Schroders
Socially Responsible Investment Review
2006 Annual Report

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

If you require any further information, please contact:

Rick Stathers
SRI Manager

Phone +44 (0) 20 7658 5534
Email richard.stathers@schroders.com

Schroder Investment
Management Limited
31 Gresham Street,
London EC2V 7QA

Fax +44 (0) 20 7658 3870

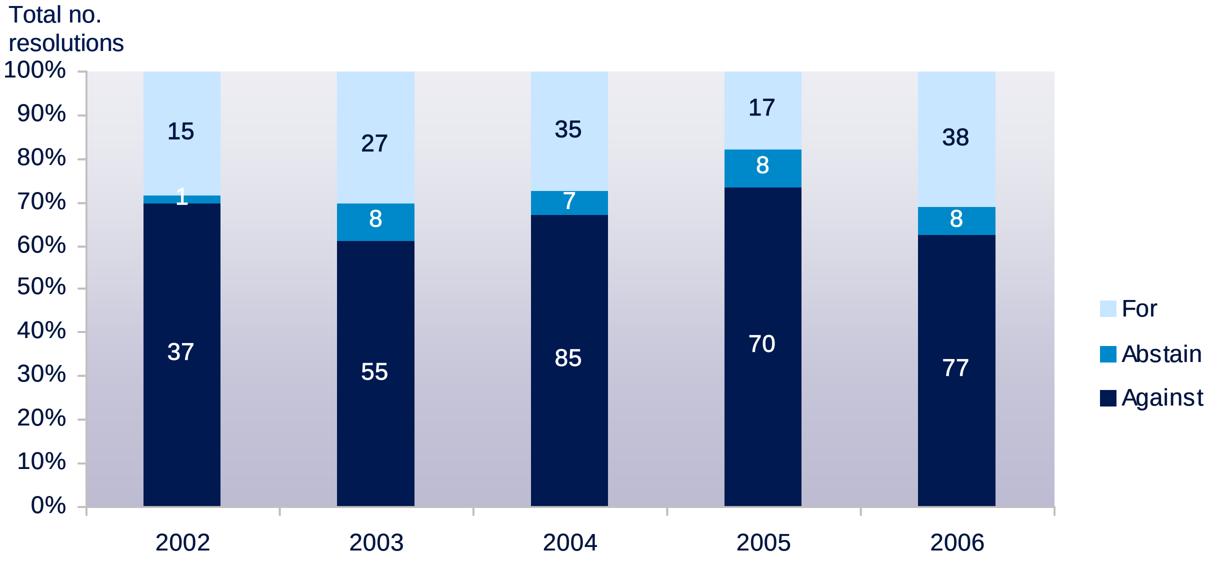
March 2007

Contents

Page

Section 1
Shareholder Resolutions Review

2006 continued to see the use of shareholder resolutions as a tool for engaging with company management and, as in previous years, the number of shareholder resolutions is predominantly tabled at the AGM's of US companies. This year saw the number of shareholder resolutions on which we have voted topping 100 for the second time in seven years (the previous time being 2004) underlining this method of engagement as a favoured tool for shareholders in US companies.



Graph 1: Schroders 5-year 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 demonstrates how we have voted on shareholder resolutions over the last five years. Our voting decisions will be determined by:

- The quality of the resolution. If the resolution is poorly or loosely worded it makes it difficult to determine the exact purpose of the resolution and hence we would be unable to support it.
- The purpose of the resolution. We will only support resolutions that are in the long term interests of shareholders. Some resolutions over the last year have had a distinct moral purpose which was not in the long term interest of shareholders and hence we have voted against it.
- The company's public disclosure with regards to the resolution. We have noticed that some resolutions are aimed at issues which the company is already publicly reporting on, or has addressed, and have therefore not supported them.
- Whether the company has faced similar resolutions in the past and how we voted on them then. In some instances companies have faced similar resolutions for several years running yet the quality of their response to the issue raised by the resolution has not improved in that time. We would take this into account in determining whether to support the proponents of the resolution or company management.

By keeping a record of the resolutions we are able to track whether they have achieved their aims. For example, we have supported a shareholder resolution tabled annually at GE's AGM since 2000. The resolution required the company to disclose the full expenses for the clean up of toxic contamination of the Hudson River. The company has previously disclosed the remedial costs of the project but were not willing to disclose the costs of its associated Public Relations activities (or 'delay tactics' as the proponents called them). In 2006 the company finally disclosed that it had spent $122m on public relations, $33.4m on lobbying, $86.6m on legal 'manoeuvring' and $2.1m on government relations. These figures account for 30% of the overall costs ($799m) that GE has had to spend in cleaning up and dealing with the toxic pollution issue.

Table 1 (overleaf) shows the break down of the more common shareholder resolutions since 2000. In creating this table we have selected information that focuses on a broad theme but acknowledge that individual resolutions may be more specific in nature. For example, resolutions focusing on board diversity, glass ceilings, sexual orientation, workforce diversity and equal opportunities are all incorporated into the Equal Opportunity group. This year we have included three new categories: toxic chemicals, environmental policy and CSR/SEE/Sustainability reports and we have excluded 'old growth forests' due to the lack of resolutions on the topic.

A review of Table 1 shows that there is a sustained increase in the number of resolutions focusing on animal welfare and animal testing issues, which is a direct reflection of the use of shareholder resolutions by animal welfare campaign groups. The number of resolutions focusing on nuclear power remains at a more constant level following the spike in 2003 and 2004 as a direct result of shareholder concerns following the shut down of 13 nuclear power plants in Japan as a result of health and safety issues. Equal opportunities and labour standards remain a high concern for shareholders as reflected by the constant high number of resolutions on these topics, with the number of resolutions focussing on labour standards increasing significantly on previous years data (it remains to be seen whether this is a sustained trend). HIV/AIDS and it impact on workforces appears to be an issue in decline whilst, in recent years, there has been increasing pressure on companies to produce corporate social responsibility reports.

It should be noted that our view of the market and hence stock selection ideas will influence our exposure to different sectors and hence this may influence the nature of the shareholder resolutions that we are required to vote on.

Issues		2000	2001	2002	2003	2004	2005	2006
Ethical	*Animal Testing/Welfare*	0	0	0	1	4	18	14
	Genetically Modified Organisms	3	5	5	2	5	6	6
	Weapons	2	3	0	4	8	5	5
	Tobacco	0	4	2	7	8	5	8
Environmental	*Toxic Chemicals*	0	2	2	3	5	3	2
	Greenhouse Gases & Climate Change	0	2	2	6	12	5	7
	Renewable Energy & Energy Efficiency	1	4	3	5	5	0	4
	Nuclear Power	1	4	3	10	11	5	7
	Protected Areas	2	2	3	0	3	2	3
	Environmental Policy	2	3	5	2	1	1	3
Social	*Equal Opportunities*	5	9	6	11	13	9	12
	Labour Standards	6	14	15	14	12	16	24
	HIV/AIDS	0	0	0	2	8	4	1
	Executive Pay	0	0	4	1	2	3	1
	Drug Pricing/Access	4	5	4	1	5	7	0
Other	*CSR/SEE/Sustainability Report*	0	0	0	3	5	3	7
Total number of resolutions voted on		37	73	53	90	127	95	123

Table 1: Breakdown of SEE voting issues since 2000 (by number of resolutions)

Section 2
Engagement Activity Review

As we reported in last year's annual review, there is substantial divergence over the definition of 'engagement' within the Socially Responsible Investment (SRI) community. This review refers to our SRI engagement activities only which we define as:

— Monitoring the ongoing Corporate Responsibility (CR) performance of a company
— Filling in gaps in our analysis (fact finding)
— Making suggestions for change if a company's CR performance is below acceptable standards

We believe that the ongoing monitoring and discussion with companies on CR is a vital part of our engagement activities even if we do not recommend that the company improve its performance in certain areas. This is because it serves to demonstrate to a company investors' interest in aspects of its CR performance and hence act as an indirect means of encouraging ongoing investment in CR programmes. We utilise the information from these meetings to further develop our analysis of a company in relation to its peers, if the company is a laggard in its sector or is not addressing specific issues that could potentially damage long-term shareholder value, then we will encourage the company to improve its performance[1].

Table 2 (below) provides a 5 year breakdown of our engagement activities. The upward trend in suggestions for change since 2003 reflects the changes in the sophistication of our engagement. When Schroders formalised its SRI activities and established a dedicated SRI resource in 2000 the level of CR disclosure by companies was very poor, with few companies producing anything more than a basic environmental policy. Since 2002-03 companies have embraced CR reporting and the number of reports, and detail of information within them, has significantly increased. At the same time the understanding of relevant key performance indicators (KPI) has increased, increasing the sophistication of the engagement process which is reflected by more micro levels of engagement (e.g. on specific indicators as opposed to general policies).

Year	Companies engaged with	Suggestions for change (absolute)	Suggestions for change (%)
2002	63	13	21
2003	49	13	27
2004	55	17	31
2005	89	39	44
2006	92	39	42
5-yr average	70	24	33

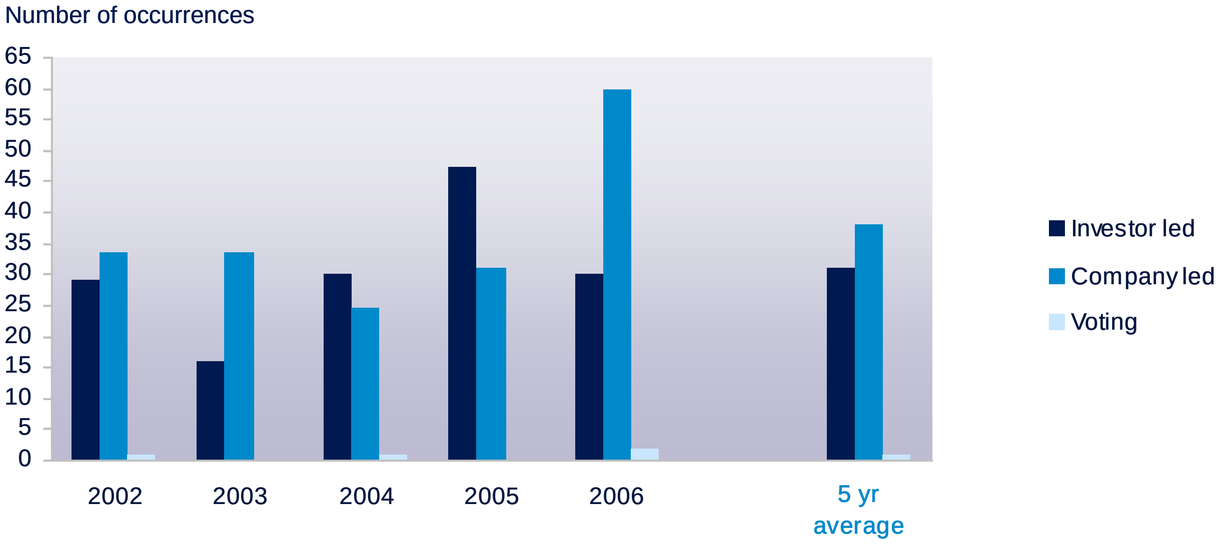
Table 2: A 5 year review of suggestions for change

Overleaf, Graph 2, provides a reflection of how active Schroders has been in its engagement programme. With regards to the legend for graph 2:

— Investor Led – refers to occasions where we have instigated engagement with companies as a result of either our sector or thematic research or as a result of a one off concern.
— Company led – this refers to instances where companies have been presenting their CR performance to the market (either directly or with the assistance of brokerage houses) or have been presenting on specific issues.

[1] 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.

