JANUARY 2025

Sustainability on the Front Line

Engaging with Companies in Conflict-affected Areas

The topic.

Licence to Operate: Companies in the Crossfire

Key figures

- 56 active conflicts in the world [1]
- 25% of the global population lives in conflict-affected areas [2]
- In the last 16 years, the average level of global peacefulness deteriorated twelve times [1]

According to the Institute for Economics & Peace, which released its 2024 edition of the Global Peace Index[1] , **there are currently 56 active conflicts worldwide**, the highest number since the end of World War II. Over the past 17 years, global stability has declined, with substantial increases in political instability, number of conflicts, deaths from conflicts, and violent demonstrations. This trend unfolds against a backdrop of a 10% global increase in overall military capacity since 2014. Consequently, the United Nations estimates that **25% of the world's population now lives in conflict-affected areas**[2].

1 - The IEP, Institute for Economics & Peace, an independent non-profit think tank. Global Peace Index 2024: Measuring Peace in a Complex World, Sydney, June 2024. Available from: http://visionofhumanity.org/resources (accessed 23/10/2024).
2 - United Nations, 'War's Greatest Cost Is Its Human Toll', Secretary-General Reminds Peacebuilding Commission, Warning of 'Perilous Impunity' Taking Hold | Meetings Coverage and Press Releases

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But has the world ever been free from war? The answer is no. Even during the celebrated era of relative peace known as the 'Pax Romana', which spanned roughly 200 years of the Roman Empire, violence was not entirely absent despite its often idealised portrayal. Despite ongoing wars and conflicts, economies must continue functioning to meet the basic needs of populations. In recent years, companies operating in crisis zones have faced heightened public scrutiny, along with increasing social and market pressure regarding their conduct. This raises critical questions: Should businesses maintain operations in conflict-affected areas? If so, to what extent, and under what conditions? Furthermore, **how can sustainable investors appropriately evaluate and address the risks involved, and promote better practices?**

The story thus far.

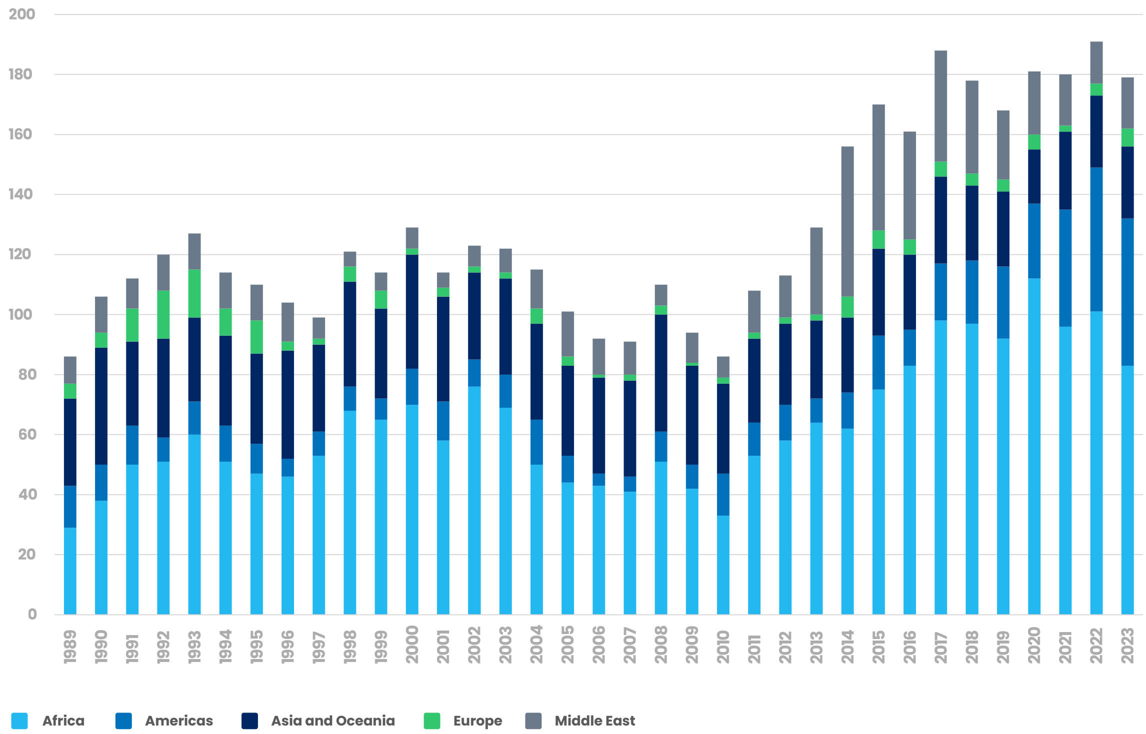
Rising Violence, more Public Attention...

