

# Investing in sustainability

NEWSLETTER ON RESPONSIBLE OWNERSHIP

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# Can BP win back confidence - again?

On 20 April 2010, a drilling platform exploded in the Gulf of Mexico, killing 11 people. In the ensuing months, the incident developed into one of the worst oil disasters in history. Over a period of 87 days, over 4 million barrels of oil spilled from the well. To put that in perspective: the accidents with the oil tankers Exxon Valdez (1989), Amoco Cadiz (1978), Braer (1993) and Erika (2000) involved spillage of 'only' 300,000, 1,600,000, 600,000 and 150,000 barrels respectively.

It soon became clear that the financial fallout of this latest spill would be colossal. Our first, conservative estimates were around \$10 billion. This included clean-up costs, but also damages paid to employees, local fishing communities and the tourist industry. We picked up signals that BP had been negligent, and that fixing the leak at 1,600 metres depth would take as long as three months. The first US congressional hearings on the disaster confirmed this, and set the tone: BP must pay! Oil industry peers openly dissociated themselves from BP and claimed the disaster could have been prevented.

## Reputational damage

In the weeks following the accident, we fine-tuned our estimates of the damage for BP. A month into the crisis, we concluded the loss of value for BP could amount to \$60 billion - a combination of direct costs of the disaster and the reputational damage to BP and the industry as a whole. At the depth of the crisis, two months after the accident, the oil giant had indeed lost nearly half its stock market value. The company's future was hanging by a thread. To cover the cost of the oil spill, BP had to sell over \$30 billion's worth of assets. CEO Tony Hayward, who had initially tried to downplay the impact of the spill and had lost all credibility, stepped down.

So now it's up to the new CEO Bob Dudley to restore confidence in BP. Ironically, that's exactly the task his





predecessor was faced with when he took office in 2007. Hayward vowed then that BP would focus 'like a laser' on safety and aimed to become the industry leader in this area. Then, too, confidence in the company had crumbled following a series of incidents, including a refinery explosion in Texas in 2005 that killed 15 people.

Statistics show 2010 started well for BP, with a significant fall in the number of accidents. However, an annual review by an independent panel of safety experts concluded that BP was a long way from being an industry leader in safety. BP had made progress at implementing new systems, and the 'tone at the top' was also as it should be. But the panel found the safety culture at BP wanting. The company needed to be far more self-critical and improve the quality of its audits. Nevertheless, before the disaster BP still featured high in sustainability rankings like the Dow Jones Sustainability Index and the FTSE4Good ethical index.

#### **Defensive response**

The Gulf oil spill confirms what the experts said about BP's deficient safety culture. So in August, we asked BP which measures the company is taking to prevent further accidents. BP's first response was defensive, in our view, as was BP's own analysis of the disaster, in which it puts much of the blame on contractors. In the report published by BP in September, the company admits that BP platform staff misinterpreted crucial test results and that there had been failures in its oversight of contractors. But in the dry and highly technical report, the blame on all other counts is shifted firmly to contractors or to the industry at large. Between the lines, BP seems to be saying: there wasn't much we could do about it and we were just extremely unlucky.

#### **APG engages CEO**

BP is taking the easy way out, we feel. To seriously address the safety culture in the company, BP will really have to take a closer look at its own performance. We

have shared our concerns with the new CEO and asked him to take concrete measures without delay. We also recommended strengthening top-down control of safety and risk management. BP needs to make sure that when crucial adjustments are made to operational processes, for example in relation to testing the stability of a well, the risk assessment is not left to local managers. Indeed, in the Gulf oil spill, commercial considerations seem to have prevailed in decisions to adjust the design and procedures in the final two days preceding the disaster.

### Strengthening the safety culture

In early October, Mr Dudley announced a series of drastic organisational measures as first steps towards strengthening the safety culture. Control is to be centralised. A new department, reporting directly to the CEO, is to monitor safety and risk management. The new department will enjoy wide powers at all levels of the organisation. In addition, safety will carry more weight in the employee remuneration structure. As a symbolic gesture to start with, the fourth-quarter bonuses have been made entirely dependent on safety performance. We see this as a first step, but have asked BP to produce a balanced remuneration system for 2011, which includes relevant safety performance indicators.

### Critically monitoring implementation

So BP has begun to move in the right direction, but it has a long way to go. The company is the subject of numerous inquiries and legal proceedings, which in 2011 should provide more insight into where responsibility really lies. After Mr Hayward's previous attempt to transform BP, this is the company's last chance to regain its credibility as a premium brand. Sadly, BP has in the meantime taken a step backwards. In his first speech to the company's US staff, Mr Dudley accused the media and industry rivals of exaggerating the magnitude of the disaster and BP's role in it. We wonder if these remarks will be helpful in achieving the desired cultural change. Nor do they contribute towards better relations with legislators. The CEO turned down an invitation from US Senator Markey to appear before a congressional committee. The Wall Street Journal

reports that the Senator is angry at BP for still 'continuing to point the finger at everybody but themselves' despite promises to change. We share the Senator's point of view and will be monitoring the implementation of the measures announced with a very critical eye.

