CONFIDENTIAL REPORT

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ASSET4: The Problem, An Overview of a typical ESG Ratings Agency

The ASSET4 Integrated Rating Framework is promoted as enabling both professional investors and corporate executives "to integrate extra-financials into mainstream investment and decision making processes systematically and transparently."[1]

Methodology

It is difficult to obtain a clear understanding of the methodology used within the framework as ASSET4, despite basing its framework on the GRI indicators, which are in place to, (it says) encourage greater corporate transparency, provides limited information within its website. However, the website does indicate that the framework relies on the use of publicly available information such as annual reports and company listings, to obtain information on their four "pillars" of financial, environmental, social and corporate governance management.

The framework includes over 250 Driver and Outcome Indicators organised into 18 categories addressing the four pillars. "Driver indicators provide information on management quality, by looking at the different policies, means of implementation and control mechanisms a corporation has in place. They are lead indicators forecasting future outcome. Outcome indicators give a picture of actual performance, performance improvements, transparency and areas with higher than average risk exposure."[2]

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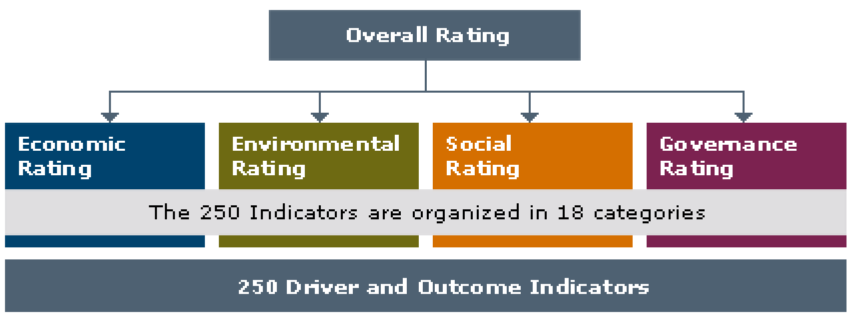

ASSET4 developed its list of material and relevant indicators from the nearly 3000 identified within the Global Reporting Initiative (GRI) "Only the most objective indicators of performance, risks, opportunities and reputation were selected for an initial set of possible indicators. Indicators were also only selected if we could find answers to them for at least 10% of the relevant companies."[4] **This practice alone excludes huge numbers of companies from any assessment.**

The indicators are considered to reflect the best management practices possible as the GRI was developed from a multi stakeholder consultation process incorporating expertise from a

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[1] http://www.ASSET4.com/page120.html. December 15, 2006.
[2] http://www.ASSET4.com/page130.html. December 15, 2006.
[3] http://www.ASSET4.com/page130.html. December 15, 2006.
[4] http://www.ASSET4.com/page130.html. December 15, 2006.

variety of subject areas. At present there are approximately 850 companies worldwide complying, to various degrees, with the guidelines?[5]

Versions 2 of the GRI Sustainability Guidelines (superseded in October 2006 by Version 3) are considered to have major faults which raise the risk of any rating system being based upon it being significantly flawed.

- **GRI does not have in place a mechanism to ensure the accuracy of the claims within reports by companies who state that they comply with the GRI guidelines. In fact GRI insists that it is not its role to pass judgement on the quality of information in the reports.**

This remains a considerable problem within Version 3 of the guidelines for as GRI continues to say that "it should play no role in certifying reports. But as the numbers using the framework continue to rise; it may have to do more to maintain high standards of disclosure. Or as Markus Reichart, of South African corporate responsibility consultants URS puts it, at some point GRI must "flush out the freeloaders."[6]

- **The GRI guidelines provide standards for reporting not for performance. There is no control of the listed firm's performance. However, given that there is no formal mechanism to certify reports, there is also no mechanism to remove credibility to those companies whose reporting does not match their performance.**

Whilst there are now three layers of compliance with the guidelines identified, both versions fail to comment upon how well or how accurately, particular indicators are covered. It remains the responsibility of the companies to self-declare their level although in version 3 there is further advice on doing so. However, even when a company seeks to be accurate in its declarations, this proves difficult as **each reporting company has to make its own definition of the measurement of the indicators and indicators are ambiguous for example, companies within some countries are unable to comply with the guidelines as some national legislation make it illegal to register an employee's nationality which is sought within the guidelines.**

The guidelines have been criticised as indicators are 'narrative' describing policies and procedures without any mechanism to ensure that the policy and procedures are followed in practice.

