

# Second-Party Opinion

## Otto Group Sustainable Finance Framework

### Evaluation Summary

Sustainalytics is of the opinion that the Otto Group Sustainable Finance Framework is credible and impactful and aligns with the four core components of the Green Bond Principles 2018 (GBP), Green Loan Principles 2018 (GLP), Social Bond Principles 2018 (SBP) and Sustainability Bond Guidelines 2018 (SBG). This assessment is based on the following:



**USE OF PROCEEDS** The eligible categories for the use of proceeds are aligned with those recognized by the Green Bond Principles, Green Loan Principles and Social Bond Principles. Sustainalytics considers that the purchase of responsibly sourced raw materials will lead to positive environmental impacts and advance the following UN Sustainable Development Goals: (1) No Poverty, (4) Quality Education (5) Gender Equality, (8) Decent Work and Economic Growth and (15) Life on Land.



**PROJECT EVALUATION / SELECTION** the Otto Group's internal process for evaluating and selecting projects is aligned with market practice. The Sustainable Finance Committee, which is comprised of representatives from Group Corporate Finance, Group Corporate Responsibility and relevant subject matter experts, is responsible for project evaluation and selection.



**MANAGEMENT OF PROCEEDS** the Otto Group's processes for management of proceeds are aligned with market practice. Proceeds will be managed with a portfolio approach and will be tracked until full allocation. Pending full allocation, the Otto Group may temporarily invest the proceeds from any instruments issued under this Framework in its treasury liquidity portfolio (in cash or cash equivalents) or use such proceeds to pay back outstanding indebtedness. However, the Otto Group expects proceeds issued under this Framework to be fully allocated at the time of issuance to refinance expenditures related to the procurement of certified textiles and furniture as outlined by the eligibility criteria in the Otto Group Sustainable Finance Framework.



**REPORTING** The Otto Group intends to report allocation of proceeds and impact metrics on a portfolio basis on its creditor relations website and in its sustainability report which is published as a part of the annual report. The Group intends to report to investors within one year from the date of issuance and annually, until full allocation of proceeds from sustainable finance instruments. Sustainalytics views the Otto Group's allocation and impact reporting as aligned with market practice.

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## Introduction

Otto (GmbH & Co KG) (the Otto Group or the “company”) was founded as a mail order company in 1949 and today is one of the world's biggest e-commerce companies. The company is based in Germany and operates in more than 30 countries. The Group contains more than 123 companies in the retail and retail-related services industries.

The Otto Group has developed the Otto Group Sustainable Finance Framework (the “Framework”) under which it is considering issuing bonds and/or loan instruments and using the proceeds to finance and/or refinance a “Sustainable Investment Portfolio” of expenditures (“Eligible Projects”) in the following categories:

Responsible sourcing of certified materials:

- a. Purchasing costs for textiles with the Cotton made in Africa (CmiA) label
- b. Purchasing costs of products with Forest Stewardship Council® (FSC®) certification

The Otto Group engaged Sustainalytics to review the Otto Group Sustainable Finance Framework, dated March 2019 and provide a second-party opinion on the Framework’s environmental credentials and its alignment with the Green Bond Principles 2018 (GBP), Green Loan Principles 2018 (GLP) and Social Bond Principles 2018 (SBP).<sup>1</sup> This Framework has been published in a separate document.<sup>2</sup>

As part of this engagement, Sustainalytics held conversations with various members of the Otto Group’s management team to understand the sustainability impact of its business processes and planned use of proceeds, as well as management of proceeds and reporting aspects of the Otto Group’s sustainable finance instruments. Sustainalytics also reviewed relevant public documents and non-public information.

This document contains Sustainalytics’ opinion of the Otto Group Sustainable Finance Framework and should be read in conjunction with that Framework.

