# oekom Corporate Responsibility Review 2015

Taking stock of sustainability performance in corporate management and capital investment

oekom research

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# Foreword

In 2015, sustainable investment will continue to grow in importance. One does not need to be particularly brave to make this prediction, as, especially in Germany, the SRI market still operates at a fairly modest level which lags behind that of many European countries, despite the growth rates of recent years.

Over the past year we have been able to track a number of changes that justify this optimistic outlook. The number of signatories to the Principles for Responsible Investment (PRI) rose in 2014 to over 1,350. They pledge, among other things, to take ESG criteria into account in their analyses and investment decisions. This will then (probably) lead to an increase in investment in sustainable investments. Moreover, other initiatives such as the increasing number of vocational training programmes by e.g. the European Federation of Financial Analysts EFFAS or the reporting initiative of the SASB (the US Sustainability Accounting Standards Board) show that investors worldwide are taking action. Scandinavia, the Netherlands and France already have a very high proportion of assets held in sustainable investments. Although the framework conditions in those countries are different, this will have an impact on Germany.

In addition, the EU Commission has adopted a Directive on compulsory sustainability reporting which makes it obligatory for companies which have more than 500 permanent employees and are publicly listed or part of the insurance and banking sector to publish a sustainability report. Although the specific form of disclosure has not yet been laid down, it is expected that this will lead to greater transparency on the non-financial performance of the around 5,500 companies affected. This is an urgently needed change, as only 2,500 of the 42,000 major companies in the EU currently publish sustainability reports. For small and medium-sized enterprises in particular, this new requirement will necessitate expansion of their own reporting systems which will be a challenge as there are few tools for recording the relevant data that are specifically designed for such companies. The German Sustainable Development Council's Sustainability Code, which is explicitly mentioned as an example in the publication of the EU Directive, seems to provide particularly suitable guidance.

Last year saw once again the publication of numerous studies on sustainability and performance. Altogether around 900 studies, both from academia and companies in the field, are currently available. The findings all point in the same direction – the performance of sustainable investments is at least as good as that of non-sustainable ones, in many cases even better. So how is it that sustainability continues to be an opt-in rather than an opt-out criterion? What would the effect be if investors did not have to make an active decision in favour of sustainable investments, but an active decision against them? Despite the large number of studies in existence, further light still needs to be shed on individual aspects of investment in various asset classes. The bond market in particular has not yet been adequately researched. This is especially true of green bonds and corporate bonds, on which you will find some information in this annual review.

However, some of the issues facing us in 2015 will have an enormous impact on sustainable investments and make everything else fade into insignificance. These are the effects of TTIP, which are as yet totally unclear but so far give little cause for optimism from the point of sustainability, the UN climate summit in Paris, and the course that the energy transition takes. Decisions made now on which path to follow could set sustainability back a few years or alternatively open up huge potential opportunities for investors. Let us work on this and hope that on balance the potential opportunities will prevail!

I hope you will find this review a stimulating read.

***Prof. Dr. Alexander Bassen***
University of Hamburg
German Council for
Sustainable Development

# Editorial

Critics of international agreements or organisations are fond of using striking examples to convey their points to the public. For example, the cucumber and the light bulb were used as symbols of over-regulation from Brussels, and the same is now happening with "chlorine chicken" in connection with the controversial TTIP free-trade agreement between the European Union and the US. In the case of TTIP, the "Transatlantic Trade and Investment Partnership", this particular issue has come to symbolise the fear that high European standards, for example in the areas of environmental and consumer protection or genetic engineering in agriculture, will be undermined by the agreement. This would be the case if companies were able to take legal action against the relevant regulations where they felt these were putting their commercial operations at a disadvantage.

The final word on this delicate issue has yet to be heard. However, we have looked into the question of how great the differences are, broadly speaking, between European and US companies in terms of environmental and social responsibility. At this point, it can safely be said that they are considerable. For example, whereas the sustainability performance of European companies is rated as "good" in no fewer than one-third of cases, not even one in ten US companies achieves this rating. If it is assumed, as the critics of TTIP do, that the treaty might lead to a reduction of social and environmental standards to the lowest common denominator, this would have to be seen as a very critical development from the point of sustainability

Overall, the sustainability-related efforts of the global players analysed in the annual review also remain at a critical level. As in previous years, barely one in six companies achieved a good rating in oekom's Corporate Rating and was awarded oekom Prime Status as a result. One in every three companies is beginning to tackle the challenges of sustainability more vigorously, but our analysts report that almost half the companies are still taking little or no action in this area. However, these companies, rated as "poor", now make up a smaller proportion of the total than in the previous year.

The universe covered by our analysts now comprises around 3,500 companies, and these are evaluated on the basis of around 100 largely sector-specific criteria. This generates a total of approximately 350,000 items of company-specific information with a total of a million data points, which are regularly recorded and evaluated. They provide an extensive and robust fundament for our Corporate Ratings and thus also for this annual report, the sixth oekom Corporate Responsibility Review in the series so far. The management of such large quantities of data requires our analysts to have extensive industry knowledge and technical expertise, as well as diligence, conscientiousness and perseverance. I would like to offer my sincerest thanks to all our analysts at this point for their commitment.

I would also like to thank Professor Alexander Bassen, who has not only served as a new member of our Advisory Board over the last year, but has also contributed a foreword to this annual review. It forms the prelude to what I hope you will find to be an interesting and enlightening read.

***Robert Haßler***
CEO oekom research AG

# In a nutshell: a summary of the key findings

### *The development of sustainable investment – facts and figures*

- As at 31 December 2014, the number of sustainable mutual funds licensed for marketing in **the German-speaking countrie**s was 393, according to calculations by the Sustainable Business Institute (SBI). The number of funds is therefore up by ten from the number recorded at the end of 2013. The volume of funds stood at an overall total of 47 billion euros, compared to 40 billion euros at the end of 2013.

- As at 31 December 2013, according to Forum Nachhaltige Geldanlagen (FNG), **sustainable capital investments in the German-speaking countries** totalled 134.5 billion euros. The market has thus grown by twelve per cent compared to the previous year. Asset overlays – i.e. exclusion criteria applied to the entire investment universe – in the German-speaking countries totalled 2.46 trillion euros.

- The number of **mutual funds licensed in Europe** has also increased. 957 such funds were licensed for marketing as at 30 June 2014, 33 more than in mid-2013. Their volume is up by 17.6 per cent from the preceding year, to 127 billion euros.

- Overall, the European industry association Eurosif estimates that at the end of 2013 in **Europe as a whole** almost 9.9 trillion euros were invested taking ESG criteria into account. More assets are covered by an exclusion-based strategy than by any other sustainable investment strategy.

- In addition, a study by Novethic reveals that **European asset owners** are increasingly making use of ESG strategies. 185 long-term investors (e.g. pension funds and insurance companies) in 13 European countries were surveyed. 72 per cent of respondents stated that in 2013 they had raised their formal requirements for sustainable investments. More than half of those surveyed now state that they apply ESG criteria to all their assets under management

- **Worldwide**, the total volume of sustainable investments stands at around 18,9 trillion euros. Europe accounts for the largest share of these. In the US, around 5.8 trillion euros are invested taking sustainability criteria into account.

- Various analyses have shown that by taking sustainability criteria into account, investors can obtain a **double dividend**, securing returns which are at the very least in line with the market while at the same time achieving social, environmental or ethical goals. Whereas in the case of equities the issue of performance is at the forefront, in the case of bonds the primary concern is the risk that the capital invested will not be recovered in full at maturity or that the guaranteed interest will not be paid. The oekom Corporate Bonds study indicates that the use of sustainability ratings improves the risk-return ratio of investments in corporate bonds.

- The market for **green bonds** has grown steadily in recent years, reaching a volume of 36.32 billion US dollars in 2014. Corporate issuers have discovered the market and now feature among the leading players on the green bond market.

## *Corporate responsibility – status and trends*

- oekom research regularly evaluates around 3,500 companies from 55 industries and over 50 countries. Major national and international equity indexes are covered. The oekom Universe additionally comprises sustainability leaders outside these indexes as well as small & mid caps from sectors closely linked to the area of sustainability (e.g. renewable energies, recycling) and major non-listed bond issuers. From this **parent population**, around 1,600 large companies which are domiciled in industrialised countries and operate internationally were selected for analysis as part of the Corporate Responsibility Review.

- At the end of 2014, 16.3 per cent of the companies met the minimum sector-specific requirements in terms of sustainability management and sustainability performance defined by oekom research and were thus awarded **oekom Prime Status**. 34.1 per cent of the companies have begun to take action on sustainability, but many of these are not yet integrating sustainability-related issues into their management systems on a systematic and company-wide basis. Compared with the previous year, the proportion of such companies – classified as "medium" – has risen by 4.0 percentage points. The analysts at oekom research rated the sustainability performance of just under half of all companies (49.7 per cent) as "poor". This proportion is down by 3.4 percentage points compared with the previous year.

- In an **EU vs. US country comparison**, the European companies performed significantly better than their US competitors, achieving 40.6 on a scale ranging from 0 to 100 (highest score), compared to the US companies' score of 25.2. While the sustainability performance of the European companies was classified as "good" in 37.2 per cent of cases and as "medium" in 42.3 per cent, the corresponding figures for US companies were just 9.4 and 32.8 per cent. In sectors where the volume of goods and services exchanged between the two economic areas is particularly high (e.g. in the automotive sector, machinery and the chemicals and pharmaceuticals industries), European companies generally performed better in the area of sustainability.

- At the **sectoral level**, as in the previous year manufacturers of household products achieved the highest average rating. On a scale ranging from 0 to 100 (highest score), they achieved a score of 47.2. They were followed by car manufacturers (43.2) and, with some distance, by manufacturers of electronic devices & appliances (35.5).

- Examination of the top three companies in each of the 22 sectors analysed here gives the following picture: German companies achieved a total of 13 "podium positions", and they were the **industry leaders** in as many as six sectors. Next came UK companies, with twelve top three rankings and four industry leaders, followed by the US with eight rankings and one industry leader.

- Companies from the metals and mining industry were those most frequently involved in **breaches** of the principles of the **UN Global Compact**. More than one in three companies (35.6 per cent) were in breach of at least one of the ten principles, with environmental violations being the type most frequently documented. They were followed in second and third places by companies from the oil and gas sector (34.5) and textiles companies (20.7).

- There was evidence of involvement in **corruption** in the case of almost one in five construction companies (18.5 per cent), almost one in six oil and gas suppliers (15.0 per cent), and one in seven companies in the health sector (14.3 per cent). However, experts estimate that 80 to 90 per cent of cases involving corruption go unreported.

- Despite the high level of public awareness following the accidents in Bangladesh, **violations of labour rights** in the textile industry are still widespread. 17.2 per cent of companies have committed violations of this kind. The retail sector (14.5) and producers of electronic devices & appliances (14.0) were ranked 2nd and 3rd worst in this regard. Two-thirds of all violations of labour rights occur in the supply chains of the companies analysed.

- The companies most frequently implicated in **human rights violations** were those in the metals and mining industry. 8.9 per cent of companies have committed violations of this kind. oekom research has also documented cases of human rights violations in the oil and gas sector and in conglomerates and international trading groups, among others.

- When it comes to **environmental destruction,** companies in the oil and gas sector (31.0 per cent) and the metals and mining industry (26.7 per cent) are also particularly frequently involved. They are followed by energy and water suppliers (9.8 per cent) and commercial banks (6.9 per cent), the latter because it is often their project financing which makes environmentally critical projects feasible in the first place and they thus share responsibility for the environmental destruction.