— Voting – Section 1 has already reviewed the shareholder resolutions that Schroders has voted on. These are more common in the US then Europe due to different corporate governance regulations between the two regions. However there are occasional shareholder resolutions placed at the AGMs of Pan-European companies and these are included here.



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

The increase in SRI resource in Schroders in 2005 has led to an expected escalation in the number of company engagement activities undertaken. In 2006 we have seen a significant increase in the number of company led engagement instances. Whilst it is not possible to pin-point the exact reason for this, there has been a substantial growth in the number of brokerage houses providing research and other services to the SRI market which could have been a reason for this increase as they may have been hosting more interactions with brokership companies. Or the increasing societal awareness of environmental and social issues may have acted as a stimulus for companies to demonstrate their Environmental, Social and Governance (ESG) activities.

This year we have seen the number of engagements with continental European companies increase from 31% of our overall engagement activity in 2005 to 40% in 2006, in addition we also engaged with 1 US company (Coca-cola - due to its significance on a global scale). The number of UK company engagements has decreased from 61 in 2005 to 54 in 2006, but this reduction has been offset by an increase in European company engagements and the overall number of UK company engagement activities remains at a similar level to that prior to the addition of extra SRI resource in 2005[2], when Schroders had an average of 51 UK company engagements per year (based on 2001 to 2004 data).

[2] To facilitate an extension of our SRI coverage from the UK to the Pan-European market

Section 3
'Suggestions for Change' Performance

This section reviews the effectiveness of the engagement instances where we have recommended that a company change an aspect of its CR programme (e.g. improved disclosure, greater focus on more strategic issues). As we have noted in previous SRI annual reports, that whilst it is possible to claim participation in a 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, government and investors) as well as legislative drivers and industrial forces.

Table 3 provides a review of our 5 year performance between 2001 and 2005. Any requests for change are reviewed on an annual basis as this tends to be the standard reporting period for most companies on CR. In the table the arrows indicate whether there has been an increase/decrease/no change in that category over the year.

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 begin to 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

	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
2001	2	19	18	0 (-)	2 (↓)	0 (-)	14 (↑)	Thistle has been taken over and Rank Group sold off its hotel operations.
2002	1	50	13	1 (-)	0 (↓)	3 (↑)	8 (-)	Enterprise Oil was taken over by Royal Dutch Shell
2003	0	36	13	1 (-)	1 (↓)	2 (-)	9 (↑)	
2004	1	35	20	2 (↓)	4 (-)	4 (-)	10 (↑)	
2005	0	49	40	7	11	6	16	

Table 3: UK Engagement activity since 2001 and assessment of the effectiveness of suggestions for change. The arrows (and dashes) indicate the trend on last year's data.

Table 3 demonstrates how successful our engagement activities have been over a five year period. It shows that 89% of suggestions for change were 'almost there' or 'achieved' between 2001 and 2003. This figure drops to 83% between 2001 and 2004 and to 71% over the five year period of 2001 to 2005, indicating that the assumption that suggestions for change can be met or almost met within one year may be too optimistic.

An analysis of the 2005 data indicates that 55% of suggestions for change could be rated 'almost there' or 'achieved' over the one year period. This is a downward trend on the statistics that that can be drawn from the 2004 and 2003 SRI annual reviews which showed that 71% and 61% (respectively) of suggestions for change could be rated as 'almost there' or 'achieved' within one year. We do note that there has been a significant increase in the number of suggestions for change made in 2005 (double the figure for 2004), and that 60% of these are focussed on two sectors.

The banking sector accounted for 40% of suggestions for change (16 instances), of which 30% were 'achieved' or 'almost there' within the year, whilst the oil and gas sector accounted for 20% (7 instances) with 75% of suggestions for change being rated as 'achieved' or 'almost there' during the year. One of the key reasons for the slow pace of change within the banking sector is that we encouraged companies to improve their disclosure on customer satisfaction data, however many of the banks stated that this is commercially sensitive information and any improvements in disclosure are likely to occur as a result of a sector shift in disclosure (e.g. due to regulation) as opposed to company level improvements.

Year	Company	Reason
2002	Colt Telecom	We had originally suggested that Colt could improve its CR performance by disclosing quantitative data on human capital, energy efficiency and client relations.
2003	BP	This company is recognised as one of the leaders in CR (despite an *annus horribilis* in 2006). Unlike financial reporting, there are no legislative standards for reporting on CR data and so we had suggested that the company report its performance against industry wide data (where possible) which would enable a better analysis of its performance with regards to its peers. To date this has not been done and there is only one other company in this sector (Shell Transport and Trading) which is beginning to make efforts to do this.
2004	BAE Systems	We had encouraged BAE Systems in 02 and 03 to improve various elements of its CR reporting, which it had done. With the company being able to demonstrate that it was measuring elements of CR performance we suggested that in order to facilitate continued improvement the company should set targets. This is still to be achieved.
	House of Fraser	The company had very poor CR disclosure and we discussed the benefits of being able to demonstrate to shareholders the benefits of measuring and managing its environmental and social exposures. The company has not improved its disclosure levels, however we have no shareholdings in the company and so our influence with management will be limited.
2005	Dixons/DSG International	Since this engagement Dixons has re-named itself DSG International. Dixons had previously stated that it would publish human capital data in its Annual Report, but we have had no such statement from DSG and there is no information in its report.
	Svenska Handelsbanken	The company has a very decentralised structure, which means collating group level data is a challenge. We encouraged the company to produce group level data on human capital and customer satisfaction which it has not been able to do.
	Dairy Crest	The company has not responded to our request to develop group level environmental performance targets
	DNB	We encouraged the company to improve its CR disclosure, no improvement was recorded within the year
	EGG	We encouraged the company to improve the level of its CR disclosure but no improvements were detected during the year EGG has subsequently been purchased by Prudential.
	Colt Telecom	Following on from our review of engagement activities last year we wrote re-iterating our suggestions that it could improve its disclosure on human capital, customer relations and energy efficiency. We have not had a response.
	Nestle	We have suggested that the company produce an annual report (as opposed to regional) and to publish health and safety data. No change was detected.

Table 4: Engagement actions where 'no change' has been achieved.

Table 5 (below) provides examples of instances where, following a review of a company's publicly available information, we have rated the initial reasons for suggesting change with the company as having been achieved. On occasions we may have met a company on more than one occasion during the year and reiterated our suggestions for change (e.g. Tesco, Royal Bank of Scotland and Tullow). These instances will have been recorded separately in our engagement log but we have reported them together in the following table, hence there being 11 companies listed in Table 5, but 16 records of 'achieved' for 2005 data in Table 3.

Company Name	Result
Tesco	In 2006 the company announced that it would be rolling out its new community plan on a global level and that it will be setting CR and KPI targets on a global level this year. We had suggested that the company develop longer term targets and globally applicable policies
Rio Tinto	In 2005 the company established a climate change leadership panel and has stated its recognition of the costs of climate change to the business. It has set in place emission reduction targets and has begun working with customers to look at the life cycle impact of their products. We had suggested that the company should increase its disclosure on the long term strategic issues faced by the company (especially Life cycle assessment and climate change).
Tullow Oil	Tullow's first CR report in 2005 is to be commended as a start and covered some aspects of risk management, the integration of ESIA's in project feasibility and development and execution. It also describes its H&S management system and crisis response system, reports against HSE KPIs, provides an improved breakdown of resource consumption and eco-efficiency programmes and reports on human capital management (HCM) indicators for the first time. This achieves a request for improved disclosure in these areas last year..
Standard Chartered	We previously recommended the company to develop more KPIs to enhance its reporting on customer satisfaction, H&S, human capital management and environmental credit risk assessment. Its new report fulfils these recommendations.
Barclays	Barclays' 2005 CSR report covered the key SRI issues relevant to the bank, including treating customers fairly, responsible lending, equator principles, environmental credit risk, climate change and internal HSE issues. We had previously encouraged the company to improve its disclosure on customer related performance indicators, absenteeism and turnover.
Alliance & Leicester	We encouraged Alliance and Leicester to enhance its service to, and reporting on, customer service. This years CSR report details new models of customer service in both business and retail banking and enhanced the clarity and transparency of its product offerings
Bradford & Bingley	Bradford and Bingley have increased the number of KPI's it is using, especially in the management of customer satisfaction and it continues to improve the quality of KPIs in areas of environmental management and HCM. It has also disclosed who has executive accountability for CSR management. We had previously encouraged the company to disclose information on its CSR governance structure; to set targets with regards to its Environmental Management Assessment System (EMAS) and disclose measures of employee productivity and customer retention.
Royal Bank of Scotland	RBOS is now running extensive customer and employee satisfaction surveys to illicit stakeholder views and concerns. A Human Capital Board was set up to oversee the implementation of HCM initiatives across the Group in 2005 and this has led to improved transparency and reporting of KPIs in this area. Its EMS system has also been standardised and is set to produce more comparable year on year data. We had encouraged RBOS to continue enhancing the robustness of its Environmental Credit Risk Assessments, customer service delivery model and HCM programmes and RBOS have responded proactively.
Scottish and Southern	The company now discloses on HCM indicators, which we had encouraged it to do so in earlier feedback, as well as applauding the company for its renewable energy strategy as evidence of its long term strategic approach to managing its exposure to climate change.
Scottish Power	The company is now disclosing data on absenteeism and sick leave as well as looking at other indicators for employee moral, which is information we had encouraged it to produce.
Cairn Energy	Cairn's 2005 CR report has been assured by an external environmental auditor. Implementation of CR policies and Guiding Principles has also been assessed by the IFC as part of the 'due diligence' process associated with the negotiations for additional funding arrangements. The efficiency of its operations has improved resulting in reduced greenhouse gas (GHG), including methane emissions. We consider this a step forwards but note that absolute emissions continue to increase. We had previously encouraged the company to reverse the trend of increased water use, effluent production and GHG emissions as a result of company expansion as well as encouraging the company to seek independent assurance of community and biodiversity programmes.
BP	BP has revamped and re-structured its Group HSE policy and operating systems. Engagement with the company several times during 2005 has resulted in a detailed account of the specific changes that have been made, including additional senior management responsibility to Group HSE, additional support teams, new prescriptive standards, internal auditing at Group level. We had encouraged BP for more open disclosure of how the company's projects and subsidiaries are accountable to the Group's standards.

