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SELECTION BIAS IN ESG CONTROVERSIES AS A RISK FOR SUSTAINABLE INVESTORS

EDITORIAL



JEAN-PHILIPPE DESMARTIN
Head of the Responsible Investment Team

Sustainable Finance and Responsible Investment Chair

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FIR FORUM POUR L'INVESTISSEMENT RESPONSABLE

PRI Principles for Responsible Investment

ADDRESSING THE "LONG-TERM" TAKES COURAGE AND COMMON SENSE

In today's digital era of social networks, populism and "fake news", citizens, political leaders, and corporate decision-makers find themselves having to operate in increasingly short time frames - one hour, one day, or at best, the end of the year. A prime topical example would be the upcoming elections in Europe in June, and in America in November.

Henceforth, responsible investment is struggling to escape the "tragedy of the horizon", to quote British economist Nicholas Stern, when he referred to the astronomic financial and social cost of inaction against climate change back in 2006. In essence, it is important to look towards the next three, five, ten and twenty-five years.

This will be our roadmap as we explore the challenge of sustainably feeding 10 billion humans by 2050 in our News feature.

The academic research we shall discuss in these Chronicles addresses the issue of controversies. Whether governance, social or environment-related, their materiality is growing over the short, medium, and long-term.

Our reading recommendation is "Career and Family" written by the latest Nobel prize winner for Economics, Claudia Goldin, who takes a century-long look at the role of women at work in the United States. A highly instructive read!

Finally, in one month, as part of the Net Zero Asset Manager (NZAM) initiative, we shall communicate on our climate objectives for 2030 which are aligned with the pledge to achieve Net Zero in 2050.

It appears that addressing the "long-term" does not simply need courage, it also requires common sense. And I believe that former French President Georges Pompidou, celebrated in April as we mark the 50th anniversary of his death, would not disagree.

Please note that this editorial was not written using artificial intelligence/ Chat GPT! We wish you a pleasant read.

NEWS

THE FAILINGS OF OUR AGRI-FOOD PRODUCTION SYSTEMS

The French farmers' protests that have recently made the headlines may be complex and multi-dimensional, but they have put the spotlight on the dysfunctions that are rife in our global food production systems. The most widely spread model – intensive farming and livestock breeding – is harmful both to our ecosystems and to our well-being.

From an environmental perspective, the current production methods are not sustainable. For example, due to the intensive use of pesticides, we are now faced with a worrying deterioration in water table quality. The FAO has indicated that between 2000 and 2021, the use of pesticides has risen by 62%[1]. The expansion of farming land is also accelerating marine and terrestrial biodiversity loss. And as these phenomena combine, one third of the world's human-caused greenhouse gas emissions may be attributed to the way we produce, process and package food[2]. A further key challenge is the use of water and its scarcity: globally, agriculture[3] is responsible for 70% of the consumption of freshwater resources.

From an economic standpoint, shocks – such as the Covid-19 pandemic, and increasingly frequent extreme weather events, are pushing food prices upward. Governments worldwide are being called upon to consider environmental factors when allocating subsidies[4]. On top of these crises, armed conflicts, such as the Russian invasion of Ukraine and the Israeli-Palestinian conflict, also have direct repercussions on global food supply.

70% of the world's hungry people live in areas afflicted by war and violence. According to the United Nations' World Food Programme[5], our production system is facing an "*unprecedented global food crisis*"[6].

The food industry now lies at the heart of our social priorities. In 2022, 345 million people were still suffering from hunger[7], while 2.5 billion adults were overweight. Both our agricultural policies and our consumption habits, including food waste, must change if the system is to become more sustainable.



"Where are the non-lethal foods?"

1. FAO, *2023 Statistical Yearbook*, 2023.

2. I4CE, *Estimating greenhouse gas emissions from food consumption: methods and results*, 2019.

3. World Bank, *70% of freshwater resources are used for agriculture*, 2017.

4. World Resources Institute, *Repurposing Agricultural Subsidies to Restore Degraded Farmland and Grow Rural Prosperity*, 221.