# 1. The development of sustainable investment – facts and figures

## 1.1. Current market trends in various markets

### *1.1.1. German-speaking countries*

*Sustainable mutual funds*

According to data from the Sustainable Business Institute (SBI), a total of 393 sustainable mutual funds were licensed for marketing in Germany, Austria and Switzerland as at 31 December 2014. The total volume of assets in the funds stood at 47 billion euros. Compared with the end of 2013, the number of funds has increased (+10) and the volume has risen by 17.5 per cent (31 December 2013: 40 billion euros).

The SBI recorded a total of 28 new funds in 2014. Some of these funds were new launches, some were existing funds that had switched to a sustainability-oriented strategy and some were funds that had previously been licensed in other countries. 18 funds had been closed or amalgamated with other funds since the beginning of 2014.

The 209 equity funds had the highest volume of investments, totalling 24.9 billion euros. Around 9.4 billion euros were invested in the 72 bond funds, the volume of the 75 mixed funds stood at 7.8 billion euros, and around 0.4 billion euros were invested in the twelve umbrella funds.

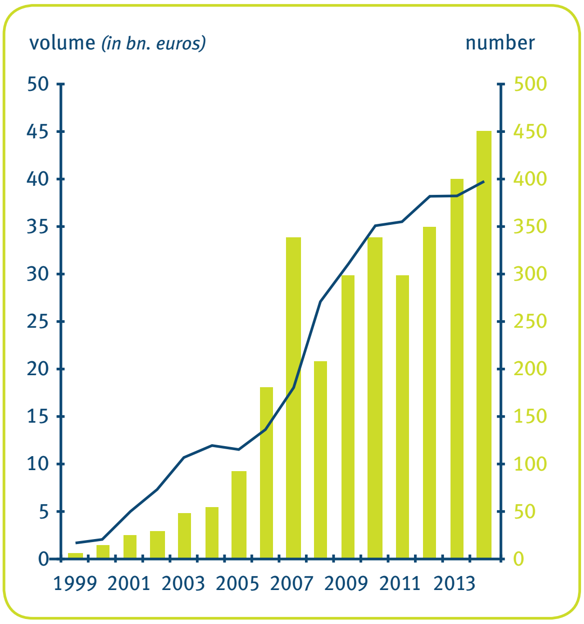



*Fig. 1: Volume of sustainable mutual funds in German-speaking countries; as at: 31. 12. 2014; in bn. euros; source: SBI (2015)*

*The overall market for sustainable investment*

According to a May 2014 study by Forum Nachhaltige Geldanlagen (FNG), more and more private and institutional investors are opting for sustainable investments. As at 31 December 2013, the total volume of sustainable investments in Germany, Austria and Switzerland stood at 134.5 billion euros. The market had thus grown by twelve per cent compared with the previous year. The volume of sustainable investments in Germany amounted to 79.9 billion euros and was thus nine per cent higher than in the previous year.

Third-party and own investments accounted for the lion’s share (50.8 billion euros), followed by mandates (43.1 billion euros) and investment funds (40.6 billion euros).


*Fig. 2: Volume of assets managed in sustainable mutual funds and mandates in German-speaking countries; as at: 31. 12.; in bn. euros; source: FNG (2014)*

The German market accounts for a disproportionate share of third-party and own investments (97 per cent), while the bulk of mandates and investment funds are from Switzerland.

Between 2005 and 2013, the volume of assets in sustainable investment funds and mandates increased more than sixfold.

When taking stock, account must also be taken of so-called asset overlays. These involve exclusion criteria which are applied to the entire investment universe. In the German-speaking countries, the main focus is on cluster munitions and anti-personnel mines. FNG calculates that asset overlays in the German-speaking countries now total 2.46 trillion euros.

### *1.1.2. Europe*

#### *Sustainable mutual funds*

According to an analysis by vigeo, as at 30 June 2014, 957 SRI funds were licensed for marketing in Europe, 33 more than in mid-2013. The volume of the funds was up by 17.6 per cent, to 127 billion euros. This equates to a market share of 1.7 per cent of all mutual funds licensed in Europe.

According to vigeo, France is still the largest market for SRI mutual funds, in terms of both market volume (46 billion euros) and number of funds (263). With the exception of Luxembourg, market volume has increased in all countries, particularly in Denmark (+102 per cent), Italy (+40 per cent), Norway (+31 per cent), France (+20 per cent) and the UK (+17 per cent).

Equity funds account for the lion's share (553), followed by bond funds (175) and mixed funds (154). The average volume of a sustainable mutual fund stands at 132.7 million euros.

### *European asset owners' ESG strategies*

*In December 2014, the French SRI organisation Novethic published its annual survey on the integration of ESG criteria by European asset owners. This survey assesses the views of 185 long-term investors (e.g. pension funds or insurance companies) in 13 countries representing a total asset value of over 6 trillion euros.*

*The survey shows that European asset owners are stepping up their requirements on responsible investment. The Nordic countries and the Netherlands are the most mature, boasting the broadest range of responsible investment strategies. 72 per cent of the investors surveyed said they had drawn up formal responsible investment policies, an increase of 7 per cent on 2013, while more than half of them integrate ESG criteria across all their asset classes.*

#### *The overall market for sustainable investment in Europe*

If, in addition to mutual funds, investments by institutional investors are also included, the overall volume of sustainable investments in Europe at the end of 2013 totalled just under 9.9 trillion euros, according to an analysis by the European umbrella organisation Eurosif.

Assets subject to exclusion criteria grew by 91 per cent between 2011 and 2013 and cover an estimated 41 per cent (6.9 trillion euros) of European professionally managed assets. Exclusions cover more assets than any other SRI strategy and have the most consistent usage across Europe. Assets subject to engagement and voting policies have grown by 86 per cent over the period to reach 3.3 trillion euros, versus 1.8 trillion euros in 2011. Half of that growth comes

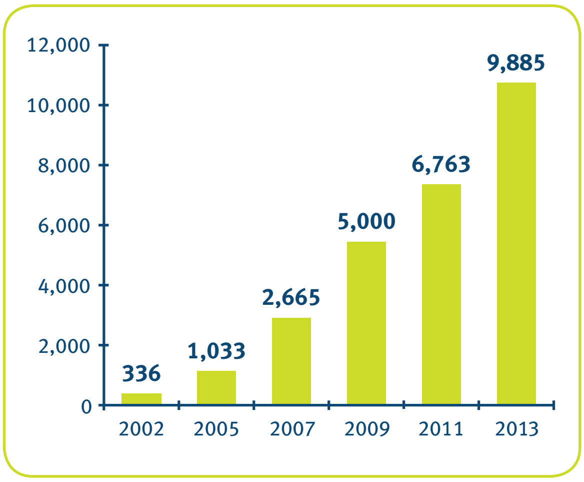



*Fig. 3: Volume of capital invested according to sustainability criteria in Europe; as at: 31.12.; in bn. euros; source: Eurosif (2014)*

from the UK, with other key contributors being the Netherlands, Norway and Sweden.

The study sheds light on how the integration of non-financial factors into investment decisions is implemented. All forms of ESG integration have grown by 65 per cent since 2011, making it one of the fastest growing strategies.

| Strategy | Capital influenced |
|---|---|
| Exclusions | 6,854.0 |
| Integration | 5,232.1 |
| Norms-based screening | 3,633.8 |
| Engagement / Voting | 3,275.9 |
| Best in class / Positive screening | 353.6 |
| Sustainability-themed investments | 59.0 |
| Impact Investing | 20.3 |

*Fig. 4: SRI strategies in Europe by volume; as at: 31. 12. 2013; in bn. euros; source: Eurosif (2014)*

### *1.3. US and Canada*

The volume of sustainable investments in the US had risen to 5.8 trillion euros (6.57 trillion US dollars) by the end of 2013, according to a market analysis by the Forum for Sustainable and Responsible Investment US SIF. This represents a growth of 76 per cent from the level at the end of 2011. Overall, one in every six dollars managed professionally in the US is now invested responsibly. US SIF differentiates between just two SRI strategies: ESG incorporation (integration) and shareholder resolutions (engagement and voting). ESG criteria are incorporated into the investment analysis and securities selection process in the management of 4.3 trillion euros, while shareholder resolutions are applied to 0.33 trillion euros of assets under management. 1.19 trillion euros of investments make use of both strategies.

The "2015 Canadian Responsible Investment Trends Report" by the Canadian Responsible Investment Association (RIA) shows that in Canada too the sustainable investment market is continuing to grow. For example, since December 2011 the volume of assets managed according to sustainability criteria has grown by 68 per cent to over 700 billion euros (1 trillion Canadian dollars), as at December 2013. This represents a market share of 31 per cent of all assets under management in Canada. Among the main influencing factors cited were growth in SRI investments by pension funds and increasing awareness of ESG risks among investment managers.

### *1.1.4. Asia*

A December 2014 study by the industry association ASrIA, the Association for Sustainable & Responsible Investment in Asia, puts the volume of assets in Asia (excluding Japan) invested responsibly using one or more SRI strategies at 39.5 billion euros (44.9 billion US dollars), as at the end of 2013. The volume of sustainable investments has thus grown an average of 22 per cent a year since 2011. In addition, strong growth in fund volumes and numbers of funds indicates a dynamic Asian SRI market, despite weaker economic growth in the region in recent years.

As in Europe, the entire range of SRI strategies is employed in Asia. The integration approach is particularly common. This strategy is used in the management of 20.6 billion euros (23.4 billion US dollars). The largest SRI market in Asia (excluding Japan) is Malaysia (34 per cent), followed by Hong Kong (25 per cent) and South Korea (19 per cent).

In November 2014, the Japan Sustainable Investment Forum published the latest figures on the market for sustainable mutual funds in Japan. According to these, the number of sustainable mutual funds licensed for marketing as at 30 September 2013 stood at 78, while two years before there had been 90. The volume of the funds stood at 1.7 billion euros.

Compared to Europe and the US and given the economic strength of countries such as China and Japan, the volume of SRI investments in Asia is still far short of its potential.

### *1.1.5. Global*

The Global Sustainable Investment Alliance (GSIA) puts the total volume of sustainable investments worldwide at more than 18.9 trillion euros (21.4 trillion US dollars). This equates to a market share of 30.2 per cent of total assets under management.

The calculations included data for Africa, Asia, Australia, Europe and North America. For other regions, for example the Arab states or South America, no current data is available. When interpreting the data, it must be borne in mind that there is as yet no globally valid standard definition of what constitutes SRI investment. The categorisation of individual investments as responsible may therefore differ from region to region.