## Call for more checks, balances and supervision

*On 23 November 2010, we had further discussions with BP. This time we spoke at length with the Vice President, Health Safety, Security and Environment. This new department will tighten up safety and risk standards and monitor their proper implementation. We welcome these plans, but we have asked BP to build more checks and balances and top-down supervision into its operational control procedures. For example, we think BP ought to monitor measurement data on oil platforms in real time at its onshore command centres.*

# Barrick Gold – engagement bearing fruit

As part of our ongoing dialogue with the Canadian gold mining company Barrick Gold (see also Investing in Sustainability no. 3), we recently visited their Porgera mine in Papua New Guinea. The Porgera Joint Venture (PJV) has had some bad press for dumping its mining waste directly into the nearby river. There have also been reports about human rights violations around the mine by the police and the mine's own security forces. This then raises the question whether Barrick operates in line with the UN Global Compact, in particular Principles 7 (precautionary approach to the environment) and 1 (respect for human rights). APG expects companies to comply with all ten UN Global Compact Principles.

We wanted to see for ourselves how the mine operates. In preparation, we performed research of our own, commissioned specialist environmental research, spoke with human rights organisations and consulted experts on sustainable mining and on Papua New Guinea.

The mine operates in a challenging social and physical environment. The country is known for its volatile security situation. The people we spoke with, including representatives of a tribe living adjacent to the mine, actually want a police presence in the valley, especially as more and more people are moving in. At the Porgera mine, the gold is visible, and we saw with our own eyes how people walked into the open pit and on the waste dumps with just their shovels. The risks to their safety are enormous.

## Environmental scorecard a positive step

Where the river leaves the mine, it is coloured red because of the tailings, and along the subsequent stretch until it joins with another river, it becomes gradually less red and more sediment-coloured like



*The mine's environmental specialist shows rehabilitation efforts of the waste dumps.*

other nearby rivers. The real environmental impact of the tailings on the water, the ecosystem, the river bank and the health of the people in this area can't be judged with the naked eye, though. That calls for solid scientific environmental monitoring data. PJV has published an environmental scorecard for 2009, which is a good step, but we believe that it needs to disclose the actual impact assessments and the environmental data over time to allow outside scrutiny. Showing compliance with the national and international ecosystem standards, at a point closer to the mine than at the compliance point 160 kilometres downstream, would also help alleviate concerns. From what we understand this is actually something that the mine can do already.

### Transparency works

We also had the opportunity to talk to employees in charge of environmental management, community relations and security, and certainly got the impression that the staff is dedicated to operating the mine in the best possible manner. Current disclosures, however, fail to convey the complexity of the security challenge, making PJV's response difficult to understand. One of our recommendations was to put a grievance mechanism in place in line with the 'Protect, Respect, Remedy' framework for business and human rights designed by UN representative John Ruggie. Other recommendations were to publish the memorandum of understanding with the police and to report more broadly on how PJV implements the Voluntary Principles on Security and Human Rights. Concerns remain, but Barrick can only address these by communicating more effectively about how it deals with security issues and by visibly taking responsibility for the consequences of its actions. This way, external stakeholders can better understand and assess how the company adheres to the principles of the UN Global Compact.

Besides visiting the mine, we also talked to local stakeholders. In the capital Port Moresby we met with the Government Mineral Resource Authority and the Chairman of the Porgera Environmental Advisory Committee. This gave us a better idea how the mine's benefits are shared. The landowners around the mine



*The open pit, where regular blasts are triggered to get to the deeper-lying gold. Non-employees simply walk down with their shovels.*



*Large truck tipping its cargo into the grinder where it is crushed into smaller and smaller pieces.*

site have an equity stake in the mine and receive royalties, so the first generation of Porgerans has done very well out of the mine. But the third generation's only benefits are employment or mine-related business development. And what happens once the mine closes? To us it brought home one of the biggest challenges of sustainable mining: to create a lasting positive legacy.

All in all, we have come away with a much better understanding of the challenging social and physical environment that the PJV operates in. We spoke to Barrick Gold's CEO about what we learned in Papua New Guinea. He ensured us that various of the suggestions we made in recent years would be followed up.

