Schroders

Responsible Investment Report

2008 Annual Report

In this booklet we provide general information on our asset management services.
If you require any further information, please contact:

Rick Stathers
RI Analyst
Phone +44 (0) 20 7658 5534
richard.stathers@schroders.com

Karen Shaw
RI Analyst
Phone +44 (0) 20 7658 6548
karen.shaw@schroders.com

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Executive Summary

This year the Schroders RI Team has continued its focus in three key areas of activity: shareholder resolutions, engagement activities and ethical investment.

Ninety two shareholder resolutions were voted on in 2008, mostly tabled at the Annual General Meetings (AGMs) of US companies. Requests were most frequently put to management on labour standards and equal opportunities, animal welfare and animal testing issues, emissions of climate change and greenhouse gases and corporate disclosure on climate change related risks and opportunities. Just over 30% of shareholder resolutions were supported by us.

Our engagement activities in 2008 culminated in a total of sixty two RI-led corporate engagements. The Schroders RI team continues to demand more consistent and output related key performance indicators and evidence of deeper integration of CR into business strategy. This enables companies to justify corporate investment and allocation of resources to this area, encourages programmes adding incremental value and improves overall disclosure and transparency on behalf of all stakeholders. Our efforts in change facilitation continued in this respect, but despite the adverse market environment we noted that commitment to improving CR programmes is growing within companies and requests for change are not always needed. When we do make requests, we often find these take more than one year to implement and so monitoring of the progress of company CR programmes remains a key part of engagement.

This year, total Ethical Funds Under Management (FUM) as of the 31st of December 2008 is £3.7bn. The decline in overall assets under management is primarily a function of the overall macro economic environment. Around 17% of our ethical FUM continue to be in 'no tobacco' only screens and 30% in 'no or restricted investments in Sudan'.

2008 was the second year since the launch of our new specialist product: the Global Climate Change Fund. The RI team has continued to actively support the Global Climate Change Fund, utilising a comprehensive knowledge of global climate change trends and policy to evaluate the impacts of climate change on sector and company strategy. Those companies believed to benefit from climate change trends and policies have been placed in the Global Climate Change Fund Universe.

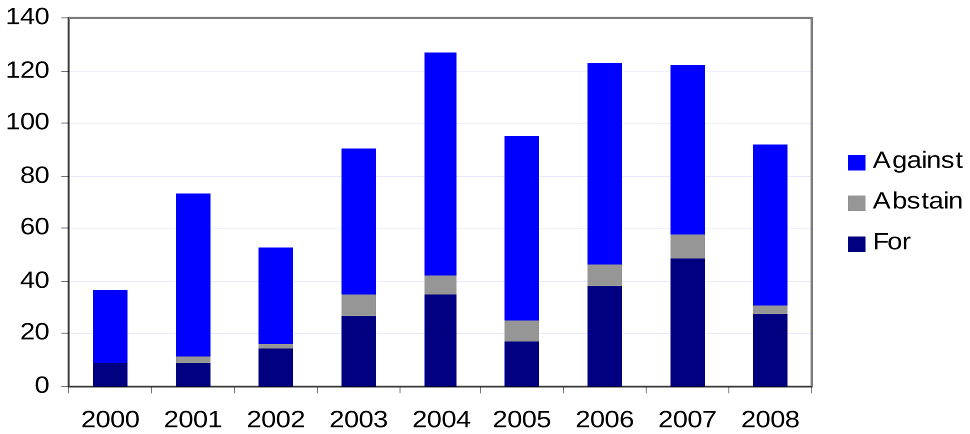
Externally, Schroders has participated in a number of industry initiatives promoting corporate disclosure and political leadership on the risks and opportunities presented by climate change. We were signatories to the Poznan Communiqué issued by the Corporate Leadership Group on Climate Change and continue to be a signatory to the Carbon Disclosure Project.

Section 1

Shareholder Resolutions Voting Review

In 2008 Schroders continued to see the use of shareholder resolutions as a tool for engaging with company management. 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 reach 92, broadly on a par with shareholder resolution activity in 2005, but not as busy as the preceding years 2006 and 2007 (see Graph 1). This continues to underline the importance of this method of engagement for shareholders in US companies.

Graph 1: Schroders International voting record from 2000-2008 on SRI shareholder resolutions (by number of resolutions voted on)



Our voting decisions are determined by:

- <u>The quality of the resolution</u>. 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.
- <u>The purpose of the resolution</u>. 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.
- <u>Transparency</u>. 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.
- <u>Historical voting actions</u>. 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.

Some of the reasons why we vote against a resolution include: if the nature of the resolution is not fully aligned with regulatory requirements, if the cost involved in meeting the resolution would significantly outweigh the benefits to shareholders; if the time frame proposed for meeting the resolution is unrealistic; if the wording of the resolution is not specific and the requirements of the resolution are unclear, then a conclusion on how to vote cannot be reached. Graph 2, overleaf, shows the proportion of shareholder resolutions that we have voted for, against or abstained from over the last eight years as a percentage of the total number of resolutions voted.

Graph 2 demonstrates how we have voted on shareholder resolutions over the last five years. (by percentage of voting decisions)

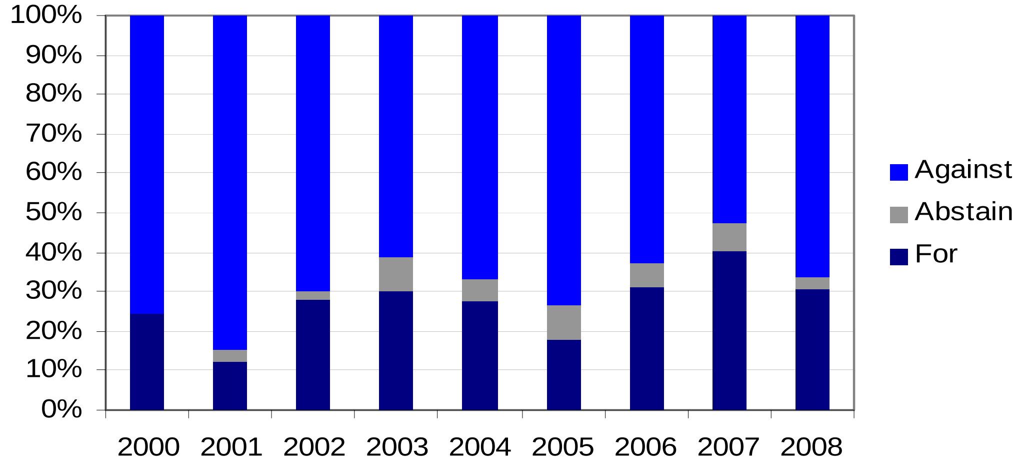


Table 1 (over leaf) shows a break down of the more common shareholder resolutions since 2000. In creating this table we have selected information that focuses on a broad theme but acknowledge that individual resolutions may be more specific in nature. For example, resolutions focusing on board diversity, sexual orientation, workforce diversity and equal opportunities are all incorporated into the 'equal opportunity' group.

The number and subjects of resolutions will vary year on year due to changes in investment strategies altering the types of companies we are invested in. Table 1 shows that labour standards and equal opportunities remain the greatest area of concern for shareholders as reflected by the constant high number of resolutions on these topics. There also continues to be a relatively high number of resolutions focusing on animal welfare and animal testing issues, a trend which has continued since 2005, and is a direct reflection of the current use of shareholder resolutions by animal welfare campaign groups. Resolutions on climate change and greenhouse gases remain popular reflecting ongoing concerns by shareholders about the risks and opportunities that climate change presents to companies.

This year saw a fall in resolutions requesting sustainability and CR reporting, perhaps partly due to the emerging financial crisis in the latter half of 2008 and also partly down to continued improvement in CR reporting by multinational companies. There have also been no resolutions on HIV/AIDS in 2007 and 2008, perhaps reflecting progress in these areas as most multinational companies working in heavily HIV/AIDS exposed areas now operate comprehensive HIV/AIDS management programmes.

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

	Issues	2008	2007	2006	2005	2004	2003	2002	2001	2000
Ethical	Animal Testing/Welfare	8	12	14	18	4	1	0	0	0
	Genetically Modified Organisms	2	3	6	6	5	2	5	5	3
	Weapons	3	5	5	5	8	4	0	3	2
	Tobacco	2	3	8	5	8	7	2	4	0
Environmental	Toxic Chemicals	3	2	2	3	5	3	2	2	0
	Greenhouse Gases & Climate Change	12	14	7	5	12	6	2	2	0
	Nuclear Power	6	10	7	5	11	10	3	4	1
	Renewable Energy & Energy Efficiency	1	1	4	0	5	5	3	4	1
	Protected Areas	1	1	3	2	3	0	3	2	2
	Environmental Policy (including timber)	0	1	3	1	2	2	5	3	2
Social	Equal Opportunities	12	15	12	6	9	10	6	9	5
	Labour Standards	25	22	26	17	13	16	16	14	6
	HIV/AIDS	0	1	0	4	8	2	0	0	0
	Drug Pricing/Access	0	1	0	7	5	1	4	5	4
Governance & Reporting	Corporate Responsibility /Sustainability Report	3	10	7	3	5	3	0	0	0
	Executive Pay link to environmental, social and governance	0	2	1	1	2	1	0	0	0
Other	Miscellaneous	14	20	17	7	22	17	2	16	11
Total number of resolutions voted on		92	122	123	95	127	90	53	73	37

Section 2

Shareholder Advocacy Review

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

— Monitoring the ongoing Corporate Responsibility (CR) performance of a company and, or, filling in gaps in our analysis (fact finding)

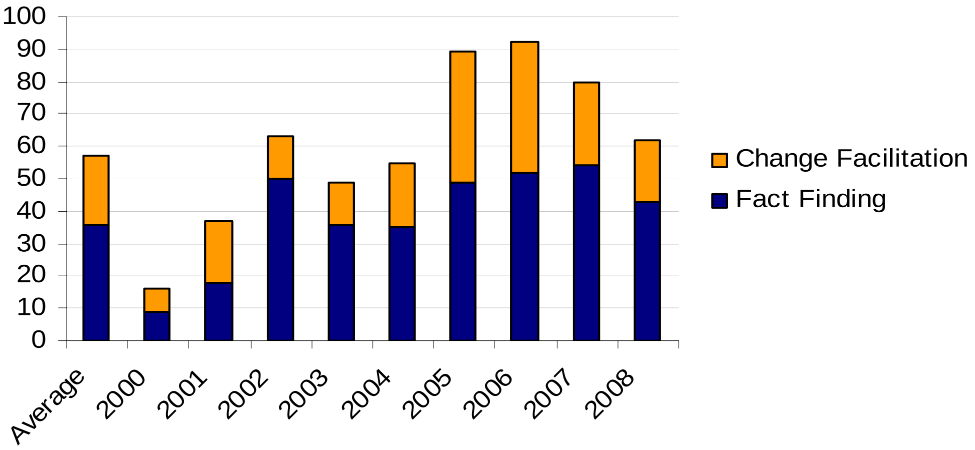
— Making suggestions for change if a company's CR performance or processes present a risk to shareholder value

We believe that 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 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.