Table 5: 'Suggestions for change' rated as achieved during 2005

Section 4
Company Engagement Report

Company	Engagement Activity
Basic Materials	
Chemicals	
Air Liquide Q2	Air Liquide is well positioned to take advantage of new emerging environmental niche markets in the areas of emissions reduction, the cleaning of industrial processes, fuel cells for mobile phones and innovations in the healthcare and food industry, all through the application of hydrogen, oxygen and carbon dioxide. Demand for hydrogen, in particular, is being driven by environmental fuel regulation requirements and subsequent desulphurisation needs in the oil and gas industry. The company is one of the few players to have R&D expertise throughout the hydrogen life cycle and is pursuing research in fuel cell application in mobile equipment, though they state they are not market leaders in this field.
Akzo Nobel Q2 & Q3	Akzo Nobel has three main business segments, pharmaceutical, coatings and chemicals. The largest of these is the coatings business which represents 60% of sales. Sustainability drivers are different for each business. For coatings, the EU regulation on volatile organic compounds has caused a shift from organic (oil based) to water based solvents in domestic markets, (even some industrial markets) which has reaped significant cost savings. For the chemicals industry the focus has been on process efficiency, particularly energy efficiency and cost savings. There are ongoing targets to reduce their energy efficiency index by 2% every year to 2010 based on 1990 levels. Already Akzo is 19% more efficient than in 1990 which saves the company €90 million year. Akzo's pharmaceutical division has a relatively low environmental footprint. Akzo has set up a corporate REACH committee to take responsibility for compliance with this new legislation. Through systematic identification of all raw materials and chemicals in use they have identified some products of 'high concern' for which tonnage and use will be affected and substitutes may be required. We requested more disclosure on human capital productivity and CSR governance structures.
BASF	BASF is focussing on process innovation and new product opportunities (through eco-efficiency and product stewardship). The meeting highlighted that the group has a focus on nanotechnology application, as a means for generating future material process efficiencies. BASF intends to achieve 10% market share in this field, although it would not disclose current market share. Sales are currently around €2 billion. Biotechnology is also offering potential process efficiency improvements, but currently this contribution is small. White biotechnology is producing sales of around €4-500 million, whilst plant biotechnology is still in the R&D phase and the first product is still to be launched either in 06 or in 07. BASF sees potential in these technologies as it believes its energy efficiency opportunities are already optimised, though significant targets exist to 2012 to reduce GHG and other emissions. In terms of products, no data has been produced on the extent to which BASF's 8000 products serve environmental markets. Nonetheless, as part of a product stewardship program, 250 product lines have been evaluated and audited for eco-efficiency. We have encouraged the group to disclose employee key performance indicators and to be more open about its commitments in product innovation and customer service. Nonetheless significant targets exist to 2012 to reduce greenhouse gas and other emissions. It's unclear how the group plans to achieve this. We have encouraged the group to disclose employee key performance indicators and to be more open about its commitments in product innovation and customer service.
Ciba Chemicals Q1 & Q3	Ciba has improved HSE performance significantly in the last few years keeping energy consumption fairly constant since 2000 despite a doubling of output. Their business strategy includes obtaining further cost efficiencies; it will be interesting to see how the Ciba eco-efficiency program aids this. They are aiming for a further 10% reduction in energy consumption, which will have a positive knock on effect for water consumption (primarily used for cooling tanks). Currently a cost break down of sales would be as follows: 43% raw material, 23% product costs, 5% transportation costs, 4% R&D. Of the 23% of product costs, 50% is down to employee costs, and a significant portion of the remainder is down to waste disposal and energy costs, which increased 30% last year, more than raw material price increases which increased 10%. On the product stewardship is much less developed - a few products are more inherently sustainable and are promoted by the company as examples of 'sustainable technology', such as plasma car coating. However, there are questionable social health risks with this emerging technology, also promoted by other companies.
DSM	We met with the IR Officer and the Corporate Social Responsibility (CSR) Manager. The company has launched its strategy for 2010, which is based on organic growth and consolidation of its existing business divisions. It markets sustainable development through a strategy of product innovation. Emerging development areas include biomedical materials, speciality packaging, personal nutrition and biotechnology. These technologies are promoted as eco-efficient (e.g. they can save about 65% of the cost of the production process and is very resource efficient, using less water, energy and other resources)..
Johnson Matthey	Johnson Matthey is developing a more cohesive and structured governance of corporate social responsibility. A Compliance Committee was set up in 2006 with the Director of IR as chairman and divisional directors as members. It is hoped that this structure will facilitate a clearer value-adding agenda of CSR priorities within Johnson Matthey. The company has employed a health and safety consultant to advise it on how to reduce

Company	Engagement Activity
	incident rates and the initial results are positive with new programmes emerging and reporting becoming more transparent. Improvements in environmental performance this year also demonstrated a possible dissociation between company performance and environmental emissions for the first time.
Lanxess	We met with Investor Relations to discuss how Lanxess is establishing its HSE management systems since its spin off from Bayer. Currently it is aligning HSE management across the group to ensure the same world class environmental and health standards. This process should be complete by end of 2006. The board has also established a HSEQ committee which is responsible for establishing ISO 9001 and ISO 14001 EMS systems. The group aims to have its sites certified to these standards by the end of 2007. The company will start reporting environmental data when its HSE management systems are completed. Currently the group estimates that environmental pollution prevention measures amount to 4.9% of operating costs annually. Forthcoming legislation (entitled REACH) was listed as a potential threat to the direct costs of the company, depending on the finalised HSe standards. Management were clear about Lanxess's aims where HSE is concerned and provided an informed discussion about company views on this forthcoming legislation.
Linde	Linde is in the process of merging with BOC (and divesting its material division) so its plans to develop group level targets in EMS and H&S maybe delayed slightly beyond its target of the end of 2006. Currently, the group has EMS targets at regional level. Due to client interest and demand Linde is also developing HSE policy and targets at group level and increasing site certification, especially in the gas division. 80% of raw material price increases have been passed on to the customer. However, 20% is to be achieved through process efficiency, in particular energy efficiency targets, and this is a challenge for Linde. 80% of its electricity is derived from air separation plants which are carefully monitored and already maximised in efficiency terms. One area where further cost savings might be achieved is through onsite customisation of gas delivery (now used by 24% of Linde gas clients and a fast growing market), which also reduces transport costs for Linde. Future R&D investment (€177mn/annum - 1.8% sales) is focussed on hydrogen storage and fuel cell development, desulphurisation and existing hydrogen markets, but also hydrogen extraction from biomass and ionic liquid, which are fairly new research developments and promising fields.
Solvay	We met with the Head of Corporate Responsibility. This was the first time we met with Solvay. The company has a strong focus in the pharmaceutical, chemical and plastics sector. Solvay provided examples of a range of mainstream chemical processes which have been improved from an eco-efficiency perspective; these included changes in the pulp and paper manufacturing process from chlorine to hydrogen peroxide, Laundry detergent composition which has changed from including perbolate to percarbonate and ongoing developments to close the loop of the PVC manufacturing process. Solvay is confident that it is very innovative in this respect and motivated by clear cost savings. The company has a group management tool called S3 which it is developing to assess further potential for eco-efficiency improvements. The company is also well prepared for REACH, where it has 130 substances to register and considers that risk assessment information for these dossiers, has always been available within the company. Energy costs are approximately 8% of operating costs. We have encouraged Solvay to make clearer the financial benefits of eco-efficient investment and process changes, which have clearly benefited the company and represented long term investments.
Umicore	We met with the Director of Investor Relations and the Vice President of Environment Health and Safety at Umicore for the first time. The Company works to quantified reduction objectives in its EMS. Targets have been ambitious and not all have been achieved, energy consumption has fallen only marginally and CO2 emissions per tonne have actually increased. This is an ongoing challenge for Umicore but investment programmes are underway to target energy process efficiency in zinc electrolysis (which accounts for 77% of total energy consumption) and precious metal chemistry. A significant proportion of their business is metal recovery (Precious Metals division) and this supplies 30% feedstock for other divisions. The company aims to improve this recovery capacity, attempting to collect waste electronic material from the same people it supplies new products to, thereby closing the life cycle. In terms of innovation, Umicore is ready to launch a diesel particulate catalyst for trucks/lorries to help them comply with regulation (the EURO5) coming into force in 2008/9. This market is estimated at approximately €100million. We encouraged Umicore to progress with its ambitious environmental targets but also not to neglect human performance indictors.
Mining	
Anglo American	This meeting focused on Anglo Coal, the challenge presented by climate change and related value chain opportunities. Anglo is focusing on promoting and developing carbon mitigation technologies, as well as maintaining health and safety standards and community involvement efforts. The company's investment guidelines now require a carbon price to be included in investment project appraisal. Carbon credit trading is also being conducted by the Anglo treasury. The overall energy efficiency program at Anglo American aims for a 15% energy efficiency improvement and 10% carbon emission reduction over a ten year period. Research efforts will continue to focus on methane extraction from coal beds and carbon sequestration which are currently in pilot projects.
BHP	This meeting discussed the management of political risk in the BHP portfolio, access to resources and project management of social and environmental risks. The company takes political risk into consideration through project discount rates and through detailed social assessments at all stages of project management. BHP has a cultural challenge to overcome in South Africa in raising standards of personal responsibility in health and safety. It also knows that the recently acquisitioned WMC Resources is yet to be brought up to group HSE standards. BHP has demonstrated a clear improvement in HSE performance in recent years but forthcoming targets could usefully be stretched to a longer term period than 2007/08 and incorporate more challenging

Company	Engagement Activity
	goals. BHP is considered one of the best performing companies from a sustainability perspective and needs to continue this momentum in 2007.
Rio Tinto	Rio has developed a Climate Change Leadership Panel (together with emission reduction targets) and is starting to work with clients on assessing and reducing the life cycle impact of its products - both areas that we had questioned the company about last year. RT was able to demonstrate continued reductions in health and safety incidents with figures that were well below North American or Australian industry averages. The company is looking at the business case in maintaining a healthy workforce and we urged the company to publish this information when available. Given the current growth in the extractives sector there are high levels of turnover and hence challenges in securing skilled operatives, RT is trying to respond to this but acknowledges the challenges of keeping employees happy in remote locations, however it assured us that sufficient systems were in place to ensure that health and safety wasn't compromised with high turnover levels. We have also encouraged the company to increase its human capital indicators.
Xstrata	Xstrata is keen to maintain a leadership position in CSR management within this sector. It has successfully kept absolute energy and GHG emissions fairly constant since 2003, despite its dramatic business growth. The group is prioritising the resolution of specific cultural and H&S concerns in South Africa and has developed a 2-3 year program to address these. Relationships with workers, trade unions and communities seem relatively stable with no disruptions to production in the company's three year history. We also engaged with the company on the impacts of climate change on demand for coal. The company provided examples of new technologies which decrease CO_2 production, or capture it and sequester it, and is keen to demonstrate the long term viability of coal as a future fuel source.
Industrial Metals	
Norsk Hydro	We engaged with Norsk Hydro's aluminium division, investigating the environmental drivers for aluminium use in Norsk's end consumer markets of automobiles and construction and the direct impacts of the new EU carbon trading systems on its aluminium business. The demand for aluminium in automobiles and sustainable building systems is growing as aluminium offers light weight, lower emissions potential for cars and improved strength, corrosion resistant, formability and energy efficiency for sustainable building systems. Norsk's carbon emissions from aluminium smeltering are about 30% whilst carbon emission from power generation account for the remaining 70%. Over the last 15 years Hydro has reduced power consumption by 15% and direct CO_2 equivalent emissions by 60% over the same period.
Consumer Goods	
Automobiles & Parts	
BMW	We met with the Head of Sustainability and a member of the Investor Relations team. This was the first time we had met with the company and was an interesting opportunity to hear about how the company is rising to the challenge that climate change presents to its core product, how the company is meeting in-coming EU directives on vehicle emissions as well as other sustainable development issues. With ground transport estimated to account for 21% of global anthropogenic CO_2 emissions, car manufacturers are under pressure to improve the fuel efficiency of their fleets whilst at the same time meeting customer demands for more powerful and safer cars. BMW is focusing on developing hydrogen powered cars (which is a different strategy to many companies which are looking at electric powered cars [by fuel cells]) as well as looking at novel ways of using inherent energy in current cars (e.g. harnessing the energy created when braking). The company was able to demonstrate that it has a clear long-term strategy in place for adapting to climate change and that it has a very good overall approach to corporate responsibility.
Continental AG	We attended a conference at which the VP for Unit Electric Devices of Continental was presenting. With Governments increasingly focused on reducing GHG emissions, car manufacturers are predicting that the hybrid (electric/petrol driven cars) market will increase. Continental estimates that the global market for hybrids will increase from half a million to two million units by 2013. During this time the battery of choice will shift from the Nickel Metal Hybrid to a Lithium-Ion one which Continental is producing. Despite offering greater fuel efficiencies and environmental benefits, hybrids will remain more expensive than petrol engines until productions costs can be reduced.
Daimlerchrysler	The Director of the Calibration Department was speaking at a conference on the future of fuels. The company was presenting specifically on the future of diesel. Whilst diesel uptake has been good in European markets (between 20-65% market share), the uptake in the US has been very poor (c. 2%) and the company has been trying to shift this perception. The new diesel Mercedes has been able to set several distance and performance records and also out performs the new hybrids. DC is hoping that this can shift consumer sentiment in the US to this cleaner, more efficient, vehicle. The new engine technology means that DC diesel engines can meet European vehicle emissions regulations up to 2009 and are likely to meet the incoming European regulations post-2009. Diesel also has the benefit that it can be produced from coal, gas or biomass (the biomass option will have a much lower environmental impact then the other two), has lower GHG emissions and is increasingly more attractive as an alternative fuel in periods of high crude prices.
Volkswagen	The Director of Group Research was presenting on the development of vehicles and fuels with regards to sustainability. Whilst climate change continues to be a driver for technological development, the issue of energy security is increasingly having a role to play. So VW, whilst continuing to focus on becoming CO_2 neutral and improving the efficiency of its engines, is also exploring the role of alternative fuels in engine