## Barrick takes action

*The latest news is that Barrick has indeed become a signatory to the Voluntary Principles on Security and Human Rights. And Barrick has announced that it is following another one of our recommendations: they will shortly be appointing a director with environmental expertise to their board.*



# Investing in healthcare in Africa

In Africa, healthcare is by no means a readily available commodity. Often it is hard to access, and the quality varies. The private sector, while providing over half of all healthcare, is fragmented and underdeveloped. Commercial companies in this sector have limited access to capital, which they do need to meet the huge demand for healthcare among the growing middle classes. We also see that more and more companies offer healthcare to their employees as a fringe benefit, pushing up demand even further.

## EUR 12.5 million invested in healthcare in Africa

In 2009, responding to the situation just described, APG invested 12.5 million euros in the Investment Fund for Health in Africa (IFHA). This private equity fund invests on our behalf in private healthcare companies in sub-Saharan Africa active in pharmaceuticals supply, health insurance, private hospitals, private clinics and laboratories. By investing in IFHA, APG contributes toward better healthcare in Africa which is more readily accessible to the rapidly growing ranks of middle-class Africans.

## Social and environmental guidelines

As a shareholder in IFHA, APG encourages better occupational health & safety and better environmental practices in IFHA's investee companies. To reflect this, internationally recognised social and environmental guidelines have been incorporated in IFHA's investment policy.

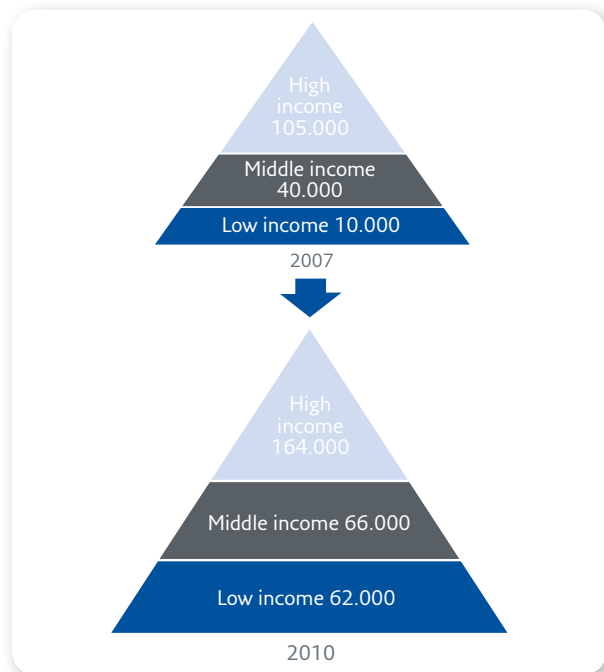
From its very first dealings with companies, IFHA identifies potential social and environmental risks. While the investment is in portfolio, IFHA regularly tests the company for compliance with locally applicable and international guidelines. For example, the fund's pharmaceuticals distributor has improved working conditions and addressed problems with refrigeration and transport of its drugs.

## Economic and social developments

With this investment, APG also contributes towards the realisation of the United Nations Millennium Goals. These include increasing the number of insured people in the lowest income bracket (under 1,500 euros a year). The first results were achieved with an investment in a Nigerian health insurer. Since IFHA's investment in 2007, the number of low-income insured individuals has risen from 10,000 to 62,000 (see diagrams below).

With its investment, APG strengthens this health insurer's financial base. Several other investors have followed APG's lead, further improving the company's financial health and enabling strong growth. The company's value has risen steeply as well, making it an attractive acquisition target. When the company has been sold, the proceeds go to the investors in IFHA, including APG. This enables us to meet the objectives of our clients: attractive financial returns and a positive contribution to society.

The number of policy holders at a Nigerian health insurer in which IFHA invests.





## Climate change - has the climate changed?

This time last year, the eyes of the world were on Copenhagen. Would the world's governments manage to reach an international agreement to tackle climate change by limiting greenhouse gas emissions and providing funding for new technology and forest conservation in developing countries? The Copenhagen Summit was a disappointment, producing only a non-binding agreement instead of the binding international treaty that many – including APG – had called for. Expectations of the latest round of climate change negotiations, being held in Cancun, Mexico, in the first two weeks of December, are muted. There is no prospect of a comprehensive climate change treaty being signed – despite the continuing warnings from the scientific community of the urgent need for action. Individual governments around the world are also backing away from earlier

commitments. The US Congress has rejected proposed legislation to cap CO<sub>2</sub> emissions, and the Spanish government is drastically restricting subsidies for solar power.