The GSIA states the following with regard to the SRI strategies used:

| Strategy | Capital influenced |
|---|---|
| Exclusions | 12,700 |
| Integration | 11,345 |
| Engagement / Voting | 6,218 |
| Norms-based screening | 4,884 |
| Best in class / Positive screening | 876 |
| Sustainability-themed investments | 147 |
| Impact investing | 96 |

*Fig. 5: SRI strategies worldwide by volume; in bn. euros; as at: 31. 12. 2013; source: GSIA (2015)*

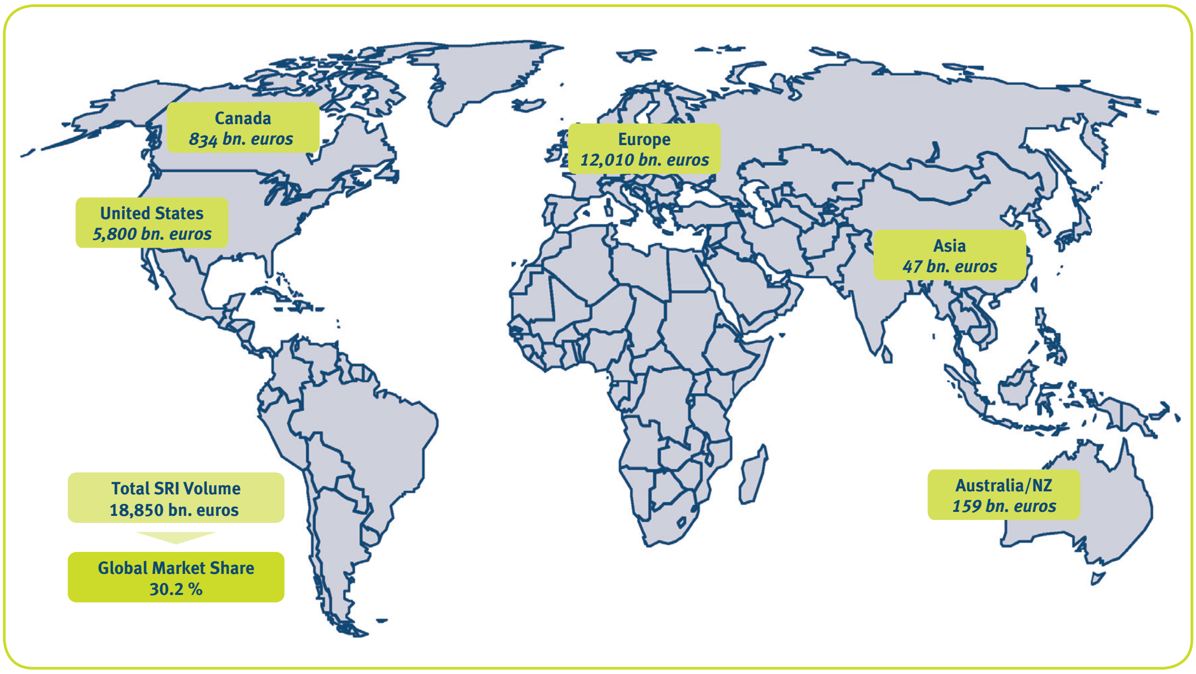



*Fig. 6: SRI worldwide; as at: 31. 12. 2013; source: GSIA (2015)*

## 1.2. Performance of sustainable investment

The preconception that sustainable investments perform worse structurally than conventional investments still persists. The main argument frequently cited for this is that any restriction of the investment universe, for example through the use of exclusion criteria, must inevitably lead to a reduction in potential yield and a higher risk, due to the reduced opportunities for diversification. Sustainable investors, by contrast, are convinced that these additional criteria regarding social and environmental performance actually help to provide a more comprehensive understanding of the opportunities and risks presented by an issuer.

This view is backed by numerous studies, for example two metastudies by the consultancy firm Mercer from 2007 and 2009, a Deutsche Bank metastudy published in summer 2012, a 2011 analysis by the asset management company RCM, which forms part of Allianz Global Investors, and an analysis by Steinbeis University in Berlin (2013). According to these, taking sustainability criteria into account does not automatically lead to lower returns or higher risk. On the contrary, by taking relevant criteria into account, investors can obtain a double dividend, securing returns which are at the very least in line with the market, while at the same time achieving social, environmental or ethical goals.

The fact that the studies' generally positive findings also apply to oekom research's corporate analyses is shown by a performance analysis carried out by oekom research in collaboration with the Deutsche Performancemessungs-Gesellschaft für Wertpapierportfolios (DPG). During the period from 1 January 2005 to 31 December 2013, i.e. over a period of nine years, oekom's Prime Portfolio Large Caps (PPLC), weighted by market capitalisation, achieved a cumulative return on investment of 81.90 per cent. Over the same period, cumulative returns for the MSCI World Total Return Index® came to 77.32 per cent. During the period under consideration, the oekom PPLC thus achieved a return that was 4.58 percentage points or 5.92 per cent higher than that of the conventional benchmark index. If equal weighting is given to the securities in oekom's PPLC, their cumulative returns actually rise to 140.10 per cent, more than 80 per cent above those of the MSCI World Total Return Index®.

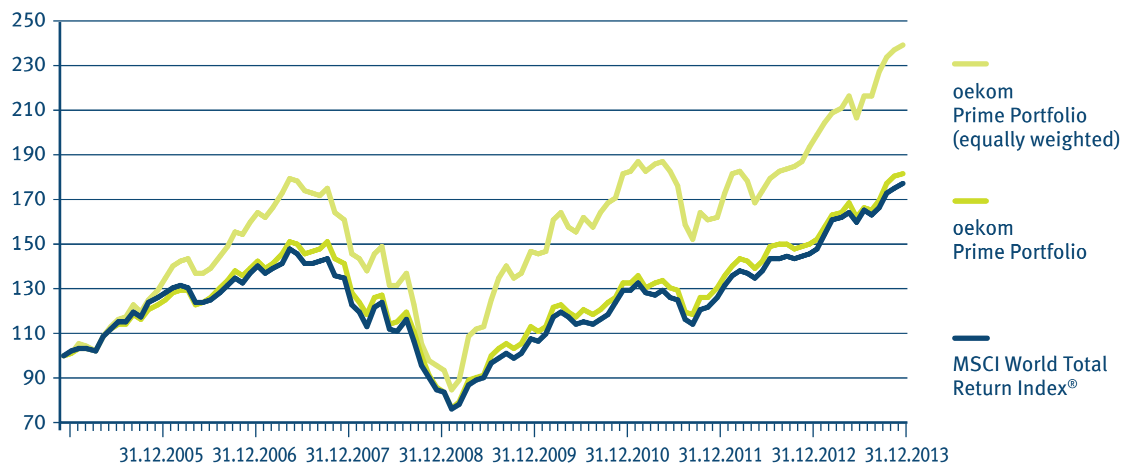
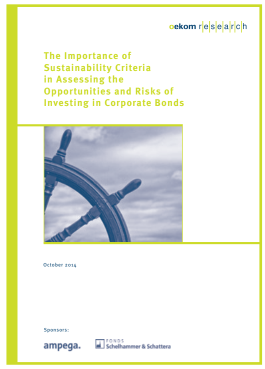



*Fig. 7:* ***Return of investment during the period 01. 01. 2005 tos 31. 12. 2013; source: oekom research/DPG (2014)***

Whereas in the case of equities the issue of performance is at the forefront, in the case of bonds the primary concern is the risk that the capital invested will not be recovered in full at maturity or that the guaranteed interest will not be paid. oekom's Corporate Bonds study, published in October 2014, looked at the ability of sustainability ratings to predict the capacity of companies to meet their obligations arising from the issue of bonds. To do this, we firstly examined and analysed the available literature on this topic. Secondly, two studies were carried out based on oekom research's sustainability ratings, one of which was concerned with explaining and evaluating the risk premiums on corporate bonds, i.e. the credit spreads, while the other examined the accuracy with which such ratings are able to forecast companies' solvency.

The analyses show firstly that a better sustainability performance, and thus a better sustainability rating, goes hand in hand with a higher equity ratio. Companies with oekom Prime Status have equity ratios around five percentage points higher than those of companies whose sustainability performance does not meet the requirements for Prime Status. The equity ratio can thus be interpreted as an indication of the ability of companies to meet their obligations arising from the issue of corporate bonds. On the other hand, sustainability ratings also provide important information for explaining and evaluating credit spreads. It can be seen that companies with an above-average sustainability rating have a lower credit spread and are thus seen by investors as being less risky.

Sustainability ratings thus impact positively on decisions about investments in corporate bonds in two ways. Firstly, they provide important pointers to the risks of a partial or total loss which might arise if the issuing company gets into economic difficulties. Secondly, the systematic integration of ESG criteria into the selection of corporate bonds not only makes it possible to improve the sustainability quality of a portfolio, but also has a positive impact on the financial return of a portfolio invested in corporate bonds.




## *Green Bonds*

*Since the World Bank issued the first green bond in 2008, the market for these bonds has grown steadily. Whereas green bonds were initially issued almost exclusively by development banks, increasing numbers of companies are now opting to use such bonds in order to appeal, in particular, to investors with a sustainability-based approach to investment.*

*In 2014, the volume of green bonds issued totalled 36.32 billion US dollars. The previous year, the corresponding volume had been just 10.98 billion US dollars. Experts anticipate that this rapid growth will continue in the near future.*

*Green Bonds are an important tool for financing climate protection and environmental conservation projects and are thus an attractive form of investment, particularly from the point of view of sustainability-oriented investors. The latter have high expectations in terms of the social and environmental standards of green bond issues and are particularly sensitive to any suspicion of greenwashing where a bond issue is concerned. An independent review of the selection criteria for the projects financed by green bonds and of the actual use of proceeds, as part of a so-called "second party opinion", should ensure that the green bond will meet the requirements of sustainability-oriented investors.*

## 1.3. Outlook

The market for sustainable investment has grown enormously in recent years. According to Eurosif, all sustainable investment strategies exhibited double-digit growth rates between 2011 and 2013, while the European SRI market as a whole grew by 46 per cent. If you look back even further, to 2002, the volume of sustainable investments in Europe has increased around thirty-fold. In the US, one in every six dollars managed professionally is invested responsibly, and the SRI share of the global market stands at 30.2 per cent.

These figures are impressive. Yet the high SRI market share is based on the two SRI investment strategies of exclusion and integration. The bulk of sustainable investments are thus made on the basis of SRI strategies which have very little impact in terms of improving the sustainability performance of companies. This was one of the key findings of the oekom Impact Study carried out in 2013. According to the companies surveyed as part of this study, the best-in-class approach and dialogue between investors and companies have the greatest influence on their sustainability management. By allocating their capital in a more impact-oriented way, investors could significantly enhance their ability to influence companies to take a more active approach to enshrining sustainability management within their business. One of the main reasons sustainable investment came into being in the first place was to promote corporate responsibility.

# 2. Corporate responsibility – status and trends

## 2.1. Basis for the analyses: the oekom Universe

In total, oekom research analyses and evaluates more than 3,500 companies. The oekom Universe covers all companies listed in major international stock indexes as well as in numerous national indexes and can be divided into three groups:

1. large listed companies from conventional sectors;
2. listed, often small and medium-sized, companies from sectors closely linked to sustainability, e.g. in the fields of renewable energies and energy efficiency, recycling technologies or water treatment;
3. non-listed bond issuers, e.g. regional banks, supranational organisations such as the World Bank, or railway companies.

### *Best-in-class approach*

Under the best-in-class approach, all companies are analysed using a standard procedure and based on comprehensive lists of criteria. The aim of the best-in-class rating is to evaluate companies' sustainability performance comprehensively, and to identify within individual sectors those companies which are particularly committed to sustainable development. To this end, companies are rated against a large number of criteria relating to all areas of corporate responsibility.