Claims as to the widespread nature of stakeholder consultation are also not unproblematic. **Historically the GRI organisation has been mainly financed by business which inevitably prioritised business interests rather than social and environmental interests. More recently "voices from the financial markets – including representatives of FTSE, Goldman Sachs and UBS – played an influential role in developing the guidelines**. This willingness and interest from investors to be involved was

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[5] Russell, J. 2006. Europe special report: the Global Reporting Initiative - GRI's G3 Guidelines - Standards at a crossroads. http://www.ethicalcorp.com/content.asp?ContentID=4619. December 18, 2006.
[6] Russell, J. 2006. Europe special report: the Global Reporting Initiative - GRI's G3 Guidelines - Standards at a crossroads. http://www.ethicalcorp.com/content.asp?ContentID=4619. December 18, 2006.

absent four years ago, observes Ernst Ligteringen, GRI chief executive. And their demands are reflected in the new guidelines, he says."[7]

Examination of the GRI's Stakeholder Council Members, Board of Directors and Stakeholder Organisations shows a clear bias for industry, SRI institutions both financial and consultative and lacks any significant representation from the international world of certification such as ISO, DNV etc.

Further in September 2006, the Financial Times obtained a report commissioned by the UN Environment Programme, a GRI supporter since 1998 and written by the Global Public Policy Institute, a Berlin-based think-tank raised significant concerns about the likely levels of company reporting on social and environmental impacts in the future. The study considered that "non-financial reporting" in the future would only play "a 'very limited role in sustainable development" with such reporting limited "to trans-national companies based in industrial countries."[8]

Corporate social responsibility advocates who consider the reporting of non-financial issues to be core to efforts to improve such practices will view the prediction that "by 2020 only 11 per cent of transnational companies - let alone other businesses - will provide social and environmental data"[9] with dismay.

Despite the flaws described above, ASSET4 has developed its rating framework by adapting the GRI indicators in such a way as to obtain 'quantitative' indicators. Vice President of Marketing and Business Development, Henrik Steffensen[10] comments that they take "information and quantify it; we take qualitative statements and turn them into quantifiable data."

The article (hosted on the website of ASSET4) by Martin Hurst for *Investment and Pensions Europe* describes the methodology and considers that ASSET4;

> "Provide information on management quality by looking at the different policies, implementation, monitoring and improvements…These are what ASSET4 terms 'lead indicators forecasting future outcomes.' These are typically points requiring yes/no answers, for example; does the company under review have an environmental policy?"[11]

Probus considers that the weakness of this approach is demonstrated within the ASSET4/GOE report, *The Relation Between Sustainability Performance and Financial Performance of Firms.* The report describes it's quantification of the GRI.

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[7] Russell, J. 2006. Europe special report: the Global Reporting Initiative - GRI's G3 Guidelines - Standards at a crossroads. http://www.ethicalcorp.com/content.asp?ContentID=4619. December 18, 2006.

[8] Williamson, H. 2006. *The Americas and International Economy: UN fears decline in non-financial reporting.* FT. http://search.ft.com/searchArticle?queryText=GRI&y=0&javascriptEnabled=true&id=060925000932&x=0. December 18, 2006.

[9] Williamson, H. 2006. *The Americas and International Economy: UN fears decline in non-financial reporting.* FT. http://search.ft.com/searchArticle?queryText=GRI&y=0&javascriptEnabled=true&id=060925000932&x=0. December 18, 2006.

[10] Hurst, M. 2006. *SRI/Governance Driving the Outcome.* Investment and Pensions Europe. March 2006. Pg 62. http://www.ASSET4.com/page230.html. December 15, 2006

[11] Hurst, M. 2006. *SRI/Governance Driving the Outcome.* Investment and Pensions Europe. March 2006. Pg 62. http://www.ASSET4.com/page230.html. December 15, 2006

"Qualitative indicators were reformulated such that they could be answered with either a 'yes' or 'no.' As a clarifying example, consider the question 'What are the main issues for the organisation related to the major themes of sustainable development?' …This question was reformulated as follows: 'Does the organization report on its main issues with respect to the major themes of sustainable development?' Qualification was achieved by assigning all 'yes' answers a value of 1 and all 'no' answers a value of '0'. "[12]

Whilst this process provides a quantitative score, it is one premised upon a number of subjective considerations. For example who has decided what the 'main issues'? are? What level of expertise do they process to make this decision? What are the main themes of sustainable development? How is the quality of an environmental report assessed? This approach leaves both the company assessed and the rating system vulnerable to accusations of 'greenwash.'

The weaknesses in the ASSET4 approach are apparent. For example, in embedding itself within the GRI approach, it is inevitably linking itself to the Corporate Social Responsibility methodology of company self reporting, which is unreliable. Whilst companies "that form ASSET4's universe have the opportunity to verify the information that is collected and fill in the gaps where information is missing"[13] there is no information to suggest that any information gained has received third party endorsement. Of course if relying on financial statements of companies these will have received third party audit by financial auditors. However, these auditors are not generally qualified to assess the social, environmental and corporate governance claims of companies.[14]

Therefore, despite ASSET4's claims that they evaluate "a company by means of a very clear and methodical process against each of the indicators that it tracks" using a "scientifically validated and model-based evaluation,"[15] the publicly available information to date does not support this claim.

