Schroders

Responsible Investment Report

2009 Annual Report

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

This report provides a global review of Schroders Responsible Investment (RI) programme, the types of processes in place and the assets they apply to. The report defines RI as any process or product, which involves at some stage in the investment process, a consideration of environmental, social, and governance (ESG) factors or screening of ethical factors. Within this definition there are a variety of RI processes in use within Schroders, which are explained in detail throughout this report.

Schroders believes that the integration of environmental, social and governance issues is part of our fiduciary duty to act in the long term interests of our beneficiaries. Schroders became a signatory to the UN Principles for Responsible Investment (UNPRI) in 2007, seven years after our RI team was established. Our policies and processes, both before and since this date, have been in compliance with the Principles. The advent of the UNPRI has seen the responsible investment market grow rapidly, and we remain committed to expanding our own RI processes across more asset classes and across the Schroders group.

Since 2000, Schroders RI programme has evolved from being focused on two RI processes (shareholder advocacy and screening) across mainly UK equities, to four RI processes (including integration and thematic investments) across global equities and property.

In 2010 we will be looking to continue and deepen this level of ESG integration through all asset classes. In 2009, Schroders' progress and achievements in RI can be summarised as follows:

Engagement:

– The continued development of our engagement programme with the UK and Pan European equity team

Integration:

– The development of integration processes across certain equity large cap teams: Emerging Markets, Global and USA.
– The introduction of our first ESG auditing processes for the large cap Emerging Markets team on their ESG integration processes.

Voting:

– The combined reporting of corporate governance and ES team voting data in the annual report

Ethical Funds:

– The introduction of ethical 'monitoring' of client exposure to investments in Sudan.
– The introduction of ethical 'monitoring' of bond screening, in addition to equity investments for certain clients and funds.
– The introduction of our first religious pooled fund: the Shariah fund.

Property:

– The development of a UK Responsible Property Investment (RPI) Policy for the property team.
– The establishment of an RPI focus group, to bring together the property team and RI team on key ESG issues and to develop key performance indicators.

Introduction

The aim of this report is to provide a global review of Schroders Responsible Investment (RI) programme, the types of processes in place and the assets they apply to. In this review RI is defined broadly as any process or product, which involves, at some stage in the investment process, a consideration of environmental, social and governance (ESG) factors or screening of ethical factors.

Schroders operates a RI programme because it believes the integration of ESG issues is part of our fiduciary duty to act in the long term interests of our clients. To communicate this commitment, Schroders is a signatory of the UNPRI. We believe that our policy and processes comply with and support the implementation of UNPRI. In applying these to our business, we aim to help clients align both their responsible investment and financial objectives.

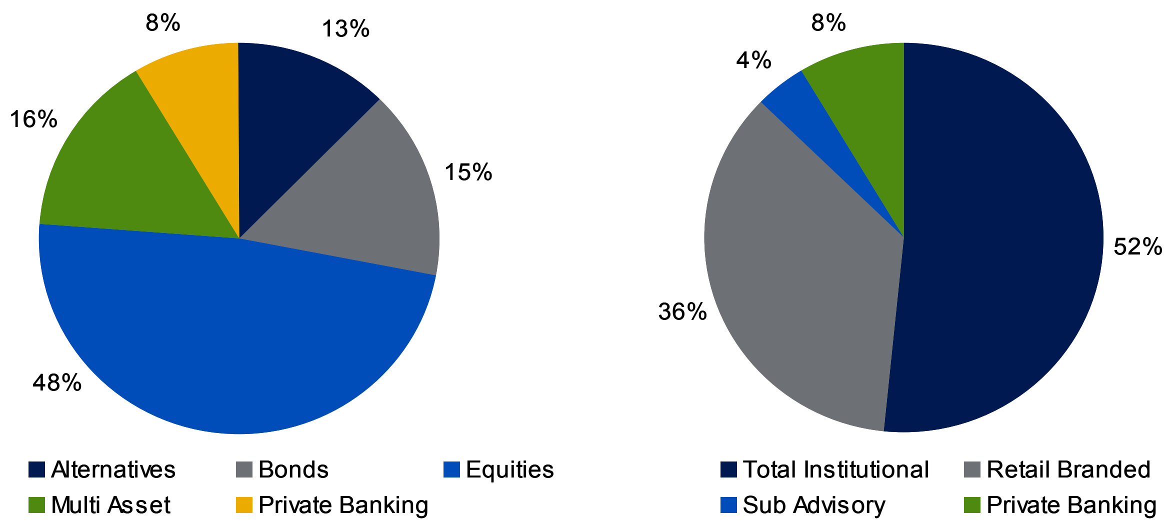
Schroders RI policy has been drafted to ensure that in all cases the overriding criteria are always seeking to maximise the investment return for beneficiaries. However, maximising the investment return for beneficiaries now also requires the consideration of ESG issues and their impact on investments, both positive and negative, over the short and long term as a fundamental part of investment process and selection. This is because ESG issues can be financially relevant. RI identifies ESG risks and opportunities not always captured by conventional financial analysis. In capturing this additional information, it improves long term investment performance.

The following report is divided into several parts. A background to RI at Schroders follows this introduction to provide the reader with a historical perspective on RI at Schroders, and the different types of RI processes that we use. The following pages then go into detail into each RI process (integration, shareholder advocacy, screening and thematic investment) and how it is managed and executed at Schroders. We also include a section on property, where our RI reporting approach is developing and conclude with a summary of our progress in 2009.

Background to Responsible Investment at Schroders

At Schroders, we have a diverse investment portfolio. In 2009, just fewer than 48% of all assets were in equities, 15% in bonds, another 16% in multi-asset platforms, 8% in private banking and 13% in alternatives. The ownership of which, by our clients, can be broken down into institutional (52%), retail (36%), private banking (8%) and sub advisory (4%), see Diagram 1.

Diagram 1. Group FUM by asset allocation and client type



Schroders utilises a variety of RI processes, which can be applicable to one or more asset classes. Table 1, summarises the different RI processes used in Schroders and where they are applied. There are four RI processes used: integration, shareholder advocacy (comprising engagement and voting), negative screening and thematic investments. These processes take ESG issues into account differently.

Table 1. Different RI processes applied in different asset classes

RI Process	Asset Class	Definition
Integration	Equities	Explicit incorporation of ESG into fundamental investment analyses and decision making
RI related thematic Investments	Equities	Investments in particular RI themes e.g. climate change. Other RI related thematic proposals are under development.
Shareholder Advocacy (Engagement and Voting)	Equities,	Active voting and engagement in which Schroders has a shareholding.
Negative Screening / Monitoring	Equities, private banking, bonds	Avoidance of investment in targeted companies, industries and countries, based on one or more multiple ESG criteria.

