16 June 2014

Kepler Cheuvreux

Business Ethics

ESG

Environmental, Social and Governance

Soft law violation & liability

Towards Fiduciary Duty 2.0

Sustainability Research

Strategic partnership with:

affectio mutandi

CSR, Legal, Corporate & Public Affairs

www.affectiomutandi.com

Data partner for this report:

REPRISK

ESG Business Intelligence

Changing anatomy of liability: Civil society 2.0 & CSR regulation

The growing quantity and scope of normative standards and transparency mechanisms, which can form the basis for hard law, are proving an efficient avenue of reference for redress available to civil society and those with a grievance against a company. The proliferation of social media in corporate branding, online press and civil society campaigns presents new mechanisms of accountability and greater reputational risk.

Soft law and reputation risk targeting controversial companies

Corporates with controversial activities have increasingly found themselves in the crosshairs of “soft law” with over 175 cases so far filed via the OECD complaints process alone, comprising diverse environmental and social concerns but with human rights a central area. Reputational damage and resulting financial and operational impacts are often the greatest effect rather than monetary penalties.

Towards a new P/E ratio: price-to-ethics

Soft law documentation can provide useful indicators that integrate ESG factors into the business context. We uncover an OECD NCP supply chain report on Rana Plaza and extract from it engagement questions and indicators that can assist investors who are pushing for metrics that straddle both economic interest and sustainability concerns.

Investor collateral damage

Although CSR commitments may not be a legal obligation, the proliferation of soft law complaints and hard law litigations against corporates introduces new risks to investor assets. The credibility of corporate and investor claims relating to sustainability processes are particularly vulnerable, as they depend on trust rather than legally enforced audits. Furthermore, SRI investors are held as potential influencers of investee behaviour and may increasingly be drawn in to cases where corporates are targeted.

Limited Liability & Fiduciary Duty challenged

While investors’ legal liability remains uncertain for controversial holdings, soft law precedents insist on responsibility for minority shareholdings, and more cases are likely to come up. The focus on fiduciary duty by long-term frameworks, such as the UK Stewardship Code and Kay review, implies the need for better investor due diligence and response processes to mitigate reputational risk, liability and facilitate the remediation of violations. This report aims to provide a detailed framework for these issues.

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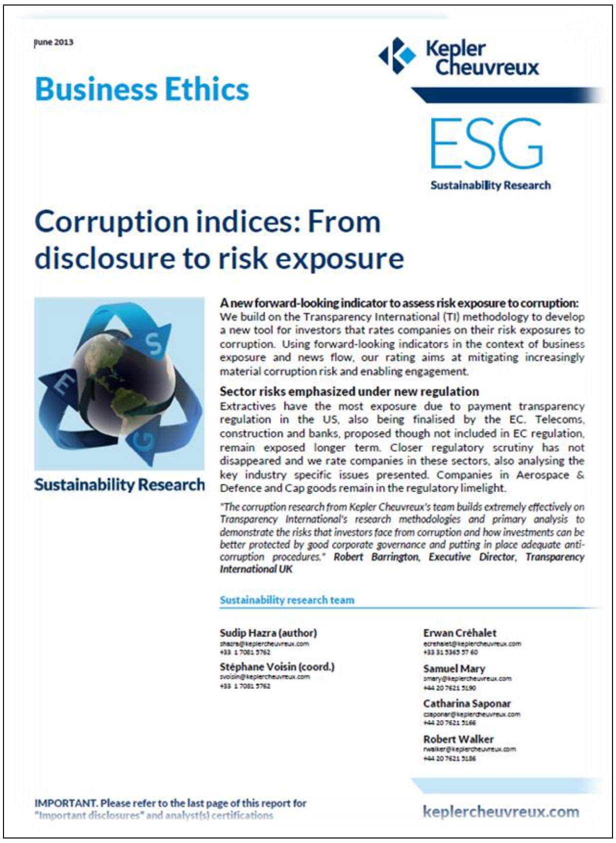
Contents

This report is part of a series on business ethics



June 2013

Business Ethics

ESG

Sustainability Research

Corruption indices: From disclosure to risk exposure

Sustainability Research

A new forward-looking indicator to assess risk exposure to corruption: We build on the Transparency International (TI) methodology to develop a new tool for investors that rates companies on their risk exposures to corruption. Using forward-looking indicators in the context of business exposure and news flow, our rating aims at mitigating increasingly material corruption risk and enabling engagement.

Sector risks emphasized under new regulation
Extractives have the most exposure due to payment transparency regulation in the US, also being finalised by the EC. Telecoms, construction and banks, proposed though not included in EC regulation, remain exposed longer term. Closer regulatory scrutiny has not disappeared and we rate companies in these sectors, also analysing the key industry specific issues presented. Companies in Aerospace & Defence and Cap goods remain in the regulatory limelight.

"The corruption research from Kepler Cheuvreux's team builds extremely effectively on Transparency International's research methodologies and primary analysis to demonstrate the risks that investors face from corruption and how investments can be better protected by good corporate governance and putting in place adequate anti-corruption procedures." ***Robert Barrington, Executive Director, Transparency International UK***

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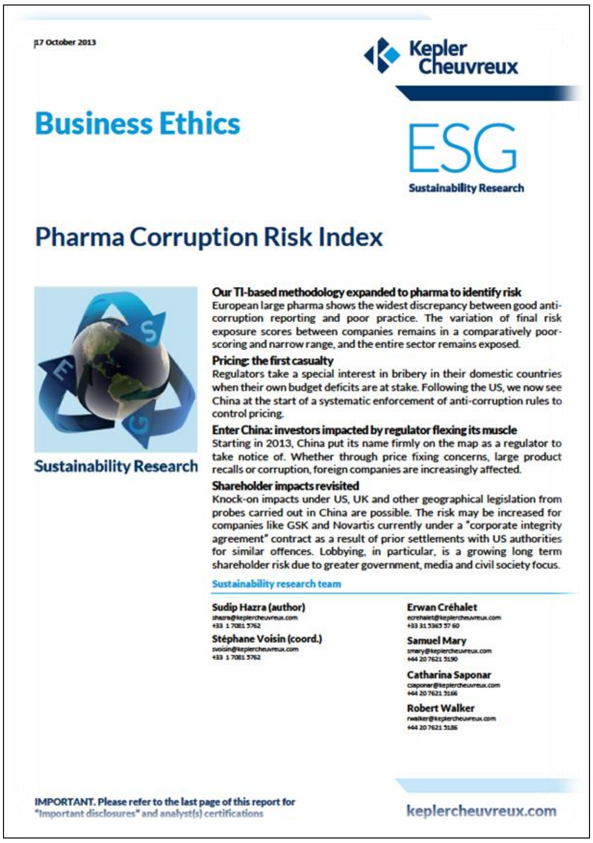

17 October 2013

Business Ethics

ESG

Sustainability Research

Pharma Corruption Risk Index

Sustainability Research

Our TI-based methodology expanded to pharma to identify risk
European large pharma shows the widest discrepancy between good anti-corruption reporting and poor practice. The variation of final risk exposure scores between companies remains in a comparatively poor-scoring and narrow range, and the entire sector remains exposed.

Pricing: the first casualty
Regulators take a special interest in bribery in their domestic countries when their own budget deficits are at stake. Following the US, we now see China at the start of a systematic enforcement of anti-corruption rules to control pricing.

Enter China: investors impacted by regulator flexing its muscle
Starting in 2013, China put its name firmly on the map as a regulator to take notice of. Whether through price fixing concerns, large product recalls or corruption, foreign companies are increasingly affected.

Shareholder impacts revisited
Knock-on impacts under US, UK and other geographical legislation from probes carried out in China are possible. The risk may be increased for companies like GSK and Novartis currently under a "corporate integrity agreement" contract as a result of prior settlements with US authorities for similar offences. Lobbying, in particular, is a growing long term shareholder risk due to greater government, media and civil society focus.

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Corruption indices: From disclosure to risk exposure [Document link]

Business ethics: Pharma corruption risk index [Document link]

Previous reports include:

- *Aerospace & defence: working with the transparency international index*, January 2012
- *Conflict minerals*, November 2011
- *Bribery & corruption: the trillion dollar phenomena*, April 2011

A note on our approach to sources

We neither confirm nor deny allegations reported by the media in including them in this report. ESG analysis requires us to consider all stakeholders and media sources in order to assess potential reputational risk for investors. In this report, we use a variety of journalistic sources, including local ones where we feel they reflect a relevant area of risk. Often allegations will surface long before evidence is objectively presented or any official announcements are made either by authorities or less so by companies themselves. However, they are of key interest to investors as news flow, and critical within the context of the reputational risk we examine.

Introducing Affectio Mutandi

Affectio Mutandi is the first consulting agency to specialise in reputational, social and normative strategies, working at the confluence point of multiple stakeholders, linking corporate communication, crisis management, influence, public affairs, reputation, CSR, legal issues and NGO Relations. Its expertise combines a:

- Strategic mix of CSR, public affairs, legal issues and corporate communications consulting
- Strategies of influence, dialogue with stakeholders and normative engineering
- Management of legal, social and reputational risks of ESG issues

Yann Queinnec (Director General)

Expert in CSR normative engineering and stakeholder coalition building, with a strong experience of influence, NGO advocacy and legal activism.

Pierre-Samuel Guedj (President)

Expert in reputation management, crisis communication, influence and public affairs with a specific expertise in CSR, NGO management and sustainable development.

Additional Inputs provided by

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Rob Lake, Consultant, Rob Lake Advisers

Lene Wendland, Office of the United Nations High Commissioner for Human Rights

Rainer Geiger, Formerly OECD Directorate for Financial, Fiscal and Enterprise Affairs

Jehan-Philippe Wood, Partner, Norton Rose Fulbright

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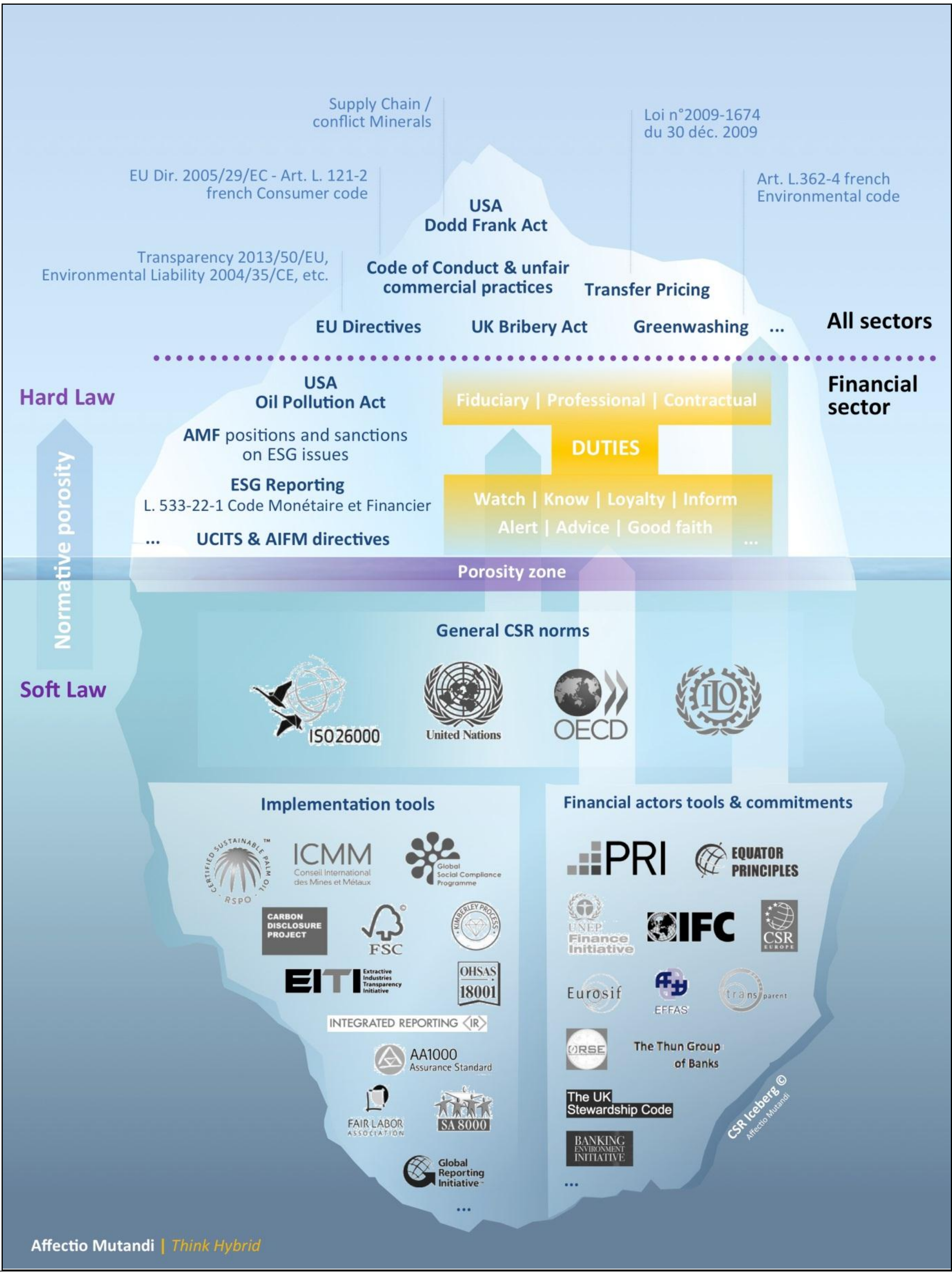
Dr Raj Thamotheram, CEO, Preventable Surprises

Data partner for this study: RepRisk ESG Business Intelligence

RepRisk is a global provider of business intelligence on environmental, social and governance (ESG) risks. It runs the most comprehensive database on the ESG performance of companies, projects, sectors and countries.

Chart 1: The CSR Iceberg by Affectio Mutandi in partnership with Kepler Cheuvreux



Source: Affectio Mutandi, Kepler Cheuvreux

Executive summary

Changing the anatomy of liability: the rise of soft law may break bones

The concept of soft law relates to voluntary mechanisms that set out standards or "norms" for institutions, individuals, governments and of course companies to follow. These have been in existence for decades, but with the growing globalisation of corporate behaviour, such soft law mechanisms have increased in both quantity and scope. "Soft law" sometimes proves the only avenue of reference or potential redress available to stakeholders with a grievance against a company. Binding regulation ("hard law") has arguably struggled to keep up with globalisation in the multiple areas covered by CSR, particularly in the domain of corporate responsibility in social and environmental matters.

Ignore at your peril: voluntary commitments can incite legal action

A number of corporates have voluntarily committed to areas of CSR. Although these commitments may appear to be outside legally mandated reporting standards, we analyse the proliferation of legal action against corporates deemed to be "greenwashing" or "fairwashing".

CSR regulation: rewind the hard law and you will see soft law

We note the importance of soft law mechanisms which eventually become hard law. This is particularly so in areas of social regulation, where hard law can be weak, uncoordinated, unenforced or in some emerging markets non-existent. The starting point is civil society, where activism is the catalyst for improving the normative strength of voluntary standards via sector frameworks or international bodies such as the OECD or the UN. Furthermore we are seeing NGOs continue as watchdogs around CSR related themes when voluntary self-reported declarations become legally mandated requirements.

A transparency empire: favoured tool of NGOs, business and regulators

Mapping the emergence of greater sustainability efforts hinges on one major aspect: transparency. So what's the problem? Stakeholders disagree on what should be disclosed. Corporates lobby heavily for voluntary, self-regulated standards, which in turn fall far short of NGO expectations. Governments increasingly fall between the two, but have begun to introduce CSR-related reporting regulations. In this process, disclosure of SRI and responsible investment methodologies, still at an early stage in terms of standardisation and usage, is undergoing its own challenges.

Corporates: the primary target

Corporates are the primary target for complaints via soft law mechanisms, with over 175 so far filed via the OECD complaints process through its guidelines for multinationals. In 2013, for the first time NGOs have been the main source of complaints, overtaking unions. The complaints cover the whole range of OECD Guidelines, from allegations of environmental damage, violation of labour rights, displacement of local communities, to tax avoidance and violation of privacy.

Reputation: the material of materiality for soft law and NGO campaigns

Of the multiple impacts that NGO-led soft law challenges can have on corporates and investors, reputation is the primary concern. The credibility of claims relating to sustainability or SRI processes is particularly vulnerable to these kinds of challenges.

Web 2.0 facilitates e-reputational value creation and…destruction

We note the multifaceted impacts of reputational considerations through the increasing use of social media and internet platforms, which can increase the speed of dissemination of allegations and garner support. Key developments in reputational risk management for corporates and civil society activism are centred on globalised social media presence and fluid online channels, allowing for instantaneous broadcasting of campaigns, financial support through crowd-funding, media stories and the dissemination of leaks.

Towards a new P/E: price-to-ethics

In this report we argue for specific indicators and transparency, not just related to social or environmental performance, but meaningfully integrating economic value and business model contexts so as to actually influence operations. One example is the focus in the work by the French OECD National Contact Point following the Rana Plaza disaster on how to ensure that buyers integrate specific sustainability issues. This reflects an integrated reporting approach in using a “Price/ Ethics” ratio to measure the potential attractiveness of each supplier not just on cost but also specific social risk such as health and safety performance.

The definitions of CSR have changed, will SRI follow?

A decade ago, CSR was largely defined on a case-by-case and theme-by-theme basis by companies that voluntarily allied themselves with the concept. Things have changed: the reference to external frameworks from the UN Global Compact, GRI or ISO 26000 is now increasingly expected as a minimum form of CSR credibility. SRI has perhaps not yet made such a move, with a plethora of fund definitions self-labelled as “sustainable” in some way but without any norm being made fully transparent and accepted in most cases, even where such norms do exist.

Collateral damage for investors: controversial assets an investor liability?

Although corporates have for some years faced complaints via soft law mechanisms, investors are increasingly being roped into allegations of corporate malpractice. For over a decade, controversial companies have had the potential to have an impact on those that fund them. Over the years, we have seen a number of actions relating to project financing, where issues concerning human rights, local communities and environmental impacts have been highlighted in order to pressurise investors into pulling the plug on funding. However, the types of investors being targeted now extend well beyond these parameters of project financing into the realm of asset management.

Minority shareholders: beyond the turning point

The principle of limited legal liability for minority shareholders is being challenged. We think recent cases suggest minority shareholders are now in new territory. They can, and probably will, continue to be targeted for holding shares in companies alleged to have violated international norms. Critically, these norms increasingly fall into "soft law", especially those mechanisms managed by supranational bodies such as the OECD or the UN, where international guidelines on business conduct have been made official but do not constitute direct legal obligations where companies can be prosecuted.

Responsible investing: an easy target on the reputational frontline?

Recent cases show that asset owners and managers whose activity has any SRI element may increasingly become targets for NGOs and the media, due to the additional visibility they give to the relevant ESG themes. We identify an increased push for openness and accountability related to statements and policies on sustainable investing. Inconsistencies or "gaps" in investment policies are being increasingly highlighted, but investors will also be able to use this momentum as an opportunity to strengthen the relevance of their methodologies and their brand. However, a future spread to mainstream financial players, for whom ESG is less important, cannot be ruled out.

Due diligence for investors

We schematise the fundamentals of investor due diligence through the steps of Know, Watch, Alert, Influence and Remediate. Each step allows for greater exertion of control over the liability increasingly presented on the SRI stage. We map the "CSR Token", courtesy of Affectio Mutandi, our partners in this study, who centralise the use of due diligence to mitigate risk around investees' controversial activities with an increase of the investor sphere of influence in order to contribute to greater sustainable development (and remediate when controversies do occur). This symbiotic duo is at the heart of investor responsibility.

A new principle: the duty of response above all

'No comment' is no longer an option for players who have made public commitments. We look at the decisions by the OECD National Contact Points that intervened in the landmark case involving investments in POSCO. Above all, one factor emerges as unavoidable: the duty of response. Wherever responsible investing or CSR commitments have been made, failure to respond is no longer acceptable. Similarly, with enhanced public visibility thanks to an eagle-eyed media and a Web 2.0 environment, legalistic responses may backfire reputationally.

Fiduciary duty: are definitions changing?

In 2005 and 2009 UNEP FI and Freshfields laid out the legal grounds for ESG to be considered a fiduciary duty in investment processes. While we have not seen hard law test cases since the publication of these landmark reports, we do consider soft law challenges from civil society, such as those under the OECD Guidelines, as having the capacity to push forward definitions of fiduciary duty regarding the use of ESG factors. In the context of, for example, the UK Stewardship Code, the Kay Review and the work of the UK Law Commission there are clear efforts to extend fiduciary concepts to clarify not just the admissibility of ESG factors as a move to longer terms focus but their necessity. In our view, the duty to uphold reputation – which is already a fiduciary element under the UK Companies Act – has scope to become an enlarged concern for Responsible Investment. This is particularly so as reputation is a necessary core of any fund with SRI claims.

The soft law dynamic

Soft Law covers declarations and agreements for institutions, individuals, governments and, of course, business. It is non-binding, but may still give rise to legal impacts. Its primary forms include guidelines set by international bodies – i.e. the OECD and United Nations, Reporting Frameworks, Codes of Conduct and voluntary declarations (i.e. for CSR). We examine its relevant characteristics and the factors that have made it of heightened interest for both companies and investors, and look at the impacts that are emerging, including on regulation.

ESG approaches by definition go beyond hard law

The incorporation of ESG factors, whether in SRI or CSR, entails an approach that includes compliance with regulation and risk management but necessarily goes further into soft law and societal obligations which are not covered by direct legal liabilities.

The proliferation of standards, as well as potentially complicating both CSR methodologies and SRI approaches, generates uncertainty over accountability and even legal liability. The same voluntary mechanisms that apply to corporates usually include financial sector companies. Increasingly mobilised stakeholders are intensifying the exposure of both corporates and investors through the use of pervasive soft law mechanisms.

Both corporates and financial institutions ask how accountable they are under soft law mechanisms

The arsenal of soft law and accompanying grievance systems

Below we list no fewer than 54 normative approaches covering a large number of different aspects applicable to investors. We note that most include a substantial human rights element. While these norms and recommendations are numerous, we focus on the OECD Guidelines for multinationals, or MNEs (and the UN guiding principles on human rights, as they have a direct bearing): these have gained significant momentum, are global in scope, command official state level co-operation (if not binding power) and have grievance systems that have begun to be tested through cross-border cases involving both corporates and investors.

Human rights are a central concern of many of the soft law mechanisms relevant to corporates and investors

Table 1: The list of norms is growing, and human rights are covered by the majority

1	African (Banjul) Charter on Human and People's Rights
2	American Convention on Human Rights (Pact of San José)
3	Arab Charta on Human Rights
4	Arms Trade Treaty (ATT)
5	CCPR General Comment No. 14: Nuclear weapons and the right to life
6	Convention on Biodiversity
7	Convention on Cluster Munitions (CCM)
8	Convention on the Elimination of All Forms of Discrimination Against Women
9	Convention on the Rights of the Child (CRC)
10	Dams and Development: A New Framework for Decision-Making
11	Ecuador: Código Civil
12	European Convention on Human Rights (Convention for the Protection of Human Rights and Fundamental Freedoms / ECHR)
13	European Parliament Report on corruption in the public and private sectors: the impact on human rights in third countries
14	European Union Council Common Position 2008/944/CFSP of 8 December 2008 defining common rules governing control of exports of military technology and equipment
15	ILO Convention: The rights of Indigenous Peoples
16	ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration)
17	International Convention on the Elimination of All Forms of Racial Discrimination (ICERD)
18	International Court of Justice (ICJ)
19	The UN International Covenant on Civil and Political Rights
20	International Covenant on Economic, Social and Cultural Rights (ICESCR)
21	OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions
22	OECD Guidelines for Multinational Enterprises
23	Organization for Economic Cooperation and Development (OECD)
24	Political Principles Concerning Germany's Conventional Military Equipment Exports
25	Principles for Responsible Investment (PRI)
26	Principles for Sustainable Insurance
27	Protocol on Preparedness, Response and Co-operation to Pollution Incidents by Hazardous and Noxious Substances, 2000 (OPRC-HNS Protocol)
28	Report by the Federal Republic of Germany on its Policy on Exports of Conventional Military Equipment in 2011 (2011 Military Equipment Export Report)
29	Report of the Working Group on the issue of human rights and transnational corporations and other business enterprises (2013)
30	Right to Food
31	Roundtable on Sustainable Palm Oil (RSPO) Principles and Criteria for the Production of Sustainable Palm Oil (2013)
32	RSB Principles & Criteria for Sustainable Biofuel Production
33	The Code of Conduct for business taxation
34	The Equator Principles III
35	The Human Right to Water and Sanitation
36	The International Labor Organization (ILO)
37	The Rio Declaration on Environment and Development
38	The United Nations Millennium Development Goals (MDG's)
39	UN Basic Principles on the Use of Force and Firearms by Law Enforcement Officials
40	UN Code of Conduct for Law Enforcement Officials
41	UN Comment Concerning Nuclear Weapons and the Right to Life
42	UN: Convention against Corruption
43	UN Declaration on the Prohibition of the Use of Thermonuclear Weapons
44	UN Documents on Depleted Uranium
45	UN Declaration on the Right to Development
46	UN Declaration on the Rights of Indigenous Peoples
47	Kyoto Protocol
48	UN Guiding Principles on Business and Human Rights (Ruggie Guidelines)
49	UN Millennium Declaration
50	United Nations Global Compact (UNGC)
51	Universal Declaration of Human Rights
52	UNO Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security
53	Voluntary Principles on Security and Human Rights
54	War Weapons Control Act

Source: Facing Finance (NGO)

OECD guidelines for multinationals

OECD guidelines for MNEs: the "godfather" of soft law...

...global in scope, very broad in thematic treatment and with an open complaint mechanism

The OECD Guidelines[i] are a globally accepted set of recommended standards covering a number of areas pertinent to sustainable investors. Human rights, employment & industrial relations and the environment have covered the bulk of the complaints through the OECD National Contact Points until now, and all are themes for which investors could be implicated. We would identify taxation as an area (which is explicitly covered) attracting increasing interest from a variety of stakeholders including civil society, consumers, media and governments.

Watch for taxation and privacy as future areas of focus

Another emerging theme with human rights implications but also covered under the lesser used "consumer interests" chapter is the area of data privacy. Recent complaints have been lodged against telecom providers for sharing consumer data without explicit consent, and, given the civil society and media interest in this topic and the perceived inadequacy of regulation, further soft law challenges would not be surprising.

Table 2: Key themes for investors from OECD guidelines for MNEs

Theme	Notes
Disclosure	Increasing trend for hard law requirements related to ESG Transparency – central to the demands of many NCP complaints
Human rights	The key area of submissions for the NCP complaint process; data & communications "privacy" a recent factor emphasised by civil society
Employment and industrial relations	Employee rights and representation remain a strong concern with unions represented in NCP structures, unions are a major source of NCP complaints
Environment	Commonly cited impacts in NCP complaints
Combating bribery, bribe solicitation and extortion	As hard law avenues remain open usually not the primary factor in NCP complaints
Competition	Competitor/ regulator would normally resort to hard law, not much focus from civil society
Taxation	We expect this area to gain more traction in the long term, amidst gradual tightening of hard law and rapid rise in media interest in tax havens, organisational and avoidance structures and increased disclosure

Source: Kepler Cheuvreux, Affectio Mutandi

What is an NCP (national contact point) for the OECD?

NCPs are part of a national government department, not directly the OECD itself

National contact points must be appointed by each OECD country to promote the Guidelines and handle complaints (alleged violations of the guidelines by multinational enterprises). While any entity, including competitors and investors themselves, could use this NCP mechanism, in practice the bulk of complaints have come from NGO coalitions and trade unions. The OECD reports in 2013 that for the first time NGOs (14) have initiated more cases than unions (7).

Since 2000, almost 300 complaints known as "specific instances" have been processed, of which 40 were still under review at end-2013, showing an increase that firms should be aware of. 2013 saw a peak in the number of cases filed.

NCPs see themselves as "mediators" helping companies to implement the guidelines...

While the role of an NCP can be seen as that of a mediator between parties in dispute, the NCP decisions provide useful markers on the procedures expected of businesses to comply with the OECD Guidelines for MNEs – especially on due diligence. These NCP decisions and statements gradually establish a body of good practice, and sometimes best practice.

...but not as public enforcers of justice

The staffing levels and structure of each NCP can vary greatly at country level. Permanent staff are national government officials - i.e. from the Department of Business Innovation and Skills in the UK. Some NCPs chose to call experts to assist them, and only five NCPs have a tripartite governance gathering government officials, unions and companies representatives.

