ERSTE RESPONSIBLE RETURN

The ESG Letter

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Editorial

Wolfgang Pinner is Chief Sustainability Investment Officer and heads the Responsible Investments team at Erste Asset Management.

Shale gas – a saviour or the devil's work? The shale gas boom in the USA in recent years has certainly had far-reaching economic implications. Natural gas prices in the United States are currently far lower than in Europe, and lower still in comparison with those of Asia. These price differences result from the tapping of new, unconventional deposits using „fracking" technology, which has dramatically reduced the energy costs of US companies. But this process of fracturing the rock strata is raising an increasing number of issues, including its negative environmental impact and undesirable social consequences.

So far, large-scale fracking has only been employed in North America. Externalities such as groundwater contamination and methane gas leaks have been accepted for the sake of promoting the United States' autonomy in terms of energy technology. The situation in Europe is very different in many ways. For one thing, hydrocarbon deposits belong to the state, not to landowners. And European environmental standards are much stricter, with the result that there is not a single commercial shale gas project currently in operation in Europe. While in the USA there is talk of better standards, certain European players are biding their time.

In the case of fracking and shale gas, active corporate communication seems to be an important means of raising awareness about ESG-relevant issues on both sides of the Atlantic

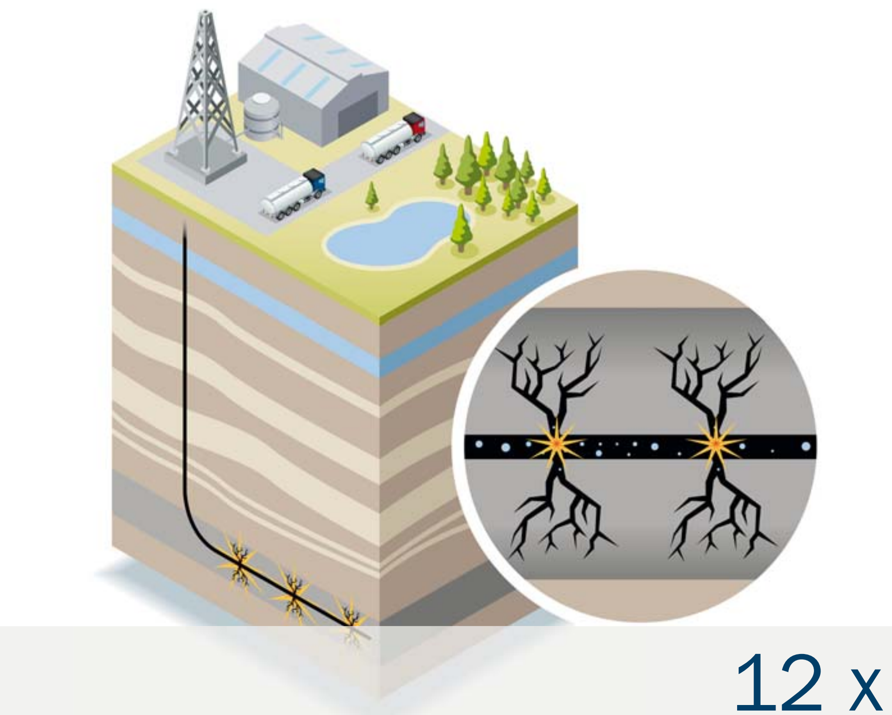
Sincerely

Wolfgang Pinner
Head of SRI Team

Investment Board

The EAM Investment Board gives a structured form to the ongoing and responsive dialogue with and among sustainability research agencies. The Board provides the opportunity for the consultation process between own research and external research to take place. It also discusses rating details, the ESG‘s assessment of the IPOs of new issuers and sustainability issues in general.

Shale gas – a controllable technology?



12 x

From 2000 to 2010, the US shale gas production has increased twelve-fold, amounting now to 25 per cent of the natural gas production in the United States.

