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SOCIALLY RESPONSIBLE INVESTMENT (SRI):
TRENDS IN SRI EVALUATION WITH RELEVANCE TO GLOBAL COMPANIES

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Structure of the paper

KEY RESULTS

In summary the key trends in SRI evaluations over the next 3-5 years reported by the leading SRI organizations are:

a) Tougher levels of climate change criteria
b) Tougher levels of sustainable supply chain evaluation
c) Tougher levels of product safety
d) Leadership for sustainable development, e.g. by product innovation
e) Adaptation to water constraints

Although each company evaluation follows their own criteria, the general trends as outlined above are to some extent supported by research from publicly available information such as websites from many SRI organizations, publicly available interviews with SRI experts and available studies. In addition to these larger trends, individual SRI organizations will alter their evaluation criteria regularly according to new developments. Another fundamental trend in SRI evaluation is a shift from the ethical aspects of SRI towards Sustainable Corporate Governance criteria. Company's ability to e.g. managing the process towards a low carbon economy, implementing standards on countering bribery and creating a work culture that stimulates innovation are the key cornerstones of many of today's SRI evaluations.

(1) INTRODUCTION

According to the EUROSIF, the European Sustainable and Responsible Investment Forum, the European Broad SRI market is now valued at over 1 trillion Euros. And although the economic crisis hit SRI funds hard they outperformed conventional funds by 15% when market rates fell severely between May and November 2008. Across Europe, we see signs of robust SRI strategies, increased mandates from institutional players and the growing involvement of more traditional financial services. More than 70 qualified rating institutions worldwide evaluate company's sustainability performances (Bertelsmann Foundation, 2006). Most of them send questionnaires and many interact closely with the companies to be rated, giving them the possibility to review the evaluation before it is used for investment decisions.

Without any doubt, hardly any company is able to answer every questionnaire and – even more, to always provide all necessary data on the questions being raised. In order to be able to generate the information needed for sound SRI ratings a pharmaceutical WEC member company has asked the WEC to identify new trends of information requirements in the next 3-5 years aligned with risks and opportunities from corporate sustainable development. In this respect WEC conducted interviews with some of the leading SRI organizations in the period of Nov. 2nd to Nov. 13th with the following organizations (the selection process is described on page 2):

- SAM Research AG (CH)
- FTSE Group (UK)
- Carbon Disclosure Project (UK)
- oekom research AG (D)
- Calvert Group (US)

Further References:

- Bertelsmann-Foundation (2006): Who is who in Corporate Social Responsibility Rating? A survey of internationally established rating systems that measure Corporate Responsibility
- OECD (2007): Recent trends and regulatory implications in SRI for pension funds
- SustainAbility (2004): Values for Money
- Website Europ. Sust. & Responsible Investment Forum (EUROSIF; www.eurosif.org) (Nov. 22, 2009)
- Website Sustainable Investment, Germany www.sustainable-investment.org (Nov. 22, 2009)
- Website Forum Nachhaltige Geldanlagen, Germany www.forum-ng.de (Nov. 22, 2009)
- Website Social Investment Forum, USA www.socialinvest.org (Nov. 22, 2009)
- Websites of selected SRI organizations (Nov. 22, 2009)

(2) Selection of SRI Rating Organizations for the Evaluation

Understanding the trends in sustainability evaluation is most valuable if the SRI-organizations approached have a great impact on the company.

Detailed information on most of the operating SRI rating institutions worldwide has been prepared by the Bertelsmann-Foundation (2006). WEC started with this list and added the newest developments in order to select those organizations of greatest value for the research undertaken.

(a) SRI-Rating Organizations with Greatest Relevance to BMS (and other WEC member companies)

(1) Sustainable Asset Management (SAM Group/DJSI) (CH)
(2) EIRIS/FTSE4Good (UK); Ratings in Germany conducted by imug (D)
(3) Carbon Disclosure Project (UK)
(4) Vigeo (incl. Ethibel) (F)
(5) oekom research AG (D)
(6) Sustainalytics (NL)*
(7) CalPERS (US)

* Sustainalytics has recently emerged from SiRi Group (Sustainable Investment Research International *Group*)

Sustainability Ratings of these organizations provide the opportunity of being part of the major sustainable investment funds in Europe and the US. These are often long-term investments. In addition, being selected into these universes brings about prestige amongst many stakeholders.

