



THEMATIC FLASH

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NEWS

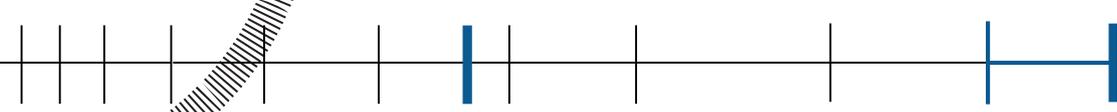
The war in Ukraine and ESG challenges

OFI Asset Management's SRI team has identified four types of extra-financial risks and ESG risks and opportunities on a sector level.

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On 24 February 2022, Antonio Guterres, the United Nations secretary-general, urged the Russian government to immediately cease its military operations in Ukraine, deeming the operations “within Ukrainian territory ... unacceptable”, but “not irreversible”.

Within one month after the invasion, Western countries and the European Union in particular had adopted five series of economic sanctions against Russia at three extraordinary summits (NATO, the EU and G7).

Although companies having subsidiaries or manufacturing facilities in Russia are not being forced to leave or to cease their activities, they have been subject to heavy criticism for several weeks. Meanwhile, companies such as [TotalEnergies*](#) and [Renault*](#) have reacted publicly and announced partial or total halts to buying and selling.

For investors who are exposed through these companies' operations, the war in Ukraine has laid bare several types of extra-financial risks arising from ESG challenges. **Our role as a responsible investor includes avoiding taking part in human rights violations through companies operating in countries that are at risk, due to an armed conflict.** As for issuers, the [UN Guiding Principles on Business and Human Rights](#) released in 2011 by the UN's High Commission for Human Rights provide them with a framework for conducting heightened surveillance of their operations in this type of situation.

By compiling and analysing records of issuer controversies, **OFI Asset Management's SRI team has identified four types of extra-financial risks** to which these issuers are exposed and on which it bases itself for monitoring the practices of European issuers operating in Russia and the responses they have made in this war environment. A letter will be sent to the most heavily exposed issuers to ask them how they manage these four risks. Where applicable and depending on trends in the context and practices, these issuers' ratings could be adjusted accordingly during 2022.

EXTRA-FINANCIAL RISKS LAID BARE BY THE CONFLICT

1 - A risk involving the company's human capital, particularly with regards to how well it respects the basic rights of employees and suppliers who operate in Russia. Our role as an investor is to ensure that companies implement all due diligence necessary to ensure that these rights are respected and to prevent any violation of them. In 2017, France passed a law on due diligence whose purpose was to place respect for human rights back among the core concerns of multinational companies. It requires that they establish and publish a due diligence plan for preventing environmental, human rights and corruption risks in their own activities and in those of their subsidiaries, both in France and elsewhere. To cite one example, [TotalEnergies*](#) has been called out on several occasions by NGOs such as Greenpeace, Friends of the Earth, and Sherpa regarding its operations in Myanmar and its links with the Burmese junta; as well as human rights violations, including forced expropriation, intimidation, and environmental damage (harm to biodiversity, to water resources and climate) at an oil project in Uganda. With regards to the conflict in Ukraine, we have questioned these issuers on their due diligence policies, in order to monitor their actions in the coming weeks.

2 - A heightened legal risk arising from corruption: Russia is already exposed to this risk and is being criticised for the close links existing between businesspersons and the government, army and certain politicians. The current conflict is raising fears that companies operating in Russia will engage in corruption to be able to continue to exercise their activities. In the past, there have been several examples of companies whose practices have been criticised in conflict situations. One of these was [Lafarge*](#), a cement-maker prosecuted for complicity in crimes against humanity for having entered into financial agreements with Islamic State, a terrorist organisation, and with merchants linked to Islamic State, to be able to continue to make and sell cement in Syria in 2014. More recently, on 27 February 2022, the French daily Le Monde published the findings of an investigation of the International Consortium of Investigative Journalists (ICIJ), into the involvement of the Swedish telecommunications giant [Ericsson*](#) in cases of corruption, bribery and conflicts of interest, particularly in Iraq.

3 - A reputational risk jeopardising a company's brand image. On 17 March 2022, like many other multinational companies, the agro-food giant [Nestlé*](#) came under a virulent social media campaign calling for a boycott of its products. This occurred after chairman and CEO Mark Schneider announced that the group would not pull out of Russia and would continue to provide “essential” products, such as baby food and pet food. The Mulliez group, which is heavily present in Russia through the [Auchan*](#), [Leroy Merlin*](#) and [Decathlon*](#) chains, has been subject to similar campaigns. This risk, which at this point is reputational, could have a negative impact in the short term on the franchises and, in the long term, become a legal risk if one day the International Criminal Court prosecutes Russia for war crimes.