Schroders formalised its RI activities and established a dedicated RI resource in 2000. In 2000, the level of CR disclosure by companies was very poor, with few companies producing anything more than a basic environmental policy. Since then companies have embraced CR reporting and the number of reports, and detail of information within them, has grown significantly. An increase in the use of relevant standard key performance indicators (KPIs) has also allowed better analysis and better evaluation of CR programmes by investors, which has encouraged further engagement.

Graph 3, shows the growth in corporate engagement since 2000. The increase in RI resource in Schroders in 2005 led to an expected escalation in the number of company engagement activities undertaken.

Graph 3: Schroders SRI Corporate Engagement records from 2000 to 2007 (By number of corporate engagements



Since 2007, the RI team also became heavily involved in the development of the Climate Change Fund, in particular in the initial development of the investment universe. This led to the initiation of a large number of climate change meetings which have not been included in our log of RI led corporate engagement due to the fact that many of these companies are outside of Schroders's RI Pan-European remit. These meetings continue to have more of a specific climate change and financial focus than typical SRI corporate engagement, which looks at a companies overall CR programme.

Table 2 provides five year average performance information on our engagement activities from 2004-2008 and also shows breakdown of our engagement activities, the total number of companies engaged with and the proportion of this engagement that has been to facilitate change (the remainder being for ongoing monitoring and fact finding).

Table 2: A 5 year review of suggestions for change

Year	Engagements	Suggestions for change (absolute)	Suggestions for change (%)
2004	55	20	36
2005	89	40	45
2006	92	40	43
2007	80	27	34
2008	62	19	43
5-yr average 2003-2008	76	29	40

Graph 4 also provides a reflection of how active Schroders has been in its engagement programme. It provides a breakdown of whether corporate engagement has been initiated by us, by the company or as a result of a shareholder resolution.

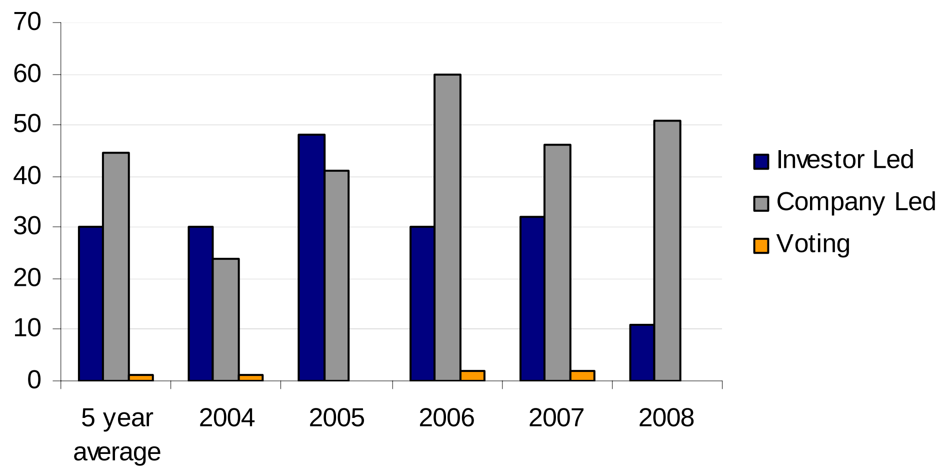
With regards to the legend for graph 4:

— 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.

— 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 4: A 5 year review of Pan-European SRI engagement activity



Since 2003 there has been a significant rise in company led engagement because more companies are ‘coming to market’ with annual CR reports, delivering RI road-shows and sustainability or CR conferences. As a result of the increase in company led activity (either directly or through broker houses), we have found companies to be more proactive in organising meetings and have not needed to be as proactive ourselves. However, we still initiate engagement with companies that are less proactive and in particular with those companies that have less comprehensive CR programmes.

The reasons for increased corporate activity in CR are partly down to increased broker research and coverage of RI activities (though RI broker coverage has diminished with the financial crisis in the last half of 2008) but also due to increased societal awareness of environmental and social issues which are acting as a stimulus for companies to increasingly publicise their Environmental, Social and Governance (ESG) standards and increased societal concern over climate change, which is having a knock on effect and encouraging investment in CR programmes generally, for example through energy efficiency.

Our current approach to RI is Pan European in focus and engagement with continental European companies was 40% of our overall engagement activity in 2006, 37.5% in 2007 and 44% in 2008.

Section 3

Shareholder Advocacy Performance Review

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 RI 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 performance between 2001 and 2007. Any requests for change are reviewed on an annual basis as this tends to be the standard reporting period for most companies on CR, though we have noted that some requests for change take longer than year to fully implement. 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

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.

Year	Total number of Suggestions for change	Current status of total number of suggestions for change					
		No change	Some change	Almost achieved	Achieved	Suggestions for change no longer applicable	Reason why suggestions for change are no longer applicable
2001	19	0 (-)	1 (-)	0 (-)	14 (-)	4	Four companies have been taken over or sold. Thistle, Rank, Hilton Hotel and Pillar Properties.
2002	13	1 (-)	0 (-)	3 (-)	8 (-)	1	Enterprise Oil was taken over by Royal Dutch Shell.
2003	13	1 (-)	1 (-)	2 (-)	9 (-)	0	-
2004	20	1 (↓)	3 (-)	5 (-)	11 (-)	0	-
2005	40	3 (↓)	7 (↓)	10 (-)	19 (↑)	1	EGG PLC has been sold to Citigroup
2006	40	9 (↓)	14(↓)	7(-)	9 (↑)	1	Boots PLC and Alliance Unichem have merged.
2007	26	5	6	4	7	4	RBOS took over ABN AMRO, Lloyds TSB took over HBOS. Vodaphone refused to disclose data considered publicly sensitive. Croda also have refused to disclose data.

Table 3 demonstrates how successful our engagement activities have been over a five year period. It shows that between 2001 and YE 2006 70% of suggestions for change had been rated as ‘achieved’ or ‘almost achieved’. If this assessment was extended to YE 2007 then the ‘achieved/almost achieved’ figure decreases, slightly, to 67.5%; indicating that it can take more than a year for some suggestions for change to be met.

Table 4, below, summarises companies which have demonstrated ‘no change’ in 2007. There are three chemical companies, reflecting our focus on this sector in 2006. The quality of reporting, on the whole, was quite high in this sector with the exception of these three companies. There are also two pharmaceutical companies, Schwartz Pharma and Sanofi; four financial companies, UBS and Zurich, legal and General and Royal Sun Alliance; two food retailers, Sainsbury and Tesco; and three other companies, Balfour Beatty, Rio Tinto and British Energy which have not responded to our suggestions for change, to date.

Table 4: Engagement actions where ‘no change’ has been achieved

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	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.
	Dairy Crest	The company has not responded to our request to develop group level environmental performance targets
	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.
2006	British Energy	We encouraged British Energy to provide more information on how it encourages energy efficiency amongst its consumer base - as this would also aid BE's case in the argument over developing nuclear fuel as a future electricity source. However, the company has not enhanced its disclosure on energy efficiency to date.
	UBS	We noted that UBS still seems to lack a clear CR strategy, including objectives and non financial performance indicators at senior management level and supporting programmes. Its not clear how the company evaluates its CR performance currently. Reporting on customer behaviour, including retention and customer satisfaction also remains absent.
	Zurich Financial Services	Zurich reports very clearly on governance, ethics and environmental management systems but we have asked the company to report on its specialist environmental liability product range and, more crucially, to provide performance information on its 2-3 year investment in a corporate cultural change programme.
	Schwartz Pharma	We had hoped to see improved disclosure from this company on human capital management, particularly on employee data, and also on the implementation of its environmental management system (EMS). It has no CR disclosure. Information on its business practices was obtained only from engagement.
	Rio Tinto	The company has an interesting and cutting edge project in the pipeline to improve workforce 'wellness' but has not presented a convincing business case for this investment, though it believes productivity will benefit. We have asked it to set performance indicators here and more generally in human capital.
	Sanofi Aventis	We have encouraged Sanofi to improve its reputation by demonstrating that it has improved internal product risk management processes, thereby avoiding share price falls as incurred by the rejection of Accomplia by the FDA and loss of key products to generic competition.
	Linde	Due to the merger of Linde and BOC last year the company has not yet produced a more recent CR report since 2005. In due course we hope to see H&S and EMS targets and employee questionnaire programmes rolled out in the near future across the group.

	Solvay	Solvay still reports on an irregular basis - there are no yearly CR reports. Performance indicators and targets need to be disclosed to provide a clearer indication of company direction in its CSR programme.
	Umicore	We have encouraged more comprehensive reporting in human capital indicators annual collation of employee satisfaction data and more explicit information on levels of investment in eco-efficiency initiatives.
2007	Sainsbury	Sainsbury's purports that it commits only to CR initiatives where it can make a visible difference to its customers, where it makes business sense and where it can take a leadership stance, but it does not define what this means in terms of key performance indicators (KPIs). We have encouraged the use of KPIs in food and health, environment and employee CR programmes.
	Legal and General	We have encouraged L&G to develop KPIs which are more specific and measurable in both HR and customer service, to connect these to broader business strategy and to develop respective programmes to support them. It is currently building up this capacity in customer services and hopes to have systems in place for 2008. Similar attention needs to be applied to human resources.
	Royal and Sun Alliance	RSA 2007 report is just about to be released. Until this is made public, its difficult to assess the extent to which they have continued to centralise and organise key performance data in 2007. Therefore due to a lack of information we have rated this as 'no change' at present.
	Tesco	We encouraged the company to provide details on staff absenteeism and sick leave as this would provide an indication of staff moral. Tesco said that it does collate this information and would provide it to us.
	Balfour Beatty	We encouraged it to develop indicators which monitor client satisfaction and which will monitor the growth of sustainable product design. Dec 08. No change in reporting in these areas this year, but developments expected next year.

In contrast, Table 5 (below) highlights those companies where, following a review of a company's publicly available information, we have rated our suggestions as having been achieved in 2007. For a full list of all company engagements in 2008 please see Appendix 1.

