

Investing in sustainability

NEWSLETTER ON RESPONSIBLE OWNERSHIP

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Dialogue with Asian Stock Exchanges

From the investors point of view of APG's customers it is important for Asian companies, like other companies worldwide, to report effectively about their ESG practices. Therefore they need sound regulatory guidance for performances in terms of sustainability and reporting. We believe that stock exchanges are best positioned to play a pivotal role in promoting them for the listed / listing companies. This is why we have long been active in engaging with Asian stock exchanges and provided investor feedback and full support for their activities. In 2010, we have been providing our feedback to HK Exchanges & Clearing (HKEx), as it was drafting mandatory ESG reporting guides for listed companies. One of the points we made was that the scope of mandatory ESG reporting

should include not only listed companies, but also new IPO candidates. APG has also participated in the education conference for the listed companies in Thailand and for the CEOs of local asset management companies. This was jointly organized by Thai Stock Exchanges, Thai Government Pension Fund, and UNPRI.

Best practices upgraded to more stringent 'Code Provisions'

On the corporate governance front, we have been utilizing both direct and indirect routes to engage with Asian stock exchanges. The latest case for the direct engagement on behalf of our clients is with HKEx where we have responded to its investor consultation regarding the new draft Code on Corporate Governance Practices and Associated Listing Rules. The draft code aims to promote a higher level of corporate governance quality at listed / listing companies. One positive feature in the new draft code is that many 'Recommended Best Practices' under the current code have been proposed to be upgraded to more stringent 'Code Provisions'. The current code has been criticised



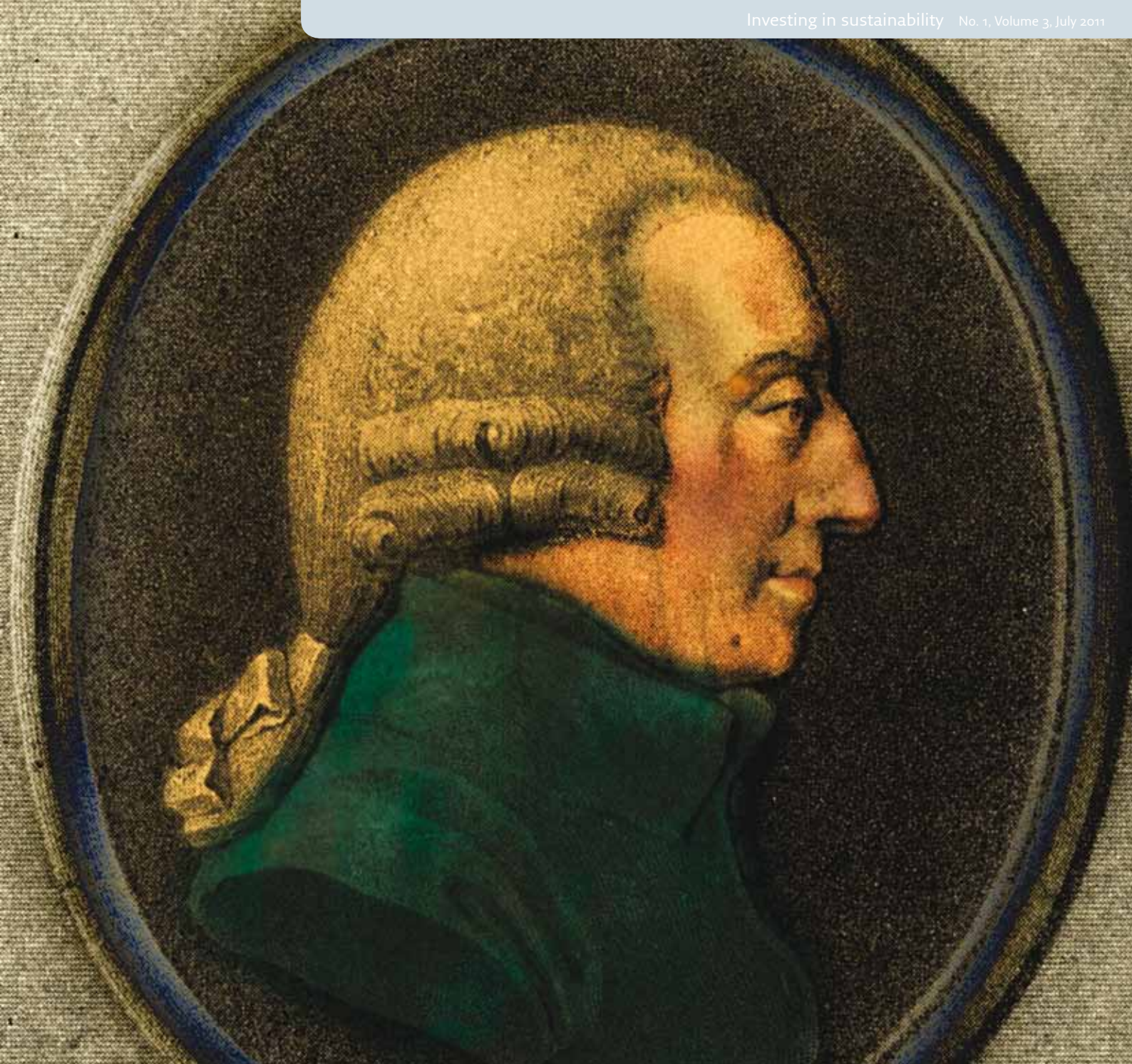
for lack of enforcement and falling behind international standards. However, we believe that it has been the main contributor in terms of education and promotion of good corporate governance principles and structures, especially for Chinese companies which have made a debut in the HK stock market. Our engagement efforts should continue in order for HKEx to come up with the best possible new code for the benefit of minority shareholders.