Furthermore, simply because one NCP makes a certain decision does not mean that another NCP would reach the same decision. Though the word “complaint” is used to cover the use of the grievance mechanism, the official terminology is “specific instance”. We reiterate that it is non-binding and the OECD itself is not involved in the grievance process: (an exception is when an NCP requests further guidance i.e. an Investment Committee’s interpretation). After receiving a case, the NCP make an initial assessment and offer good offices to help the parties to resolve the issues through a mediation or conciliation process. They hear the complaint and will issue recommendations based on the items of grievance, but they have no say in enforcing the remedial action if recommended. While the NCPs will vary as to how they see their role, the mandate of NCPs is to promote OECD Guidelines, handle enquires and contribute to the resolution of issues that arise relating to the implementation of the Guidelines.

Some NGOs also posit that the NCP process can be overly skewed toward corporate interests, disproportionately agreeing to terms put forward by the corporate. One such example is a complaint against a European oil major, which requested confidentiality, making further mediation conditional upon no public reporting of documents shared. The process went no further, as the NGO could not guarantee this condition. Needless to say, in many cases corporates have also felt that NCPs were disproportionately siding with the NGO complainant.

However, regardless of whether a final NCP declaration is issued in favour of the corporate, the potential reputational impact as a result of a complaint process, the potential for a judgment and any accompanying media interest is rarely negligible - particularly in any case where the defending institution is perceived to be non-cooperative.

Non-cooperation in the process can be damaging…

…even though the NCP recommendations are non-binding

Recent UK NCP cases focus on human rights and environment

As an indicator of the variety of issues handled via the OECD complaints process, we list those handled by the UK NCP in 2013, which are a mix of the traditional environmental and human rights concerns related to extractive projects as well as more recent themes such as corporate tax avoidance and communications privacy.

Table 3: 2013 UK OECD NCP cases involving multinationals

Company	Violations	Country involved	NGOs involved
Alliance Boots	Tax avoidance	UK	War on Want, Change to Win
Vodafone, Interoute, Level 3, BT, Verizon, Viatel	Human rights violations (privacy)	UK	Privacy International
British Gas, ENI, Chevron	Environmental, health and human rights	Kazakhstan	Crude Accountability
SOCO Int Plc	Oil exploration; Environmental, human rights	DRC	WWF
ENRC	Human rights (water rights)	DRC	Raid International

Source: OECDWatch

Labour rights: unions and soft law

Trade Union Advisory Committees are part of the OECD NCP structure

In several regions, unions have shown a willingness to use soft law mechanisms to target companies. This has not been limited to countries where union power is seen as weaker, as the NCP complaint against Marks & Spencer's during layoffs in France showed. Beyond the right to collective bargaining itself, specific issues of health and safety, intimidation, pension rights, strike activity, working hours, wages are central. TUACs or "Trade Union Advisory Committees" are part of the OECD NCP structure.

Table 4: Labour issues: unions represented in national contact points

Example: union federations with membership of the French NCP
CFDT - France
CGT-France
FO - Force Ouvrière
CFTC - France
UNSA Union Nationale des Syndicats Autonomes
MEDEF
CFE-CGC

Source: OECD NCP France

In the US there has been a long-running dispute between the United Auto Workers Union and a Nissan plant in Canton, Mississippi. In April 2014, union groups including UAW filed a complaint alleging an "aggressive campaign of interference" related to freedom of association. A decision on whether the US NCP will accept the case for mediation is still pending at the time of writing. We would emphasise, however, that the US poses a particular case regarding rights to collective bargaining, above all for European entities who may find themselves held accountable in the US and Asia by their European Union principles.

Where partnerships or consolidation occur (as with Renault's 43.4% stake in Nissan), be it by corporates or financial sector investors, these relationships can form a basis for leverage, thus increasing a company's responsibility and thereby influence when controversies arise.

Table 5: Companies named in more than one trade union NCP case

Company	Home country	Cases
Unilever PLC	Netherlands/ UK	9
Nestlé	Switzerland	7
ABN Amro Bank	Netherlands	3
British American Tobacco	UK	3
BASF	Germany	2
Compass Group	UK	2
Glencore International AG	Switzerland	2
Accor	France	2
Banco Santander	Spain	2
Bata	Canada	2
Continental	Germany	2
Angelica Textile Services	US	2
Cargill	US	2
Michelin	France	2
G4S	UK	2
Itaú Unibanco	Brazil	2

Source: TUAC

UN guiding principles

Officially known as the United Nations Guiding Principles on Business and Human Rights this framework was endorsed in 2011 by the UN Human Rights Council after five years of John Ruggie's mandate as Special Representative of the United Nations Secretary on Business & Human rights. Principles two and three are directly applicable to corporates:

Table 6: Three pillars of UN guiding principles for human rights

1	Protect: the state's duty to protect human rights
2	Respect: the corporate's responsibility to respect human rights
3	Remedy: access to remedy for victims of business-related abuses

Source: UN

Pillar 1 – "Protect" - binds states, but has an indirect impact on corporates. States are being asked to guarantee access to justice for victims, resulting in practice in initiatives to adapt national laws. For example the French parliament is currently debating a proposal to impose a duty of vigilance (*devoir de vigilance*) on parent companies and purchasers towards their subsidiaries and suppliers regarding ESG externalities. This regulatory proposal has been prepared by members of parliament with the support of NGOs, such as Sherpa.

Pillar 2 – "Respect" - hinges on a "know and show" process highlighting due diligence as a primary mechanism therein. The 2011 update of the OECD Guidelines was the occasion to introduce a new chapter on human rights and to harmonise the definition of due diligence. This item is referenced in several NCP statements on grievances brought to them.

Pillar 3 - "Remedy" - emphasises dialogue and engagement and includes potential soft law mechanisms in the process of exchange and arbitration.

We cite for example the need to engage with corporates on their grievance mechanisms later in this report as one application of pillars two and three.

Furthermore the UN Guiding Principles provide specific guidance that can be used by investors in the due diligence and engagement process providing the specific standards of reference to hold corporates to account in a variety of human rights policy and implementation areas:

Table 7: UN Guiding Principles recommendations applicable to corporates

	Human rights statement of policy that is:
1	Approved at the most senior level of the business enterprise
2	Informed by relevant internal and/or external expertise
3	Stipulates the enterprise's human rights expectations of personnel, business partners and other parties directly linked to its operations, products or services
4	Publicly available and communicated internally and externally to all personnel, business partners and other relevant parties
5	Reflected in operational policies and procedures necessary to embed it throughout the business enterprise

Source: UN Guiding Principles

The UN Global Compact: a further look reveals gaps...

The UNGC principles are a widely used framework for investors to identify key risks. We would argue that, with a number of emerging themes, investors should take a closer look at the UNGC to see if further transparency is required and principles might be violated. Any complaint against investors would look to highlight exactly such potential gaps, reflecting the view of some within civil society and even the investment community that the UNGC provides a superficial sense of security.

The interpretation of the ten UNGC principles could perhaps be extended further by investors...

...to comprise a far larger number of ESG factors than currently taken into account

Conflict minerals is one such area. For a full view see our 2012 report "Conflict politics, Conflict metals...Investment conflict". In US and EU legal terms, conflict minerals currently cover gold, tin, tungsten and tantalum - the four minerals most heavily mined in the regions of the Eastern DRC, where severe human rights violations have been funded by the trade of these commonly used metals for some years. However, the broad term applies to diamonds and a number of other minerals mined in many global regions including Asia and South America that are not necessarily covered by explicit legislation for corporates.

While a number of companies would not necessarily be flagged as non-compliant with the UNGC if disclosing the following areas generally, they could well be at risk of violating the principles below if there is no specific policy or due diligence carried out with respect to this theme (conflict minerals) or others to which the company is exposed. The UNGC serves as a broad framework, but as an enabling tool its ultimate use is in how key stakeholders such as investors push and use the transparency it promotes. For many within civil society, the UNGC is criticised for being used to float a superficial sense of security by investors.

Table 8: For certain companies, having no conflict minerals policy could mean non-compliance with UNGC

Principle	Theme	Potential UNGC violations if sourcing from DRC conflict mines
	Human rights	
Principle 1	Businesses should support and respect the protection of internationally proclaimed human rights	X
Principle 2	Make sure that they are not complicit in human rights abuses.	X
	Labour	
Principle 3	Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining	X
Principle 4	The elimination of all forms of forced and compulsory labour	X
Principle 5	The effective abolition of child labour	X
Principle 6	The elimination of discrimination in respect of employment and occupation	
	Environment	
Principle 7	Businesses should support a precautionary approach to environmental challenges	X
Principle 8	Undertake initiatives to promote greater environmental responsibility	X
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	X

Source: Kepler Cheuvreux

The OECD Guidelines allow for a complaint mechanism, which the UNGC does not have. While the Global Compact can forward issues raised if it so chooses, we have seen no cases of companies being ejected due to complaints by third parties. Where ejections have occurred, they have been due to a lack of transparency in reporting according to the ten principles – namely for not reporting at all.

As for other more detailed reporting frameworks such as the GRI or ISO26000, these are helpful and relevant only to transparency - again with no grievance mechanism or ability for the organisations to intervene if complaints of non-adherence are raised. Any third-party checks or self-certification are, like the other widely used frameworks, not legally binding. Transparency frameworks have not been created with a view to allowing external challenges to their veracity. Indeed for the most part, few stakeholders till now have sought to challenge the disclosure resulting.

CSR used to be self-defined

The "norms" they are a-changing...

A decade ago when CSR was still in its infancy and common standards were much less readily available, self-defined CSR was widespread, and credit more often given for corporate responsibility declared on a case-by-case basis, without explicit reference to external frameworks.

Is the investment community in such a situation with Socially Responsible Investing? Each asset manager will have largely varying definitions of their own form of SRI, and the commonality that may exist is not readily declared in any standardised form.

Any convergence of norms means increased pressure

On the corporate side, we have certainly seen an increasing emphasis on normative standards in the official views of sustainability. For example, within the European Commission there has been a clear shift since 2001 from the purely self-defined voluntary commitments of corporate responsibility to the use of both legal obligations and international normative standards:

A communication from the EC dated 25 October 2011[i] - defines CSR broadly as:

"The responsibility of businesses vis-à-vis their effects on society"

It specifies:

"To meet this responsibility, companies must first comply with legislation and collective agreements between social partners. In order to fulfil their social responsibility companies should have engaged in close cooperation with stakeholders, a process to integrate social concerns, environmental ethics, human rights and consumers in their business operations and core strategy (...)"

We can see how the emphasis on the voluntary nature of CSR that characterised the EC definition of CSR in 2001[ii] has faded over the last decade ("*a concept that refers to the voluntary integration by companies of social and environmental concerns in their business operations and their relationships with their stakeholders*").

We can see further proof of this trend in the increasing reference to the rule "first and foremost respect the law" in UN and OECD Guidelines, ILO or ISO 26000, as relevant CSR standards.

Certification

The area of certification is one where there are a number of ramifications for CSR. In the financial domain a clear distinction is required between accounts that are legally certified/audited and those that are not. In a variety of CSR areas no legally binding certification exists. Obviously, therefore, the credibility of such non-regulated certification depends upon the trust placed in the auditor, the reporting framework and the company itself.

In a number of diverse certifications there are multiple certifiers and with each we are usually able to find multiple criticisms from civil society. The main accusation is greenwashing: thus mere certification alone is not always a guarantee of reputational enhancement. Real adherence to the principles of the certification may well mean going beyond the stated guidelines.

Table 9: Multiple choice: a sample of the most commonly used certification schemes

Certificate	Theme
BREEAM	Green building certification
LEED	Green building certification
ISO 9001 or 14001	International Standard certifying quality and environmental management
Energy Star	Product energy efficiency rating
WaterSense	Water efficient products & services
FSC	Responsible forestry for paper/wood products
SFI	Sustainable forestry initiative for paper/wood products
Green Seal	Multi product multi attribute
FairTrade	Commodity labour and environmental standards
RSPO	Roundtable on sustainable palm oil
ISCC	International sustainability and carbon certification

Source: Kepler Cheuvreux, Affectio Mutandi

In SRI the number of certifications available is far lower than in the corporate world, with Novethic being the best known label for sustainability funds (and LuxFLAG a recent new entrant). Such labels can interact and promote transparency in tandem with other voluntary standards. Novethic, for example, requires the funds its labels to publicly disclose a response to the Eurosif Transparency Code, with obligatory information on the SRI process and ESG selection steps.

Of the two major transparency codes for SRI in Europe we note the PRI and Eurosif. The latter identifies as a key motivation the need to:

"Proactively strengthen a self-regulation that contributes to the development and promotion of SRI funds by setting up a common framework for transparency best practices"

Self-regulation on a voluntary basis, whether as a first step to later regulation or not, always represents an initial fundamental move towards greater accountability. We would expect the above SRI transparency frameworks to continue to increase in scope and standardisation, providing an essential standard-setting platform and allowing for increased levels of comparability.

Accounting standards for CSR

We note a variety of increasing transparency requirements mandated by law in this report. However, accounting standards that are embedded legal requirements in financial reporting still for the most part contain few if any obligatory ESG line items.

The US-based SASB or Sustainability Accounting Standards Board this year published a number of drafts for sector sustainability reporting for the healthcare, financial, technology and communications sectors. These are of interest as they serve as guidance for pre-existing standards - i.e. for 10-K and 20-F SEC filings. As a voluntary adjunct to the filings already required, the approach here is that detailed, pertinent and material ESG factors can be reported relatively simply under the current disclosure system.

Integrated reporting is a key solution to the problem of relevant, material long-term disclosure of ESG factors intrinsic to the business model of companies reporting. Through the IIRC (International Integrated Reporting Committee), which looks to coordinate and influence across other sustainability (i.e. the GRI) and accounting standards (i.e. IFRS, GAAP), the objective is to arrive at a general scope of reporting applicable to any company globally.

At the end of this report we extract supply chain metrics from the French NCP report on Rana Plaza. The metrics both reflect and influence sustainability concerns within the business model and can be used as KPIs for investors to engage with companies on within the theme of supplier selection and management. Examples include the proportion of suppliers accepted as a result of specific CSR related screens (ie for health and safety). We illustrate that certain metrics should be localised – according to country risk. Herein approaches such as integrated reporting which specifically acknowledge business risks around for example the floating discretion of supplier choice, mobility of factory base and the resulting business risk are critical in the greater expectations of stakeholders around CSR disclosure.

The civil society dynamic

NGO reach increasingly global in scope

NGO campaigns – large or small – should not be ignored

While international NGOs such as Greenpeace may have the ability to mount activist operations on the largest and most conspicuous scale, most users of soft law mechanisms such as the OECD NCP grievance process are smaller and less well-known, sometimes local NGOs. In any case, several NGOs may well form alliances to submit complaints or mount joint activism across themes, platforms and regions.

Civil society in emerging countries is growing

The origin of the use of soft law as a favoured tool of NGOs is perhaps related to the fact that most controversies originate from emerging markets, where the rule of law may be weak and human rights and environmental law, if existing at all, remains unevenly unenforced.

NGOs may be seen as intrinsically political by certain governments in emerging markets. Their history is far more recent than in developed markets and for the most part they may be more restricted in their activities, visibilities and general ability to operate freely in some emerging market countries.

Soft law influence asserted by NGOs for many years

Table 10: Normative frameworks are a favoured tool of civil society

Some characteristics of NGOs and soft law
➢ Activism increasingly sophisticated - incorporating a wider variety of stakeholder targets
➢ Increasing quality (i.e. basis, leverage, rationale and stakeholder impact) of cases submitted
➢ Emerging markets are increasingly represented by both new local NGOs and global civil society alliances
➢ Media is increasingly receptive to NGO campaigns, increasing reputation impact
➢ Reputational vulnerability of entire financial sector since crisis is still elevated, meaning consumers more receptive to NGO activism and regulatory mandate for heightened enforcement and reform

Source: Affectio Mutandi, Kepler Cheuvreux

Company Annual General Meeting (AGM) signal key NGO concerns

Poignant questions to the CEO from a representative disadvantaged by a controversial project...

Numerous uses are made of AGMs by civil society. First and foremost, statements are made and questioned raised. ShareAction has for example systematically put forward questions around the payment of a living wage for employees at several UK AGMs across multiple sectors.

...awareness raising "events" outside the AGM entrance

Another area that is common is activism or staged events in the vicinity of the AGM buildings. At the simplest level these are leaflet distributions but NGOs have attracted significant attention through highly published and colourful awareness raising campaigns also.

...shareholder resolutions filed in coordination with NGOs

In some cases NGOs actively cooperate to file shareholder resolutions. This is more common in the US – Oxfam and 33 investors including Trillium Asset Management filed a resolution at PepsiCo in November 2013 pushing for greater accountability and transparency regarding land rights issues within the supply chain. Oxfam's prominent "Behind The Brands" campaign was one of the origins and supporting backgrounds of this action. Two key pointers can magnify the effectiveness of such AGM proposals - the aggregate AUM of the supporting investors (in this case 1.4 trillion USD) but also the very playing off of direct competitors in the sector. Coca Cola Company had agreed to engage with Oxfam's preliminary demands and the public pressure for Pepsi was therefore greater. This is also commonly seen in the banking sector where an NGO will publicise that one or two institutions have withdrawn funding for controversial projects in order to increase pressure on the remaining financiers.

Chart 2: Over two hundred NGOs have used the OECD NCP complaint mechanism

Source: KeplerCheuvreux

NGO impacts at their maximum

Shell & Greenpeace Brent Spar campaign

While civil society activism may rely on specific agendas related to campaigns, once public opinion is mobilised, the reputational damage can extend into operational and financial damage with visible negative consequences for shareholders. One such case took place in 1995 at the height of environmental campaigning by Greenpeace. Shell was accused of ignoring environmental concerns in favour of cost by moving to dispose of a North Sea oil storage platform offshore. A vigorous campaign led to the occupation of the platform and several press conferences, widely disseminated on global television and in the press. Public pressure (including boycotts) and eventually greater visible political support was secured for the NGO campaign.

Public and political interest extended well beyond local concerns

Boycotts, reputational damage, activism against staff, visible public campaigns, opex costs, and share price impacts

Key developments included wider political and popular interest beyond the UK into Northern Europe. This continued even when Greenpeace conceded that its assessment of the oil content of the platform had been greatly overestimated (5,500 tonnes vs. Shell's estimate of 50). We reproduce below an extract from Shell's public statement in reversing its decision to sink the platform:

A larger campaign to prevent deep-sea sinking of platforms captured public and political interest…

"Shell's position as a major European enterprise has become untenable. The Spar had gained a symbolic significance out of all proportion to its environmental impact. In consequence, Shell companies were faced with increasingly intense public criticism, mostly in Continental northern Europe. Many politicians and ministers were openly hostile and several called for consumer boycotts. There was violence against Shell service stations, accompanied by threats to Shell staff."

…despite admitted inaccuracies in vastly overestimating the contents of the platform

Now Web 2.0 plays a leading role

A number of recent campaigns such as that by Greenpeace against Nestle have used social media platforms. An anti-palm oil campaign culminating in 2010 mimicked KitKat advertising, and, according to the NGO, resulted in 1.5m views and over 200,000 campaign emails. Other more common methods, such as AGM presence and activism around corporate headquarters, were also integrated. The central objective was a change of Nestle's major suppliers, such as Sinar Mas, who were held to be responsible for environmental damage. Nestle changed its sourcing policy as a result of the campaign, after initially being accused of heavy-handed tactics, such as requesting the legal removal of the advertising.

The same dynamic that drives the push for consumer facing corporates to establish social media presence renders them more accountable (and more at risk reputationally – see section on e.reputation) when NGO activism references their web and social media presence. The embeddedness of such image building in the consumer consciousness leaves any activism to be served readily, quickly, and reproducible en masse to the same consumer targets sought out by a corporate.

From crowdfunding to "clicktivism"; harnessing social networks stands to magnify campaigns' potential reputational impact

A recent campaign by Greenpeace mimicked the use of crowd funding against the international and institutional funding of projects that NGOs consider controversial core issues, such as nuclear power, genetically modified organisms, arctic drilling and overfishing. While the sources of funding of civil society are numerous and vary greatly, the addition of crowd funding adds to the web base donation that has become a new and sometimes major source of revenue.

Below we also cite an increasingly publicised global campaign platform from the Avaaz Foundation that uses internet and social media platforms to petition and self-fund activism from numerous third-party civil society requests globally. It aggregates and prioritises key themes and leads to specific direct action and other forms of activism. At the time of writing, its website claims to have almost 36m "members" – although the majority are likely to be passive.

Table 11: Priority Issues for Civil Society Campaign Network Avaaz.org: 2013

Human rights, torture, genocide, human trafficking	60%
Political corruption and abuse of power	46%
Climate change and the environment	45%
Economic policy that benefits the common good over the elite few	45%
Poverty, disease and development	42%
War, peace and security	41%
Biodiversity and conservation	33%
Democracy movements and challenging tyrannical regimes	32%
Food and health	31%

Source: Avaaz

Finally, while extreme in scope and for the time being halted in its tracks, we note that the WikiLeaks effort started a chain reaction of reputational impacts via the web that set a significant precedent for corporates and unwanted disclosure. Julian Assange claimed that half the documents forwarded to the WikiLeaks mission came from corporate sources, i.e. corporate whistleblowers who successfully disclosed information via the site leading to reputational and legal consequences for the businesses allegedly involved in their claims. Many of the privacy and data security themes with huge reputational impacts now being encountered globally by consumers, the media, security agencies, payment systems, global businesses, PR agencies attempting to change opinion over unwanted disclosure and governments controlling damage to themselves, have their precedents in the WikiLeaks case. All of these individual elements remain relevant to corporate and investor management of reputation risk and the conflictual interaction patterns of press, NGO, legal challenge and whistle blower are still clearly visible.

From WikiLeaks to Offshore Leaks….

The role of banks in assisting clients in tax avoidance – particularly in the US was a pivot point for Web 2.0 activism through WikiLeaks whistle blower allegations against Bank Julius Baer. The ICIJ (The International Consortium of Investigative Journalists) Offshore Leaks Database[iii] though no relation to WikiLeaks continues in this area – selectively disclosing certain ownership information about companies in offshore jurisdictions including the activity of banks.

The phenomena of "soft power" is central to civil society effectiveness

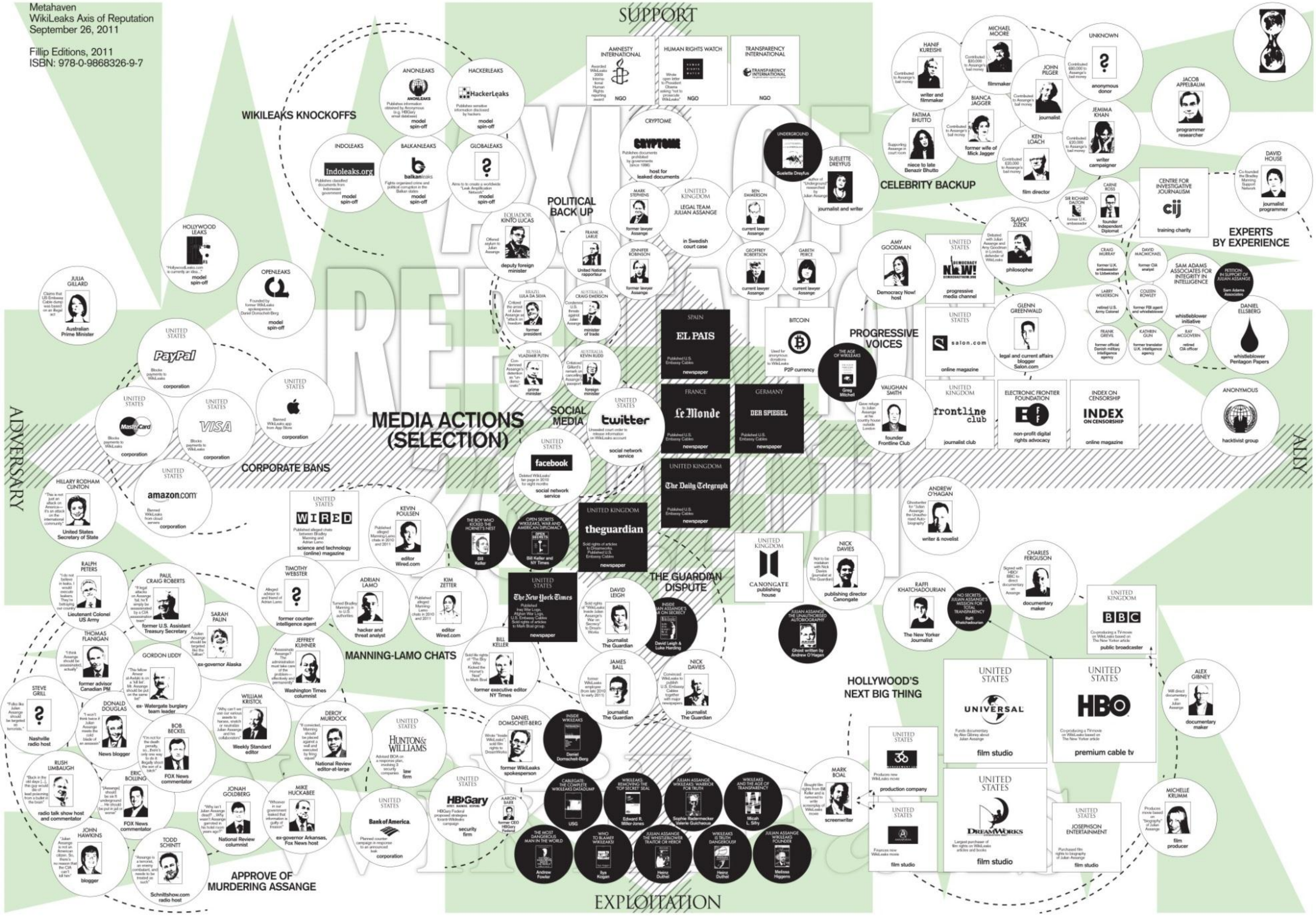
"Soft Power" refers to influence gained through co-opting or *attracting* an audience more voluntarily (i.e. through values) rather than using "hard" power means such as money or arms. A term first coined by Joseph Nye of Harvard University it is central to this reputational debate. Companies and investors reacting to NGOs without acknowledging the increasing soft power that civil society has developed are more likely to be rebuffed by popular opinion (with accompanying reputational effects) even with far superior media budgets and global legal teams.

Table 12: Factors increasing company risk to soft law violation impacts

Factor	Issue	Information Source	Notes
Disclosure	Lack of disclosure for material CSR issues Policy disclosure without evidence of implementation Basic invocation of soft law frameworks through "promises" rather than visible implementation & reported metrics	Company sources (Website/ CSR Report)	Any sustainability disclosure can be used as leverage in a campaign if perceived to be greenwashing
Controversies	Negative media coverage	Press Data Providers	Existence of controversies requires investor due diligence
Activism	Online & onsite NGO campaigns Poor (legalistic) or no response from company	NGOs/ Web 2.0 Press	Good faith company response, dialogue and engagement is critical element in containing impacts of soft law violation allegations
AGM	NGO coalitions with shareholders resulting in resolutions AGM-specific activism (on site & web/social media based) NGO/union & local community questions to board & CEO during AGM	Company reports Web 2.0/ Press	AGM provides signals of soft law exposure through these elements
Whistle Blowing	Grievance mechanism lacks credibility i.e. follow through/buy in from key stakeholders	Company sources Code of Ethics/ CSR Report/ Leaks	Poor grievance mechanisms increasingly result in evidence of wrongdoing forwarded to press and NGOs

Source: Kepler Cheuvreux, Affectio Mutandi

Chart 3: Metahaven map "WikiLeaks Axis of Reputation"



Source: Fillip 15, WikiLeaks: Axis of Reputation

The hard law dynamic

The fusion of civil society activism and the accountability of companies for their own self-declared voluntary commitments and adherence to soft law frameworks has major implications in terms of regulatory challenges. We can see the emergence of new legal risks as stakeholders become more familiar with and mobilise the normative environment of CSR. Two separate elements that figure in a number of litigations are those contesting and extending the **"sphere of influence"** of a global company via subsidiaries, cross shareholdings, business relationships and government interaction- i.e. Shell, Comilog, Continental and that of alleged **greenwashing** or fairwashing e.g. Nike, Samsung, Schneider, Toyata and Auchan. The following examples are illustrative of past and current litigations linked to CSR concerns:

Corporates and litigation around key sustainability issues

Table 13: A survey of key corporate cases and outcomes

Company	Year	Theme	Notes
Nike	2002	Misleading advertising (social issues)	Nike accused of inaccuracy in USA over statements it makes on Asian labour standards, settles out of court for 1.5m USD paid to Fair Labour Association
Total	2012	Oil pollution Negligence	Total recognised responsible for the 1999 Erika oil spill disaster. The French Supreme Court has considered the violation of the voluntary *vetting* process as a demonstration of negligence. 200m EUR in damages to French state and fisheries, 375,000 EUR fine.
Samsung	2013 in progress	Misleading advertising (social issues)	Consumer protection invoked due to alleged violation of Code of Conduct (ie non enforcement) in relation to claims of mistreatment of Asian factory workers.
Schneider	2013 in progress	Misleading advertising (environmental issues)	The day after Samsung case the union CGT, through its consumer association launched a claim for alleged violation of Schneider commitments to reduce its CO2 emissions (Climate change issues)
Shell	2013	Human rights	Related to long standing case of Niger Delta human rights violations complicity US decision on "Alien Tort Act" reduces margin for foreign companies to be tried in US but future claims still possible. Dutch courts potentially involved in next stage.
Comilog	2008 In progress	Labour	French courts take case of en masse (955 workers) dismissals in Congo, (COMILOG acquired by French company ERAMET) Illustrates potential for movement of labour disputes from a foreign subsidiary to the jurisdiction of the parent company.
Continental	2013 in progress	Labour	Through the concept of "co-employer" judges are asked to reconsider the boundaries between legal entities within a corporate group. Taking into account the financial health and the influence of the German parent company on its French subsidiary were decisive elements in objecting to conditions of layoffs.
Toyota	2011	Misleading advertising (environmental issues)	French case requires Toyota to remove publicity of 4x4 vehicle against natural landscape "green" backdrops, after Fiat, Land Rover, VW and Ford comply.
Auchan	2014 in progress	Misleading advertising (social issues)	Consumer protection invoked alongside violation of Code of Conduct in relation to working conditions in garment industry supply chain in Bangladesh (Post Rana Plaza drama first judiciary initiative). A preliminary investigation has been opened in May 2014.
E.ON	2008	Environment	E.ON denied claims of compensation from Greenpeace after the occupation of a production site. The jury considered that the action was legally justified because activists were trying to prevent climate causing greater damage to property around the world. Preventing property damage caused by climate change was a lawful premise considered as more important than the business claim of EON.