5. Action contre la faim, *Conflits : quels impacts sur la faim ?*, 2022.

6. https://fr.wfp.org/crise-alimentaire-mondiale

7. The World Bank, *What you need to know about food security and climate change*, 2022.

FROM AN ACADEMIC POINT OF VIEW

SELECTION BIAS IN ESG CONTROVERSIES AS A RISK FOR SUSTAINABLE INVESTORS

Ralf Barkemeyer is Professor of Corporate Social Responsibility and Director of the PhD program at KEDGE Business School. His research focuses on the interface between business, the environment and society. Ralf has published articles in journals such as Journal of Business Venturing, Journal of International Business Studies, Business Ethics Quarterly, Journal of World Business and Nature Climate Change. He is currently co-editor of Business Ethics, the Environment & Responsibility (Wiley).

Christophe Revelli is Professor of Sustainable Development and Impact at Kedge Business School. He holds the KEDGE-CANDRIAM Chair and is co-holder of the KEDGELCL Chair. He was a board member of the French SIF from 2017 to 2022. He founded and directed the MSc Sustainable Finance at Kedge Business School, the first pioneering European program entirely dedicated to sustainable finance.

Anatole Douaud

The demand for reliable ESG data has steadily increased over the past decade as ESG ratings have become pillars of the sustainable investment landscape and ESG information has increasingly come to be seen as financially material and relevant for conventional investors.

One factor that impacts the validity of ESG assessments is that to some degree, companies are evaluated based on information that is published by these same companies. Prominent examples include Volkswagen, which had consistently been characterized as an industry-wide sustainability leader right until its "Dieselgate" environmental scandal broke in September 2015.

Within this context, ESG controversies data, based on the screening of independent media outlets by ESG data providers, have developed into an important dimension of ESG evaluations. By filtering news per source and relevancy, ESG controversies data providers synthesize mainstream media coverage. Investors gain time and reduce the complexity of ESG controversies data thanks to this service.

Is this service unbiased? Both ESG data providers and the mass media act as information intermediaries and their respective choices in filtering out relevant information will impact investors' assessments of corporate non-financial performance.

Existent research has treated ESG controversies as a black box, applying the dataset without scrutinizing how it is constructed. The present study addresses this knowledge gap by investigating on how media sources are selected by ESG data providers as part of the sampling of ESG controversies.

DATA AND METHOD

The study applies a two-pronged analytical approach. First, the authors analyze the Vigeo-Eiris ESG controversies database, based on the screening of 10,000 controversies updates between 2000 and 2019, to identify trends and patterns in relation to geographical scope and language use of ESG information providers.

Second, they carry out a case-based, company-centered analysis of the Kazakh operations of steel manufacturing company Arcelor Mittal, comparing country level news coverage with the controversies information reported by three leading ESG information providers. To assess the data gap between information sources, the authors compare the coverage of ESG corporate misconduct by these providers and the local press, focusing on Tengrinews, a local and online newspaper in Russian, covering Kazakh operations of Arcelor Mittal.

The combination of these two perspectives helps to generate a more holistic understanding of how bias in media selection might underlie controversies based ESG evaluations.

GEOGRAPHICAL DISTRIBUTION AND SUPPORTING LANGUAGE

The 1,605 different media outlets underlying the controversies data reports are not represented evenly in the sample. US- and UK-based media sources represent more than 50% of the number of media sources, accounting for almost 70% of individual news items. A number of other countries, including France, Canada, India, Australia and Korea, follows them. A striking similarity can be observed between the countries of origin of the media sources and the home countries of companies involved in ESG controversies.

Moreover, an overwhelming majority of news items (92%) is reported in English. At 6%, French is the only other relatively widespread language used. In other words, the geographical concentration of media sources is reinforced by language use. The chances of companies hailing from English-language countries to be covered by a controversy report times higher than those hailing from other language contexts, and three times higher for French-language countries. ESG incidents occurring outside of the English-speaking world have more chance to remain undetected by ESG data providers.

Consequently, the geographic and linguistic bias increase the odds for companies which headquarters located in the global north to see their ESG controversies covered.