Asia Corporate Governance Association

The other work stream – an indirect way – is that we have been closely working together with ACGA (Asia Corporate Governance Association) in promoting Asian stock exchanges to adopt good corporate governance rules and practices. APG has been at the forefront in supporting ACGA's engagement initiatives with Tokyo Stock Exchange, Taiwan Stock Exchange, and National Stock Exchange of India in 2010.

Depending on the importance of the issues raised, we have gone an extra mile by directly engaging with our portfolio companies, while ACGA has been working with the stock exchanges. One good example is our recent engagement with Taiwanese companies on audit committees. We not only have been supportive on ACGA's Taiwan initiative and its engagement with the Stock Exchange, but also have decided to separately engage with leading companies in our portfolio on the lack of audit committees, a clear weakness from a board oversight point of view. The Taiwanese Securities and Exchange Act allows companies to choose either to establish an audit committee or to have a supervisor (whose role/responsibility is rather limited compared to that of audit committee members). It is fairly common that companies have no established audit committee in place, and in fact, we found that most of the leading companies in Taiwan do not even disclose whether they have an audit committee in place or not.





Can Reporting Drive Change?

Already Adam Smith (1759) recognised that it pays for business to take a societal perspective. McKinsey surveys (2008 and 2010) showed that more than 75% of executives and investors believe that environmental, social, and governance (ESG) initiatives create corporate

value in the long term. The Global Financial Crisis has fundamentally shaken the trust that society has in business and calls for accountability and transparency get ever stronger. It has also become clear that a lot more than just financial information is needed to understand how a business operates and performs: who is at the helm of the company and what structures are in place to manage risks and identify opportunities? How does the company build relationships with its stakeholders and manages its social and environmental impacts?



Interlink of three types of capital

Financial reporting has evolved over the past 100 years and still is not considered good enough. Sustainability reporting is more of a recent phenomenon and has its own flaws in that it often does not connect to business strategy and financial performance. However, a company's performance depends on how well it makes use of financial, social and natural capital to ensure that it can perform well in the long-term. The three types of capital are interlinked and one affects the other, but how is rarely explained.

As investors we need to make informed investment decisions. For example, understanding how a company ensures the security of its raw material supplies is key for consumer companies and this strongly depends on how well these companies manage environmental and social aspects of their supply chains.

Role of APG

APG has taken an active role in the consultation process by the European Commission about non-financial or ESG disclosures, and has joined the International Integrated Reporting Committee (IIRC) where a broad group of stakeholders involving the IASB and the GRI seeks to develop a framework for integrated reporting. We recognise the legal and regulatory requirements that companies have to meet in terms of filing their report and accounts, and believe that an integrated report should build on existing reporting principles and definitions to define what should be represented in an integrated report.