Source: Affectio Mutandi

These litigations use various legal grounds, from classical tort law issues to violation of laws regulating companies' activities potentially generating tort, criminal or administrative sanctions for the legal entity or its executives. These legal strategies are made possible thanks to new kinds of coalitions between NGOs, Unions, consumer associations, etc. in order to guarantee standing for legal actions.

Table 14: Snapshot of diverse legal raw material for litigation on CSR issues

Company law	Misappropriation of business assets Misleading accounts Lack of transparency on ESG performances
Labour law	All range of working conditions (from health, safety and security issues to minimum wages, etc.)
Consumer law	Misleading advertising Class actions
Environmental law	Oil pollution act, anti-greenwashing, precautionary principal and environmental damage recognised
Competition law	Unfair commercial practices
Investment law	Local content Free Prior and Informed Consent (FPIC)
Human Rights Law	Alien Tort Claim Act (US), French Slavery Bill (2013)

Source: Affectio Mutandi

The financial sector: emerging hard and soft interactions

Financial companies' activities have faced a series of supervisory moves in recent years. These are now fuelling ESG performance measurement, which have been the object of recent initiatives that assume non-financial transparency to be standard.

There is now an abundant, or even overabundant, source of mixed hard-law and soft-law standards: national and regional legislators (Loi Grenelle 2, FACTA, Dodd Frank, UCITS, AIFM, etc.); market regulators (AMF, ACP, COB, etc.); professional associations (Eurosif, EFFAS, ORSE, etc.); international bodies (UN[2], OECD, ILO, etc.), multilateral or bilateral funders (World Bank, IFC, etc.), the banks themselves (Equator Principles, The Thun Group of Banks, EFRAP, etc.); and hybrid multi stakeholders initiatives (ISO 26000, GRI, etc.).

[2] See for example due diligence questionnaire for potential private sector partners of the Global Compact - http://business.un.org/en/documents/10312

Table 15: Saturation point? Norms, norms everywhere…

National and Regional Legislation	Grenelle 2 (France) FACTA (US) Dodd Frank (US) UCTIS (EC) AIM (UK)
Market Regulators	AMF (France) ACP COB
Professional Associations	Eurosif EFFAS ORSE (France)
International Institutions	United Nations OECD ILO
Multilateral/ Bilateral Agencies	World Bank SFI
Financial Sector Guidelines	Equator Principles Thun Group of Banks ERAPF
Multi Stakeholder Initiatives	ISO 26000, GRI
Sector Frameworks	IPIECA, ICMM, EITI (Extractives)

Source: Kepler Cheuvreux, Affectio Mutandi

Liability regimes vary according to the regulator's ambitions, ranging from the disciplinary power of the Autorité de Contrôle Prudentiel, to the "comply or explain" regime of article 533-22-1 of the CMF, to strict liability for custodians (AIFM and UCITS) or oil project financers (Pollution Act). Further grounds for legal liability are of course also derived from the range of professional obligations related to the requirements of good faith, trustworthiness, caveats, information, advisory obligations and vigilance.

Table 16: Key legal & enforcement mechanisms in financial sector

Regulators	Disciplinary power over companies and regulated individuals
Transparency requirements	French legislation (Article 533-22-1 of the CMF) decrees an explanation of SRI policy in funds. "Comply or explain" regimes (i.e. UK)
European & National Asset Management Directives	Strict Liability imposed on trustees/ custodians within AIFM and UCITS
Environmental legislation	Pollution Act imposes strict liability on funders of oil projects
Professional obligations	Good faith, loyalty to client, duty of care, information requirements, etc.

Source: Affectio Mutandi

This "cohabitation" of hard law and soft law is the focus of our study. It leads to a kind of regulatory leakage, whereby companies can find themselves hauled before the courts for having failed to meet their voluntary commitments.

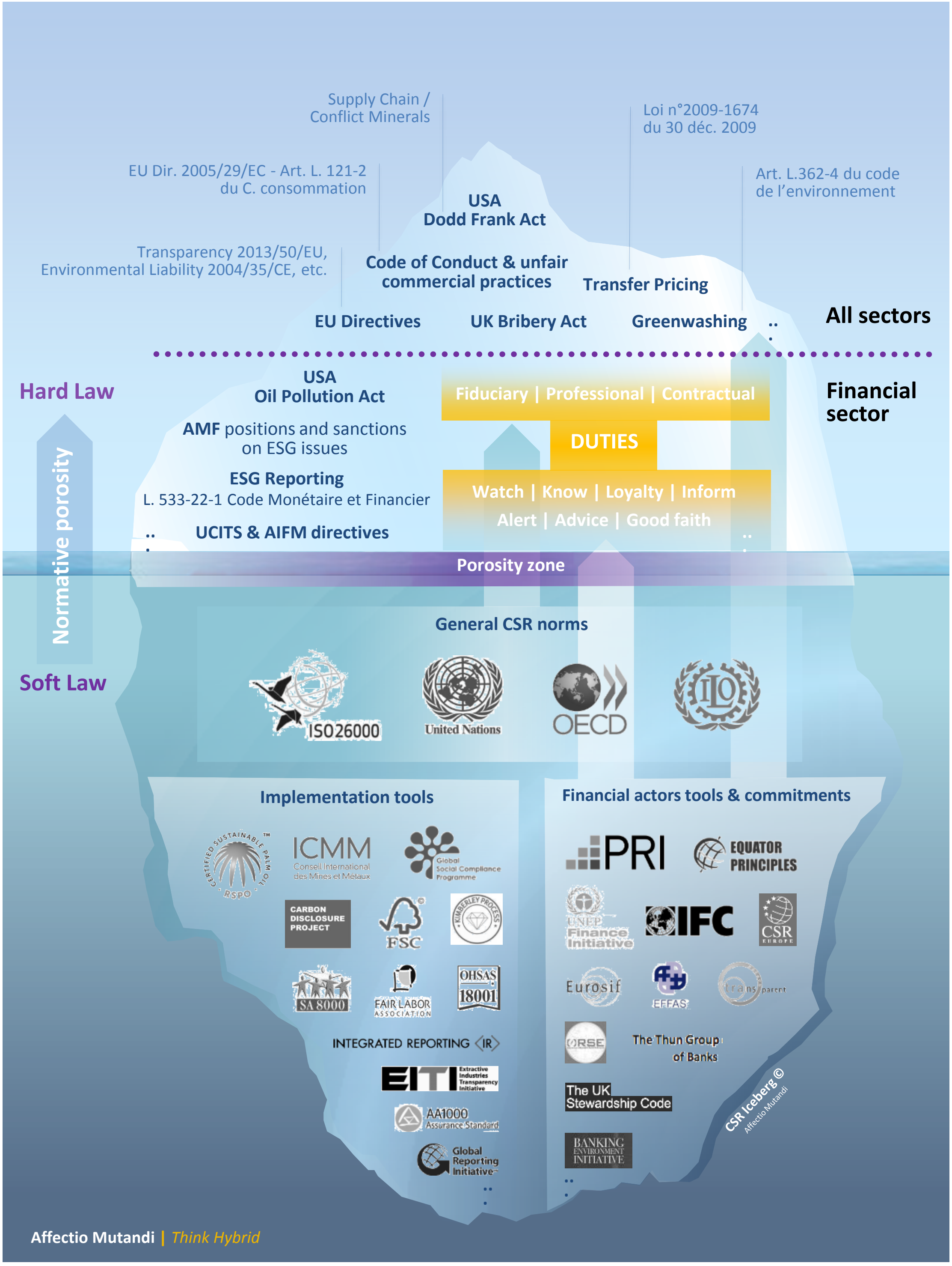
This phenomenon does not spare financial companies, as shown by the POSCO case, which gave rise to the decision by the Norwegian and Dutch OECD NCPs, (Case Study page 78), or the inspection of some French banks' by the consumer protection services division of the government (DGCCRF) in order to verify challenges to their adherence to ESG commitments.

Clearly there are emerging risks calling into question the liability of the financial sector at the level of both investment policy and CSR claims (which of course are interconnected for this sector).

Mapping soft law/hard law porosity: "normative engineering"

The following diagram maps the exposure of SRI asset owners and managers to legal risks via the observation that soft law nourishes the more conspicuous part of liability – which is hard law. In many cases involving social regulation and transparency, soft law forms the less visible base of liability.

Chart 4: The CSR Iceberg by Affectio Mutandi in partnership with Kepler Cheuvreux



Source: Affectio Mutandi, Kepler Cheuvreux

Diligence and influence – a key normative duo

Recently stabilized CSR normative frameworks (namely through the adoption of UNGP, the update of the OECD Guidelines, the new definition of CSR adopted by the EU Commission, the adoption of the ISO 26000 or the evolution of the Global Reporting Initiative) have initiated the emergence of a key normative duo: diligence/influence.

If the notion of due diligence has generated a consensual approach (UNGP and OECD Guidelines have harmonised their definition in the context of human rights), the concept of influence has been debated.

The notion of Sphere of influence, initially used in the Global Compact and introduced in the ISO 26000 is central within this debate around corporate responsibility. There has been since the popularised use of the term "CSR" a clear evolution, whether self-defined or through adherence to normative standards or through push from activist agendas, consumers or regulators to enlarge the sphere of influence of the corporation and its potential accountability. This trend is extremely challenging for companies, namely those facing various and complex business relationships in weak governance countries.

If we cannot within the scope of this study detail to what extent the notion of sphere of influence might expose to business legal risks, **we want to highlight the two objectives lying behind the exercise of influence: prevent and remediate in case of negative impacts and maximise contribution to sustainable development.**

ISO 26000, adopted in 2010, after a 5 year process involving 90 national delegations and majors institutions such as OECD, UN, WTO, or ILO, etc. states that "*when approaching and practicing social responsibility, the overarching objective for an organization is to maximise its contribution to sustainable development*" and provides an interesting synthesis of this twin nature of the notion of influence in stating that " *An organisation can exercise its influence with others either to enhance positive impacts on sustainable development, or to minimize negative impacts or both*" (ISO 26000 § 7.3.3.2):

Regarding the preventive side, below we cite the work of the UN Guiding Principles which lays out the specific concepts of leverage and influence – which are to be systematically increased in order to fully meet corporate responsibilities.

Table 17: The axes of leverage and influence: a model applicable to investors

	Have leverage	Lack leverage
Crucial business relationship	A. • Mitigate the risk that the abuse continues / recurs • If unsuccessful	B. • Seek to increase leverage • If successful, seek to mitigate risk that the abuse continues / recurs • If unsuccessful, consider ending the relationship; ** or demonstrate efforts made to mitigate abuse, recognising possible consequences of remaining
Non-crucial business relationship	C. • Try to mitigate the risk that the abuse continues / recurs • If unsuccessful, take steps to end relationship*	D. • Assess reasonable options for increasing leverage to mitigate the risk that the abuse continues / recurs • If impossible, consider ending the relationship*

* Decisions on ending the relationship should take into account credible assessments of any potential adverse impact on human rights.
** If the relationship is deemed crucial, severity of impact should also be considered when assessing the appropriate course of action.

Source: UNCHR

As the diagram referring to this duo principle the “CSR Token” illustrates below, corporates are no longer just expected to reduce negative impacts related to their activities but also to maximise their added value to society. The sample of extracts in the diagram show the variety of proactive expectations attached to this notion of sphere of influence. It echoes the multiplication of ethical engagements which we have observed previously - all of which become factors of additional liability.

Chart 5: Affectio Mutandi presents the CSR token: the due diligence and sphere of influence duo

Source: Affectio Mutandi

How soft law and civil society activism morphs into hard law

OECD conflict minerals due diligence standards were referred to in the recent US Dodd Frank law as a global norm…

The evolution of conflict minerals from an NGO campaign theme into OECD normative standards and into hard law regulation shows how over time seemingly local activism can turn into a global concern and concrete regulation applicable to global corporations. For some time, the *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High Risk Areas* were established as the most comprehensive normative standard in this area. With activism by NGOs such as Global Witness and Enough Project, the US passed a pivotal law within the Dodd Frank cannon to require audits and transparency on global supplier sourcing chains using conflict minerals for SEC-listed companies. Media interest intensified, and recent efforts both by major consumer electronics firms to comply and by NGOs to uncover wrongdoing have received comparatively prominent mainstream press attention.

NGOs were the primary driver in lobbying for that regulation

Civil society making its mark through "normative porosity"

We would highlight here the potential long-term evolution of soft law (powered namely by NGO activism) into regulatory mandates. The links between hard law and soft law standards in social areas and CSR can be much firmer than is perceived. This trend is part of phenomenon we call "normative porosity" or the flow of influence from civil society into soft law, policy making and regulation.

Recent activism in 2014 by NGO Global Witness targeted alleged wrongdoing by metals exchange regulators, a key gold refiner and a global Big4 auditor for effectively breaking and watering down standards and turning a blind eye to alleged breaches of conflict minerals due diligence and labelling procedures. We would fully expect such activism to target key players in the industry, promoting a conflict-free metals usage policy and catching those using suppliers with inadequate due diligence. Investors remain exposed to a number of risks related to holdings engaging inadvertently in the use of conflict minerals and it could be a natural extension of current activism to target socially responsible investors.

We use a simplified timeline below to highlight the evolution of regulation from soft law and civil society origins:

Table 18: Soft law and NGO pressure push regulatory change: conflict minerals

Year	Stakeholder	Trigger
2007	Civil Society	NGO Enough Project founded, instrumental in lobbying for Dodd Frank 1502
2007	Civil Society	Global Witness complaint using OECD NCP against Afrimex for traffic in conflict minerals
2009	Hard Law	Failed attempt to introduce US "Congo Conflict Minerals Act"
2009	Soft Law	OECD Guidelines on Conflict Minerals Due Diligence developed and endorsed by UN
2010	International Convention	Lusaka Declaration signed by 11 heads of states
2010	Private Sector	Steve Jobs declares "honestly there is no way of knowing" if Apple suppliers use conflict minerals
2012	Hard Law	Dodd Frank 1502 passed in US, specific reference to OECD Guidelines as a global standard
2013	Hard Law	Sherpa and other French NGOs initiate a regulatory proposal introducing a duty of vigilance on parent companies and purchasers – under discussion in French parliament
2014	Soft Law	EC proposes voluntary rule on conflict minerals

Source: Kepler Cheuvreux, Affectio Mutandi

The trajectory of corruption (bribery) from a phenomenon that was held to be the "norm" into one that is regularly reported negatively in the mainstream public media and financial press and regularly affects shareholder value also shows the same drive from NGOs, soft law and media before regulators intensify their focus on the issue. There is a clear trajectory from the foundation of the two key global NGOs Transparency International and Global Witness in 1993 at a time when the majority of European countries had still not explicitly outlawed the tax deductibility of bribes to the current stage where large global corruption enforcements against corporates are routinely front-page news.

Table 19: Soft law and NGO pressure push regulatory change: corruption

Year	Stakeholder	Trigger
1989	Soft Law	OECD working group of bribery of foreign officials established
1993	Civil Society	NGOs Transparency International and Global Witness formed at a time when payment of bribe still tax deductible in many European countries
1994	Soft Law	OECD adopts Recommendations on Bribery in International Business Transactions
1998	Hard Law	Major European countries withdraw tax deductibility of bribes as a result of OECD pressure
1999	International Convention	OECD Anti-Bribery Convention comes into force
2007	Soft Law	OECD criticises UK decision to stop bribery enquiry into BAE Systems
2008	Hard Law	Siemens pays record fines for bribery 2bn USD globally lead by US FCPA penalties
2012	Hard Law	UK Bribery Act & Dodd Frank 1504 introduced

Source: Kepler Cheuvreux

UK Draft Modern Slavery Bill and Voluntary Initiatives

In the current Draft Modern Slavery Bill[iv] in the UK parliament there are specific acknowledgements of civil society under “Voluntary initiatives”:

“NGOs have played an important role in raising awareness of the problem of modern slavery and especially in uncovering some of the worst examples of slavery and forced labour in companies' supply chains. The Walk Free Foundation's Global Slavery Index in particular has helped to provide much needed data on countries where slavery is most prevalent. “

But there is clear recognition that the current legislation needs to be strengthened with citation of a common third party view that a differentiation between the business impact of purely CSR labelled initiatives and those that make for director level accountability is essential in pushing the agenda forward:

“Voluntary codes of practice in corporations typically get done by their corporate social responsibility people, whereas mandatory regulations end up being handled by their general counsel and even their directors because they are part of a filing requirement.”

As a further proof of the push toward hard law, French law adapted its penal code to criminalise modern forms of slavery in August 2013.

Regulation and CR: corporate responsibility or corporate resistance?

Global corporates often foreground soft law, and particularly voluntary industry frameworks as being of greater value than regulation. One such example has been the oil & gas industry reacting to a civil society push to introduce mandatory legislation in this area. The Extractives Industry Transparency Initiative or EITI is the preferred reference for such claims. However, we note that it carries no obligation in terms of corporate payments transparency. This extends even to those companies who serve on the board of the EITI, whose voluntary disclosure in this area can often be patchy. In the US, in particular, we have seen quite public lobbying against this generation of transparency rules.

If a voluntary framework is invoked by preference by corporations rather than hard law then it befalls civil society by default to enter as a watchdog, rather than the regulator. We would expect this to entail greater collaboration or at least dialogue with NGOs and local communities together with appropriately increased disclosure undertaken by the firms advocating "soft" law.

In effect, the intensive lobbying seen against the US Dodd Frank 1504 Act - requiring country and project payment transparency - shows that this is far from the case. Although arguments over disclosure in particular countries, excessive costs and anti-competitive practices abound, no credible alternatives that would serve investors to better quantify a variety of financial and non-financial risks have been presented.

Furthermore, the primary lobbying group against Dodd Frank 1504 - the American Petroleum Institute or the API - contains a number of EITI board member companies. While the corporations would not consider this an anomaly or in any way a conflict of interests, it is worth noting that companies have used lobbyists to push for voluntary frameworks and have actively worked against hard law.

The implication for the investor is that the discrepancies between public statements supporting greater transparency and actual lobbying against such rules amid poor voluntary practices should be addressed. The non-binding sector frameworks and programmes may require additional engagement from investment communities, so that investor transparency needs are more fully represented within such bodies.

Lobbying carries its own risks, of course, in that it is usually carried out without much visibility. As such, the amounts spent, its efficiency in terms of ROI, the parties involved (with the transitory nature of their political power) and any resulting reputational risk remain largely hidden, impossible to assess and fraught with conflicts of interest.

The trajectory from civil society activism into soft law frameworks, regulatory implementation and enforcement has been seen with a number of CSR areas, especially those concerning demands from multiple stakeholders for increased transparency.

Below we list some major transparency-based hard law recently implemented across a variety of areas, all have civil society campaigns aimed at greater regulation and disclosure.

Transparency: the favoured tool of CSR regulation globally

Table 20: Transparency is a favoured tool of social regulation

Theme	Regulation	Geography	Theme	Companies affected	Status
Payments transparency	Dodd Frank 1504	US	Anti-corruption	Any US listed oil, gas, mining	Passed 2012, first reports expected mid 2014
Payments transparency	EC Accounting Directive	EC	Anti-corruption	EC listed oil, gas; mining, forestry	Being finalised 2013, not yet in place, first reports not expected till at least 2015
Payments transparency	Capital Requirement Directive IV	EC	Tax, risk management, accountability	EC banks	2014 will see competitivity test, first reports not expected until at least 2015
Conflict minerals	Dodd Frank 1502	US	Supply chain & human rights	Any US listed manufacturers using metals and any company supplying them	Passed 2012, first reports expected mid 2014
Board gender diversity	EC Directive	EC	Diversity	Certain large EC listed companies (but comply or explain only)	Ongoing proposal
Sustainability reporting	EC Accounting Directive	EC	Sustainability reporting incl. human rights & corruption	All companies	Ongoing proposal
French L533 Directive	French Fund Directive	France	Reporting on use of ESG factors in funds	Funds marketed in France	Implemented
Healthcare professionals payments	Physician Payments Sunshine Act	US	Anti-corruption	Public reporting of company payments to doctors	Being Implemented 2014
Carbon emissions Reporting	Companies Act Amendment	UK	GHG emissions	Only UK listed companies	From Oct 2013

Source: Kepler Cheuvreux

Civil society as regulatory watchdog

A particular question that arises in social transparency laws is who polices them. It is not the regulators who verify the correctness of the information being reported; NGOs and investigative journalists commonly present evidence of infractions and build the case that the law has been broken. This, for example, has been made explicitly clear in the case of conflict minerals regulation, under Dodd Frank 1502 in the US.

A press release (16 May 2014) from NGO Global Witness (in this case one of the original campaigners for the law) states:

Global Witness calls on companies to fully comply with Section 1502 and submit comprehensive reports that are audited. Global Witness ***plans to monitor*** *the substance and quality of the reports with a view to assessing the extent of company efforts to source minerals responsibly.*

Indeed once the reporting deadline came into effect the NGO released rigorous commentary on the content of disclosure:

Table 21: Conflict Minerals Law - clearest monitoring not from the regulator or a Big4 auditor survey but an NGO

	Response to first set of conflict minerals SD reports – Global Witness Press Release
1	Some companies have published minimal, if any, information on their efforts to determine from which countries the minerals in their products are sourced
2	Many companies have not explained how they assess their suppliers' due diligence practices
3	Many companies have not shown the steps they have taken to identify and mitigate the risks in their supply chain
4	Only one company, Intel, had obtained an audit of its conflict minerals report

Source: Global Witness, June 2014

Personal liability – regulatory attempts have remained just that

The call to increase personal liability for individuals with positions of senior responsibility has increased in recent years, and is particularly strong from the media. The phrase widely used during the financial crisis – "too big to fail" – morphed into "too big to jail" as a backlash against holding any individuals to account.

Certain regulatory regimes such as Sarbanes Oxley in the US, implemented after the ENRON scandal in 2002, introduced personal liability for directors of companies, with criminal penalties for knowing or wilful misstatement by those certifying financial statements. Furthermore, criminal penalties were introduced for any retaliation against good faith whistleblowers. However, although over a decade has passed since the introduction of SOX in 2002, criminal prosecutions of individuals have been rare.

In the first half of 2014 the Italian government made two attempts to impose ethics clauses on ENI and Finmeccanica by introducing a motion to implement company bylaws requiring directors indicted of financial crimes to resign. In both cases, although the state held 30%+ of the company, minority shareholders voted against the proposal. Holdings in other substantial government interest companies such as ENEL and Terna will be subject to the same vote.

However, as we note on page 44 of this report, mounting public pressure for visible accountability of senior corporate individuals - especially CEOs - has led to, at least within Anglo-Saxon culture, a proliferation of televised political committee hearings. Sometimes hard-hitting, often populist in tone but almost always headline-generating, these public interrogations rarely fail to cause reputational damage, even if personal liability remains distant.

Corporates: the primary target

Corporates rather than investors are the primary target of allegations around soft law violation. In this chapter we look at the characteristics of some of the potential violations through specific cases.

Case study: Bolloré parent company cross shareholdings

Via an NCP complaint the Bolloré group was criticised by Sherpa and other NGOs for poor working conditions in a Cameroonese entity, SOCAPALM (palm oil activity), in violation of the OECD Guidelines. The Bolloré group initially denied any influence on the company, as it did not hold more than 50% of the shares.

Holding board seats with key legal entities cited as a factor of business relation and therefore influence

However, in its decision of 3 June 2013, the French NCP recognised the existence of business relationships between companies holding shares in the entity operating the Cameroonian palm oil activity (SOCAPALM), which is accused by the NGO complainants of violating the OECD Guidelines. The French NCP's finding also confirms their application of these principles to minority shareholders and takes account of cross-shareholdings (through entities located in Belgium - Financière du Champ de Mars - and Luxembourg - and SOCFIN SOCFINAF SA). The holding of board seats in key legal entities was an additional element in the analysis of interrelationships.

Another remarkable element in the French NCP's decision is the high degree of precision with which it lists the breaches found. These specifications provided a solid basis for the negotiations initiated by the parties, which should cover the following issues:

Table 22: Action plan areas for SOCAPALM/ Bolloré resulting from French NCP mediation

1	Communication with the local communities
2	Environment (noise reduction and pollution of water and air)
3	Assignment of public services under the assignment agreement of SOCAPALM (access to water, electricity, health and education of residents and workers)
4	Local development (support to villagers and local hiring)
5	The situation of workers at SOCAPALM and subcontractors (including the issue of security and housing conditions)
6	Transparency, compensation for riparian loss and use of resources and land issues (concession boundary, retrocession)

Source: NCP France, Affectio Mutandi

The terms of the action plan negotiated between the Bolloré Group and Sherpa provide useful markers on the actual exercise by a parent of its influence over a subsidiary, if the latter is deemed to be in breach by the NCP (paragraph 6.1 of the decision). The Bolloré Group has already announced the launch of a Quality Health and Environment programme and a certification policy for SOCAPALM. The terms of the action plan are a key development, referencing governing relations between a parent company and its subsidiaries, which is not without impact on the legal liability of parent companies (see CA Paris, 20 June 2013 No S 11/ 05953, the Comilog case, which recognises the competence of the French courts to rule on the fate of former employees of a Congolese subsidiary).

Case study: SOCO International

The SOCO complaint raised by the NGO WWF is based on oil exploration in a UNESCO protected site in the Democratic Republic of Congo (DRC) and was first filed in October 2013. In February 2014, the UK NCP confirmed that the case could be accepted for further mediation. Following NCP mediation SOCO announced in June 2014, that it would commit not to explore the Virunga site unless UNESCO and the DRC government agreed that such activities were not incompatible with World Heritage status.

Following a variety of activism including financial press advertising, investor outreach and the use of the UK OECD NCP agreement was reached

Of note is that the NGO behind the complaint identifies best-practice standards and the norms it believes should be followed, alongside those companies where activism has so far successfully clarified adherence as well as a company following global best practice, which would prevent such complaints from being filed.

NGOs can help investors identify peer group best practice

Adverse environmental and local community impacts could allegedly be exacerbated through insufficient impact assessments, the use of state security forces and specially negotiated exemption clauses with the DRC state. At the heart of the issue is the use of protected sites for commercial purposes. The United Nations Educational, Scientific and Cultural Organisation (UNESCO) maintains a list of world heritage sites of unique value (e.g. cultural or environmental). The DRC Virunga site is one such example of unique natural diversity. At issue is the potential damage of oil exploration that has recently commenced within the borders of the site by SOCO International plc, after authorisation from the DRC government.

Best practice highlighted by NGO with relevant benchmark standards

The WWF cites Total and ENI saying they will *not* drill within UNESCO protected site areas, and this is at least partly due to prior activism by the WWF and other environmental NGOs.

The WWF also highlighted that Royal Dutch Shell (though not present in this DRC site) is following best practice in following International Council on Mining and Metals (ICMM) guidelines not to explore or exploit within World Heritage Sites. The Shell decision itself follows intense NGO campaigning around its controversial plans to explore around the protected Sundarbans site in Bangladesh. It agreed to stop activity in 2003 not just on this site but on any World Heritage site, alongside an ICMM recommendation.