The type of RI process used, reflects, in most instances, the process which best complements the qualities of the product it relates to and its legal parameters. Schroders set up and formalised its RI programme in 2000. At this time, the RI programme was UK focused with two RI processes on offer: shareholder advocacy and negative screening. Shareholder advocacy has two forms. The first, engagement, involves meeting with companies to evaluate and improve disclosure on corporate responsible programmes (CR). This process has been used as an 'overlay' in addition to the mainstream investment process. The results of engagement may not be explicitly incorporated into traditional financial analysis, but the information will be used to understand the companies more holistically and to improve their CR performance.

The second form, voting, is where shareholders can request to the company that more CR information is disclosed. Ultimately, the reason for requesting more information is the same as with engagement – to improve the disclosure and management of the CR programme.

The use of negative screening, however, is quite different. This refers to pre-screening an investment universe of companies based on specific ESG criteria. Investment can only then occur from this pre-screened and therefore narrowed universe of companies. This approach has been mainly used with our private banking and charity clients.

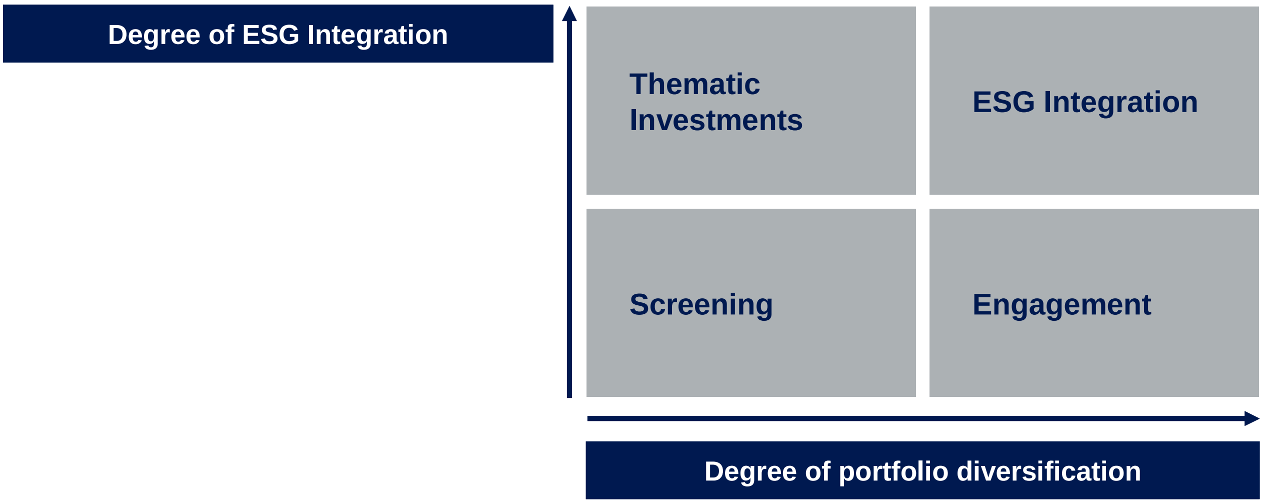
From 2005, Schroders' engagement programme expanded to become Pan European in coverage, supported through Schroders Pan European Responsible Investment Policy, which remains in place today. In addition, in June 2007 a thematic Global Climate Change Fund was set up, specifically to integrate climate change issues into mainstream investment processes. Thematic Investments are based on ESG criteria which identify or define a specific investment universe.

In 2009, another RI process was introduced called 'ESG Integration', which led to the expansion of ESG investment analysis across other equity teams, including the global, USA and emerging markets. We define integration as the analysis of ESG related risks and opportunities and the integration of this analysis into the stock valuation and selection process.

Diagram 2, below, summarises the difference in RI approaches. Screening and thematic investments use a pre-selected and narrowed investment universe which therefore reduces the level of portfolio diversification. Engagement and integration processes do not impact the investment universe. However, integration and thematic investments also integrate ESG analysis into the stock valuation and selection process, whilst screening and engagement processes do not focus so explicitly on this.

In summary, since 2000, Schroders RI programme has evolved from being focused on two RI processes across mainly UK equities, to being globally focused across global equities and UK property. We are continuing to develop RI programmes in all of these areas.

Diagram 2. Current RI Strategies



Section 1.0

Integration

Schroders believes that an analysis of ESG issues and their positive or negative impact on investments, over the short and long term, is a fundamental part of the stock valuation and selection process. This is because ESG analysis provides a greater understanding of the quality of the company and its management. ESG issues can be financially relevant, for example, by impacting a company's reputation and hence share price (e.g. labour standards in the supply chain) and by impacting on operating costs (e.g. the EU Emissions Trading Scheme and electric utilities).

Historically, this ESG integration has been implicit within our investment process. Our RI team has implemented a more explicit process across our UK and Pan-European holdings since 2000 and variations of this approach are now being rolled out across our global product range, with company analysts preparing explicit comments on the ESG performance of a company and with the RI team providing support for this. Exactly how ESG information is integrated into financial fundamentals is up to the analyst. One example of an integration process is provided by a sector analyst below:

"…I try and think whether any of these [ESG] factors will actually impact the price investors will be willing to pay for that stock i.e. its fair market value. If necessary, I might then make a subtle adjustment to the fair value to reflect this e.g. for an emerging market stock with poor governance and, or reporting standards, the lack of transparency and proper management practices should mean it trades at a discount to identical peers which do not share the same problems."

Different regional teams have developed slightly different ways of assessing the ESG performance of stocks under their coverage. Some teams have developed a simple rating process; others have preferred to adopt more qualitative processes, without ratings.

Table 2. ESG Coverage by Desk

Region	Responsible Investment Process	Companies with an ESG investment view	No. of Companies in investment universe (with financial rating)	% of investment universe with ESG rating
Large Cap				
UK	Integration / Engagement	50	214	23%
Continental Europe	Integration / Engagement	34	159	21%
North America (US)	Integration	65	270	24%
Latin America	Integration	70	103	68%
Pacific Ex Japan	Integration	8	75	11%
Japan	Integration	185	221	84%
Emerging Asia	Integration	252	328	77%
Eastern Europe, Middle East and Africa (EMEA)	Integration	151	163	93%
Global	Integration	67	Undefined universe	N/A

In addition to the large market capitalisation companies, a number of desks manage companies with smaller market capitalisation (small cap funds). Globally, these desks select companies from a universe of circa 6000 companies. Only circa 800 are invested in at any one point in time. The non US stocks have explicit ESG ratings whilst the US stocks implicitly look at these factors when evaluating the stock.

Most ESG information is captured on our proprietary internal information systems along with all company and sector research produced internally. In 2009, our review of our internal systems indicated that we have ESG coverage on a reasonable percentage of our investment universe.

To supplement our internal research, we also use an external research agency which provides circa 2200 external ESG ratings of companies. These are not included in Table 2 which is our own proprietary research.