Source: US Department of Energy, http://energy.gov; Photo: iStock

Long gone are the times when natural oil and gas could be extracted with minimum effort. The fracking technology developed in recent years is one answer to the imminent „peak oil“ scenario, in which the worldwide maximum output is anticipated to decline. In fracking, the process of fracturing rock strata several kilometres below the earth‘s surface is used to extract new reserves of natural gas and oil, yielding the products known as shale gas and shale oil. In contrast to conventional extraction from beds of sand and limestone, the fossil fuels in the fracking process are extracted from thick layers of clay. This involves the use of both mechanical processes and diluted, toxic solvents.

In recent months, the focus of exploration has shifted from shale gas to shale oil. The problems associated with the burning of gas that is extracted with natural oil and the resulting CO_2 emissions have thus greatly increased.

From a social perspective, the use of fracking technologies means the proliferation of traffic flows to and from drilling sites, involving the transport of water, contaminated fracking fluids and natural oil and gas. Not least for these reasons, moratoriums have been imposed on the extraction of shale gas in certain heavily populated American states. Measures such as these and the public discussion on stricter regulations are responses to the fact that fracking technology has arguably been implemented too soon and too liberally in the USA. The regulatory environment in Europe is much stricter and characterised by higher costs.

Fracking combines mechanical and chemical methods

In a final assessment of the technology, it is also worth remembering that there are other new and controversial extraction technologies besides shale gas extraction. Mixes of chemicals are also used, for instance, in the maximal exploitation of old, conventional wells.

Status of „shale gas“:
The fracking technology used in the activities of multinational companies in North America has been given a negative assessment by EAM sustainability research. For the stakeholder assessment of companies in the oil and gas sector, the importance of „shale gas“ has increased.

112

The chemical cocktail used in fracking is suspected to poison not only groundwater, but also surface water. According to a study of the German Federal Environment Agency, until now 112 different substances have been used for fracking activities in Germany. Of this total, 76 substances could be identified. One biocide was classified as „severely hazardous to water“ and 17 other substances as „water endangering“.
36 substances used could not be clearly identified.

Source: Gutachten: Umweltauswirkungen von Fracking bei der Aufsuchung und Gewinnung von Erdgas aus unkonventionellen Lagerstätten, A73
(„Report on the environmental impact of fracking regarding exploration and extraction of natural gas from unconventional deposits“)
http://www.umweltdaten.de/publikationen/fpdf-l/4346.pdf; Photo: iStock

Engagement

Engagement is of great importance for EAM's sustainable investment approach. It combines own initiatives with collaboration on a national and international level. The structured engagement process is based on the „EAM Engagement Guideline“ which determines engagement issues, approach and procedures.

Engagement focus „fracking“

Under the slogan of „energy independence“, there has been a huge increase in the extraction of shale gas, and recently also shale oil, in North America over the past several years. Fracking technologies are used by all major oil and gas companies in the USA. At Exxon, Chevron and ConocoPhillips, „unconventional“ extraction accounts for less than 20% of total production. All of these companies address the topic on their web sites, but only ConocoPhillips offers a detailed explanation of the relevant technologies and processes, along with background information on the risks involved.

Each drill hole requires up to 19 m litres of water

Erste Asset Management has contacted each of these multinational oil companies about the issue of fracking. Our first questions dealt with water, which is consumed in huge amounts during the fracking process. In the case of ConocoPhillips, for example, up to 19 million litres of water are needed for each well in order to fracture the subterranean rock strata. That is equal to the annual water consumption of 100 households or the volume needed to water three hectares of farmland for a year.

We therefore asked the companies how they deal with limited water resources, and whether they attempt to use the least amount of groundwater possible.

Oil and gas companies also face problems associated with potential methane leaks. Although the companies assert that wells are protected in the groundwater strata by multiple layers of steel piping and cement sheathing, while the actual fracking takes place several thousand metres below the groundwater level, reports of contaminated drinking water have surfaced repeatedly in the past.