What are the implications of this for an investor like APG? Well, mixed. APG already has numerous investments in its portfolio that will directly help to tackle climate change – wind and solar power in Europe, landfill gas capture in the US, geothermal energy and more. Some types of investment with direct climate change benefits are still attractive. These are often driven by commercially attractive technological innovation and the cost savings associated with reducing energy consumption. It's investments like these that APG is on the lookout for. For example, we have recently committed up to \$300m to Energy Capital Partners, a US-based fund that will improve energy efficiency in buildings, invest in 'smart grid' technology to improve the efficiency of electricity distribution, and build new power transmission lines to link renewable energy generation plants to the grid.

**Handsome returns on sustainable real estate**  
Meanwhile, real estate companies – most notably in

Europe and Australia – see strong financial reasons to invest in greener buildings. There is strong evidence that greener buildings perform better as investments. And that means lower carbon emissions. APG is actively encouraging leading property companies to pursue this opportunity. Some of the largest in the world – including Unibail-Rodamco and Vesteda in the Netherlands, Hammerson in the UK and Westfield in Australia – have taken significant steps to improve their environmental management following APG's engagement.<sup>1</sup>

### Time for governments to act

But the financial viability of many new investments in tackling climate change depends on the right government policy being in place. Budget constraints in the wake of the financial crisis are prompting many governments to cut support for renewable energy. Uncertainty over government policy has been one factor behind falls in the share prices of many renewable energy companies. The increased risk of policy changes also makes it difficult for APG to make new renewable energy commitments in asset classes such as infrastructure: 'green' investments, like other investments, must perform financially. Only then are they in our clients' interest.

APG therefore continues to work with other investors to stress the urgency of action by governments to create strong, long-term frameworks that will support the large-scale investment in climate change solutions that is needed (\$500 billion a year by 2020, according to a recent report by the World Economic Forum and Bloomberg New Energy Finance).<sup>2</sup> Through the Institutional Investors Group on Climate Change<sup>3</sup> we have joined forces with 259 investors around the world with a total of \$15 trillion in assets to call on governments to push hard for real progress at the Cancun summit.

APG remains committed to seeking out investment opportunities that help to tackle climate change. We will take these opportunities wherever they are sufficiently financially attractive. But we cannot invest where risks are too high and returns too low. It is now time for governments to act. Then we can put our capital to work, sustainably and profitably.



<sup>1</sup> You can find more examples of our climate change investments and other work in our 2009 Responsible Investment Report, available at [www.apg.nl](http://www.apg.nl)

<sup>2</sup> World Economic Forum, Green Investing 2010: Policy Mechanisms to Bridge the Financing Gap, January 2010, <http://www.weforum.org/pdf/climate/greeninvesting2010.pdf>

<sup>3</sup> [www.iigcc.org](http://www.iigcc.org)



## Cocoa farming 10 years on: child labour still not eradicated

Ten years ago, the chocolate industry came together to put an end to child labour on cocoa plantations. As US Senator Engel and Representative Harkin looked on, the companies agreed to set up a verification system in the next ten years that could trace the origins of the cocoa they used in their products. That way, they would know whether their suppliers had employed children.

Recently, results were published by an American University that had been commissioned to investigate progress in the cocoa sector. The report's conclusions are discouraging. Despite the efforts of the companies, the international organisations and the governments involved, child labour is still very much a feature of cocoa farming in Western Africa. By child labour, we don't mean children helping their parents out with the harvest when they come home from school. The researchers observe that children below the legal minimum working age of 15 work long hours in dangerous conditions. The report also contains evidence of human trafficking, with children being taken from Mali and Burkina Faso to work on the plantations, mainly in Ivory Coast.

### Child labour issue still not resolved

The chocolate industry, which gets most of its raw material (cocoa) from Ghana and Ivory Coast, has in recent years had major problems dealing with the dwindling supply of sufficient good quality cocoa. Companies have long been working with the many local farmers to modernise production methods, which are currently far from efficient. Through training and supply of more effective pesticides, farmers are encouraged to adopt a different business model. As a part of this drive, the sector is trying to convince farmers not to employ children.



It is clear to us that the sector's efforts have not had sufficient effect. As investors, we see poor supply chain management as a risk. We believe the sector should adopt a more structured approach to stop child labour in their supply chain.

### Call for structured approach

Since 2009, we have been engaging the large companies on their unconvincing attempts to take control of their supply chain. We have called for a structural approach that provides insight into the conditions under which their cocoa is grown. We've also asked them to report systematically on their progress. After all, amid the bad press we also see that the companies are moving in the right direction. Increasing numbers of them are using more cocoa that is certified, or at least traceable. And they are reporting in an increasingly structured way about the results of the development projects that they have set up in these countries, sometimes in partnership with international organisations.