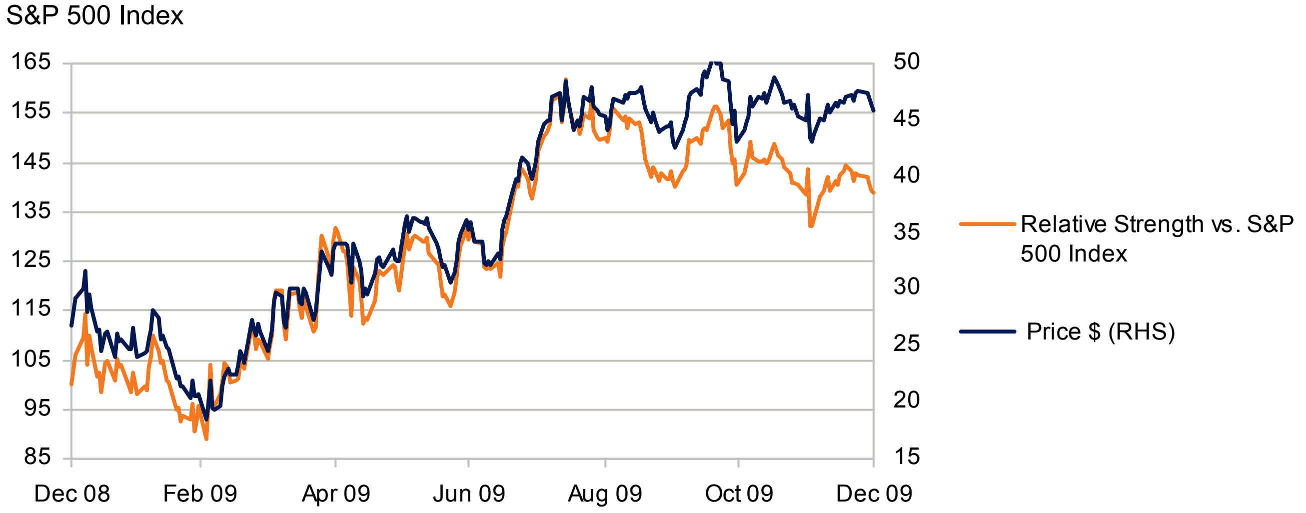
However we do use this research to provide a quarterly ESG assessment of the portfolio holdings by desk, and this is also used to direct our engagement with the lower rated companies.

An example of a company we have a positive ESG integration view on is Cummins:

Cummins: Reasons to buy

- Commercial trucks 3 years into a downturn – normal trade cycle is 4 years. Cummins is the leading engine supplier to the industry
- Emerging markets (China and India) are an incremental earnings driver that is underestimated by consensus
- Power generation market offers long-term secular growth and should perform better in downturn than many expect.
- ESG: Leader in emissions technology and fuel economy for diesel engines globally. Has developed products that are compliant with the US and Europe emission regulations due to be enforced in 2011. The company also has best practice supplier management strategies.

Graph 1: Cummins Performance in terms of price ($) against the S & P 500 Index.

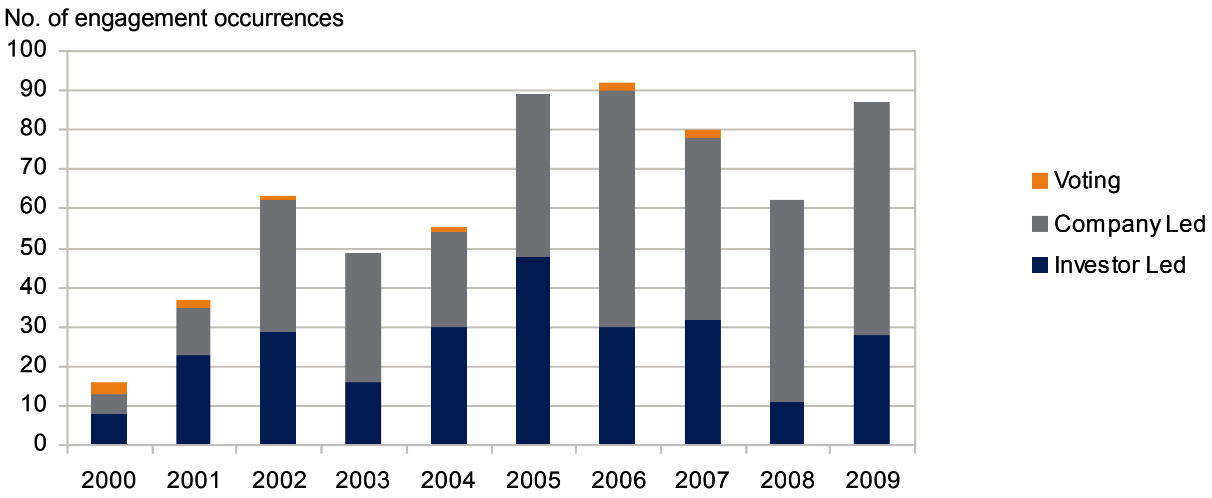


Section 1.1

Shareholder Advocacy – Pan European Engagement

Since 2000, Schroders has operated an engagement process which is supported by the Pan European RI Policy. Engagement involves meeting with companies to evaluate what they are doing on ESG in order to enhance our analysis and to encourage improved management of ESG issues where it represents a risk or opportunity to the business. We provide guidance on developing policies and systems and seek to improve disclosure on corporate responsibility programmes (CR). Graph 2, shows the growth in corporate engagement since 2000 (and also includes any engagement undertaken specifically resulting from Pan European voting activity on shareholder resolutions). It provides a reflection of how active Schroders has been in its engagement programme, illustrating whether corporate engagement has been initiated by us, by the company, or as a result of a shareholder resolution. There are occasional shareholder resolutions placed at the AGMs of Pan-European companies and these are included here, although they are more common in the US than Europe (see Section 1.3 Voting), due to different corporate governance regulations between the two regions.

Graph 2: Pan-European RI engagement activity since 2000



There has been continued growth in company led engagement because more companies are producing CR reports, road-shows and conferences. However, we focus our engagement with companies with whom we have shareholdings and where CR programmes are perceived to be insufficiently managing ESG risk or opportunities in the market. Typically, approximately 40% of our engagements are with Continental European companies.

As mentioned earlier, our engagement activities can fall into one of two categories: simply ‘fact finding’ and filling in the gaps in our ESG analysis, or engaging to make suggestions for change and improvement to the CR programme, known as ‘change facilitation’. We believe that ongoing monitoring and discussion with companies on CR is vital as it demonstrates investor interest in CR performance and hence acts as an indirect means of encouraging corporate investment in CR programmes. If a company is a laggard in its sector or is not addressing specific issues that could potentially damage long-term shareholder value, then we will engage with a company for the purpose of ‘change facilitation’. Table 3 provides five year average performance information on our engagement activities from 2005-2009 and shows the total number of companies engaged with and the proportion of this engagement that has ‘facilitated change’ (the remainder being for ‘fact finding’).

Table 4, reviews the effectiveness of our ‘change facilitation’ engagements, 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, 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. With this caveat, we have presented in Table 4, those change requests that have been met.

We conduct one-year rolling reviews so data for 2009 is not available yet. The table shows that between 2001 and YE 2008, 44% of suggestions have been rated as 'achieved'.