A distinction needs to be drawn here between the relative and absolute best-in-class approaches. Under the relative approach, a certain percentage of companies in an industry is defined as "best in class", e.g. the top 20 or 30 per cent. The disadvantage here is that the lowest-scoring companies which make it into the leading group under this approach do not necessarily have to satisfy high sustainability standards. In the case of the absolute best-in-class standard, an attempt is made to avoid this by defining (ideally industry-specific) minimum standards which companies have to meet in order to be awarded best-in-class status.

oekom research employs the absolute best-in-class approach. Under this approach, the only companies to receive best-in-class status – for which oekom research has introduced the term "Prime" – are those which have achieved a minimum rating specified by oekom research on its rating scale, which ranges from A+ (highest score) to D–. In this context, oekom research uses the term "Prime threshold", which is determined separately for each industry.

Corporate Responsibility Prime

rated by oekom research

As a general rule, the greater an industry's (potential) adverse impact on the environment, employees and society, the higher the bar is set. In the oil and gas sector, for example, companies have to achieve a minimum score of B– in order to be rated as Prime. Software manufacturers, on the other hand, only need a C.

The lists of criteria each comprise around 100 individual criteria, a large proportion of which are industry-specific. They relate, for example, to the way in which the company treats its employees and suppliers, the ecodesign of products and the scope and quality of environmental management systems. The criteria are regularly updated in order to take into account e.g. new technical, social or legal developments. To illustrate this better, in some of the evaluations below, for example in the calculation of industry and country averages, the alphabetical scores have been converted to numerical scores on a scale from 0 to 100 (highest score).

*Exclusion criteria*

Private and institutional investors use exclusion criteria to exclude from investment companies which earn their money through the sale of controversial products and services or which show evidence of engaging in controversial business practices.

oekom research conducts analyses in respect of possible violations of a total of 17 exclusion criteria. These distinguish between controversial business areas, such as alcohol, nuclear power and military, and controversial business practices, such as violations of human rights or labour rights. oekom research's list of exclusion criteria includes, among others, the criteria recommended by the Evangelical Church in Germany (EKD).

***Please note:***

*The following evaluations of the quality of sustainability management and of breaches of the Principles of the UN Global Compact relate not to the whole corporate universe covered by oekom research, but to the sub-universe of large companies based in industrialised countries and operating internationally. Altogether there are at least 1,600 such companies, which will be referred to below as the **Global Large Cap Universe (GLCU)**.*

## 2.2. Corporate responsibility: overall performance

The overall rating of the sustainability performance of large international companies (Global Large Cap Universe, GLCU) has remained fairly stable in recent years. It remains the case that almost half the companies (49.7 per cent) demonstrate little or no engagement in the area of sustainability. A good third of the companies (34.1 per cent) have taken initial steps toward an active approach to tackling the challenges of sustainability, but this is often not implemented systematically or comprehensively. Fewer than one in six companies (16.2 per cent) were rated as "good" by the analysts, and only 0.1 per cent of companies fell into the "excellent" category.

Over the last year there were slight shifts in the two lower rating categories. The proportion of companies rated as "medium" rose from 30.1 to 34.1 per cent. By contrast, the proportion of companies rated as "poor" fell by 3.4 percentage points, from 53.1 to 49.7 per cent.

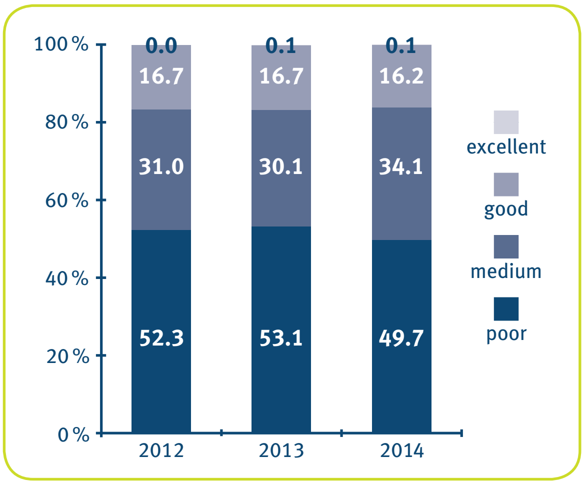



*Fig. 8: **Evaluation of the sustainability performance of large companies based in industrialised countries and operating internationally (GLCU); in %; as at: 31. 12.; source: oekom research (2015)***

The causes of this slight shift lie in two areas: firstly, transparency on sustainability-related engagement has improved somewhat, especially in companies which had previously been largely intransparent. Secondly, there were minor changes in the parent population. In the GLCU, for example, there was a slight decline from 2013 to 2014 in the proportion of companies from sectors such as oil and gas and real estate, which tend to be rated less positively (cf. section 2.4.1.), while sectors which tend on the whole to achieve better ratings, such as the IT industry, were somewhat more strongly represented.

## 2.3. Country comparison EU – US

TTIP, the Transatlantic Trade and Investment Partnership, became an increasingly hot topic of debate in 2014. Supporters of this free trade and investment protection treaty point to the positive effects of removing barriers to trade in goods and services between the EU and the US. The removal of tariffs and the harmonisation of technical regulations, standards and approval procedures are intended to reduce costs, which should lead to economic growth and the creation of new jobs. A study by the Bertelsmann Stiftung in collaboration with the Ifo Institute predicts growth of around 80 per cent in the volume of trade between the EU and the US, 4.7 per cent growth in the German economy as the powerhouse of the European economy, and the creation of two million new jobs in the OECD countries. By contrast, other studies, including some conducted in the US, warn of the potential loss of up to 600,000 jobs in the EU by 2025.

Criticism of TTIP is directed at a number of different aspects of the treaty. Particularly controversial is the enshrined right of companies to claim compensation if they feel that they have suffered economic losses due to laws or government policies. This can also apply to laws passed in the public interest, such as environmental and consumer protection legislation. As standards in these areas, for example agricultural genetic engineering and employee rights, are often stricter in the EU than in the US, which has for example still not recognised all the ILO's core labour standards, it is feared that such lawsuits would be filed mainly by US companies and could lead to European standards being undermined. There are also significant differences regarding one of the cornerstones of European environmental policy, the precautionary principle. In the EU, companies must prove that their products and processes are harmless before these can be approved. If the authorities perceive a risk, they will refuse approval as a precautionary measure. In the US on the other hand, the regulatory authorities can intervene only as a remedial measure after damage or loss has already occurred. Particularly in view of the differences of opinion regarding investment protection, experts now see it as unlikely that the treaty negotiations will be completed by the end of 2015 as planned so that the treaty can then be adopted by the participating governments.

Against this background, the question of the standards of sustainability management in companies on either side of the Atlantic and the social and environmental quality of their products is becoming a hugely important one. In order to answer this question, oekom research has compared the corporate ratings of US and EU companies from the GLCU parent population against one another.

### *Overall performance compared*

The overall rating of companies reveals significant differences in terms of the extent to which they accept their social and environmental responsibilities towards society, the quality of their response to these responsibilities and their transparency on it.

US companies achieved an average rating of 25.2 on a scale from 0 to 100 (highest score), while companies based in the EU had an average score of 40.6 (see introduction in section 2.4. for more information on the scale). While in the EU 37.5 per cent of companies analysed by oekom research were rated as good or excellent, the corresponding proportion in the US was 9.4 per cent. Conversely, the proportion of companies in the US rated as poor, at 57.8 per cent, was considerably higher than the proportion in the EU (20.3 per cent).

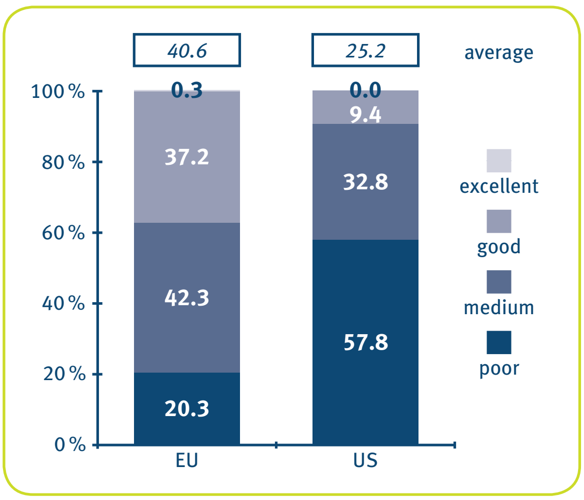



*Fig. 9: Comparison of the rating of companies based in the EU and the US; in %; as at: 31. 12. 2014; source: oekom research (2015)*

### *Sectoral comparison EU-US*

In sectors where the volume of goods and services exchanged between the two economic areas is particularly high, clear differences can be seen in companies' sustainability-related performance (cf. Fig. 10). In all the sectors examined here, the European companies achieved better average ratings than their US competitors. These differences are most pronounced in the oil and gas industry, where the European companies achieved scores on a scale from 1 to 100 which were on average 25.9 points higher than the US companies. There were also marked differences between manufacturers of electronic components (23.1), makers of electronic devices & appliances (20.3) and car manufacturers (19.9), although in the latter case only two US manufacturers were included in the rating. The gap was relatively small in the case of automotive suppliers (4.5) and also in the food industry (9.1), which is frequently alluded to in the public debate about TTIP.

These figures show that there are significant differences in how companies in the EU and the US are tackling the challenges of sustainability. If it is assumed, as the critics of the TTIP treaty do, that the treaty will lead to a "race to the bottom", a reduction of social and environmental standards to the lowest common denominator, this would have to be seen as a very critical development from the point of sustainability.

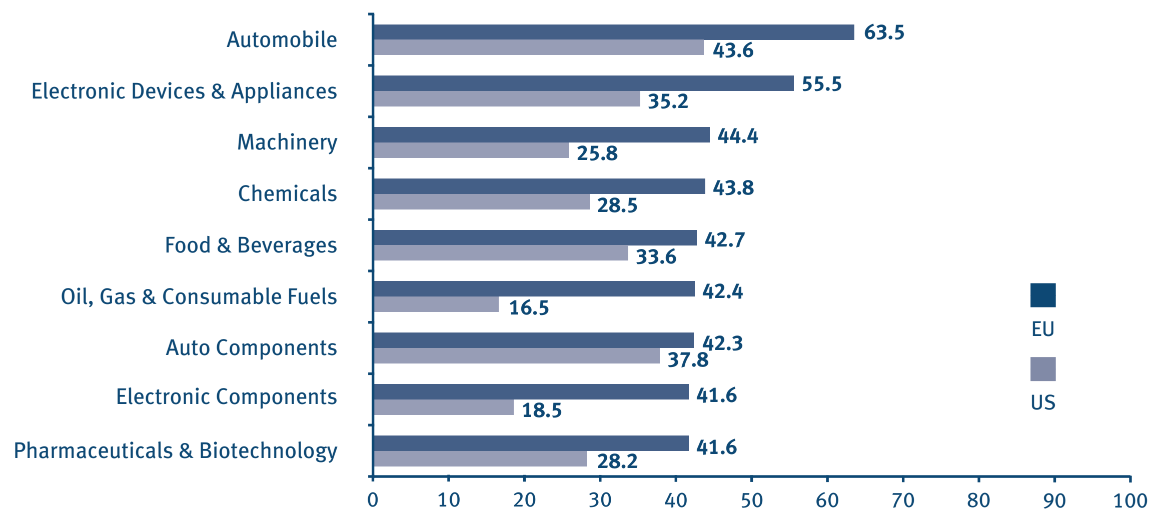



*Fig. 10: **Comparison of the average rating of companies based in the EU and the US in selected industries on a scale from 0 to 100 (highest score); in %; as at: 31. 12. 2014; source: oekom research (2015)***

## 2.4. Corporate responsibility in selected sectors

oekom research takes a decidedly sector-specific approach to the rating of companies. Of the total of approximately 700 individual indicators, around 90 per cent relate to sector-specific aspects. oekom research's view is that, particularly in the case of companies' products and services, it is only in an sector-specific context that the facts evaluated can be meaningfully defined. In order to nonetheless enable comparison of the ratings of different sectors, the alphabetical grades on oekom's scale from D– to A+ (highest grade) have been converted below to numerical scores, on a scale from 0 to 100 (highest score). When sectors are compared, a higher rating means that the companies in one sector handled sector-specific sustainability challenges better than companies in another sector with a lower rating.