CASE STUDY: ARCELOR-MITTAL'S MINES IN KAZAKHSTAN

The authors explore the extent to which locally reported ESG controversies regarding Arcelor Mittal's Kazakh operations are covered by the three major ESG data providers, Vigeo-Eiris, Sustainalytics and RepRisk. Tengrinews, a major web-based Kazakh news portal, was screened for all articles mentioning the company at least once, arriving at a final sample of 182 articles published between November 2012 and June 2019, regrouped into 60 controversies.

Tengrinews coverage is clearly more extensive than that of the three ESG information providers as it reports on a number of controversies that are not covered by any of the three ESG information providers. As an example, out of 19 controversies about work incidents reported by Tengrinews including workers injuries and or death, only three are reported by Vigeo-Eiris, two by Sustainalytics, and six by RepRisk. It is interesting to notice that RepRisk, which is the only one of the three ESG information providers to use Russian language media sources, shows more comprehensive coverage when compared to the two other ESG information providers.

A number of material controversies that are reported by Tengrinews in fact remain undetected by major ESG information providers and this difference in coverage and reporting raises important questions.

DISCUSSION

ESG controversies data appear to be highly concentrated and geared towards a smaller subset of large, typically US- and UK-based media sources, with a clear underrepresentation of local and regional news content. The concentration of sources introduces in turn geographical and language bias to ESG controversies data which can be explained by the cost and time optimization of source's research by ESG providers.

If rational, it constitutes an obstacle to a complete and comprehensive coverage of ESG controversies happening in non-English speaking countries. The lacking data participates in the "spotlight effect": the best-known companies are more monitored than smaller ones potentially acting unsustainably. This selection bias will impact the validity of ESG assessment data and potentially distort ESG-related decision making.

In addition, the concentration of sources, and with it the narrowing of the ESG agenda, is also likely to influence corporate sustainability practice, leading to a 'headquartering' effect as it incentivizes centrally coordinated responses to the subset of issues prioritized. It finally reduces the diversity of ESG information and increases non-financial risk.

CONCLUSION

The study contributes to previous research by highlighting the selection bias of ESG information providers as a result of media sources concentration. It thus has started to open the black box of ESG performance evaluation. It might be useful that future research extends the present research to other samples, data providers and geographic contexts. Another promising avenue to pursue would be to explore the extent to which other dimensions of ESG performance evaluation may reflect similar types of selection bias.

R. Barkemeyer, C. Revelli, A. Douaud, Selection bias in ESG controversies as a risk for sustainable investors, Journal of Cleaner Production 405 (20023)

https://www.sciencedirect.com/science/article/abs/pii/S0959652623011939?via%3Dihub

COMPANY MEETINGS

A VISIT TO MIPS AB, PROVIDING SAFER HELMETS FOR ALL SPORTS

Last February, we visited MIPS AB's research & design facilities in Taby, Sweden.

MIPS, which stands for Multi-directional Impact Protection System, was born from the collaboration of a brain surgeon with the Royal Institute of Technology in Stockholm. The company's technology, patented until 2030/2031, protects the wearer from multidirectional impacts by mitigating the impact of the strain on the brain in the event of a fall and/or shock.

MIPS AB specialises in the design of protection systems for helmets used in various sports, principally cycling, but also skiing and horse riding.

MIPS sells its products to sporting goods manufacturers, with an addressable market estimated at 130 million consumers.

On the environmental front, while the company's impacts are limited, MIPS has developed its own climate policies (SME SBTI at the end of 2022), which are useful for managing its supply chain.

On the labour side, the SME's headcount has doubled since 2019 and 48% of its employees are women, a percentage that has risen sharply compared to 2019 (+28%). MIPS also stands out for its ability to retain skills, with a low personnel turnover ranging between 4 and 10% over the past three years.

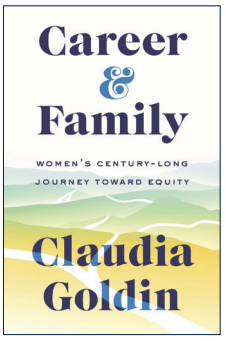
Finally, in terms of governance, the company signed up to the UN Global Compact in 2022; its board of directors is largely independent, and women account for 50% of the board; furthermore, executive compensation is linked to ESG goals.