Company	Engagement Activity
	development. Currently VW sees diesel as one of the most efficient fuels to meet these social and environmental mobility challenges. It has developed a fuel (sunfuel) which is carbon neutral and is designing vehicles and engines to exceed regulatory requirements regarding blended fuels (gasoline and ethanol blends). It was clear from the presentation that the company is developing technologies to deal with the environmental and social issues that will affect future mobility.
Beverages	
Coca-cola	We met with the Director of the Global Water Resources Centre, the Director of Global Stakeholder Relations and the Director of Shareowner affairs. Whilst our SRI policy currently focuses on the Pan-European market we took the opportunity to learn from one of the world's leading beverage companies how it is managing water resources. The issue of access to fresh water grows increasingly important as more fresh water reserves are consumed and less clean fresh water is available. The presentation gave a very good indication of how a good water resource management programme can be implemented and this will be useful when analysing other beverage companies.
Food Producers	
Cadbury Schweppes	Cadbury Schweppes held a Corporate Social Responsibility seminar at which the Director of External Affairs and the CEO were presenting and our financial analyst was attending. The presentation dealt with Cadbury's 'five pillars of CSR' - human rights and employment standards; ethical sourcing and procurement; marketing, food and consumer issues; environment, health and safety; community - but questions focused on the June 17th product recall of Dairy Milk contaminated by salmonella, which the company estimates to have cost £20m in recall costs and brand damage sustained. It was admitted that issues relating to the salmonella contamination were raised as early as February, but that due to a poor communications system, it was not initially clear that contaminated products had been released to consumers, and the issue was not escalated early enough. Although systemic improvements to internal communications will take a little while to roll out throughout the organisation, the CEO is confident that such an incident will not recur. Other concerns, including potential problems sourcing sufficient ethical cocoa, the company's road accident record, and the impact of removing chocolate vending machines from schools, were easily and persuasively allayed.
Nestle Q1 & Q3	We have met with Nestle on several occasions over the year. The company clearly demonstrates a level of commitment to an effective CR strategy, through the publication of several regional CR reports. However there is a lack of clarity on how this is co-ordinated throughout its global operations. We have suggested that the company produce an annual report for its global operations (this was last done in 2002) and that it look to improve disclosure on human capital management and health and safety.
Personal Goods	
L'Oreal	L'Oreal was taken by surprise at the level of scepticism over its acquisition of The Body Shop earlier this year and it appears that the company is integrating some of the leading corporate responsibility practices of The Body Shop into its own operations. It has instigated a supply chain management programme (though we have encouraged the company to provide quantitative data to demonstrate the effectiveness of this programme) and has acquired a synthetic skin company to reduce the necessity for animal testing. These are good signs that the company is beginning to more thoroughly address stakeholder concerns.
Consumer Services	
Food & Drug Retailers	
J Sainsburys	We met with the company twice this quarter, once with dedicated representatives from the Corporate Responsibility team and the second time with the CEO. Like Tesco, the company has put in place a more formal approach to corporate responsibility which should co-ordinate the existing approach and improves the reputational value of the company. There is a clear strategic drive to improve corporate performance and we have suggested that the company could underline evidence of success in this by providing quantifiable data on customer satisfaction, environmental performance and human capital management.
Tesco Q2 & Q4	We met with the company on a couple of occasions during the year. The first was for the company to provide details on its new Community Plan, which has formally placed sustainability concerns into the business strategy. We were concerned that this was only being done in the UK but has subsequently been reassured that it will be rolled out to its global operations. In 2005 we pressured the company to develop a globally applicable CSR plan and implement KPI targets, we were reassured that the new community action plan is being rolled out on a global basis and that corporate responsibility and KPI targets would be set on a global level over the course of 2006 in response to shareholder concerns. We also met the company to review its annual CR performance we again re-iterated the need to ensure that the community programmes would be rolled out to its global operations which the company has said it will do, we also expressed our concern that human capital management disclosure has deteriorated over the year and we have asked the company to address this.
Food & Drug Retailers	
Boots	We visited Boots Head Office to review its approach to corporate responsibility. During the day we met the Head of CSR, as well as several sustainable development managers for different aspects of the business. As Boots points out the vast majority of its products are either ingested or placed on the skin and hence its customers place a large amount of trust in them which can be eroded through poor performance or a bad

Company	Engagement Activity
	reputation. During the day we discussed the EU chemicals directive REACH and the impacts this will have on increasing animal testing (Boots has a policy not to test on animals and uses generic chemicals [not required to be tested on animals] or materials tested 10-20 years ago, in addition suppliers are audited on animal welfare). We also discussed the WEEE directive which has had a financial impact in Ireland, and we are likely to see similar impacts when the UK government implements it here. With regards to Boots' supply chain, it has audited its own-brand suppliers and some of its non-brands on H&S and environmental issues (this is a vital area as product recalls damage reputation and have a direct financial cost). It was good to see the company looking at how to communicate the message of sustainability to its customers and that it is including some corporate responsibility performance data in its financial presentations. We were unable to discuss human capital data on the day and have written to the company with our suggestions for increased disclosure on human capital performance and morale indicators.
Media	
Pearson	We met with the Director of People and the Director of Investor Relations for the company's first presentation to investors on it's CSR performance. The focus of the presentation was on the company's products, specifically it's education business and the role of technology in improving education around the world. The company hinted at ambitions for the developing world (India and China) but also demonstrated awareness of the needs of the developing world markets (e.g. it is looking at tools for increasing the speed of teacher training in South Africa where the number of teachers has been severely depleted by HIV). The level of the company's reporting on some of its operational data is impressive and we have encouraged it to improve disclosure on its human capital indicators, and provide greater clarity on how CSR governance fits into the overall governance. However the company clearly demonstrated its understanding of, and commitment to, CSR.
Travel & Leisure	
Easy Jet	Our financial analyst met with the CEO and the FD. The company supported efforts to include the aviation sector in the EU ETS as the most cost effective tool to account for the GHG emissions of the sector, though it did not see this happening until post 2010. Since the meeting the UK Government announced an increase in Air Passenger Duty as a ‘green’ tax on the sector and the EC announced a proposal for including the aviation sector in the EU ETS in 2011. It is too early to integrate the impact of EU ETS inclusion into current company valuations.
First Choice	We met with the Finance Director of First Choice to hear the company's views on the potential impacts of avian flu on its business and the company's response. In comparison to its competitors First choice has performed well over a difficult last five years for the leisure and tourism industry (e.g. 01/02 - World Trade centre attacks; 02/03 SARS & Iraq invasion; 03/04 African embassy bombs; 04/05 - Tsunami, increased global terrorism and increased hurricane activity). The flexible business model that First Choice adopted five years ago has delivered profits for the company whilst many of its competitors faced severe financial difficulties (and are now adopting similar models). The company wasn't able to say much about its response to the potential pandemic (the World Health Organisation say it is a matter of when not if, but cannot indicate when 'when' maybe or how severe the human version of the virus will be) save that there has already been board level discussions on the issue, continuity plans have been reviewed and (as is peculiar to First choice) an assessment of the staff impacts has been made.
Firstgroup	The company is facing a shareholder resolution asking them to implement a company wide human rights policy which would ensure that the company is in compliance with the International Labour Organisations Declaration on Fundamental Principles and Rights at Work; that the company prepare an annual report on this issue and that all expenses for the resolution are born by the company. We met with the CEO, the Company Secretary and the company's legal counsel to discuss the resolution and the company’s response. The company already produces a sustainability report and is rated highly with regards to its corporate responsibility performance, but there is no explicit mention of supporting workers rights to collective bargaining and freedom of association which is the thrust of this resolution. The company gave assurances and examples that it supported these rights of employees but acknowledged that it could do more to explicitly state so and would revise its code of ethics in the future. Given that the company already has a suitable code of ethics and equal opportunities policy, and that the employee handbook refers to employees’ rights to freedom of association and collective bargaining, and assurances from the company that they would amend their code of ethics in the near future we did not vote against management on this resolution.
Financials	
Banks	
Barclays	Barclays is seeking to improve its CSR position and has recently recruited a senior commercial manager to improve the profile of CSR within the company. This is a positive sign for future CSR performance; there is already evidence of greater leadership, a merging of CSR and business strategy and a recognition of different business segment responsibility, which was absent in previous years. There is also a new Code of Conduct emerging this year, and a number of non financial indicators for all business segments to report against. The report needs to focus on developing greater consistency in reporting against indicators, particularly in areas of customer service, human capital and environmental lending. Despite this, the report expressed a clearer and more focussed message of what CSR means to Barclays than it ever has previously and disclosure had, overall, improved on last year.