Table 5: 'Suggestions for change' rated as Achieved during 2008

Year	Company	Reason
2004	Standard Chartered	Ongoing engagement has confirmed that Standard Chartered has heavily invested in its environmental and social credit risk assessment process in recent years and the quality of its credit risk assessment process continues to improve, in line with peers and industry best practice. We believe this is a good proxy for the overall robustness of its credit risk management systems and dealings with all clients. We originally had concerns that the company had insufficient protection against loss of reputation and credibility from loans to corrupt governments.
2005	DNB	DNB have produced a comprehensive CR report for 2006 which demonstrates and reports on its CR programme.
	Lloyds TSB	Lloyds CR programme has developed more direction and includes performance indicators for human capital, customer and HSE management. We originally asked for more comprehensive reporting on material RI issues to the bank, with greater emphasis on CR strategy and reporting areas such as human capital and customers.
2006	Swiss Re	Swiss Re is a market leader in product management of environmental and social risks, but was weaker with respect to the management of its own general operations. We recommended the company develop indicators on human capital management. Swiss Re now has indicators on age range, diversity, contract type and turnover, with full descriptions of related policies and programmes to drive performance in the above areas.
	Nestle	A review of the website in 2007 indicates that the company does produce consolidated data for environmental indicators, but not for the range of stakeholder issues you would expect to be disclosed. However on writing to the company on this issue we have received a written confirmation that a group level report will be produced in 2008 and annually thereafter. We therefore rate this as achieved.
	GlaxoSmithKline	As suggested, GSK has demonstrated increased focus on product risk management and continues to lead the sector in non financial performance. The company has demonstrated excellent CR reporting this year in its 2006 report.
	Barclays	Barclays 2006 report demonstrated leading practice on all the relevant RI risks and opportunities to the business and a comprehensive reporting format in all these areas. The report had a slightly more strategic focus than previous years as requested.
	First Group	The company has amended its code of ethics to include reference to unionisation and the ILO principles which is what we had recommended.

2007	Telecom Italia	We asked TI to maintain standards of global reporting information at the level of sophistication that it has previously reported to. This was achieved in TI's 2007 report which now applies to its global operations and includes quantitative targets
	L'Oreal	We asked L'oreal to improve its disclosure on supply chain management (SCM). The 2006 sustainability report provides a high level of disclosure on supply chain management, including information on the company's commitment to labour standards, streamlining of the SCM process, audits undertaken and the results of these audits. This helps to show that the company is making efforts to ensure that it has good engagement with its supply chain an area of potential risk to sales and reputation should any negative issues over labour practices emerge. We therefore rate this engagement as achieved.
	Holcim	Has now produced a full sustainability report for 2006.
	Standard Chartered	The report also demonstrates an improved business focus, with the value of specific projects highlighted in annual achievements. Although there is room for further improvement in identifying the business case and value added from this CR programme, we have reiterated this in another suggestion for change in 2008.
	Royal Bank of Scotland	RBS has prioritised its CR programme in three areas - financial crime, customer service and selling (as a result of its stakeholder consultation) and it's clear that these areas can and will add real business value to the bank. What is now required is a cohesive plan of action in each area to achieve this, with relevant KPIs.
	Xstrata	Xstrata has provided efficiency data based on different commodity streams. Group targets and a revised HSEC programme ensure that Xstrata is in a position to ensure that step changes in resource efficiency can and are being taken. Xstrata has stated that it is difficult to provide comparable site benchmark data as every company/site is different.
	Saint Gobain	Saint Gobain has improved H&S statistics in 2007. Fatalities (in the workplace) were 9 (11 in 06), 8 contractors (9 in 06), 0 temporary workers and 0 third parties (3 in 06). Non work place deaths and fatalities on the way to work (which amounted to another 23 in 2006) have not been reported in 2007. Despite the relatively high number of fatalities and incidents, there has been an improvement, as we requested and fatalities in the workplace have been reduced as a result of the Serious Accident Plan. Continued improvement is expected.
	Schneider Electric	As requested, the company is actively marketing the environmental credentials of its products and has produced literature for its customers on how they can improve energy efficiency within their operations.
	Stora Enso	We requested disclosure on the origin of wood and how it is tracked all the way from the forest to the mill. In 2007, 91% of the wood and pulp passing through these systems was also covered by third-party certification schemes such as chain-of-custody, controlled wood, EMAS and/or ISO 14001.
	Reckitt Benckiser	Dec 08. Independent assurance by Deloitte Touche assessed the validity of the carbon methodology the company uses and how it complies with different greenhouse gas protocols.

Section 4

Ethically Screened Investments

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 investment universes that reflect our clients' values. Typically these would exclude companies based on certain moral criteria, for example tobacco, pornography or alcohol, however we are also able to develop more sophisticated screens 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 production or tobacco retail).

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

Year	Ethical FUM (£bn)	Percentage of overall Group FUM
2008	**3.68**	**3.3**
2007	6.00	4.4
2006	4.22	3.3
2005	4.47	3.6
2004	3.97	3.8

Table 6 provides data on Ethical funds under management since 2004 and the proportion that this represents of our overall FUM. Table 7 demonstrates the key ethical screens that we implement by ethical FUM and by percentage of clients with ethical screens. Schroders currently runs ethical screens for 83 clients, representing £3.7bn of funds under management at year end. 30% of Ethical FUM exclude investment in companies with operations in Sudan due to human rights concerns, 17% of Ethical FUM have a pure tobacco exclusion and 25% have a combination of ethical constraints.

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

Screen	% ETHICAL FUM	% Clients with ethical screens
No Tobacco	17%	49%
No Tobacco or alcohol	1%	1%
No Arms and Defence Securities	3%	1%
No Arms or Defence Securities, no tobacco and no gambling, no biotech and nuclear	3%	8%
No Alcohol or Gambling	18%	4%
No or restricted investments in Healthcare and Pharmaceuticals	2%	6%
No or restricted investments in listed companies with direct or indirect operations in Sudan	30%	14%
Other	25%	16%
TOTAL	100.00%	100.00%

Section 5

Specialist Product - Global Climate Change Fund

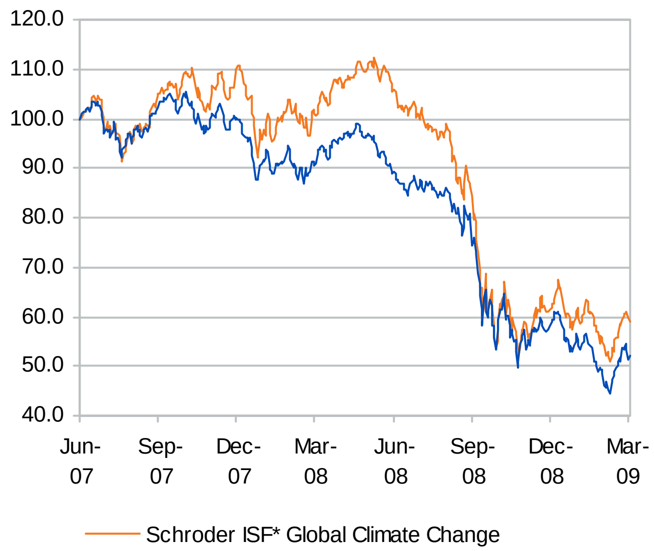
In 2007 Schroders launched the Global Climate Change Fund, the underlying investment philosophy of which is that we believe that climate change will be the main driver of industrial change over the next 20 years. The fund therefore invests in companies that stand to gain from efforts to abate climate change emissions or to adapt to changing climatic conditions.

This view is supported by the accelerating pace of national and international policy action on climate change, which is creating a favourable medium and long term outlook for companies involved in efforts to mitigate or adapt to climate change. It is also supported by the Stern Report (2006) which states that to avoid an average global warming of 2°C or more by the end of the century emissions per unit of GDP need to be cut to 25% of current levels by 2050. In order to achieve these we are likely to see revolutions in both the electrical and transport sectors to decarbonise them (or make them carbon neutral) as well as significant changes in most other industrial sectors.

The RI team has been actively involved in the development of this fund through the process of researching and identifying companies that will benefit from the efforts to mitigate greenhouse gas emissions or to adapt to a changing climate. Mitigation would cover companies involved in clean energy, energy efficiency, low-carbon energy, sustainable transport and carbon capture and sequestration whilst adaptation would cover companies exposed to efforts to adapt to drier climates (e.g. water companies and agricultural companies), more adverse weather and high costs of living, for example. Currently about 80% of the fund is invested in companies exposed to mitigation due to the political and consumer drivers recognising the need for mankind to drastically cut its greenhouse gas emissions; whilst the impacts of a changing climate are deemed to be slightly longer term in nature, though efforts need to be made now to adapt to them as economic research has demonstrated that this would reduce costs in the long run.

The Global Climate Change product utilises a bottom-up, fundamental research driven process, and aims to outperform the MSCI World index. Schroders believes an unconstrained portfolio dedicated to investing in these well positioned industries and companies will generate very strong investment returns. On Dec 31st 2007, the Global Climate Change Fund had £205 Million AUM and, as a result of deteriorating market conditions, this fell to £151.24m AUM at 31st Dec 08. Graph 5 (below) demonstrates its performance against the MSCI World Index since inception.

Graph 5: Schroders Global Climate Change Fund performance since inception ** versus the MSCI World Index



Source: Schroders, Bloomberg. *ISF Schroder International Selection Fund. Performance shown is the "I" share institutional share class net of all management fees. NAV to NAV (Bid to Bid). The Index is the MSCI World Net Dividends Reinvested. ** Inception date 29th June 2007

Section 6
Responsible Property Investment

The Schroders' Property investment process incorporates a review of the environmental and social factors concerning the properties it directly owns and manages and the properties it indirectly has invested in and with whom management responsibility. By factoring corporate responsibility considerations into the design, construction and operation of buildings Schroders believes this can increase long term market value, investment performance and reduce operational costs. In addition, through managing the environmental and social impacts of property, Schroders aims to reduce exposure to the risks of adverse publicity, legal penalties and to be one step ahead of emerging legislation.

Schroders recognises the importance of emerging legislation in real estate on the properties that it manages. For example, in response to the Kyoto Protocol, the European Parliament introduced Energy Performance Certificates. In the UK these became compulsory for any building being sold or let in England and Wales from 1 October 2008. Certain public buildings are also required to have Display Energy Certificates and it is expected that these will soon be required for all commercial buildings. Therefore it is important that these issues are anticipated in the investment process. With the UK government planning to reduce 1990 carbon emission levels by 80% by 2050, it is clear that property investors would be failing in their fiduciary responsibility if the energy efficiency of property assets was not a key consideration when making buy/sell decisions.

In addition, Schroders support for sustainable development stems from our belief that future institutional investing should include the creation and ownership of whole communities, with residential and social uses forming part of the mix alongside more traditional commercial uses. Creating an aspirational residential community either owning or privately renting within a vibrant and sustainable town centre is one of the new challenges facing the property industry early in the 21st Century.

Schroders is also establishing a strong role in thought leadership in this evolving area with its partnership with the developer Stanhope and major regeneration schemes in Bracknell and Croydon where sustainable and Eco-friendly residential solutions are at the heart of the vision.

Direct Management

Most of Schroders property assets are directly owned. The Schroders' property team have been focused on issues relating to sustainability for a number of years, whether it be the impact on the environment from site pollution, strategies to clean up and reposition Brownfield sites, through to matters relating to climate change and reducing a building's environmental footprint by working with our occupiers to create strategies for the likes of waste recycling, reducing energy consumption and water conservation.