### Harkin and Engel strike deal with governments

In September 2010, several companies announced significant contributions to the programme initiated by US Senator Harkin and Representative Engel as a follow-up to their 2000 initiative. This time, the Ivorian and Ghanaian governments are co-signatories of the agreement in which the industry promises to make every effort to end the worst manifestations of child labour in cocoa farming. The industry is committing at least 7 million dollars up front to the public-private initiative led by the ILO (International Labour Organisation).

### Sharing experiences

Our efforts to eradicate child labour are not limited to the cocoa sector. APG has been invited to participate in a working group led by the Dutch organisation IDH (Initiatief Duurzame Handel). This multi-stakeholder platform has been working since 2008 to make international supply chains more sustainable. Alongside the Dutch trade union FNV, three companies and the Ministry of Social Affairs and Employment, we will help draft the IDH child labour programme. In this programme, companies in various sectors will be encouraged to share their experiences

with child labour and the dilemmas they face. By also sharing possible solutions, early movers can encourage followers to take measures to prevent child labour in their own supply chains. We will work to make the programme's outcomes relevant and accessible to other investors.

### Advice to the minister

In September we took part in a discussion with the Minister of Social Services and Employment about child labour. Minister Donner wanted advice from the field about how the Netherlands could contribute towards worldwide eradication of child labour. We shared our experiences as global investors with the minister. Indeed, we often find that while European companies can have quite progressive views on corporate social responsibility, these are not always shared by companies from other parts of the world, like Asia. In the United States, too, consumer pressure on chocolate producers is far weaker, as is demand for fair trade or certified chocolate.

Needless to say, we would like to see more momentum in the process of eradicating child labour. The result of all the work that has been done to date is not good enough. Still, engaging the sector and individual companies on child labour does help. For example, earlier this year the Swiss chocolate maker Nestlé proved receptive to our suggestions on how to organise its supplier monitoring. We reported on this success in issue no. 2 of this newsletter. We will continue to raise this topic in our dialogue with the business community and governments.

# Focus on corporate governance – looking back on the 2010 voting season

Investment is never risk-free. Investors in shares of listed companies, for example, are exposed to management risks: risks resulting from bad decisions and mismanagement by the people who run the company. Since the introduction in the Netherlands of the Tabaksblat Corporate Governance Code in 2004, corporate governance has climbed the agenda in Dutch society, and a similar trend can be seen in other countries. APG's corporate governance policy is aimed at identifying and minimising management risks. As an investor in some 4,000 companies around the globe, APG works to best serve the interests of the pension funds it invests for by: 1) exercising the voting rights attached to the shares in portfolio, and 2) engaging companies. In this article, we look at how APG has used its voting rights at shareholders' meetings in 2010.

## Influence through voting

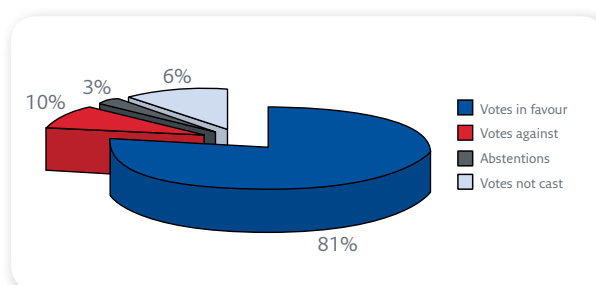
By voting at shareholders' meetings, APG has a say in board appointments, remuneration policy and issues of new shares. APG's voting policy specifies how we vote on standard proposals. For individual companies, APG's portfolio managers and corporate governance specialists as well as external consultants help us decide how we vote. If APG disagrees with a company's proposal, we seek dialogue where possible with the management to explain our views. Generally, companies prove to be open to such discussion, and as a result agenda points are sometimes revised or even withdrawn.

## Remote, in person or by proxy

In 2010, APG exercised its voting rights at shareholders' meetings in some fifty countries. Because of the vast number of equity positions APG holds worldwide, it is

impossible for us to be represented in person at every one of these meetings. That is why APG nearly always votes electronically. That said, particularly in the Netherlands, we regularly send a representative to shareholders' meetings, for example those of Aegon, Ahold, Kasbank, Philips and Ahold. Alternatively, we give other institutional investors the authority to speak and vote on our behalf at shareholders' meetings in and outside the Netherlands. For example, APG gave a proxy to PGGM for the shareholders' meetings of TSMC and Acer in Taiwan.