### 2.4.1. The top-performing sectors

As in previous years, manufacturers of household products were particularly successful in addressing sustainability-related challenges. They achieved an average score of 47.2 on a scale from 0 to 100 (cf. Fig. 11). Compared with the previous year, their score improved by 0.9 percentage points. The top spot within the industry was taken by the German manufacturer Henkel (cf. p. 21). This year, as last, companies in the automotive industry again took second place in the sectoral rating. They achieved an average score of 43.2. Others ranked high in the table included manufacturers of electronic devices & appliances, producers of construction materials and automotive suppliers.

Among those at the bottom of the ranking of the sectors analysed here by oekom research were the commercial banks and insurance companies, the construction and real estate sector, the oil and gas and retail industries and the logistics business. It is notable that even the best industries fail to achieve as much as half of the maximum possible number of points, with most sectors obtaining less than a third and the worst not even managing to obtain a quarter of the available points.

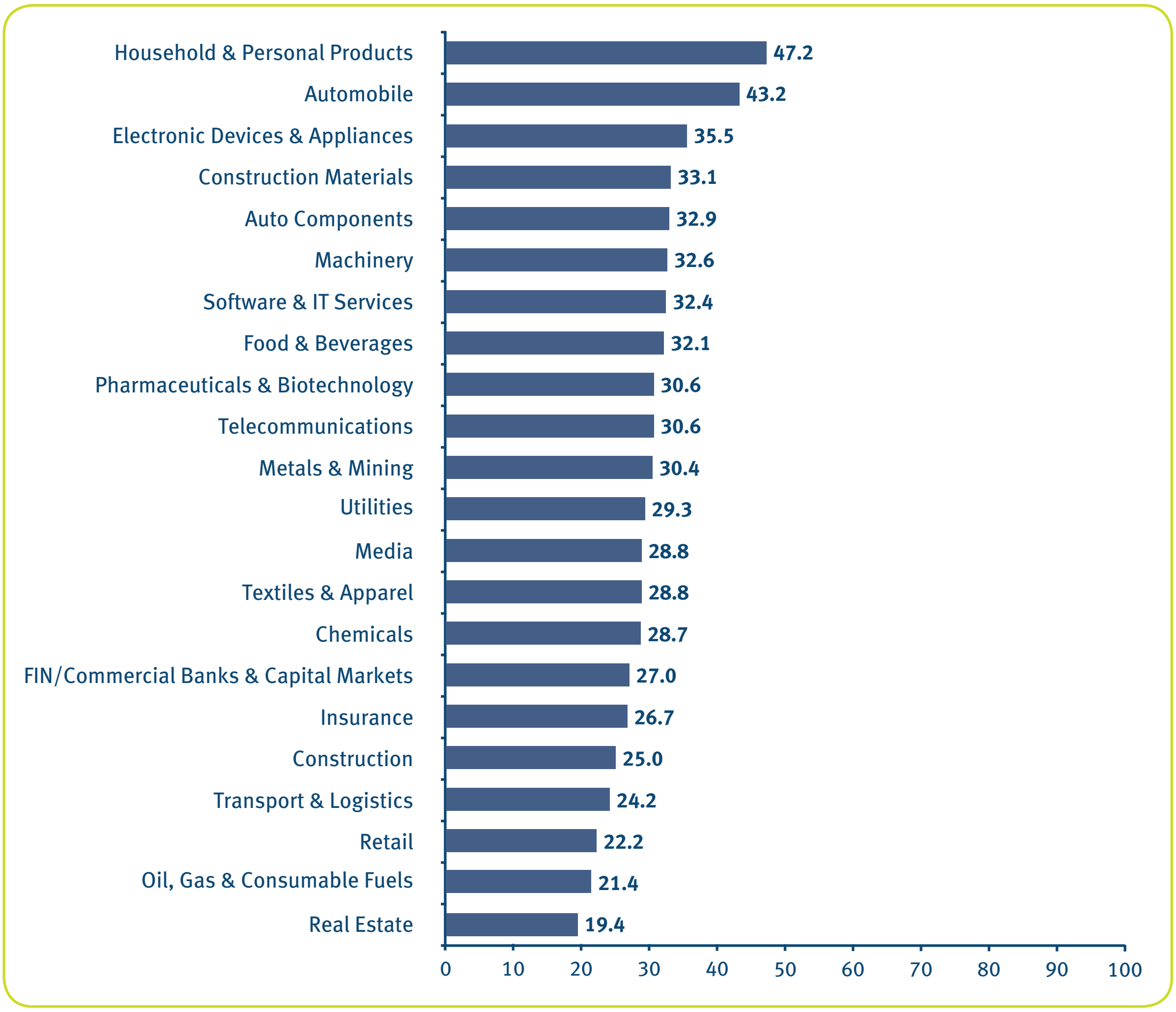



*Fig. 11: Average rating of companies from selected industries on a scale ranging from 0 to 100 (highest score); basis: GLCU; as at: 31.12.2014; source: oekom research (2015)*

The slight shift in companies rated poor to medium, which was described in section 2.2. on overall performance, is also reflected in the trend in the average rating of selected industries over recent years (cf. Fig. 12). A slight upward trend can be seen in the majority of the industries examined here, this being particularly pronounced in the chemicals and pharmaceuticals industry and in the commercial banking sector, for example. Last year saw a decline in the ratings of the oil & gas companies and energy and water suppliers.

When examining trends over time, it should be borne in mind that oekom research continually updates the rating indicators in order to take into account factors such as new legal, social or technical developments. Such adjustments to the indicators generally lead to a tightening of the requirements for companies.

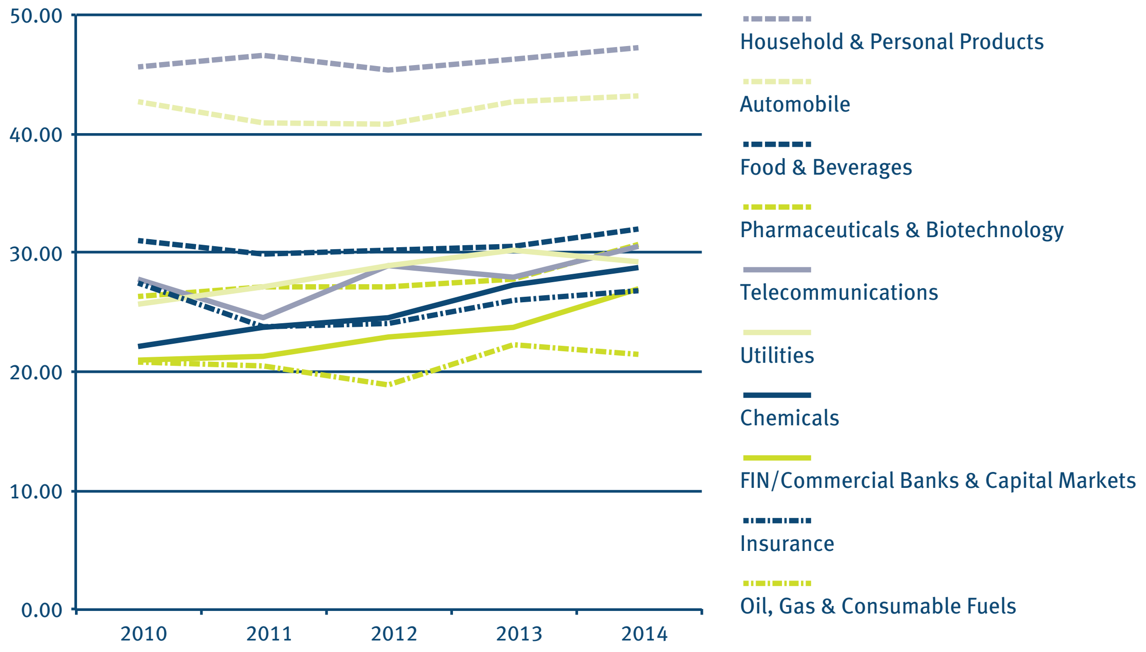



*Fig. 12: **Trend in the average rating of selected sectors in previous years; scale from 0 to 100 (highest score); as at 31. 12.; source: oekom research (2015)***

### *2.4.2. The industry leaders*

The disparity between Europe and the US in addressing sustainability-related challenges, described in section 2.3., is also evident among the industry leaders. In 19 of the 22 industries shown below (cf. Fig. 13) the highest-rated company is from Europe: only in the food sector does the industry leader come from the US. One industry leader is from Japan, another from Canada. It is interesting that despite the cultural similarities between the two countries, the total of around 110 UK companies in the GLCU parent population yielded more industry leaders than the nearly 580 companies from the US. Four industry leaders are based in the UK, putting it in second place in this "ranking of nations" behind Germany, which provided six industry leaders. Three of the industry leaders are based in Italy, with Norway and Sweden each represented by two companies.

If the analysis is extended to include the three top companies in each sector, the following picture emerges: with a total of 13 "podium places", Germany once again takes the lead, followed by the UK with twelve and the USA with eight top spots. Next in the ranking were France (7), Sweden (6) and Italy (4). In the media and retail sectors, all the top three places went to UK companies. In a number of other sectors, top spots were taken by two companies from the same country, for example by German companies in the automotive, chemicals, logistics and insurance sectors, and by US companies in the food industry.