SOCO includes SRI funds among its holders

We cite this case as an ongoing example of the OECD complaint mechanism gaining momentum and media visibility (a number of news agencies including the financial press have publicised this case from inception to conclusion). We note that a number of investors integrate ESG criteria into their investment methodologies and SRI funds in the Top 50 equity investors of Soco International plc. and our view is that, while no investor was explicitly drawn in, the targeting of and interest of investors - essentially those with SRI exposure - is likely to have had a positive lever impact on the changes agreed by the company.

As noted elsewhere in this report, the media has been increasingly receptive to civil society campaigns – as evidenced through the mainstream newspapers' willingness to include coverage on activism. In the case of SOCO, the WWF recently posted a full-page advert in the *Financial Times*, specifically targeting "responsible investors" (Chart 1). This was a controversial tactic, not for targeting investors per se, but for the direct mention of the OECD "examining SOCO's operations". The UK NCP handling this "specific instance" case issued clarifications following this advert. It highlighted that the staff of the UK NCP were in fact from the UK government department (business, innovation and skills) and clarified that the OECD itself had no direct part in handling the complaint. NCPs are set up by national governments to manage the OECD obligation to consider complaints.

Though a mediation result has been achieved, the WWF will continue to monitor SOCO to ensure commitments are upheld. Similarly the result achieved is likely to be referenced in future activism around protected sites. One such example is any potential construction work taking place around the Great Barrier Reef in Australia.

Table 23: SOCO case - issues examined by UK NCP

	The issues for further examination by UK NCP	extracts from SOCO response
1	Access to information contained in the 'Environment Impact Assessment'	The company has sought permission and has received a commitment from the DRC government that the PAR (EIA) will be made public.
2	The level of human rights due diligence that is appropriate to the context of SOCO's operations	We believe the level of due diligence has been appropriate to the context of SOCO's operations, being a seismic survey (lasting approx. one month), environmental baseline studies and community investment programmes. No drilling has been planned or is even warranted. SOCO looks to the OECD Guidelines, which notes that due diligence is an on-going exercise, recognising that human rights risks change over time as operations evolve.
3	How the company should interpret its obligation to contribute to sustainable development.	The company looks forward to contributing to a further examination of how sustainable development can be achieved whilst addressing the views of the international community together with the DRC's legitimate right to manage and protect its own energy resources.

Source: SOCO

Reputation: to be feared and prized

What is reputation?

Here we try to provide an analysis of the concept of reputation risk, a term widely used in CSR and SRI, but never defined in terms of principles or an agreed protocol of materiality. This is despite the fact that reputation and brand have become dominant facets of 21st-century capitalism.

Reputation is the public's opinion, or technically speaking, its social assessment, of a natural or legal person (individual, group or organisation).

At the heart of the concept is *affectio societatis*, or the spirit of cooperation, whether it bears on human relations and coexistence, or on relations between constituted bodies operating around the world (countries/ governments, IGOs, businesses, NGOs), and their respective opinions from different standpoints: e.g., that of a citizen, a consumer, an employee, a local resident, a community, etc. It's a central factor of trust and social acceptance within organised societies.

And reputation risk?

"It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently" Warren Buffett

The expression "reputation risk" refers to the (mainly financial) risk run by companies whose brand image could be tarnished by scandal or controversy, particularly in relation to their social, environmental and governance practices. While difficult to evaluate, reputation risk can have real impacts, to varying degrees, in terms of loss of trust and social acceptance.

Social, environmental, safety and ethical concerns lend themselves far more readily to ongoing reputational impacts than purely financial concerns. Indeed in the early manifestations of CSR – following the publication of the Turnbull Report in the UK, a 2000 paper from the Association of Chartered Certified Accountants[v] states: "*…Turnbull stretches wider than financial controls, to encompass social and environmental issues – matters that have recently come to be grouped together under the generic heading of "reputation risk"*.

We are beginning to see the material impact of reputation more readily

The media and, in turn, regulators are becoming increasingly important brokers in the public "perception" that forms the basis of reputation. Resulting impacts on companies are felt in a variety of areas. We list a sample of impacts and examples below, noting that exact quantification may be difficult if not impossible to establish, although visible impacts seem nonetheless increasingly numerous. As a push factor, the regulatory interest in the number of areas related to corporate malpractice has grown exponentially in terms of actual and headline-grabbing potential penalties.

Table 24: Reputation impacts* - hard to quantify but side effects not always hard to see

Share price decrease on news flow	G4S: Olympics Security - untrained personnel leading to additional UK military as partial replacement at games
Settlements & momentum of investigations	Barclays LIBOR settlements covered by popular press, accelerating public badwill and regulatory mandate against firm and entire sector
Operational disruption	Public protests/boycotts against Shell during the Brent Spar campaign (offshore oil rig disposal), retail facing staff at sharp end
Drops in intangible value	Merchant Bank Barings purchased for a fraction of its value following rogue trader scandal, which punctured reputation and balance sheet
Legal fees	Litigation around issues leading to reputation damage regularly require ongoing counsel: see Walmart's disclosure of FCPA corruption legal costs approaching USD500m since 2012
Communication costs	Rarely disclosed but essential as an emergency response: see retail horse meat scandal (i.e. Tesco)
Compliance costs	Bank sector incrementally increasing compliance - see HSBC following money laundering scandal
The difficulty of retaining and attracting talent	Rarely quantified, but employee motivation, increased turnover and difficulty of recruiting are common concerns
Impacts on business strategy	NewsCorp: UK regulator halts purchase of BSkyB following phone hacking scandal
Supply chain revamps	Nestlé suspends sourcing from Sinar Mas after social media palm oil campaign by Greenpeace
Reactive restructuring	Bank sector sees significant job losses - partly due to erosion of reputation
Suspension of payments	Algerian National Oil Company suspends EUR1bn payments to ENI/Saipem following bribery allegations
Cancellation of contracts	Difficulty in acquiring new UK contracts for G4S post Olympics. Finmeccanica India helicopter contracts cancelled following allegations of bribery
Limitations on multilateral and bilateral agency financing	Siemens units barred from World Bank funded projects for three years
Government contract debarment	BP sees US EPA block new fuel contracts post-Macondo
Sales drops	GSK reports 61% China sales drop in Q3, 2013 following reluctance by local doctors to take meetings with sales reps following bribery investigation

* Perceptions by consumers, clients, media and regulators

Source: Kepler Cheuvreux, Affectio Mutandi

The background of increased reputational risk is heightened through increasingly aggressive enforcement mandates from regulators. One can see this clearly in the trend for larger corporate penalties and criminal settlements. (The financial services sector has paid over 100bn USD in penalties since the start of the financial crisis – more than the sum total of entire penalties across all sectors in the US at any point prior.)

Table 25: Corporate penalties on the rise (2012 and 2013 were record years, 2014 could follow suit…)

Company	Sector	Country	Criminal penalty USD	Total penalty USD	Year	Offence
BP	Oil & Gas	UK	1.256bn	4.5bn+	2012	Environmental
Pfizer	Pharma	US	1.2bn	2.3bn	2012	Mis-marketing
GlaxoSmithKline	Pharma	UK	956m	3bn	2012	Mis-marketing
Eli Lilly	Pharma	US	515m	1.415bn	2009	Mis-marketing
AU Optronics	Cap Goods	Taiwan	500m	500m	2012	Antitrust
Abbott Laboratories	MedTech	US	500m	1.6bn	2012	Mis-marketing
Hoffman-La Roche	Pharma	Canada	500m	500m	1999	Antitrust
J&J	Pharma	US	485m	2.2bn	2013	Mis-marketing
Siemens	Cap Goods	Germany	450m	2bn	2009	Corruption
JP Morgan	Banks	US	N/A	1.7bn	2014	Aiding fraud (Madoff)
JP Morgan	Banks	US	N/A	13bn	2013	Mortgage bond mis-selling
Credit Suisse	Banks	Switzerland	2.6bn	2.6bn	2014	Client tax evasion

Source: Kepler Cheuvreux

Although the nature and extent of reputational exposure varies greatly by sector and business model, its impacts can be enormous in any of its forms. We take as an example luxury goods, which has an extreme and visible form of dependence on reputation.

A large number of NGOs operate campaigns in this sector ranging from animal rights, conflict diamonds and gold, pollutive impacts, use of toxic chemicals, indigenous people's rights, excessive packaging, poor labour practices, sexual discrimination. Large global players in this industry are regularly scored in specific campaigns (i.e. "Deeper Luxury" - WWF) and as a sector where perception is all, and civil society has shown its ability to exert influence over perceptions, the luxury goods industry has had possibly the most interaction with NGOs. As a result in recent years major companies have incorporated NGO dialogue into their overall reputational risk management strategies. As an industry where fame and star value is central to advertising we have also seen the reverse where NGOs adopt stars to speak out against poor practices (i.e. Joaquin Phoenix for PETA against Hermes). However. NGO Oxfam recently saw Scarlett Johansson drop her role with them due to public disagreements on positions regarding corporate presence in Israeli occupied regions. The trigger was her acceptance of an advertising contract from drinks machine maker Sodastream, which has manufacturing presence in the West Bank. Though Oxfam had been critical of the company, media focus on the situation srrounding Israel and Palestine was nonetheless incrementally heightened due to the incident.

Celebrity is the life blood of brand marketing campaigns…

…but NGO campaigns have begun to leverage star value

The Cost of Brand Value

Taking estimates from specialist agencies, we note the enormous values attributed to the brand capital of the leaders in this field using key luxury goods companies and also the overall Global Top 10 Brands according to Interbrand:

Table 26: Brand value accounts for about one-quarter of the market cap of the top ten global brands

		2013 Brand Value (USDbn)	Market Cap (USDbn)	Brand Value/ Market Cap
1	Apple	98.3	549.2	18%
2	Google	93.3	370.5	25%
3	Coca Cola	79.2	179.7	44%
4	IBM	78.8	186.6	42%
5	Microsoft	59.5	332.8	18%
6	GE	46.9	268.6	17%
7	McDonalds	42.0	100.3	42%
8	Samsung	39.6	211.2	19%
9	Intel	37.3	137.7	27%
10	Toyota	35.3	196.6	18%
	Average			*24%*
	Luxury goods sector brand value:			
	Louis Vuitton	24.9	100.7	25%
	Gucci	10.2	27.7 (Kering)	N/A
	Hermès	7.6	37.3	20%
	Cartier	6.9	N/A	N/A
	Prada	5.6	19.2	29%
	Tiffany & Co.	5.4	12.8	42%
	Burberry	5.2	11.4	46%

Source: InterBrand, Bloomberg, KeplerCheuvreux

Brands cannot afford controversy over sustained periods. Although brands understand this issue perfectly, they encounter myriad difficulties in proactive and reactive responses to the challenge. Much has been said of the need to integrate a sustainable culture within a company to prevent issues. Equally, when responding to controversies the temptation to respond legalistically (i.e. request removal of "libellous" statements, insist on legal non-responsibility in actual events concerning an allegation etc.) are a common trap for corporates. Decades are spent building strong brand capital that can be tarnished in just a few days.

Nevertheless, controversies can be marginal - particularly if dealt with immediately. Gucci understood this when it was challenged by the Clean Clothes Campaign report back in 2008. The group responded by setting up a comprehensive and ambitious plan for its 2,000 suppliers (more than 2,700 audits for the PPR Group in 2010).

ESG factors increasingly formalised in approaches to brand valuation

In its 2013 Interbrand annual review of the "Best Global Brands" report "Apple " (which has made conspicuous hires from the luxury goods sector including Burberry and Yves Saint Laurent) tops the list, whose brand is worth an astonishing USD98.316bn; however, explicit reference is made to recent ESG reputational controversies: i.e. "Despite having its reputation tarnished by patent spats with Samsung and the Foxconn labor conditions scandal…":

Table 27: Apple InterBrand Report explicitly references ESG factors impacting reputation

Labour/supply chain	The company has announced that the Mac Pro will be assembled in the US, which demonstrates that Apple has taken criticism over Foxconn worker conditions in China to heart
Environment	The brand's environmental commitments also appear to be growing: Apple is still the only company in the tech industry whose entire product line exceeds US Energy Star specifications and a new solar facility - the largest privately owned solar array in the US - is now fueling its North Carolina data center. The company plans to achieve 100 percent renewable energy for its data centers and facilities worldwide and already has a second solar facility scheduled to be operational by the end of the year. In a move that may further shore up its reputation, Apple hired former US EPA chief, Lisa Jackson, as its first VP of Environmental Initiatives
Antitrust	However, its reputation has taken a few hits this past year, including being found guilty by a US court of conspiring with publishers to fix the price of e-books bought via iTunes; the ongoing Apple vs. Samsung patent trials and ;
Tax avoidance	a US Senate hearing examining the company's "highly questionable" tax minimization strategies

Source: Interbrand "Best Global Brands" 2013

The auto sector faces safety consequences of supply chain decisions with life-or-death impact on consumers

Another industry with reputational exposure is the Auto sector, with product recalls on the rise – but where supply chain decisions have safety consequences not only on those involved in the manufacture of the product but also the end consumer.

Table 28: Auto sector reputational risk drivers

Product reliability	Reliability is a key component of corporate image that engages carmakers at the reputational and financial levels. It mainly depends on **traceability** in supply chain management in order **to minimise risks and costs of recalls in the event of component failure**. Toyota's leading reputation was built on quality, and based on close relations with suppliers and on Jidoka, Toyota's production system, that was able to highlight problems and stop any machines involved in the production process as soon as a malfunction is discovered. However, the recent turmoil, with **estimated costs up to USD2bn in lost output and sales**, may be attributable to a race for growth.
Industrial espionage	Given its size, the large number of players, and the strategic role of innovation, the sector is particularly at risk for industrial espionage. The risk requires a high level of security and protection of industrial property. In case of leaks, crisis management control is essential to limit the scope of damage, duration and costs, as we saw recently with Renault. The group jeopardised its management's reputation for reliability on the back of disinformation and accusation of bribes, combined with untrue information from security services.
A residual risk of corruption	Bribery scandals remain a **highly visible reputational risk** for carmakers' executives in their efforts to **secure business overseas** and in the **customer-supplier relationship**. After several recent convictions, manufacturers continue to strengthen their anticorruption measures through dedicated services and resources.

Source: Kepler Cheuvreux

The roots of e-reputation risk

Competition for audience in the media sector has been intensified by the way subjects are given saturation coverage in online media and/or on social networks.

The digital transition has accelerated exchanges and created an interactive frenzy that is increasingly difficult to control, along with new factors of image risk or even legal risk. We note the following:

- Increased "ego-feeding" by public personalities, via their personal blogs or Twitter account, and by those in the habit of following the news about such public personalities and who comment on such news, to give themselves a presence (experts and journalists).
- The risk of permanent escalation linked to the acceleration of transparent online exchanges, culminating in legal risks if commitments are entered into publicly.
- The default starting position is a lack of a right to be forgotten, because everything is saved and historical data is accessible online.

The digital transition has led to an upsurge in the individual's share of voice, with citizens able to express themselves directly, whatever their angle: electors, consumers, employees, residents, etc.

- They end up commenting on situations online.
- They are given the opportunity to directly address public decision-makers in the world of politics, economics, charity, etc., via digital media and social networks, thereby intensifying the media's focus on particular subjects, and facilitating attacks on reputation.

Thus, within the last decade, there has emerged the concept of e.reputation, a component of overall reputation, but more immaterial and still harder to control.

Maintaining reputation via open social media interaction is a challenge...

The links between positive social media presence and the more clearly established in multiple approaches to intangible value. Interbrand the agency that measures brand value for example, in its valuation methodology for Brand Strength (on which it puts a monetary figure) uses a factor it labels as "Presence"[vi] in which it explicitly incorporates social media

"The degree to which a brand feels omnipresent and is talked about positively by consumers, customers, and opinion formers in both traditional and ***social media****."*

The building process of a reputation risk – the e-era

According to insurance company ACE's recent survey of risk managers and CFOs in 15 EMEA countries, 92% of companies surveyed consider reputation risk to be the hardest risk to manage, and more than two-thirds struggle to quantify the financial impact of reputation risk on their activities.

It is essential to understand the process by which a reputation risk arises, especially as the digital media are disrupting traditional interaction with legal and societal risks.

While each case is unique, reputational crises tend to develop on the basis of the following three main pillars:

Trigger:

- internal dysfunction, with a wide range of causal factors: incidents, failure of governance or management ethics
- external allegations (whether founded or not) by a third party, the spreading of rumours, or a reputational attack in response to influence mechanisms aimed at undermining a specific target
- natural events: floods, tsunamis, earthquakes

Amplifier:

- endogenous: lack of preparation, lack of reactivity, failure to consult stakeholders, lack of communication and transparency; it's often a matter of managing the situation technically, while also broadcasting the fact that one is doing so, in order not to give the impression that the situation is not being taken in hand and managed
- exogenous: the history of the business in terms of controversies, sector sensitivities, particular sensibility to a subject (e.g. German public opinion on nuclear power, Spanish public opinion on oil quality, etc.), quiet news period resulting in excessive media coverage of an incident (e.g. August in France)

Aggravating interaction with public and stakeholders

- between those who have to take a position, being directly involved in the area via their responsibilities (public administration, politicians, charity sector)…
- … and those who find that the situation gives them the opportunity to have a presence in the media or "15 minutes of fame": the syndrome of the expert commenting on a situation of which he has no prior knowledge, but that gives him a presence on the TV screens or in the written press, thereby aggravating the media crisis, which is the main source of attacks on reputation.

e-reputation risk interacts with social risks…

The development of digital technology is facilitating online mobilisation, which is gradually taking precedence over the more restrictive "physical" citizen mobilisation. This societal risk historically took different forms, depending on the players involved, from the mobilisation of employees by the unions during strikes or occupations of industrial sites, to demonstrations in the voluntary sector, to boycott campaigns, etc.

There has been an observable trend towards radicalisation and a form of innovation, with management kidnappings, threats to the integrity of industrial or environment sites, infiltration of sensitive nuclear sites by environmentalist NGOs, or the acquisition of financial stakes by NGOs in companies where they wish to exert influence and assert claims, e.g. Total. This radicalism has not been without legal risk for those embarking on it, but strong media coverage of their actions has usually protected them from prosecution.

As they are digitalised, societal risks are being reinvented and are taking on new forms. Thus, there has been a spate of Facebook "like" campaigns aimed at mobilising opinion on controversies or public debates, with calls to share such position-taking on personal networks, in order to boost the campaign's impact. The development of the online petition by the likes of Change.org and Avaaz (see p25) has created a strong lever for exerting pressure on political or economic targets during social mobilisations. Anyone with a cause to push can set up a petition, which will be given media coverage via the social networks.

...and legal risks

The direct democracy made possible by digital technology through the principles of open governance carries the seeds of new legal and reputational risk factors, particularly for economic players.

Online debates enable the sharing of views by stakeholders and encourage the joint elaboration of regulations, as reflected by the Parlement & Citoyens initiatives in France, notably the discussion of the proposed law on regulating non-agricultural plant protection products conducted with internet users by a member of the Senate.

In addition, we note an acceleration in the “judicialisation” of society via digitalisation, which is facilitating access to justice. Thus, platforms like www.porterplainteenligne.fr have emerged, which are gradually opening up new legal risks, such as class actions when articulated by imaginative members of civil society via online petitions. Whistle blowing to government agencies remains on the rise – and a central source of legal complaints - often from employees who have attempted to forward evidence of wrong doings within corporate internal systems but been rejected. This is particularly so in the US where under the False Claims Act, Sarbanes Oxley and most recently Dodd Frank whistle blower systems and protections are not only enshrined but financially rewarded.

Moreover, judicial time, which is longer than media time and longer still than digital time, creates a lasting threat to reputation. It takes several years to untangle the truth of a situation, with each court session an opportunity for more mentions of the subject, thereby imprinting an incident from the past onto the collective memory.

Finally, we note a trend towards litigiousness when addressing ESG issues. With the recent development of ethical, societal or environmental commitments, not backed by the resources needed to enforce them, the watchdogs have been alerting public opinion and the media to denounce instances of greenwashing and fairwashing. This in itself was a first attack on reputation. But EU Directive No2005/29/CE on deceptive marketing practices, transposed into French law in 2008, has created the risk of prosecution for deceptive marketing practices if an operator fails to respect a code of conduct. This risk materialised in 2013 with the filing of the first complaints against Samsung and Schneider (see Table 11).

We thus discern a new form of legal, societal and reputational risk, linked to normative changes in ESG issues and the various transitions our societies are working through as we enter the age of “homo digitalis”.

Chart 6: Affectio Mutandi outlines interactions between Reputation, Social and Legal Risk

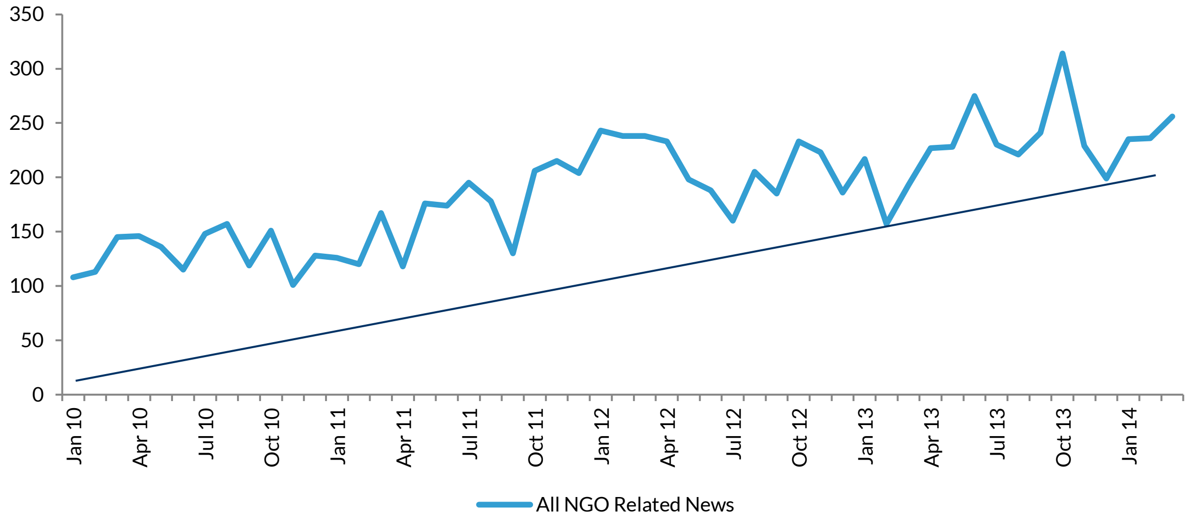
Source: Affectio Mutandi

Media representation and reputation

NGOs are an increasingly important news source for a data provider sourcing controversies

We look at the influence of the media in raising awareness of activist causes. Within the asset management domain the use of news controversy providers is embedded in the investment process of SRI funds. We take a commonly used and reputable supplier of such data, *RepRisk ESG Business Intelligence*, to highlight some key emerging elements of tracking controversy. Critically, the provider has increased the number of NGOs from which it sources new controversies. We think this is an important move in keeping up with the increasing trend for the mainstream press to include coverage of NGO activism – notably because it will be of increased relevance to the SRI investor.

Chart 7: NGO-sourced news flow shows gradual growth



Source: RepRisk ESG Business Intelligence

In partnership with data provider RepRisk, we look at the key trends in controversies that investors should be aware of. The fundamental principle here is that the most mediatised themes attract the most attention in terms of potential reputational risk for investors. We note below some key themes that investors remain exposed to, with accompanying notes on soft law mechanisms, hard law, NGOs concerned, regions and examples of engagements.

Central is an NGO campaign's credibility with the media. Increasingly we see the mainstream financial press ready to include coverage of key campaigns. This can work in favour of companies targeted, with reputational capital increasingly a factor in certain controversial projects.

In the following table we differentiate between those news sources that can sway reputation most readily (major global media houses and syndicates such as the FT etc) which are "High Influence" and those which are "Medium Influence" (regional media and NGOs – as classified by RepRisk. However we note also – see Chart 8 which follows that campaigns by NGOs are increasingly captured by high influence sources.

Critically "Violation of national legislation" is the highest ranked theme for both high and medium influence sources – and as such the major broad area that investors should monitor. The key difference in the Top 15 themes picked up between high and medium influence sources is that the global media has recently begun to take adopt remarkable interest in **Tax** and **Remuneration** themes. Medium influence sources have had less focus in aggregate on these two key emerging ESG areas.

Table 29: Global media versus local media & NGOs: tax & executive compensation become high-influence themes

	High influence (major global media)		Medium influence (incl regional media & NGOs)
1	Violation of national legislation	1	Violation of national legislation
2	Fraud	2	Impacts on communities
3	Corruption, bribery, extortion and money laundering	3	Impacts on ecosystems/landscapes
4	Impacts on communities	4	Fraud
5	Impacts on ecosystems/landscapes	5	Local pollution
6	Anti-competitive practices	6	Corruption, bribery, extortion and money laundering
7	Human rights abuses and corporate complicity	7	Occupational health and safety issues
8	Local pollution	8	Human rights abuses and corporate complicity
9	Controversial products and services	9	Poor employment conditions
10	Occupational health and safety issues	10	Anti-competitive practices
11	Products (health and environmental issues)	11	Controversial products and services
12	Poor employment conditions	12	**Waste issues**
13	**Tax evasion**	13	Products (health and environmental issues)
14	Supply chain (ESG issues)	14	Supply chain (ESG issues)
15	**Executive compensation issues**	15	**Local participation issues**

Source: RepRisk ESG Business Intelligence

Chart 8: NGOs increasingly influence reputational capital when campaigns are covered by the mainstream press


May 23, 2014 10:41 am

Deutsche Bank refuses to bankroll Barrier Reef port expansion

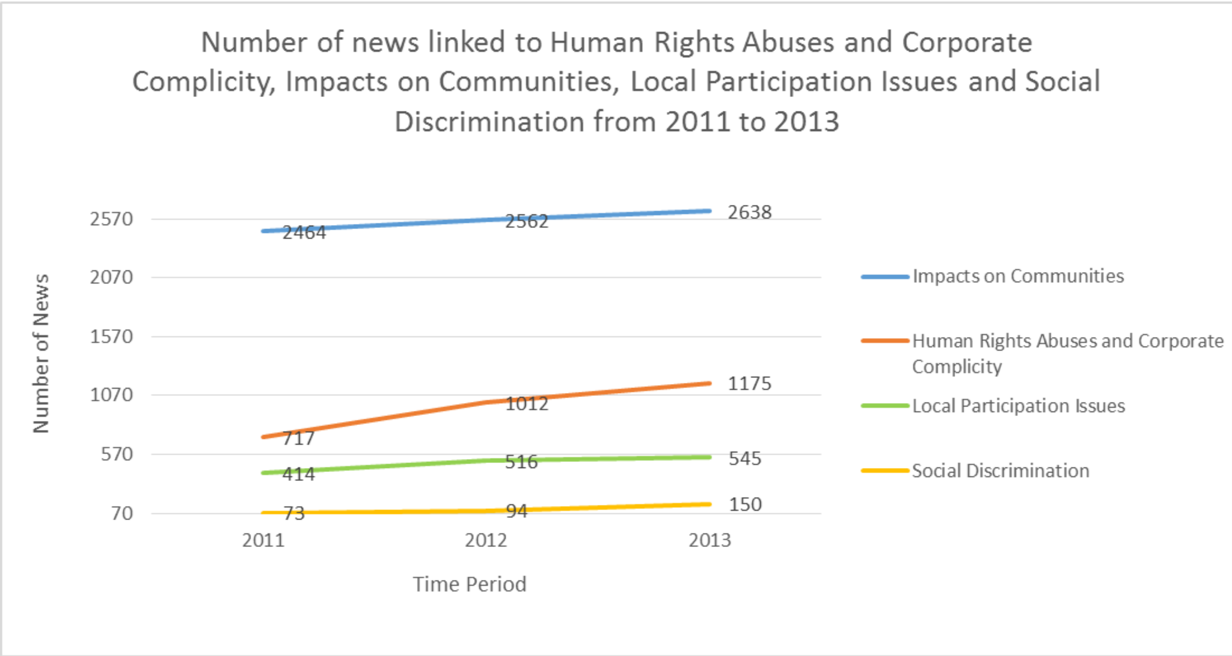
By Jamie Smyth in Sydney   Author alerts

Indian conglomerate Adani Group's plan to raise billions of dollars to expand a port near Australia's Great Barrier Reef has been dealt a symbolic blow after Deutsche Bank refused to fund the project following lobbying by environmental groups.

Juergen Fitschen, Deutsche Bank's co-chief executive, told shareholders that the bank would not be involved in the Abbot Point project, which the world heritage agency Unesco has warned risks damaging the fragile ecosystem of the reef.

Source: FT May 23, 2014

Chart 9: Key controversy news trends: human rights shows steady momentum increase



Source: RepRisk ESG Business Intelligence

Analysing the materiality of reputation risks

SRI and extra-financial analysis often refers to “reputation risk” but very seldom defines it or proposes a methodology for assessing its materiality. The economic value of reputation, nevertheless, is a very simple equation: reputation has a value, since the lack of it has a clear cost to business. Putting a financial figure on such value is, however, a complex exercise. Reputation has become a key intangible asset to a number of business models, most strongly linked to branding, but going well beyond - to impact customer demands, future cash flow, communication and marketing cost, licence to operate as well as labour productivity, individually or all together, depending on the controversial issue.