>WEC has asked each of these organizations for interviews in the period of Nov. 2nd to Nov. 13th and conducted further research. In addition, WEC included Calvert Group (see below) to its evaluation in order to increase the number of US based SRI organization for this research.

(b) SRI-Rating Organizations with Secondary Relevance to BMS (and other WEC member companies)

(8) Bank Sarasin (CH)
(9) Storebrand (NO)
(10) CoreRatings/Det Norske Veritas (UK/NO)
(11) Risk Metrics Group (US)**
(12) BNY Mellon/Insight Investment (UK)
(13) Calvert Group (US)
(14) HSBC (UK)
(15) UBS (CH)
(16) WestLB (DE)

In our opinion these organizations are of secondary importance to the pharmaceutical company that requested our evaluation because (8) and (9), although being highly recognized, influence smaller investment universes, while (10) to (16) bring about smaller secondary benefits (being in-house research providers, their recommendations have limited effects on image and opinion making)***. If companies, however, have people on the ground to work on questionnaires of these organizations we strongly recommend to do so.

**Risk Metrics Group has aquired Innovest Strategic Value Advisors in February 2009 and KLD Research in November 2009.
***although this is also true for CalPERS, they play a greater role due to their huge investment universe as the US' largest pension fund

(c) Further SRI-Rating organizations whose information requirements we found to be of second priority

From our perspective, further Sustainability Ratings do not have to be observed proactively by WEC member companies, either because of (a) small investment universe, (b) rating methodology not proven to be widely accepted, (c) formal reasons not qualifying the pharmaceutical company who requested this research to be part of the universe (e.g. ratings of companies based in a certain country), (d) limited secondary benefits (e.g. limited public knowledge about SRI service provider or in-house research that cannot be used to increase reputation). Other important funds that follow ethical principles such as the Norwegian Government Pension Fund are not based on the best-in class methodology but disinvest on the grounds of exclusion criteria. There is no need to provide detailed information as long as a company is not confronted with a disinvestment procedure.

Furthermore, organizations that conduct ratings of sustainability reporting and sustainable governance have not been selected for this analysis as they only indirectly influence SRI portfolios. Among these are (a) Accountability Rating (Accountability and CSR network), (b) SustainAbility Rating (SustainAbility's program on Corporate Reporting), (c) future/IÖW Ranking of Sustainability Reports (future/IÖW/Capital), (d) Corporate Register Reporting Awards, (e) Good Company Rating (Deloitte/manager magazin), (f) The Greenest Big Companies in America (Newsweek/KLD/Trucost/CorporateRegister) and (g) Roberts Environmental Center at Claremont McKenna College.

(3) NEW TRENDS IN SRI EVALUATION

According to the recent dialogue on SRI "extra-financial" factors can affect (increase or lower) expected returns and portfolio risk, especially in the long run. Historically, the factors considered by SRI investors have fallen into three main categories (OECD; 2007):

(1) *Social factors*: human capital (training and education, working conditions, and health), community development, labour rights (such as the right to unionisation);

(2) *Environmental factors*: urban and industrial pollution, global warming, depletion of some natural resources (such as oil) and restricted access to others (such as clean water), the reduction of the world's flora and fauna populations;

(3) *Ethical factors*: violations of human rights, use of child labour, manufacture or distribution of weapons, inhumane testing of products on animals, implicit support of oppressive political regimes, slavery, forced prostitution, as well as the traditional ethical concerns around pornography, alcohol and gambling.

