ESG Report **Gold**

Extracting the true cost of gold

Institutional investors have been integral to the boom in gold prices over the past five years, but are they fully aware of the high-impact nature of their investments? **Nina Röhrbein** reports

As the world's premier athletes proved during the Olympics a few weeks ago, there is nothing better than gold. It captivates, it radiates – but as with Olympic gold medals, it is not all sparkling beneath the surface.

Gold is an popular asset class, hitting a record high of over $1,900 (€1,537) per ounce in September 2011. According to the World Gold Council (WGC), it is a time-tested store of value, acts as a diversifier, cannot be artificially devalued by policy-makers and is a proven hedge against inflation. It has performed strongly against other investments, gaining approximately 20% annually over the past five years.

But, according to a survey by Swiss investment consultancy onValues, institutional investors are largely unaware of the significant role they play in the international gold market.

"Their perception is that they are a negligible player in gold and unlike the jewellery sector, industries and central banks do not carry any major responsibility," says Ivo Knoepfel, managing director at onValues. "However, institutional investors account for roughly 40% of global gold demand and have been the driving force for incremental growth of the gold market over the past few years."

Around two-thirds of gold supply comes from mines, mainly from countries such as South Africa, China and the US, while one third is recycled gold, the provision of which has stagnated.

By far, the majority of key environmental, social and governance (ESG) issues in the gold supply chain occur at the mining stage. The refining, according to Knoepfel, usually happens in controlled environments, either locally in large producer-owned plants or in countries like Switzerland, which holds around 50% of the global gold refining capacities and whose banks are an important conduit for investment in gold.

"There are ESG issues with respect to gold-mining companies and, indirectly, gold investors," says Therese Niklasson, head of ESG at Investec Asset Management, which has a larger holding in gold and platinum mining shares and only a small amount of direct gold exposure. "We have the view that with our current miners there is scope to engage robustly and be part of helping to highlight investor concerns, as well as potentially addressing the current perception gaps that exist. It is, however, a high-impact environmental and social activity – but it is also a very large employer and over time a significant contributor to the economic prosperity of countries like South Africa."

One of the main issues with gold mining is its huge water consumption, which often competes with local agricultural use and lately forced mining company Newmont to step back from a large project in Peru. Another problem is water and soil pollution because of the high volumes of tailings containing heavy metals and chemicals such as cyanide, that are then released into rivers and lakes. Biodiversity impacts often accompany mining projects too. And in some cases, human rights, indigenous rights and occupational health issues are not properly taken care of.

Dutch pension fund service provider PGGM has made the mining sector a priority for its best-practice engagement programme, which started at the end of 2011. "There is a wide variety of awareness and standards in the sector," says Saskia van den Dool-Gietman, senior adviser for responsible investment at PGGM Investments. "In our best-practice project, we try to look beyond the usual suspects. Some of the smaller companies have not had investors on their doorstep asking questions about these issues so they are pleased to see we are interested, particularly if you speak to the internal sustainability head because our interest helps them build their case internally. There have been some first results, such as improved reporting or the development of policies on particular issues, but a lot of work still needs to be done."

PGGM has engaged with Barrick Gold and Goldcorp, among others. It is also involved with a UN Global Compact and UN Principles for Responsible Investment project to engage extraction companies operating in conflict-zones and high-risk countries.

New York-based Christian Brothers Investment Services (CBIS) also uses engagement as a primary tool for pursuing its responsible investing strategies.

It has an indirect portfolio exposure to gold through investments in mining and jewellery companies. "We have found that the implementation of ESG policies by companies is a process that usually happens over a period of time – it is not the result of one engagement or decision," says Dan Nielsen, director of socially responsible investing at CBIS. "Whether a company develops and implements effective ESG policies often depends on corporate culture, priorities and business strategy. Our role as an investor is to push companies to adopt best practices, both for the sake of affected communities and stakeholder as well as to reduce investment risk."

The gold industry has been actively trying to improve its environmental and social footprint. The WGC and the International Council on Mining and Metals have, for example, developed a sustainable development framework for gold.

"However, these are mainly transparency guidelines, not performance standards," says Knoepfel. "An alternative is fair-trade and fair-mined standards developed by NGOs for smaller mines, but these are not suitable for mainstreaming ESG considerations to cover the needs of large institutional investors."

Knoepfel highlights the Responsible Jewellery Council's (RJC) code of practice and chain-of-custody (CoC) standard as the best solution to be endorsed by institutional investors. It aims to support the identification of responsibly sourced, conflict-free jewellery materials produced, processed and traded through the jewellery supply chain. "The RJC one is a performance standard with minimum standards in the three areas of ESG along the whole supply chain," he says. "It also has an operational system in place for certifying the whole supply chain."

RJC member jeweller Tiffany is already sourcing responsible gold from Rio Tinto. Non-RJC member retailer Walmart is offering responsible gold, which is mined exclusively in best-in-class mines from Newmont and Rio Tinto in the US. "Other jewellers like RJC founder member Richemont take the mainstreaming route and want the gold industry as a whole to improve by applying the RJC standard to their entire operations," says Knoepfel.

The problem with the RJC is that it still counts few of the big mining companies among its members.

"The mining companies fear that the RJC will force them to certify their entire production according to these minimum standards at a pace that they consider too demanding," says Knoepfel. "But the big gold producers have told us that they plan to raise their ESG standards anyway, the costs of which they will not pass onto the investors. Only extra costs arising from external certification of certain standards and facilities might be passed onto end-users, but at less than 0.1% of the current gold price, that cost is practically negligible."

Section 1502 – Conflict Minerals – of the 2010 US Dodd-Frank Act contains a provision for diamond and gold importers to guarantee a chain-of-custody.

But, says Knoepfel, some responsible investors want to be able to trace the precise origin of the gold, such as the names of the mine and refinery. "However, the gold miners are resistant to this notion of traceability, as they fear local NGO scrutiny and the complexities of handling gold of different origin, which goes against the notion of a highly fungible commodity," he says.

The WGC is working to eradicate gold that triggers or fuels conflict from the supply chain through the introduction of its Conflict-Free Gold Standard.

"Most of the current concerns around minerals fuelling conflict are focused on the Democratic Republic of the Congo (DRC)," says Terry Heymann, director responsible gold at the WGC. "However, the DRC is responsible for less than 1% of newly mined gold. Our standard, which is under development as part of a consultation process, is global and applicable to all areas assessed to be conflict-affected and high-risk, in common with the OECD's approach. Conformity with the standard will be externally assured."

Knoepfel advises responsible investors to support the RJC standard. He says: "Similar to the roundtable on sustainable palm oil, if the financial sector endorsed the RJC standard and team-up with jewellers, the gold industry would have a strong incentive to follow suit."

But despite the various chain-of-custody efforts, a black market for gold continues to exist. And no-one can be certain that the institutional investment market for gold is totally segregated from black market sources.