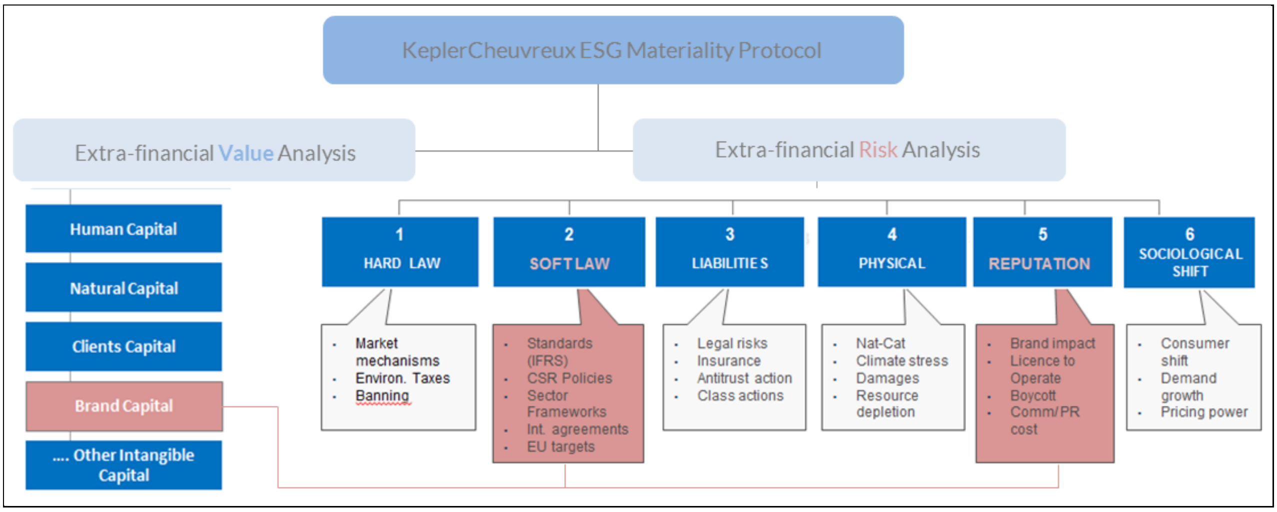
Reputation has become a key intangible asset to a number of business models… but a tough one to value

From an investor point of view, reputation impact is even harder to capture in asset performance, for two reasons:

1. It is difficult to extract among all the other stock performance factors.
2. It often relates to the risk/reward profile of an asset rather than to its absolute or relative performance as long as the financial risk does not materialise.

Below, we outline our ESG Materiality Protocol: reputation is an intrinsic element, which is amplified within extra-financial analysis and is impacted in particular by the expanding materiality of soft law:

Chart 10: Kepler Cheuvreux ESG materiality protocol integrates reputation risk and soft law



Source: Kepler Cheuvreux

In tracking the materiality of reputational risk we would include the visibility of NGO campaigns within the context of media coverage – this can be either as a direct result of campaigning instigated by the NGO or pre-existing concerns that fit with a media agenda (there will of course be multiple angles).

"Settlements/ Occupation" have become an enlarged theme for civil society in recent years. Whilst soft law pronouncements can appear certain on this subject declaring the illegality and immorality of settlements, the application of hard law judgements in practice- especially to business and investment interactions - is far more ambiguous.

We can take three different examples of regions affected by questions of occupation: Israel-Palestine, Morocco-Western Sahara and China-Tibet. Of these it is only Israeli settlements in Palestine that have attracted widespread media attention. Below we list the most prominent NGO campaigns according to data provider RepRisk. We use the proprietary Peak RRI (0-100) from the RepRisk Index which gives an indication of financial, reputational and investment risk.

Table 30:NGO campaigns captured by news flow from RepRisk

Campaign	Peak RRI	Change (Trend)	Sector	Theme	NGO
Clean Clothes Campaign (CCC)	57	-5	Retail	Fair labour in garments industry incl Rana Plaza campaign	CCC
Detox our Future	47	-1	Retail	Chemical use and water pollution in garments sector	Greenpeace
Save Khoper	46	-1	Mining	Social and environmental impacts of Russian copper-nickel project	Save Khoper Movement
gegenstrom.13	45	-1	Utilities	Environmental and social impacts of coal-generated power	gegenstrom.13
Cotton Campaign	43	-1	Retail	Labour issues in Uzbek cotton industry	Cotton Campaign
Boycott, Divestment and Sanctions (BDS)	40	6	Multi Sector	Against Israel presence in Palestine	BDS
Campaign for Fairer Gambling	40	-2	Gaming	Increased regulation for gaming	Fairer Gambling
Keep Rivers Free Movement	40	-2	Infrastructure, Utilities, Fisheries, Extractives	Multiple	
Kein Patent auf Leben (No Patents on Life)	40	0	Biotech	Use of GMO and restrictive IP by major seed producers	Swissaid, Greenpeace
Play Fair 2008	40	0	Retail	Labour rights in sporting goods	Play Fair
Stop Pillage	40	-1	Mining, Forestry	Human rights violations in conflict regions	
US Campaign to End the Israeli Occupation	40	35	Multi Sector	Against Israel presence in Palestine	OSJI, CAP, TRIAL
Detox Catwalk	37	-1	Retail	Pollution in garment industry	Greenpeace
Hamburg Initiative Against Arms Exports Containers	37	-8	Defence	Arms exports from Hamburg	Hamburger Bündnis gegen Waffenexporte
Make It Better	37	-2	Consumer Goods	Social and environmental impacts of manufacturing	Friends of the Earth
Frack Off Scotland	36	-2	Energy	Unconventional gas projects	Frack Off Scotland
IF (Enough Food IF)	36	-2	Ford & Bev	Tax, Land rights & supply chain in LDCs	
Intern Aware	36	-1	Multi Sector	Labour rights in internships	Intern Aware
Save the Arctic	36	0	Extractives	Environmental impacts of arctic drilling	Greenpeace

Source: RepRisk ESG Business Intelligence

The single largest increase (an RRI score of +35) by far comes from the “US Campaign to end the Israeli Occupation”. The trend that US lead campaigns generate newsflow traction is certainly intact. The second highest rise (RRI +6) also comes from the “Boycott, Divestment and Sanctions” campaign which has also launched a high-profile campaign against Israeli projects in the Palestinian occupied territory. In the table above we note key Israeli based companies that have been subject to occupation based exclusion from SRI funds.

Several investors have been requested to clarify their positions on investment in companies with exposure to Israeli-led projects in Palestine; we think one reason for this is heightened media attention. While we would not argue either way in terms of what any position should be, a clear, well thought-out policy relevant to the fund and/or beneficiaries may be better than none, even if it goes against the grain of the predominant angles reported by the global media. Though there is a fair claim that any move towards exclusion may be perceived as overtly political and beyond the remit of even an SRI investor, non-exclusion is also subject to be seen as a political statement. We review some of the exclusions of Israeli companies in the table below. To our knowledge no large cap global bank has been excluded for potentially controversial settlement related funding activity and there is a predominance of smaller national banks.

Table 31: Israeli based companies excluded from funds for occupation based human rights violations

Company	Excluding Institutions' Assets (USDbn)	Excluding Institutions (#)
ELBIT SYSTEMS LTD	1,418.37	10* (defense sector)
AFRICA-ISRAEL INV LTD	989.65	4
DANYA CEBUS LTD	989.65	4
SHIKUN & BINUI LTD	929.56	4
BANK HAPOALIM BM	314.77	2
MIZRAHI TEFAHOT BANK LTD	192.68	1
FIRST INTL BANK ISRAEL	192.68	1
ISRAEL DISCOUNT BANK-A	192.68	1
BANK LEUMI LE-ISRAEL	192.68	1

Source: Bloomberg

The US accounts for the largest NGO activist presence globally

The US (see Table 29) is shown both as the country generating the largest amount of news coverage and that with the largest number of NGOs. The potent formula here for aggressive regulatory leverage based on a very large revenue and financial markets presence of global companies in the US means that companies and investors need to take note fully of any reputational implications both as a result of civil society activity and regulatory enforcement.

Table 32: Breakdown of NGOs on RepRisk: US versus emerging countries

Country of origin	Number of NGOs
Total	*6,309*
United States of America	**1,524**
India	301
Brazil	180
Philippines	115
Mexico	111
China	109
Argentina	99
Indonesia	99
Korea; Republic of (South Korea)	99
South Africa	83
Russian Federation	81
Peru	72
Chile	71
Colombia	60
Nigeria	54
Thailand	47
Malaysia	44
Myanmar	39
Ecuador	35
Cambodia	33

Source: RepRisk ESG Business Intelligence

Reputation and governance

"When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact." Warren Buffett

Experience and recent history show that reputational issues remain more attached to a company than to its leaders. As a very disruptive factor in the structure of corporate governance, i.e. the management and board, reputation risk sometimes results in a penalty leading to a change in senior personnel without reducing the reputational impact at the level of the business: the "circuit breaker" effect of replacing a CEO or board member no longer works as a means of erasing a company's poor image.

CEOs and government hearings

Although there is mounting debate around increased personal liability for CEOs, we do see, particularly within Anglo-Saxon political culture, momentum towards parliamentary or Senate hearings, which attract widespread and global media coverage. Although in certain cases the underlying controversy may contribute to a CEO stepping down, one thing is certain: governments want to be seen to be being harder on corporate crime. Reputationally, the political committees that conduct interrogations (almost always televised) are hard hitting. Putting a face on the controversy (above all when it is at the CEO level – i.e. standing for the entire company) magnifies negative media views – whether or not a balanced and detailed coverage of events is achieved or not.

Table 33: Reputational damage extended...political committees and televised hearings

Company	CEO	Theme	Year	Country
Apple	Tim Cook	Tax policy	2013	US
GM	Mary Barra	Safety recall	2014	US
Credit Suisse	Brady Dougan	Tax avoidance products	2014	US
JP Morgan	Jamie Dimon	Risk management: "London Whale"	2012	US
HSBC	Irene Dorner (US)	Money laundering & sanctions violations	2012	US
Barclays	Bob Diamond	LIBOR	2012	UK
Pfizer	Ian Read	AstraZeneca Takeover: Tax, R&D, Jobs	2014	UK
NewsCorp	Rupert Murdoch	Phone hacking	2012	UK

Source: Kepler Cheuvreux

Two types of focus for controversies: static versus dispersed

In the following case studies we distinguish between two case types: static projects and dispersed supply chains: these two main types of environments differ in practice and have a significant impact on the nature and manner of action expected in investment systems and procedures. In this report, the Bolloré, SOCO International and POSCO cases would be considered static – with the resulting investor focus being on due diligence for new and existing projects, including the existence, efficacy and follow-up on impact assessments (environment and human rights). Specific issues include protected statuses relating to indigenous peoples, land rights and areas of natural diversity. The FPIC (Free, Prior, Informed Consent) is central in one of the most common areas where investors are requested to engage by local communities and NGOs – so a company's approach to surveying and implementing this concept is key, particularly where local authorities are not assertive in maintaining these rights.

By contrast, the Rana Plaza case would be considered as a dispersed project marked by a focus on the supply chain and identifying the role of fluid participants and asserting and extending control to those specific suppliers and their sites' health & safety and labour performance. Although the focus is one country, primarily Bangladesh, the incentive is clear for investors in assuring that the due diligence and accompanying actions to prevent safety disasters and prolonged labour disputes that can damage shareholder value are applied globally. In this area exclusion policies against any single company are rare on the basis of controversies and may be of limited use. By contrast engagements with a number of global buyers on supply chain issues is likely to exert more top down pressure on the damaging procurement practices in question. The actual suppliers who manage the sites may be small unlisted companies over which global investors can exert absolutely no direct control – Tazreen Fashions Ltd of Bangladesh for example - which remains in the Top10 most controversial companies according to RepRisk.

For procurement themes sectorial engagements may be far more effective than excluding a controversial company or its supplier as a response to a disaster

Table 34: Risk profiles: static versus dispersed projects

Relevant criteria for ESG risk assessment	Static	Dispersed
Territorial perimeter	Local Content	Extraterritorial
Number of stakeholders	Limited	Multiple
Nature of contractual relationship	Stability	Volatility

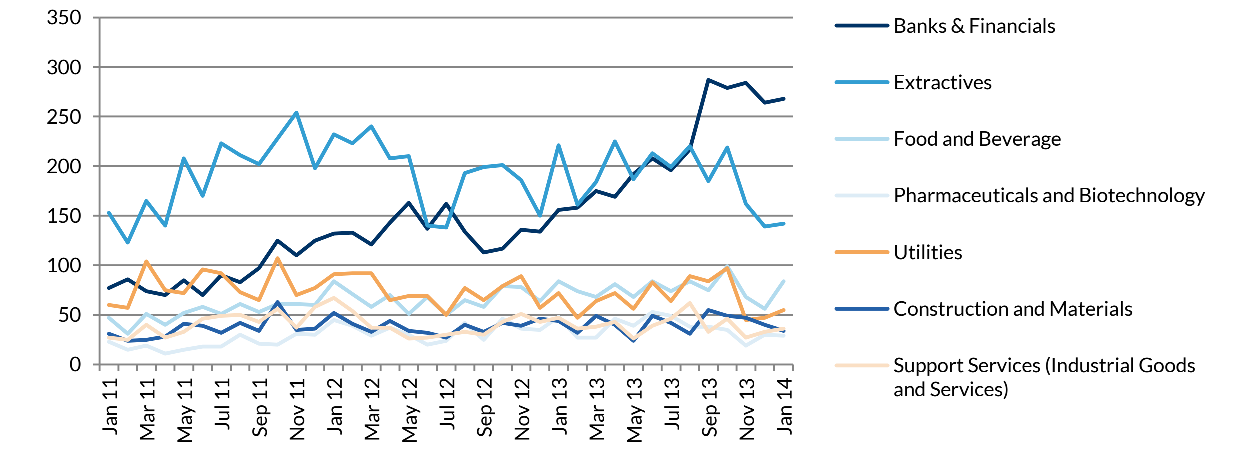
Source: Affectio Mutandi

Extractives sector: continued risks for static projects

We highlight extractives as a sector that is still highly exposed, and accounts for the largest number of NCP cases. Historically, the extractives sector accounts for around 50% of the 184 cases presented by NGOs to NCPs globally. In 2013, nine out of the thirty cases filed were linked to the extractive sector.

Historically, 50% of OECD NCP cases are from extractive sectors

Chart 11: Extractives the most steady source of controversy news flow, financial sector peaks since crisis



Source: RepRisk ESG Business Intelligence

At the time of writing, banks and financial services are the most exposed companies based on RepRisk data (via their "Peak RRI" indicator). We list European companies with their sectors below. The RRI is a measure that captures criticism and quantifies a company's exposure to ESG risks - it takes into account news value (i.e. influence, harshness and newness) alongside intensity (frequency and timing of information – primarily media based).

Table 35: Europe - Snapshot of reputational risk related to ESG issues: banks currently dominate

Name	RRI Trend	Peak RRI (Overall ESG risk exposure indicator)	Sector(s)
Lonmin PLC	3	73	Mining
HSBC Holdings PLC (HSBC)	0	69	Banks
Standard Chartered PLC	-13	69	Banks
TeliaSonera AB	-10	67	Telecommunications
Barclays PLC (Barclays)	0	66	Banks; financial services
GlaxoSmithKline PLC	6	65	Pharmaceuticals and Biotechnology
Credit Suisse Group AG	0	65	Banks
Glencore Xstrata PLC	-1	65	Industrial metals; mining
ICAP PLC	-1	65	Financial services
BNP Paribas SA	-10	65	Banks; financial services
UBS AG (UBS)	-2	64	Banks
Total SA	1	63	Oil and gas
Deutsche Bank AG	-1	63	Banks
Royal Bank of Scotland Group PLC (RBS)	-11	63	Banks
Bayerische Motoren Werke AG	15	62	Automobiles and parts
Royal Dutch Shell PLC (Shell)	0	62	Oil and gas
G4S PLC	-1	62	Support services (industrial goods and services)
Banca Monte dei Paschi di Siena	-2	61	Banks
ING Groep NV	-4	61	Banks; financial services; Insurance
Lloyds Banking Group PLC	-11	61	Banks; financial services

Source: RepRisk ESG Business Intelligence May 2014

With the clear brand damage that the entire financial services sector has suffered, specific cases linked to investment in extractive industries have an incremental ability to effect reputational loss. Interestingly the above companies that have generated the most controversy are often good performers according to ESG data provider ratings, highlighting the need to monitor a company and ensuing controversies beyond the results of sustainability ratings and company disclosure alone.

Specific initiatives related to the extractives sector

Investors interact to differing degrees within industry frameworks. The following are often referenced in cases where norms may have been breached. While the industry bodies may not have the level of adherence or the rigour of enforcement that civil society pushes for, they can provide useful reference points for investor engagement. This may come through the access that certain bodies provide to investors – e.g. EITI investors are represented on the board alongside companies and governments. Investors that find the guidelines satisfactory may push companies that are not members of the body to join. They may also choose to engage with a set or subset of companies that are members of the industry body where they feel standards need to be raised with reference to a particularly area within the framework.

However, the voluntary nature of the sector frameworks can allow for large disparities between the level of transparency and implementation expected by civil society and that maintained by the industry body itself.

Table 36: Key extractives industry voluntary frameworks

	Full name	Investor relevance
ICMM	International Council on Metals and Mining	Mining sector social and environmental guidelines, investor outreach, social investment
EITI	Extractives Industry Transparency Initiative	Guidelines for government payments reporting, investors are a stakeholder group in the structure
IPIECA	International Petroleum Industry Environmental Conservation Association	Reference standards for social & environmental factors, social investments guide
"Voluntary Principles"	Voluntary Principles on Security and Human Rights	A framework for security issues which are increasingly material for investors

Source: Kepler Cheuvreux

Table 37: Recent individual cases in extractives sector filed with OECD National Contact Points

Title	Issue	Date filed	Status
Canada Tibet Committee vs. China Gold Int. Resources	Environmental, HR & disclosure issues China Gold Int.	29 January 2014	Filed
WWF vs SOCO	Oil exploration by SOCO in Virunga National Park DRC	7 October 2013	Pending
FIDH et al vs. Corriente Resources Inc/ CRCC-Tongguan Investment (Canada) Co	HR abuses at Mirador mining project in the Ecuadorian Amazon	25 July 2013	Filed
Crude Accountability et al. vs. British Gas/ ENI/ Chevron	Environmental, health & HR violations by KPO in Kazakhstan	6 June 2013	Filed
RAID vs. ENRC	Restricted water supply close to ENRC mine in DRC	13 May 2013	Pending
Amadiba Crisis Committee vs. MRC Ltd.	Human rights violations by mining agents. Amadiba, S. Africa	1 February 2013	Rejected
IAC & WDM vs. GCM Resources plc	Human rights violations at GCM's coalmine in Bangladesh	19 December 2012	Pending
Lok Shakti Abhiyan et al. vs POSCO/ ABP/ Government Pension Fund - Global	POSCO's involvement in HR and environmental impact in India	10 October 2012	Pending
SEW and Stroitel vs. Barclays/ Standard Chartered/ RBS/ Shell	Shell & 3 UK banks link with violations Sakhalin II complex	31 July 2012	Rejected
Communal landowners vs Excellon Resources	Excellon Resources' dispute with landowners in Mexico	28 May 2012	Rejected
ACIDH et al vs Compagnie Minière de Sud Katanga	Human rights violations at CMSK mine in the DRC	4 April 2012	Concluded
Miningwatch Canada et al vs Centerra Gold	Centerra Gold's HR & environmental violations in Mongolia	15 March 2012	Rejected
Amnesty International and Friends of the Earth vs Shell	Human Rights and Environmental violations by Shell Nigeria	30 December 2011	Withdrawn
Norwegian Climate Network et al vs Statoil	Relation Statoil's oil sands production and climate change	28 November 2011	Rejected
FOCO et al vs Barrick Gold	Environmental pollution at Barrick's gold mines in Argentina	9 June 2011	Pending
CEDHA vs. Xstrata Copper/ J-Power/ Usibelli Coal Mine	Xstrata's activities and impact on glaciers in Argentina	1 June 2011	Pending
Sherpa et al vs First Quantum Minerals/ Glencore	Tax Evasion by Glencore and First Quantum Mining in Zambia	12 April 2011	Concluded
MiningWatch Canada et al vs. Barrick Gold Corporation	Human rights violations at Barrick's Porgera JV Mine in PNG	1 March 2011	Pending
CooperAcción et al vs. Renco Group	Pollution at metallurgical complex in La Oroya, Peru	24 February 2011	Closed

Source: OECDWatch

Case study: GlencoreXstrata

We take GlencoreXstrata as an example of a company within the extractives sector that is at the crossroads of a variety of concerns aired by civil society and themes frequently referred to OECD national contact points. Within its sector, GlencoreXstrata is far from the only company encountering controversy, and we use it as an illustrative case as a large number of potential NGO concerns are embodied in its activities. The size, nature and footprint of operations will of course mean controversy is more easily attracted.

GlencoreXstrata is far from the only company in the sector with controversies…

In the time since the merger of Glencore and Xstrata, new sustainability policies have been implemented and disclosed with the most recent Sustainability Report highlighting initiatives across multiple CSR areas. Despite these definite steps in the right direction the company typifies several concerns of NGOs, local communities who use the NCP system.

…but both Glencore and Xstrata have been the subject of multiple NCP complaints

For many years, Glencore had faced a range of allegations from environmental damage, water rights, bribery and aggressive tax avoidance before its merger with Xstrata. Both companies had been the subject of complaints via NCPs, e.g. Glencore for tax avoidance and Xstrata for land rights.

A combination of factors suggest that the controversies may not be put to rest by the Glencore merger with Xstrata, the latter of which was more developed in some areas of its sustainability policies. For example, one area of hard law legislation that could have Glencore Xstrata in its cross hairs in the long term is EU country-by-country reporting regulation. A company like Glencore Xstrata would be under particular scrutiny for its corporate structure and the potential aggressive use of transfer pricing which allows companies to declare profits in lower-tax jurisdictions to lower their overall effective rate.

NGO Global Witness[vii] for example has specifically stated that, in its opinion, there was a risk of Glencore's involvement in corruption due to the way that large government stakes were sold in secret. We would add that as well as potential reputational risks, GlencoreXstrata shareholders are exposed to any regime change, given the fragile position of the DRC state, as a future government might decide to jeopardise, renegotiate or nullify any prior contracts perceived to be the result of corrupt agreements. Recent DRC political proposals have suggested the renegotiation of contracts. The human rights impacts of corruption are increasingly foregrounded by civil society – with specific

NGOs want more transparency on Glencore's activities in the DRC…

…going forward we think investors would benefit also

In relation to country-by-country reporting, Glencore already faces considerable demand for such data from issues in relation to allegations of aggressive tax avoidance. For example, the NGO "*Publish What You Pay*" maintains that over half of Glencore's subsidiaries are incorporated in tax havens[viii] Glencore International AG was the most opaque mining company in the survey, with 46% of its 46 subsidiaries incorporated in secrecy jurisdictions. Against the backdrop of tax havens coming under increasing pressure to tighten their regulation business structures and potentially reduced tax payments, we see a clear momentum for this theme, pushed by the media, regulators, civil society.

"This is relevant given information contained in Glencore's recent listing document which confirms that its effective tax rate for its 2010 USD234m tax bill, 'was 9.3% compared to 12.6% for 2009' on revenues of USD144.9bn and profits of USD4.1bn."

Country-by-country reporting may amplify scrutiny of Glencore's tax payments

Tax avoidance has been the subject of a complaint against Glencore and partner First Quantam using the NCP complaint mechanism (see below). We would identify it as an area where hard law changes are in their early stages and civil society show a number of growing campaigns. Alongside the accompanying extraordinary public and media interest further NCP complaints in this area seem probable.

The absence of a robust global whistle-blowing policy at GlencoreXstrata further exacerbates concerns that sustainability issues will not be picked up, or will be handled internally before such information is acted upon by the media and external agents where the repercussions will be more severe for investors.

A 2012 televised BBC documentary interviewed Glencore CEO in response to several allegations. Though credit worthy in eliciting a serious CEO level response to the questions posed the company nonetheless suffered continued negative press as a result of the coverage.

Table 38: Glencore and Xstrata legacy cases filed with OECD NCPs

Company	Theme	Country	Description	Year filed
Glencore	Tax evasion	Zambia	Allegation that Zambia-based Mopani Copper Mines plc. (joint owned with First Quantam) manipulated accounts to evade taxes	2011
	Forced evictions	Zambia	Case regarding jointly owned entity with First Quantum and forced evictions in Zambia	2001
Xstrata	Environmental Impact (glaciers)	Argentina	Impact on Argentinian glaciers	2011
	Health risks	N/A	Leaded petrol health risks	2011
	Forced evictions	Columbia	Columbian coal mine and displaced local communities	2007

Source: OECDWatch

Table 39: Soft law violation risks – factors of exposure for Glencore Xstrata

Factor	Notes on GlencoreXstrata
Disclosure	Predominance of statements in sustainability report rather than implementation metrics for policies. (Externally audited GRI A+ rating would not reduce soft law violation exposure in itself)
	Existence of CSR 2014 objectives is proof of progress – increasing transparency but also accountability
	Disclosure on industry & lobbying organisations is a positive first step, financial support amounts and policy positions would be a step forward
Self-declared accountability to soft law mechanisms (invoked in sustainability report)	• Human Rights Policy developed in accordance with Universal Declaration of Human Rights, ILO Core Conventions on Labour Standards, Equator Principles, UN Guiding Principles on Business and Human Rights. • Mention of "Free Prior Informed Consent" for indigenous peoples as endorsed by ICMM (International Council on Mining and Metals (joined May 2014)). • Working on application for admission to Plenary of Voluntary Principles on Security and Human Rights. • Kazak & Quebec Gold refineries accredited by London Bullion Market Association's Responsible Gold Programme *But not* mentioned except in glossary: OECD Guidelines for Multinationals (subject of prior complaints)
Controversies	RepRisk RRI Score of 65 (placing it in top ten companies in Europe for controversies & ESG risk exposure) Key areas include pollution, corruption, tax avoidance, labour, child rights, health & safety standards. Coverage in dedicated BBC documentary.
NGO engagement	Some positives below but far short of civil society expectations • Mention of funding for RustenBurg Food bank • Bread for All Swiss NGO and UK/ local partners invited to site visits • Partnerships with child sports Tanzania NGO Right to Play, South African Health NGO Re-Action! • Plans to "strengthen partnerships with NGOs further, including building strategic partnerships across the Glencore Xstrata Group"
Activism	Enormous NGO focus & campaigns against Corruption, Labour Standards, Commodities speculation, Environment and Tax Avoidance (Global Witness, Bread for All, SwissAid, Sherpa, Mining Watch, Berne Declaration, L'Entraide Missionnaire, CTPD, War On Want, PIPLinks, London Mining Network, Christian Aid, TJN, PublishWhatYouPay, Oxfam, FoE) Prior use of OECD NCP complaints against both Xstrata & Glencore
AGM	Numerous AGM questions & press coverage of responses concerning CSR areas - diversity, health & safety, remuneration, Columbian citizen voicing complaint on displaced communities
Whistle Blowing	Poor disclosure - internal email exists for reporting but no further info on anonymity, global implementation, access to external stakeholders, languages available, help & guidance, independence, usage and follow-up

Source: Kepler Cheuvreux

Case study: Rana Plaza outcomes

By taking the NGO campaigns with the highest amount of criticism generated we can see the presence of the retail sector as a central concern of civil society. We use the RRI indicator from RepRisk to list prominent campaigns. The campaign that has generated the most media attention is the Clean Clothes Campaign, and its focus on the Rana Plaza disaster (See page 53 for campaign rankings).

The single most visible civil society campaign in the last two years was centred on the Rana Plaza disaster

In 2013, the French NCP issued a comprehensive report on findings and recommendations for the supply chain post Rana Plaza. We believe this document can be of great use to engaged investors. The report commissioned by the French Ministry of Trade contains insights into the background of sector supply chain issues.

The French NCP document *Due Diligence in the Clothing & Textile Sector* (English translation released in February 2014) is a key piece of soft law that can be referenced in dialogues with companies in the retail sector and its supply chains. In our view the NCP observations can feed into the due diligence framework we outline in the last chapter of this report with extracted "Supply Chain Engagement Questions" for investors.

The report is available at the NCP's site: http://www.tresor.economie.gouv.fr/File/396748

Risk factors laid out

The NCP report urges an approach to look at the specifics of country-related risks (we would highlight for example the prevalence of building safety issues around multi-use properties in Bangladesh or hard-line military crackdowns on wage protests in Cambodia), sector risks (see below) and aggravating factors (e.g. contractual obligations that pit key economic requirements against broad CSR policies).