This is captured in a notorious image in the film „Gasland“, in which the stream from a water tap is set on fire using a lighter. So we asked the companies how they deal with methane leaks, and about their existing and planned measures for preventing such incidents as well as the environmentally harmful torching of extracted gas („flaring“) during shale oil production.

To the oil multinationals silence is golden

Although we posed our questions twice, six weeks have now gone by without any answers from Exxon, Chevron or ConocoPhillips about the standards used in fracking (as of 14 March 2013).

150 bn cu m

Every year, over 150 billion cubic meters of natural gas are being flared and vented worldwide.

Source: web.worldbank.org; Photo: iStock

Status of Exxon, Chevron and ConocoPhillips:
Continuation of the engagement process and downgrading of their ratings if necessary. Elimination from the investment universe will be considered as a final consequence.

C_nH_{2n+2}

Like most cosmetics companies, Shiseido uses paraffin wax for its products. The petroleum distillate described by the formula C_nH_{2n+2} divides opinions. Many regard it as harmless or even useful, while natural cosmetic manufacturers avoid the waxy, tasteless and odourless alkane.

Sources: www.shiseido.de, www.chemie.de; Photo: iStock

Changes in the investment universe, March 2013

The definition of our investment universe is the corner stone in building our funds.

INCLUDED

ABB Ltd
(„Heavy Electrical Equipment“ sector) is a globally active company in the areas of power and automation technology. Its product portfolio ranges from light switches and robots to transformers and management systems for power networks.

☺ Statute of limitations applied to the labour rights exclusion criterion based on a 2011 case in Córdoba/Spain
☺ All production sites have an occupational safety management system in accordance with the OHSAS 18001 standard and an environment management system in accordance with ISO 14001; administrative units work with their own environment management system
☺ Strict measures in place to reduce dangerous and toxic substances in the production process
☹ Frequent cartel investigations by the EU Commission

Shiseido Co Ltd
(„Personal Products“ sector) produces cosmetics for the luxury segment. Its product range primarily comprises skin, hair and body care products

☺ Signatory of the UN Global Compact
☺ Since August 2010 member of the Roundtable on Sustainable Palm Oil
☺ Extensive measures in place to reduce packaging material
☺ Development of alternative test methods to reduce/discontinue the mandatory testing of cosmetics on animals, but without a binding phase-out date
☹ Reference to „Green Procurement Standards“ in the procurement function, but this is not publicly verifiable and it is therefore unclear whether standards are actually applied

EXCLUDED

Sony Corp
(„Consumer Electronics“ sector) is a global provider of consumer electronics. Its product range includes televisions, audio equipment, cameras, game consoles, tablets, smart phones, notebooks, storage media, etc.

☹ Violation of the labour rights exclusion criterion. Reports by the American NGO „China Labour Watch“ from October/November 2012 accused the supplier Foxconn of employing underage workers in several factories in China, among other things.
☹ In January 2013, the Dutch NGO SOMO (Center for Research on Multinational Corporations) reported that suppliers in Malaysia were demanding extensive medical examinations before employing foreign workers. Even after workers were hired, these examinations continued to be performed once a year. Women also had to agree not to become pregnant throughout the term of their employment.

Company of the month: **OMV**

The integrated oil and gas company OMV is active in upstream (exploration and production), downstream (refining processes and marketing) and gas business. In 2005 OMV, which has a global exploration portfolio, acquired a majority stake in the privatised Romanian company Petrom which is active in the same business areas.

OMV initially exploited shale gas and oil in the Weinviertel area of Austria, but a moratorium was imposed in the wake of protests by the local population. OMV nonetheless worked with the Austrian Montanuniversität Leoben on developing a „clean fracking“ technology, a process that, instead of using chemicals, relies only on water, bauxite sand and sheer force. At present, OMV is keeping a low profile on the topic of shale gas, and is not willing to enter into any dialogue on the subject.