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<sup>1</sup> The Green Bond Principles are administered by the International Capital Market Association and are available at <https://www.icmagroup.org/green-social-and-sustainability-bonds/green-bond-principles-gbp/>

<sup>2</sup> The Otto Group Sustainable Finance Framework is available on the Otto Group’s website at: <https://www.ottogroup.com/en/die-otto-group/daten-fakten/Creditor-Relations.php>

## Sustainalytics' Opinion

### Section 1: Sustainalytics' Opinion on the Otto Group Sustainable Finance Framework

Sustainalytics is of the opinion that the Otto Group Sustainable Finance Framework is credible and impactful and aligns with the four core components of the Green Bond Principles 2018, Green Loan Principles 2018, Social Bond Principles 2018 and Sustainability Bond Guidelines 2018. Sustainalytics highlights the following elements of Otto Group's Sustainable Finance Framework:

- Use of Proceeds:
  - The use of proceeds for (i) socio-economic advancement and empowerment and (ii) environmentally sustainable management of living natural resources and land use are recognized as impactful by the Green Bond Principles, Green Loan Principles and Social Bond Principles.
  - The Otto Group intends to source from two certification schemes, CmiA and FSC®. FSC® is an internationally renowned forest certification scheme that has been promoting sustainable forest management for 25 years. CmiA is an independent initiative of the Aid by Trade Foundation (AbTF) which was founded by Dr. Michael Otto, Chairman of the Otto Group Supervisory Board, in 2005. CmiA works with smallholder farmers to impart knowledge related to both farming and business management. With about one million African cotton farmers certified to the CmiA standard and about 103 million CmiA textiles in 2018,<sup>3</sup> CmiA has continued to grow each year and thereby helps to improve the livelihood of African cotton farmers and their families as well as workers in cotton ginneries. Farmers are trained in sustainable cultivation methods that enable them to improve yields and income, while reducing environmental impacts. A special focus is put on female farmers in order to foster gender equality through special training sessions, as well as to support to women's groups kick-starting a diversification of income sources through additional on- and off-farm business activities.<sup>3</sup> For more information on impact please refer to Section 3. Sustainalytics views both the CmiA and FSC® certification schemes as credible and impactful (For more information on CmiA and FSC® see Appendices 1 and 2).
  - The sustainable finance instruments will be used exclusively to finance operational expenditures (OPEX) related to purchasing costs, including the sourcing of cotton textile products with the Cotton made in Africa (CmiA) label and sourcing of FSC® certified furniture. Given the nature of the projects, Sustainalytics believes that OPEX directly linked to the procurement of sustainable textiles and furniture will be important to sustaining the positive social and environmental impacts associated with the associated certification schemes. The Otto Group is monitoring expenditures for sustainably sourced textiles and furniture and can allocate and match these expenditures specifically to the issuance proceeds, verifying that OPEX is directly tied to eligible assets (sustainable cotton products and responsibly sourced furniture).
- Project Evaluation and Selection:
  - In alignment with market practice, the Otto Group has established a Sustainable Finance Committee, which is comprised of representatives from Corporate Finance, Corporate Responsibility and relevant subject matter experts from the Group's subsidiaries. Projects to be refinanced through the bond will be selected from eligible categories as outlined by the Framework. Sustainalytics positively notes the Group's application of its minimum environmental and social standards and its general risk management measures for capital allocation decisions to its process for project evaluation and selection.
- Management of Proceeds:
  - Proceeds from sustainable finance instruments will be managed by the Otto Group using a portfolio approach. The Group will track all proceeds to ensure they are managed until full allocation in accordance with the framework. The Group will review the Sustainable Investment Portfolio annually and determine new eligible projects, which have taken place in the calendar year prior to the issuance date of the oldest outstanding instrument in the framework, and in the

<sup>3</sup> CmiA 2017 Annual Report available at: <https://cottonmadeinafrica.org/en/materials/annual-reports/197-cmia-annual-report-2017>

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years thereafter. Expenditures will be removed from the Sustainable Investment Portfolio when instruments mature, such that, at any time, the oldest expenditures included in the Sustainable Investment Portfolio will be those incurred in the calendar year prior to the issuance date of the oldest outstanding Instrument. Through this approach, the Otto Group has established an implicit look back period that extends to the beginning of the preceding calendar year of the issuance.