The information about the companies cannot be assimilated to an opinion of Edmond de Rothschild Asset Management (France) on the expected evolution of the securities and on the foreseeable evolution of the price of the financial instruments they issue. This information cannot be interpreted as a recommendation to buy or sell such securities.

RECOMMENDED READING

WOMEN AT WORK: HOW TO BALANCE CAREER AND FAMILY

Claudia Goldin, winner of the 2023 Nobel prize for Economics, is a professor at Harvard University. Much of her career has focused on studying the role and the place of women at work, particularly in the United States. In "Career and Family", published in 2021, the Nobel prize winning author examines the challenges experienced by women over the past 100 years as they struggle to balance their professional and family lives. The book addresses a wide variety of issues, including women's' careers after their first child, gender pay equality, the glass ceiling, the impact of the Covid crisis... and offers potential solutions, including the role played by men at home and in the upbringing of their children. A highly recommended read.



Career and Family », women's century-long journey toward equity ***by*** Claudia Goldin

Environment:

Deforestation operations in the Amazon fell by almost 50% in 2023 compared with 2022, reaching their lowest level since 2018. However, they remain 6 times larger than New York City, at just over 5,000 km².

Source: https://www.nationalgeographic.fr/environnement/bresil-actualites-la-deforestation-ralentit-en-amazonie-bresilienne

Social:

77% of business leaders worldwide find it difficult to recruit candidates with the right skills, according to the ILO.

Source: ILO article "Les pénuries de main-d'œuvre risquent de persister dans le monde", Les échos, Tuesday January 16, 2024

THE 2024 AGM VOTING SEASON HAS KICKED OFF

As the 2024 proxy voting season began a few days ago, we felt this was an opportune time to look back at 2023 and discuss the changes we have made to our voting policy.

Edmond de Rothschild AM is a thorough and independent shareholder. In 2023, we exercised 97% of our voting rights and voted at 518 shareholders' meetings out of a total 534. Overall, we voted against 25% of the total 6,959 resolutions that were put to the shareholders' vote. Our main objections concerned board composition (board of directors and supervisory board), where we expect independence, diversity and availability (35% of our votes against), followed by executive remuneration (almost 26%). Indeed, on this aspect, we like to ensure that the compensation mechanisms are performance-linked and are determined by an independent remuneration committee disclosing clear and detailed information.

For 2024, we have committed to uniform voting across all portfolio holdings (excluding external SICAVs), regardless of the issuing company's country of origin, as long as the information supplied by the issuer is sufficient and that the custodian banks are technically able to process the vote. As a reminder, our ownership threshold was previously set at 0.01% of the capital, which was already very low.

We have also made a few small changes to our proxy voting policy. First, we expect the systematic inclusion of environment-related criteria in executive compensation reports. Consequently, Edmond de Rothschild AM shall vote against these reports if:

i) there is no mention of performance criteria in the company's variable compensation (short-term bonus and long-term incentive pay);

ii) principally for European companies, if the criteria fail to include transparent and quantifiable extra-financial criteria;

iii) for all companies operating in carbon-intensive sectors, in the absence of any climate or environment-related criteria.

Furthermore, we expressed our views on many external resolutions put to the shareholders' vote. In 2023, Edmond de Rothschild Asset Management (France) voted on 214 external resolutions put on the agenda by other shareholders, accounting for 3% of the total resolutions, up from 2.5% in 2022. As is already the case with standard management resolutions, Edmond de Rothschild Asset Management (France) supports resolutions submitted by external shareholders when these are aligned with our voting policy and fundamental principles. In 2023, we approved several shareholder resolutions on Climate policies and the impact of activities on communities. Examples include Alphabet, Bank of America, Citigroup, Coty, FedEx, General Electric, Microsoft, and The Mosaic Company.

Finally, as part of our stewardship approach, we co-filed two resolutions at shareholder meetings. Both concerned the climate policies of two oil companies: TotalEnergies (the resolution received 30.4% support) and Shell (20% support).

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EDMOND DE ROTHSCHILD
ASSET MANAGEMENT (FRANCE)

47, rue du Faubourg Saint-Honoré, 75401 Paris Cedex 08

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