Henderson Global Investors

Henderson Global Investors sriquarterly

Autumn 2005

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We welcome all feedback about SRI Quarterly and are keen to hear your comments. Please direct these to **sri@henderson.com** or in writing to SRI Team, Henderson Global Investors, 4 Broadgate, London EC2M 2DA.

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Edited by Jane Goodland

Introduction

Hurricane Katrina is the most recent example of the scale of devastation possible from extreme weather events. The full extent of the social, economic and environmental loss is yet to be fully counted, but some estimates run into the tens of billions. With extreme weather events set to become more frequent and intense as a result of global warming, Katrina has provided a timely wake-up call to those sceptics still down-playing the severity of climate change.

As governments and business grapple with how to build a low carbon economy, some analysts have begun to argue that the world's declining nuclear industry should be revived. Our investigations suggest that nuclear is neither economically or environmentally sustainable, and priority needs to be placed on market-based solutions such as energy efficiency and micro-generation.

We also report on our SRI review of the big five UK banks carried out over the summer. This found that whilst some banks are rising to sustainability and responsibility challenges, there remains much room for improvement. We highlight some good practice and discuss what this means for our SRI funds.

As tax moves ever-higher up the corporate agenda, we've explored how companies are matching the tax and corporate responsibility agendas. Our latest report, Responsible Tax, sets out guiding principles and a good practice framework which can help companies to adopt a tax management approach that balances their shareholders' interests and wider social responsibilities.

This issue also contains an interview with Paul Hohnen, a member of Henderson's SRI Advisory Committee. Paul considers how the Advisory Committee can contribute to Henderson's SRI business and what the future holds for sustainable and responsible investment.

Our dialogue with companies continues, and during July, August and September, we met 74 companies to discuss a range of issues with them, including investment prospects, business strategy, corporate responsibility management and corporate governance. ■

Nuclear Power: Still 'No Thanks'

Nuclear energy currently produces about 16% of world electricity, and 24% of Britain's power needs. However, throughout its 50 year history, nuclear has been highly controversial, not least because of the links between civil and military applications of nuclear technology, the legacy of radioactive waste the industry produces and the high cost of state subsidies to make nuclear an economic option.

Following the Three Mile Island and Chernobyl disasters, a number of countries decided to phase out nuclear, including Italy, Sweden and Germany. Britain ceased building new plants a decade ago. Due to its negative security, environmental and economic impacts, nuclear power has long been avoided by socially responsible investors. All the Global Care funds as well as the Industries of the Future fund therefore exclude companies that operate nuclear plants, provide nuclear generation equipment or mine uranium.

As the threat of climate change has grown, however, the nuclear industry has argued that it offers a zero carbon energy source. The industry has been joined by some high-profile scientists, notably Sir David King, the government's chief scientific adviser. The UK Government is currently reviewing the country's energy policy with suggestions that this could lead to a nuclear rebuilding programme.

Our investigations into the issue have concluded that nuclear is still not economically or environmentally sustainable – and its revival would hinder rather than help a solution to climate change. From an investment perspective, nuclear power plants are highly capital intensive, and can only be profitable through special state subsidies not available to other power producers. For example, the risks associated with the operation of nuclear plants means that it cannot obtain normal insurance cover for accidents. The industry also has a poor track record of delivering projects on time and to budget. Sizewell B was the last nuclear power plant to be built in Britain and took 15 years to go from proposal to production and cost more than twice the original estimate.

More seriously still, the UK's privatised nuclear operator, British Energy was forced to seek a major government bail-out in 2002, following poor financial results – described at the time by Financial Times columnist John Kay as "the biggest write-off in the history of capitalism" (FT 19/08/02). It was therefore no surprise that the UK's Energy White Paper concluded in 2003 that "the current economics of nuclear power make it an unattractive option for new generating capacity."