This focus was enhanced in 2007 when we started to work with sustainability advisers, called 'Upstream', to raise our awareness of the importance of sustainability. We have participated in their Third Dimension benchmarking service which measures a number of sustainability factors in Schroders' UK Funds against a universe of properties owned by other institutional investors. These factors include energy efficiency, water efficiency, recycling and risk of flooding. We are also working with Upstream to see how this benchmark can be developed across the rest of Europe.

In November 2008 we held our Sustainability Conference which brought together our pan European teams, partners and service providers to learn from each other about best practice across Europe.

Other

Where Schroders property assets are not directly owned this is because we invest in third party funds with no control over day to day management. This is similar to investing in a company (listed or unlisted) and Schroders will assess if managers are applying appropriate environmental and social standards in line with what we would apply to our directly managed assets.

Section 7

General Industry Involvement

In addition to our engagement and voting activities, the RI team maintains its awareness of issues through participation in numerous industry events, and utilises its experience to help provide feedback to industry initiatives and to ensure Schroders has a voice in the continual development of RI. Tables 8 and 9 below summarise the main industry events we have attended and participated in during the course of 2008.

Table 8. Sector Activities

Sector	Activity	Host Organisation	Details
Automotive	Collaborative Research	Institutional Investors Group on Climate Change (IIGCC)	The IIGCC published a disclosure framework which offers a uniform reporting format for the automotive sector, enabling a better analysis of their environmental exposure. We participated in the development of this framework.
Aviation	Collaborative Research	Sustainable Development Commission	We represented the investment community providing feedback to the Sustainable Development Commission in its stakeholder consultation exercise about the sustainable development of aviation.
General Retailers	Collaborative industry project	UK Social Investment Forum (UKSIF)	We are continuing our involvement in an initiative with other investors looking at the Supply Chain Management programmes and practices of various UK retailers
Nuclear Industry	Collaborative Research	European Social Investment Forum (EUROSIF)	We participated in a research project funded by EUROSIF which produced sector research notes on environmental, social and governance risks and opportunities facing this industry.
Nuclear Industry	Seminar	EUROSIF	We hosted a seminar on nuclear power, following the publication of the EUROSIF note on the nuclear industry.
Oil and Gas	Seminar	Cooperative Asset Management and UKSIF	We attended a seminar co-hosted by UKSIF and the Cooperative Asset Management to hear the result of a research project into the social and environmental impacts of oil extraction at Canada's tar sands in Alberta.
Pharmaceuticals	Seminar	Pharmaceutical Shareholders	As members of this investor group we took the opportunity to discuss and review two reports recently published by PricewaterhouseCoopers on the Pharmaceutical Sector www.pharmafutures.org
Pharmaceuticals	Collaborative Industry project	Access to Medicine Index (AtM)	This index continues to assess how the pharmaceutical industry responds to the access to medicine issue. The AtM index project, led by the Access to Medicine Foundation aims to assist Innovest in benchmarking company performance.
Real Estate	Seminar	Gerson Lehman Group (GLG)	We attended a Zero Carbon Housing Seminar which gave a presentation from industry representatives on the implications to the construction industry of the UK Governments target for Zero Carbon Housing by 2016.
Real Estate	Conference	Investment Property Forum (IPF) and IIGCC	We attended a joint Investment Property Forum (IPF) and IIGCC breakfast seminar on sustainable property investment.
Utilities	Seminar	UKSIF	Energy Utilities and Fuel Poverty (with higher fuel prices, a decreasing supply and potentially colder winters, the issue of fuel poverty is becoming increasingly important for UK electricity and energy providers).

Table 9. Thematic Activities

Thematic	Activity	Host Organisation	Details
Climate change	Collaborative Industry project	Carbon Disclosure Project	We have agreed to be signatories to the CDP questionnaire for the next three years. We have also provided feedback to the continued development of the CDP questionnaire in order to ensure that the most relevant information is being extracted from companies for investors to use www.cdproject.net
Corporate Responsibility	Seminar	Good Corporation	The topic of the seminar was "Do Investors Care About Corporate Responsibility and will the business review help make a difference?" We participated in a discussion on this topic.
Green Consumers	Seminar	UKSIF	Green Consumers (a focus on the current economic climate and its impact on green or ethical consumers
Human Capital	Seminar	UBS Brokers	Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity prices. The presentation reported on an American study which argues that the stock price does reflect companies with the best employee policies, programmes and employee satisfaction ratings.
Poverty Alleviation and Development	Conference	Oxfam	We have attended seminars on Poverty Alleviation and Development (a conference launching an initiative by Oxfam to assess the potential for investors to contribute to poverty alleviation through their investment decisions and influence as investors)
Responsible Investment	Collaborative Industry project	UKSIF	We attended this seminar to discuss the future of the responsible investment industry as result of the current financial upheaval.
Responsible Investment	Seminar	ECOFACT consultancy	We attended this responsible investment seminar organised by ECOFACT, an environmental and social risk management consultancy, which presented "Responsible Investment Policies: Implementation and Challenges"
Sustainable Energy	Conference	Finance Network for Sustainable Energy	Schroders hosted the inaugural Finance Network for Sustainable Energy which provides a forum for investors and the sustainable energy network to meet. This provided a useful chance to meet small companies (by market cap) and unlisted companies, developing technologies and solutions that are not currently discussed by larger, listed companies.
Waste Water Treatment	Seminar	Gerson Lehman Group (GLG)	We attended an industry seminar on wastewater pipeline rehabilitation in Europe, as part of an ongoing effort to assess the industry's investment requirements in order to adapt to climate change (notably floods and storms) and meet general rehabilitation needs in order to conserve water resources.
Water Industry	Collaborative Research	EUROSIF	As a member of the steering group on this project we provided feedback to EUROSIF on the development of this report.
Water supply	Seminar	Goldman Sachs	We attended this seminar which focused on the issues facing the continued supply of fresh water and some of the solutions to it.

In 2008, we were signatories to the Poznan Communiqué issued by the Corporate Leadership Group on Climate Change. We also supported the IIGCC in various lobbying activities, summarised in Table 10, below. and we continue to be a signatory and advisor to the Carbon Disclosure Project.

Table 10. IIGCC lobbying activities 2008

Target	IIGCC lobbying activity
UN	IIGCC wrote a letter to the UN Framework on the Climate Change Process and provided an accompanying Investor Statement on the Global Agreement on Climate Change.
America SEC	IIGCC wrote a letter to the SEC promoting interpretive guidance on climate risk disclosure.
UK Government	IIGCC wrote a letter to the government asking for leadership and direction on new coal-fired power generation in the UK.
UK Government	IIGCC held a meeting with DEFRA, DFID and the Treasury to communicate the Statement on Global Agreement on Climate Change.

Appendix 1

Annual Compilation of Company Engagements 2008

Company	Engagement Activity
Basic Industries	
Chemicals	
Air Liquide	Air Liquide demonstrates leading CSR performance in the industrial gas sector. Their health and safety performance shows year on year improvement since 1991. They have a very comprehensive environmental management system and have set themselves a challenging target to reduce the electricity consumption of 250 air separation plants (representing 80% of all electricity consumption for the group). Human resource indicators are also comprehensive and average for the industry. The company is benefiting from strong growth prospects in clean energy led gasification markets. 60% of the R&D budget is targeted at markets such as carbon capture, oxy-combustion, coal to liquids, coal to chemicals, gas to liquids and biomass to liquids. Currently 33% of company sales are attributable to sustainable development markets and this is likely to grow significantly moving forwards. Their biggest market at the moment is the oil industry's requirement for hydrogen to remove sulphur content from fuel. They are also benefiting from the growing healthcare market in America, with their new anaesthetic products.
Bayer	Bayer is one of the most energy efficient companies in the chemicals sector, after BASF. As a result it has reduced total Greenhouse Gas (GHG) emissions by 37% between 1990 and. This has improved the company's cost management as well as mitigated its potential liabilities from carbon emissions. Bayer expects absolute GHG emissions to remain stable in the future, despite volume growth and a tighter carbon regulatory environment. Bayer sees market opportunities in the plant, Jatropha, and its use in biodiesel and ongoing Genetically modified (GM) seed development – both of these are expected to be key elements of future business growth. Bayer appears to be managing its carbon and environmental risks adequately in its materials division, and investing in opportunities in its crop science division where targets for GM sales remain on track.
Syngenta	Syngenta is well positioned to benefit from drivers in the Crop Science business where it has a leading presence (after Monsanto) in the GM seed market. It presents GM as the utopian solution to achieving world food requirements and more sustainable agriculture. Syngenta argues that farmers benefit from increased profit margins by using GM seed and associate chemicals, but there is concern that this is in exchange for a deepening dependent and contractual relationship with agribusiness and the question remains as to whether this is entirely welcome by all farmers, especially in emerging markets. Nonetheless, whilst governments in emerging markets are being persuaded, the company is not optimistic that it can persuade European markets to use GM. In the meantime GM seeds are taking more global market share every year (circa 30% currently of the seed market) and this continues to grow.
Umicore	We met with the CEO, CFO & IR (also the CSR representative). Umicore has an evolving CSR programme which shows signs of increasing maturity, as more resources are clearly being given to co-ordinate the different 15 business segments and pull together different areas of expertise (e.g. zinc and the EU ETS, supply chain management, environmental management, ethical global standards etc). The company's main risk is a skills shortage in the zinc sector and data is still required to demonstrate a proactive response to this problem. Overall, however, the business will increasingly benefit and grow from strong environmental regulatory drivers in the areas of catalyst, solar cell, lithium battery production and scrap metal recycling moving forwards.