Create trust

In our view the primary integrated report should be targeted at investors and cover how companies address stakeholder concerns. Additional disclosures should be targeted directly at those stakeholders to satisfy their information demands. The internet will play a very important role in this.

Several European countries require some degree of ESG disclosure by their domestic companies. It will be important going forward to harmonise such requirements and avoid the mushrooming of too many different standards. This creates an unnecessary burden for

companies. The leading ones have already realised that the move towards an integrated report is inevitable in order to create trust by being more accountable.

The process of integrated reporting can be a challenging journey as sustainability data is not yet of the same quality as financial data. Systems and processes are still lacking. But boards will find that eventually their understanding of the strategic business drivers will have broadened and allow them to make much more informed decisions.

Involvement in developing a supplement for real estate

In our view sustainability and reporting is important for our industry. We were willing to support and participate in an initiative that can create more transparency in a sector which is seen as one of the highest polluting sectors when it comes to carbon dioxide – 40 percent of greenhouse gas emissions come from the built environment. The sector is also a heavy user of water, land and materials like wood.

Perfect timing

Current real estate investments of APG customers account for around €21 billion on a global scale; mid 2009 it was hard to measure the level of sustainability, but APG was seeking for a baseline study covering both listed real estate and private property fund investments. The timing of the Global Reporting Initiative for drafting the Construction and Real Estate Sector Supplement (GRI CRESS) was perfect. Early October 2009, we had the first GRI CRESS working group meeting in London. With the GRI CRESS, we are able to give a boost to disclosure of non-financial information in the property sector. We thought it would be good to have one language – one set of indicators – for multiple stakeholders. In some cases, there is relevance for investment. Especially, in real estate, there is a direct relationship between energy efficiency and operational costs of managing buildings. By looking at sustainability performance, we are protecting our clients – for example, when looking at climate change impacts, non-energy efficient buildings may be devalued.

The only institutional investor

We are the only institutional investor in the Working Group. Our goal is to make sure the metrics of GRI CRESS are also investment relevant and are widely used and

adopted by industry associations. However, they will not all be investment relevant in financial terms, but probably a quarter to a third of the current 90 indicators will be. From an investor's point of view, indicators must be measurable as we have to verify the data. In that sense, environmental indicators are more meaningful to investors – one can measure impacts and have the data audited. For the real estate sector this includes energy consumption, carbon emissions, water use and how one deals with waste.

Social indicators are important, but maybe less so in developed markets, where these issues are mostly covered by laws and regulations. Indicators covering human rights and labour standards are important in Asia, for example. Moreover, in developed markets we are mostly dealing with existing buildings, whereas in emerging economies the impact on communities can be far greater as there is a lot of growth and construction. Issues like safety for the construction workers, (forced) resettlements and corruption and bribery are a couple of examples that require the attention of real estate companies.

Many more real estate sustainability initiatives

APG is on behalf of its clients involved in many sustainability initiatives for the real estate sector such as EPRA's (European Public Real Estate Association) Sustainability Reporting Committee and INREV's (European Association for Investors in Non-Listed Real Estate Vehicles) Sustainability Committee. We see it as our role and responsibility to harmonize key performance indicators and their commonly used definitions as much as possible. In the end, we would like to be able to compare sustainability performance of different property funds or listed real estate companies. That's why we pushed leading real estate associations to use part of the Supplement. The Global Real Estate Sustainability Benchmark, cofounded by APG, also uses part of the draft CRESS supplement. It is an investor-led benchmark that asks around 50 questions, some of which are based on the supplement. If real estate funds or companies complete the questionnaire, they can see their performance compared to that of their competitors. A complete questionnaire also nearly fulfils all the requirements of a level C GRI report.



Mixed picture

The current state of reporting in the sector is a mixed picture if you look at the US, Asia or continental Europe. In Australia and the UK the majority of companies are producing sustainability or corporate responsibility reports. But it is a rapidly progressing sector – many companies are already including their sustainability performance data in their financial report. We believe that integrated reporting which provides an interlinked account of a company's financial, governance and sustainability strategies and performance is the future. Therefore we are active in the International Integrated Reporting Committee (IIRC) of which GRI is also a member alongside financial standard setters and other stakeholders.