Beyond the question of economics, no solution has yet been found to the problem of radioactive waste, some of which will need to be stored for hundreds of thousands of years. In the UK, it is now projected that it will cost £56 billion for the clean-up the nuclear sites as production ends. Ecological footprinting experts at Best Foot Forward estimate that the external environmental costs of nuclear outweigh those of fossil fuels, such as coal, oil and gas. The safety issues surrounding nuclear power stations and their vulnerability to terrorist attack have also been accentuated following the 9/11 and 7/7 incidents.

The heartening thing is that nuclear is simply not needed either to keep the lights on or tackle climate change. Authoritative reports published this year by the Green Alliance and the New Economics Foundation all show that cost-competitive emission reductions can be made through energy efficiency, the roll-out of micro-renewables – such as household-level solar, wind and 'combined heat and power' systems – as well as large-scale, wind, wave and tidal power. The estimated £20 billion needed to construct and operate new nuclear plants to replace Britain's existing 23 reactors could be far better spent elsewhere – without storing up a radioactive legacy for the future or squeezing out the country's nascent renewables industry. And according to Amory Lovins, energy guru at the Rocky Mountain Institute in the USA, "a portfolio of least-cost investments in efficient use and in decentralised generation will beat nuclear power in cost and speed and size by a large and rising margin".

For all these reasons, we will continue to avoid nuclear power in Henderson's SRI funds, searching for inherently safe and sustainable solutions to the world's energy problems.

UK Banks Review

Britain's high-street banks are facing increasing pressure to demonstrate their ethical credentials. To develop a better understanding of recent trends and performance, we carried out an in-depth review over the summer. As part of this, we met with senior management from the 'big five' UK banks - Barclays, HBOS, HSBC, Lloyds TSB and Royal Bank of Scotland - to probe them on their practices. We also met bodies such as Which? (The Consumers Association) to gain insights from other perspectives. We rated the five banks on a series of social responsibility factors: overall strategy, corporate governance, ethical conduct, employee relations, environmental factors in commercial lending and sustainable products.

Out of this, two leaders emerged from the pack, HBOS and HSBC, followed by Lloyds TSB. In our opinion, HBOS has the most rounded corporate responsibility strategy, with a special emphasis on employee relations. For example, they have stated that they have no plans to 'off-shore' staff, and have a strong commitment to diversity in the workplace. HSBC has improved considerably since our last review, and now leads the sector in terms of its environmental commitments. HSBC has become the world's first 'carbon neutral' bank and has introduced the toughest environmental risk standards in the sector for its commercial lending division. We have worked with HSBC as part of our programme of engagement and are pleased to see its progress including the introduction of a board-level committee on social responsibility to drive the strategy forwards. Lloyds has generally good performance across the board, but its retail lending practices have come in for criticism, an issue we have raised with the chief executive who gave us assurances that necessary measures have been taken.