Table 40: Textile sector risks

	Sector risks could include:
1	Child labour in cotton fields and workshops,
2	Forced labour
3	Hidden labour
4	Non-compliance with the principle of decent wages,
5	Prohibition or restriction of trade union freedom and freedom of association,
6	Over-exploitation of workers,
7	Non-payment of overtime,
8	Endangering workers' health (use of banned chemicals in dyeing textiles)

Source: NCP France, Rana Plaza Report

Aggravating factors - avoiding conflicting economic and CSR clauses

One method of reducing the risk is also related specifically to ensuring that economic requirements that include punitive measures such as penalties for the delay or non-compliance of quantity or quality clauses do not directly conflict with the broad CSR issues of worker safety, living wages, union rights, the environment, etc.

Contracts, contractors and hidden subcontractors…

Buyers are potentially able to reduce the risk by not placing orders that amount to 30% of a single supplier's total capacity (thereby potentially overstretching them at peak periods). This also serves to avoid economic dependence harmful to both parties. However, the OECD Guidelines require the buyer to use its leverage to influence the behaviour of the suppliers, noting that where contracts may account for over 30% of capacity, influence would be significant, and therefore the ability to require non-use of harmful subcontracting could be greater. One solution suggested is having more evenly spaced regular delivery requirements throughout the year.

Table 41: Recommendations for multinational enterprises

1	Formalise ethical commitments and compliance with OECD and ILO international standards
2	Map the supply chain and identify risks
3	Implement risk management systems to prevent adverse impacts from arising
4	Control subcontracting in order to minimise risks
5	Promote sustainable and balanced business relationship between customer and supplier
6	Tighten the social, environmental and safety aspects of audits
7	Consult local stakeholders and encourage dialogue
8	Ensure respect for the workers' rights established by the ILO
9	Ensure that suppliers pay an adequate wage to satisfy the basic needs of workers and their families
10	Participation with all stakeholders in compensation and reparation for damage when a direct link is established

Source: OECD NCP France

Table 42: Proposals for multinational enterprises

1	Engage in joint improvement and monitoring activities with suppliers
2	Join in multi-stakeholder initiatives such as accession to an international framework agreement for the textile and clothing sector
3	Publish reliable and comparable information on due diligence measures, including information on social and environmental risk management systems
4	Train and assess buyers in the implications of ethical and sustainable supply
5	Raise consumer awareness of the conditions in which textile products are manufactured

Source: OECD NCP France

Collateral damage: minority shareholders

A turning point in soft law has been passed

Recent soft law cases suggest that minority shareholders have entered new territory. In our view, minority shareholders can and will be increasingly targeted for holding shares in companies alleged to have violated international norms. Critically, these “norms” are often not legal obligations for the corporates and investors targeted. The “soft law” mechanisms arising for example from the OECD Guidelines for Multinational Enterprises and the UN Guiding principles Business and Human rights. Both clearly state that minority shareholders are covered by their guidelines:

“The question is thus not whether the OECD Guidelines apply to the financial sector and minority shareholding but how they apply.” OECD National Contact Point, France

"Even though the UN Guiding Principles do not explicitly reference institutional investors, the application of the Guiding Principles to all enterprises regardless of sector is understood to also comprise all enterprises in the financial sector, including institutional investors...There is nothing in the text to indicate that their scope of application is limited to situations where institutional investors hold majority shareholdings.” UN Commission For Human Rights

Civil society and investors

With the normative frameworks increasingly important to civil society activism, it is not surprising that they are used more aggressively to target the financial sector. However, we notice an overall move particularly by larger NGOs to engage in dialogue and awareness-raising with the investment community. Many of the newer generation of actions taken will not be aggressive in nature and intentionally non-confrontational, with the objective of inclusion and cooperative influence:

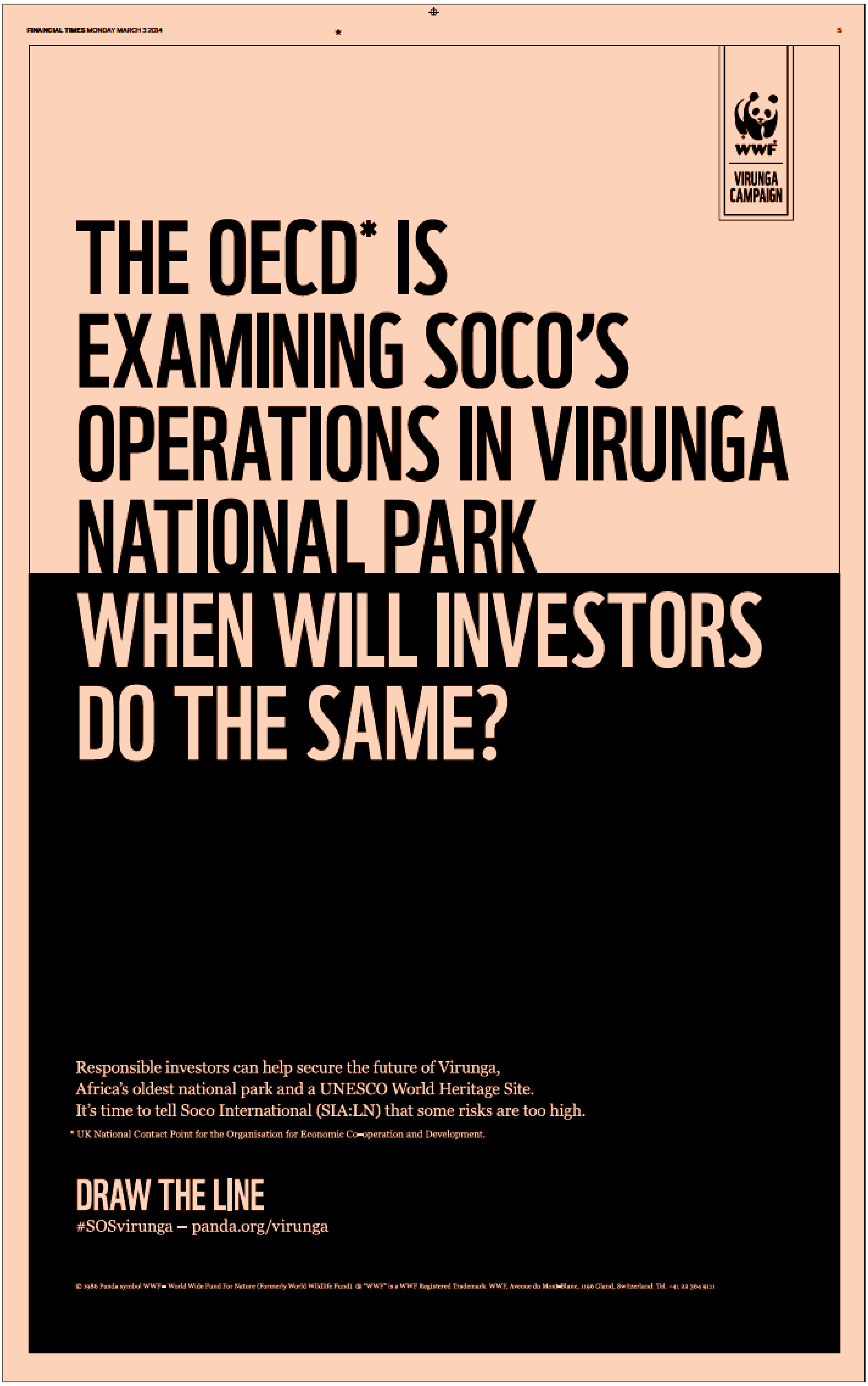
Table 43: NGO actions to influence financial sector

Action	Examples	Level of confrontation	Potential reputational impact on investors	Notes
Investor Guidance	ActionAid Tax Investor Guide	None	No	A tool to assist analysis of tax issues from social engagement viewpoint
Investor Outreach	Oxfam Round Tables with Investors	None	No	Investors informed and included as campaign stakeholders through non-confrontational approaches
Hiring of dedicated investor specialists	Greenpeace Recruitments	Variable according to approach but potentially High	No	Finance sector specialists and legal specialists increasingly central to campaigns (i.e. coal, air pollution)
Direct Activism against Investor	BankTrac, Facing Finance Campaigns	Potentially High	Yes	Also potential positive reputational impact
Direct Legal Action	Sherpa against Head of States for misappropriation of public assets	High	Yes	Litigation around assets acquired through corruption in Equatorial Guinea/ The former executive director of Société Générale local subsidiary has been heard by judges on fund transfer operations
Lobbying and Advocacy	Finance Watch and EC regulation	Variable (depends on whether public or not)	Yes	Lobbying, often secretive, but advocacy may involve simultaneous public campaign and regulatory engagement
Advertising Campaigns targeted at Responsible Investors	WWF & SOCO	Low if sector as a whole targeted but potential for escalation	Yes	Still relatively unusual, potential to be used increasingly
Use of Soft Law Grievance Mechanisms	Various NGOs use of OECD Mechanisms	Potentially high	Yes	Negative to positive depending on outcome/ negative in 2013 Norwegian NCP decision in the POSCO/ NBIM case

Source: Kepler Cheuvreux, Affectio Mutandi

Overleaf, we reproduce a full-page ad taken out in the *Financial Times* on 3 March 2014 by the NGO WWF in relation to its complaint against SOCO for exploration on a UNESCO-protected site in the DRC. The ad targets "responsible investors", but does not define them, and while the FT may mention prominent NGO campaigns, it is rare for an NGO to use the mainstream financial press to advertise its campaigns. We take this as an indicator of the leverage civil society believes the investor community has, and we think NGOs will continue to be more aware of the avenues available to them in targeting investors.

Chart 12: Valid tactics? Campaign advertising implicates "responsible investors"



Source: Financial Times 3 March 2014

Increasing sophistication of NGO campaigns tracking multiple asset classes

A number of NGOs track multiple asset class investments in companies they consider to be controversial. A long-running example that has had considerable success is the campaign by the Pax Christi NGO, which produces detailed reporting on not only companies that may have indirect involvement with cluster munitions manufacturing but also listings of investors and multiple asset classes including loans, convertible bonds and equity investments linked to those companies. Greenpeace has also been active in identifying banks they believe to be involved in controversial investments in, for example, palm oil companies or Russian oil & gas operators.

Table 44: NGO definitions of "investor": Pax Christi

We define investor as someone financially involved in a cluster munitions manufacturer. We consider any financial link to be an investment regardless of:

- The investor's importance for the cluster munitions producer;
- The investment's importance for the investor's portfolio;
- The contribution of cluster munitions production to the company's total turnover; or
- The cluster munitions producer's other activities.

Source: Pax Christi

Pax Christi's definition of an investor in the above table states that the normal hierarchy in the investment world (i.e. the size of the position, the revenue generated from the controversial activity, the potentially reduced ability to influence holdings in passive positions, etc.) will not relieve investors of their responsibility.

Table 45: NGO definitions of "investor": Pax Christi

Financial institutions should develop policies that exclude all financial links with companies involved in cluster munitions production. Because all investment facilitates this production, no exceptions should be made for third-party financial services, for funds that follow an index or for civilian project financing for a company also involved in cluster munitions. Policies should not be narrowed to refusing project financing for cluster munitions.

Source: Pax Christi

Divestment vs Engagement – Controversial Products vs Projects

Divestment is sometimes preferred for controversial products...

Although investors may not agree with such an absolute description, where controversial products are concerned, a complete or partial divestment is often the goal. If all current investors were to divest following such a campaign, the new sources of capital may not be subject to the same scrutiny, e.g. they could be from countries less amenable to civil society influence.

...whereas controversial projects may see demands for influence and engagement

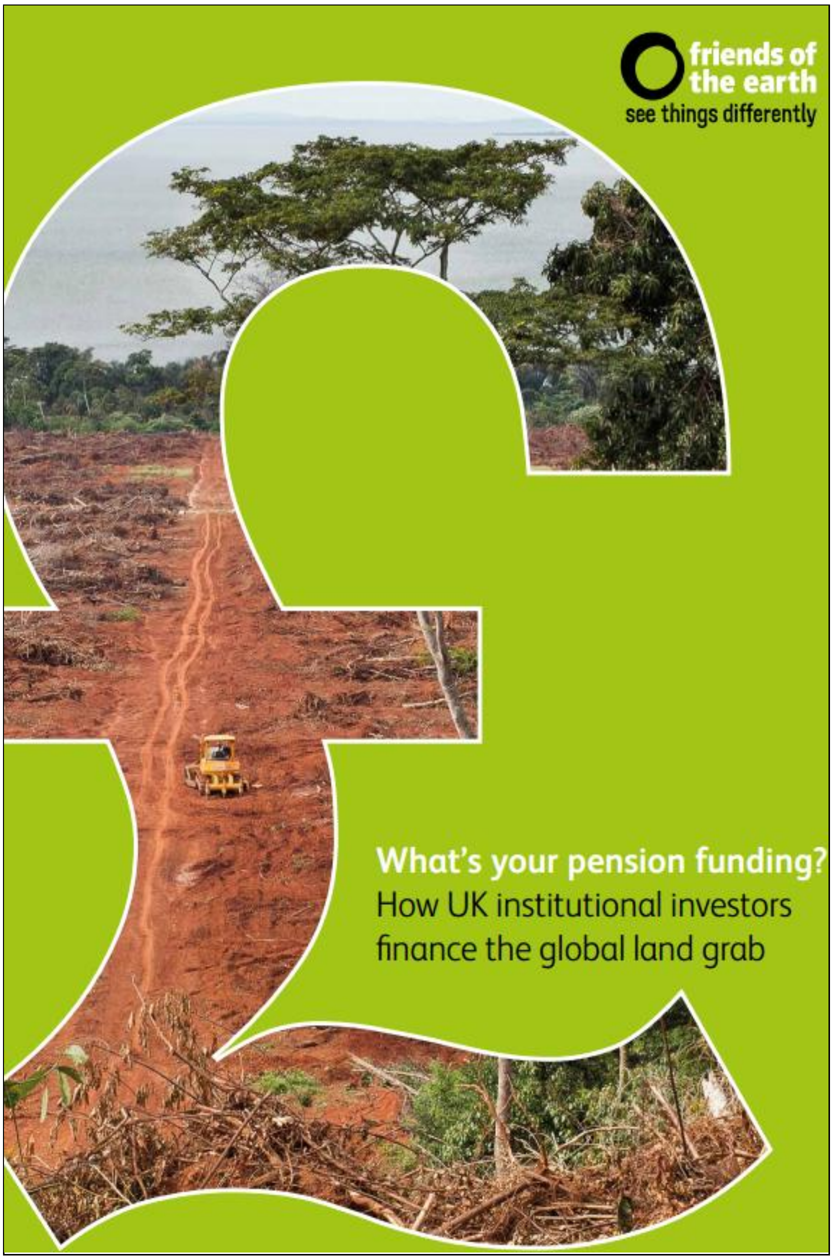
However, where a controversial project, rather than a product, is involved, divestment is often not the end game, as civil society and local communities would look to corporates and investors to assert their influence in order to ultimately improve conditions on the ground.

Table 46: NGOs know you better than you might think... asset class tracking becoming increasingly sophisticated

	Theme tracked	Equity	Bonds	Corporate loans	Project finance	Investment banking services
Pax Christi	Controversial armaments	x	x	x		
China IPE	Cement sector impacts	x	x			x
Facing Finance	Multiple ESG themes	x	x			
BankTrack	Coal sector impacts				x	
FoE	Palm oil, "Land Grabs"	x	x	x		
Greenpeace	Multiple environmental				x	

Source: Kepler Cheuvreux

Chart 13: Asset Owners can be targeted alongside Asset Managers



Source: Friends of the Earth UK

Along with asset managers, NGOs have also begun to aggregate asset owner data. One such example is the June 2014 report from Friends of the Earth, entitiled "What's your pension funding ?", centring on land grabs, which identifies UK pension funds and their holdings in companies it accuses of involvement in unethical land related acquisitions. The report includes basic pointers to potential investment risks and reputational impacts. The term Stranded Assets is also introduced and explained within the context of environmental degradation damaging the value of land significantly enough to trigger writedowns and writeoffs. Critically, the report points out that some soft law frameworks, (UNGC, PRI, Principles for Farmland Investment, World Bank Principles on Responsible Agricultural Investment, RSPO) *"are no guarantee that companies are not violating human rights or damaging the environment"* and calls for *"far greater due diligence, transparency and accountability"* from investors regarding land tenure. However, the UN Guiding Principles on Business and Human Rights and the UN Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests are mentioned as the two most relevant codes. The report is, in our view, a continued signal of the increasing sophistication of NGOs in targeting investors – here both asset managers and owners of both equity and bond holdings.

Asset owners can be targeted as well as asset managers

The report highlights the most relevant soft law frameworks…

… and those it believes fall short

The following is an extract from Chinese NGO the Institute of Public & Environmental Affairs, which summarises the thinking behind the inclusion of investors by civil society. It is even more pertinent coming from China, where we expect activism, still relatively contained by the state (which like a number of emerging markets may view some NGO activity as political opposition), to increase in coming years.

"We think energy intensive companies are not currently sensitive to consumer pressure.

Nevertheless, they are capital-oriented and sensitive to pressure from their investors. The "Green Stocks" project focuses on listed companies with high-energy consumption and heavy-pollution profiles, and their investors in the financial capital market. By focusing attention and pushing for actions from various stakeholders, "Green Stocks" aims to push investors to make green investment commitments and drive green production, thus pushing manufacturers to reduce their pollution."

In our view, the overall size of the position is not the driving factor in choosing investor targets for activism. While financial logic might follow the lines of "higher holding = more influence", NGO campaigns will often rest on the leverage available, via the actual SRI commitments of the investor (where the potential reputational impact will be higher), its visibility and, where relevant, the characteristics of the ultimate beneficiaries of the fund.

For NGOs, size doesn't matter when it comes to investment stake

Further evidence of the trend to incorporate the financial sector into civil society activism can be seen in the entrance of this priority in the Institute for Business and Human Rights' list of the most important issues for 2014.

Table 47: Financial sector approaches to human rights risk enters top-ten issue list for 2014

	(Not in order of importance)
1	Responding to growing pressure on tech companies to respect privacy rights in an age of mass surveillance
2	Promoting corporate respect for human rights as part of post-2015 international development goals and a new global climate change framework
3	Expanding collaboration between human rights advocates and movements seeking tax justice and revenue transparency
4	Ensuring non-discrimination of Lesbian Gay Bisexual and Transgender (LGBT) individuals
5	Improving the legitimacy and effectiveness of multi-stakeholder initiatives in the human rights field
6	Strengthening efforts to end human trafficking and forced labour in global supply chains
7	Increasing scrutiny of human rights due diligence efforts by companies from emerging economies
8	Making living wages and youth employment opportunities part of the business and human rights agenda
9	Finding common ground on human rights due diligence for all involved in the preparation of major sporting events
10	***Developing tools and approaches for the financial sector to understand and address human rights risks***

Source: Institute of Business and Human Rights

Below we list cases where financial institutions have been drawn in to the OECD complaint mechanism. Human rights are almost always a central issue and emerging-market countries are where alleged violations take place. The range of NGOs involved varies from smaller local players to well-known international networks.

Table 48: Sample civil society cases relevant to investors

	Issue	Company targeted	Financial Institution	Theme	Year
OECD NCP cases with financial institutions					
1	POSCO's involvement in human rights and environmental impact in India	POSCO	ABP/ NBIM	Human rights, environment	2012
2	Shell's and three UK banks' link with violations at Sakhalin II complex (Russia)	Shell	Barclays, RBS, Standard Chartered	Human rights, environment, health & safety	2012
3	Banco del Trabajo's labour rights abuses in Peru		Banco del Trabajo	Human rights, labour	2007
4	ANZ Bank Papua New Guinea forestry	Various	ANZ	Human rights, environment	2006
5	Botnia's Orion pulp mill project in Uruguay	Various	Nordea	Human rights	2006
6	Belgian companies illegal resource exploitation in DRC	Various	Belgolaise	Human rights, conflict minerals	2004
7	BTC oil pipeline in Azerbaijan, Georgia and Turkey	BP	ING, Dexia, KBC	Human rights, environment	2004
8	West LB financing of oil pipeline in Ecuador	Various	West LB	Human rights, environment	2003
Non-OECD complaint examples involving investors					
9	Palm oil impacts	Sinar Mas Group	HSBC	Environment	2010
10	Israeli settlements in Palestine	Corporates including Alstom Veolia Cemex/ Vitens Dexia Israel Elbit/ G4S Sodastream	Bank Hapoalim Bank Leumi Israel Discount Mizrahi Tefahot FIBI	Human rights	2013/ Ongoing
11	Sugar plantation loan	Phnom Phen Sugar	ANZ	Human rights, labour	2014

Source: Kepler Cheuvreux, OECDWatch

The "sphere of influence" applied to investors

Table 49: Extending the "sphere of influence" - a paradigm shift for investors?

Influencer with responsibility	←→	Source of controversy
Retailers		Suppliers
Parent company		Partly owned subsidiaries
Investors		*Minority shareholdings*

Source: Kepler Cheuvreux

Central to this idea of the responsibility of the minority shareholder is the ability of investors to influence the companies held in their portfolios.

This concept of this "sphere of influence" fundamentally shakes up the hierarchy of norms when applied to investors, who have traditionally considered themselves to be on the edges of the sphere, if within it at all.

Corporates used to argue they were not accountable for certain suppliers' actions

The key here is the cohesive responsibility within the chain from investor to company to supplier. Until a few years ago, it was common practice for large corporates to claim impunity for controversies affecting their suppliers. We have seen an increasing non-acceptance of this argument by multiple stakeholders. In our view we are witnessing a similar effort to enlarge the sphere of investor responsibility via soft law and civil society. In particular the relationship between equity investors and their minority shareholdings is becoming a testing ground via the OECD Guidelines complaint mechanism.

Companies and investors in the crosshairs of grievance mechanisms

NGOs increasingly target not only companies they see as violating international norms but also investors in those companies - often within the same campaigns and grievance processes (where used). Reasons for this include increased leverage on companies to achieve activist goals for NGO campaigns. However, if the company targeted is operating in territories where environmental and social accountability structures are poorly governed – which is usually the case - investors are seen as being able to have a key influence. The rise of the use of sustainable branding and the visibility of sustainable funds also provide grounds for those within civil society who seek to further the application of sustainability commitments by both corporates and investors to their areas of activism.

Engagement implies influence: the UN Commission for Human Rights

Engagement seen as evidence of a "business relationship"

One of the key bodies in soft law is the UN – in pinpointing investor responsibility it notes via the Commission for Human Rights that engagement is seen as evidence of one of the most important factors in soft law mechanisms: "the business relationship". Investment funds themselves can see the process of engagement as being one where influence is being established or strengthened.

"It should be added that it is also common practice among some institutional investors to engage with the companies in which they invest to promote good corporate governance as part of a strategy to safeguard investments. Such engagement suggests an implicit recognition of a business relationship between the entities concerned." UN Commission for Human Rights

Table 50: What makes SRI investors a target?

	Perceptions, inconsistencies, opportunism and holding "sustainable" investing to account
1	Holding a controversial company (according to NGO campaign or media coverage)
2	"Partial" Environmental or Social Investment Policies excluding key themes
3	A company or its project excluded through Equator Principles but held in funds
4	Investments that conflict with internal CSR policies (i.e. environmental policies, forestry)?
5	Existence of external complaint mechanisms applicable to investor
6	Clear evidence of legal breaches (rare)
7	Lack of Screening leading to investment in company with pre-existing controversies
8	Insufficient Engagement with Company after new breaches/ controversy discovered
9	Perceived lack of transparency/effectiveness of SRI process if controversial holdings kept in fund without comment
10	Non-involvement with soft law mechanisms and civil society requests
11	Civil society's willingness to test sustainability claims and methodologies & push them further
12	Perceptions of a "hands off" approach through non reactivity to ongoing controversy

Source: Kepler Cheuvreux, Affectio Mutandi

PRI signatories should be more concerned by the phenomenon of increased liability in all its forms

If we take a current snapshot, those in the financial sector who have displayed SRI credentials are the most exposed to challenges based on violations of sustainability principles, for the simple reason that challengers have more leverage in their claims, and a solid basis upon which to assert their claim of violation – not just of an international norm but also potentially of an internal ESG investment process or CSR policy.

PRI signatories are therefore very much concerned, and certainly those institutions that have expressing commitments in sustainability and human rights such as the Thun Group of Banks (see below for profile) or those that have signed the Equator Principles can expect at least greater scrutiny of their processes if challenges arise, particularly if they offer dedicated SRI products. However, funds with less visible or no SRI branding are not necessarily off the hook; there is nothing to stop activism against them.

As we are highlighting investment processes, we would expect the actively managed funds to be the target. However challenges that call into question an SRI investment commitment may not differentiate between passive holdings and active ones.

With regards to SRI funds, a large number are packaged and marketed to retail investors globally. In our view, the presence of retail investors can only increase overall visibility of the fund, and the potential for it to be considered a more valid target based on "public interest" and the impact of lower investor sophistication. It goes without saying that the mainstream non-financial media would take a greater interest in issues or allegations surrounding a fund marketed in the retail segment.

Table 51: Thun Group of Banks (human rights): civil society may push for consistency across voluntary principles

	PRI	Equator Principles	Wolfsberg Group (AML)	UNGC	SRI AUM FY 2012	SRI AUM FY 2013
Barclays		X	X	X	Non disclosed	Non disclosed
Credit Suisse	X	X	X	X	5,263m CHF	1280m CHF
UBS	X		X	X	254 bn CHF	576 bn CHF
Unicredit	2012	X		X	1,160m EUR	Non disclosed
BBVA	X			X	848m EUR	3,617m EUR
ING Group	X	X		X	3,883m EUR	4,412m EUR
RBS Group				X	Non disclosed	Non disclosed

Source: Bloomberg, Wolfsberg

Are norms consistently applied by civil society?

SRI investors find the logic of civil society activism is not always in sync with the realities of global investment

We note several inconsistencies in the approach of NGOs in using soft law grievance process mechanisms against investors in controversial companies:

- Targeted investors are not the largest holders of the company.
- Investments may contain substantial passive holdings.
- Companies targeted may even be present in numerous Sustainability Indices (DJSI, FTSE4GOOD, etc.).
- Investors who have begun to integrate ESG or SRI funds and have concrete actions find themselves targeted rather than funds (the majority) where no SRI element exists at all.

These inconsistencies, among others, should be identified not only as sources of risks but also as relevant markers for investors to concentrate their efforts.

Towards a new P/E: price-to-ethics

One area we think is rife for systematic integration into investment methodologies is the use of indicators that leverage and influence operational activity and decision making based on sustainable outcomes.

The integration of sustainability factors related to an ethical supply chain is integral for example in any due diligence practice. Investors pushing for such an approach, where metrics and incentives are integrated into decision-making, stand a good chance of being effective in the process of monitoring and influencing corporates they hold. We think it key that such metrics are not just about transparency (i.e. rating the volume of information disclosed). Without tangible, verifiable (i.e. externally audited) results on the implementations and the incidents that have occurred, policy information can be insufficient if not completely misleading, and even add liability.

Compliance costs for the financial sector are an example of this. After the recent systematic application of penalties within the sector (100bn USD since 2008), increased compliance costs extending into recruitment, systems as well as for process and reorganisations have become commonplace. Although largely the product of regulatory demands (post-hoc rather than preventatively), mainstream investors have seen such reforms and additional transparency as reflecting a business need in the current operational environment.

As with a variety of ESG themes, both shareholder value and CSR contribution will benefit from a proactive approach to understanding the long-term shareholder benefits of such costs.

Legislation, such as India's proposal (under the India Companies Act 2013) to require comply-or-explain transparency from larger companies and to allocate 2% of average net profits to broad, but localised, CSR and regional economic development goals is evidence that governments are increasingly looking to encourage such thinking (for a more complete list see the table of recent transparency regulations for ESG-specific regulation).

Rana Plaza - increasing pressure on investors

The French NCP report regarding Rana Plaza and due diligence in the textiles sector is a new key piece of soft law with clear elements of guidance regarding the due diligence that investors may invoke in engagements with corporates, where both investor reputation and shareholder value are at risk. The potential incorporation of a Price/Ethics ratio in a supplier management process highlighted above is a strong signal that buyers take into account the need to balance economic imperatives with clearly increasing social, ethical and environmental risks.

We believe this applies not just to the garment sector but is pertinent for supply chain engagement in general.

The objective of a Price/ Ethics ratio and related metrics is to balance costs with CSR related risks. The ethics part of this ratio can be a result of a scoring system – i.e. poor transparency around supplier safety leading to a low score or automatic exclusion despite a favourable pure cost or price outcome. A central engagement question (see page 88) is the following.