We see three main reasons why companies' business conduct in oppressive regimes and conflict-affected areas has become a topic of concern :

- **Escalating conflicts:** The past decade has seen a rise in conflicts, with the deadliest years since the Cold War being 2021, 2022 and 2023[3] - mainly related to three conflicts: the civil war in the Tigray region in Ethiopia, the Russian invasion of Ukraine and the Israel/ Palestine conflict. For Europeans, some of these have hit close to home, hence a heightened perception of violence. These conflicts, along with increases in weapons trade and military spending – such as in Ukraine, Myanmar and north Macedonia – have contributed to a continuous decline in the Global Peace Index [4].

3 - Conflict Trends: A Global Overview, 1946-2023, Peace Research Institute Oslo (PRIO), 2024
4 - Institute for Economics & Peace. Global Peace Index 2024: Measuring Peace in a Complex World, Sydney, June 2024. https://www.visionofhumanity.org/wp-content/uploads/2024/06/GPI-2024-web.pdf Available from: http://visionofhumanity.org/resources (accessed 14/01/2025).

Figure 1:
Our world has known a significant rise in armed conflicts in the past decade



Source: Uppsala Conflict Data Program and Peace Research Institute Oslo (2024) – processed by Our World in Data
Note: Some conflicts affect several regions. There may therefore be double-counting.

- **Globalisation:** The global economy has become more and more fragmented as intense competition has led companies to expand their global footprint to gain market shares and reduce production costs; they now have clients and suppliers all around the world. In previous decades, multinational companies could choose to avoid conflict-affected areas as these regions typically represented an insignificant share of the global GDP. However, the growing international exposure of companies, coupled with the expansion of conflicts to economically significant regions, has heightened the risks for multinationals operating in such areas. For instance, Russia accounts for 1.9% of global GDP[5]. Taiwan, though contributing less than 1.0% of global GDP, plays a critical role in the semiconductor supply chain, making its stability vital to global technology production. This increasing interconnectedness exposes businesses to grater operational and strategic risks.
- **Heightened public and investor interest in Corporate Social Responsibility:** Individuals are increasingly attentive to companies' business ethics and practices, and to their impact on the environment, the economy, employees, and communities.

5 - Source: World Bank 2023

... and no Operating Manual

Following Russia's invasion of Ukraine, many large international companies swiftly announced plans to exit the country. Two years later, over 1,000 global multinationals had fully withdrawn, while hundreds of others continued their operations[6]. What is the right course of action in such circumstances? Certain industries, such as oil and gas, utilities, and mining, tend to have more experience dealing with conflicts and are better equipped to navigate such challenges. **However, for many company managers, these situations are unprecedented, leaving them unprepared to make appropriate decisions in such complex circumstances.**

The Lafarge case: What companies should *not* do

Lafarge, a French cement company, is embroiled in a major controversy for allegedly paying, through a subsidiary, up to 13 million euros to armed groups, including the Islamic State, to keep its cement factory operational in Syria between 2012 and 2014. The company is accused of complicity in crimes against humanity, financing terrorism, and endangering the lives of its Syrian employees by maintaining operations in a conflict zone.

The company was ordered to pay a financial penalty of $777.78 million to resolve the U.S. Department of Justice's inquiry. The company will also stand trial in France in the second half of 2025.

Source: Bloomberg Holcim's Lafarge to Face Trial in France Over Terrorism Funding Accusations - Bloomberg

Walking a Fine Line

Determining the appropriate corporate conduct during a conflict is a highly complex challenge with no one-size-fits-all solution. Numerous parameters must be carefully considered. Conflicts impose severe challenges on companies, including higher operational costs and deteriorating security conditions for staff. Additionally, stakeholders - employees, local suppliers, communities -, may suffer significant impacts. In some cases, companies may inadvertently fuel local conflicts or instability. The associated risks are multifaceted, spanning financial, operational and reputational domains. However, **companies that recognise these challenges and take proactive steps to mitigate**

6 - Source: News Insights, Top-10 international companies still operating in Russia in 2024 despite Russia's war in Ukraine

negative impacts can bring positive change and stability to the region by addressing critical needs during crises – consider the role of logistics, food or pharmaceutical companies, for example. As underlined by the UNGC and PRI, *"The primary responsibility for peace, security and development rests with governments, but the private sector can make a meaningful contribution to stability and security in conflict-affected and high-risk areas"*[7].

If there is no good and bad answer, how do we evaluate the risks related to companies operating in conflict areas? And where do we draw the line?

How do we apply our policies?

At Candriam, we have clear principles. Specifically, **we do not invest in debt issued by sovereign or quasi-sovereign entities that are on our list of oppressive regimes** (see Candriam's Exclusion policy).