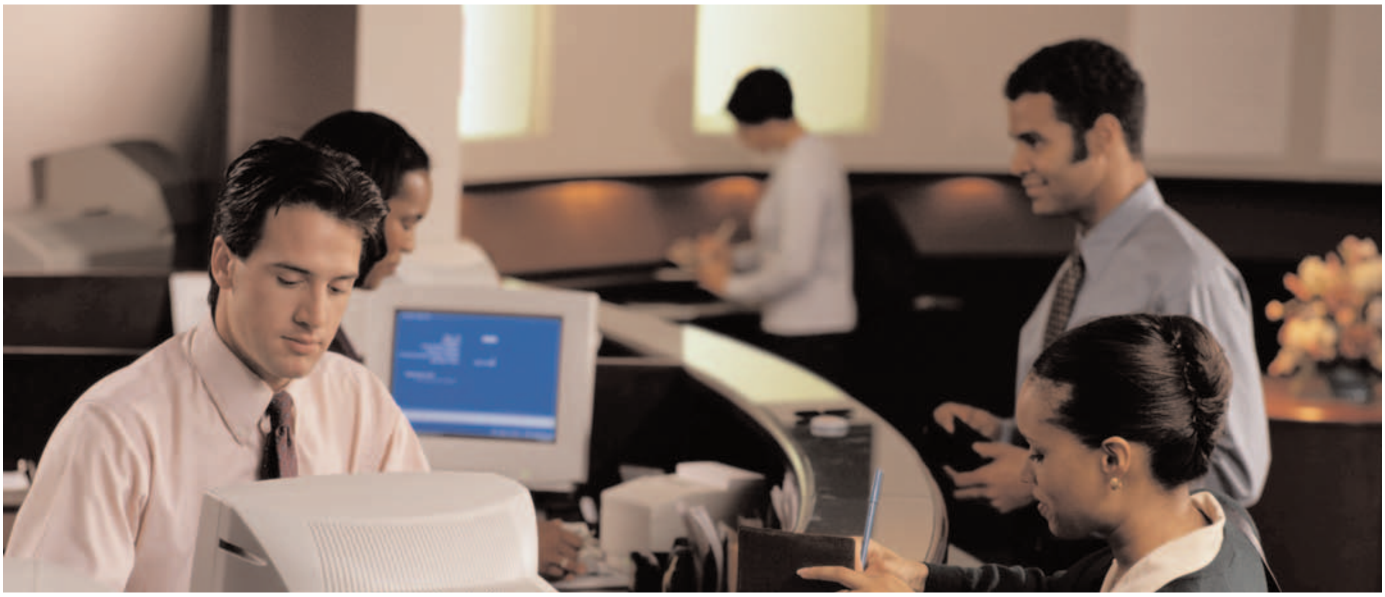
Overall, we found that performance in a number of areas had improved in the last two years. However, much still needs to be done, and we will continue to engage with the banks to encourage higher standards in the future. As a result of the review, we have now added HSBC to our list of approved companies for the Global Care Income and Managed funds, along with HBOS and Lloyds TSB. We also invest in other more medium-sized banks in these funds, such as Alliance & Leicester and Northern Rock, where we have also observed enhanced practices.

If you have comments on the topics discussed here, or issues you would like us to raise as part of our engagement, please contact us through **sri@henderson.com**

NEWS UPDATE

HSBC goes carbon neutral three months early

6 October 2005 -- HSBC has become the first major bank to go 'carbon neutral'. It has reduced its carbon dioxide (CO_2) emissions to zero by reducing energy use, buying green electricity and then offsetting the remaining CO_2 emissions by investing in carbon projects. In 2004 HSBC made public its intention to go carbon neutral by January 2006 and has achieved its objective three months ahead of schedule. Find out more at **www.hsbc.com/news**



Responsible Tax

Earlier in the year we published *'Tax, risk and corporate governance – Findings from a survey of the FTSE350'* which focused on the approach to tax being taken by the board's of the UK's largest companies. Following the FTSE350 survey, we engaged in discussions with the heads of tax at a number of FTSE100 companies. These discussions explored the day-to-day judgements made by companies in an environment characterised by constant investor pressure for high financial returns, increasing complexity and change in tax regulations and new drivers of reputation risk linked to public expectations of corporate behaviour on tax.

Tax is a cost to business as it is to individuals, and paying tax unnecessarily may breach legal duties to shareholders. But the companies we have spoken to have a finely nuanced approach. They recognise that there is value to be derived from positive working relationships with tax authorities and a good reputation in the eyes of government more broadly, as well as with customers, employees and the public at large. Where these sources of value might be prejudiced by 'aggressive' tax planning, the prudent business course might be to forego the tax opportunity.

Our latest report 'Responsible Tax' summarises a set of principles being used by leading companies which can guide tax decision-making.

Principles specific to tax

- ***Presumption of openness with tax authorities***
  Written guidelines for many tax departments state explicitly that the company should always make full disclosure to tax authorities. As one head of tax put it, 'a scheme that depends on something not being found out is a bad scheme'.