- The Otto Group will aim to ensure that allocated proceeds for the Sustainable Investment Portfolio will match or exceed the balance of proceeds from its outstanding instruments issued under this framework. Additional projects will be selected and added to the portfolio until net proceeds from outstanding instruments are fully allocated. Until all proceeds are fully allocated, the Otto Group may opt to invest unallocated funds in its treasury liquidity portfolio or use them to pay off outstanding debt. However, the Group has indicated that it fully intends to allocate all proceeds from the Framework at the time of issuance, refinancing sustainable procurement that took place up until the beginning of the calendar year preceding the year of issuance. Sustainalytics views this management process to be in alignment with market practice.
- Reporting:
  - The Otto Group will report annually on both allocation and impact. Allocation reporting will provide a full break down of the total amount of expenditures selected for the Sustainable Investment Portfolio, including a breakdown of expenditures by eligible category, the amount of expenses by calendar year and the balance of unallocated proceeds. The allocation report will be made available on the Group's creditor relations website.
  - Additionally, the Otto Group intends to track and report on progress achieved towards sustainability goals related to sourcing sustainably certified cotton and forest products. This will be included in the Sustainability Report which is published as part of the Annual Report, which is available on the company website. Sustainalytics views this reporting approach as aligned with market practice. The Otto Group will report on the following impact indicators: volume (tonnes) of CmiA cotton / cost (€) of purchases for CmiA labelled textiles for own and licensed brands; Number of farmers benefitting from the initiative; number of CmiA labelled textiles; kg CO<sub>2</sub>-eq saved per 1kg/CmiA lint cotton (vs conventional cotton); percentage of sustainable cotton for own and licensed brands, number of articles / cost (€) of purchases that are FSC® certified; percentage of FSC® certified articles.
  - Sustainalytics notes that the Otto Group intends to request a limited assurance report covering allocation of proceeds from an external auditor for any instruments issued under the framework, which is a best practice approach to reporting.

### Alignment with Sustainability Bond Principles 2018

Sustainalytics has determined that the Otto Group's Sustainable Finance Framework aligns to the four core components of the Green Bond Principles 2018, Green Loan Principles 2018, Social Bond Principles 2018 and Sustainability Bond Guidelines 2018. For detailed information please refer to Appendix 2: Sustainability Bond/Sustainability Bond Programme External Review Form.

## Section 2: Sustainability Performance of the Otto Group

### Contribution of framework to the Otto Group's sustainable sourcing targets

The Otto Group has had a historical focus on sustainability and environmental stewardship, which has been an important part of the company's strategy since the 1980s. The company has since embedded these values in its corporate culture and continues to drive results. The company has a Corporate Responsibility Strategy 2020 which was adopted in 2012 and includes the following five targets:<sup>4</sup>

1. Textile Strategy - TARGET: 100% sustainable cotton in own and licensed brands by 2020
2. Furniture Strategy - TARGET: 100% FSC®-certified furniture by 2025
3. Paper Strategy - TARGET: 60% FSC®-certified catalogue paper by 2020

<sup>4</sup> The Otto Group CR Strategy available at: <https://www.ottogroup.com/en/verantwortung/Nachhaltige-Unternehmensfuehrung/CR-Strategie.php>

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4. Social Programme<sup>5</sup> - TARGET: 100% integration of suppliers for own and licensed brands by 2020
5. Climate Strategy - TARGET: 50% reduction of CO<sub>2</sub> emissions by 2020 (compared to the base year 2006)

As of 2018, the company sourced 93% of its textiles from sustainable cotton for own and licensed brands; 59% FSC certified furniture for its own and licensed brands and 54% of FSC certified catalogue paper. Otto Group has also confirmed that, as of 2018, 96% of its suppliers were integrated into its Social Programme and that the organization had achieved a 47% reduction in CO<sub>2</sub> emissions compared to 2006.<sup>6</sup>

Sustainalytics believes that the Otto Group's Sustainable Finance Framework will contribute to the targets for the textile and furniture strategy through purchases of Cotton made in Africa (CmiA) certified textiles and Forest Stewardship Council® (FSC®) certified furniture.

### Well positioned to address common environmental and social risks associated with the projects

The proceeds from the Otto Group's Sustainable Finance Framework will be invested in Eligible Sustainability Projects that Sustainalytics considers impactful, but it is acknowledged that the eligible categories also entail environmental and social risks. The key risks are related to the potential for human rights abuses and child labour in the cotton supply chain and risks related to forest biodiversity, illegal logging, agricultural production and pesticide use.