OMV's assessment is above average from a sustainability perspective. The following is a brief description of the major ESG criteria:

Foto: OMV

Health and safety.

In this respect, OMV is far above the sector average, having developed an „HSSE“ management system for health and safety based on the international standards ISO 14001 and OHSAS 18001. The frequency of accidents as measured by the TRIR (total recordable injury rate) per million working hours has noticeably decreased in recent years, from 2.17 (2008) to 1.01 (2011).

Key Figures of OMV	
Sector	oil and gas
ISIN	AT0000743059
Share price (18 March 2013)	33.91 EUR
Estimated P/E (18 March 2013)	8.2
Dividend yield	3.5

Biodiversity and land use.

OMV complies with the applicable legal framework conditions and uses environmental sustainability studies and approval processes to examine biodiversity issues in advance of new projects and activities. The company has not published any detailed principles on this subject to date, and should include them on its agenda.

Corruption.

OMV earns a relatively positive assessment for its code of conduct adopted in 2003, with rules applicable to employees and the entire supply chain. The company's goal is a commitment to honesty and integrity.

CO_2 and toxic emissions.

All OMV refineries have implemented energy management systems certified in accordance with the ISO 50001:2011 standard. From 2008 to 2011, the company reduced the amount of greenhouse gases and CO_2 emitted, as well as sulphur dioxide (SO_2) and nitrogen oxide (NO_x) emissions. Direct greenhouse gas emissions are above average for the sector; there is room for OMV to improve in this respect.

In 2012, OMV generated consolidated sales of EUR 42.65 billion, with a workforce of around 29,000. At the end of 2012, OMV's proven natural oil and gas reserves amounted to around 1.77 billion BOE (barrel of oil equivalent), with daily production in 2012 running at around 303,000 BOE. In the refinery and marketing area, OMV has approximately 4,450 filling stations in 13 countries, including Turkey. In the gas and power area, OMV operates a 2,000-km gas pipeline network in Austria.

Responsible funds at a glance

Erste Asset Management recognized the importance of responsible fund management early on. Over the course of the past decade we have developed and successfully introduced a broad range of sustainable funds. The following funds are available in line with Erste Asset Management's „Responsible Investment Approach".

Stock Funds

All funds are denominated in Euro.

Fund name	Since 1.1.	2012	2011	2010	2009	2008	Mgmt. fee	Volume in mn.	Risk notes [1)]
ERSTE RESPONSIBLE STOCK GLOBAL	6.65	9.51	–4.90	16.61	29.66	–37.42	1.50	206.5	A, B
ERSTE RESPONSIBLE STOCK EUROPE	3.88	20.88	–23.03	9.40	27.01	–54.99	1.50	10.1	A, B
ERSTE RESPONSIBLE STOCK AUSTRIA	1.37	29.19	–38.75	16.63	36.08	–56.62	1.50	10.8	A, C, D
ERSTE RESPONSIBLE STOCK EUROPE EMERGING	–2.59	24.99	–31.51	16.65	55.19	*	1.80	17.7	A, B, D
ERSTE WWF STOCK CLIMATE CHANGE	9.11	–7.35	–25.66	3.19	21.37	–45.82	1.50	8.4	A
ERSTE WWF STOCK UMWELT	7.49	5.63	–23.39	14.25	17.84	–48.02	1.50	41.0	A

Performance calculated according to the OeKB (Österreichische Kontrollbank AG) method, as of 28 February 2013. The management fee is included in the performance. Subscription fees applicable at the time of purchase of up to 5.00% and other fees that may reduce returns, such as individual account and deposit fees, are not included in this presentation. Past performance is not a reliable indicator of the future performance of a fund. Please note that it is not possible to draw any conclusions on the volatility or risk of an investment from annualized averages for multi-year periods.