In 17 sectors the best-performing companies achieved ratings in the B range, and in three sectors their commitment to sustainability was sufficient to gain them a B+. As in previous years, no company performed well enough overall for oekom research to award it a rating in the A range. This fact indicates that even in the best-performing companies, there is still a need for further action. In five industries, even the best-performing companies only managed score of C+ for their sustainability-related performance.

| Sector | Rank 1 | | | Rank 2 | | | Rank 3 | | |
|---|---|---|---|---|---|---|---|---|---|
| Auto Components | Pirelli | IT | B– | Johnson Controls | US | B– | Michelin | FR | C+ |
| Automobile | Renault | FR | B | BMW | DE | B | Volkswagen | DE | B– |
| Chemicals | BASF | DE | B– | Akzo Nobel | NL | B– | Linde | DE | B– |
| Construction | Skanska | SE | B– | Hochtief | DE | C+ | Ferrovial | ES | C+ |
| Construction Materials | Geberit | CH | B+ | Sekisui Chemicals | JP | C+ | CRH | IE | C+ |
| Electronic Devices & Appliances | Ricoh | JP | B– | Toshiba | JP | B– | Ericsson | SE | B– |
| FIN/Commercial Banks | DNB | NO | C+ | Westpac Banking | AU | C | Societe Generale | FR | C |
| Food & Beverages | Coca–Cola Enterp. | US | B– | Coca–Cola HBC | CH | B– | Campbell Soup | US | C+ |
| Household & Personal Products | Henkel | DE | B+ | L'Oreal | FR | B | Colgate-Palmolive | US | B– |
| Insurance | Allianz | DE | C+ | Swiss Re | CH | C+ | Munich Re | DE | C+ |
| Machinery | Atlas Copco | SE | B | MAN | DE | B– | SKF | SE | B– |
| Media | Reed Elsevier | GB | B– | Sky | GB | C+ | WPP | GB | C+ |
| Metals & Mining | Norsk Hydro | NO | B | Anglo American | GB | B– | Boliden | SE | B– |
| Oil, Gas & Consumable Fuels | Snam | IT | B | Enagas | ES | B | Neste Oil | FI | B– |
| Pharmaceuticals & Biotechnology | AstraZeneca | GB | B | Sanofi | FR | B– | GlaxoSmith Kline | GB | B– |
| Real Estate | British Land | GB | C+ | Unibail-Rodamco | FR | C+ | Intu Properties | GB | C |
| Retail | Marks & Spencer | GB | C+ | Tesco | GB | C+ | Kingfisher | GB | C+ |
| Software & IT Services | SAP | DE | B | Microsoft | US | B– | IBM | US | B– |
| Telecommunications | Deutsche Telekom | DE | B | BT Group | GB | B– | Telecom Italia | IT | B– |
| Textiles & Apparel | Gildan Activewear | CA | B– | Hennes & Mauritz | SE | C+ | NIKE | US | C+ |
| Transport & Logistics | Deutsche Lufthansa | DE | C+ | Deutsche Post | DE | C+ | (UPS) | US | C– |
| Utilities | Terna Rete | IT | B+ | Red Eléctrica | ES | B | Suez Environne-ment | FR | B |

*Fig. 13: The top 3 companies in selected industries; basis: GLCU; as at: 31. 12. 2014; companies in brackets were not awarded oekom Prime Status; source: oekom research (2015)*

## 2.5. Controversial business practices

Besides the scope and quality of sustainability-related efforts, oekom research also documents and evaluates the extent to which the companies analysed are involved in controversial business areas, e.g. nuclear power, agricultural genetic engineering or military, or in controversial business practices. In the latter case we use recognised standards as a yardstick, such as those formulated in the ten Principles of the UN Global Compact, the most significant voluntary commitment made by companies worldwide to responsible company management:

### *Principles of the UN Global Compact*

***Human Rights***

| | |
|---|---|
| *Principle 1:* | *Businesses should support and respect the protection of internationally proclaimed human-rights; and* |
| *Principle 2:* | *make sure that they are not complicit in human rights abuses.* |

***Labour***

| | |
|---|---|
| *Principle 3:* | *Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;* |
| *Principle 4:* | *the elimination of all forms of forced and compulsory labour;* |
| *Principle 5:* | *the effective abolition of child labour; and* |
| *Principle 6:* | *the elimination of discrimination in respect of employment and occupation.* |

***Environment***

| | |
|---|---|
| *Principle 7:* | *Businesses should support a precautionary approach to environmental challenges;* |
| *Principle 8:* | *undertake initiatives to promote greater environmental responsibility; and* |
| *Principle 9:* | *encourage the development and diffusion of environmentally friendly technologies.* |

***Anti-Corruption***

| | |
|---|---|
| *Principle 10:* | *Businesses should work against corruption in all its forms, including extortion and bribery.* |

The following sections document breaches of the Principles of the UN Global Compact by large international companies (GLCU). The basis for this is oekom research's application of the Principles in its corporate ratings.

### *2.5.1. Breaches of the UN Global Compact: the most controversial sectors*

More than a third of companies from the metals and mining sector (35.6 per cent) have breached at least one of the Principles of the UN Global Compact (cf. Fig. 14). This gave the sector the dubious honour of taking the top place among those sectors which have breached the Principles. Environmental violations are particularly frequent here, but violations of labour rights and human rights are also comparatively common in this sector.

Close behind in second place came companies from the oil and gas sector. Here, too, more than a third of companies (34.5 per cent) had breached the Principles at least once. Breaches of Principles 7 to 10 (environmental protection and corruption) are even more common here than in the metals and mining industry, but violations of labour rights and human rights have been documented somewhat less frequently. The fine of (so far) around 20 billion US dollars imposed on BP in the wake of the serious accident in the Gulf of Mexico (Deepwater Horizon) and that of around 19 billion US dollars given to Chevron in Ecuador exemplify the scale of such breaches in this sector.

Ranked third among the sectors breaching the ten Principles most frequently is the textiles industry. Approximately one in five companies (20.7 per cent) here has been involved in breaches of the UN Principles. Most breaches here are in the area of labour rights, and these occur mainly in the supply chain.

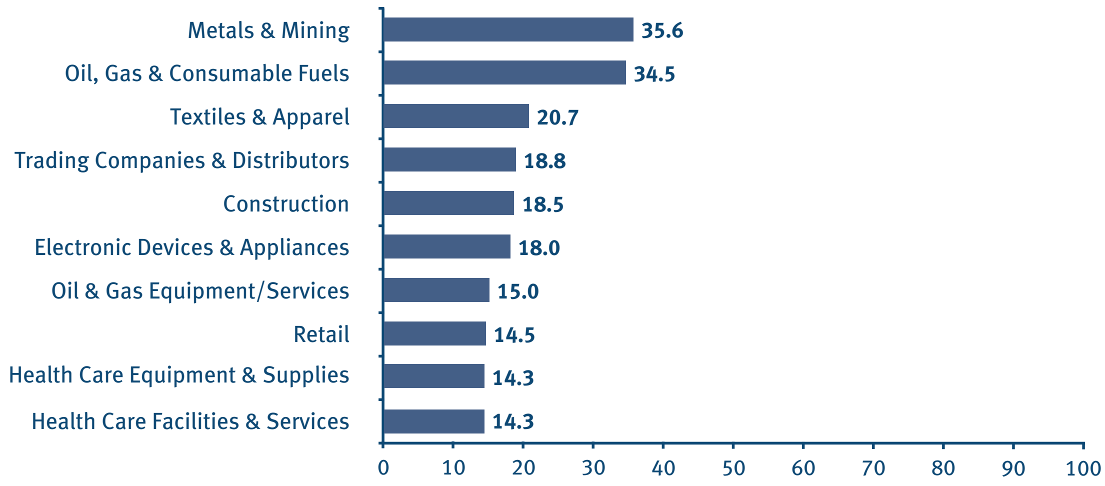



*Fig. 14: **Proportion of companies in the top ten sectors which have breached the Principles of the UN Global Compact; in %; as at: 31. 12. 2014; source: oekom research (2015)***

### *2.5.2. Corruption*

At the beginning of 2014, the EU Commission presented its first report on corruption in all 28 member states. When presenting the report, the then European Commissioner for Home Affairs, Cecilia Malmström, described the scale of the problem as "breathtaking". The Commission estimates the economic costs resulting from corruption in the EU at up to 120 billion euros a year. This equates to around one per cent of the EU's gross domestic product.

Nonetheless, European countries still perform relatively well with regard to corruption, as can be seen from the Corruption Perceptions Index published by the anti-corruption organisation Transparency International (TI). In 2014, the organisation published

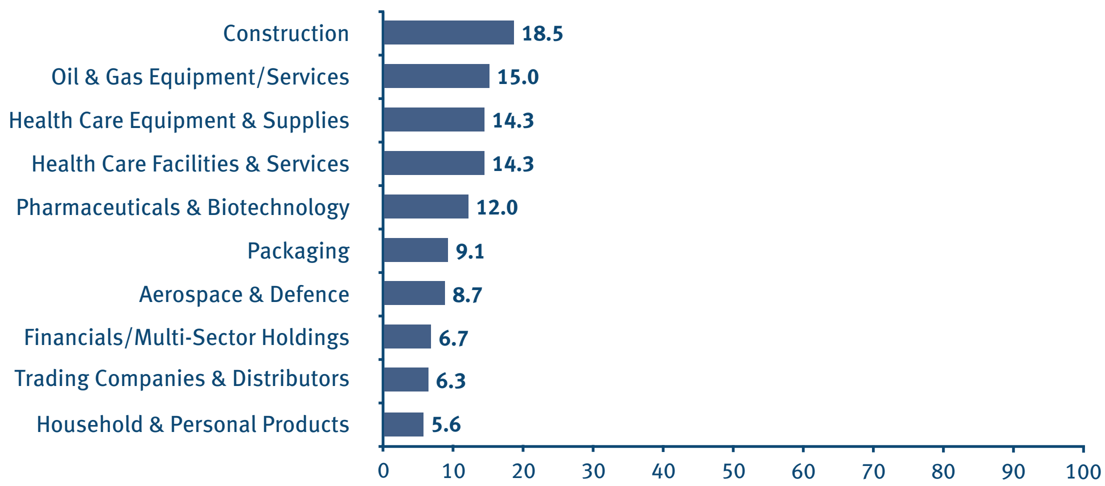



*Fig. 15: **Proportion of companies of the top 10 sectors with breaches in the area of corruption; in %; as at: 31. 12. 2014; source: oekom research (2015)***

the Index for the 20th time. It covers 175 countries and territories and measures perceived levels of corruption among politicians and public officials. The ranking is traditionally headed by northern European countries, and Denmark took first place as the country with the lowest levels of perceived corruption, scoring 92 out of 100 possible points. Finland (89) came in 3rd place, Sweden (87) in 4th, and fifth place was shared between Norway and Switzerland (86). Only New Zealand, in second place (91), managed to break through the phalanx of Scandinavian countries. Germany came in 12th place jointly with Iceland, with 79 points, while Austria scored 72 and ranked 23rd. The UK (78) came in at 14th place, while France shared 26th place with Qatar (69), the controversial host of the 2022 Football World Cup. North Korea and Somalia, with just eight points each, came joint last.

As a sector, construction companies are particularly frequently involved in corruption cases. oekom research has documented such breaches in almost one in five of the large companies analysed (18.5 per cent). The proportion of offenders in the industry is up by 4.2 percentage points compared with last year, moving the industry up the corruption ranking list from 4th to 1st place. Suppliers and service providers in the oil and gas sector remained in 2nd place, although the proportion of companies involved has risen here, too (from 12.9 to 15.0 per cent). The proportion of companies involved in corruption cases also reached double figures in the health sector (14.3 per cent) and the pharmaceuticals sector (12.0 per cent). When interpreting the figures, it is important to bear in mind that experts estimate the proportion of unreported corruption cases to be very high and only ten to 20 per cent of cases are ever detected. Corruption tends to thrive in sectors where governments are major customers, for example in the armaments and construction sectors, and in large infrastructure projects.

### *2.5.3. Labour rights violations*

On 2 December 2014, an alliance of representatives of different faiths and denominations (Christian Catholic, Anglican and Orthodox, Buddhist, Hindu, Jewish and Muslim), one which was perhaps historically unprecedented and given current conditions constituted a landmark development, came together under the slogan #ENDSLAVERY to mark the “International Day for the Abolition of Slavery” by signing a joint declaration against forced labour and slavery. The signatories – including Pope Francis, Grand Ayatollah Mohammad Taqi al-Modarresi and Datuk K Sri Dhammaratana, Chief High Priest of Malaysia – are campaigning for the worldwide abolition of modern slavery and human trafficking by 2020.