An example of the operational impact of Price/ Ethics: positively influencing supplier selection and therefore risk management according to ESG factors

When rating the pool of suppliers, are buyers encouraged via a system of rewards and penalties applied to their purchasing costs, to place their orders with suppliers who offer the best quality price/ethics ratios?

At its basic this implies that cost cannot be the only factor in this area of operation around supplier selection. Though clearly it cannot be ignored either it must be balanced with ethical considerations. Ignoring these increasingly has a cost, even though they may not be easily quantified - especially by external stakeholders.

Fiduciary duty: are definitions changing?

The exercise of fiduciary duty continues to be the subject of debate. Following the 2012 Kay Report on "UK Markets and Long Term Decision Making" and the official government response[ix] to it - the Law Commission will shortly publish recommendations for "Fiduciary Duties of Investment Intermediaries". Together with the Stewardship Code[x] a body of soft law has emerged in UK pushing longer term investment practices and looks set to maintain its pertinence particularly within SRI.

Other countries which have launched governance based soft law frameworks include South Africa (CRISA), Switzerland, Italy, Netherlands (EUMEDION) and Canada. Around specific areas we also note ICGN (International Corporate Governance Network) and EFAMA (European Fund Management Association) guidelines.

Globally the concept of limited liability for minority shareholders for their holdings has been less subject to a change in fundamental beliefs. The extent of liability that a minority investor has – clearly drives some of decision making (read short termism) of the global financial markets but is still firmly entrenched even in longer term and responsible investment thinking.

The principle of limited liability is being challenged

Though currently the avenues for holding an equity investor legally liable for any controversies arising in its minority holdings are highly limited we think it's worth looking at the recent use of the OECD NCP mechanisms against minority shareholders as a manifestation of what future liability mechanisms might look like – in the shorter term where civil society may push further.

Given the parallels we drew in this study of NGO activism starting on a very isolated journey - void of hard law support but instrumental in constructing soft law mechanisms, we don't think imagining a future change in investment thinking around increased accountability for minority holdings is an outrageous proposition. This is particularly so if we regard comparable changes in the corporate world (which has clearly gone slightly further down this road) around supplier responsibility.

We believe the same due diligence around non-financial factors that corporations are increasingly requested to incorporate and disclose by stakeholders (and more recently regulators in some areas) will be increasingly demanded of investors. At the forefront of this trend, of course, is sustainable investing. Below - we review some of the legal pointers and facets around ESG and due diligence that could integrate into increased investor responsibility. These are amplified around the continued Fiduciary Duty debate.

Converging common law and continental law trends

Given the internationalisation of their business, financial institutions must be able to combine a variety of sources of law, in particular common law and what we refer to as the continental law (or Romano-Germanic law). The specificities of common law, in particular fiduciary duties, and those issuing from continental law, are the raw material available for the identification and design of appropriate due diligence measures.

There is a gradual convergence of approaches illustrated in particular by a broad interpretation of the fundamental principles governing the activities of financial institutions.

In the common law universe, it is increasingly recognised that in the exercise of their fiduciary duties, trustees should integrate ESG dimensions.

Lord McKenzie made the following statement during an official debate on the Pension Bill 2008.

"*There is no reason in law why trustee cannot consider social and moral criteria in addition to their usual criteria of financial results, security and diversification. This applies to trustees of all pension funds. It is an obligation on pension fund trustees not simply a right or option to state in their statement of investment Principles what the fund's guidelines are on responsible investment and to what extent social, environmental or ethical consideration are taken into account*".

(In Fiduciary responsibility, Legal and practical aspects of integrating ESG issues into institutional investment, a follow up to the AMWG's 2005 'Freshfields Report', UNEPFI July 2009, p.15)

French marketed funds required to state whether ESG criteria are integrated

In continental law, various professional duties binding financial actors, and namely duty of care (*devoir de vigilance*) are converging in the same direction. In French case law, the pivotal duty to consider the client's interest is moving towards also taking into consideration ESG issues in investment decisions. This trend is confirmed by the recent transparency mechanism (comply or explain) requiring asset managers to comment on whether they have included ESG factors in their funds' investment strategies or not (Art 533_22-1 of French Monetary and Financial code)

The potential for challenges directed at asset managers is a push factor towards legal challenges and further potential regulatory considerations. In this respect, the EU AIFM and UCITS directives should also be mentioned as sources of further due diligence and transparency requirements. In the UK the Stewardship Code also requires broad transparency from investors on how they will handle certain fiduciary responsibilities.

We reference the pivotal work of the Freshfields report published in 2009 entitled *Fiduciary II*. In laying the theoretical foundation in hard law for the necessity to consider ESG, Paul Watchman states the following in this report:

"*In tendering for an investment mandate, it would be expected that the investment consultant or asset manager would raise ESG considerations as an issue to be taken into account and discussed with the client even if the pension fund had no specified ESG considerations as material to the tender. If the investment consultant or asset manager fails to do so, there is a very real risk that they will be sued for negligence on the ground that they failed to discharge their Professional duty of care to the client by failing to raise and take into account ESG considerations.*" (ibid., p.16).

Indeed a number of legal concepts could have ramifications on fiduciary duty in relation to SRI:

Table 52: Potential SRI investor liabilities around fiduciary duty

False claims	Public statements on sustainability and CSR "branding" and / or SRI funds can be a target for activists, local communities, public consumer protection agencies and charitable associations or the media to search either for weak points of investment context or to launch challenges against misleading CSR claims – even more so if advertised. For financial products presence of retail or less sophisticated investors/clients magnifies risk.
Reputation risk	The element of "trust" more central to Sustainable Investing compared to mainstream. SRI therefore more vulnerable to any claims undermining the credibility of sustainability processes within the investment methodology (see section "How central is reputation to fiduciary duty?")
Negligence	The Freshfields report, the key work in this area, states clearly that not employing sustainability criteria may leave the fund manager open to claims of negligence. This is also a potential legal avenue in continental law in case of breach of professional duties (diligence, care, information, alert, etc.)
Breach of contract	Where a contract with sustainability clauses exists - clearly the risk of legal challenge is heightened - particularly if an event factor causes significant loss or damages reputation

Source: Affectio Mutandi

The UK Law Commission issued a consultative paper entitled "Fiduciary Duties of Investment Intermediaries" in October 2013. Though the approach of the paper allows for the multifaceted complexity of the definitions it does make one statement which is promising before the full paper is published in June 2014;

"Given the evidence that ESG factors can lead to better returns in the long run, the answer is clearly that pension trustees may use wider factors. We hope that we can finally remove this misconception."[xi]

We are also seeing, in relation to specific themes such as climate change, that the fiduciary position of both corporates and investors is being explicitly pushed:

From tax avoidance to climate change accepted notions of fiduciary duty are slowly being challenged

Tax Justice Network in conjunction with law firm Farrer & Co[xii] published a legal opinion that no duty exists under English law for UK Company Directors to minimise tax payments on behalf of shareholders and in fact good arguments exist for the reverse (i.e. in the Companies Act 2006 s172 - see page 77):

"The proposition that there might be a strictly "fiduciary" duty to avoid tax is wholly misconceived"

Furthermore in terms of investors and obligations to engage against climate change the United Nations is clear on fiduciary aspects:

"Institutional investors who ignore the risk face being increasingly seen as blatantly in breach of their fiduciary duty to their beneficial owners –men and women who have worked hard all their lives to put away something for their retirement and for their children."

"Universal owner" concept increasingly invoked for larger pension funds

The above extract is from a 2014 statement by Christiana Figueres at the UN Investor Summit on Climate Risk. Where an issue such as climate change with long-term environmental, social and shareholder value damage is increasingly visible, we see an increasing invocation of the "universal owner" concept. This is particularly pertinent for larger pension funds, where longer-term exposure to negative externalities, which the certain investments clearly contribute to. These may not only affect the value of the fund itself but also entail questions about the fund's long-term responsibility to its ultimate beneficiaries. Engagement is even more central in such cases where divestment alone would be insufficient.

ESG integration, fiduciary duty and materiality

The most common approach to ESG integration is that based on concerns of materiality (in the absence of specific clauses contracting ESG considerations): with the resulting thinking being that *where ESG concerns are material they should be integrated as part of fiduciary duty*. As a growing number of ESG issues become visibly more material, we would expect an increasing requirement for the integration of them.

As part of the growing body of research (including our own) we note factors such as settlements, operational disruption, drops in intangible value, legal fees, the difficulty of retaining and attracting talent, business model impacts, increased compliance costs, supply chain revamps, reactive restructuring, cancellation of contracts, limitations on multilateral and bilateral agency financing and government contract debarment as examples of the plethora of material impacts on share price that have emerged as a result of ESG issues and in particular violations. However, even in the absence of an ESG mandate and perceived materiality of ESG factors, we would not equate this with the absence of risk around ESG factors for the investor.

Are your dividends the proceeds of crime?

Outside the area of Fiduciary duty, other areas of regulatory and enforcement innovation remain. In the following landmark case we note the increased liability for a parent as a direct result of a subsidiary's behaviour based on proven criminal conduct. Investors have long seen dividend cuts as a result of poor ESG risk management however a recent case in the UK required a parent company investor to actually repay dividends retrospectively. We note also that the case triggered statements on the responsibility (if not the direct liability) of institutional investors. Evidence of regulatory precedent to extend responsibility for those benefiting financially in extreme cases (i.e. where criminal behaviour proven) is apparent in this case, even if minority shareholders of listed companies are not the target.

UK company Maybey & Johnston was found guilty in September 2009 of breaching UN "Oil-for-Food" sanctions and paying bribes of GBP831,878 for contracts worth GBP44.4m. The company was penalised GBP6.6m, with individuals fined for breach of UN sanctions.

Mabey Engineering Holding agreed to repay a GBP131,201 dividend received from Mabey & Johnson for infrastructure construction activity in Iraq. Two former executives received jail terms.

Richard Alderman formerly of the UK Serious Fraud Office, stated in 2012: *"…shareholders and investors in companies are obliged to satisfy themselves with the business practices of the companies they invest in. This is very important and we cannot emphasise it enough. It is particularly so for institutional investors who have the knowledge and expertise to do it. The SFO intends to use the civil recovery process to pursue investors who have benefited from illegal activity. Where issues arise, we will be much less sympathetic to institutional investors whose due diligence has been lax in this respect."*

At the time of writing French bank BNP Paribas – is expected to settle with US regulators for sanctions violations for several billion dollars. Of note is that analysts have already factored in significant dividend cuts as a direct result of the potential penalties. Furthermore a recent criminal settlement by Credit Suisse in the US around aiding clients to avoid US taxes has set the precedent for criminal pleas. Though the implications for the future are not yet fully clear – criminal acknowledgment of guilt may necessitate specific waivers from relevant authorities in order to be allowed to continued access to regulated and licensed operations. BNP Paribas is allegedly being also pushed toward a US criminal plea.

Extraterritoriality

By default, global corporates are held accountable globally...

With respect to the OECD Guidelines, there is an element of de facto extra territoriality in their application, even as voluntary guidelines with non-binding judgements by national contact points (NCPs). However, where human rights hard law enforceability is concerned, the most recent landmark judgement concerning extra territoriality was not favourable. The case of Kiobel in the US concerning alleged violations of human rights by Shell in the Niger Delta was a key judgement.

Human rights lag behind other areas, such as legal enforcement of corporate corruption when applying extraterritoriality

In 2013, the US courts ruled fundamentally that the links with the US were not significant enough for that country to pass a judgement in this case. In the meantime in 2013 the Paris Court of Appeal admitted the competency of French jurisdiction in a case concerning the violation of Congolese labour law (cf. Table 11 – Comilog case)

There remains a large discrepancy between the way that human rights violations involving companies is enforced using extraterritorial laws compared to other infractions with clear social impacts. We have seen in corruption settlements involving global corporations that the threshold of connection with the US may not be central: i.e. US bank accounts used for corruption by a European company in the Middle East or South America may be all it takes for US courts to intervene as long as there is some form of leverage against the company – e.g. a US sales, capital markets, supplier or employee presence. Similarly, in the case of sanctions violations under US law, extraterritoriality has been readily applied to European banks entering into prohibited transactions with Iran, Cuba, Burma and Sudan, for example.

Responsible investors: an easy target?

Until now the two institutions referenced in NCP specific instances APG and NBIM have had a strong presence within the SRI community. The leverage and visibility of their brands has undoubtedly been a pointer for civil society to target them. However we believe any fund could be targeted.

This would mean both less visible SRI funds and any kind of non SRI funds could readily be brought into soft law complaint processes. If we look at the challenges brought against corporates for example - "mainstream" corporations have frequently been in the crosshairs both to challenge any CSR related claims and for violations in the absence of them.

Does reputation risk's materiality make it core to fiduciary duty?

Until now, cases of "green washing" or false sustainability claims, either through the courts or soft law mechanisms, have been limited almost completely to corporates rather than investors. Notable cases include Nike around its fair labour claims (a similar case involving Samsung's supply chain in China is pending in France) and Toyota, which was convicted of "green washing" in France in 2012.

Within laws concerning corporates we see specific reference to the responsibility of board members/ executives upholding reputation. For example, the reference in the UK Companies Act 2006, Section 172 to "the desirability of the company maintaining a reputation for high standards of business conduct".

Table 53: Company reputation explicitly identified as a director responsibility in the UK

	UK Companies Act 2006: director responsibilities
S171	To act within their powers
S172	To promote the success of the company by considering:
1	- the long term consequences of decisions
2	- the interests of employees
3	- the need to foster the company's business relationships with suppliers, customers and others
4	- the impact on the community and the environment
5	**- the desire to maintain a reputation for high standards of business conduct**
6	- the need to act fairly as between members
S173	To exercise independent judgement
S174	To exercise reasonable care, skill and diligence
S175	To avoid conflicts of interest
S176	Not to accept benefits from third parties
S177	To declare an interest in a proposed transaction with the company

Source: UK Companies Act 2006

(In regulatory terms the debate around fiduciary duty for corporates has moved forward faster than that for investors)

With reference to SRI funds the "specific instances" or complaints that arose within the National Contact Points for the POSCO cases with APG and NBIM (see case study on page 54), there was an element of civil society looking to test the sustainability claims of both companies. Recent calls for the competition and consumer French authority (DGCCRF) to investigate the respect of banks' CSR commitments also illustrate a new scrutiny of sustainability policies generating emerging risks.

Reputational risk is gradually entering into the category of operational risks being taken into account by financial institutions. For example, a recent study by ORSE (a French body promoting sustainable business practice) highlights how the Basel 2 framework can be enriched through references to indicators from ISO 26000 and EFFAS *(How to integrate ESG risks to devices operational risk management in the financial sector standards, ORSE June 2012[xiii]).*

Too often forgotten: reputational damage can affect ROI...

Gradually it is being recognised that such reputational damage, due to pressure from stakeholders, can delay infrastructure projects and ultimately affect the expected return on investment.

Accordingly, reputational risk occupies a central place for SRI investors, irrespective of the legal system in which they operate. However, we can begin to qualify the level of risk considering the following:

Table 54: From reputational risk to legal risk in SRI

Reputation	The loss of reputation can be a major concern for those throughout the SRI investment chain
Inclusion of specific contractual obligation is possible	Investors may want to contractualise a clause regarding reputational risk in order to preserve their own reputation and that of the vehicle they finance, and assign an objective of this kind to their fund managers. This is then a terrain for which the *contractual* liability of asset managers may be sought.
However no legal duty to preserve reputation	There is however no specific duty of managers (i.e. directors of companies or fund managers) causing them to preserve the reputation of their constituents and vehicles managed in corporate law or in financial regulations, whether in France or the US, to take two examples.
Burden of proof is problematic	While preserving reputation in these terms can be considered a legitimate concern of diligent directors or asset managers, proving that this very general duty has been breached may be difficult to establish for the disgruntled investor.

Source: Stefan Alamovitch

One complication would apply to credit investors where specific obligations of "non-interference" (i.e. with client and potentially the use of funds) exist. Avenues of engagement might necessarily be more limited than those of the equity investor in such cases.

Shareholders largely foot the bill for corporate misdemeanours

A common complaint, particularly from mainstream investors is that shareholders too directly and disproportionally pay for any regulatory penalties. We would extend this even further - shareholders pay for corporate's ethical misjudgements long before regulatory cases are finalized and in myriad ways outside the penalties which are the tip of the iceberg (See Table 9). When reputational impacts are factored in the effects can also last long after legal settlements. The response commonly suggested is that shareholders themselves may be to blame for not holding companies to account better around these areas: greater engagement would send a much clearer signal that this is a concern and the focus on short term financial objectives actively clouds addressing such factors.

Case study – POSCO – investor challenges

Table 55: POSCO Case and NBIM, APG

Grievance	Corporate targeted - POSCO: alleged lack of consultation with stakeholders and people affected by a project of mine and mill steel production in the State of Odisha in India Investors targeted APG, APB & NBIM: NGO Complainants consider that the analysis and management of social and environmental impact of the project by POSCO India Private Limited is not in accordance with the Guidelines. In particular a due diligence & impact investigation was called for.
NGOs	KTNC Watch - South Korea Lok Shakti Abhiyan - India Global Green Fair Alliance - Netherlands Forum for environment and Development - Norway
Business relationship	<1% for both NBIM & APG entities
Key outcomes	The case that established judgements from the NCP and UNCHR that minority shareholders are covered under OECD guidelines for MNEs Complexity and enormity of fund size not seen as a practical barrier by civil society or OECD NCP Perceived "lack of transparency" equated to lack of cooperation with NCP in conciliation process and factored in final statement judgements A decision via a final statement reached even without agreement from parties Transparency regarding overall pre-existing systems (i.e. due diligence + engagement prioritisation) in place count significantly towards OECD MNE compliance

Source: Affectio Mutandi / Kepler Cheuvreux

POSCO case: In October 2012, four geographically disparate NGOs (see table above) submitted a complaint to the NCPs of Norway, the Netherlands and South Korea, alleging lack of consultation with stakeholders and people affected by a planned mine and steel production facility in the state of Odisha, India. Without a proper consultation process, the complainants consider that the analysis and management of social and environmental impacts of the project by POSCO India Private Limited do not comply with the guidelines.

The Norwegian NCP published a final statement on the responsibility of the NBIM which had a small minority share (0.94 %) of the South Korean company POSCO (Pohang Iron and Steel Company) and the Dutch NCP on its findings and interactions with APG, which also had a small holding in POSCO.

The conclusions of the Norwegian NCP were that breaches of duty of reasonable care could be claimed on the basis that NBIM failed to take appropriate measures to prevent or mitigate damage to human rights in the context of its investment in POSCO. However, this was partly based on a lack of documentation received by the Norwegian NCP in its investigation process. One specific outcome was that the Norwegian NCP indicated that by restricting its attention to "children's rights", NBIM unduly limited its sphere of influence and neglected its potential impacts on other fundamental rights, in particular that of local communities to be consulted in advance of project activity affecting them.

The Norwegian NCP was critical of an alleged lack of strategy and appropriate internal processes to identify and react to the risk of damage to broader human rights, although it may remain the case that full evidence was not made visible via the NCP mediation process due to a reluctance from NBIM to reply to the NCP requests for information at the level of detail demanded.

Beyond confirming the application of the principles for the financial sector, the case raised questions over the various steps to be followed by any company within the framework of due diligence. The NCP's conclusions stipulated that the preliminary assessment of the actual and potential impacts on human rights should be broad, and the results should be used by the investor to exercise his/her influence on the partner, followed by response monitoring and the communication of information pertinent to due diligence and engagement and any resulting investment decision about the case.

The NCPs final statement in the POSCO case highlights the importance of extra-financial analysis in the identification, prioritisation, assessment and management of the environmental and social risks a company is exposed to.

We note also that the size of the fund is significant and the practical day-to-day work of monitoring the vast number of holdings is clearly more complex for NBIM than potentially any other fund that has incorporated ESG factors. In terms of the remit of the fund, however, civil society argues that it be held and managed on behalf of the Norwegian population as its beneficiaries. This shows the scope for civil society to "represent" a sovereign wealth fund held for the general public is large. The size of the Norwegian Oil fund at USD829bn at end-2013 makes it one of the largest funds of any kind in the world.

On these grounds, we would take the view that the challenge faced in holistic screening, and engagement for all global holdings where controversy arises, is also huge. It is often argued that larger funds would have the resources to meet this challenge, in spite of the practical operational difficulties, political constraints and the consideration of the potential impact on returns. Nonetheless, we reiterate that large funds with a high profile, (not just sovereign funds), are likely to face continued activism in the long term. The aforementioned constraints may well not be given due regard in any activism based on soft law challenges.

Duty of response was a defining factor…

Regarding APG, the Dutch NCP[xiv] did not find any violation of OECD guidelines. APG's willingness to engage in the mediation process positively impacted the decision; specific exchanges in which APG's investment process in a particular engagement were also cited. The fund's transparency regarding pre-existing SRI methodologies applied in this case (i.e. a clear engagement prioritisation process and approach based on multiple inputs) was highlighted as a key factor in compliance and one that could be invoked in future cases.

…as were the application preexisting systems of engagement prioritisation

We would also highlight that APG's challenges are different from NBIM's as a result of size, political constraints, the nature of funds and their manoeuvrability. In terms of staffing, APG was also able to present specialist skills potentially relevant to the POSCO case, for example it employed a Korean speaker.

Investor leverage in action even without the outcomes targeted by NGOs

Although POSCO and Indian authorities may not have carried out the desired actions in terms of local community rights, APG's favourable disposition was clear, especially regarding its efforts over two years to dialogue with POSCO and its willingness to use and increase its leverage. An example of this was when it brought NGO agreements to POSCO's attention and urged it to address the issues at hand. The Dutch NCP states "APG used its leverage through extensive correspondence, phone calls, as well as face-to-face meetings with POSCO representatives at POSCO's offices in Seoul."

Some decision making has taken place at the Norwegian Government level around the existence of the Council of Ethics which feeds decisions around exclusion to NBIM. Based on varying statements from the finance ministry at different times there has clearly been some attempt to reconcile prioritization of investment return with social responsibility. The latest decision based on a parliamentary vote has been confirmed (despite rumours to the contrary) that the Council of Ethics will be kept. The primary change implemented is that it will report not to the Finance Ministry but to the Central Bank of Norway. This has been done with a view to ensuring greater independence (i.e. not appearing to be political or foreign policy arm of the government). It is also suggested that exclusion decisions will be quicker as a result of this reporting change.

We view this a positive, as the loss of the Ethical Council would send a potentially negative signal to others in SRI, with a loss of a flagship decision maker with its influential transparency followed by many in the industry. Though the POSCO case and the accompanying Norwegian NCP decision was never officially mentioned as a reason for the potential changes we highlight the pressure that soft law decisions can put upon SRI methodologies and the unofficial impact they may have in forcing “self-review” of processes. This includes the risk that SRI methodologies may be weakened if the ultimate decision is to move away from responsible investing justified by pure investment return priorities.

Towards a "due diligence compact"

Our conclusions after including soft law and regulatory trends across corporate and financial sectors described by the CSR Iceberg and cases presented are as follows:

- The proliferation of normative standards leads to increased liability.
- New compliance requirements increase the range of operational risks.
- The collection, processing and use of data is the DNA of ESG due diligence.
- Not just documented processes but also the specific application and actions resulting from them are required to maximise "influence".

Good faith efforts are rewarded when proved

Table 56: A definition of "good faith"

	How the OECD defines "good faith" for the NCP process
1	Responding in a timely fashion
2	Maintaining confidentiality where appropriate
3	Refraining from misrepresenting the process
4	Refraining from threatening or taking reprisals against parties involved in procedure
5	Genuinely engaging in the procedures with a view to finding a solution to the issues raised

Source: Implementation procedures of the OECD guidelines

How can we define "good faith"?

Although the above definition comes from the OECD in relation to NCP "specific instances" or complaints guidance, the tenets are central and serve as a broad definition applicable in a very wide range of settings. We note that that they attribute responsibility to all parties involved – equally or in some cases more so to civil society (i.e. for confidentiality) than to the company that is the subject of the complaint. In certain regulatory contexts, particularly those with CSR impacts, certain references to good faith efforts have been defined in detail regarding documented activities amounting to due diligence required to claim that a company has indeed acted in good faith.

The latest generation of regulation to avoid systemic risk or fight against tax evasion and corruption puts the emphasis on the notion of transparency regarding systems and processes. The UK Bribery Act contains the notion of "adequate procedures", where evidence of anti-corruption policy and its implementation will allow for a specific corporate defence. We also note regarding the US Foreign Corrupt Practices Act (FCPA) that a case involving Morgan Stanley and its detailed presentation of its documented anti-corruption policies and implementation led to its exoneration at corporate level. This echoes the spirit of certain soft law engagements which would put the greatest emphasis not on the achievement of a specific result, remediation or avoidance of all negative impacts but rather on that of a documented good faith process.

With the US Dodd Frank Wall Street Reform and Consumer Protection Act, transparency is seen as a key regulatory tool, with inbuilt oversight mechanisms.

Table 57: Good faith compliance efforts make a difference

Prove it! Hard law recognising good faith efforts to avoid liability	
UK Bribery Act	Adequate procedures
US FCPA	Fines systematically lowered
US Dodd Frank 1502	Supply chain due diligence with "reasonable country of origin enquiry"

Source: KeplerCheuvreux, Affectio Mutandi

We believe the same approach is critical in ESG due diligence - duty of care is above all necessary. Most stakeholders will look for a process in place (i.e. through transparency) rather than expect fixed results and objectives in terms of never holding a company accused of prolonged and multiple violations of any kind. This is the rationale behind the recent French Monetary and Financial Code comply or explain mechanism applying to asset managers in order to inform about the integration of ESG issues in their investment strategy (L. 533-22-1). Being able to comply or explain requires a great level of transparency and good faith.

The duty of response, cooperation with process and implementation of adequate systems far outweigh achieving any fixed result around a third party's actions

Duty of response is intrinsic to this good faith effort. Investors involved in engagements know the importance of this duty first hand:

Table 58: PRI - assessing intensity levels of engagement

Basic	A single letter to the company in which action is requested
Moderate	A single meeting or call with the company at which action is requested
Extensive	Multiple letters, meetings and calls with the company in pursuit of the investor's objective

Source: PRI

The above shows the basic degrees of engagement involvement. The entire framework will of course depend on certain factors, including the resources available. In some cases, companies are clearly not responsive; this can apply to both investor engagements and NCP requests to mediate. In the case of investors, attempts to increase leverage through investor coalitions, voting proposals or multi-stakeholder initiatives occasionally remain open. All these forms of engagement can be seen as good faith efforts to use investor leverage and influence. And the same responsiveness is required of investors if they become the objects of engagement – i.e. from civil society, as a token of their good faith at when they are at the receiving end of the stick.

In the NCP complaints process some companies that are completely nonresponsive or do not respond as requested may face reputational consequences. In addition, the level of global and localised media scrutiny, customer interest, and the extent of reputational impact will depend on how explicitly the brand is dependent on its sustainability credentials, the extent of the allegations and the NCP's conclusion on whether a violation of OECD Guidelines has occurred.

Back to basics: what is due diligence?

There are many definitions of due diligence. From a risk management point of view, the first thing to do is to identify objectives. Next come process and system implementation. Finally, consistent follow-up actions must be taken.

Table 59: Three parts to due diligence risk

Risk management		
1	Objectives	Prevent, anticipate, remediate
2	Means	Governance tools, relevant ESG data
3	Actions	Be informed, inform, verify, alert

Source: Affectio Mutandi

For human rights due diligence, we reference the United Nations Guiding Principles:

"In order to identify their impact on human rights, prevent these impacts and mitigation, and report how they remedy them, companies must exercise due diligence in terms of human rights. "(Guiding Principles on Business and Human Rights, Principle 3 general regulatory and policy functions of the state).

It is under these terms of "Protect, Respect and Remedy" that the guidelines issued by the UN describe the obligation companies have to prevent violations that may occur because of their activity.

The due diligence process is continuous

In applying these terms to mainstream financial services, all banks conduct due diligence and risk assessments on client relationships, transactions and operational decisions and will have processes in place to ensure compliance with the law (including human rights laws), international sanctions, financial crime prevention measures and other internal and external requirements. A key pointer for us comes from work published by the Thun Group of Banks (Seven institutions aiming to forward human rights – see page 31) where due diligence is cited as an ***ongoing*** phenomenon.

The due diligence outlined in the guiding principles has additional parameters covering potential adverse impacts and related risks that may occur in the context of the bank's own activities or through the provision of financial products and services to clients. This due diligence is an ongoing process, ***not something to be completed once and not revisited*** *(in UN Guiding Principles on Business and Human Rights*[xv] *– Discussion Paper for Banks on implications of Principles 16-21, The Thun Group of Banks, Oct 2003, p9).*

A fundamental characteristic of the due diligence is that it does not generate an obligation of results but an obligation of means. In principle therefore a documented good faith effort has significant value where allegations arise. This characteristic should be remembered, as it reflects the specifics of investment activity, namely through the duty of care.