- ***Beware of complexity***
  Complex tax structures have become more risky in the current environment of rapid change in tax regulations. In some developing countries complex arrangements may be misunderstood by tax authorities and challenged, even where they are technically robust. This may prejudice relations with governments.

- ***Alignment with the underlying business***
  Many companies have formal guidelines requiring tax arrangements to be consistent with 'real world' business operations. These are judged to be more robust, more likely to be operated correctly, less likely to be closed down, and easier to explain to investors and others.

- ***Awareness of reputation and relationships***
  Tax departments attach value to having good relations with tax authorities and actively consider the implications of tax initiatives for their wider corporate reputation.

Principles enshrined in corporate commitments

- ***Abide by the letter and spirit of the law***
  The notion that compliance with the letter of the law is not sufficient to meet society's expectations of responsible corporate behaviour is already widely recognised by companies. Many companies make an explicit commitment to abide also by the spirit of the law. Companies recognise that some tax planning that is within the letter of the law but inconsistent with its spirit is likely to harm their relationship with tax authorities.

- ***Social responsibility***
  Many companies make formal statements of commitment to social responsibility, corporate citizenship, making a contribution to societies in which they operate, or similar concepts. The OECD Guidelines for Multinational Enterprises, which are widely recognised as a reference point for corporate responsibility (CR), also urge companies to follow the spirit of the law in relation to tax. This is also an important component of public expectations regarding CR and tax. Companies may be particularly vulnerable to public criticism if they are perceived as not making an appropriate contribution to poverty reduction in developing countries, or as being able to gain unfair advantage over tax authorities in these countries that have limited resources and technical capacity. Being able to report cash tax payments that are 'appropriate' in this context is a growing preoccupation for some companies.

Based on our research we believe that these principles represent good tax management practice. Implementing the principles could help companies ensure that their tax management approach serves both shareholders' interests and demonstrates wider social responsibility.

The report suggests a good practice framework for a 'responsible tax' and concludes by recommending greater disclosure to investors and others on tax in the Operating and Financial Review and corporate responsibility reporting. The report can be downloaded in full from our website **www.henderson.com/sri** ■

Advisory Committee Interview: Paul Hohnen

Paul Hohnen

Paul Hohnen is an Australian national with extensive experience in global environmental and sustainability policy formulation. An international lawyer by training, he has worked as a diplomat (including to the OECD and the EU), as an international civil servant, as international political director of Greenpeace, and currently as a private consultant to a range of UN, business, and non-profit organisations. From 2002 to 2004 he was Global Reporting Initiative's Director of Strategic Development and was closely involved in the negotiation of many of the leading international treaties on sustainability, in the work of the UN Commission on Sustainable Development, and in recent work by ISO and the OECD on corporate social responsibility.

Why do you think the Advisory Committee is important?
The role of the Advisory Committee can be summarised in one word: 'information'. Information increases an organisation's options, sharpens its strategic thinking, and increases the probability of enhanced performance. I see the Committee's information role in Henderson's SRI programme as having essentially two directions.

The first of these is 'radar'. No matter how well-intentioned, no organisation is able to identify and maintain contact with all its key stakeholders. Like its competitors, Henderson has well-developed mechanisms for engaging with clients and the companies in which it invests. But by having an Advisory Committee composed of individuals with close links to the business, academic, union, NGO and sustainable development worlds, Henderson can also keep abreast of the latest thinking in these sectors that play such a vital role in shaping the ethical environment.

The second is 'x-ray'. By providing a forum for systematically identifying and evaluating external trends, the Committee helps Henderson continually re-assess its SRI policies, processes and products. It helps Henderson look inward at its performance and encourages thinking about how SRI work can be progressively refined and improved. This is a two-way process, and engagement with the SRI team ensures that the Advisory Committee is fully sensitive to Henderson's performance needs.