Votes cast



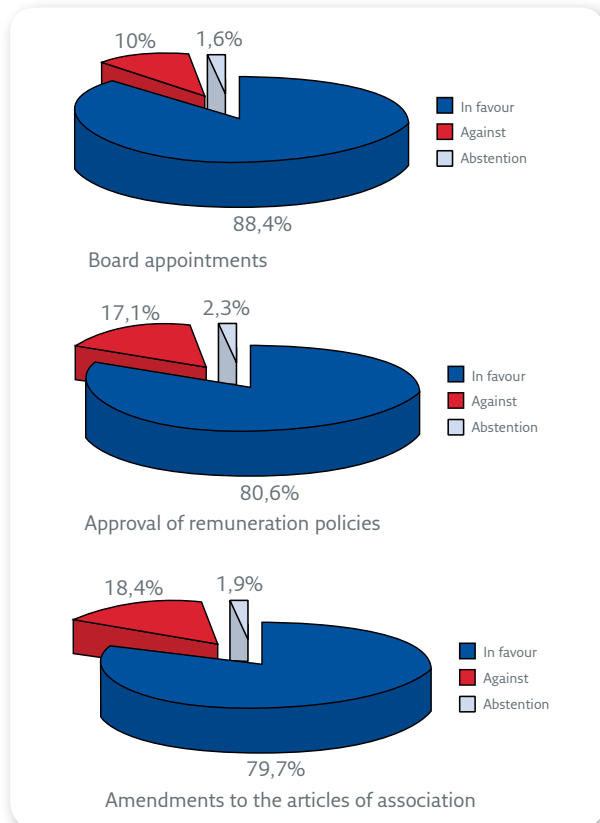
## 2010 voting record

In 2010, APG exercised its voting rights at over 3,900 shareholders' meetings, where over 37,000 proposals were put to the vote. The range of issues voted on in 2010 was very wide. Three examples:

1. Board appointments
2. Approval of remuneration policies
3. Amendments to the articles of association

The pie charts below show how APG voted on these issues.

#### Voting record



#### Dialogue

Outside shareholders' meetings, too, APG seeks dialogue with company boards, for example in drafting the agenda for the annual general meeting. Usually, discussions with boards are not made public, but in 2009 we made an exception in the case of our dialogue with the management of Prologis European Properties.<sup>4</sup> Our engagement of the management of Prologis had not produced the desired result. In such a case, seeking publicity to propagate our own point of view is an option.

<sup>4</sup> For more information on APG's engagement of Prologis European Properties, see issue no. 1 of our newsletter Investing in Sustainability.

When engaging companies, APG regularly joins forces with other institutional investors. In the Netherlands, for instance, we work with other members of Eumedion, the Dutch corporate governance platform for institutional investors. If we intend to vote against a proposal on the agenda of a shareholders' meeting, we try to be as transparent as possible towards the companies.

Holding shares means holding influence, that much is clear. APG will continue its efforts to exercise this influence in the most responsible way possible. In the interest of our clients, the pension funds we invest for.



# Coal production: digging beneath the surface

Mining is an activity with a significant impact on people and planet, as recent accidents in Chile, Hungary and New Zealand make clear. APG wants to ensure that mining companies operate responsibly and provide insight into their social and environmental performance, so investors can take this on board in their investment decisions. But first we need to better understand the issues, the performance and their relevance for investors.

To get a better understanding, APG has chosen to team up with two very different partners, both recognised as leading players in their respective fields: investment broker CLSA delivers data on markets and companies in the Far East in particular, and the Washington-based think-tank World Resources Institute (WRI) the technical and scientific know-how we need to assess sustainability performance.

## Valuable insights

Recent research by CLSA has provided us with valuable insights into China's coal industry. China's coalmines have made huge strides in safety terms, with deaths per million tonnes of coal produced falling from 6.1 in 2000 to 0.89 in 2009, but safety performance varies greatly from company to company. At the best end of the spectrum, Hong Kong-listed Chinese mining giants in which we have holdings are achieving cutting-edge performance that is way ahead of the industry average in terms of safety. In sharp contrast is the uninvestible space, featuring small private mines where over ten workers lose their lives for every one million tonnes of coal extracted, largely due to a lack of investment and safety processes as well as a focus on short-term profits. This means investors need to look closely at the safety performance of each company that they own.

Investors also need to be aware of another major risk to

long-term profitability: possible claims for damages from miners who have contracted illnesses like black lung disease. We believe the market has not yet factored in the contingent liability for the Chinese coal industry, which employs more than 3.5 million people with varying degrees of exposure to perilous work environments.

## Assessing water-related risk

Another issue APG is interested in engaging mining companies on is water. Hardrock mines (ones that extract minerals or metals from the earth) rely heavily on water to operate. They use water in all steps of the mining process, for instance to cool equipment, separate waste from valuable minerals and control dust. Inevitably, this poses environmental and social risks. Local communities may be left with insufficient water for their needs, and mining waste can contaminate water supplies, threatening drinking water and aquatic ecosystems. In the case of accidents, mining companies may be fined and sued, and face new regulations and operational disruption. But it is very hard for investors to analyse water risk exposure properly. The WRI Report Mine the Gap, sponsored by APG, presents a preliminary framework that the financial community can use to assess water risk, including a series of questions for mining companies about their water use:

- What type of mining processes are employed?
- What is the environment surrounding the mine?
- How does the company measure and track its water use?
- How does the company monitor and manage water quality concerns?