Forestry and Paper	
SCA	This was the first time that we have engaged with this hygiene, pulp and paper company. The company is in the early stages of developing its corporate responsibility programme and is being spurred on by increased customer demand and the realisation that operating costs can be reduced by improved environmental performance. Fifty percent of the company's raw material comes from its own managed forests, which are seen as a strategic asset as the debate about forestry as a carbon sink looks likely to see forests included in a post-Kyoto agreement with a resulting appreciation in forestry asset values. SCA appears to have successfully recognised the business benefits of an integrated CR programme and the company looks to be developing a suitable strategy that will see the business benefit from this going forwards.
Mining	
BHP Billiton	We wrote to BHP asking for clarification on non financial metrics, in particular how health and safety (H&S) is taken into consideration in executive compensation packages. The remuneration committee states explicitly that these metrics are taken into account, yet despite rising fatality numbers of the last few years the compensation package does not appear to reflect poor H&S performance.
Lonmin	We met with IR to discuss the company's strategy for managing employee welfare and health and safety issues following strikes that erupted in South Africa in 2007 which reduced platinum production. In addition the company reported three fatalities in 2007. New legislation in South Africa now requires a mine to close every time there is a fatality and investigations to follow, which means further production delays, impacting shareholder value. The cause of the strikes was considered to be poor union relations due to high turnover of senior management and a poorly managed change over in a HR operating system which led to delayed salaries and provoked the unions to leverage for further pay rises. A subsequent agreement has been reached between Lonmin and the local union; however, the company needs to maintain this relationship, as a priority. In addition, while Lonmin's fatality rate is lower than its peers, any fatality now causes national consternation as the SA government is taking a proactive view on addressing endemic H&S issues in the underground mining industry. Therefore, Lonmin's continued focus on mechanisation is warranted and may place it in a better position relative to peers who are less mechanised, leading to fewer employees and lower probabilities of fatality events. We encouraged the company to improve union relations and investment in health and safety programmes.
Xstrata	Xstrata continues to demonstrate leading CSR practice within the mining sector. The company has reassessed the HSEC assurance 2004 programme this year and tightened the 17 social and environmental standards it uses to ensure commodity business retain sector leadership. The adjustment provides reassurance that Xstrata intends to keep a leading edge on competitors, for example by requiring site energy and water efficiency and biodiversity plans. This is combined with new stringent commodity business efficiency targets to ensure that the necessary larger step resource efficiency improvements are being taken, ensuring that Xstrata can expand business despite operating in increasingly resource constrained environments. Sourcing an appropriately skilled workforce remains a risk to the sector generally. Xstrata also demonstrates an exemplary H&S programme and good union relations in S. Africa and is well positioned to improve on Lonmin's track record should the takeover be completed.

Consumer Goods	
Automobiles & Parts	
Michelin	This was the first meeting we have had with the company and a very timely one given the increased political focus on reducing transport emissions, not only through improved car/engine design but also improved wheel design. Michelin estimates that improving the rolling resistance of the tyre is the cheapest way to decrease transport emissions and is pushing for regulation to acknowledge the rolling resistance of tyres which would give it the edge over its competitors. The company was clearly able to demonstrate that it has recognised the benefits that climate change can bring to its business and has started to develop new business models to capture this (e.g. tyre leasing), it faces supply chain challenges in water constraints and competition for plantations but the opportunities presented by its energy saver tyres appear to outweigh these risks.
Renault x2	The key issue for the company at the moment is reducing the CO_2 emissions from its fleet in the face of ongoing legislation. Renault has not based all of its efforts on one solution to reducing CO_2 emissions, and is exploring ways of improving engine efficiency, developing hybrid technologies and new electric vehicle networks. Renault has started developing projects and partnerships with energy providers and an infrastructure developer for the roll out of its mass produced electric vehicles in 2011. The relative low emission profile of Renault's fleet will also help it develop some competitive advantage as efforts to tackle the transport sectors contribution to GHG emissions continue, within the EU in particular. Legislation in Europe has already negatively impacted the sale of large CO_2 emitting vehicles and positively influenced the sales of smaller, more efficient vehicles in the first few months of this year, a trend that looks likely to continue.
Food Producers	
Nestle	Nestle was presenting on its first consolidated group sustainability report. The report highlighted the focus on implementing one set of principles across the company's global operations and quantifying its performance. It also went some way to demonstrating that the company has made great strides in appreciating the long term sustainability challenges that it faces and how it is aiming to address these, through discussion about water resources, new business models for the developing world, empowering women and engaging with its supply chain. The Creating Shared Value report is also particularly encouraging as it satisfactorily addresses the issues of increased transparency on human capital and health and safety data as well as the development of a global report which we had asked the company to produce.
Unilever	This was the first time that we had seen Unilever for four years, and the company did not disappoint. The company was able to provide a clear indication that it is aware of the risks and opportunities posed to it and is developing suitable business models to deal with this. Whether these are focusing on specific products for the "base of the pyramid" consumers (now accounting for 44% of 2007's revenue) or developing products to deal with specific social and environmental issues (e.g. health or decreasing water reserves). The company provided a very comprehensive overview of corporate responsibility practices within its operations and can clearly demonstrate that it sees addressing CR risks and opportunities of direct relevance to the successful performance of the business and that it is probably leading its peers in this area.
Cadburys	Cadbury's CEO delivered a presentation which clearly showed that the company has made great efforts to understand the sustainability challenges and opportunities the company faces and it now has a very firm corporate responsibility (CR) management system that is integrated into its mainstream business model. The company is one of the first to set absolute emissions reduction targets and programmes which have been put in place to realise these targets are already starting to provide cost-savings. The company has made strong efforts to understand the challenges within its supply chain, working closely with local farmers on improving productivity, diversifying their income and using alternative crops, this should all help to ensure the sustainability of its supply chain. The meeting served to clearly demonstrate Cadbury's understanding of sustainability and its commitment to effectively managing the ESG risks and

	opportunities it faces.
Household goods	
Philips	Philips was clearly able to demonstrate the business opportunities to its business as we make efforts to decarbonise our global economy and as changing demographics create new business opportunities. With lighting accounting for 19% of global electricity use, but with most of this electricity being converted to heat in incandescent lighting, Philips is actively promoting and lobbying for the phase-in of fluorescent light bulbs, which offer significant cost savings over their lifetime as well as reducing carbon emissions. Philips is also promoting its Green Products range which it is seeking to grow to 30% of revenues by 2012. With regards to health care the company has recognised that a growing and aging population will require more and cheaper services and is developing solutions to meet this. Finally Philips has started to explore product ranges for the developing and emerging economies, these can range from more efficient wood stoves (reducing the amount of wood burnt and hence the time spent collecting wood) to water purification and rechargeable lighting. These products are at pilot stages and unlikely to develop commercially for a few years. This presentation clearly demonstrated that Philips is addressing the sustainability issue that faces its business and realising valuable opportunities as a result.
Consumer Services **Food & Drug Retailers**	
Metro	We were contacted by Metro to provide feedback on the quality of their sustainability reporting and provide peer comparison feedback as well. We have re-iterated the need for improved transparency across the board, from environmental performance to human capital management.
Carrefour	We met with Carrefour who were presenting on their latest annual review of Corporate Responsibility. The presentation clearly demonstrated that the company has committed significant global resources to integrating the consideration of corporate responsibility into the business. The company has developed global targets and has linked manager's performance reviews to how they meet these targets. Carrefour was also able to provide some evidence of how the company links this process to the business case (e.g. cost savings through reducing waste, water and energy use). There are still areas to improve in the reporting on human capital data, and we have encouraged the company to provide information on staff turnover and length of service, which can affect business performance and operational costs. Carrefour is also working on Life Cycle Assessments of certain products to identify ways of reducing environmental and social impacts and hence reduce costs; it is hoped that this work will identify ways to expand to other product ranges and help the company develop a corporate responsibility reputation with customers.
Tesco	Tesco was presenting an annual update on the implementation of its community programme as one part of its overall business strategy. This decision was announced last year and a community plan covering all countries will be in place by the end of the year. The presentation covered supply chain management, environmental initiative, animal welfare, customer choice, and the impacts of increasing commodity prices on food prices. The presentation demonstrated that Tesco is effectively implementing its community programme and increasing its response to sustainability issues that are affecting the global economy. It also served to demonstrate that the company is aware of the impacts that these can have on customer choices and how it is aiming to respond to these to enable customers to make informed decisions when purchasing products. However it is not all good news as year-on-year performance data is lacking and we have encouraged the company to address this. In addition, following a shareholder resolution on animal welfare we have written to the company encouraging it to participate in an industry review of basic industry animal welfare standards and whether they comply with their stated intentions.

General Retailers	
Debenhams	We met with Debenhams to discuss its supply chain management policies and processes. Whilst recent evidence with other retailers suggests that consumers are not concerned about poor supply chain standards, this meeting served to demonstrate that supply chain management (SCM) is not all about reputation but also about good business strategy. Debenhams was able to provide evidence that good labour practices lead to retention of skilled workers and hence improved quality of garments. Good supplier communication can reduce wastage and the length of time to produce a garment and Debenhams was able to show that the company is rolling these improved communication methods out through the supply chain. Debenhams clearly takes SCM seriously and has dedicated significant resources to SCM which is realising business benefits. We have suggested that the company improve its transparency on this and corporate responsibility in general.
Kingfisher	When we met Kingfisher in 2007 it appeared to have lost its momentum with regards to sustainability, however this meeting demonstrated that it is now back on track again. It is beginning to collate the data necessary to understand the environmental and social impacts of its operations and has recognised the growing demand from its customers for eco-efficiency. Energy efficiency offers the opportunity to reduce carbon emissions whilst also saving money and the projects that Kingfisher is starting to implement should yield results as the eco-efficient consumer sentiment increases.
Next	We met with the Group Property Director and the Group Code of Procurement Manager to discuss Next's supply chain management practices. It was clear that Next has invested significant resources in this area, but it is still just beginning to integrate ethical purchasing practices with commercial practice. Having said that the new risk management tool will identify suppliers at risk and will help the company improve these suppliers' labour standards. Of the few projects Next has been working on within its supply chain it has found that there is a significant correlation between improving the labour practices and the productivity and quality of product from its supply chain, underlining the link between social performance and the bottom line. The role out of these programmes to its entire supply chain will take time, but the benefits should justify the costs.
Financials **Banks**	
Barclays (x2)	We attended a presentation by Barclays Head of Environmental Risk. This presentation focused on the impacts of climate change on clients, from a mitigation and adaptation perspective. Barclays is investigating how to factor into credit risk assessments the potential impact of climate change regulation, physical impacts and market based impacts on client businesses and their viability. In addition we attended a presentation by Barclays' Chairman on the company's sustainability programme. The company has set targets in various aspects of its business to reduce its carbon footprint, including 'green travel' targets, a goal to go zero carbon across the entire company by 2009, a commitment to developing more climate orientated products, such as Barclaycard Breathe (where 50% of the net profits of the card go to climate change projects in developing countries) and a commitment to community based investment in solar installations. However, all these projects are essentially good PR for the company and fairly superficial to the bank's core activities. It remains to be seen whether the company takes the prospect of carbon liabilities in its lending book or indeed opportunities to lend to carbon friendly projects seriously, potentially creating some financial benefits.
ABN Amro	We attended a presentation by ABN AMRO on their Sustainability programme. This confirmed that the company is highly tuned into sustainability risks and is evaluating their relevance for clients and markets from a risk and new market development perspective. To this end, the bank already has a carbon trading desk, green investment fund, finances renewable technologies, supports micro finance, carbon offset based products, green credit cards, car loans and insurance. However, there is still no real evidence of demand for 'green' retail products and the bank cannot demonstrate to investors that these products or other sustainability processes are