Sustainalytics is of the opinion that the Otto Group, using CmiA and FSC®, has ensured that adequate policies and programmes are in place to mitigate the main environmental and social risks linked with the use of proceeds, as follows:

- Cotton made in Africa is actively addressing child labour through a stated aim of improving the living conditions of cotton workers through higher incomes. CmiA upholds Conventions 138 and 182 of the International Labour Organization (ILO).<sup>7</sup> The CmiA criteria bans any form of exploitative child labour, which is defined by the ILO as labour "that deprives children of their childhood, their potential and their dignity, and that is harmful to physical and mental development."<sup>8</sup> Furthermore, any type of child labour that is performed outside of the family, is strictly forbidden by the CmiA standard, including human trafficking and forced labour.<sup>9</sup> However, CmiA recognizes that not all the work children perform on family farms falls into the category of child labour and, at times, is a financial necessity for the families. According to the standard "The work the children perform on the family farm is permitted, provided they have enough time for school and free time. However, any work that is harmful to the health and development of children is prohibited."<sup>10</sup> For example, children are not allowed to handle or apply pesticides or carry heavy loads. Children can help with driving livestock away from cotton fields and other tasks that do not create a health or safety risk.<sup>10</sup> In order to ensure that farmers are effectively trained on how children are permitted to assist on the family farm, CmiA has developed extensive training materials that provide guidance to farmers.<sup>11</sup>
- In addition to the labour requirements of the CmiA standard, the Otto Group is committed to continuing improvement of safe and fair working conditions for workers at supplier production sites. The company has implemented a code of conduct and Social Programme through which factories are audited and supported on implementing and maintaining socially acceptable working conditions. All suppliers for own and licensed brands of Group companies that produce these goods in high risk countries (as defined in

<sup>5</sup> "The Social Programme, under continuous development, aims to ensure acceptable working conditions and robust social management systems at the production sites. Integrated into the program are all suppliers for own and licensed brands of the Group companies, that produce these goods in high risk countries (as defined in the amfori BSCI classification\*). This includes all suppliers that submit valid and acceptable social audits or certifications for all production facilities where goods are manufactured on behalf of the Otto Group." At:

<https://www.ottogroup.com/en/verantwortung/Arbeitsbedingungen-in-den-Produktionsbetrieben.php>

<sup>6</sup> The Otto Group Sustainable Finance Framework is available on the Otto Group's website at: <https://www.ottogroup.com/en/die-otto-group/daten-fakten/Creditor-Relations.php>

<sup>7</sup> CmiA Against Child Labour available at: <https://cottonmadeinafrica.org/en/training/cmia-against-child-labour>

<sup>8</sup> ILO Child Labour definition available at: <https://libguides.ilo.org/child-labour-en>

<sup>9</sup> CmiA Standard available at: <https://cottonmadeinafrica.org/en/materials/cmia-standard>

<sup>10</sup> CmiA Against Child Labour available at: <https://cottonmadeinafrica.org/en/training/cmia-against-child-labour>

<sup>11</sup> The training materials consist of picture blocks that show examples of what good practices and bad practices look like. Due to literacy issues in the region, training via pictures can be an effective instructive tool. Trainers will show pictures to the audience and discuss the activities being shown in the image, which can then provide the trainer with guidance on what issues to address. CmiA, "Picture Block against child labour", at: <https://www.cottonmadeinafrica.org/en/materials/training-material/173-picture-block-against-childlabour-english-ghana/file>

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the amfori BSCI classification)<sup>12</sup> have been integrated into the Social Programme. As of 2018, the Group has integrated 96% of suppliers into the Programme.

- Regarding the risks of labour issues in the forest products supply chain, FSC® requires all certified companies to adhere to the ILO core conventions. Any company who violates any of the conventions faces immediate termination.<sup>13</sup>
- CmiA includes several criteria to protect biodiversity and reduce the harmful impacts from improper pesticide use.<sup>14</sup> In order to remain certified to the CmiA standard, smallholder farmers are required to achieve continuous improvement through certification.<sup>15</sup> This approach requires farmers to phase out the use of harmful pesticides, which have a negative impact on both the environment and the health of the community. Additionally, the CmiA standard does not allow the use of any pesticides regulated by the Rotterdam or Stockholm Convention or which the WHO has ranked as extremely or highly hazardous.<sup>16</sup> It should be noted that the use of Paraquat, which is a toxic chemical widely used as an herbicide, especially in cotton farming, is allowed in some circumstances.<sup>17</sup> However, through discussions with the Aid by Trade Foundation, Sustainalytics was able to confirm that the use of paraquat is minimal and, out of 22 certified partners, there is only one who distributes small amounts of this substance to farmers. Noting the minimal distribution of this substance, Sustainalytics encourages the Otto Group to encourage all its suppliers to ban the use of paraquat. Beyond the impact of pesticide usage, cotton farming has a variety of other impacts including its contribution to global greenhouse gas (GHG) emissions and consumption of large volumes of water. To assess and monitor these impacts, CmiA conducted a Life Cycle Assessment (LCA) in 2014, which demonstrated that the impacts of CmiA farming are significantly less than those of conventional techniques.<sup>18</sup> In addition, the smallholder farmers practice rainfed agriculture exclusively, which means they do not use any artificial irrigation.
- Finally, as an internationally renowned forest certification scheme, FSC® has robust environmental protection criteria which contributes to responsible forest management and conservation of biodiversity.