Company	Engagement Activity
Credit Suisse	Credit Suisse has concentrated its CSR priorities on the Equator Principles and micro finance. It has launched the first microfinance fund in Switzerland, which it believes spearheads sustainable finance opportunities in the sector. The bank also has a significant project finance division and reports on the number of projects accepted by value and category under the Equator Principles. The number and value of SRI asset management products also continues to grow. There was limited disclosure on employee survey data, customer behaviour and money laundering, which are also felt to be important concerns for the company. Concerns over historical events of fraud in the investment business practice were also raised but limited information offered.
HBOS	We met with IR and the Head of CSR to discuss the impact of ongoing public enquiries into banking charges; personal protection insurance; the transparency of financial literature and levels of unsecured debt. HBOS is leading the sector in promoting clear literature. It predicts that unsecured debt levels will peak at the end of 2006. The industry's average loan to value is 61% and HBOS's average is just over 43%. In addition, as much as 93% of their loan book is secured lending. HBOS therefore has a relatively low exposure to default risk from unsecured lending in the UK. HBOS continues to demonstrate responsible lending practice within the banking sector.
HSBC	The Environmental Adviser to HSBC (accompanied by the IR Manager) gave a presentation on developments within HSBC this year. HSBC has recently re-structured internal systems to accommodate three new sustainable development teams focussing on risks, opportunities and HSE. The focus of the presentation was primarily on microfinance and climate change, which are very non-material issues to the business. We would have preferred to hear HSBC also present on more relevant issues such as customer quality, employee satisfaction, money laundering and consistency of group standards. One area of commitment and strength continues to be the integration of environmental lending criteria in certain project financing and corporate financing decisions.
Standard Chartered	This meeting focussed specifically on their sustainable banking initiatives and expansion into East Asian and African markets. The company claims that its reputation and high standards in these markets is drawing a pool of high quality talent, of all ages and experience into the company, mainly people of local nationalities in countries of operation and people with international experience. Together these qualities ensure a competitive advantage in client relationship management. Group policies and processes for assessing the environmental risks of lending are more clearly defined than in previous years but the impression is still that there is a great deal of responsibility left to the relationship manager to make decisions and, despite having one of the most advanced systems in this area, only a small percentage of the loan portfolio is assessed for SEE risk. Micro Finance is a growing area but accounts for less than 5% of revenue. Much of this micro level finance is implemented through arrangements with other local companies.
UBS	UBS is a leading international wealth management and asset management business with a strong presence in investment banking. Figures for 2005 show improvement in their environmental management systems including reduced resource consumption since 2003. Employee training in environmental awareness continues to grow, as do SRI invested assets (now 1.93% of total invested assets). Improvements on last year included the reporting of employee data including diversity and survey data which included information that 70%+ employees were satisfied with their work situation. The company needs to develop a more coherent and clear CSR strategy at senior management level, including objectives and non financial performance. There is too limited reporting on customer behaviour, including customer retention and satisfaction.
Life Insurance	
Non-life Insurance	
Munich Re	We attended a presentation by the Head of Geo Risk Research on Munich Re's response to climate change. In order to ascertain the potential impact of climate change on their business they are modelling and monitoring natural events and disasters to estimate the probability of their occurrence, company exposure and cost to the company. The resulting figure depends on many variables associated with a natural event such as whether there is inland flooding, theft and looting, arson, contamination, claims inflation, demand surges for claims, repair-cost-delay inflation and coverage erosion. Options for mitigating the impact of climate change on the business include adjusting risk models to changing hazard situation, improved accumulation of exposure figures in portfolios, improved claims handlings (loss adjustment), introduction of liability limits and deductibles, exclusion of particularly exposed areas and reinsurance. Munich Re is regarded as a sector leader in the evaluation of climate change impacts
Swiss Re	Swiss Re has established a Sustainability and Emerging Risk Management Committee, which sits within their Risk Management division and deals with all emerging sustainability risks across the group. A company wide SONAR database system uses four stages of risk identification, assessment, evaluation and implementation (where underwriting can exclude certain risks or encourage the development of new products to reflect them). Currently Swiss Re is focussed on mitigating risk against electromagnetic radiation, genetically modified organisms, Toxic Mold and vCJD. Risk taking through new product design is focussed on Insurance Linked Securities, Weather Derivatives and GHG. Swiss Re also engages in a level of proactive dialogue on emerging risk issues, in order to raise awareness of risks with their clients and the wider public. Group Revenues were down in 2005 approximately CHF2.5-3bn due to increased hurricane activity. In terms of their reporting it would be useful to see more indicators on human capital management, such as turnover, employee survey data both current and historical.

Company	Engagement Activity
Zurich Financial Services	We engaged with the Head of IR, the legal Officer and the Global Chief Risk Engineering Officer. The company is clearly still getting to grips with what CSR means to Zurich and they have set up a Corporate Citizenship Council to guide this process. Zurich is mid-way through a program of cultural change which is requiring considerable re-training, a change of mindset and value recognition from all employees. However, to date they have not attempted to monitor the benefits or return from this, now, two year program. Additionally, they have developed some specialist taskforces to consider future social, environmental and ethical risks over the forthcoming 1-5 years. The company has at least six products which offer some degree of environmental liability protection. No information has been provided on what percentage of the product portfolio this constitutes and what value this generates to the business, but it is thought to be very small.
Real Estate	
British Land	We met with the corporate responsibility manager to discuss British Lands' CSR strategy over the next few years. The company has been active over the last year and has developed waste management and biodiversity management processes, to be implemented at those few sites which it has management influence over. Real estate management is normally the responsibility of tenants and influence over the practice of their tenants is currently limited, but they are looking at ways to improve this, eg. contractual relationships with waste suppliers. Significantly, they have also written a Sustainability Brief, which outlines a full management process by which site developments can achieve sustainability in development, design and construction, upon acquisition. Qualification with BREEAM is used to support this definition of sustainability. In terms of in-house CSR, the company is building a CSR management system, summarised in a book called the CSR Handbook. Currently there is no Group level HCM or HSE department and no group level information available on this, which indicates a lack of formal structure for these important issues.
Land Securities	Land Securities is the largest holder of UK quoted property (owning 21% of market) and the largest quoted commercial property company in Europe. Land Securities believes it demonstrates a leading position in the sustainable construction sector. New properties are designed and built for the long-term investment of their portfolio and are designed with the future regulatory environment in mind All buildings must meet 'very good' and 'good' environmental and social standards (under BREEAM) as part of standard operating procedure and must anticipate new government regulations, which requires an estimated 10% improvement in current energy efficiency levels in their new commercial buildings. Land Securities believes other companies may well need to find 30% more efficiency in their new properties, so they believe they have a competitive advantage. They claim to be the largest procurer of renewable energy in the UK and are considering identifying the carbon footprint of all portfolio assets. In the future they see a market their eco-efficient approach; especially for large companies wanting to keep costs down and maintain a reputation in this area. These buildings may achieve premium prices. Land Securities believes its CSR commitments have ensured a good social licence for operation; attracted and retained talent and ensured competitive bids.
Slough Estates	Slough has reduced all its facility management responsibilities to approximately 0.01% of its portfolio and therefore has little incentive to invest in the EHS management of its portfolio. The only site responsibilities it continues to hold are certain estate management responsibilities, which are also delegated to tenants as far as possible. Slough was frank about having very limited authority or ability to enforce environmental standards on its tenants. The company carries out an annual HSE audit on sites used by tenants. Occasionally tenants don't dispose of hazardous waste appropriately and then Slough will negotiate with the tenant, informing the Environment Agency as a last resort if the tenant refuses to cooperate. Interests in eco-efficiency standards are evident among the largest businesses (20% of tenants). Slough is experimenting with on site windmills (and other decentralised energy sources) with an expected 6 year payback period. Whether these would be allowed to pay tenant bills or pay's Slough's bills for estate management is under discussion.
Health Care	
Pharmaceuticals & Biotechnology	
As part of a sector report, policies and positioning on product safety, product innovation, patent expiry, clinical trials and marketing ethics were discussed with all of the following companies.	
Astrazeneca	Astra Zeneca is experiencing some troubles from generic challenges to its key products and that it has also experienced difficulty with the FDA, which has black boxed[3] classes of drugs, a few of which have been Astrazeneca's leading product classes. Whilst group sales, overall, were not affected, FDA criticism on one product did result in the share price being suppressed taking a year to return to pre-criticism levels. Astra Zeneca appears more vulnerable to these issues than some its peers. The company has responded to concern by building an independent website on clinical trials to ensure information is fully available on negative side effects. They have reasonable internal governance standards and can point to programs which audit marketing standards against internal codes of conduct. Breaches of these standards are recorded.

[3] Blackboxing occurs in the US when there is an adverse event in the chemical trials of a product leading to restrictions in the marketing of that product in the US by the Food and Drugs Agency (FDA).

Company	Engagement Activity
GlaxSmithKline Q1 & Q2	GSK has a unique system of reward for its R&D staff, which is focussed in different 'Centres of Excellence' by therapeutic area. Innovation in these centres is encouraged through flexible remuneration policies which reward high productivity and are believed to explain the high number of compounds in their product pipeline over other companies in the sector. GSK also focus on 'extended patents' and 'controlled release' technology as a way of renewing patents and extending product shelf life. GSK has experienced a rise in the number of black boxing of its products, Advair has been blackboxed, but this has not significantly impacted sales. Trials costs are increasing above average industry cost increases. No trials are conducted in countries where the company has no intention of launching a product. GSK has relatively strong and transparent internal ethical policies on the conduct of its sales representatives. It donates over 5% of its tax before profit to charity, including access to medicine programs. Separately, we also visited GSK's vaccine production plant in Belgium. GSK has 25 vaccines currently available, including vaccines for malaria, polio, rubella and 20 more in clinical development. The vaccines to some less developing areas are priced to exclude the costs of manufacturing, research and development but not sales and distribution. Forthcoming vaccines include Rotarix (diarrohea) and Cervarix (cervical cancer).
Novartis	Novartis has increased the number of its staff in R&D in recent years by 1000+. It has particularly focussed recruitment on the academic sector, seeking high quality research staff to motivate and add new innovation to the R&D team. R&D costs have risen due to the increased complexity of trials and Novartis is responding through a specific programme to consolidate the research pipeline, designed to cut costs, whilst improving clear trial design and product safety. Product launch delays are increasing due to more diligent FSA practices. Potential reputation damage to the industry is also a concern, with increasing black boxes and in one instance where negative effects of a drug were leaked to the media before the FDA had made a decision on the safety of the drug, leaving a stigma which was hard to remove and damaged sales. The company has ensured a tough approach to its patenting in recent years and this has protected drugs from loss of patent to generic companies. The company's main access to medicine donation is through its malaria product which it offers at cost price. This product is insignificant to the business from a commercial perspective but treats hundreds of thousands of malaria patients annually.
Novo Nordisk	We met with Investor Relations to discuss various CSR issues. The company has a very specialist target market for diabetes. They have a new business ethics code which provides strong guidance on ethical conduct, particularly with product promotion. The code is mandatory to all employees. However, the transparency of their internal systems for measuring and monitoring compliance with external international standards and internal standards could be improved. The structure of CSR governance systems was unclear in this respect. In terms of product safety, the company has a clean track record with the public and regulatory authorities with its current major products, with the exception of hormone replacement therapy and concern over breast cancer implications. There are 37 lawsuits pending the in US in this respect, which are not deemed to be financially significant. Generic competition has not been an issue. The company is improving its disclosure on clinical trial information and submits information to two public databases. It's also constructing its own online clinical trial database.
Roche Q1 & Q2	Roche has a clear CSR Core Team structure complimented by expert teams in specialised topics such as animal welfare, bio warfare and risk assessment, and where Roche has identified industry risks and reputation concerns. The company does not donate drugs but works closely with committed governments to supply drugs via NGO's, particularly with respect to HIV, thus ensuring they reach the customer. They have set up a comprehensive clinical trial database with an independent host, for phase II, III and IV trials. Roche has a relatively clean record in terms of product safety. The only recent concern has been with Avastin (colon cancer drug) and an adverse side effect in trials. Otherwise no major products have had serious side effects except Roaccutane (Acne drug), which was black boxed. Sales were unaffected as there is no alternative prescription available. The company has no product liability provisions and has a positive attitude towards black boxing, because they see it as a way of ensuring safe consumption of their drug and of protecting the brand. They market products directly to physicians. The speciality of their drugs makes them a relatively difficult target for generics and they have received lower than expected patent challenges. Overall the company is relatively less exposed to SEE risks than its competitors.
Sanofi Aventis	Generic challenges are a very real threat to Sanofi. It is experiencing generic challenges to two of its key products, Plavix and Lovenox. The company has already lost a generic challenge to the key product Allegra, which damaged returns in the US and impacted share price. Its strategy is to combat this through more innovation, by owning a small generics company in Europe and generic partnership in America. It also has a 35% sales base in 'old' products, which it continues to produce to optimise economies of scale in manufacturing and because there remains a substantial market for some of these products. 2006 saw the controversial launch of Accomplia (an obesity drug) along with suspicions that negative side effects to this drug are being withheld and ongoing moral questions about whether obesity should be treated as a disease. Their internal HSE systems appear to be some of the best in the industry. They have an insurance policy to cover product liabilities. They expect R&D costs to increase by 6% this year. This is due to an increase of 3000 staff in R&D and in part some increased clinical trial costs.