APG is confident the supplement will provide further guidance on how to build sustainable buildings which anticipate future environmental legislation and buildings codes; fulfill tenant demand for green buildings and protect investors' value by yielding higher net incomes (through lower operational costs and occupancy gains).

New survey will boost number of participants

Currently less than 100 real estate companies (excluding construction companies) and fund managers are using GRI Guidelines. Starting in March 2011 we have sent a survey to more than 1000 listed real estate companies and private property funds, covering the full investor universe – hopefully this will give a boost to the use of the Supplement. Our aim is at least to double the number of GRI reporters in the real estate sector by 2012. More information about this survey in the next issue of Investing in Sustainability.



New corporate human rights reporting guidance

The Global Reporting Initiative has published an update and completion of its latest Sustainability Reporting Guidelines. The Global Reporting Initiative (GRI) has developed the world's most widely used sustainability reporting framework. In 2009 GRI was directly notified of some 1500 reports. The reporting framework sets out the principles and disclosures that organisations can use to measure and report their economic, environmental, and social performance. The cornerstone of the framework are the sustainability reporting guidelines.

Guideline improved to disclose expectations of investors

In the latest version of the guidelines, the reporting guidance on human rights is one of the sections that has been improved significantly to better meet the human rights risk related disclosure expectations of investors and other stakeholders. APG has contributed to the development of the updated guidelines. We have participated in the GRI working group and shared our perspective and experience of engaging with companies on human rights issues as an investor .

Why should companies report on human rights?

Corporate reporting on human rights is one of the environmental, social, and governance (ESG) factors that investors identify as critical for effective investment analysis regarding companies in their portfolios. Better reporting provides investors with access to crucial information on the human rights impacts of the companies in which they invest in.

We expect companies as a minimum to meet the UN Global Compact Principles. This includes that companies should ensure that they do not become complicit in human rights abuses. We are looking to understand if and how companies have their due diligence in place in

order to mitigate the human rights risks in their business activities. GRI found in a 2008 study that a majority of reports emphasized positive human rights impacts, while failing to include the negative impacts of the business operations of companies.

New Guidelines respond to corporate expectations on due diligence

Recent developments within the realm of business and human rights are leading to new perspectives on how human rights relates to businesses with implications for human rights reporting. The revisions proposed by the GRI working group take account of these developments in order to keep GRI in line with the evolving conceptual framework and practice. The revisions address the policy framework put forward by the United Nations Special Representative of the Secretary General on Business and Human Rights (SRSG), John Ruggie, and formulate disclosure expectations in the field of human rights due diligence and access to grievance and remedy mechanisms.

Ruggie has stressed that while states have the duty to protect human rights, companies have a responsibility to, at minimum, avoid infringing on the rights of individuals or groups. This is not simply a passive responsibility, but requires taking positive steps to become aware of, prevent and address any adverse human rights impacts connected with their business activities. Consequently companies are expected to explain and disclose how they meet these due diligence requirements.

Outcomes of the working group; updated Guidelines

Central element in the updated version of the Guidelines is the disclosure of human rights due diligence processes. Human rights due diligence means that a company has processes in place to ensure it is aware of the effect of its operation on human rights on an ongoing basis, and takes steps to anticipate, prevent or mitigate any negative impacts, as well as to enhance positive impacts. Proper disclosure of a company's human rights due diligence processes should allow investors to determine how well the organisation manages human rights issues, and how well it is implementing its own policies and processes.



The Working Group recommended that companies identify human rights principles relevant to them, and operationalise their framework for dealing with those rights. It was agreed that a good corporate report should not only focus on the positive contributions a company made to respect human right. We found it important that the report helps enable readers to determine the ability of the organisation to proactively anticipate, prevent, manage and mitigate risks to stakeholders' human rights and risks posed to the organisation by not respecting human rights. Effective corporate reporting on human rights should define which human rights issues are material for the management of risks and opportunities by companies, and provide specific information on the ability of companies to address their responsibility to meet Ruggie's requirements to protect, respect, and remedy. Reports should also address the practical application of corporate due diligence processes, by including information on negative impacts on human rights, including violations, in addition to positive impacts.