However, the current evolution in normative standards linked to ESG issues will certainly continue to generate ambiguity within the financial community as stated by the Thun Group of Banks in its Discussion Paper for Banks on Principles 16 – 21 of the UN Guiding Principles on Business and Human Rights (October 2013, p.19)

The due diligence processes described in this document are far from simple or standard. Each customer, transaction, project or asset holding is unique and the assessment and mitigation must be tailored appropriately. There are also a number of additional challenges that should be noted (and among them):

- *Difficulty in achieving a consistent approach across an international organisation spanning many different cultures and jurisdictions and including many different business and subsidiaries.*
- *Managing external expectations, so that the scope of due diligence conducted by banks will be greater than is possible or appropriate.*

However, we identify clear starting points for a robust "*diligence compact*" or framing of goals and processes related to due diligence:

Table 60: A "diligence compact" – starting points

The starting point for a diligence compact consists in identifying the relevant requirements in two main categories	
1	Meet the investor SRI requirements expressed and contractualised
2	Comply with its own commitments announced through adherence to individual or collective codes of conduct or issuance of SRI labelled products (most common case in practice)
Once these requirements are clearly identified, they help framing the adequate due diligence in order to :	
1	Obtain guarantees from the issuer and / or the borrower (project funding) on the relevance of their own processes to prevent ESG impacts
2	Prevent violations that may occur because of their activity
3	Meet external expectations

Source: Affectio Mutandi

A fund marketed as socially responsible may have a higher risk of scrutiny over false marketing…

…the existence of retail investors may heighten reputational risk

In this report we have highlighted a number of cases where corporates have faced legal challenges (hard law) in relation to allegations of misleading advertising. Although product "misselling"– i.e. in relation to mortgages or payment protection insurance (PPI) has led to multi-billion dollar settlements, financial advertising is also a potential source of liability. We note a previous case where the liability of a bank has been established for breach of professional standards on publicity (Cass Com., 24 June 2008, No. 06-21798).

"*Advertising issued by the person who offers his client to subscribe to shares in mutual funds must be consistent with the proposed investment and mention if any the less favourable characteristics and risks associated with options can be the corollary benefits statements*"

(s. 33, paragraph 2 of the Regulation No. 89-02 of the COB)

Data providers, another shifting liability

The provision of data is central to any ESG analysis and investment cannot be concluded without some provision of standardised information. Data constitutes the raw material of relevant due diligences processes.

Effectively, this means the selection of service providers (ESG controversy monitoring products, extra financial rating agencies, etc.). However, the mobilisation of in-house resources should be designed to guarantee the range, relevance and accuracy of data, particularly given that in many cases service and data providers and research agencies will have contractual waivers/disclaimers regarding their own liability (although a recent Australian case against S&P in 2012 found it owed a duty of care to investors; i.e. analysis showing a reasonable basis that leads to a rating)[xvi]. A EUR5bn lawsuit has been filed in US courts in 2014 on a similar basis.

Regarding data, financial institutions should take particular care to be able to justify why they were not aware of crucial stakeholder expectations, or decided not to take them into consideration.

Escalating due diligence: know, watch, alert, influence, remediate

Know

We extend the principle of "Know your customer" (KYC) to "Know your product". In the frame of SRI the first steps of due diligence require the collection of relevant ESG information on the activities of companies whose securities are included in the investment universe. This phase is the starting point, as it will be the initial effort to gather relevant data but also to construct an accurate mapping of the relevant stakeholders.

Watch

What we are attempting to identify potentially transcends the interests of the client and calls on the fund to consider the effects of its activities on external considerations, relating to public interest. The surveillance of a client or its operations may have an ESG impact, without the need for a material impact on the financial performance of a funded project or a financial product. At this stage of due diligence, the damage or violation of norms has not yet occurred but the risk is made potentially material by information brought to the attention of the financial institution – for example through the screening process revealing controversies.

Alert

The violation of the norm has occurred or is likely to occur and the asset owner should alert relevant stakeholder, not only the client.

Extending the “Know” stage, within the principle of alerting the client, we include the notification and potential interaction with relevant stakeholders - those likely to be affected and those likely to influence engagement outcomes positively.

- Processes implemented by the financial institution have allowed it to access relevant information and it must inform clients of this in order to give them the option to decide to disinvest, for example.
- The alert may also be addressed to any stakeholders likely to be affected.

The grounds for the application of this stage can be based on a mix of signals:

- The emergence of controversies.
- A social or civil society movement.
- Complaints using soft law tools such as OECD Guidelines.
- The use of courts or any mobilisation of judicial tools.
- Divestment by other financial institutions.

Table 61: Escalating due diligence – influence, a key prevention/optimisation tool

Measure influence	This requires a mastery of the expectations and perceptions of stakeholders
Exercise influence	This requires a mastery of the normative tools of CSR – for example the mechanics of the NCP complaint process
	Knowledge and constant monitoring of best practice to be able to ask the right questions to companies

Source: Affectio Mutandi

Influence

In order to boost the Alert phase or when this later proves to be inefficient, the notion of "Influence" provides relevant guidelines. Influence is meant not only as leverage to prevent or mitigate adverse impacts, but also as maximisation of companies' contribution to sustainable development. To do so, investors should exercise their influence methodically. This requires a mastery of the expectations and perceptions of stakeholders, a mastery of the normative tools of CSR and a knowledge and constant monitoring of best practice. The aim for investors and their financial service providers should namely consist asking the right questions to companies and initiate constructive coalition to optimise leverage.

Remediate

Once a violation has occurred, remediation is the clear priority. Asset owners and managers may play a key role in increasing pressure on companies involved in activities that generate environmental and social damage. In the Rana Plaza case, the agreements dedicated to indemnification for victims meant USD40m had to be found. Less than 50% has been reached at the time of writing. Amid evident social concern globally, potential regulatory challenges, consistent reputational tests and the possibility of shareholder loss, there is clear scope and requirement for investor influence.

Table 62: The means of leverage investors can invoke and subsequent risks

Theme	Notes
Assets Under Management (Total & % SRI AUM)	Larger positions may mean more leverage. However, those funds with significant SRI assets currently more likely to be targeted rather than the actual largest non-SRI holders
Sustainable investment policy	A first step; however, any inconsistencies must be addressed or risk being targeted
Exclusion criteria	Consistent exclusion criteria, though gaps will increasingly be challenged
Threat of divestment	Companies may not be responsive but a record of divestment can be seen as a sufficient threat in itself
Shareholder coalitions	Free-rider effect is a problem, but joint engagements aggregate leverage, can improve branding and visibility if public
Stakeholder partnerships	New generation of corporate/NGOs partnerships with clear sustainable development aims should inspire investors/NGOs partnerships
Multi-stakeholder engagements	Can be highly effective, although public nature can attract unwarranted attention
Public vs. private dialogue	Private dialogues are often successful, a central issue is their transparency
Shareholder proposals	Issue specific activism - recent example of Exxon & carbon risks proposal
Voting	Evidence of voting proxies relevant to ESG criteria
Use of soft-law tools	Investors facing lack of collaboration from companies could use mediation processes such as OECD Guidelines in specific instances
Make-up of beneficiaries	Sovereign wealth funds may have elevated risk

Source: Kepler Cheuvreux – Affectio Mutandi

A promising new principle: the duty of response

In a final step in developing the case that CSR issues generate obligations of means more than obligations of results for companies (whether or not in the financial sector), we note that the ability of any party to definitely resolve often complex multi-party controversies in remote locations are probably less critical than the means devoted to achieve such resolution, given the available resources.

The duty of response becomes central in this context, especially considering the potential for a reputation feedback effect. A company asking its suppliers to respond to its questionnaires for CSR transparency which develops an image of being non-responsive itself, will probably suffer from a lack of buy-in from such stakeholders. Those that maximise their responsiveness put themselves in a strong position if faced with challenges from civil society either through soft or hard law.

The motivation for conceptualising this new duty of response is generated by a long list of cases and best practice for mitigating exposure to soft law violation and reputation risk. It is also a principle of good CSR governance: companies (or investors) that are facing specific ESG controversies, directly or through their assets, should respond privately or publicly, stating how they have managed their controversial practice or holding.

'No comment' no longer an option for players with public commitments

"Tell us how you managed that controversy' seems a fair expectation from both beneficiaries and civil society when such an issue occurs with asset managers. Some voluntary guidelines already take such a duty of response into account: as mentioned within the European SRI Transparency Code[xvii]:

"Signatories to the code should be open, honest and disclose accurate, adequate and timely information to enable stakeholders, in particular consumers, to understand the ESG policies and practices of the fund."

The code explicitly states that its "key motivations" are twofold:

1. An opportunity for retail SRI funds to clarify their SRI approach to investors and other stakeholders in an easily accessible and comparable format.
2. An opportunity to proactively strengthen self-regulation, to facilitate the development and promotion of SRI funds by establishing common framework for transparency best practice.

According to the UK Stewardship code "an asset manager should disclose how it delivers stewardship responsibilities on behalf of its clients"… [and] should respond to (beneficiaries') concerns on critical issues and at critical times…"

One key difference in the outcomes between the case of APG and NBIM in the OECD NCP mediations regarding investments in POSCO was that of response and perceived co-operation in the dialogue process. A central outcome was that an investor or indeed any corporate could be found in violation of the OECD Guidelines for not engaging fully – e.g. not responding to requests for information from the NCPs. This duty of response is explicitly enshrined in the OECD Guidelines and was referenced in the Norwegian NCP statement on NBIM.

Innovation in engagement: "normative engineering"

Could investors lodge complaints using the OECD NCP process?

We conclude by saying that while thus far investors themselves have not launched complaints against corporates using the OECD NCP process, the door is open. In cases for example where engagement receives no response from a corporate and clear violations are documented, investors themselves should have recourse via the NCPs within the OECD mechanism.

Investor coalitions with NGOs launching NCP complaints...

...an interesting route to optimising influence

Transparency regulations: human rights

Reporting on human rights policy is becoming compulsory (under a "comply or explain" approach) in many countries. Such transparency regulations will raise the bar for challenges: either a company will be held accountable for the quality and comprehensiveness of its policy, or it does not declare, in which case its explanation can be challenged, the company being held to account via for example civil society. These are also further points of reference and interaction of course for SRI funds assessing the company and potentially engaging with it on the basis of its policy transparency.

We reiterate the driving force behind these regulations: *soft law*. In the 2013 UK Action Plan on business and human rights the impetus is largely from the implementation of the OECD Guidelines for MNEs and the UN Guiding Principles. The application of corporate transparency laws thus fulfils national commitments toward international obligations.

Table 63: Human rights reporting for companies is moving forward in Europe as a result of soft law

	Human rights reporting regulations
UK	Quoted companies under Companies Act Strategic Report Regulations 2013 (see also FRC Draft Guidance)
France	Listed companies and non-listed companies with more than 500 employees in France
Sweden	State-owned enterprises in Sweden
Denmark	State-owned enterprises, listed companies and non-listed companies that exceed at least two of the following three size limits (total assets/liabilities of DKK 143 million, net revenue of DKK 286 million, an average of 250 full-time employees) in Denmark
EC	In April 2013, the European Commission adopted a proposal for a Directive (now being examined by the European Parliament) that would require the largest 18,000 European companies to publish a non-financial statement (always under a "comply or explain" framework) containing information relating to human rights, diversity, anti-corruption and other ESG factors.

Source: Affectio Mutandi

Focus on grievance mechanisms

The existence of firm grievance mechanisms within a multinational company (if operationally effective and acted upon) may be valuable in preventing a civil society case from being presented or escalated legally or to the OECD or other normative frameworks where a complaint or mediation process exists. Below we examine the key elements of an internal alert system for multinationals, especially those with complex multi-border supply chains.

Those frameworks with a grievance process open to third parties should expect to be further tested by civil society

The OECD Guidelines are the broadest in scope and one of the few with the ability to claim against corporates and investors

We believe the whistle-blowing system is one of the most important adjuncts to the systems available overall, capable of reducing a variety of sustainability and legal risks if well implemented alongside relevant policies and accompanying systems of implementation for the key risks.

The information gained from such systems can be a valuable part of an ongoing and adaptive due diligence systems around key environmental, social and governance risks.

Table 64: Whistle-blowing for global corporations is a key element in handling sustainability risks

Focus on multinational company grievance mechanisms	
External	Maintained by a third party for the first step of receiving and processing calls, Reduce the risk of compromise in reporting process, increase psychological willingness to report
Open to non-employees	Suppliers, agents and contractors, etc. can be a crucial source of information
Allow reporting on subjects beyond accounting and fraud	Allow for a broad use including human rights and environmental concerns
Usage Stats	Number of concerns raised may show credibility of systems, year on year zero calls may not equal squeaky-clean problem-free operations
Action Stats	Number of disciplinary actions resulting , or remedial measures (i.e. on internal systems) shows commitment from company to handle issues that arise, conversely a relatively high number of enforcements by the company may signal efficiency of its business ethics systems
Audited	Independent third-party audits on functioning of the system may function as checks
Awareness & Training	Notification and dissemination of the alert system to relevant parties, included in training
Global	Available globally, where issues are most likely to occur
Languages	Available in local languages where local presence warrants and resources permit

Source: Kepler Cheuvreux

Of note also in terms of national legislation is the increasing prominence of grievance mechanisms. The UK recently established its action plan for human rights in response to requests to implement the UN Guiding Principles. Two key goals are explicitly set out:

Table 65: Grievance mechanisms in UK National Action Plan for Human Rights: access to remedy

1	Task UK Trade and Investment (UKTI) advises UK companies on establishing or participating in grievance mechanisms for those potentially affected by their activities and to collaborate with local authorities in situations where further state action is warranted to provide an effective remedy
2	Encourage companies to extend their domestic UK practice of providing effective grievance mechanisms to their overseas operations, adapting them where necessary according to local circumstances and consulting interested parties. This also applies to dispute arbitration/mediation mechanisms through their sector of activity or collective industry organisations

Source: UK Government - Implementing the UN Guiding Principles on Business and Human Rights, Sept 2013

Regarding the second factor in the table above, there is a clear indication of the multinational nature that grievance mechanisms should follow.

Similarly, as an example of the collective industry organisations we would include the recent Community Grievance Mechanism toolbox project from the IPIECA (global oil and gas industry association for environmental and social issues) and the explicit inclusion of grievance mechanisms in the multi stakeholder initiative "Voluntary Principles on Security and Human Rights". Another example is via recent EC Human Rights Sector Guidance – i.e. for Employment Agencies, ICT and Oil & Gas[xviii] – which not only has specific implementation points concerning operational level grievance mechanisms for the industry but advises more generally that the information in the Guide can be tested with SRI investors. Explicit reference standards for investors to cite in engagement are not only manifold but increasingly under the eye of legislators.

Engaging with civil society

We have discussed concerns among NGOs with a number of local and multinational civil society networks. Time and again, we have noted that the quality of interaction with the NGO was key, but the perception of "good faith" involvement evidenced by a commitment to communicating with the NGO, including a willingness to share documents and enter into correspondence, was a trigger for avoiding the escalation of activism. Opportunism was also a strand we detected, in that with any soft law or voluntary framework that carried a grievance mechanism this generated a new avenue of activism, particularly if it was sensed that the complaint could result in media interest.

Civil society campaigns and dialogue may also carry clear signals of where investor due diligence needs to be focused.

Investor engagement templates

Extracts from French NCP Report on Rana Plaza

Supplier tracking is a prerequisite to complete supplier due diligence

How many suppliers are there? Can these be reduced to increase leverage and long-term influence (i.e. over five years)

Supplier dependence/leverage

Does the company know the percentage of turnover its orders represent for its suppliers?

According to the company, what is the percentage of turnover representing a potential dependency for the suppliers?

According to the company, what is the percentage of turnover generating a threshold of influence on suppliers' practices?

Preferred supplier status

Is there a "preferred supplier" approach including a detailed process of accepting new suppliers that balances economic priorities with social and environmental risks?

Managing subcontracting risk

Is there limited recourse to subcontracting or where relevant prohibition of subcontracting unless structured through a system of prior authorisation?

Tracking country risk

Can the company track the location of all subcontractors and therefore its own country risk?

Going beyond Tier 1 knowledge

Are tier-1 supplier(s) able to list their own suppliers and give precise information on where products are actually made?

Are there Tier 2 supplier CSR obligations and how does the company track interaction between Tier 1 and 2 (and thereafter)?

Audits

Has the company put in place a third-party verification process?

Sustainability clauses in contracts

Does the perimeter of verification process cover criteria reflecting all the supplier's ESG contractual engagements?

Who pays?

Do Tier-1 suppliers bear the costs of verification audits?

Are the supplier relationships collaborative rather than punitive (avoiding unnecessary supplier rotation)?

What have follow-up audits shown as key areas where remedial actions must be taken and what action plan has been implemented as a result?

Compensation models

Has the company signed specific agreements that require compensation payments? (c.f. recent industrial agreement on compensation).

Does the company explicitly commit to compensate workers in factories that are closed due to safety concerns (i.e. after safety audits).

Stakeholder dialogue

Do the companies communicate regularly with other stakeholders affected by suppliers' activities (neighbours, unions, local NGOs, training institutions, etc.)?

Are incentive premiums for suppliers or key buyers used, for instance on the ethical quality of products?

Are these buyers' price/ethics rewards and penalties indexed on suppliers ESG performances?

When rating the pool of suppliers, are buyers encouraged via a system of rewards and penalties applied to their purchasing costs, to place their orders with suppliers who offer the best quality price/ethics ratios?

Engagement Template – Anti-Bribery

Area	Engagement question	Reason	Regulatory exposure	Best practice example	Best practice company
Governance	How is the board made responsible for anti-corruption measures?	"Tone from the Top"	Anti Corruption Laws - US FCPA, UK Bribery Act + other national regulations	Reporting line direct to CEO, Ethics Committee consisting of Board members	Technip, Siemens
	Is the company and key (especially listed) subsidiaries willing to make a signed & publicly available CEO statement to endorse Code of Ethics ?	"Tone from the Top" and indicates CEO responsibility	Anti Corruption Laws - US FCPA, UK Bribery Act + other national regulations	CEO states commitment clearly	Anglo American
Whistle blowing	Is the company willing to disclose statistics on a) the number of reports coming through their whistle-blowing systems and b) the number of disciplinary actions as a result of violations of Code of Ethics both by employees and third parties such as contractors/ agents?	Indicates that the system is functional and the company capitalizes information to avoid informants reporting to external authorities	Anti Corruption Laws - US FCPA, UK Bribery Act + other national regulations Whistle Blower Protection & Reward Laws US SOX & Dodd Frank	Disclosure of Number of cases , Breakdown of subject area i.e. Safety/ Fraud Number of Disciplinary Measures	BG Group
Facilitation payments	Is there a policy to ban facilitation payments (which are specifically outlawed in several countries)? If yes, then why does it not make it public?	UK Bribery Act legislates against these payments. If made in aggregate and in large volumes risk is higher. Difficulty of accounting for such payments even where they are legal in certain territories due to exposure to different legal jurisdictions	Anti Corruption Laws - mainly UK Bribery Act but potentially other national regulations also	Complete ban	
Operations strategy to reduce exposure to demands for such payments, engagement with senior officials, alliances with other firms, support from internal legal	Rio Tinto				
Risk assessments	How is corruption risk included as a parameter in making business decisions?	Integrated consideration at a strategic level embeds corruption risk reduction more effectively and works preventative rather than relative measure	Anti Corruption Laws - US FCPA, UK Bribery Act + other national regulations	Embedded in Country, Transaction, Business Opportunity & Partner Risk analysis	Statoil
Country by country & project reporting	Will the company disclose country level payments but also revenues and other key data?	Transparency can signal better risk management	Extractives: Dodd Frank 1504; EC Accounting Directive (If illicit payments are made, the likelihood of them being discovered may continue to increase in the mid term as a result of this regulation)	Country Level Payments and Project by Project Reporting	Statoil (country reporting) Rio Tinto (project reporting)
Company structure:	Does parent company disclose fully the organisational structure of the company - especially foreign operations?	Transparency can signal better risk management	Tax & Anti Corruption Laws : Increased scrutiny of use of opaque global corporate structures	All material subsidiaries disclosed with country of incorporation and % ownership	Allianz

Source: Kepler Cheuvreux

Notes

i. COM(2011) 681
ii. COM (2001) 366
iii. https://offshoreleaks.icij.org/search
iv. http://www.publications.parliament.uk/pa/jt201314/jtselect/jtslavery/166/16608.htm#a39
v. http://www2.accaglobal.com/pdfs/environment/turnbull.pdf
vi. http://www.interbrand.com/Libraries/Articles/Brand_Valuation_Final.sflb.ashx
vii. http://www.globalwitness.org/campaigns/corruption/oil-gas-and-mining/secret-sales/glencore
viii. http://www.publishwhatyoupay.org/resources/piping-profits-secret-world-oil-gas-and-mining-giants
ix. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253457/bis-12-1188-equity-markets-support-growth-response-to-kay-review.pdf
x. https://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx
xi. http://lawcommission.justice.gov.uk/docs/cp215_fiduciary_duties_summary_web.pdf
xii. http://www.taxjustice.net/cms/upload/pdf/Farrer_and_Co_Opinion_on_Fiduciary_Duties_and_Tax_Avoidance.pdf
xiii. http://www.orse.org/force_document.php?fichier=document_1194.pdf&fichier_old=2012_how_to_integrate_ESG_risks_into_financial_sector.pdf
xiv. http://www.oesorichtlijnen.nl/sites/www.oesorichtlijnen.nl/files/final-statement-somo-bothends-apg-abp.pdf
xv. https://www.credit-suisse.com/responsibility/doc/thun_group_discussion_paper.pdf
xvi. http://www.bloomberg.com/news/2014-03-05/s-p-says-business-at-risk-on-australian-liability-ruling.html
xvii. http://www.eurosif.org/sri-resources/sri-transparency-code/download-transparency-code-a-related-documents
xviii. http://shiftproject.org/sites/default/files/ECHRSG.OG_.pdf

Research ratings and important disclosures

Disclosure checklist - Potential conflict of interests

Stock	ISIN	Disclosure (See Below)	Currency	Price
Alstom	FR0010220475	nothing to disclose	EUR	29.51
Barclays	GB0031348658	nothing to disclose	GBP	302.63
BBVA	ES0113211835	nothing to disclose	EUR	9.74
Bolloré	FR0000039299	nothing to disclose	EUR	469.15
BP	GB0007980591	nothing to disclose	GBP	506.00
Continental	DE0005439004	14, 16, 18	EUR	173.30
Credit Suisse Group	CH0012138530	nothing to disclose	CHF	27.53
Dexia	BE0003796134	nothing to disclose	EUR	0.04
E.ON	DE000ENAG999	nothing to disclose	EUR	14.30
ENI	IT0003132476	14, 16, 18	EUR	19.02
G4S	GB00B01FLG62	nothing to disclose	GBP	252.20
Glencore Xstrata	JE00B4T3BW64	nothing to disclose	GBP	324.20
HSBC	GB0005405286	nothing to disclose	GBP	380.60
ING Group	NL0000303600	nothing to disclose	EUR	10.64
KBC	BE0003565737	nothing to disclose	EUR	42.21
Nestlé	CH0038863350	nothing to disclose	CHF	69.65
Nike	US6541061031	nothing to disclose	USD	75.14
Royal Bank of Scotland	GB0007547838	nothing to disclose	GBP	199.90
Royal Dutch Shell	GB00B03MLX29	nothing to disclose	EUR	29.23
SOCO International	GB00B572ZV91	nothing to disclose	GBP	1,610.00
Standard Chartered	GB0004082847	nothing to disclose	GBP	1,838.67
Total	FR0000120271	nothing to disclose	EUR	51.72
UBS	CH0024899483	nothing to disclose	CHF	17.99
Unicredit	IT0004781412	2, 14, 18, 19	EUR	6.77
Veolia Environnement	FR0000124141	nothing to disclose	EUR	14.36
Vodafone	GB00BH4HKS39	nothing to disclose	GBP	199.40
AUS.AND NZ.BANKING GP.	AU000000ANZ3	nothing to disclose	AUD	33.9
BANK HAPOALIM B M LTD.	IL0006625771	nothing to disclose	ILS	20.32
LEUMI LTD.	IL0006046119	nothing to disclose	ILS	13.33
BT GROUP	GB0030913577	nothing to disclose	GBP	393.9
DEXIA ISRAEL BANK	IL0007110104	nothing to disclose	ILS	697.7
FIBI BANK	IL0007630119	nothing to disclose	ILS	87.84
HENNES & MAURITZ 'B'	SE0000106270	nothing to disclose	SEK	291.5
DISCOUNT	IL0006912120	nothing to disclose	ILS	6.02
LEVEL 3 COMMS.	US52729N3089	nothing to disclose	USD	42.41
MIZRAHI TEFAHOT LTD.	IL0006954379	nothing to disclose	ILS	45.59
POSCO	KR7005490008	nothing to disclose	KRW	294000
SAMSUNG ELECTRONICS	KR7005930003	nothing to disclose	KRW	1422000
ROYAL DUTCH SHELL A	GB00B03MLX29	nothing to disclose	EUR	29.23
SODASTREAM INTERNATIONAL	IL0011213001	nothing to disclose	USD	37.8
VEOLIA ENVIRONNEMENT	FR0000124141	nothing to disclose	EUR	14.36
VERIZON COMMUNICATIONS	US92343V1044	nothing to disclose	USD	49.37
WESTLB MELLON ASTMGMT. DJS AI.PAC.600 RL.EST.EX	DE000A0H0777	nothing to disclose	EUR	12.4

Source: Factset closing prices of 11/06/2014

Stock prices**:** Prices are taken as of the previous day's close (to the date of this report) on the home market unless otherwise stated.

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Reduce	21.0%	0.0%
Not Rated/Under Review/Accept Offer	5.5%	0.0%
Total	100.0%	0.0%

Source: Kepler Cheuvreux
A: % of all research recommendations
B: % of issuers to which Investment Banking Services are supplied

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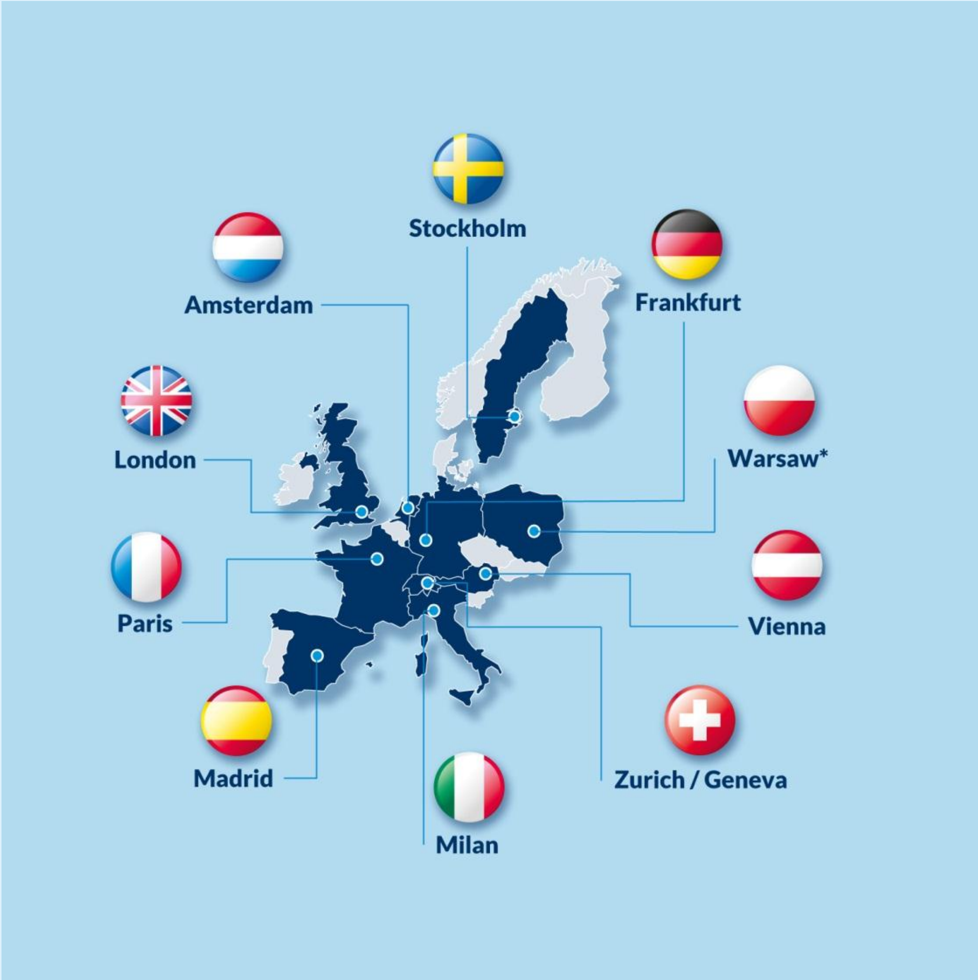

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