#### *Joint Declaration of Religious Leaders Against Modern Slavery*

*We, the undersigned, are gathered here today for a historic initiative to inspire spiritual and practical action by all global faiths and people of good will everywhere to eradicate modern slavery across the world by 2020 and for all time.*

*In the eyes of God, each human being is a free person, whether girl, boy, woman or man, and is destined to exist for the good of all in equality and fraternity. Modern slavery, in terms of human trafficking, forced labour and prostitution, organ trafficking, and any relationship that fails to respect the fundamental conviction that all people are equal and have the same freedom and dignity, is a crime against humanity.*

*We pledge ourselves here today to do all in our power, within our faith communities and beyond, to work together for the freedom of all those who are enslaved and trafficked so that their future may be restored. Today we have the opportunity, awareness, wisdom, innovation and technology to achieve this human and moral imperative.*

*Source: www.globalfreedomnetwork.org/declaration*

According to the International Labour Organization (ILO), around 21 million people currently live in slavery or under conditions of forced labour, with no regard for their fundamental rights and freedoms, and aid organisations even put the figure as high as 35 million. Like freedom of association and the right to collective bargaining, the abolition of child labour and the elimination of discrimination in respect of employment and occupation, the elimination of forced labour is one of the ILO’s core labour standards. These were adopted in 1998 and as qualitative social standards take the form of universal human rights which are valid in all countries, irrespective of their level of economic development. The fact that an alliance of religious leaders is looking at one of the core labour standards, more than 15 years after their adoption, highlights the continuing need for further action in this area.

Besides failure to comply with the aforementioned ILO core labour standards, there are other critical aspects which are important in the documentation and evaluation of labour rights violations in oekom research's Corporate Rating. These include for example workplaces which pose a hazard to human health, inadequate workplace safety, excessive overtime and extremely low wages, as well as compulsory pregnancy and HIV tests. In this context – as with the other controversial circumstances examined here – oekom research refers to a breach when the incidents concerned are comparatively serious. On top of these, companies may also be involved in minor or moderate controversies, so the total number of companies affected will be higher than the figure for those which are formally deemed to be in breach of labour rights.

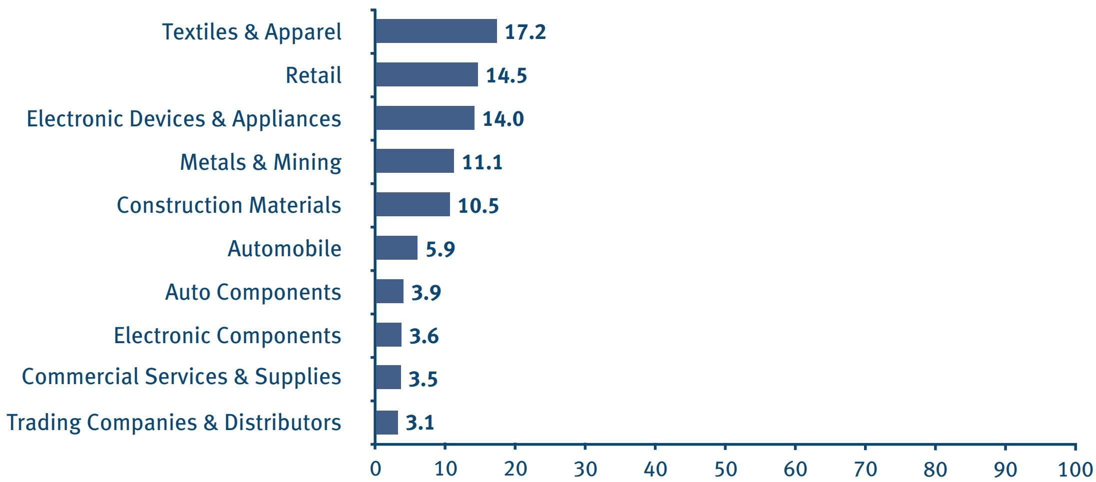



*Fig. 16:* ***Proportion of companies of the top 10 sectors with breaches in the area of labour rights; in %; as at: 31. 12. 2014; source: oekom research (2015)***

The proportion of companies breaching the standards is particularly high in the textiles industry. More than one in six companies in the industry has, either itself or more frequently in its supply chain, been found to be in breach of the ILO's core labour standards or of other key labour rights. Following the dramatic incidents in textile factories in Bangladesh in recent years, public awareness of working conditions in the global textiles industry has risen. However, many of the promises made by the textiles industry in the wake of the incidents with regard to improving the situation have not been kept. The major German textiles companies and the German textiles associations have been unwilling to take part in the "Bündnis für nachhaltige Textilien" [Alliance for Sustainable Textiles], forged last year and formally launched in mid-October 2014 by the German Minister for Development Gerd Müller.

The ILO is banking on bilateral agreements to improve the situation in the textiles industry's value chain. In mid-September last year it signed what it described as a hitherto unique joint agreement with the Swedish fashion group H&M on sustainable global supply chains in the textiles industry. H&M is currently ranked 2nd in the rating of the textiles industry (cf. p. 21)

The breaches of labour rights documented by oekom research apply first and foremost to miscellaneous aspects such as working hours and workplace safety (cf. Fig. 17). oekom research's analysts have currently documented a total of 42 breaches by the companies in these areas. There have also been a number of violations of each of the labour rights covered by the Global Compact. When looking at these, it becomes apparent that a significant majority of the 78 documented cases of violations of labour rights, i.e. 52, took place in the supply chain of the GLCU companies, with 26 cases occurring in the companies themselves. oekom research is not alone in believing that companies from industrialised countries are responsible for their suppliers' compliance with labour standards. This distribution of violations high-

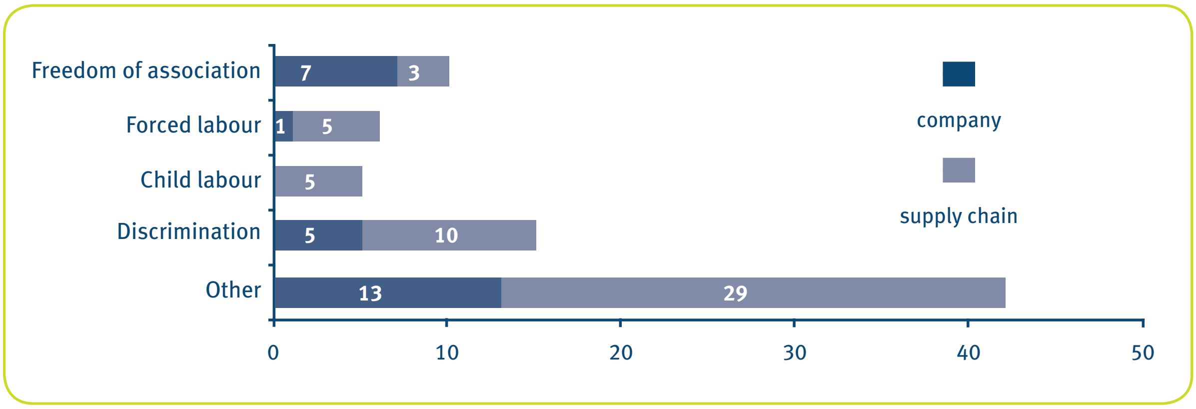



*Fig. 17: Forms of labour rights violations; by number of breaches; as at: 31. 12. 2014; source: oekom research (2015)*

lights how important it is to analyse supply chains when carrying out sustainability ratings of companies. Apart from one exception, forced labour and child labour occurred only in supplier companies, which are generally based in developing and emerging economies.

### *2.5.4. Human rights violations*

In January 2012 there was a huge landslide near the limestone quarry at Tumbi, Papua New Guinea. The landslide destroyed many houses and cost 27 people their lives. The official report assessed the landslide as being a natural disaster caused by heavy rainfall, but residents and an Italian environmental consultancy firm stated that even before the accident happened, they had already called into question the safety of the quarry, which belonged to ExxonMobil. In the inspection report published in May 2014, the inspectors said that prior to the landslide, established safety standards were not being implemented.

oekom research classifies such incidents, where the health or lives of local residents, customers or other persons are knowingly put at serious risk, not as labour rights violations, but as violations of human rights. These also include:

- activities which fall under human trafficking;
- activities and projects which grossly violate third parties' right to self-determination and
- activities and projects which grossly disregard third parties' right to cultural self-determination or their cultural dignity.

Breaches in these areas occur particularly frequently in companies in the metals and mining industry (cf. Fig. 18). 8.9 per cent of the large companies in this sector which have been analysed by oekom research have committed a breach of this kind. These frequently involve the disruption of the livelihood and natural environment of the local population, for example through the contamination of soil or bodies of water, inadequate compensation or even the forced displacement of local residents following the expansion of mines.

For example, a recent study by Amnesty International states that in November 2009 the Congolese police destroyed over a hundred houses in Kawama village. The village lies on the outskirts of Lubumbashi, the capital of Katanga province, near a copper and cobalt mine. The inhabitants of Kawama received no warning of the planned clearance, for which there was no legal basis. The destruction and forced evictions rendered hundreds of people homeless. No replacement accommodation was provided. According to the human rights organisation, the Belgian mining company Groupe Forrest International requested the police intervention in order to take action against small-scale miners. Its subsidiary Entreprise Générale Malta Forrest (EGMF) provided the bulldozers and drivers. It was not until November 2014 that the company admitted that the destruction of the houses had taken place, but it still denies that it was responsible for this.

oekom research has also documented cases of human rights violations linked to companies in the oil and gas sector and in conglomerates and international trading groups, as well as in the food and utilities sectors. With respect to human rights violations, too, oekom research applies rigorous criteria for defining what constitutes a formal breach. In addition, there are numerous minor and moderate controversies which do not qualify as "breaches", meaning that the overall proportion of companies involved in human rights violations is even higher.

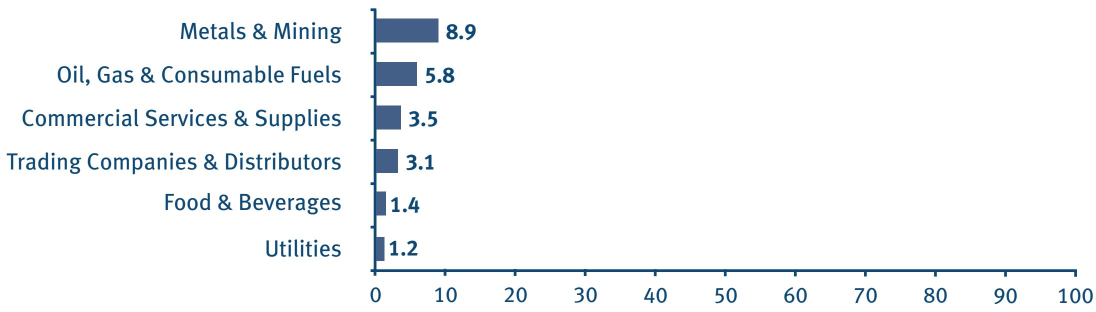



*Fig. 18:* ***Proportion of companies in individual sectors which have committed violations of human rights; complete list of sectors involved; in %; as at: 31.12.2014; source: oekom research (2015)***

### *2.5.5. Environmental violations*

Companies in the metals and mining industry are also particularly frequently implicated in cases involving environmental destruction. More than one in four of the companies analysed (26.7 per cent) have been found to have committed breaches of this kind. Examples of such breaches have included the large-scale impact of opencast mining, as well as the inadequate pretreatment and containment and/or the inappropriate disposal of toxic tailings. The scale of encroachment by opencast mining is clearly illustrated for example by the El Cerrejón mine in the north-east of Colombia, one of the largest opencast coal mines in the world. The mine covers an area of around 69,000 hectares, which is equivalent to approx. 95,000 football pitches. By way of comparison, the highly controversial Garzweiler opencast mine in the lignite mining district of the Rhineland covers an area of 11,400 hectares. German and European energy suppliers are among those procuring coal from the Colombian mine to operate their coal-fired power stations. oekom research sees them as bearing part of the responsibility for the enormous environmental damage done by this opencast mine. Altogether 9.8 per cent of utility companies are involved in such or similar environmental violations.