1) Risk notes

A The ERSTE RESPONSIBLE STOCK GLOBAL ERSTE RESPONSIBLE STOCK EUROPE, ERSTE RESPONSIBLE STOCK AUSTRIA, ERSTE RESPONSIBLE STOCK EUROPE EMERGING, ERSTE WWF STOCK CLIMATE CHANGE, and ERSTE WWF STOCK UMWELT funds may display increased volatility due to the composition of the portfolio. As a result, share values may be subject to significant fluctuations even over short periods of time.

B The ERSTE RESPONSIBLE STOCK GLOBAL, ERSTE RESPONSIBLE STOCK EUROPE, and ERSTE RESPONSIBLE STOCK EUROPE EMERGING funds may invest significant amounts in derivative instruments (including swaps and other OTC derivatives) pursuant to Paragraph 73 of the InvFG 2011 (Investment Fund Act, Austria).

C The ERSTE RESPONSIBLE STOCK AUSTRIA fund is an index fund pursuant to Paragraph 128, section 5 line 1 in conjunction with Paragraph 75 of the InvFG 2011 (Investment Fund Act, Austria). The aim of the investment strategy is to emulate the VÖNIX (VBV Austrian Sustainability Index).

D The ERSTE RESPONSIBLE STOCK AUSTRIA and ERSTE RESPONSIBLE STOCK EUROPE EMERGING funds may invest significant amounts in sight deposits or deposits with a maturity of no more than 12 months pursuant to Paragraph 72 of the InvFG 2011 (Investment Fund Act, Austria).

* Fund inception during the fiscal year

Bond funds, mixed funds

All funds are denominated in Euro.

Fund name	Since 1.1.	2012	2011	2010	2009	2008	Mgmt. fee	Volume in mn.	Risk notes [2]
ERSTE RESPONSIBLE LIQUID	0.20	5.33	0.60	2.21	10.99	–2.91	0.24	38.7	–
ERSTE RESPONSIBLE BOND	–0.19	10.57	0.94	1.72	9.07	4.51	0.60	146.1	a)
ERSTE RESPONSIBLE BOND EURO-CORPORATE	0.10	12.89	*				0.60	110.6	–
ERSTE RESPONSIBLE BALANCED	0.58	*					1.20	2.3	b)

Performance calculated according to the OeKB (Österreichische Kontrollbank AG) method, as of 28 February 2013. The management fee is included in the performance. Subscription fees applicable at the time of purchase of up to 3.50% and other fees that may reduce returns, such as individual account and deposit fees, are not included in this presentation. Past performance is not a reliable indicator of the future performance of a fund. Please note that it is not possible to draw any conclusions on the volatility or risk of an investment from annualized averages for multi-year periods.

2) Risk notes

a) The ERSTE RESPONSIBLE BOND fund may invest significant amounts in derivative instruments (including swaps and other OTC derivatives) pursuant to Paragraph 73 of the InvFG 2011 (Investment Fund Act, Austria).
b) The ERSTE RESPONSIBLE BALANCED fund may invest significant amounts in investment funds (UCITS, UCIs) pursuant to Paragraph 71 of the InvFG 2011 (Investment Fund Act, Austria).
* Fund inception during the fiscal year

Microfinance funds

All funds are denominated in Euro.

Fund name	Since 1.1.	2012	2011	2010	2009	2008	Mgmt. fee	Volume in mn.	Risk notes [3]
ERSTE RESPONSIBLE MICROFINANCE	0.06	3.20	2.48	0.79			1.00	24.4	x)

Performance calculated according to the OeKB (Österreichische Kontrollbank AG) method, as of 28 February 2013. The management fee is included in performance. Subscription fees applicable at the time of purchase of up to 3,00% and other fees that may reduce returns, such as individual account and deposit fees, are not included in this presentation. Past performance is not a reliable indicator of the future performance of a fund. Please note that it is not possible to draw any conclusions on the volatility or risk of an investment from annualized averages for multi-year periods.