	adding value to the bank at present. As this is one of the leading banks in sustainability issues in Europe, ABN AMRO is a useful indicator for monitoring the growing impact of climate change on bank operations.
Lloyds TSB	We attended a presentation by Lloyds TSB. This was rather a defensive presentation, highlighting the group's perceived lack of influence and responsibility in 'policing' client carbon footprints. There is evidence of rising litigation, where banks are starting to be drawn into litigation issues in climate change and banks may be accused of being complicit in causing it through lending activities, which Lloyds would need to be aware of. Also, if this is indicative of a narrow focus on financial lending criteria when assessing credit risk, then this may add vulnerability to default risk, if client exposure to climate change is ignored.
Credit Suisse	The company has expanded its commitment to sustainability issues, with the development of a new division called the Environmental Business Group. The aim of this group is to develop profitable opportunities in clean tech, environmental assets and commodities (e.g. forestry), climate change and carbon (e.g. carbon credits) and renewable energy. This new division has been constructed to utilise the in house expertise of CS's existing divisions, whilst avoiding in house conflicts of interest. Aside from this, the 2006 report is still disappointing as it does not contain organised and comprehensive disclosure on labour practice and customer service, like some it is peer reports.
Standard Chartered	We met with the sustainability team to discuss Standard Chartered's strategy going forwards. Key points communicated to the team were that a) the strategy needs to be embedded in the group's business strategy, b) its needs to be driven by respective heads of business, c) it needs to be relevant to local markets and respective stakeholders, so given Standard Chartered's international scope, different local strategies may be required for different markets. The company is keen to develop the brand and PR image of the bank to improve stakeholder relationships, it is also keen to develop environmental standards in risk lending, without turning away clients; to continue the development of niche products, though these are extremely niche to date; and to involve employees in these and other 'green' activities as this is seen as a driver for employee engagement within the company. These are the companies focus areas and commercial drivers going forwards to 2011/2.
HSBC	The bank's most recent presentation conveyed better appreciation and integration of sustainability within core banking operations. For example, they have designed a new Sustainability Risk Framework which incorporates Group Sustainability Standards and Group policies and methods for managing Sustainability Risk. This is an improvement on previous presentations which have focused more on niche markets such as micro finance or niche programmes such as going carbon neutral. In our view, these are not central to the core business operations of the bank. We have encouraged the bank to focus on employee engagement and uptake of this new Sustainability Risk Framework and to demonstrate this integration through appropriate performance measures. HSBC is a sector leader in addressing sustainability issues within the banking sector.
Royal Bank of Scotland x2	We met with IR and the Head of CSR. RBOS's CSR programme is showing greater leadership and improved integration within the business. The company is focusing on key areas such as financial crime, customer service and responsible lending and whilst the report provides examples of isolated achievements and progress in each area across the group, we recommended that the group focused on continuity and direction in reporting in these areas to provide a basis for performance measurement. We encouraged them to address this going forwards. Interestingly, they found an apparent disconnect between the corporate responsibility issues rated highest by the company (financial crime, customer service and selling and lending practices) and those apparently rated by SRI investors (according to the company) e.g. the Equator Principles.

Deutsche Bank	This was the first time we met Deutsche Bank. The bank is clearly developing a CSR programme, but there are aspects which need to mature. Relative to UK based banks, the company's environmental and social risk assessments in corporate lending seem undeveloped and there was insufficient evidence that formal system and procedures for assessing this risk exist. The structure of the CSR programme in the annual report, also gives the impression that most of the CSR programme is dedicated to philanthropic activity (art, education and volunteering), rather than more integrated programmes (such as those focused on customer service) which could offer greater value adding activity to the bank. Environmental data collation also seemed restricted in coverage. The current CSR programme seems a little ad-hoc and uncoordinated; goals to 2008 could benefit from more quantitative performance data. Nonetheless, the elements of a good CSR programme are emerging.
Life Insurance	
Aviva	This was the first time that we had met with Aviva and the company was reporting on its general CR performance. It views CR performance as a key competitive differentiator, helping it to enhance its reputation (attracting customers and employees alike) and to manage risks as well as recognise opportunities and the company has made great efforts to embed CR into its global operations even including CR performance targets in executive remuneration. The company is beginning to explore the market for responsible product offerings (e.g. pay-as-you-drive; insurance discounts for hybrid and electric vehicles or for homes with heightened energy efficiency). The company is impressive with its efforts to embed CR into its business, and whilst this is clearly at the embryonic stage it appears to be implemented very thoughtfully and it will be interesting to follow how the CR performance impacts on the general business performance.
Life and Non-life Insurance	
Royal & Sun Alliance	We met with RSA IR and Sustainability team to discuss the company's ability to manage natural hazards and the risks they present. RSA uses a risk assessment tool which enables them to calculate an additional premium for all buildings insurance (and to some extent car insurance) exposed to flood risk. It also has a storm exposure model which is based on a history of claims (storm and flood) since 1990. RSA has the lowest flood losses as a percentage of aggregate exposure when compared to its peers. It has taken aggregate reinsurance cover in recent years which has worked well, as cumulative small events have been more costly than one off more extreme events. Its risk management approach seems comprehensive and its track record is impressive - in addition RSA is also an expert in offshore, onshore wind insurance and other renewable forms of insurance. This is a strong business growth area for the bank.
Health Care **Pharmaceuticals & Biotechnology**	
Astrazeneca	The focus of this presentation was to explore the challenges that AZ has in 'access to medicine' and meeting the needs of the developing market where the vast differences between the poor and the middle class, a lack of infrastructure and a lack of suitably trained medical staff make it very difficult to distribute drugs and AZ is looking to partner with host government's and other healthcare companies to overcomes these challenges. AZ is focusing its efforts on developing a new drug for the treatment of tuberculosis, which is a major killer amongst AIDS sufferers as well as a killer in its own right, however no new drugs have been developed in 40 years and those that are used are beginning to fail, meaning that new therapies are desperately needed, though difficult to find. AZ's research efforts into this area mark a noticeable change in developing drugs for diseases of the developing world, but with burgeoning middle classes in India and China, it is one that also makes good business sense.
Novo Nordisk	Novo Nordisk predominantly produces Insulin for the treatment of Diabetes. As the number of people in the world adopting a more 'western' lifestyle increases than the prevalence of Diabetes across the world increases. This is creating opportunities for Novo Nordisk to adapt its business model to the challenges of developing countries, where there are significant numbers of people with the disease, but few who have been diagnosed. The efforts to develop a business model for the developing world and

	to understand the challenges in implementing it successfully will benefit the company as developing countries economies and lifestyles improve.
Industrials	
Construction & Materials	
SIG	We met with SIG management to discuss the impact of UK legislative energy efficiency drivers on the business. The company confirmed that energy efficiency drivers were increasing demand for higher quality and more expensive insulation products. This is because increasingly higher building standards are constraining the use of lower quality products which take up more space in cavity spaces and roofs, than higher quality products. Demand is mainly being driven by new build regulations and policy targets on utility companies to improve consumer energy efficiency standards. Both these drivers are providing some mitigation against the wider negative impacts of structural issues in the housing market. Nonetheless, this is only a small impact at present and energy efficiency drivers are not expected to really positively impact the business until stronger drivers for the retrofitting of existing residential and commercial buildings are introduced.
Holcim	Holcim is taking industry leadership in sourcing significant amounts of substitute clinker materials for emerging market cement production plants within the EU. This is to protect the business against the paradox of expanding operations to meet demand whilst having to reduce C02 emissions per unit by 20% by 2010. The company is on track to achieve this target. However, a risk to this strategy is that producing less clinker could leave existing assets working at under capacity and be costly. In addition, substitute clinker can also be as expensive as making clinker and the market currently does not accept a premium on substitute cement products. To avoid eroding profitability, Holcim must ensure it can continue to source cheap substitute clinker; but contracts currently seem short-term and pricing power is not always in favour of Holcim. This challenge will become more serious post 2012 as the carbon market tightens and carbon permit prices rise. Holcim could be at an advantage to competitors if the EU ETS charges for carbon permit allocation. However, it could also suffer if the pricing of substitute clinker rises and therefore the level of risk to this carbon business strategy remains uncertain.
Kingspan	Kingspan has a commercial insulation panel which offers greater energy efficiency than competing products (rock wool). It is hoping to benefit from a doubling of sales of this product, at least in the UK, over the next few years, through a forthcoming UK Code on Commercial Sustainable Buildings. This new Code is expected to lay down a target for all new commercial buildings to be zero carbon by 2019. Kingspan is also expanding into the USA and Canada where it believes there is a growing opportunity in supplying to 'green' businesses such as Walmart.
Lafarge	Lafarge has one of the best CR programmes in the cement industry, second only to Holcim. This meeting assessed its progress in tackling the three major environmental challenges to its business strategy; environmental rehabilitation, safety of operations and carbon regulation. Lafarge is attempting to accelerate planning permission acceptance which can take 10-12 years but it believes this can be reduced by 2-3 years by demonstrating the highest environmental standards of quarry rehabilitation within the industry. Its second challenge is to keep fatalities down, but Lafarge already has 20+ this year due to contractors working on acquisitions in emerging economies. Its third challenge is to implement a climate change strategy to manage the Lafarge carbon exposure to Phase III of the EU ETS. The potential for 100% auctioning of carbon permits on the horizon presents a real risk to the continued operation of European clinker production.
Saint Gobain	We wrote to Saint Gobain to request an update on the methodology used to calculate its H&S performance. There were inconsistencies in the methodology between 2007 reporting and that of previous years and the overall number of fatalities is still well above industry average. We asked for reassurance that the appropriate level of commitment is going into reducing annual fatality numbers.

Industrial Engineering	
Alstom	Alstom's exposure to power generation and public transport mean that it is well positioned for a transition to a decarbonised economy. In terms of power stations the company helps utilities improve their efficiencies through retrofitting existing power stations (this technology was viable before the carbon market due to the lower combustion efficiencies of older power stations). Alstom is also developing carbon capture and sequestration technologies but doesn't expect the technology to become cost effective until 2015. Alstom was involved in a controversial hydroelectric project in Sudan, it has maintained its involvement in this project but decided not to explore any new projects until the human rights situation improves in Sudan. We have encouraged the company to improve its disclosure on human capital and H&S as there is currently a paucity of data in this area, which, with there being a potential squeeze on engineers in the future, is an area of future risk and hence wanting to see the company demonstrating effective management practices and proactive recruitment practices.
Vestas	We met with the CEO of Vestas. As a wind turbine company the company is in a very good position to benefit from continued and growing efforts, to reduce carbon emissions from electricity generation, and will benefit from the growth in carbon markets and the associated carbon price that will be attached to fossil fuel generated electricity. We were concerned that like many industrial companies it would be suffering from a lack of suitable employees to continue its expansion plans and Research and Development programmes, however the company is finding that applicants for its graduate programmes have increased threefold in the last two years which it partly puts down to the nature of its business and to the strategy of sighting research centres near the talent and not expecting the talent to come to them. This company stands to significantly benefit from efforts to reduce carbon emissions and has had the foresight to develop suitable programmes and strategies to attract the talent it needs to help it do this.
Support Services	
Amec	We met with the CEO, Head of Sustainability and a representative from the Renewables team. In terms of its operations, Amec uses clear performance indicators to measure its environmental, employee and health and safety performance. As an engineering company, its faces an industry wide challenge of recruiting and retaining skilled engineers, and has 15-16% employee turnover which the company says is competitive in the industry. Environmental management data is reported in absolute terms, but could usefully be normalised to account for company growth. The company is becoming involved in emerging market opportunities in wind, CCS, biomass, biofuels, hydrogen and nuclear. However, the extent of its exposure to these markets is unknown by management and therefore unlikely to be very material to the company.
Oil & Gas **Oil & Gas Producers**	
Statoil	We met with the Head of Technology and Exploration Upstream to discuss aspects of Carbon capture and sequestration technology (CCS). Although Statoil is a pioneer in CCS, the meeting revealed little additional information on the costs of CCS or the value of carbon required to make it viable. At present Statoil has four projects, the first which has been storing carbon for 10+ years (Sleipner), the second and third projects (Snohvit and In Salah) are operational and the final Mongstad is a CHP project, due to commence in 2010. The company reiterated several times that it is a lack of government support for the required pipeline infrastructure which is holding back CCS development and not general technological capability. Management also stated that the price of CO_2 would have to increase 'significantly' for CCS to become viable. We were left with the impression this was not going to happen anytime soon and possibly not within the next ten years.
BP	We went on a site visit to Wytch Farm, BP's largest drilling site in Europe. The emphasis of the trip was to demonstrate to us BP's improved health and safety standards. Overall our impression is that the company's new central auditing function is ensuring much greater priority of health and safety standards on the ground and at