Where environmental violations are concerned, the mining sector is outdone by the oil and gas industry, where almost one in three of the companies analysed (31.0 per cent) has been found to have committed an environmental violation. Exploration for and extraction of oil and gas have a particularly negative impact on flora and fauna and on the environmental media air, water and soil, as does the construction and development of the associated infrastructure, e.g. roads and pipelines. The proportion of companies involved has dou-

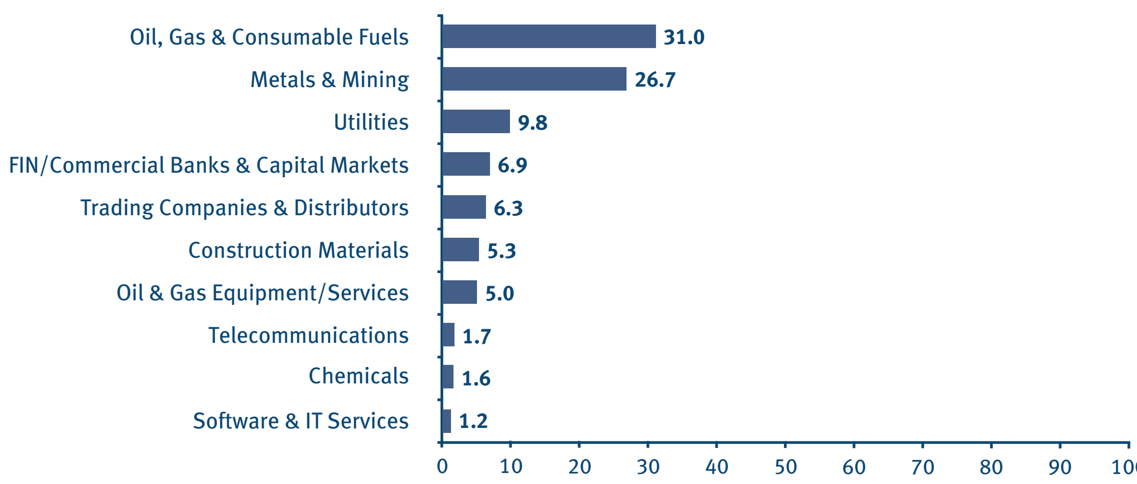



*Fig. 19:* ***Proportion of companies of the top 10 sectors which have committed violations in the area of environmental protection; in %; as at: 31.12.2014; source: oekom research (2015)***

### *Excursus: Hydraulic Fracturing*

*The increasing scarcity of conventional, easy to exploit deposits as well as the increasing need for security of energy supply and autonomy, especially against the backdrop of the current crises in Eastern Europe, Northern Africa and the Middle East, incentivise the oil and gas industry to enter riskier regions and implement controversial extraction methods to extract so-called unconventional reserves.*

*In this context, the process of hydraulic fracturing (fracking) in particular is the subject of controversial and multi-layered disputes. The often quoted "shale gas revolution" in the United States and attempts of numerous countries to emulate the US shale boom have placed hydraulic fracturing (fracking) at the centre of energy- and environmental policy debates. While the proponents emphasise opportunities in the areas of energy autonomy, security of supply and climate protection, the method is flatly rejected by environmental protection groups and citizens' initiatives with reference to considerable negative impacts on and risks for the environment and human health. Critics focus on the technically advanced form of high-volume fracking in combination with horizontal drilling practiced since the early 2000's, which made the commercial extraction of shale gas and tight oil from very dense rock possible in the first place.*

*Various studies associate fracking with significant negative impacts on the environment and health, particularly with respect to the use of toxic mixtures of chemicals that can contaminate the soil, surface waters and groundwater as a result of industrial accidents, leaking wells or by means of an upward migration through the geological strata. In addition, incidents related to improper disposal of toxic wastewater accumulating during fracking (flowback and production water) as well as high emissions of air pollutants (e.g. volatile organic compounds such as benzene, and sulphur- and nitrogen oxides) have already lead to environmental contamination and health problems. The rationale that due to a favourable carbon footprint shale gas can make a contribution to the reduction of greenhouse gas emissions has not been confirmed scientifically so far. In fact, there are indications suggesting that fugitive, highly climate-impacting methane emissions during the extraction of unconventional deposits using fracking are higher than previously assumed.*

*About 90 per cent of the worldwide unconventional oil and gas production using fracking takes place in the US. The negative environmental and health impacts experienced there can, among other things, be traced back to insufficient regulation of the technology in some federal states of the US and could be partly mitigated through the application of best practice methods. All in all, it can be concluded that the extensive application of fracking in tens of thousands of wells has already lead to considerable cumulative environmental burdens and effects on health, and a significant lack of knowledge with regard to long-term risks continues to exist.*

*Against this background, oekom research has decided to take a critical approach to the method of hydraulic fracturing in its evaluations. Consequently, the application of the technology for the commercial extraction of shale gas, tight gas and tight oil in principle leads to downgradings in the oekom Corporate Rating of the companies concerned. In addition, for companies which use this technology on a large scale and number among the most significant producers of shale gas, tight gas and tight oil, the exclusion criterion "Controversial Environmental Practices" is activated.*

bled over the past year, from 15.1 to 31.0 per cent. This is primarily attributable to the fact that in 2014 oekom research started classifying particular types of fracking as environmental violations.

Ranked fourth in the list of industries which have committed violations in the area of environmental protection, the commercial banking sector, unlike the first three industries, is not one whose involvement in environmental destruction is immediately apparent. However, 6.9 per cent of the banks analysed are affected. That such violations are, figuratively speaking, committed not just by people in overalls but also by those in suits and ties is due to the fact that controversial companies and projects, e.g. dam projects in South America and palm oil plantations in Indonesia, are often financed by banks. They could, by defining suitable requirements for creditors, help to ensure compliance with environmental standards. If this is not the case, or only to an insufficient degree, the banks must expect to be held partly responsible for the environmental damage. The same applies in principle to insurance companies.

## 2.6. Outlook

"The one constant in the universe is change," as the Greek philosopher Heraclitus of Ephesus recognised long ago. The responses triggered by the facts and changes documented in this report will depend on the viewpoint of the reader. Some might point out that in a difficult global economic climate at least some progress has been made in tackling the challenges of sustainability. Others might perhaps despair over the pace at which changes are taking place, in view of the huge global problems and the consequent need for action.

But how can the changes in the corporate sector which are key to the sustainable development of the economy and society be instigated? On the one hand, suitable stimuli may come from the outside. The Directive on CSR reporting adopted by the EU Parliament last year for example falls into this category. The goal of this Directive is to increase transparency and consideration of social and environmental issues of companies in the EU. In future, entities in the public interest will be required to disclose more information on their environmental protection efforts, social and employee-related initiatives, respect for human rights and anti-corruption aspects. Transparency is essential for changes to be initiated, recognised and demanded or incorporated into purchasing and investment decisions. The addition of this body of data will also improve the quality of oekom research's analyses still further.

This report shows that external stimuli are increasingly also coming from the SRI market. Companies will not be indifferent to the fact that the volume of responsibly invested capital, at almost ten trillion euros in Europe alone, has again reached a new record high. The incentive for them to structure their sustainability management systems in line with investors' demands, many and varied though these sometimes are, increases with each euro invested responsibly.

However, stimuli may also come from the inside, from within companies themselves. The strongest argument for active commitment to sustainable development within the company is probably the positive influence it has on key conventional variables for measuring corporate success – profitability, return on investment and equity ratio. Here, the preconception that one "has to be able to afford to be sustainable", i.e. that good sustainability management is possible only when a company is economically successful, often still persists. This preconception is contradicted by the results of the oekom Corporate Bonds Study mentioned above which oekom research published last year. The findings of the study support the argument that it is more likely that the basis of this economic success is systematic sustainability management that is geared to the challenges of the particular sector.

Unfortunately, many companies seem to operate according to the Faustian motto "I hear the message, but cannot believe". However, the connection described between sustainability and economic success is crystal clear: only those who manage energy and raw materials efficiently, treat their own employees and those of their suppliers fairly, and offer products and services that are environmentally and socially sustainable and tailored to changing consumer needs can also be economically successful. Environmental and social commitment are thus not the product of economic success, but rather its root cause. When this realisation takes hold, there will probably no longer be any need to worry about the pace of change in companies.

# oekom inside

oekom research is one of the world's leading rating agencies in the field of sustainable investment. The agency analyses companies and countries with regard to their environmental and social performance. oekom research has extensive experience as a partner to institutional investors and financial service providers, identifying issuers of securities and bonds which are distinguished by their responsible management of social and environmental issues. More than 100 asset managers and asset owners routinely draw on the rating agency's research in their investment decision-making. oekom research's analyses therefore currently influence the management of assets valued at over 600 billion euros.

Key to the success of oekom research AG is the credibility of our analyses. In order to guarantee this, there are in our view two particular aspects that are of crucial importance: independence – both at agency and at analyst level – and a sophisticated quality management system. In both these areas, oekom research has followed a consistent path since its founding in 1993 and has put appropriate standards in place on various levels. For example, we do not permit any companies which we evaluate, nor any financial market players, to be shareholders in oekom research. We also consciously refrain from providing any form of consultancy to the companies which we evaluate.

With regard to the quality of our rating processes, the market has for years acknowledged our leading position over our competitors. Nonetheless, over the last year we have subjected our rating system to a detailed audit by external auditors of our compliance with the internationally recognised quality standard ARISTA® of the Association for Responsible Investment Services (ARISE) (www. aristastandard.org).

Our interdisciplinary team currently numbers 68 persons, of whom 53 are analysts, including eleven analysts at GES, our strategic marketing and research partner. The continuous training and professional development of our analysts is very important to us, as it enables us to meet the various demands of our clients and other stakeholders and to provide a high-quality service. Besides this subject-matter expertise, the global market increasingly requires a high degree of internationality: between them, our staff currently speak approximately 20 languages.

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## Publications

The following publications or series of publications were published in 2014 or are regularly published by oekom research. Publications for which a charge is made are marked with an asterisk (*). All publications are available from oekom research on request (info@oekom-research.com).

### *Studies*

oekom Corporate Responsibility Review 2014,
March 2014

oekom Corporate Bonds Study,
Oktober 2014

### *Sectoral reports*

oekom Industry Report Telecommunications*,
August 2014

oekom Industry Report Pharmaceuticals & Biotechnology*,
November 2014

### *Theme reports*

oekom Facts & Figures on individual findings of our rating

oekom Position Paper Tax Havens,
June 2014

oekom Position Paper Corporate Green Bonds,
September 2014

oekom Position Paper Hydraulic Fracturing,
November 2014

The following oekom Position Papers are currently available:

- Biodiversity
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Layout:
Reihs Satzstudio, Lohmar

Munich, as at March 2015

Printed on 100 % recycled paper

Picture credits:
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