Together, this 'x-radar' role of the Advisory Committee can give Henderson a competitive edge in the marketplace.

Why are you particularly interested in SRI?
Individuals have limited ways of shaping a better world. We can exercise our vote, support good causes, or buy products that are produced in ways we approve. That's about it. Voting takes place every few years, and votes tend to cancel each other out. Donations to NGOs can be highly leveraged, but lack a sense of personal action. Decisions on how we buy, and how we invest, by contrast, are not only more frequent, but send powerful signals to markets and policy-makers. Put crudely, every investment has the potential either to advance - or undermine - human rights or the environment. By providing a structure for identifying and defining sustainability and responsibility, Henderson's SRI portfolio can help investors achieve both good financial returns, and promote 'public goods'.

What do you see as the future potential for SRI?
If the alternative to SRI – commonly referred to as 'mainstream' - is 'unsustainable irresponsible investment', the question is rather what future does that have? Looking at the magnitude of threats we face, such as climate change, and the fantastic technological opportunities that can help respond, it seems inevitable that the SRI concept will continue to gain increasing recognition and market share. Just looking at the rapid rise of concern about sustainable development over the last decade, and the level of engagement across all sectors of society, I cannot help but conclude that SRI will assume ever-greater importance as the key to protecting both the value of assets and safeguarding shared values. ■

Industries of the Future: Stock Profiles

Social Property & Finance, Sustainable Transport and Quality of Life are three of Henderson's 10 Industries of the Future investment themes. Here we provide examples of six stocks in these themes that the SRI funds invest in.

Social Property & Finance Theme

Dexia (Belgium) Dexia is the leading provider of public project finance in Europe. Typical customers include local authorities, hospitals, social welfare bodies, social housing bodies, not-for-profit organisations, and private companies providing public services. It also operates in the retail financial services space and is one of Europe's leading providers of socially responsible investment products.

Ambac (USA) Ambac provides financial guarantee insurance for municipal bonds. These guarantees help municipalities lower the financial costs of raising capital and broadens their investor base by decreasing the perceived risk of their bonds. Ambac works closely with governments and government agencies throughout the United States to improve access to the capital necessary for infrastructure projects and local financing needs. Cities and communities with poor credit ratings benefit from this insurance as without it they may not be able to raise finance and carry out necessary projects.

Sustainable Transport Theme

Shimano (Japan) Established in 1921, Shimano is now one of the top global bicycle parts' manufacturers. The majority of the company's revenue is generated from the manufacture of bicycle components such as brakes and gears which are sold in Europe, the USA, Asia and Japan. Shimano is well positioned to benefit from growing demand in markets such as China, where the company has been establishing operating businesses since the 1990s.

Umicore (Belgium) Umicore is a metals refining company whose products are used in the manufacture of automotive catalysts which help reduce pollution. The company reports that approximately one car in four produced today contains a Umicore catalyst. The company has a strong track record in environmental, health and safety issues, with steady improvements over several years in areas such as energy efficiency and emissions of metals to air and water, and occupational exposure of its workforce to toxic materials.

Quality of Life Theme

ABC Learning (Australia) Child care is a growth market in Australia. It is estimated that between 1999 and 2002, the number of children using child care increased by 27% to 732,100. By 2004, this figure had risen to 752,800. ABC Learning is one of the leading providers of day care centres, now with 644 in operation across the country. ABC also runs accredited training courses in child care and education for those wishing to work in the industry. The company is well positioned to benefit from an increase in the number of working mothers, which has risen by 20% in the last 20 years.

VCA Antech (USA) VCA Antech was founded in 1986 under the name Veterinary Centers of America. It is a leading provider of pet healthcare services in the United States through its 365 animal hospitals which treats millions of pets each year. Pet ownership generally improves peoples quality of life, therefore, the health of pets is important and spending is on the increase. In the USA between 1996 and 2001 the annual rate of growth of spending on pets was 10.6%.