Between the use of credible certification schemes and internal policies, Sustainalytics views the Otto Group as having adequate measures in place to reduce the risk of human rights abuses, biodiversity loss and environmental degradation as a result of cotton farming, textile production, forestry and furniture production.

### Section 3: Impact of Use of Proceeds

The use of proceeds categories are recognized as impactful by GBP, GLP, SBP and SBG. Sustainalytics has focused on two below where the impact is specifically relevant in local context.

#### **Cotton made in Africa's impact on the socio-economic advancement and empowerment of cotton workers**

The cotton industry emerged in West Central Africa (WCA) in the 1960's and 1970's. The industry developed rapidly, and between 1970 and 1988 cotton yields grew at a rate of 6.1% per year, compared to the average of 1.9% in world cotton yield growth. However, from 1980 to 2005, cotton yields in WCA remained stagnant. Additionally, due to ineffective price-setting mechanisms, subsidies for cotton in other countries and a variety of other market failures, African cotton farmers have historically been paid well below market rate for their crop. The region has failed to introduce significant reforms and national policies have done little to address the issues.<sup>19</sup> As such, African cotton farmers are stuck in a cycle of poverty. As an attempt to help alleviate

<sup>12</sup> Amfori is a global business association that promotes sustainable trade. The association brings together over 2,000 retailers, importers, brands and associations spanning over 40 countries. Amfori, "Country Risk Classification 2019", at: <https://www.amfori.org/resource/countries-risk-classification>

<sup>13</sup> FSC Policy for the Association of Organizations with FSC available at: <https://ic.fsc.org/file-download.policy-for-the-association-of-organizations-with-fsc-fsc-pol-01-004-v2-0-en.a-8060.pdf>

<sup>14</sup> CmiA Standard available at: <https://cottonmadeinafrica.org/en/materials/cmia-standard/cmia-standards-documents/68-cmia-criteria-matrix-vol3/file>

<sup>15</sup> CmiA Standards Criteria available at: <https://cottonmadeinafrica.org/en/standards/criteria>

<sup>16</sup> CmiA Standard available at: <https://cottonmadeinafrica.org/en/materials/cmia-standard/cmia-standards-documents/68-cmia-criteria-matrix-vol3/file>

<sup>17</sup> Paraquat can have long-term health effects ranging from respiratory issues to kidney failure, heart failure and other fatal conditions. Center for Disease Control and Prevention, Paraquat info available at: <https://emergency.cdc.gov/agent/paraquat/basics/facts.asp>

<sup>18</sup> CmiA Eco-Footprint Study available at: <https://cottonmadeinafrica.org/en/english-docs/cmia-standard-1/impact-measurement/75-cmia-eco-footprint-study-2013-1/file>

<sup>19</sup> The "Cotton Problem" in West and Central Africa: The Case for Domestic Reforms available at: <https://www.cato.org/publications/economic-development-bulletin/cotton-problem-west-central-africa-case-domestic-reforms>

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some of these poverty issues, Cotton made in Africa (CmiA) was founded in 2005 as an independent initiative of Dr. Michael Otto, with the aim of improving the livelihoods for cotton workers in Africa. A study carried out in 2014 determined that, on average, in four out of the six countries that CmiA was active, farmers were able to increase their cotton income by more than 98%.<sup>20</sup> However, the study acknowledges limitations and notes that although they tried to ensure an equal comparison, external factors such as weather and market prices can have an adverse effect on results.<sup>20</sup> In general, the findings of the study indicate that CmiA has had a positive impact on farmers in Western Africa.