Table 3: A 5 year review of instances of Engagement for change versus fact finding

Year	Total Engagements	Engagements for change (absolute numbers)	% Engagements for change (%)	Engagements for fact finding	% of Engagements for fact finding
2005	89	40	45	49	55
2006	92	40	43	52	57
2007	80	27	34	54	68
2008	62	19	43	43	70
2009	87	37	43	50	57
5-yr average 2005-2009	82	33	42	50	61

Table 4: 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	2 (↓)	5 (↓)	7 (↑)	7 (↑)	5	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. First Choice merged with TUI Plc.
2008	20	7	3	3	6	1	HBOS taken over by Lloyds TSB

*In the table the arrows indicate whether there has been an increase/decrease/no change in that category over the year.

Key:

No Change – there is no obvious response to our suggestions

Some change – the company demonstrates that it has started to implement a response which would satisfy the suggestions we made

Almost there – the response by the company has gone a long way to satisfying the suggestions that we made

Achieved – the aim of our suggestion for change has been met

When we engage with companies we do find that some ESG issues are more characteristic of certain sectors than others. This means that there are trends in reporting, both in coverage of ESG issues and in the level of disclosure across sectors. For example, our engagement with the automobile industry focused particularly on corporate climate change strategy, low carbon emissions from vehicles and alternative technology, such as hybrid technology, as a means to staying one step ahead of environmental legislation. Similar issues arose with the utility sector, where the European Trading Scheme (EU ETS), is placing a growing obligation on companies to invest in gas, rather than coal, to improve energy efficiency and to find innovative ways of reducing or offsetting carbon emissions. In contrast, our engagement with banks focused on corporate governance issues, such as the linkage of ESG issues with executive remuneration, risk management, and human capital management with respect to appropriate remuneration incentives. Other issues, for example in the pharmaceutical sector, included evaluating the social benefits of new drug development and access to medicine programmes. In the mining sector we challenged companies to get a better grasp of stakeholder management, particularly in local communities and to really design and run their operations sustainability, rather than with a few eco-efficient trimmings. In the consumer sector we focused on supply chain management and the efforts companies are making to enforce or promote social standards.

As a general guide we have enclosed, in Appendix 1, all the different companies we have engaged with on a Pan European level. We have ticked E, S and G boxes (defined in Appendix 1, Table 1 & 2) to demonstrate the coverage of our engagement for different companies. The total number of engagements with different companies is 84. In some instances, we will have met a company more than once, so this does not equate to the total number of instances of engagement. We engaged with 46% of companies on social issues, 71% on environmental issues and 82% on governance issues.

Section 1.2

Shareholder Advocacy - Voting

Schroders recognises its responsibility to make use of voting rights and to evaluate voting issues on our investments and, where we have the authority to do so, to vote on them in line with our fiduciary responsibilities in what we deem to be the interests of our clients. We normally hope to support company management. However, we will withhold support or oppose management if we believe that it is in the best interests of our clients to do so.

Schroders will vote for, or against, any proxy requests relating to companies listed in the UK and for companies listed outside the United Kingdom and for non-UK clients on proxy requests relating to the following securities: the largest 500 International (non-UK) holdings by value; the largest 300 UK holdings by value; European smaller company and Japanese holdings where Schroder Investment Management holds above 5% of equity market capital; and securities which local regulations require to be voted.

Table 5, shows that in 2009, Schroders voted for 46,410 resolutions at 5022 meetings worldwide. Resolutions require voting on subjects as wide as re-electing the board and board members, agreeing remuneration, re-electing auditors, accepting the annual report and accounts, stock plans and long term incentive plans. Of this total number of voted resolutions, Schroders cast 10,246 (22%) votes against management, (97% overseas and 3% in the UK). The rational for why we have voted 'against' management include, amongst other reasons, the remuneration policy not being favourable to shareholders, or executive to non executive ratios on the board being unfavourable to shareholders. In addition, we voted at a total of 5,022 AGM/EGM meetings, 626 (12%) in the UK and 4396 (88%) overseas.

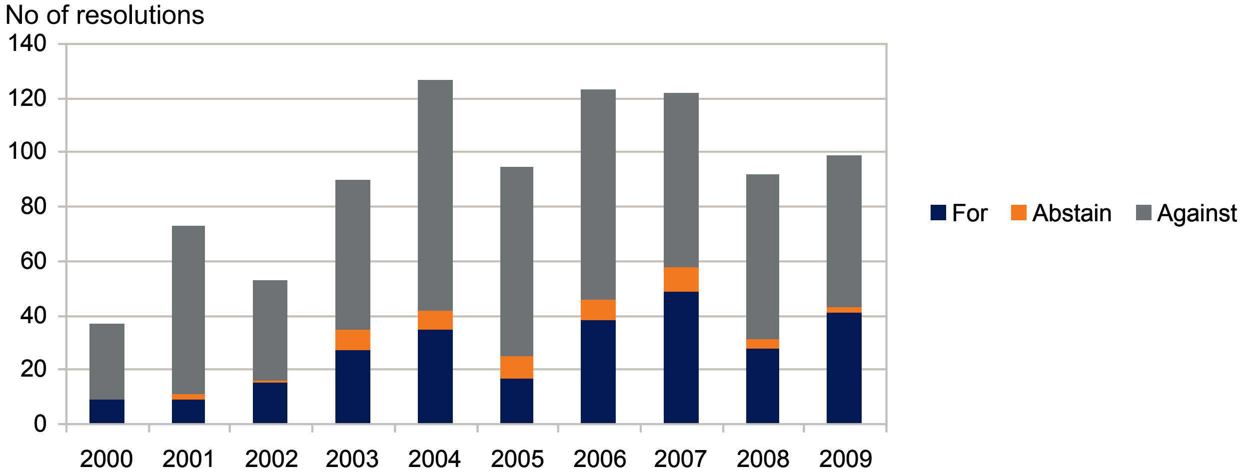
Table 5: Schroders Global Voting Records 2009

	UK	UK % of Total	Overseas	Overseas % of Total	Total
Total resolutions voted on:					
with management	5974	17	30,190	83	36,164
against management	265	3	9981	97	10,246
Total Resolutions	**6239**	**13**	**40,171**	**87**	**46,410**
Total resolutions voted by:					
management	6219	14	39,279	86	45,498
shareholders	20	2	892	98	912
Total Resolutions	**6239**	**13**	**40,171**	**87**	**46,410**

Of these resolutions, in 2009, a tiny percentage (<1%) were specifically on environmental, ethical and social issues, voted on by the responsible investment (RI) team. As in previous years, most of these were tabled at the AGMs of US companies.