We establish this list based on data gathered from external sources, such as the Freedom House's Freedom in the World Index, the World Bank Governance Indicators, and the Economist Intelligence Unit's Democracy Index, which inform our qualitative review of non-democratic countries. The list is updated every six months and currently comprises sixteen countries[8].

How do we define Oppressive Regimes?

They are countries in which human rights are severely breached on a regular basis, fundamental liberties are systematically denied and the security of people is not guaranteed due to government failure and systematic ethical breaches.

We also extremely carefully consider totalitarian states or those countries in which the government is involved in war against its own people.

As for companies present in oppressive regime countries and conflict-affected areas, our rule is also clearly stated in our Exclusion policy: **we exclude companies with more than 10% of aggregate revenues in oppressive regime countrie**[9], we tolerate companies with exposure below 5%, and we engage with those that have between 5 and 10% of exposure to determine if their risk management is acceptable.

Our analysis and engagement efforts are not limited to oppressive regimes but extend to **Conflict-Affected and High-Risk Areas (CAHRAs), a notion that emerged recently**.

7 - Source: Guidance on Responsible Business in Conflict-Affected and High-Risk Areas: A Resource for Companies and Investors. A joint UN Global Compact – PRI publication
8 - Candriam, as of 31 December 2024.
9 - For portfolios applying the level 2B and 3 exclusions – see page 4 of our Exclusion Policy

CAHRAs – The new frontier ?

CAHRAs, or **Conflict-Affected and High-Risk Areas**, were defined by the OECD's Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, first published in 2011[1].

They are precisely identified by "the presence of armed conflict, widespread violence or other risks of harm to people. Armed conflict may take a variety of forms, such as a conflict of international or non-international character, which may involve two or more states, or may consist of wars of liberation, or insurgencies, civil wars, etc. High-risk areas may include areas of political instability or repression, institutional weakness, insecurity, collapse of civil infrastructure and widespread violence. Such areas are often characterised by widespread human rights abuses and violations of national or international law."

The European Union maintains an indicative, non-exhaustive list of such areas, located **in 28 countries** [2].

1 - OECD (2016), OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: Third Edition, OECD Publishing, Paris, https://doi.org/10.1787/9789264252479-en. Accessed on January 2nd, 2025

2 - CAHRAs , accessed on January 2nd, 2025

Evaluating companies' exposure

In order to identify the riskiest companies in our portfolios, on which we will conduct specific research, we rely on a combination of external sources: news flow, controversies, norm-based analysis – i.e. the principles of the United Nations Global Compact –, but also the United Nations and NGOs such as the Institute for Economics & Peace and The Fund for Peace. Gathering information on individual companies' exposure to conflict areas is a challenge, as the topic is not specifically covered by the usual large ESG service providers. So direct dialogue with exposed companies is often a way to help refine our analysis and assess the adequacy and performance of their risk management.

Building experience from our engagements

For several years now we have regularly engaged with companies that have exposure to oppressive regimes or CAHRAs, with the Human Rights topic at the forefront of our discussions, especially since we formalized Candriam's Human Rights Policy in 2023.

During these discussions **we aim to gauge how companies balance the risk of operating in an oppressive regime or a conflict area against the societal benefits of their presence**. Companies often argue that shutting down operations could be detrimental to employees and local communities, that they have adequate reinforced security measures, or that selling local assets at a depressed price might ultimately benefit entities aligned with the regime; they conclude that maintaining operations in such regions is the more responsible course of action. Our role is not to encourage a company to either stay or leave a high-risk area – these are highly strategic decisions with heavy consequences. When entering in a dialogue with a company exposed to these areas, **as a responsible investor our first objective is to assess whether it is correctly equipped to face the increased risks, and look for evidence of a strong structure in place to guarantee rational and timely decision-making, as well as risk mitigation**.

We would like to see more companies with risk procedures in place as well as heightened human rights due diligence. We like to see evidence of regular human rights impact assessments and local stakeholder engagements indicating that risks have been understood and mapped - a prerequisite for implementing a relevant strategy. Questions we ask investees as part of our engagement framework typically include:

- Does the company have a Human Rights policy that acknowledges the existence of oppressive regimes, conflict-affected and high-risk areas?
- Does the company have appropriate governance in place?
- Does the company carry out impact assessments in high risk areas?
- Are there specific processes or measures for protecting Human Rights in conflict-affected areas?
- Does the company provide transparency on its actions?
- Does the company have an exit/ remain strategy?

Following this due diligence, we may be reassured - or not - on issuers with substantial presence in high risk areas.

This dialogue is also an opportunity to share the best practices gathered through our contacts with companies, regulators, NGOs and peers.