One of the environmental and social concerns for cotton farming in Africa is the overuse of pesticides. Due to a lack of education, cotton farmers are generally unaware of how to properly handle, apply and dispose of these chemicals. This can endanger the health of everyone in the community as well as harm the environment. CmiA certified cotton companies in Africa and agriculture experts provide cotton farmers with training on sustainable, modern and efficient cotton farming techniques,<sup>21</sup> which play an important role in preventing adverse health effects on farmers who are not properly educated on the impact of pesticides and how to handle them.<sup>22</sup> Since 2012, the CmiA initiative together with the extension service teams of certified cotton companies have been providing business management training for smallholder farmers as part of the "Farmers Business School". Farmers are taught basic business knowledge skills, how to assess production risks and manage their budgets. This knowledge allows farmers to take control of their business and improve the productivity of their farms.<sup>23</sup>

Beyond the trainings, the initiative connects farmers with an international alliance of retailers, brands and other supporters that create demand for CmiA certified cotton and support nature protection and the improvement of livelihoods for farmers and ginnery workers by paying licensing fees for CmiA cotton. In 2017, 1.78 million hectares (1.75 average hectares per farmer) have been CmiA-certified and approximately 90 million CmiA labelled products have been produced by retail and brand partners.<sup>24</sup> By providing African cotton farmers with agricultural training on cotton growing, harvesting and processing techniques along with creating a demand for the product via the Demand Alliance, Sustainalytics views CmiA certification as a positive contribution towards improving the socio-economic situation of African cotton workers.

### Alignment with/contribution to SDGs

The Sustainable Development Goals (SDGs) were set in September 2015 and form an agenda for achieving sustainable development by the year 2030. This sustainable finance framework advances the following SDG goals and targets:

Use of Proceeds Category	SDG	SDG target
Socio-economic advancement and empowerment	1. No Poverty	1.4 By 2030, ensure that all men and women, in particular the poor and the vulnerable, have equal rights to economic resources, as well as access to basic services, ownership and control over land and other forms of property, inheritance, natural resources, appropriate new technology and financial services, including microfinance.
	4. Quality Education	4.4 By 2030, substantially increase the number of youth and adults who have relevant skills, including technical and vocational skills, for employment, decent jobs and entrepreneurship.
	5. Gender Equality	5.A Undertake reforms to give women equal rights to economic resources, as well as access to ownership and control over land and other forms of property, financial services, inheritance and natural resources, in accordance with national laws.

<sup>20</sup> CmiA and COMPACI Newsletter 14<sup>th</sup> edition (2014) at: [https://www.deginvest.de/DEG-Documents-in-English/Download-Center/Compaci\\_News\\_No-14\\_Engl\\_FINAL.pdf](https://www.deginvest.de/DEG-Documents-in-English/Download-Center/Compaci_News_No-14_Engl_FINAL.pdf)

<sup>21</sup> CmiA Agricultural Training available at: <https://cottonmadeinafrica.org/en/training/agricultural-training>

<sup>22</sup> Organic Cotton Production in West Africa available at: [https://afsafrica.org/wp-content/uploads/2015/11/Organic\\_cotton\\_West\\_Africa.pdf](https://afsafrica.org/wp-content/uploads/2015/11/Organic_cotton_West_Africa.pdf)

<sup>23</sup> CmiA Economic Training available at: <https://cottonmadeinafrica.org/en/training/betriebswirtschaftliche-schulungen>

<sup>24</sup> Cotton Made in Africa 2017 Annual Report available at: <https://cottonmadeinafrica.org/en/materials/annual-reports/197-cmia-annual-report-2017/file>

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	8. Decent Work & Economic Growth	8.3 Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services.
Environmentally Sustainable Management of Living Natural Resources and Land Use	15. Life on Land	15.2 By 2020, promote the implementation of sustainable management of all types of forests, halt deforestation, restore degraded forests and substantially increase afforestation and reforestation globally

## Conclusion

The Otto Group Sustainable Finance Framework will contribute to the company’s sustainability goals related to the procurement of sustainably sourced raw materials and carbon reduction. By using the proceeds to purchase sustainably produced Cotton made in Africa and FSC-certified wood and paper products, the Otto Group is contributing to sustainable management of natural resources as well as the socioeconomic advancement and empowerment of cotton farmers and workers in Africa and forest owners. These expenditures will contribute to SDGs including no poverty, quality education, gender equality, decent work & economic growth and life on land. The project evaluation and selection process, management of proceeds and reporting process are all aligned with market practice. Based on the above, Sustainalytics is of the opinion that the Otto Group is well-positioned to issue green bonds and that the Otto Group Sustainable Finance Framework is credible, impactful and aligned with the Green Bond Principles, Green Loan Principles, Social Bond Principles and Sustainability Bond Guidelines.