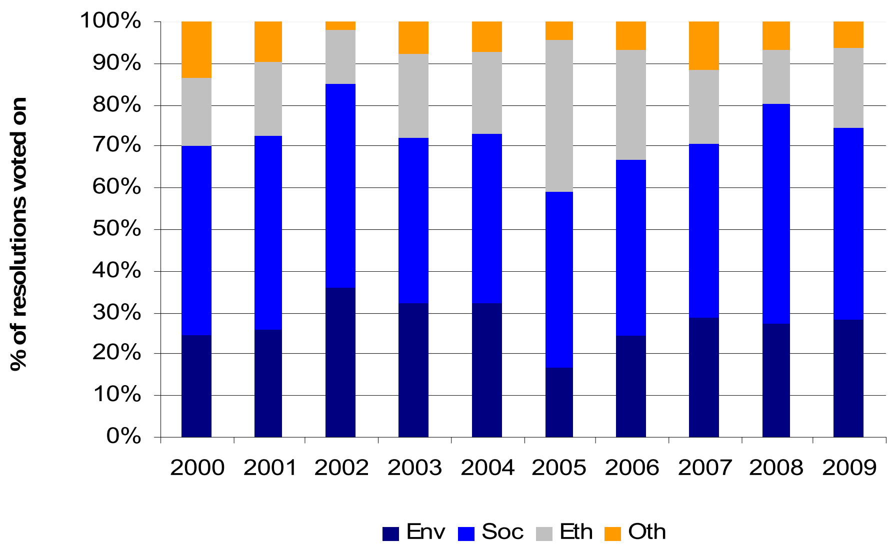
Voting decisions made by the RI team are determined by the purpose of, and quality of, the resolution, the level of public disclosure or transparency of the company, whether there have been historical voting actions on the same issue and how we have voted then and, whether the resolution will benefit shareholders. 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. Graph 3 shows the number of resolutions that we have voted for, abstained or voted against since 2000.

Graph 3. Schroders International voting record from 2000-2009 on SRI shareholder resolutions (number of resolutions voted on)



Graph 4, shows a break down of the more common shareholder resolutions since 2000. In creating this graph we have broadly divided shareholders resolution into four categories: environmental, social, ethical and other. The most popular types of shareholder resolutions are social (e.g. equal opportunities, labour standards, HIV and AIDS, drug pricing, heath care, health and safety and pay disparity). In addition, equal opportunities can be more specific in nature and range from board diversity, sexual orientation, workforce diversity to more general equal opportunity issues.

Graph 4. Schroders International voting record from 2000-2009 by category of vote (% of resolutions voted on)



The number and subjects of resolutions vary year on year due to changes in investment strategies altering the types of companies we invest in. In 2009, labour standards and equal opportunities remained the greatest area of concern for shareholders as reflected by the constant high number of resolutions on these topics. Resolutions on climate change and greenhouse gases were also popular reflecting ongoing concerns by shareholders about the risks and opportunities that climate change presents to companies. There was also a rise in health care resolutions (due to the public policy reform in the USA) and ongoing demands for improved disclosure on CR issues. Finally, there remained some ethical resolutions on animal welfare and testing, a trend which has continued since 2005, and is a direct reflection of the current use of shareholder resolutions by animal welfare campaign groups.

Section 1.3

Screened Investments

Segregated Funds

Schroders performs a wide range of screens on its investments. The type of screen chosen is a function of client value preferences, fund objectives and parameters, and other financial and legal criteria. Clients with segregated funds typically exclude companies based on moral criteria, such as tobacco, pornography or alcohol. It is possible also to screen the materiality of a company's exposure to an issue, by turnover and the source of a company's exposure, for example whether its retail or production. A few clients also prefer to develop more sophisticated screens, including environmental protection concerns and social issues, such as international labour norms. Schroders uses both in-house expertise and specialist agencies to screen criteria according to client requirements. Table 6 shows total ethical funds under management (FUM) since 2005 and the proportion that this represents of group FUM. Table 7 demonstrates the key screens that we implement for these ethical FUM and by percentage of clients: 57% of ethical FUM excludes investment in tobacco and 11% excludes investment in arms, tobacco, gambling, biotech and nuclear.

Table 6: Ethical FUM, using December Year End data

Year	Ethical FUM (£bn)	Percentage of overall Group FUM
2009	3.84	2.6
2008	3.68	3.3
2007	6.00	4.4
2006	4.22	3.3
2005	4.47	3.6

Table 7: Ethical FUM by type of Screen and by Client

Screen	% ETHICAL FUM	Number of clients (as a % breakdown)
No tobacco	17.2%	57%
No alcohol or gambling	45.5%	4%
No arms, no tobacco, no gambling, no biotech and nuclear	3.9%	11%
No or restricted investments in listed companies with direct or indirect operations in Sudan	15.9%	4%
Other	17.8%	23%
TOTAL	100%	100%

Pooled Funds

In addition to the above Ethical FUM of £3.84 bn which are actively screened, we also calculated in 2009 another £4.8bn FUM of funds which are 'monitored' for their exposure to companies with investments in Sudan. Where it is not always possible to exclude companies from funds, for legal and financial reasons, clients have chosen, instead, to be informed of their exposure on a regular basis.

In addition, in May 2009, Schroders launched its first religious pooled Shariah fund in Indonesia. The investment objective of the Schroder Syariah Balanced Fund is to provide potential for capital growth through exposure to a multi-asset portfolio comprised of Syariah-compliant equities, Islamic bonds (Sukuk), and Syariah-based money market instruments, in accordance to the Islamic principals in the capital market.

Section 1.4

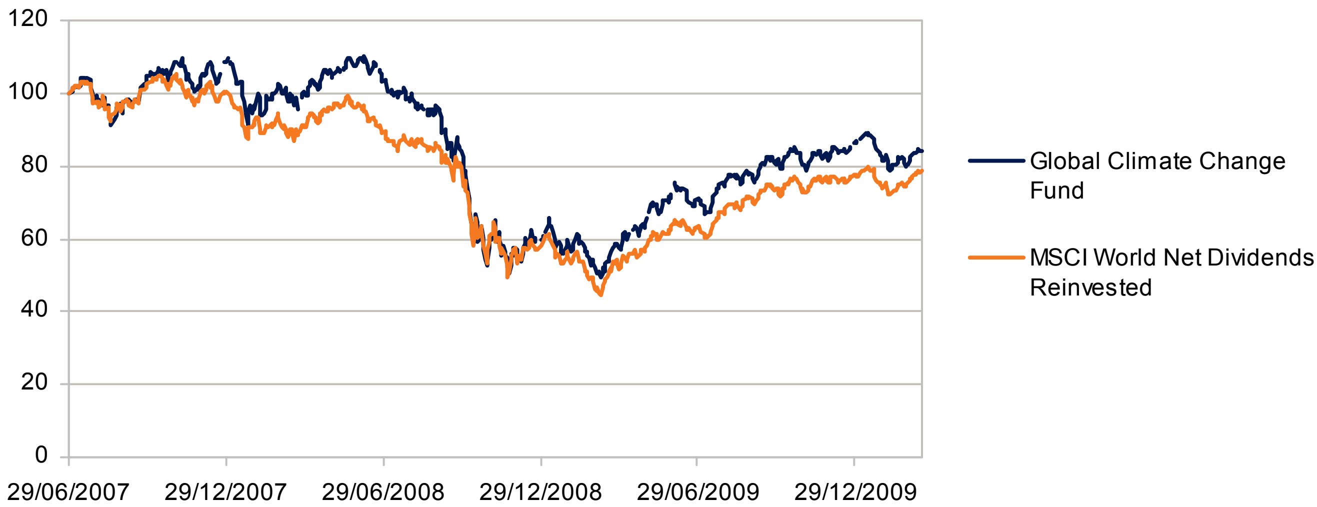
Thematic Investments - Global Climate Change Fund

Schroders launched the Global Climate Change Fund in June 2007 and has delivered out performance of the MSCI World Index since inception (see Graph 5, below). It was rated the **"Best climate change fund, 2009"**, in the climate change awards run by Holden Partners and Incisive Media.