	executive and board level, with the CEO overseeing progress of immediate improvements and the implementation of the ongoing Six Point Plan (Major Accident Risk Control, Integrity Management, Control of Work, Compliance, Audit and Operations Competence). The company has a developed a statutory 'red book' which provides quarterly updates to the board on the progress of this Plan and also an assessment of the 'state of health' of all plants, processes and people. We were satisfied that health and safety has taken much greater priority within the company, but felt that Wytch Farm was probably a best in class case-study and highlighted to BP the importance of consistent performance at all plants.
BP	We met with the CSR Director of BP to discuss the company's involvement in unconventional oil (tar sands). The main project is based in Alaska and BP took time to demonstrate that it has minimised its environmental impact on the local area and taken into account the concerns of the local indigenous populations. If American fuel standards become too stringent for this heavy oil, BP state it will be shipped elsewhere, e.g. China. We also discussed the number of group dismissals for non compliance and unethical behaviour which has risen each year since 2003 and we recommended that BP provide details of the general nature of these dismissals so that this trend could be better understood.
Shell	We met with the CEO & Director of Corporate Affairs. Shell continues to diversify its portfolio into alternative energy sources investing in gas to liquid technology. It also wishes to invest further in offshore wind platforms, but considers the commercialisation of hydrogen fuel cells and carbon sequestration to be far more longer term (approx 10 years away possibly more). Shell takes into consideration the price of carbon in all investments but will not disclose the figure used. Whilst Shell hopes to benefit from its low carbon investment strategy; the reality is that these investments are unlikely to offset the rise in use of unconventional oil resources in the main portfolio, which are more energy intensive, both upstream and downstream. Therefore, it's unlikely that Shell will be able to reduce its absolute carbon emissions going forwards and it's questionable whether the higher margin costs of operating its diversified strategy, could even put Shell at a disadvantage to rivals, in the short term, until the carbon price is fully incorporated into share prices. The CEO believes this will happen within the next ten years and considers this longer-term strategy an investment in the future.
Total	We met with Total to reassess the company's exposure to environmental, social and political risk in upstream operations. The company continues to be exposed to a high level of political risk in Myanmar and in Africa. Historically the company has faced allegations of forced labour and has faced related law suits which, in 2005, resulted in financial compensation to local communities in Myanmar. Total has denied all accusations and has Group security policies which state the company meets / adheres to international human rights norms and standards. However, management could not provide full reassurance that allegations of breaching human rights norms would not arise again, hinting corruption is the 'norm' in Myanmar. The company shows no signs of retreating from working in political sensitive regions, stating that it cannot choose where oil is located. The company continues to invest in reducing flaring, improving energy efficiency in refining and in carbon sequestration but doesn't demonstrate sector leadership in any of these areas.
BG	We met with the executive Vice president and managing Director for the Americas and Global Liquefied Natural Gas. The presentation was purely focussed on the LNG business. LNG offers a low carbon intensity alternative to oil and with rocketing prices for oil and increasing efforts to reduce anthropogenic carbon emissions the demand for LNG has increased rapidly growing from 7% CAGR from 1980-2004 to 11% CAGR since 2005. The global gas market has also grown from a regional one to an international market and all the indicators are that this is set to grow further. With fears over security of supply, environmental issues and increased demand the market looks set to continue its growth. BG's portfolio is 2/3rds gas and 1/3rd oil and is likely to stay at this ratio. BG is in a very positive position to benefit from the necessary shift to a low carbon economy.

Tullow Oil	As a small company Tullow has committed significant resources to the development of its corporate responsibility function. Historically it has focused on developing good community relations in the countries in which it operates and it is clearly, and rightfully very proud of this. However in other areas of corporate responsibility the company has still to improve its performance, we have suggested that in a period where engineers are in short supply the company needs to improve its disclosure on human capital management to demonstrate that its employees are satisfied and it has in place suitable systems to attract and retain employees. The company acknowledged that this is an area of concern and that it has a new HR manager who is developing the systems to monitor this as well as improving training at the country level and increasing its contact with universities. In addition we criticised the poor H&S performance this year, which the company explained was due to a new acquisition in Uganda and that it was working to improve the H&S culture there. The company is clearly committed to CR and has in place good community relations, but these may have been developed at the expense of other areas.
Oil and Gas Equipment Services and Distribution	
Technip	Technip demonstrates best in class CSR performance in the oil and gas equipment sector. The company has 83% of entities reporting to internal environmental performance indicators, many in line with ISO14001. Health and safety and environmental performance are considered an important aspect of winning contracts; failure to perform in these areas can result in significant financial contractual penalties. As such, the company is following a programme of HSE development, with management systems being upgraded and expanded, to ensure the company retains a leading market position. The company is also developing a presence in growing markets such as the hydrogen market, through the completion of hydrogen units, biofuels and renewables (such as an alcohol dehydration unit and polycrystalline silicon production plant).
Telecommunications **Fixed Line Telecommunications**	
Deutsche Telecom	The company was presenting on the developments within its corporate responsibility programme. Previously the company did not have a very good grasp of the non-financial issues that it faced, but this presentation provided reassurance that this has now changed with the company embedding corporate responsibility at the board level and developing relevant key performance indicators. It has a way to go (as this information is predominantly collated from the German operations) but it does provide reassurance to investors that the company is beginning to address non-financial risks (e.g. customer satisfaction, energy efficiency, human capital management).
Deutchse Telekom	Since 2006 Deutsche Telekom has clearly embraced corporate responsibility and the benefits that good management in this area can bring to the business. The company provides clear evidence of its commitment to human capital management and clearly monitors this well which has helped during a long term process of restructuring and head count reduction. It is developing projects to look at how the companies products and services can help the communities where businesses operate, which will enable it to predict future demands and develop a strong reputation with its customers (which show year on year increased satisfaction with the company) and DT has made efforts to seriously reduce its CO2 footprint which will help in future operational strategies as government policy continues to strive to lower national carbon footprints. Deutsche Telekom has clearly worked hard to integrate Corporate responsibility into its business and one would expect to see benefits of this in the future, it has already been able to demonstrate some current financial benefits as a result of its activities.
France Telecom	We were interviewed by a consultant for France Telecom on what the key corporate responsibility issues were, in our opinion, for a telecommunications company, which the company would use in developing its corporate responsibility strategy. We mentioned that, amongst other topics, issues such as digital divide both in the developed (e.g. the elderly) and the developing world (where mobile telecommunications are having positive economic benefits); energy use and other environmental costs, and health concerns (though the science indicates that there is no evidence) should all be covered by the corporate responsibility report.

Mobile Telecommunications	
Vodafone	We provided feedback on Vodafone's latest corporate responsibility report to the company. Vodafone clearly has an understanding of corporate responsibility and the business case. It has continued to explore the role it can play in the socio-economic progress of its clients in developing countries as well as providing more evidence of efforts to capture environmental and social performance data and to set targets to improve on its performance in these areas. We have suggested that the company could provide more evidence of how it intends to meet its CO2 reduction figure and whether it would be realising cost savings as a result or an increase in costs to customers. We also suggested the human capital data could be continued to be improved by including length of employee service, but have been impressed by the progress the company has made in this area. We have asked whether the company will look at ways to assess the cost of sickness to the firm and hence its efforts to improve employee health.
Utilities	
Electricity	
British Energy	We visited Sizewell B (which supplies 3% of the UK's electricity), which gave the opportunity to assess how a nuclear power station operates in reality and to see how spent fuel is stored securely on site. There are on-going concerns about the long term storage of high level nuclear waste and about the exact costs for decommissioning, but these have moved more into the political arena than an industrial one. However with the forthcoming closure of the current fleet of nuclear reactors in the UK, reduced engineering graduates and a global boom in demand for nuclear power, there is an apparent risk about the supply of suitable human capital for the industry. BE is working with its supply chain and is also developing partnerships with British Universities and believes that the long lag time will ensure there is a suitable intellectual capital base when required.
RWE	RWE is the biggest emitter of CO2 in Europe, and therefore faces the key challenge in either reducing its own emissions or purchasing credits whilst the EU seeks to reduce its overall emissions. Whilst RWE has involvement in energy efficiency, CCS technology and renewable energies it appears to be focusing predominantly on the purchasing of emissions reduction credits to meet its target, though how this will work post 2012 remains politically unclear. With a high carbon portfolio the company is strongly exposed to future legislation to reduce carbon emissions, and its willingness to explore carbon permit trading shows signs of a long term strategy, however the company also stated that there may come a crunch between power supply and climate change and that this means that it would be wise not to start changing the carbon load of its generating capacity.
Gas, Water & Multiutilities	
Centrica	Centrica was presenting on the issue of fuel poverty - according to some estimates, a quarter of UK households could soon be living in fuel poverty in the future. Fuel poverty is defined as “a household dedicating more than 10% of its total income to paying electricity and gas bills”. This is a key area of risk for the business as high energy prices, declining household incomes and a potentially colder winter could create an energy squeeze in the short term, coupled with a potential energy crunch over the long term as a result of declining power supplies. The UK government has recently announced a fuel poverty package of £900m, largely funded by the utilities and there is the potential for the UK government to continue to intervene by raising funds from the utilities should they not take proactive measures. Centrica has developed a sector leading response to managing fuel poverty and spends more than double the combined expenditure of other suppliers on the issue whilst having 1/3rd of the UK customer base. This should reduce the risks of future legislative impacts, though with the price of carbon driving up the costs of electricity this will remain an area of concern for Centrica and other energy suppliers.