Recent research (OECD, 2007) -that is supported by current web presences of SRI-Rating organizations- shows that institutional investors such as pension funds have in the past 3 years increasingly focused on the non-ethical aspects of SRI, and have instead incorporated corporate governance criteria. This new approach to SRI is motivated by mounting evidence that social, environmental and corporate governance (ESG) factors affect a firm's long-run specific and non-diversifiable risks. Managing the process towards a low carbon economy, implementing standards on countering bribery and creating a work culture that stimulates innovation are three factors that become increasingly visible (see e.g. appendix FTSE4Good_Countering_Bribery_Criteria, page 3). In conclusion, better corporate social performance – and particularly having a reputation for social responsibility – results in lower firm specific financial risks

To understand the latest developments in SRI WEC conducted telephone interviews with some of the Heads of Research from the most prominent SRI organizations in November 2009.

Interviews were made in the period of Nov. 2nd to Nov. 13th with:

- **Sustainable Asset Management (SAM) (CH)**
  Edoardo Gai, Head of Sustainability Services
- **FTSE Group (UK)**
  Tony Campos, Executive, Responsible Investment
- **Carbon Disclosure Project (UK)**
  Nigel Topping, Chief Development Officer
- **oekom research AG (D)**
  Matthias Bönning, Head of Research/Member of the Executive Board

- **Calvert Group (US)**
  Alya Kayal, Vice President, Sustainability Research (Calvert Group) (supported by Lily Donge)

WEC approached more of the leading SRI organizations. Three of these, unfortunately have refrained from participating in the interviews. Risk Metrics Group, after the acquisition of Innovest and most recently KLD (November 2009), was not able to give an interview due to restructuring.

- CalPERS (US)
- Sustainanalytics (NL)
- Vigeo (F)
- Risk Metrics Group (US)

RESULTS from WEC's interviews

Generally, all SRI organizations made clear that they slightly revise their rating criteria according to new scientific knowledge and stakeholder concerns on a yearly basis. However, the below mentioned general trends are expected to continue in the next 3-5 years.

SUSTAINABLE ASSET MANAGEMENT (SAM)

- **Climate Change:** SAM will apply tougher levels of climate change/energy efficiency criteria (this clearly also includes measures in the Supply Chain)
- **Sustainable Supply Chains:** SAM will apply tougher levels of sustainable supply chain evaluation (environmental standards, labour issues)
- **Opportunities for Sustainable Development:** Beyond evaluating overall sustainability records SAM will evaluate a company's ability to demonstrate that it is a sustainability leader in any special item (e.g. being part of the solution for sustainable development by providing innovative products or services)
- **Pharmaceutical sector:** SAM will apply tougher levels of access to medicine criteria (and development of products for uncommon diseases, such as products that cannot become blockbusters but are desperately needed)

FTSE GROUP

- **Climate Change:** FTSE4Good Index will apply tougher levels of climate change criteria (details can be found in appendix FTSE4Good_Climate_Change_Criteria, page 4)
- **Health and Safety:** FTSE4Good Index will apply tougher levels of Occupational Health and Safety criteria from risk industries such as Chemical, Oil & Gas, etc. (details not yet available)
- **Sustainable Supply Chains:** FTSE4Good Index will apply tougher levels of climate change criteria and occupational health and safety criteria (details not yet available)
- **Opportunities for Sustainable Development:** Some FTSE indices provide opportunities for global companies whose product portfolio already contains a significant proportion of sustainable/green products (e.g. 20% of revenue). To make these transparent companies should define green/sustainable products, find ways to estimate the amount of revenue generated from these products. They should, in general, report increasingly clearly about them.

CARBON DISCLOSURE PROJECT (CDP)

- **Climate Change:** CDP does not expect much change in its requirements for climate change reporting since they have turned out to be rather stable due to their 10 year existence. Each year in early November there are minor changes due to new regulations and investor's priorities.
- **Supply Chains:** CDP will apply (1) tougher levels of reporting of scope 1 and 2 emissions from tier 1 suppliers for the Carbon Disclosure Leadership Index, and (2) easier levels of requirements for SME's in the supply chain in reference to their lower ability to measure and report and to encourage their willingness to provide the information needed.
  >>Suitable reporting schemes for supply chains are being tested in CDP's supply chain program. CDP would be interested to include more global companies in that program in order to develop suitable reporting schemes.