Schroders believes that climate change will be the main driver of industrial change over the next 20 years, so the investment strategy of the fund is to invest 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^{o}C or more by the end of the century, emissions per unit of GDP need to be cut to 25% of 2006 levels by 2050.

Through our own internal research expertise we are identifying companies that are benefiting from efforts to mitigate greenhouse gas emissions and, or, to adapt to a changing climate. Mitigation investments, mainly driven by policy and legislation, include companies involved in clean energy, energy efficiency, low-carbon energy and sustainable transport whilst adaptation investments include companies exposed to investments in water management, agricultural productivity and forestry. Currently about 80% of the fund is invested in companies exposed to mitigation and 20% of the fund is invested in companies exposed to adaptation. The impacts of adaptation are deemed to be slightly longer term in nature, although adaptation investment needs to be made now as economic research has demonstrated that this would reduce costs in the long run.

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 1.5

Responsible Property Investment

The Schroders' Property investment process incorporates a review of the environmental and social factors concerning both the properties it directly owns and manages, and the properties it indirectly invests in through third party funds. We believe that by factoring corporate, social and environmental responsibility considerations into the design, construction and operation of buildings you can increase their long term market value and improve investment performance whilst reducing our tenant's operational costs. In addition, through careful management of these issues Schroders can reduce exposure to the risks of adverse publicity, legal penalties and to be one step ahead of emerging legislation.

Schroders fully recognises the potential impact of emerging legislation in real estate on the properties that it manages. Following on from the introduction of Energy Performance Certificates as a first step in the UK government's target of reducing greenhouse gasses by 80% by the year 2050, the most immediate legislative requirement facing property owners is the introduction of the CRC Energy Efficiency Scheme (CRC). CRC is a new mandatory emissions trading scheme with the aim of improving energy efficiency and reducing the amount of carbon dioxide emitted in the UK. CRC will affect large electricity and gas consumers who will be required to participate in the scheme, monitor their emissions and purchase allowances sold by the government, for each tonne of CO_2 they emit. The more CO_2 an organisation emits, the more allowances it will have to purchase, so there is a direct incentive to reduce emissions. This latest piece of legislation makes it clear that property investors would be failing in their fiduciary responsibility if, inter alia, the energy efficiency of property assets was not a key consideration when making buy/sell decisions.

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 is 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 issues such as waste recycling, reducing energy consumption and water conservation.

Our focus has been enhanced through our work with sustainability advisers, 'Upstream', and our participation in their Third Dimension benchmarking service which measures a number of sustainability factors in Schroders' UK property funds against a universe of properties owned by other institutional investors. Factors include energy efficiency, water efficiency, recycling and risk of flooding. The results were presented at our Sustainability Awards ceremony which once again brought together our fund management teams, partners and service providers, for a day when we focussed on many of the issues relating to sustainability and climate change, which could impact the investment performance across our portfolios.

Reporting

Schroders' Property has produced a Responsible Property Investment policy that outlines our role and responsibilities as owners, managers and developers of property assets. We are currently developing further our reporting systems to allow formal monitoring of our performance on key RPI issues and we have enlisted the help of the Schroder Responsible Investment analysts, currently involved with the global equity and bond teams, to drive this forward in 2010. An RPI focus group has been established to bring together all areas of the Schroder Property team, including both direct and indirect fund management, asset management, transaction staff and product management. Investment reporting has historically been client driven, but in 2010 we intend to use Schroders' pension trustee training sessions to explain how environmental, social and corporate responsibility issues are taken into consideration throughout the investment management process.

Whilst we continue to codify our investment practice into policy statements, our approach to these issues will remain one which is driven by the delivery of on-site solutions which help us effectively achieve our clients' objectives. At the same time we continue, through our membership of industry bodies, to lobby for greater standardisation of reporting against a backdrop of competing benchmarks, questionnaires and voluntary codes that themselves conflict with regulatory methodologies.

Summary and prospects for 2010

In summary, in 2009, Schroders expanded its RI programme from a Pan European equity programme to a global equity programme. This is reflective of the importance of equities to Schroders (circa 50% of assets under management) and the fact that equity investments were the first asset class to emerge more fully in the RI market. This RI equity platform also provides for private banking assets. To enable this expansion, we have made ESG analysis more explicit than before within the investment process and taken integration of ESG in investment thinking to a new level, both in large cap and small cap companies. We are pleased with the progress that has been made in integrating ESG into equity assets this year.

In addition, Schroders is starting to explore the application of RI processes to other asset classes such as property and bonds. We do not envisage this will require the introduction of new RI processes; actually we hope to evaluate both screening and engagement opportunities, for the bond and property asset classes, respectively.

Some objectives for 2010 include:

Group:

– Develop an over arching global RI equity policy for Schroders Group
– Develop an over arching global RI property policy for Schroders Group
– Continue to improve reporting and benchmarking against the UNPRI Principles

Engagement:

– Begin expanding our ESG engagement programme to other geographies

Integration:

– Continue development of integration processes and coverage across equity teams, globally
– Continue development of integration processes in the global small caps team
– Provide a second round of ESG auditing for the large cap Emerging Markets team on their ESG integration processes and possibly extend this to other equity teams

Ethical Funds:

– Evaluate Schroders RI capabilities and client demand for expanding screening bond investments

Property:

– Develop engagement processes and systems for the establishment of key performance indicators for 2010 in property management.

Appendices

Appendix 1

Annual Compilation of Pan European Company Engagements 2008

We have categorised our Pan European engagements in terms of their ESG focus which we have adapted from the definitions put forward by the UNPRI (see Table 1). This is a non exhaustive list of typical issues covered under ESG. The annual compilation of Pan European Company engagements includes all Pan European engagements by the Responsible Investment team and the Corporate Governance team. A tick by each category indicates the main focus of the meeting.

Table 1. Definitions of E, S and G,

Definition	Explanation
Environment	Typical environmental issues may be: biodiversity loss, greenhouse gas (GHG), emissions, climate change impact, renewable energy, energy efficiency, depletion of energy resources, chemical pollution, waste management, depletion of fresh water, ocean acidification, stratospheric ozone depletion, change in land use, nitrogen or phosphorous cycle etc.
Social	Typical social issues may be: activities in conflict zones, distribution of fair trade products, health and access to medicine, workplace health safety and quality, HIV/AIDS, labour standards in supply chain, child labour, slavery, relations with local communities, human capital management, employee relations, diversity, controversial weapons, freedom of association etc.
Governance	Typical governance issues may be: benefits and compensation, bribery and corruption, shareholder rights, access to proxy, business ethics, board diversity, independent directors, risk management, whistleblower schemes, stakeholder dialogue, lobbying, government relations, disclosure , CR strategy, policy, performance and KPIs, links between CR, and business strategy and executive remuneration etc.