Three principles of the policy framework:

In 2008 the SRSG, John Ruggie, put forward a policy framework to address business and human rights challenges, which is based on three principles:

- 1. the state duty to protect against abuses committed by third parties, including business*
- 2. the corporate responsibility to respect all human rights*
- 3. the need for greater access by victims to effective remedy, judicial and nonjudicial.*

Effects of environmental legislation on credit quality of chemical companies

APG is constantly looking for ways to integrate environmental factors into its investment decisions. Each asset class is different and therefore requires a different approach. APG needs reliable information to be able to integrate the dimension of sustainability. Only once we have such information is it possible for us to analyse the potential effect of environmental factors on the investment return and risk.

The effect of American government policy concerning climate change on companies in the chemical sector

We wish to take environmental, social and governance (ESG) risks and opportunities into account in our investment decisions, also when investing in fixed income securities. For this reason, in 2010, APG made a financial contribution to a report by the World Resources Institute (WRI), a global think tank on environmental issues. Together with the credit rating agency Standard & Poor's (S&P), the WRI published a research report on the effects of climate change. The report, 'How U.S. Federal Climate Policy Could Affect Chemical's Credit Risk,' examines how the factors behind American federal government policy on climate change can be incorporated into the credit ratings of chemical companies. In the study, two kinds of scenarios of American climate policy were analyzed for 13 subsectors in the chemical sector that consume high levels of energy. These subsectors account for almost 90 percent of the American chemical industry's total emissions, which themselves account for approximately 5 percent of total American emissions. The report presents two hypothetical examples of companies and describes the effects on these chemical companies in terms of their creditworthiness.

Effect on competitive position

The study shows that the credit ratings of these chemical companies are directly related to the (energy) input of oil and natural gas and related raw materials. The policy effects depend largely on a company's range of products, its energy consumption, and its greenhouse gas emissions. The aim of American Power Act is to establish policy for the reduction of emissions in accordance with market conditions. The study shows that while most subsectors will experience only a moderate additional risk under the American Power Act, energy-intensive chemical companies may, depending on market conditions, have no option other than to pass on costs. This could affect the competitive positions of some companies with high energy and emission levels and ultimately weaken their credit positions.

APG financed WRI's contribution to the study because of its groundbreaking research due to its unique emphasis on credit quality. The full report is available on [APG's website](#).





Integrated reporting gives insight into success factors

We endeavour to look after our client's interests as good as we can, and therefore we are represented on some of the most influential committees on accounting and auditing, such as the Audit Committee of Eumedion the Dutch institutional investor organization working on corporate governance. Recently the chairman of the Board of APG was appointed as a Trustee to the board of the International Financial Reporting Standards (IFRS) Foundation, which oversees the work of the International Accounting Standards Board (IASB). The objective of the IFRS is to develop a single set of high quality, understandable, enforceable and globally accepted international financial reporting standards (IFRSs) through its standard-setting body, the IASB.

Transparency and accountability

Both accounting and audit are other important areas where we are trying to influence regulatory standards and the way companies comply with those standards. High quality financial information is a key vector for good corporate governance; both in terms of disclosure and - equally important - in terms of accountability. Board of directors - as the principal stewards of investors' interests - should ensure that robust, transparent and reliable financial information is provided. It should be useful to existing and potential investors, lenders and other creditors when making investment decisions.

Key assumptions

It is important that we constantly adjust to new realities. Instead of the retrospective and cost-oriented accounting techniques of the past, we need a higher standard of (narrative/contextual) reporting that focuses not only on financial performance but also on business strategy and risk management. The most



recent financial crisis has shown that effective risk management is the lifeblood of a company, in particular for financial institutions. It is important that key assumptions used for judgments that materially affect the financial statements are disclosed. That is regardless of whether those assumptions are at the low, or most likely at the high end of the range of possible outcomes.

APG supports the improvement of the quality of reporting by integrating environmental, social and governance factors with general financial disclosures by companies. With an integrated report, users of financial reporting will be provided with a more com-

prehensive picture of the success factors of a company: its business model, strategy and performance. In conjunction with such disclosures the role of independent auditors needs to be strengthened to give investors more confidence in the integrity of the information they receive. We will therefore on behalf of our clients continue to remain active in our support for narrative and financial reporting as well as EU initiatives to increase the independence of the audit function further.

For some recent examples please take a look at the website of Eumedion (www.eumedion.nl) or at the website of ICGN (www.icgn.org).



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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