In our experience, many of our discussions with companies have been disappointing: only a few of them carry out heightened human rights due diligence or human rights impact assessment. Although the world has gradually become less stable in the past decade, few companies have effectively been confronted to conflicts until recently, so many of them still lack governance and processes adapted to the new environment. We will keep engaging companies on their risk management performance and push for stronger practices.

Highlights from our recent engagement campaigns

We regularly report on our engagement initiatives with companies exposed to conflict-affected areas (see our latest Annual Engagement and Voting report).

In 2024, we engaged with eight companies with substantial exposure to oppressive regimes (most of them due to large exposure in Russia, the others in the Democratic Republic of Congo and in Myanmar). In most cases we were reassured that the companies were winding down their activity or operating with acceptable risk management measures. But in two cases, we saw high levels of risks or inadequate due diligence which led us to downgrade the companies' eligibility to our portfolios applying an exclusion policy.

We also engaged with seven companies present or exposed to CAHRAs, in particular to the Israel/Palestine conflict. This analysis led to:

- downgrading the eligibility of one company in article 9 funds,
- downgrading the ESG score of five other companies which were missing a specific policy or governance for high risk areas, and adequate risk management and mitigation procedures.

Stronger together

A number of initiatives have emerged on this topic, notably :

- the **Investor Alliance for Human Rights** (240 institutional investors in 21 countries), which provides institutional investors with a dedicated platform to increase their capacity and impact in addressing human rights risks associated with business activities. It organises investor workshops on CAHRAs with Heartland Initiative and the PeaceNexus Foundation.
- the **Forum pour l'Investissement Responsable** - French SIF, which notably opened discussions on the responsibilities of companies active in Russia.
- the **Investor Initiative on Human Rights Data** (II-HRD) which is engaging the major ESG data providers advocating for an improved depth and breadth of corporate human rights data available to investors, with a focus on companies' presence in high risk areas.

We have joined these initiatives and are actively supporting them through our engagement.

Our voting approach

Our voting activities are the logical extension of our engagement activities. We analyse proposals on a case-by-case basis and in the past, we have voted in favour of multiple shareholder resolutions asking for greater scrutiny of human right risks in CAHRAs. Examples of these shareholder resolutions include adopting a policy on products and services in conflict areas, producing a report on the risks of operating in countries with significant human rights concerns, and reporting on the due diligence process of doing business in conflict-affected areas.

Next steps?

Strengthening regulations will provide increased transparency

Unfortunately, geopolitical trends are not pointing to an immediate relief of global tensions. On the positive side, regulators are stepping up to enhance corporates' transparency on extra-financial topics that matter to investors.

The **CSRD (Corporate Sustainability Reporting Directive)** is a broad initiative at European level, making the sustainability reporting compulsory for 50,000 companies and providing some first level of enhanced transparency from corporates on their practices.

Regarding human rights, specific regulations have emerged such as the **Loi sur le Devoir de Vigilance** (Due diligence law) in France (2017) and the **German Supply Chain Due Diligence Act** (2023). Both put human rights at the heart of large companies' concerns, and require large to medium-size companies to have and to implement a reasonable due diligence plan – involving all stakeholders - to preserve the environment and identify and prevent risks of violations of human rights and fundamental freedoms. The scope of the laws is not only the companies' own operations but also their supply chain.

The EU also stepped up on the topic with the **Corporate Sustainability Due Diligence Directive** (CSDDD) which entered into force on July 25th 2024 with the aim to "identify and address potential and actual adverse human rights and environmental impacts in the company's own operations, their subsidiaries and, where related to their value chain(s), those of their business partners"[10] . The directive is now being challenged by the Omnibus Simplification Package currently under study by the European Commission. This package aims to ease the regulatory burden introduced by the Taxonomy, CSRD and CSDDD on businesses.

10 - Corporate sustainability due diligence - European Commission

Explore
Close up

Ready to Engage

The latest edition of the World Economic Forum's Global Risks Report reveals a stark reality: interstate armed conflict now ranks among the top five most severe risks over the next two years. The potential for conflict contagion is alarming, with hotspots like Ukraine, Israel and Taiwan posing high-stakes ramifications for the geopolitical order, global economy, and the safety and security of populations. **While we hope for swift resolutions, we must prepare for any further negative developments.**

At Candriam, we have not waited for this rise in conflicts to allocate the necessary resources for an efficient dialogue with our investees. **Our engagements are thorough, focused, and have material impacts on our ESG opinions and the eligibility of companies and issuers in our portfolios.**

We firmly believe that this due diligence is an essential part of our responsibility as sustainable investors, for the benefit of our clients' portfolios as well as many other stakeholders.

11 - Source: World Economic Forum, The Global Risks Report 2024, WEF_The_Global_Risks_Report_2024.pdf