Table 2. Engagement Activity

Engagement Activity	Environment (E)	Social (S)	Governance (G)
Automobiles and Components			
Auto components			
Michelin	√	√	√
Automobiles			
Fiat	√		√
Peugeot	√		√
Renault	√		√
Volkswagen			
Financials			
Commercial Banks			
Banca MPS		√	√
Barclays	√	√	√
BBVA	√	√	√
BNP	√	√	√
Deutsche	√		
HSBC	√	√	√
RBS			√
Santander	√	√	√
Standard Chartered			√
Capital Goods			
Aerospace & Defence			
BAE			√
Meggitt	√	√	√
Construction and Engineering			

Alstom		√	
Kier Group	√		√
Skanska	√		√
Lupus Capital			√
Electrical Equipment			
Gamesa			√
Invensys			√
Renishaw	√	√	√
Schneider	√	√	√
Industrial Conglomerates			
Phillips	√	√	√
Intertek			√
Commercial Services and Supplies			
Davis Service Group	√		
Xchanging	√	√	√
OPD			√
Consumer Services			
Hotel, Restaurants and Leisure			
Millenium and Copthorne	√	√	√
Sol Melia			√
Whitbread	√		
Diversified Financials			
Diversified Financial Services			
MAN	√	√	√
Thrifts and Mortage Finance			
International Personal Finance			√
Energy			
Oil, Gas and Consumable Fuels			
British Gas	√	√	√
Shell Transport and Trading	√		√
Total	√	√	√
BP			√
Food Staples			
Food and Staples Retailling			
Danone	√		
Tesco	√		√
Wn Morrison	√		
Household Products and Personal Products			
Food Products			
Greggs	√		
Household producers			
L'Oreal	√	√	√
PZ Cussons	√	√	√
Insurance			
Life / Non life Insurance			
Old Mutual			√
Swiss Re	√	√	√
Materials			
Chemicals			
Air Liquide	√	√	√
BASF	√		√

BAYER	√		√
Croda International	√		
Umicore	√	√	√
Syngenta	√		√
Yule Catto			√
Materials			
Construction and Materials			
Amec	√	√	√
Balfour Beatty	√	√	√
Carillion	√	√	√
Holcim	√	√	√
Imerys	√	√	√
Metals and Mining			
Kazakhmys	√	√	√
Rio Tinto			√
Xstrata	√	√	√
Paper and Forest products			
Bunzl	√		
DS Smith			√
Rexam			√
Media			
Cable and Wireless			√
Pharmacauticals and Biotechnology			
Pharmaceuticals			
Astra Zeneca	√	√	√
Fresenius	√	√	√
GSK		√	√
Novo Nordisk			√
Real Estate			
Real Estate			
Grainger	√	√	√
Hammerson	√	√	√
Land Securities	√	√	√
Retailing			
Internet and Catalogue Retail			
Home Retail Group	√		
Multiline Retail			
Burberry			√
Marks and Spencer	√		
Next	√		
Software and Services			
IT Services			
Logica	√	√	
Automony		√	
SAP		√	√
Telecommunication Services			
Wireless Telecommunication Services			
Vodafone	√		√
Transportation			
Airlines			
British Airways	√		√

Road and Rail			
National Express	√		√
Air Freight and logistics			
Autologic			
Utilities			
Electric Utilities			
Iberdrola	√		
RWE	√		√
Multi Utilities			
Veolia Environment	√	√	√
TOTAL COVERAGE	71%	46%	82%

Appendix 2

Compilation of Engagement actions for facilitation

Table 3: Engagement actions where 'no change' has been achieved

Engagement Review

This section reviews what action has occurred based on suggestions for change we made. There are four possible results: 'Achieved, Almost, Some Change and No Change'.

Banks		
Commercial Banks		
Credit Suisse	Improve disclosure on customer and human capital performance programmes	**Some Change** Improved qualitative disclosure but insufficient disclosure of performance indicators
Deutsche Bank	Request for clearer division of CR sub programs and more structured reporting. Plus greater attention to environmental credit risk assessment in the report and bank.	**Some change** The company has improved the structure of its reporting and CR program. However, there is no significant improvement on environmental credit risk assessment disclosure.
HSBC	Enforcing and educating employees on group sustainability standards	**Almost** In 2008 it made sustainability a key element of the employee induction and senior management training programmes; its annual report also states that sustainability is now fully integrated into risk management processes for all corporate clients. It has also appointed regional heads of Sustainability. In 2009 it aims to include a sustainability module in new global induction courses for new employees.
Royal Bank of Scotland	Request for more strategic direction and key performance indicators in financial crime, customer services and responsible lending	**No change** We are due to meet with RBS in October 2009. This has been a quieter year for them on the CR front due to the financial crisis. The bank's CR program is comprehensive but has suffered from a lack of integration in business strategy and divisions, hence our request for more long term direction and meaningful key performance indicators.
Standard Chartered	Embed CR aims in business strategy	**No Change** Strategic business case for CR remains unclear in reporting.
Capital Goods		
Construction and Engineering		
Saint Gobain	Clarification of methodology for H&S data collection.	**Achieved** The company sent a detailed explanation of its HSE reporting methodology and gave evidence to demonstrate that it has some of the lowest fatality rates amongst its peers when using comparable data.
Consumer Services		
Food and Staples Retailing		
Metro	Improved transparency of reporting generally	**No change** Unable to verify as the company has not produced a 2008 sustainability report at this time of review.
Tesco	Publish y-o-y performance data; initiate industry wide talks on animal welfare	**Some Change** Tesco has initiated talks with DEFRA to encourage an industry wide discussion on animal welfare standards. However it has not published year on year performance data as it has only been able to collate group wide performance data this year.