3) Risk notes

x) The ERSTE RESPONSIBLE MICROFINANCE fund may invest significant amounts in investment funds (UCITS, UCIs) pursuant to Paragraph 7 line 1 of the InvFG 2011 (Investment Fund Act, Austria):

Warning pursuant to the InvFG 2011 (Investment Fund Act, Austria): The ERSTE RESPONSIBLE MICROFINANCE invests entirely in assets pursuant to Paragraph 166, Section 1 line 3 of the InvFG 2011 (Alternative Investments), which represent a higher investment risk compared to traditional investments. In particular, these investments may result in a loss or even a total loss of capital invested.

Renaming of Funds

New Name as of 30.11.2012	Former name
ERSTE RESPONSIBLE STOCK GLOBAL	ESPA VINIS STOCK GLOBAL
ERSTE RESPONSIBLE STOCK EUROPE	ESPA VINIS STOCK EUROPE
ERSTE RESPONSIBLE STOCK AUSTRIA	ESPA VINIS STOCK AUSTRIA
ERSTE RESPONSIBLE STOCK EUROPE EMERGING	ESPA VINIS STOCK EUROPE EMERGING
ERSTE WWF STOCK CLIMATE CHANGE	ESPA WWF STOCK CLIMATE CHANGE
ERSTE WWF STOCK UMWELT	ESPA WWF STOCK UMWELT
ERSTE RESPONSIBLE LIQUID	ESPA VINIS CASH
ERSTE RESPONSIBLE BOND	ESPA VINIS BOND
ERSTE RESPONSIBLE BOND EURO-CORPORATE	ESPA VINIS BOND EURO-CORPORATE
ERSTE RESPONSIBLE MICROFINANCE	ESPA VINIS MICROFINANCE

On 30 November 2012, all ESPA VINIS funds were rebranded to ERSTE RESPONSIBLE funds. The fund names of the WWF product family remained the same, while the prefix ESPA changed to ERSTE. The profile of all sustainable funds remained completely unchanged.

pin it down

Closing words by Wolfgang Pinner

Skewed vision of shale gas?

"Are oil barons actually worse than investment bankers?", Wolfgang Pinner wonders

Of course they are, you say, as BP and Deepwater Horizon in the Gulf of Mexico, or Shell and Brent Spar in the North Sea immediately spring to mind. You go about refuelling your car with a good conscience, and then have these disasters to contend with. As if that weren't enough, now the oil companies are starting to „frack around" – contaminating drinking water and unleashing earthquakes!

But are Exxon & co. really the guilty ones? The growing population means there is a need for more and more energy. And energy reserves are increasingly hard to find. For oil and gas wells, that means more complicated technology, with higher risks. Could it be that the oil multinationals are just the victims of energy-hungry consumers?!

Of course, the world's big oil companies would be only too happy to accept the role of victim. But the truth is that all of the large-scale catastrophes with an „oil connection" in the last decades can be attributed to neglected risk standards. That's the case for both deep-sea drilling and damaged tankers. Because of the greed of such companies, and their habit of shifting external costs to the public, catastrophes often occur in both conventional and unconventional deposits.

Finally, a few words on the fracking crime scene of the USA in 2013: the exploitation of shale gas is boosted by farmer land owners, oil companies with dollar signs in their eyes, and an absence of environmental regulations. This makes for a special kind of cocktail that ultimately smells even worse than black gold itself.

For more than 10 years **Wolfgang Pinner** has been active in the field of sustainable investments. He has written two books on this topic and represents Austria at the industry association „Forum Nachhaltige Geldanlagen".

Wolfgang Pinner is Chief Sustainability Investment Officer at the Erste Asset Management and leads the Responsible Investments at the ERSTE-SPARINVEST.

$ 42 bn

Fracking gets the money flowing, but it might also spill the profit: In the United States the costs for 7200 drill holes are estimated to amount to 42 billion US dollars annually.

Source: Spektrum der Wissenschaft, www.spektrum.de; Photo: Fotolia

Our long-term partners in sustainability

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