OEKOM RESEARCH:

- **Climate Change:** oekom research will apply tougher levels of criteria for (a) a suitable climate change strategy, (b) explanation of policy and handling of CCS (if applicable)
- **Product safety:** oekom research will apply tougher levels of criteria for (a) approach to risk reduction if using nanotechnology, (b) status of implementation of REACH
- **Bonus system for managers:** oekom research will apply tougher levels of criteria for (a) incentive structure – social and environmental performance of company as a parameter for variable bonus

system, (b) transparency on variable bonus system, (c) transparency on gap between executives salaries and the average salary in the company
- **Lobbying:** oekom research will apply tougher levels of transparency criteria to be met
- **Water and biodiversity:** oekom research is likely to apply tougher levels of criteria to be met in the near future (3-5 years)

CALVERT GROUP
- **Climate Change Adaptation**: Calvert will apply tougher levels of risk criteria for company's ability to adapt to climate change (a) particularly for disease vectors that relate to the pharmaceutical industry, (b) insurance risk changes, (c) supply chain risks (particularly but not exclusively related to agriculture)
- **Climate Change Opportunities**: Calvert will seek companies for its product portfolio that use the opportunities from smart grids and decentralized energy
- **Product safety:** Calvert will apply tougher levels of criteria for (a) companies' approach to regulatory risks from nanotechnology but also opportunities, (b) status of implementation of regulations related to chemicals (beyond REACH)
- **Water:** Calvert will apply tougher levels of criteria for (a) transparency frameworks specific to water, such as e.g. water footprints, (b) risks from conflicts related to access of water (human rights debate)
- **Emerging market demographics/economies:** Calvert will apply tougher levels of criteria for companies' ability to adapt to (a) changing growth and demand on natural resources, (b) rural to urban population changes, (c) consumer trends specific to BRICs, (d) BRICs leapfrogging current technologies (e.g. clean tech), (e) changes in logistics/transportation given BRICs growth

(4) CURRENT SRI LEADERS IN THE PHARMACEUTICAL INDUSTRY

- **Sustainable Asset Management (SAM Group/DJSI) (CH):** Roche (BMS is also listed)
- **Carbon Disclosure Project (UK):** Bayer, Allergan, Schering-Plough
- **oekom research AG (D):** Sanofi-Aventis, Novo Nordisk, AstraZeneca
- **Vigeo (incl. Ethibel) (F):** no information on sector leaders publicly available; BMS listed in an Ethibel fund.
- **EIRIS/FTSE4Good (UK); Ratings in Germany conducted by imug (D):** no information on sector leaders publicly available
- **Sustainalytics (NL):** no information on sector leaders publicly available
- **Risk Metrics Group (US):** no information on sector leaders publicly available
- **CalPERS (US):** no information on sector leaders publicly available
- **Calvert Group (US):** Johnson & Johnson, Pfizer, Novartis

FOR YOUR ATTENTION: Two research organizations offered opportunities for WEC members to participate in their current programs.

(1) **In CDP's supply chain program** global companies participate to develop suitable reporting schemes. CDP would be interested to include more global companies in that program.
Please contact Nigel Topping, Chief Development Officer at +44 7919 074598 or Nigel.Topping@cdproject.net

(2) **FTSE4Good has started a project that evaluates how companies report revenue from "green/sustainable products".** They would like to involve WEC member companies by participating in their "environmental markets classification system's sector and subsector definitions".http://www.ftse.com/Indices/FTSE_Environmental_Markets_Index_Series/Downloads/FTSE_Environmental_Markets_Classification_System.pdf
Please contact Tony Campos, Executive, Responsible Investment - FTSE Group, at +44 (0) 207 866 8082 or Tony.Campos@ftse.com