Carrefour	Request for disclosure of staff turnover and length of service data.	**No change** The meeting with the company occurred after the 2008 CR report was published in April, so further information updates will be after April 2010.
Materials		
Construction and Materials		
Amec	Request for improved reporting on ESG business opportunities in emerging markets and more details on turnover and absenteeism.	**No change** As at September 2009 there appeared to be no change in the reporting of this information, although there was a level of improved general CR disclosure in their recent annual report. We will be meeting with Amec on October 1st and will discuss these points.
Saint Gobain	Clarification of methodology for H&S data collection.	**Achieved** The company sent a detailed explanation of its HSE reporting methodology and gave evidence to demonstrate that it has some of the lowest fatality rates amongst its peers when using comparable data.
Metal and Mining		
BHP Billiton	Increased disclosure on how HSE performance is integrated into compensation.	**No change** This information is not available in the company's report in this level of detail and we have not had a response to our letter in 2009 nor engaged with the company directly this year. We will, however, engage with them and seek clarification in 2010. In its most recent report, 7 fatalities are noted between June 2008 and July 2009, which is down on 11 fatalities the previous reporting year.
Lonmin	Improve on trade union relations.	**Some Change** Evidence of more commitment to this areas but still the company still experienced 17 illegal and legal industrial actions in 2008.
Oil and Gas		
Oil and Gas Producers		
BP	Increased transparency on nature of dismissals for unethical behaviour and non-compliance with code of conduct.	**No Change** The latest CR report has still to be produced so we are unable to determine if this objective has been met.
Total	Improved security, ethical and human rights policies and processes around operations, particularly in areas of human conflict	**No change** The company has not produced an updated CR report yet and it has not been possible from other public information to note any specific changes as yet to policies and processes.
Tullow Oil	Improved human capital disclosure	**Almost** In 2008, it restored safety performance and achieved an LTIFR of below 1.0. It also appointed a Chief HR Officer, Group Talent Manager and Group Reward Manager and developed a new Group-wide HR strategy. Other milestones included remuneration benchmarking, as part of an increased focus on reward and recognition, an Employee Assistance Programme (EAP) for the Group’s three main offices and a staff turnover rate of less than 5% despite an increase in employees by 46%.
Retailing		
Multiline Retail		

Debenhams	Requested improved disclosure on and supply chain management (SCM).	**No change** As at September 2009 there has been no improvement in the quality of reporting on the company's SCM and CR performance. There are statements on SCM but little more than this and there is some basic performance information on CR but little to demonstrate that the company has made any significant improvements over the year.
Telecommunications		
Fixed Line Telecommunications		
France Telecom	Report against energy efficiency	**No change** Unable to assess change as the company has not produced a 2008 sustainability report at this time of review.
Wireless Communications		
Vodaphone	Request for group wide supplier standards, better human capital disclosure, and climate change performance	**Achieved** The Climate change target is an absolute figure, set against a baseline figure of 06/07, though emissions appear to have risen in-line with growth indicating that the company is struggling to meet its targets. Energy savings in meeting this target are expected to have favourable pay back periods with other mechanisms used to meet the target having longer pay-back periods. The company estimates that approximately 91% of its workforce received some form of training. The company does not provide data on length of service but will be doing so in the future. The company confirmed that it does assess the costs of absenteeism to the business and it is partly this that drives investment in various initiatives to decrease TO rates but to also increase productivity. Similar supply chain standards are met throughout the group. We rate this as achieved as Vodafone has answered all our questions sufficiently and has committed to improving its human capital disclosure in the future.

Appendix 3

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 4 and 5 below summarise the main industry events we have attended and participated in during the course of 2008.

Table 4. Seminars / Conferences

Thematic	Activity	Host Organisation	Details
Human Capital Management	Seminar	UK Sustainable Investment and Finance Forum (UKSIF)	Human Capital Management Seminar. The seminar provided an insight into the key challenges and opportunities companies face in human capital management and address some of the key trends and drivers from the investment perspective.
Health and Safety	Seminar	UKSIF	A seminar on Health and Safety and its business implications. An UKSIF Roundtable on Banking, with an emphasis on improving corporate governance and risk management following the financial crisis.
Sustainable Consumption	Report	The Sustainable Consumption Institute	The Sustainable Consumption Institute launched a report on sustainable consumption, consumers, business and climate change. There were speeches and commitments by 18 CEOs of leading global companies towards recognising that business as usual is no longer an option and that a radical change in consumer actions needs to be enabled in order to achieve a low carbon society and to minimise risks to business.
Ecosystem Services	Conference	The Natural Value Initiative and UKSIF	We have attended two conferences this quarter which have explored this topic and we wrote a report on it in 2009.
Water	Seminar	Carbon International	We attended meetings on investing in water, organised by Carbon International and Brean Murray's Commentary on the water industry with an in depth valuation and review of specific stocks.
Climate Change	Seminar	HSBC	HSBC Climate Change Seminar. This seminar provided an update on latest thoughts on economic implications of climate change from Lord Stern.
Climate Change	Seminar	Mckinsey	McKinsey on the Climate Change Cost Abatement Curve Seminar. This seminar provided an update on the relative cost efficiencies of different climate change mitigation technologies.

Climate Change	Seminar	UKSIF	Hosted an UKSIF Adapting to Climate Change Seminar. The seminar examined the impacts of climate change adaptation. It provided leading perspectives on how the challenges of adaptation to the unavoidable impacts of physical climate change will affect investments across a range of sectors and economies.
Climate Change	Conference	Intergovernmental Panel on Climate Change	We have attended a meeting on the possible outcomes of Copenhagen as well as participating in a conference call with the Chairman of the Intergovernmental Panel on Climate Change, Dr Pachauri.
Climate Change and aviation	Seminar	Carbon Trust	We had a meeting with The Carbon Trust on the implications of carbon pricing to the aviation sector
Climate Change	Seminar	HSBC	We attended meetings with HSBC and the World Resources Institute on US Climate change policy and with the UK Shadow Secretary of State for Energy and Climate Change
Climate change	Awards	Incisive media,	Finally we were very pleased to attend the presentation to Schroders of the "Best Climate Change Fund Award 2009" which was awarded by Incisive Media in conjunction with UK based independent financial advisors and climate change investment specialists, Holden & Partners.

Table 5. Schroders is a Signatory to the following Organisations

Organisation	Types	Activity
Carbon Disclosure Project (CDP)	Collaborative and Lobbying	We attended the launch of the Carbon Disclosure Project's 2009 report. In addition to support the CDP with some lobbying activities we provided feedback on the report during a sponsor's lunch.
Corporate Leadership Group on Climate Change	Lobbying	We were signatories to the Poznan Communiqué issued by the Corporate Leadership Group on Climate Change
Institutional Investors Group on Climate Change (IIGCC)	Collaborative and Lobbying	We have also supported the Institutional Investors Group on Climate Change (IIGCC) in all its extensive lobbying activities. We are also members of the IIGCC property and engagement research work streams.
United Nations Principles for Responsible Investment (UNPRI)	Collaborative and lobbying	We are members of the United Nations Principles for Responsible Investment – they encourage the integration of ESG criteria into investment processes across the industry.
Forest Footprint Disclosure Project (FFDP)	Collaborative and lobbying	The FFDP aims to increase transparency around the direct and indirect impacts of corporate activities on the world's forests.

In addition Schroders has agreed to provide expertise to an initiative run by the World Wide Fund for Nature called the Finance Lab, an "initiative designed to take practical action to stimulate transformational change in the financial system so that it serves society and the environment". Schroders has also hosted and participated in a roundtable for the UNPRI and Australian Responsible Investment Association which has received sponsorship to develop an RI Academy with the remit of offering formal training in RI to analysts and those interested in becoming trained in Responsible Investment. Finally, Schroders participated in a seminar and a stakeholder panel at Nottingham University to engage new MBA and MA graduates in the CR/RI field.