Company	Engagement Activity
Syngenta	We met with Syngenta to discuss the environmental impacts of modern agricultural products, including biotechnology. The company identifies the environmental impacts of monoculture, falling soil fertility and structure, reduced biodiversity, human rights and safety issues in developing countries as reputation risks but has not yet developed a approach to managing them. Support for sustainable farming practices and education and training initiatives conducted to educate small farmers on produce use in developing countries are mainly philanthropic, rather than part of standard operating practice. Their business in biotechnology (accounting for 6% of their revenue generation) is still small, and greatly thwarted in Europe by unfavourable public perception. They do not seem keen to engage in dialogue with the public to improve this perception, which is proving detrimental to the company's future GMO strategy. We would encourage the company to be more open and engage in dialogue on these risks, with a view to managing them rather than simply discrediting them.
UK Shire	In recent years Shire has experienced heightened public concern for some of its products which are being prepared for launch, increased FDA scrutiny and delays in product launch as the FDA is taking longer to process drugs and is increasingly placing them in black boxes. The company's primary product range (Adderall) has been black boxed. Nonetheless the company does not feel that this has or will diminish product sales due to Adderall's specialist market niche and its long standing relationships with physicians who have seen the results this drug produces. The company is, however, paying increased attention to the conduct of clinical trials to ensure product delays and black boxing is minimised. Patent challenges are also increasing - again Adderall is facing a number of patent challenges. None have been successful to date. The legal costs of these trials are increasing but provisions are allocated for this. The company does not operate 'access to medicine' policies on its products as they are very specialist and primarily aimed at addressing 'western diseases', but it has waved the royalites on an HIV drug licensed and produced by GSK in South Africa.
Industrials	
Aerospace & Defence	
We attended a sector conference at which **Rolls Royce**, **Smiths**, **Meggitt**, **Cobham** and **BAE** were presenting. This was the second year running we have attended this conference and it continued to provide a useful insight into the strategic risks facing this industry. Issues raised included government relations and political risk and research and development into improved energy efficiency in products.	
BAE Systems	BAE demonstrates some evidence of improvement on last year's CSR report. The company has instigated a CSR board level committee which monitors and assesses SEE risk on a strategic level. This is complemented by a CSR forum and CSR team which aim to translate and implement these SEE risks at an operational level. BAE is in the process of developing CSR action plans for each business segment. KPI's are not developed but the company CEO has, for the first time, issued six non financial commitments which are being translated down the company. These cover the implementation and monitoring of ethics codes, HSE targets and HR recruitment. Reporting on human capital indicators is still very weak, apparently due to a lack of consensus on methodologies and how to calculate this information. HSE costs are estimated to be around 2% of overall operating costs in total. Their HSE systems are well reported but annual emissions or consumption are not significantly different from previous years, with the exception of waste. Performance could be improved here..
Construction & Materials	
Barratt Developments	The CEO of Barratt Developments presented his views on the problems around constraints in housing supply and associated concerns with the town planning regulation. He believes that housing supply is very constrained by the complexity and delays arising from the current planning application process. Councillors are not heeding local plans or planning officers in their attempts to be politically correct in the public consultation processes. This raises the issue of why public consultation is perceived to be so important, which it was suggested might be a result of a lack of public sympathy to the needs of the industry and growing NIMBY'ism, especially in rural areas. The pricing of houses is creating ever greater concerns for those on lower income salaries and first time buyers. Barratt Developments is designing 800 new eco-homes to test the cost/benefit ratio of implementing new and different combinations of eco-efficient technology and customer demand to these new home types. The company also continues to grow its urban regeneration and affordable housing projects.
Holcim	This meeting focussed on the impacts of climate change on the business, its response, and the high levels of fatalities within its operations. The cement industry is responsible for producing 5% of global CO_2 emissions, and with predictions of growth in cement demand between 40-50% by 2050 the industry would need to reduce emissions by 30-40% of CO_2 per unit produced by 2050 to meet its Kyoto targets. Holcim has a 20% reduction target by 2010 and acknowledged that to achieve higher reduction levels is beyond business as usual and would require regulatory involvement. 23 of the company's 135 cement plants are within the EU and hence affected by the Emissions Trading Scheme (ETS). With regards to the second phase of the EU ETS Holcim has been lobbying the EU to allocate allowances in a more equitable fashion (using benchmarking) which will benefit its operations in Italy and Spain. The company was clearly able to demonstrate the integration of a carbon reduction strategy into its operations, but the sector as a whole will face challenges in reducing emissions levels with soaring demand for cement. With regards to heath and safety we have suggested the company provide information on performance in comparison to the sector (as the sector is notoriously bad) and to provide data on expenditure (in time and money) on health and safety training. The company noted our recommendations, and was keen to stress the focus on improving H&S has been upped over the last three years and the targets it has set are suitably challenging.

Company	Engagement Activity
Wimpey (George)	The Deputy CEO of Wimpey presented its long term business strategy, market drivers and the impact of increasing environmental regulation on the company and its cost base. Two of its key medium term challenges are to increase the level of leadership and the product design skills in staff, allowing greater competitive advantage to be gained from product design and multiple planning use. This will be achieved in part by an increase in graduate recruitment and investment in product training for staff over the next two years. Wimpey also confirmed that build costs have risen steadily over the last 5 years, in part due to supply constraints on skilled operational labour but also due to government regulation, which is starting to have a real financial impact. The implementation of the recent Building Regulations, brought in this year, 2 years ahead of schedule, is estimated to be adding an additional cost of £800 per dwelling across the industry. Through operational efficiencies, Wimpey believes it can reduce this to £600 per dwelling. Planned revisions of building regulations 2010-2020 are likely to lead to increase costs in the future as is the imminent Voluntary Code on Sustainable Homes. Wimpey believes if regulations become more stringent, the company (and industry as a whole) will have to embrace a significant step change in technology and costs.
Electronic & Electrical Equipment	
Royal Philips	We met with the Head of Investor relations and the Senior Vice President of Sustainability. This was the first time that we had met the company and it was very impressive to hear about the initiatives that the company was implementing both in the developed and the developing world. The company has put in place an ecodesign principle since 1994 which has meant that it has not been as exposed to EU Electrical equipment legislation as some of its competitors and it has gained competitive advantage over some of its competitors. Philips is developing technologies specifically for dealing with developing world issues, and whilst these are yet to be revenue earners the experience that the company gains in developing its emerging markets business models will serve it well as these markets develop. We took the opportunity to question the company about its Human Capital Indicators (the company is currently measuring staff turnover, but is unsure whether to disclose this because it could be commercially competitive information), however the rest of the information provided by the company does go some way to demonstrating how it values and aims to develop its human capital. We also questioned the company about its supply chain, as it is decreasing the number of the suppliers (which is increasing cross business efficiencies and delivering cost savings) and it is increasing its local sourcing capacity. The company is aware of potential reputational issues within the supply chain and has systems in place to manage these, though this is an area to watch in the future as the company expands its developing market operations.
Support Services	
Capita	Capita produced an annual report this year due to increasing client interest in Capita's CSR policies and programs. Tenders from both the public and private sector in the last two years have started to require information on environmental management systems, supplier procurement policy and community donation policies. Capita intends to spend 2007 developing a central reporting function for human capital indicators and customer service quality and implementing its supplier procurement program. This meeting identified that Capita is beginning to realise a business case for CSR and we look forward to seeing how this develops.
Oil & Gas	
Oil & Gas Producers	
BG	We met with the management of BG, including their Head of Environment, Head of CSR, a member of IR and their Head of Operations in the Middle East. The company is demonstrating renewed investment interest in CO_2 reduction technologies but has not yet assessed the viability of different assets and their potential to achieve reductions. The CO_2 production of BG is governed greatly by its portfolio mix which is likely to offset any gains made through reduction emissions in future years. This is a problem they have not resolved- how to reduce absolute CO_2 emission levels whilst maintaining growth.
BP : Q1, Q2, Q3 & Q4	We have attended several meetings during the year to monitor BP's HSE policy and process changes since Texas City and the Alaska incidents. These incidents have negatively impacted both the company's reputation and share price, eroding BP's share premium, based on the quality of its management. In light of investigations into the cause of these incidents, there have been some fundamental changes at BP including the increased centralisation of HSE responsibilities with a new Group VP of Health Safety heading up a team of 7 experts in HSE and a revised, more stringent and prescriptive HSE operating system across the Group. This system, combined with other programs, places renewed emphasis on ensuring upkeep of plant integrity, more precise regulatory compliance, greater attention to process safety, accountability and clarity of job roles and group centralised HSE auditing. BP has acknowledged that Texas is not the only American refinery needing investment in HSE operations and processes, American health and safety authorities have reported concerns in other refineries. However, BP has now developed far more robust and enforceable group HSE systems than prior to Texas City. We hope this will prioritise and elevate HSE standards within the group at all levels of management. Nonetheless, we recognise a significant cultural change is required at BP, which may require more investment yet, and which will take time to fully evolve.

Company	Engagement Activity
Shell Transport and Trading Q1 & Q4	This meeting with Shell's Corporate Affairs Director and Head of IR, showed renewed drive and prioritisation of CSR within Shell. Standards in HSE are showing steady improvement from a reasonable level. The governance structure now includes a Sustainable Development Group (chaired by the CEO) and an HSE Committee as well as an independent, external, CSR advisory committee which is now taking an active role in project negotiations to improve stakeholder relations. The results of this advisory committee were very positive in Corrib and we hope the committee will continue to rescue projects from stakeholder conflict, and delays, in 2007. Meanwhile Shell's joint venture in the Shell Petroleum Development Corporation (SPDC) in Nigeria continues to create media reports of oil spills, worsening group relations and destruction to the local environment. Shell also continues to be under the scrutiny of the public and financial community with respect to Sakhalin; this year Shell was accused of has failing to comply with all aspects of the Equator Principles and was forced to upgrade river crossings, oil spill responses and dredging waste disposal to conform to required standards.
Oil & Gas Producers	
Wood Group	Our Financial analyst used their meeting with company management to discuss the issue of human capital (as well as other topics), this is a further indication of the integration of Environmental, Social and governance issues into financial analysis. Wood Group states that its biggest asset is its people and in the current scramble for experience and expertise, WG could be rich pickings for some of its bigger rivals. Management admitted that 60% of their time is currently spent on 'people' issues (recruitment, training, long term incentive schemes etc). Average wage rates at WG have already increased 3-4% above inflation and they are experiencing higher turnover of staff. That said, they continue to organically attract more staff (up 2,500 in 05) and continue to look at new countries (India, Romania, China) to build up its engineering and project management talent pool. We were left feeling that WG isn't under disproportionate pressure with regard to its human resources compared to peers.
Technology	
Software & Computer Services	
Technology Hardware & Equipment	
Ericsson	We met the Director of Corporate Responsibility and the Head of IR who provided an overview of the companies approach to corporate responsibility. The company has been developing the energy efficiency of its products; the majority of the life cycle impact of its products comes during the operating life (it has been carrying out life cycle analysis for 10 years), and is beginning to look at zero emissions products though this is still a new model. It has also been developing a Global Ecology Management system since 2002 which has looked at the issue of product take-back and meant that Ericsson was in a strong position to comply with the EU WEEE directive, and has established take-back initiatives in 20 other countries. The company is also developing its emerging market models where there are strong arguments for the benefits of mobile telephony and economic development. We questioned the company on the lack of Health and safety information, and were told that there would be improved disclosure in this year's report and the establishment of a global policy, we also questioned the company on its diversity policy and were again advised that this was on the agenda for 2006 (policy development and implementation). The company clearly has a strong commitment to sustainable development and was able to demonstrate the business rationale for this.
Telecommunications	
Fixed Line Telecommunications	
Deutsche Telekom	We met with the Head of Corporate Responsibility and Citizenship and the Vice President of Investor Relations. It was the first time that we had met with the company and was a useful introduction to its approach to corporate responsibility. It is clear that the company has an understanding of corporate responsibility, but it was not clear how it is developing a strategic response to implementing a corporate responsibility strategy.
Telecom Italia	We met with the CFO, the Group Sustainability Director and an Investor relations Manager. This was the second time we have met with the company, and it was an opportunity to see how the company has developed its CSR performance from the solid base it presented on last year. One of the key areas of interests from last year's presentation was the efforts the company was making to link non-financial issues to financial performance, they have subsequently conducted an analysis of the S&P 500 which served to demonstrate that there is a link between corporate responsibility and financial performance. The next stage of the project (to be completed by the end of 2006) is to analyse two specific issues (in this instance human capital and innovation) and their linkage to financial performance. It is encouraging to see companies exploring concepts of corporate responsibility so robustly. The company had still not developed a global reporting structure and we have encouraged them to do so in order to demonstrate that management is aligned throughout their operations. They have developed qualitative targets for the group, but are still in the process of developing quantitative ones, and these are likely to be disclosed at the end of the year. It is very encouraging to see the company clearly able to demonstrate its efforts to link sustainability into it's business process and it will be interesting to see the results of the company's efforts to link its non-financial performance with financial performance.
Mobile Telecommunications	
Vodafone	We met the company on two occasions this year. We congratulated the company on its efforts to decouple CO_2 emissions from business growth, though we noted that they were still increasing and asked the company