## Appendices

### Appendix 1: Overview of Cotton made in Africa (CmiA)

	<i>Cotton made in Africa</i>
Background	CmiA is an independent initiative of the Aid by Trade Foundation (AbTF) which was founded by Dr. Michael Otto, Chairman of the Otto Group Supervisory Board, in 2005. CmiA works with smallholder farmers to impart knowledge related to both farming and business management.
Clear positive impact	Promoting sustainable cotton farming practices that improve water quality, conserve energy, increase biodiversity, contribute to soil health and providing farmers with business and agriculture training to improve entrepreneurial skills and encourage independent ownership.
Minimum standards	<p>Whether a smallholder farmer or a cotton company may even participate in the Cotton made in Africa initiative is first determined against a set of exclusion criteria:</p> <ul style="list-style-type: none"> <li>• Only smallholder farmers who manage a small parcel of land (average 1-3ha) for securing their income may participate in the Cotton made in Africa initiative.</li> <li>• The smallholder farmers practice rainfed agriculture exclusively. This means they do not use any artificial irrigation.</li> <li>• The deforestation of primary forests is prohibited as well as encroaching upon nature reserves.</li> <li>• Child labour (according to the ILO Conventions 138 and 182), human trafficking (according to the UN Palermo Protocol) and forced labour (according to ILO Conventions 29 and 105) are strictly prohibited.</li> <li>• Freedom of association and membership in institutional structures that represent smallholder farmers and respective employees in the cotton gins. The right to and the outcomes of collective bargaining is secured (as defined by ILO Conventions 87 and 98).</li> <li>• Employees in the cotton gins are granted the freedom of association (see ILO Conventions on Freedom of Association and Collective Bargaining 87 and 98).</li> <li>• Pesticides regulated by the Rotterdam and Stockholm Convention or which the WHO has ranked as extremely or highly hazardous (class Ia and Ib) may not be used. For their own safety, pregnant women, nursing mothers, sick people, children, and untrained and/or inexperienced persons are prohibited from working with pesticides. A list of prohibited pesticides can be found <a href="#">here</a>.</li> <li>• The use of pesticides that have national approval for the use in cotton cultivation yet do not fulfill international standards and are identified in at least one local language is prohibited.</li> <li>• The use of genetically modified seeds is excluded.</li> <li>• Business relationships must comply with national laws and practices and international covenants according to the OECD guidelines for multinational enterprises.</li> <li>• The principle of equal remuneration for men and women workers for work of equal value is secured (as defined in ILO Convention 100, Art. 1).</li> <li>• Discrimination in the workplace is strictly forbidden (as defined in ILO Convention 111).</li> </ul>
Scope of certification or programme	CmiA addresses cotton farming at the smallholder level and cotton ginning in Africa and manages environmental and social issues, including agricultural management (pesticide use, water and soil conservation, crop rotation, etc.), health and safety (handling of pesticides), child labour and gender equality. The programme takes a holistic approach by not only assessing criteria but also providing training to farmers.
Verification of standards and risk mitigation	The CmiA verification process takes place over three phases, the entry phase, first subsequent verification audit (after 2 years) and subsequent verification audits that take place every two years. The first step is a self-assessment which is provided to CmiA, Self-assessments need to be updated and handed in once a year. Subsequent audits are carried out by third-party vendors.
Third party expertise and multi-stakeholder process	The CmiA standards, their criteria, and the generic verification system to monitor the standards were designed by experts involving all key stakeholders in the Cotton made in Africa initiative. These include the African cotton companies as well as social, environmental and development cooperation institutions, such as the NABU, Welthungerhilfe, or World Wildlife Fund (WWF), Wageningen University in the Netherlands, and the auditing firm PricewaterhouseCoopers (PwC). The verification system is subject to regular review and further development by a Technical Advisory Board composed of experts from NGOs, the industry, and cotton producers.
Performance Display	
Accreditation	CmiA commissions independent and qualified organizations to conduct the verification.