In contrast, the first companies that announced they were pulling out of Russia have strengthened their image and credibility in terms of social responsibility. This is the case of [Carlsberg*](#), which announced it was maintaining a downgraded level of operations in Russia so that its 8400 employees could continue to draw a pay-check. Any profits generated during the humanitarian crisis will be donated to relief organisations. Carlsberg has also spoke out against the Russian invasion and has installed a refuge near the border for its employees and their families

4 - A risk of opacity, due to the **lack of transparency** and information available to assess companies' ESG challenges. In early March, MSCI, an ESG data provider, applied a ceiling ESG rating of “B” (on a scale of AAA to C) to Russian companies covered by its ratings. Companies already rated “B” or “CCC” would hold onto their rating, but all others would be downgraded. Apart from ESG ratings, credit ratings by European agencies have been banned. Among the sanctions adopted on 15 March 2022 by the European Union member-states is a “a ban on the rating of Russia and Russian companies by EU credit rating agencies and the provision of rating services to Russian clients, [which would result in them losing even further access to the EU's financial markets](#)”.

Accordingly, when we question issuers present in Russia, **we assess their social responsibility based on their ability to**

respond to, and minimise, these four categories of risk.

Keep in mind that, traditionally, companies operating in countries where human rights are not respected (e.g., non-democratic regimes and conflict zones) have a higher level of ESG risk. This is the case, for example, of companies in sectors such as mining, agro-food, etc., which face considerable social and societal challenges, including population displacement, failure to respect the rights of local populations, dangerous working conditions, lack of trade-union freedoms, harm to biodiversity, ecosystems and local life, child labour, forced

labour, harmful occupational safety practices, etc. **Companies present in Russia will be subject to enhanced due diligence by OFI AM's SRI teams.**

RISKS AND OPPORTUNITIES AT THE SECTOR LEVEL

At the sector level and based on the current conflict, we have identified some potential ESG risks and opportunities for medium- and long-term sustainable finance (see table below).

	RISKS	OPPORTUNITIES	CONTROVERSIES
Energy	Financial attractiveness of emerging market companies, such as Aramco, Pemex and Petrobras, which have lower standards in managing environmental and social risks. Imports of US shale gas, which worsens the energy divide, owing to methane.	Accelerated development of sustainable aviation fuel. Accelerated production of green hydrogen vs. grey and blue hydrogen.	Project divestment or shutdown (e.g., TotalEnergies)
Industry	Heightened dependence on metals such as bauxite (aluminium, cans, lighter-weight vehicles), palladium (catalytic converters), and nickel (EV batteries) produced by Russia. "Just-in-time" organising and management of production; factories brought to a shutdown by a shortage of parts/inventories, with temporary layoffs in the auto sector in particular. Higher prices of transition metals.	Acceleration of the energy-efficiency thematic to offset lower consumption. Relocating certain activities to a perimeter closer to production and consumption venues. Accelerating the circular economy to offset disruptions in the supply of certain raw materials.	Scandals at certain companies that supply the Russian army. Now under sanctions, companies that have not established controls will be subject to fines.
Food and beverages	Steep rise in agricultural commodities (wheat, maize, oils, etc.).	Attractiveness of plant-based proteins due to higher wheat prices. Sustainable agriculture and exit from pesticides.	Criticised for maintaining operations. Need for retaining accessibility to basic products. Social-media appeals for boycotts, with impacts on brand images.
Technologies & telecommunications	Cyberattacks. Europe's heightened dependence on Asian semi-conductors. Censorship and restricted access to certain sites. Breaks in subsea fibre-optic cables.	Circular economy. Development of open-source intelligence (for tracing information).	
Defence	The attractiveness of sector stocks is traditionally tied to controversial weapons.		
Finance	Heightened risk of money laundering. Under current sanctions, banks that are unable to enforce KYC and capital-transfer rules are exposed to reputational and financial risks. This is the case of private banks that facilitate wealth transfers of targeted oligarchs.		
Healthcare	Accessibility issues, including: - to generic drugs: problems for generic drug makers wanting to penetrate the Russian market. - to telemedicine, with a potential obstacle to this new mode of online medicine when easy Internet access and IT technologies are lacking.		Halt to marketing and clinical trials.
Utilities	Safety and environmental risks from extension or investment in nuclear power (contamination, site vulnerability, risks of explosion and waste management). Restarting of power generation from polluting energies (e.g., coal in Europe and China).	Accelerate the energy transition into renewables (wind and solar) and nuclear power. Maximise power generate from bio-energies. Accelerate the replacement of gas boilers with heat pumps.	

The figures cited deal with past years. Past performances are not a reliable indicator of future performances.

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Completed on 31 March 2022 by the responsible investment team, with Valérie Demeure and Luisa Florez.