Company	Engagement Activity
	about the challenge of meeting absolute reduction targets (which the science states is need to minimise climate change impacts) as opposed to a relative one. Vodafone did not think this was possible whilst shareholders still want the company to grow. We again iterated that we would like to see more human capital indicators disclosed to improve our understanding of how the company is managing its employees (we acknowledged that disclosure had improved since last year and this had gone some way to address our suggestion for change in 2004). Vodafone continues to demonstrate good practice with regards to corporate responsibility, though its human capital management data, whilst improving, still lags the rest of its data.
Utilities	
Electricity	
British Energy	The company has a very good approach to CR, which is driven by the concerns over nuclear fuel. The company faces two key challenges to its long term future, one is a suitable disposal of nuclear waste and the other is the future of nuclear power as a source of electricity. Both face strong opposition and the company makes it clear that decisions on these two issues are in the hands of the politicians as opposed to financial decision makers, as political decisions would be able to create the right environment for both to be feasible. We also discussed extra efforts the company could make in working with its consumers in order to improve their energy efficiency which would help to support the company's arguments that it is committed to combating climate change and nuclear power is one solution in meeting future low-C energy generation demands.
Drax	We attended a conference at which the CEO of Drax was presenting on the impact of Carbon Pricing to the business. As coal (a high carbon fuel) is the primary fuel for the power station, Drax is significantly exposed to the carbon market. The company is adopting technologies to decrease carbon emissions, but without political clarity (or Phase III of the Kyoto protocol, post-2012), the company lacks visibility to make longer-term cap-ex decisions which could improve its competitiveness with gas or oil fired power stations.
Gas, Water & Multiutilities	
AWG	We visited AWG's wastewater treatment plant, as well as having a presentation by the Director of Corporate Services, the Director of Corporate Communications and of Corporate Responsibility as well as site engineers. It was very clear from the site visit that regulatory demands for improving the waste water treatment process increase the energy demand of the plant at a time when energy prices are increasing due to the introduction of the emissions trading scheme. Therefore the focus is on decreasing energy use whilst simultaneously increasing the efficiency of the process (the site has recently installed a combined heat and power plant run on gas generated by waste sludge). In addition the company is tasked with reducing water leakage through its systems and reducing water usage (which, though counter-intuitive, the company was able to demonstrate was in its interests as it increases the availability of water and delays investment requirements). What is clear is that the company has long term aspirations in place but is hampered in implementing them by OFWAT requirements. We have encouraged the company to provide more data on its long term climate change targets, and to increase disclosure on health and safety and human capital.
Centrica	We met with several representatives of the company, including the Head of the Environment, Director of Corporate Reputation and the Director of Energy Efficiency and Social Responsibility. The company demonstrates a very good strategy for decreasing its carbon footprint by diversifying the energy mix within its portfolio; however this would be complemented by an increased focus on improving energy efficiency with its clients. Customer satisfaction has decreased but the company has provided assurance that this is due to software changes and is a one off. Overall though the company maintains its high standards of corporate responsibility.
RWE	We met with the Environmental Planning manager and two representatives from Investor Relations. As one of the biggest CO_2 emitters in Europe, the price of carbon has a significant impact on corporate strategy and RWE has developed a suitably diverse strategy to meet this challenge through the use of renewable energy, carbon capture and storage, energy efficiency, carbon permit trading and the recent announcement of the development of a CO_2-free power plant. As with other companies in this sector, RWE also highlighted the frustration with a lack of political guidance on future climate change strategies.
Veolia Environnement	The group's operations are very integrated into the challenges of sustainable development (energy, water, public transport and waste management). Experience in water scarce regions and water polluted areas will provide the company with valuable expertise for future freshwater challenges whilst the other parts of the business provide significant opportunities in an increasingly carbon constrained world. The company also has excellent corporate responsibility transparency, with its human capital management disclosure representing market best practice.

Section 5
Sector Reports

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

A SEE Assessment of the Pan-European Pharmaceuticals Sector

This report investigates environmental, social and ethical market risks and opportunities in the Pan-European Pharmaceutical Sector. Specifically, it reviews the nature and scope of these risks and opportunities and the extent to which pharmaceutical companies are exposed to, and impacted by, them. Companies reviewed in this report include the European majors: Roche, Novartis, SanofiAventis, GlaxoSmithKline and AstraZeneca, and three other European players: Novo Nordisk, Schwarz Pharmaceuticals and Shire Pharmaceuticals.

Social, ethical and environmental (SEE) risks and opportunities to an industry result from changing legislation, government policy and public opinion among other factors. They may have short-term and/or long-term commercial significance and may influence the whole industry or one specific company within the industry. This report identifies seven areas of SEE risk and one area of SEE opportunity in the pharmaceutical sector. These eight SEE factors include product innovation, product safety, generic competition, ethical standards in clinical trials, ethical standards in sales and marketing, the pricing of drugs and access to medicine programs, environmental, health and safety standards and biotechnology investment. Our assessment uses a number of specific indicators to measure each company's performance and to ascertain which company has high or low exposure to each SEE factor.

The results of this analysis find that those companies most exposed to SEE risks are those with a track record of fines from regulatory authorities, those who have been exposed to adverse media publicity, are highly exposed to generic competition and show relatively weaker capabilities in research and development, at this time. The results have been ascertained from 14 different indicators and scores have been allocated to companies on a high or low risk basis. Those with a high risk have been given one point, relatively to those with low risk or have been given no point at all. Companies with the greatest number of points on a scale of 0-14 and therefore those most at risk are GSK and Astra Zeneca who scored 10 and 9 out of 14 respectively. These were followed by Sanofi (8), Shire Pharmaceuticals (7), Roche (5), Novartis (5), Schwartz (5) and Novo Nordisk (3). In the case of Novo Nordisk and Schwartz, company performance has been very socially responsible and these companies have a very 'clean' track record.

We conclude from this study that all the European Pharmaceutical companies could improve upon their 'social licence' to operate by more carefully managing their exposure to the mentioned SEE risks, including ensuring the highest levels of productivity are sustained in research and development, that product safety is an absolute priority, and that product patents are sufficiently strong, partially through their inherent innovative qualities. In addition, operating standards in clinical trials and sales and marketing should be strictly adhered to and monitored. Companies demonstrating reasonable standards in this area include Roche, Novartis, Schwartz and Novo Nordisk. We would recommend that other companies consider improving their performance in order to avoid further damage to their social licence. Clearly in the case of Astra Zeneca, this poor performance is beginning to impact the bottom line with noticeable changes to share price from adverse drug publicity and significant revenue losses from drug recall due to safety concerns. Companies must invest in their 'social licence' in order to avoid damaging their 'economic' licence to operate.

Section 6
Special Topics

Healthy workforce, Healthy Bottom Line

Due to the legal responsibilities of employers to their employees, health and safety has been one of the non-financial indicators which companies have measured, and have been able to provide quantitative information on, for a while. Research shows that it is now possible to quantify the effects of health and safety performance in financial terms, both on the macro (national) and micro (company) level.

In the UK somewhere between 35m and 176m (depending on which study is used) working days are lost each year through injury and ill health. This equates to between 2.1% and 4% of GDP when the indirect costs (e.g. loss of morale, reputation, performance) of absence are taken into account.

At the company level the UK Health and Safety Executive estimate that for every £1 of costs that a business can recover through insurance a further £8-£32 is lost through indirect costs or between 1.5% and 3.3% of the firm's payroll depending on the size of the company (tending to be higher in large companies) and the severity of the incident.

Given the ability to put a financial value to health and safety performance, companies with good health and safety management systems should be able to limit costs to business and hence to shareholders. It is possible to determine an absolute cost to the firm of poor health and safety performance as well as being able to demonstrate cost savings through improved health and safety performance. The materiality of which can only be demonstrated when put into the context of other financial indicators such as annual turnover, operating costs and profits or the added work or sales needed to cover the costs.

This paper looks at the economic costs attributed to health and safety performance, explores the possible components of a good health and safety system as well as providing a specific focus on stress (which is an increasingly common cause for absence within developed economies). It should be recognised that this document merely investigates the beginning of, what is, a large topic, and it is intended that this document will provide a backbone to further research into health and safety performance in different industrial sectors. It is not intended to focus on a specific region or country, but has tended to use UK biased information sources and it is recognised that different countries and cultures will exhibit different health and safety characteristics.

Climate Change: A Pan-European Sector Assessment of Risk and Opportunities

This briefing provides an overview of the key risks and opportunities presented by climate change to different industry sectors. It summarises the science of climate change and provides a brief history of the political response, highlighting key international, European and national regulatory frameworks and other emerging policies which are increasingly influencing the business operating environment. As a result, a number of sector specific and cross-sectoral market risks and opportunities are emerging and continuing to evolve. This paper draws attention to the different types of market risks and opportunities emerging at sector level and whether they have commercial significance or not.

Anthropogenic climate change refers to the impact of the changing composition of certain atmospheric gases called 'green-house gases' (GHG) in the earth's atmosphere on the average global temperature, as result of human activity. GHG include naturally occurring carbon dioxide (CO_2), methane, ozone and nitrous oxide among other types of gases. Scientific research shows that anthropogenic emissions of CO_2 (and other gases), are increasing the absorption of the sun's rays, enhancing the GHG effect, and raising the global average temperature. The scientific consensus is that in order to limit the global average temperature rise below 2^0C, world emissions of GHG's need to be stabilised within the next two decades with substantial reductions of at least 15% and maybe as much as 50% by 2050, compared to 1990 levels. The international political response to this challenge has been to introduce the Kyoto Protocol, which came into force in January 2005. It commits 38 nations, to cut their emissions of six GHG's by an average of 5.2% of 1990 levels between the commitment period 2008-2012. The European commitment to this is to reduce GHG emissions by 8%, based on 1990 levels, by 2012, using regulation and through the EU Emission Trading Scheme (EU ETS Directive 2003/87/EC). In addition, the UK government has made further commitments to a 20% reduction in CO_2 levels by 2010 and 60% by 2050 and has established a number of additional regulatory measures to achieve this.