Pennon	We met with the CEO of Pennon to discuss the forthcoming UK Government's water strategy and the waste management business, both areas that are being affected by the effort to decarbonise our economy. Viridor (the waste management business) has successfully seen the opportunities in developing revenue streams from waste (e.g. Energy from Waste, Recycling) and has won integrated waste contracts for local authorities as well as successfully competing against French waste companies in their core area of expertise, Energy from Waste. South West Water is in a relatively fortunate position as it has not had to impose a water ban in the last 12 years due to excess water, it is also well positioned to benefit from the Government's forthcoming water strategy to impose innovative water tariffs (e.g. seasonal tariffs) facilitated by the use of increased water metering. Whilst installation of water meters will be a cost to many companies South West Water has 65% metering in its region. Pennon as a whole looks well positioned to benefits from the transition to a decarbonised sustainable economy.
Seche Environnment	Seche is predominantly a waste management company involved in the treatment, and not the collection, of waste. As environmental legislation on the treatment increases Seche is recognising ongoing opportunities for its business and this is especially the case in providing specialist services (e.g. gas treatment, recovery of materials from landfills). Seche has also taken a 33% stake in a water treatment firm and believes that it has recognised synergies in the treatment of water and waste which will benefit the business overall. This business is clearly exposed to areas of society where mankind's environmental impacts will increasingly need to be managed, which is representing an opportunity for the business.
Severn Trent	Severn Trent was presenting on the challenges and opportunities in water as a result of the need to upgrade existing water infrastructure systems. The company sees growth coming from non-traditional markets such as Asia-Pacific where water shortages are a growing concern. Trends for growth will come from regulatory drivers requiring increased analytical technologies (e.g. testing for endocrine disruptors), an increase in people lacking access to clean freshwater and high energy costs driving a need for increased optimization. As with many sectors that require an engineering workforce, there was concern voiced over securing future human capital and this was recognised as a challenge in expanding to emerging markets. Severn Trent is utilising in-house expertise in the short term and aiming to develop more local recruiting practises in the long term.

Appendix 2

Compilation of SRI Sector / Thematic Research 2008

We produced three sector reports in 2007 on the chemical sector (Box 1), Food Retailers Sector (Box 2), and Construction Sector, (Box 3) and one thematic report on the water industry (Box 4). Full copies of each of these reports can be obtained from your Client Director.

Box 1

Special Topic: Sustainable Aerospace

This report investigates the major social and environmental issues facing companies in the European aerospace sector. The aerospace industry sustains our military defence equipment and operations and provides an aviation fleet for civil aerospace. The companies reviewed in this report are: BAE, Rolls Royce, Smiths, Cobham, Meggitt, Ultra Electronics Holdings, VT Group, Finmeccanica, Safran, Thales and EADS.

The issues reviewed include:

- Maintaining a competitive workforce;
- Maintaining impeccable operational and product health and safety standards;
- Minimising the environmental footprint of the aerospace industry – in particular aviation noise and greenhouse gas emissions;
- Developing the most sustainable product – by raising standards in fuel efficiency through optimal energy efficiency of airline design and engine design.

These different issues present both risks and opportunities to the aerospace industry. A generic challenge to all companies is clearly to maintain a talented employee base in order to maintain performance in R&D and innovation, which is a particularly critical driver of success, sales and therefore market share in this sector. BAE and Rolls Royce were leaders in disclosure in employee indicators, and appear to have the most comprehensive human resource programmes. The greatest risk to be managed, however, is the safety of all operations and parts, which supply airlines and defence equipment. Whilst statistics indicate that civil aviation world safety standards are extremely high, company level disclosure of health and safety data from non UK companies is generally poor and UK companies could report more comprehensively, following the example of companies like BAE. The issue of corruption and ethics is an important point for companies with exposure to the defence industry; UK companies and EADS clearly have ethical policies in place but other non UK companies do not clearly demonstrate their ethical commitments. The establishment of a new European industry initiative, which sets industry wide ethical standards, suggests that this issue is gaining prominence. Finally, on minimising environmental impact, BAE, Rolls Royce and Smiths have some of the best reporting and Ultra Electric Holdings, Finmeccanica, Safran and Thales provided little or no information.

The most interesting opportunities are in sustainable product development. Clearly this is a particularly relevant issue for EADS, Rolls Royce and Safran, as the potential for generating energy efficiencies is greatest in aircraft and engine design. Other tier suppliers are less directly impacted by the drive for fuel efficiency, but can also demonstrate smaller scale efficiency improvements, for example, Thales in cockpit electronics, landing gear and other key components. The Box below summaries those companies' best positioned to mitigate risks and to take advantage of opportunities in sustainable product development (graded 1-3 with 1 representing the best positioned and 3 the least well positioned. Views are the subjective opinion of the analyst and based on information on corporate disclosure, performance and strategy contained within this report.

Box 1. Summary of Company rankings.

Positioning	Leaders	Middle men	Laggards
Risk Management	Rolls Royce	BAE , EADS, Smith, Meggitt, VT,	Cobham, Ultra Electric, Safran, Finmeccanica, Thales
Opportunity	Rolls Royce, Safran , EADS	Finmeccanica, Thales	BAE, Smith, Cobham, Meggitt, Ultra electric, VT,

Schroders

Box 2

Special Topic: Sustainable Forestry

This report investigates the major social and environmental issues facing companies in the Pan European forestry sector. The paper reviews the following companies: Stora Enso, Svenska Cellulosa, UPM Kymmene, Smurfit Kappa, Mondi Packaging, Sequana Capital, Norske Skogindustrier. The sustainability issues reviewed in this report include labour standards, human rights standards, sustainable forest management, and resource efficiency of paper and pulp manufacturing operations and risks and opportunities arising from climate change. It is clear that the forestry sector is undergoing a period of change and there are a number of key sustainability risks that companies have to manage.

Forestry is an important element of rural economies providing employment opportunities and coming into contact with indigenous people, their culture and land management practices. Managing the impact of the businesses on these communities is important, especially in times of rationalisation. Stora Enso sets an example in the way in manages its employees with 'best in class' labour policies, in particularly redundancy programmes. It has also followed this up with a new social management system to promote employee productivity and to ease the company through a time of re-structuring. Other companies would be advised to develop similar programmes, as the sector as a whole faces a similar economic situation. In addition, companies need to maintain high ethical standards, especially when coming into contact with local stakeholders. It is helpful if companies can integrate these ethics into procurement policies to ensure business integrity.

A key aspect of ethical procurement is obviously the sourcing of legal wood fibre and if possible wood fibre from sustainable forests. Companies need to have traceability systems that ensure a flow of accountability from the original source of the wood up the supply chain to end customer markets. Some companies have more robust systems than others. Companies also gained a better ranking if wood was sourced from sustainable forests. Stora Enso and UPM have 61% and 71% of all wood from sustainable managed forest. SCA is one of the largest owners of forest in Europe and has certified all of its land.

It is important for a company to improve the efficiency of their production processes as increasing energy prices have competitive and environmental implications. Energy costs are now determining factors in the profit margins of a paper company. Therefore, it is important to consider which companies have the greatest level of self-sufficiency in energy production. Stora Enso and UPM were found to have the highest levels of energy self-sufficiency and are therefore better protected than other companies from price rises.

Finally, demand for biomass led energy supply is driving up demand for wood 'waste' and also normal wood fibre. This is driving up demand in the short term and the result is that the value of forestry land is rising and wood fibre prices are also expected to rise too. Increased cost of wood fibre will hurt the profit margins of paper companies. Only those companies that have access to their own forestry assets can be protected from this market trend, which leads us to rate SCA as the best positioned to benefit from climate change trends, because it is the largest forestry owner. In summary, companies have been allocated the following ratings.

Summary of Company Ratings

Leaders	Middle men	Laggards
Stora Enso and SCA	UPM, Norsk Skogindustrier	Mondi, Seqana Capital, Smurfit Kappa

Box 3

Special Topic: Adaptation to Climate Change and its investment implications

The current focus of meeting the challenge of climate change is predominantly on the need to reduce greenhouse gas emissions, however even if we do manage to achieve this there are sufficient levels of greenhouse gases in the atmosphere to cause the climate to continue to change for the next few decades.

To date there has been little substantial international, regional or national political efforts to address the issue of how to adapt to these changes that climate change will bring (e.g. precipitation, rising temperature, sea-level rise, less water resources, less productive ecosystems). Though evidence is growing of physical changes already occurring and this can be used to predict what the impacts to ecosystems, human health, water supplies and food will be. These changes will not be uniform across the globe, with some regions potentially experiencing benefits of a warmer global climate, whilst others (typically the sub-tropics) experiencing the most significant changes.

So far the overwhelming corporate response to developing strategies to effectively deal with the risks of climate change is to reduce their emissions of greenhouse gases (in the face of increasing regulation and energy prices). However few companies have taken steps to assess the potential physical implications of climate changes to their direct operations, their supply chains and their consumers.

Adaptation does present opportunities for business especially in areas associated with water resources (e.g. desalination, purification, pipelines, metering) and agriculture (e.g. irrigation, GM) which will be affected the most by climate changes, and we would expect sectors associated with infrastructure developments and repair to benefit in the longer term as governments develop and implement adaptation plans.

Box 4

Special Topic: Sustainable Steel

The European Steel industry employs about 280,000 people and produces about 160 million tonnes of crude steel per year, which represents just over 20% of world production (Eurofer 2008). This review covers six leading steel players in the European Steel Industry. These companies are Arcelor Mittal, Acerinox, Outokumpu, Salzgitter, SSAB and Thyssen Krupp AG. The main environmental and social issues that affect companies in the EU steel industry are environmental constraints from a resource intensive industry and stringent regulations (especially around air pollution and climate change). There are also issues of employee recruitment in the sector, health and safety and good community relations. These issues now impact company performance, determine new product and market opportunities, influence employee recruitment and retention, customer loyalty and local community acceptance.

One of the largest risks to companies in the steel industry generally is the lack of new talented engineers entering the labour market. In response to this risk, we assessed company ability to retain their existing talent base and attract new recruits, through specific human capital performance indicators. SSAB and Outokumpu both scored relatively highly, compared to their peers, in our measures of the value that companies place on their employees and employee productivity. In addition, a review of health and safety performance indicators and company performance against these highlighted that Outokumpu also has the best overall health and safety and occupational health programs and track record to date, followed by Saltzgitter.

In terms of community investment it was a surprise to find that most companies do not report on these activities. Poor community relations and a lack of investment in this area are renowned for potentially causing poor stakeholder relations, not just locally but also nationally with governments. Arcelor Mittal demonstrated the best reporting in this respect, no doubt as a result of its diverse international portfolio and activities in remote regions of the world. Nonetheless, we would expect more European focussed companies to still have community stakeholder consultation processes in place and there was no evidence of this.