## Engaging coal industry players

It is obvious that change is urgently needed, and investors like APG can play a key role in bringing change about. We can help companies to improve their health and safety performance by engaging management on issues like processes and procedures, regulations and inspections, their investments, their track record, their social responsibilities, compensations and disclosure. Our partners' research has helped us better understand the risks in our portfolio and will sharpen the focus of our engagement with mining companies worldwide and with Chinese coal companies on health and safety in particular.



# Greening real estate adds value

The value of sustainable real estate in an investment portfolio is obvious. Practically all the real estate transactions that have taken place in the Netherlands in the past few months have involved sustainable buildings. The Dutch government, the country's biggest office space tenant, has for several years now been taking the lead: it will only rent office space with an A, B or C label for sustainability. Numerous blue chip companies are following suit, and thus we see a trend similar to the one in the car lease sector: customers are increasingly excluding certain categories.

With the development of new plans currently on hold, real estate investors are now focusing on 'greening existing assets'. Sustainability is a 'must'. A sustainable building has a healthier indoor climate, which leads to higher productivity and lower operational costs. Sustainability leads to higher social and financial returns. The social returns of more sustainable real estate are a no-brainer, as the real estate sector accounts for over 30% of total carbon emissions. As for financial returns, various studies<sup>5</sup> of the US office market indicate better rents (>5%) and better capacity utilisation (3-8%) for sustainable buildings.

It was nearly two years ago that APG first picked up on this trend. We now examine the sustainability performance of prospective new real estate investments, and this factor is taken on board in the decision-making process of APG's



investment committee. Portfolio investments are screened for sustainability on an annual basis, using a Global Real Estate Sustainability Benchmark initiated by APG (read more on [www.GRESB.com](http://www.GRESB.com)).

### Win-win situation

The sustainability benchmark, now backed by a dozen more large institutional investors like PGGM and ATP, is a tool to monitor sustainability progress among real estate companies and funds. The Benchmark focuses on aspects that can be measured and influenced. This explains the strong weightings attributed to energy and water consumption and waste management in the shared space of commercial buildings. Besides their environmental impact, these factors can also have a direct favourable impact on operational results in the form of lower electricity and water bills. In other words, a good example of the win-win situation that greening real estate can bring about, with social and financial returns showing a positive correlation.

### Direct link to returns

This is also the conclusion of the first survey that Maastricht University has performed for us. The sustainability data collected were compared to financial data. A significant positive correlation was found between return on assets and the degree to which sustainability had been implemented in the real estate portfolio. A causal relationship could not be proven, however. Do the companies perform better because they are more sustainable? Or do their high returns mean they can spend more on sustainability?

### Reducing energy and water consumption

For APG's existing real estate portfolio, our intention is not to transform all our assets into ultra-sustainable buildings. This is hardly feasible in practical terms. What we can do, though, is improve their sustainability performance. To begin with by picking the low-hanging fruit, which the companies we invest in are helping us to identify. The first step is to measure current energy and water consumption, so as to have a basis for comparison. Unfortunately, less than 20% of the 200 respondents to

our survey actually measure their energy consumption. Simply monitoring consumption often already leads to savings of 10 to 20%. For example, air conditioning units are often left on during weekends, despite the fact that generally there is nobody around. In many cases, significant gains can be made by replacing inefficient and thus costly lighting. For each improvement, careful calculations are performed, because at the end of the day, our aim is to increase both social and financial returns, so that we can meet our fiduciary obligations.

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5 Miller (2008), Eichholtz (2008) and McAllister (2008)



## Independent inquiry needed at Samsung

In April 2010, APG and seven other investors jointly engaged global tech giant Samsung Electronics Corporation following the sudden death of a young ex-factory worker in March, which sparked a new round of heated debate on employee health and safety issues at Samsung. It was the ninth death reported out of a total of 23 former Samsung employees who had sought the media earlier this year after falling seriously ill, most of them with leukaemia.

Engagement was stepped up gradually, including meetings and dialogues with company representatives as well as the ailing former Samsung employees and the families of the deceased workers. Samsung, meanwhile, seeing its public image rapidly deteriorating, hired an environmental consultant in July 2010 to investigate the employee health and safety claims.