This paper has reviewed the impact of climate change and these regulatory frameworks under the headings of regulation, physical, commercial and reputation impact and discovers a number of high level sector impacts and issues that are emerging. Our results indicate that the scope of these impacts is varied and most sectors are, to some extent, affected. The regulatory impact of the ETS is, however, relevant primarily to those registered under the scheme and it is not materially significant where carbon allocations are sufficient. Where they are not sufficient, however, companies must invest in carbon reduction programmes, which can be costly. An important side effect of the ETS, which has affected all sectors, has been a general rise in electricity prices, as the utilities have passed on the cost of carbon to the customer, creating windfall profits for the industry. This has materially affected the cement, industrial metals and chemicals sectors which are unable to pass on carbon and electricity cost increases to the customer. Stringent GHG regulations outside of the ETS are also creating cost implications for the automobile and oil sector. In reviewing the physical impacts of climate change, it is clear that it will affect all sectors to some degree, but those associated with agricultural production, such as the tobacco, pulp and paper and food production sectors are most vulnerable. Companies with a heavy reliance on water (eg. utilities, chemical) may also be affected and insurers are keen to forecast the future financial costs of more extreme weather events. Despite the potentially significant physical and regulatory concerns the implications for commercial profitability and product sales are fairly benign. The chemical, automobile and household goods sectors are beginning to develop more energy efficient product solutions. Consumer preferences for a more energy efficient product are beginning to account for a growing proportion of sales. Perhaps more influential at this time, is general stakeholder pressure on company reputation and brand. Increasingly companies are responding to this, for example, by setting voluntary carbon emission reduction targets and choosing renewable energy contracts. However, the regulatory response and physical impacts of climate change present the greatest challenge to business.

It is our view that the emergence of climate change and the EU carbon market which has monetised the 'cost' of carbon has created a number of market risks and opportunities. Companies cannot afford to be unaware of their carbon emissions and what these emissions mean to them financially. When assessing companies we will look to ascertain the risks and opportunities posed by climate change and their financial implications. This will include understanding the strategic and policy commitments made by a company to climate change, which should include quantifiable targets, and the resulting investment and management response supporting those commitments, as well as data on carbon emissions, carbon efficiency and carbon performance to date.

Climate Change developments

The end of 2006 has seen some key developments with regards to climate change. The Stern Review provided new impetus for international collaboration on climate change; the new Phase II EU Emission Trading Scheme (ETS) allocations provided guidance on national emission limits for the 2008-2012 period and the UK pre-budget report indicated the level of UK fiscal support for a response to climate change from January 2007 onwards. The following is a review of these developments.

Stern Review

- Schroders welcomed the Stern report and its focus on the economic impacts of, and response to, climate change.
- We agree with Stern's recognition that climate change presents a credible economic threat through its physical impact, the regulatory responses of governments and changing consumer demand.
- In stating that the cost of stabilising GHG (at levels of 500-550 parts per million CO_2-equivalent) will be around 1% of annual GDP up to 2050, Stern has used 2001 climatic data (which is subject to a degree of variance) which means the economic costs the Stern report has predicted vary, with the 1% value being the best estimate. We recognise that this figure is likely to be the most cited by the media and other sources, but note that the assumptions made by Stern and use of base data mean that this figure should be treated with caution.
- We agree with the report that a switch to a low Carbon economy will only occur with global political support, and that getting this support represents an intense diplomatic effort.
- This report is currently the most thorough and rigorous analysis of the potential costs and the risks of climate change and of the potential response to reduce our emissions. Whilst the uncertainties within the report will be debated, the clear thrust of this report is that the expected benefits of early action will outweigh the expected costs.

UK Pre Budget Report 2006

Despite the publication of the Stern review the pre-budget report did not indicate any significant change in levels of fiscal support for climate change. A doubling in air passenger duty with effect from February 2007 is justified on environmental grounds but the funds collected from this increase do not appear to be allocated for the purpose of climate change initiatives. There will also be an increase in road fuel duties, measures to support the development of biofuels and an ambition for all new homes to be carbon zero by 2016 (with stamp duty exemption possible for a period). There is no change to the climate change levy. Environmental groups have estimated that these costs will amount to 0.1% of GDP, significantly less then the 1% GDP expenditure recommended in the Stern review.

Comments on EU ETS

The EC announced in November its review of 10 countries' draft National Allocation Plans submissions for Phase II of the EU Emissions Trading Scheme. The EC authorises National Allocation Plans (NAPs) which detail the number of emissions permits that each country will be allocated under the EU's Kyoto commitment, any excess or shortage of permits with regards to individual NAP can be traded on the EU Emissions Trading scheme. Phase I saw the over allocation of permits to industry. Phase I NAPs covered around 2,180mT of Carbon though the actual emissions for 2005 were only 1,985mT causing the price of Carbon to drop by over 50% when the over allocation was recognised earlier this year.

For Phase II, 21 of 27 countries have submitted their draft NAPs to the EC, which cover around 2,160 mT of Carbon. EC allocations for 10 countries have been formalised (representing about 50% of the EU's emissions, based on 2005 data). Overall the NAP allocations have been reduced on average by 7%. The market had anticipated a cut in emission allocations of between 5-8%, and so the impact on the 2008 carbon price has been negligible. Some market observers have been concerned about the potential impact of countries and industries being able to purchase emissions cuts from countries outside of the EU (through Combined Development Mechanisms) but the EC has revised allocation of these permits in both of Ireland's and Sweden's NAPs (by about 50% in both instances) indicating that carbon reductions should be made locally. There was also a concern that some countries could 'bank' permits from Phase I for use in Phase II (benefiting France and Poland), but the EC has ruled that all 'banked' Phase I permits will see a like-for-like reduction in Phase II allocations. Overall this sends a fairly bullish signal for the 2008 carbon future price.

Section 7
Additional SRI Activities

In addition to our engagement and voting activities, the SRI team maintains its awareness of issues through participation in numerous events, and utilises its experience to help provide feedback to initiatives and to ensure Schroders has a voice in the continual development of SRI. The following provides a list of these activities.

Feedback/Expert Advice

Business in the Community – Marketplace Responsibility

We provided input into a BITC led consultation on Marketplace Responsibility Principles for large and medium sized businesses which were published in December 2006.

FTSE4Good Climate Change Market Consultation

FTSE4Good, recognising that the impact of climate change is likely to have an increasing influence on the economic value of companies, both directly, and through new regulatory frameworks launched a market consultation programme to get stakeholder inputs into the climate change criteria to be used when selecting companies for inclusion in the FTSE4Good index to which we provided feedback. The new criteria were launched in February 2007.

Carbon Disclosure Project

We have provided advice for the format of the next carbon disclosure project questionnaire.

Conferences/Seminars Attended

Renewable Energy Foundation

Focus on the supply constraints of existing and future wind power.

Climate Change

Over the year the attention to climate change has increased significantly. We have attended presentations by the UK Government's Chief Scientific Adviser on the science of climate change, a seminar by the Carbon Trust on 'Climate Change and Shareholder Value' and a conference on the influence of carbon pricing on demand for thermal coal, steel and aluminium and the physical risks of climate change to the mining sector. In addition we have held internal training sessions for fund managers on the EU Emissions Trading Scheme.

Goldman Sachs Biofuels Conference

Overview of developments in the biofuel sector.

UBS Freshwater Conference

Focus on the growing issue of freshwater scarcity and the growth of the desalination industry.

Triple Bottom Line Investors Conference

An SRI conference covering multiple issues within the SRI industry; we attended sessions on SRI in property and bonds, the integration of SRI into the investment process and measuring the success of SRI.

REACH (Registration, Evaluation and Authorisation of Chemicals)

We attended two seminars this year on REACH, which focussed on how well prepared companies are to promote, use and develop safer chemicals and safer products, and the other on the UK Government's view on the REACH directive.

Bribery and corruption

A seminar at the Institute of Business Ethics that focussed on BP's new Code of Ethics, which explicitly states that the company does not permit any form of bribery, including facilitation payments.

Tax and Corporate Responsibility

We attended a seminar held by Sustainability (a leading sustainability consultant) on its latest report 'Taxing *Issues: Responsible Business and tax'.*

Citigroup House Builders Conference
Topics covered included problems with local planning application processes, constrained housing supply, continued increases in house prices and the impact of affordability to first time buyers and low income families. Discussions also focussed around the new government led Voluntary Sustainable Homes Code and its relationship with recent new building regulation on eco-efficiency and cost implications. A continuing challenge to the industry is to acquire appropriately skilled staff for different aspects of operations and to ensure quality leadership.

Barclays Project Finance Conference
Barclays PLC held a conference to celebrate the launch of the revised Equator Principles for the banking industry. The Principles now have 41 signatory banks, including members from Japan and Latin America, altogether representing approximately 80% of the global project finance market, to which they solely apply. Amongst the revisions the Principles have notably been extended to encompass projects valued at USD10million or above and now explicitly apply to the upgrading and expansion of existing projects; they also include compulsory minimum reporting requirements, a grievance mechanism and a project finance advisory service. Overall, the revised Principles are considered to have tightened, clarified and defined more explicitly emerging best practice in this niche market.

Collaborative Initiatives

Carbon Disclosure Project (CDP)
This quarter saw the launch of the fourth CDP report. Schroders is a signatory to the CDP which is a collaboration of 225 global institutional investors (representing $31tn worth of assets) concerned about the investment implications of climate change and requesting increased disclosure on corporate GHG emissions data. For a copy of the report please visit http://www.cdproject.net

Section 8
Ethical Investment

In addition to shareholder advocacy Schroders also provides ethical investment services. We utilise the research of the Ethical Investment Research Service (EIRiS) to help develop screens for investable universes that would reflect our clients values. Typically these would exclude funds based on certain moral criteria, for example tobacco, pornography or alcohol, however we are also able to develop more sophisticated funds which would reflect the materiality of a company's exposure to an issue (e.g. only excluding companies with over 10% of turnover derived from tobacco) and indeed the source of a company's exposure (e.g. is the company deriving revenue from tobacco due to be a tobacco producer or a tobacco retailer).

Year	Ethical FUM (£bn)	Percentage of overall Group FUM
2006	4.22	3.3
2005	4.47	3.6
2004	3.97	3.8

Table 6: Ethical FUM, using December Year End data.

Table 6 provides data on Ethical funds under management (FUM) since 2003, and what proportion this represents of our overall FUM (all data is taken from December year end data). Table 7 demonstrates the key ethical screens that we implement by ethical FUM and by percentage of clients with ethical screens.

Screen	% of Ethical FUM	% of Clients with Ethical screens
Alcohol/Gambling	48	7
Tobacco	37	54
Arms	3	4
Healthcare/Pharmaceuticals	3	2
Gambling/Arms/Tobacco	2	6
Gambling/Alcohol/Arms/Tobacco	1	10
Others	6	17

Table 7: Ethical Screen breakdown by percentage of Ethical FUM and percentage of client policies.

Section 9
Glossary

AGM – Annual General Meeting

AIDS – Acquired Immune Deficiency Syndrome

BITC – Business In The Community

BREEAM – Building Research Establishment Environmental Assessment Method

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

CEO – Chief Executive Officer

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)

EC – European Commission

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

EMS – Environmental Management System

ESG – Environment, Social and Governance

ESIA – Environmental and Social Impact Assessment

EU – European Union

EU ETS – EU Emissions Trading Scheme

FD – Finance Director

FDA – Food and Drug Agency

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

FTSE – Financial Times Stock Exchange (www.ftse.com)

GDP – Gross Domestic Product

GHG – Green House Gases

GMO – Genetically Modified Organisms

H&S – Health and Safety

HIV – Human Immunodeficiency Virus

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

HSEQ – Health, Safety, Environment and Quality

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

IR – Investor Relations

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

KPI – Key Performance Indicators

Low-C – Low Carbon

NAP – National Allocation Plan

OFWAT – Water Services Regulatory Authority

PVC – Polyvinyl Chloride

R&D – Research and Development

REACH – Registration, Evaluation and Authorisation of Chemicals

SEE – Social, Ethical and Environmental

SRI – Socially Responsible Investment

UK – United Kingdom

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

US – United States of America

vCJD - Variant Creutzfeldt-Jakob disease

WEEE – Waste Electrical and Electronic Equipment