News

Portfolio Listings

We think our investors should have access to more information about their funds. So, from this month onwards, we are publishing descriptions of each and every stock held in our SRI portfolios on our website.

GSK EHS Stakeholder Panel

Earlier this year, Henderson was invited to join GSK's Environment, Health and Safety (EHS) Stakeholder Panel. The first meeting of the Panel took place in September and we were encouraged by the company's willingness to integrate stakeholder views into EHS policies. The Panel consists mainly of external members representing regulators, non-governmental organisations, suppliers and customers with Henderson being the only investor. The purpose of the Panel is to review the company's EHS strategic plan and monitor its performance; provide external opinions on EHS issues and the company's position on them; and encourage innovation and leadership on EHS aspects of sustainable development. We believe that company panels and advisory bodies are an important way for companies to anticipate emerging sustainability and social responsibility issues; Henderson is also represented on similar bodies at BT and Reuters.

Triple Bottom Line Investing Conference (TBLI)

This year's TBLI conference kicks off on 2nd November in Frankfurt and is set to be one of the biggest sustainable investment events yet. The conference attracts sustainable investment professionals from across the globe and hosts a wide range of workshops and presentations. Nick Robins and Mark Campanale of Henderson's SRI team are both speaking at the event. Nick is participating in a roundtable discussion which will consider whether there is a carbon risk for the investment community, and if so, what can it do? Mark will be involved in a workshop concentrating on fund performance and strategy. If you are attending the conference, we look forward to seeing you there.

Eurosif Chemical Report

This month Eurosif, in partnership with EIRIS published an overview report of the Chemical sector. This is the second sector report in a series of publications aimed at raising awareness among a wide European audience on relevant social and environmental issues and the related business opportunities, potentially affecting long-term returns and productivity within the sector.

Henderson was a member of the steering committee which shaped the report and developed a way to present both the stakeholder and financial points of view. The report highlights five key challenges for the chemical sector over the next five to ten years: Climate Change, Resource Use, Chemicals of Concern in Products, Chemical Process Safety and Marketplace Conduct.

Nick Robins, Head of SRI Funds at Henderson commented, "This report clearly describes the top five sustainability challenges for the chemical sector in the next five to ten years. We believe investors should be taking a closer look at these issues and companies should be showing strategic competence in their management of them. Importantly, there are also a number of opportunities for companies to provide solutions to these challenges and therefore generate attractive returns for investors." ■

Company Dialogue

Engaging with companies enables us to deepen our understanding of the business, their corporate responsibility performance and also their alignment with the shift towards a sustainable economy. Through this dialogue we can, on behalf of our clients, encourage companies to make improvements where necessary.

During July, August and September, we met with the management of 74 companies to discuss and debate a range of topics including financial performance, corporate responsibility and sustainability. We maintain dialogue with a wide range of companies under the remit of Henderson's Responsible Investment Policy which applies to all funds. Therefore, some of the companies we engage with may not be included in the SRI funds though all dialogue helps us to develop a better understanding of company practice across and within sectors.

AB Ports
Alcon
Alta Advisers
Anglo American
Augean
BAA
Barclays (3)
Berkeley Group Holdings
BioFuels
BioProgress
Boskalis
BT
Center Parcs
Chorion
Conor Med
Coopers
Draegerwek
DS Smith
Dynamotive Management
Ekornes
Ersol
Exel
Generale de Sante
GTL Resources
HBOS
Hoku Scientific
House of Fraser
HSBC (3)
Intercontinental Hotels
Intertek
ITM Power
ITV
Lloyds TSB (2)
Metabolix
MHP
MK
Munich Re (2)
National Express
Nomura
Novera Energy
Ocean Power Technology
OLED
Plant Health Care
Plug Power
Power Integration
Premier Farnell
Q-Cells
Quantum Fuel System
RBS (2)
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