### APG pressure spurs action

Judging from various sources, including the media, we are convinced that our engagement jointly with other signatories of the UN Principles for Responsible Investment was a key driver for Samsung's swift response. It woke management up to the growing concerns in the international investor community, and essentially put pressure on them to resolve the matter as quickly as possible.

However, the outcome was not altogether positive. From the day our engagement started, reports trickled in of Samsung's behind-the-scenes negotiating with its ailing ex-employees and the families of the deceased. Local media reported that the company had tried to buy off the case. The NGOs helping the ex-Samsung workers claim this is a particularly inhumane way to treat these people, most of whom are in serious financial straits due to hefty medical bills.



### Independent inquiry needed

All in all, we are not satisfied with Samsung's response so far. The biggest issue is that the currently ongoing investigation (conducted by an external environmental consultant) does not, in our view, provide a credible basis for resolving the case. In the first joint investor letter sent out in May, we asked Samsung management to conduct a proper, thorough and transparent third-party investigation. But what the company calls an independent third-party investigation is in fact neither independent nor transparent. The environmental consultant was hired and is being paid for by Samsung. Moreover, the company has not disclosed any details on how the investigation team is being monitored, who the participating experts are, when and how the ex-Samsung workers will be involved, and so on.

The fundamental issue underlying Samsung's inept handling of the case is the worker-unfriendly labour regime which persists group-wide. This is confirmed by our dialogues and meetings with Samsung representatives, who clearly felt they were dealing with unfair accusations from labour unionists, rather than valid employee health and safety issues. This, together with lack of transparency on a corporate level in general, is why Samsung has been unable to make any meaningful progress so far on the case.

Samsung's attitude is not unique among multinationals of Asian origin. Having long benefited from a cheap and docile workforce, these companies are often reluctant to improve their corporate culture on labour issues without external pressure. Indeed, having gained considerable economic and socio-political clout in their home countries, they are seldom called to account there for social wrongs.

### Reputational damage looms

We believe that Samsung's substandard performance in respecting workers' rights poses considerable risks to its long-term profitability – risks that its shareholders also run. If Samsung persistently fails to deal responsibly with the series of employee deaths, it may face growing criticism not only at home but overseas. This may taint its brand equity—a very unwelcome development for a consumer electronics manufacturer. The best solution would be to disprove responsibility for the illnesses and deaths, but

the crucial premise is to have a properly managed investigation— not paid for by Samsung directly.

We fear escalating criticism, with further deaths among the ailing former employees fuelling new rounds of debate. Therefore, we continue to urge the management to take action. To turn the tide, we intend to step up our engagement activities, collaborating with a wider group of institutional investors as well as communicating more directly with other stakeholders. In addition, as we acknowledge poor labour standards in the electronics industry are at the root of the problem, we will be looking for ways to work together with global electronics brands on improved standards.



# APG's responsible investment principles

- 1** Responsible investment is integrated into APG's investment process.  
*We take account of shareholder rights and environmental and social issues in our investment decisions. Our research on sustainability or corporate governance can form the basis for decisions not to make an investment, to sell an investment, or to reduce or increase the size of an investment.*
- 2** APG engages with companies to promote sustainability and good corporate governance.  
*In our dialogue with companies we make clear what standards we expect in relation to sustainability and shareholder rights. To increase our influence we often work with other investors.*
- 3** APG expects companies to operate in accordance with the UN Global Compact and will divest from companies if engagement does not lead to improvement. APG does not invest in products that are prohibited under Dutch or international law.  
*This means we do not invest in companies that are directly involved in the production of landmines, cluster munitions or launch systems for these weapons, or of chemical or biological weapons. We also exclude companies involved in products or services that are generally considered in the Netherlands to be objectionable. The UN Global Compact sets out a minimum framework of standards for corporate practice on human rights, labour rights, the environment and the prevention of corruption.*
- 4** APG makes active use of its rights as a shareholder.  
*We vote at the meetings of companies in which we invest. We publish our voting record and explain our voting decisions.*
- 5** APG works in the Netherlands and internationally to advocate policy and legislation that support sustainability and good corporate governance.  
*We regularly discuss sustainability and shareholder rights with policy-makers. We also contribute to the development of standards to promote the long-term integrity of financial markets.*
- 6** APG seeks out attractive investments that promote sustainability.  
*APG invests in renewable energy, clean technology and microfinance and is constantly alert to new opportunities to make investments that contribute to sustainability.*
- 7** APG promotes its responsible investment approach actively in order to encourage sustainability and good corporate governance.  
*We work with other investment managers and pension funds throughout the world in order to increase the impact of our responsible investment policy on behalf of our clients. We play an active part in numerous investor networks in the Netherlands and internationally. We communicate extensively about our work.*



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