Clearly ASSET4 have developed persuasive and effective documentation detailing considerable claims which given their start up costs of SFr 8.5 million as of October 2005[16] & [17] is not surprising. Nor is the fact that in June 2006 Goldman Sachs licensed ASSET4 extra-financial information and took up a stake in its financing.[18]

ASSET4 states that they have established the "largest database of corporate extra-financial information and the tools necessary to track, analyse and benchmark that data,"[19] However, in June 2006 they had 700 companies within its universe and whilst seeking to reach more than 1200 companies by the end of 2006 and all 3000 organisations within the MSCI World

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[12] Weber, O. Dr et al, 2005. *The Relation Between Sustainability Performance and Financial Performance of Firms.* GOE & ASSET4. http://www.vfu.de/scin/userdata/File/Downloads/roundtable%202005/GRI_Report.pdf. December 15, 2006. Pg 8.
[13] Hurst, M. 2006. SRI/Governance Driving the Outcome. Investment and Pensions Europe. March 2006. Pg 62. http://www.ASSET4.com/page230.html. December 15, 2006.
[14] Ernst & Young were subjected to criticism when they were found to have unjustly accepted Nikes claims regarding its practices. O'Rourke, D. 1997. A Critique of Nike's Labor and Environmental Auditing in Vietnam as performed by Ernst & Young. http://www.corpwatch.org/article.php?id=966. December 18, 2006.
[15] http://www.ASSET4.com/page140.html. December 15, 2006.
[16] Thompson, V. 2005. Private equity column October. http://swissventures.blogspot.com/2005/10/private-equity-column-october.html. December 18, 2006.
[17] This figure is confirmed by Alarm:Clock Euro. 2006. *Ohnemus' ASSET4 Taps Goldman Sachs As Strategic Partner* http://www.thealarmclock.com/euro/archives/2006/06/ohnemus_ASSET4_venture_taps_go_1.html. December 15, 2006.
[18] http://www.ASSET4.com/page220.html#gs. December 15, 2006.
[19] http://www.ASSET4.com/ December 15, 2006.

Index. (Morgan Stanley Capital International)[20] in due time, this is not significantly larger than that held by Probus.

It may prove that rather than providing an objective and effective measurement of a company's environmental, social, financial and corporate governance practices, ASSET4 may have developed a useful software platform providing data to both company executives and investment executives which they can access and manipulate. For example

> "ASSET4 provides no interpretation of the data, and is a result of a range of multivariate statistical analysis methods comparing companies' financial performance with their performance in the extra-financial areas. The result is a model-based objective rating that enables users to systematically benchmark and access corporate performance, as well as use their expertise to interpret the information provided. In fact, users may change the weightings of the criteria or leave out aspects they feel are not relevant to their specific assessment. Users are thereby empowered to customise the evaluation to reflect their individual values or to focus on themes of particular importance and interest."[21]

Whilst this provides a useful service to clients, such manipulations do not enable an objective and scientific analysis to be conducted.

A detailed description of ASSET4's software platform is available at http://www.ASSET4.com/page130.html.[22] Certainly the company has developed useful software platform which Goldman Sachs considers of value. It may prove of note that ASSET4's co-founder, Peter Ohnemusone, co-founded The Fantastic Corporation, a Swiss software company that wanted to enable broadband content delivery from creator to customer.[23]

In conclusion, despite ASSET4's claims, it is our opinion that ASSET4 is embedded within SRI/CSR methodology, (the inaccuracy of which will increase exponentially) cannot provide objective and measurable data for the financial markets. It may provide the largest database to date of company information although this lead is likely to be short-lived. However, as the Integrity Research Associates comment in their article *SRI Research Going Mainstream?* SRI is becoming more mainstream as demonstrated by the Goldman Sachs collaboration with ASSET4; it has yet to "become a much more robust and profitable research practice"[24]

[20] http://www.ASSET4.com/page220.html#gs

[21] http://www.ASSET4.com/page140.html December 15, 2006.

[22] It is of interest that the only reference to any internationally agreed standard within their documentation and website relates to IBM xSP Prime Hosting certified partner, which it states is "the best possible IBM hosting certification. This certification means that specific requirements based on ISO9000 audits, relating to data security, system availability, capacity and scalability, have been fulfilled." However, a search of the IBM website was unable to identify details of this certification although it is apparent that IBM has a number of personal certification programmes which they provide. (http://www.ibm.com/us/)

[23] Alarm Clock Euro. http://www.thealarmclock.com/euro/archives/where_are_they_now/. December 15, 2006.

[24] Integrity Research Associates. 2006. *SRI Research Going Mainstream?* Equity Research News. http://integrityresearch.blogdrive.com/archive/cm-11_cy-2006_m-11_d-15_y-2006_o-0.html. December 15, 2006.