of the project finance market[8].

The Equator Principles require banks to evaluate projects against a set of baseline policy requirements, resulting in their categorisation into high, medium or low risk. Borrowers must carry out an independent social impact assessment (SIA) or environmental impact assessment (EIA) identified by the banks, for medium and high risk projects; this includes the preparation of a detailed management plan for the mitigation and monitoring of these risks. If banks are satisfied at this stage, covenants are drawn up requiring borrowers to comply with management plans and to demonstrate ongoing compliance. If banks are not satisfied with the borrower's assessment they may decline co-operation, (high risk impact projects are on the exclusion list of many, if not all, Equator banks), and if covenants are breached, banks can declare the loans in default.

In addition to these requirements, projects must conform to host country laws and meet IFC's health and safety guidelines, which are tailored to each specific industry. In developing countries, projects must also demonstrate compliance with IFC's safeguard policies which will clearly state minimum sustainability requirements for all projects.

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7 IFC (2005) Banking on the Future: The Equator Principles and the project finance market. http://www.equator-principles.com/documents/SyndLend-IFC02.pdf

8 http://www.equator-principles.com.

The Equator principles demonstrate that the finance sector can promote accountability for environmental and social risks. They represent a promising start, in a sector where there were previously no enforced social or environmental standards on lending activities and environmental and social management was entirely at the discretion of the borrower. The principles now offer the banking sector an appropriate risk management tool to influence investment, which can be integrated into lending policies, existing credit assessment procedures and internal auditing procedures.

Membership of the Equator Principles looks set to continue to grow. It is proving attractive to other financial institutions active in project financing, such as export credit agencies, bilateral agencies and banks in developing countries. The Principles are likely to have an indirect impact as well with companies that are self financing projects. For example a construction company will undertake relevant SIA' and EIA's in order not to jeopordise any future financing requirements, or merger and acquisition or divestiture options. Schroders will be monitoring the implementation of these principles and their impacts on lending procedures through their SRI engagement with the Pan-European Banking sector.

Thoughts on a nuclear future.

The rapid growth of nuclear energy in the 70's eased off dramatically in the 90's, but has recently come back into the political limelight as concerns over how to manage and reduce our carbon emissions, meet electricity demands and reduce our dependence on oil and gas have forced a re-think of our energy policy.

Schroders review of nuclear energy provides an overview of some of the drivers for the current resurgence of interest in nuclear, the alternatives that are available and the issues that nuclear energy production has to overcome. It concludes that whilst nuclear does appear to solve a lot of problems, other new technologies are also developing that are not associated with the additional risks of a nuclear programme, these will take time before they are commercial and competitive. An interim solution would be to extend the operating life of the current nuclear fleet allowing time for new technologies to develop whilst at the same time increasing the focus on energy efficiency.

To obtain full copies of these reports please contact your Client Director

Section 7
Others

RECRUITMENT - Schroders has recruited Karen Shaw to the SRI team. Karen joined us from the International Centre for Corporate Social Responsibility. Karen's recruitment has enabled the SRI team to realise its planned extension of its SRI activities to a Pan-European basis. Initially this will focus on companies in countries that are non Euro (€) European countries.

Pan-European SRI Policy - Schroders latest SRI policy was approved by the board. This extends our approach to SRI from the UK to the Pan-European market. For copies of the policy please contact your Client Director.

Ethical Funds Under Management: - Our third review of Ethical Funds under management (those clients who's monies are managed under exclusion criteria based on moral values) shows that we had GBP4.9bn at December 31 2005. This is an increase of just over Gbp1bn which is driven by a combination of organic growth in historical FUM and new clients.

Innovest - We have renegotiated our contract with Innovest for another year and to increase their coverage to include Scandinavian company analysis, in line with the extension of our SRI research to a Pan-European basis.

Transparency Guidelines for Engagement and Voting in Institutional Investors – We have completed developing these in conjunction with other fund managers, and they are currently being piloted.

Institutional Investors Group on Climate Change – Schroders attended the AGM for the IIGCC.

Carbon Disclosure Project (CDP) – Alan Brown (Schroders CIO) spoke at the launch of the CDP's third assessment of Carbon Disclosure by the FT500. The video of his speech is available on their website (http://www.cdproject.net/speeches_cdp3.asp)

Just Pensions – Schroders continued its involvement in the Just Pensions Sector note programme, which was completed in 2005. There are now nine published sector notes which are available on the Just Pensions web-site (http://www.uksif.org/J/Z/Z/jp/publ/main/index.shtml).

UKSIF AGM – 'Defining Engagement' Workshop – Rick Stathers was on the panel for this workshop, looking at exploring the evolving definitions and practices of SRI engagement, and how these were represented by the UK Social Investment Forum. The workshop was judged to be effective, as it acknowledged that there is a broader approach to SRI engagement then had previously been realised by industry bodies and that UKSIF would recognise this on its web-site.

FAIRE – We attended a conference in France at **which BASF, CIBA Chemicals, AKZO Nobel, BAYER AG from** the chemicals sector and **Premier Oil, Total, Norsk Hydro, Statoil and Repsol** from the Oil and Gas sector were presenting on their approaches to, and performance in, CSR.

Emissions Trading Conference – We attended this conference on the financial technicalities of CO2 trading and the structure of emission markets.

Housebuilders Conference – This conference disclosed the results of a second assessment of the UK's listed house-builders on sustainability performance. It will be a useful tool for future engagements with the sector.

Section 8
Glossary

AGM – Annual General Meeting

CDP – Carbon Disclosure Project (http://www.cdproject.net/)

CO_2 – Carbon Dioxide

CR – Corporate Responsibility (a term that is quickly eclipsing the CSR term as the preferred terminology)

CSR – Corporate Social Responsibility (see CR)

DTI – Department of Trade and Industry (www.dti.gov.uk)

ECRA – Environmental Credit Risk Assessment

EEE – Electrical and Electronic Equipment

EIA – Environmental Impact Assessment

EMAS – Eco-management and Audit Scheme (www.emas.org.uk)

EMR – Electro–magnetic Radiation

EMS – Environmental Management System

EU – European Union

EU ETS – EU Emissions Trading Scheme

EUA – EU Emission Allowance

FSA – Financial Services Authority (www.**fsa**.gov.uk)

GHG – Green House Gases

H&S – Health and Safety

HSE- Health, Safety and the Environment (can also be SHE, EHS)

IFC – International Finance Corporation (www.IFC.org)

IIGCC – Institutional Investors Group on Climate Change (www.IIGCC.org)

ISO – International Standards Organisation (www.ISO.org)

KPI – Key Performance Indicators

LTI – Long Term Injury

LTIFR – Long Term Injury Frequency Rate

NAP – National Allocation Plan

NED – Non-Executive Director

NGO – Non-Governmental Organisation

OFR – Operational and Financial Review (now defunct)

OSHA – Occupation Safety & Health Administration (www.osha.gov)

R&D – Research and Development

REACH – Registration, Evaluation and Authorisation of Chemicals

SEE – Social, Ethical and Environmental

SIA – Social Impact Assessment

SRI – Socially Responsible Investment

TCF – Treating Customers Fairly

UKSIF – UK Social Investment Forum (www.UKSIF.org)

WEEE – Waste Electrical and Electronic Equipment