Qualitative considerations	CmiA takes a continuous improvement approach to its certification and aims to assist African cotton farmers and workers. The standard grades practices based on a color-code system of red, yellow and green. To show improvement of the development criteria they are required to reduce the number of red/yellow criteria from one to the other certification. The label also has an organic standard for farmers who are able to pursue organic cotton farming certification.
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## Appendix 2: Sustainalytics' Analysis of the FSC Certification

FSC is based on rigorous standards and on a multi-stakeholder structure. The organization is in line with international norms such as the International Labour Organization (ILO) conventions, the Convention on Biological Diversity (CBD), and the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES). In addition to compliance with laws in the country of certification, the scheme has a set of minimum requirements that companies are required to meet to obtain and maintain certifications. These requirements include compliance with standards around sustainable management of forests, management of environmental impact of operations, preservation of biodiversity, management of socio-economic and community relations, and sourcing of sustainable wood (chain of custody). Furthermore, FSC requires an external annual audit to ensure compliance, and achieve and maintain certification.

## Appendix 3: Sustainability Bond / Sustainability Bond Programme - External Review Form

### Section 1. Basic Information

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**Issuer name:** Otto (GmbH & Co KG)

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**Sustainability Bond ISIN or Issuer Sustainability Bond Framework Name, if applicable:** The Otto Ground Sustainability Bond Framework  
*[specify as appropriate]*

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**Review provider's name:** Sustainalytics

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**Completion date of this form:** 22 March 2019

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**Publication date of review publication:** *[where appropriate, specify if it is an update and add reference to earlier relevant review]*

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### Section 2. Review overview

#### SCOPE OF REVIEW

The following may be used or adapted, where appropriate, to summarize the scope of the review.

The review assessed the following elements and confirmed their alignment with the GBPs and SBPs:

- |  |  |
|--|--|
| <input checked="" type="checkbox"/> Use of Proceeds        | <input checked="" type="checkbox"/> Process for Project Evaluation and Selection |
| <input checked="" type="checkbox"/> Management of Proceeds | <input checked="" type="checkbox"/> Reporting                                    |

## The Otto Group Sustainable Finance Framework

### ROLE(S) OF REVIEW PROVIDER

- |   |  |
|---|--|
| <input checked="" type="checkbox"/> Consultancy (incl. 2 <sup>nd</sup> opinion) | <input type="checkbox"/> Certification |
| <input type="checkbox"/> Verification   | <input type="checkbox"/> Rating        |
| <input type="checkbox"/> Other ( <i>please specify</i> ):                       |  |

Note: In case of multiple reviews / different providers, please provide separate forms for each review.

### EXECUTIVE SUMMARY OF REVIEW and/or LINK TO FULL REVIEW (*if applicable*)

Please refer to Evaluation Summary above.

### Section 3. Detailed review

Reviewers are encouraged to provide the information below to the extent possible and use the comment section to explain the scope of their review.

#### 1. USE OF PROCEEDS

Overall comment on section (*if applicable*):

The use of proceeds for (i) socio-economic advancement and empowerment and (ii) environmentally sustainable management of living natural resources and land use are recognized as impactful by the Green Bond Principles, Green Loan Principles and Social Bond Principles.

The Otto Group intends to source from two certification schemes, CmiA and FSC®. FSC® is an internationally renowned forest certification scheme that has been promoting sustainable forest management for 25 years. CmiA is an independent initiative of the Aid by Trade Foundation (AbTF) which was founded by Dr. Michael Otto, Chairman of the Otto Group Supervisory Board, in 2005. CmiA works with smallholder farmers to impart knowledge related to both farming and business management. With about one million African cotton farmers certified to the CmiA standard and about 103 million CmiA textiles in 2018,3 CmiA has continued to grow each year and thereby helps to improve the livelihood of African cotton farmers and their families as well as workers in cotton ginneries. Farmers are trained in sustainable cultivation methods that enable them to improve yields and income, while reducing environmental impacts. A special focus is put on female farmers in order to foster gender equality through special training sessions, as well as to support to women's groups kick-starting a diversification of income sources through additional on- and off-farm business activities. For more information on impact please refer to Section 3. Sustainalytics views both the CmiA and FSC® certification schemes as credible and impactful (For more information on CmiA and FSC® see Appendices 1 and 2).

The sustainable finance instruments will be used exclusively to finance operational expenditures (OPEX) related to purchasing costs, including the sourcing of cotton textile products with the Cotton made in Africa (CmiA) label and sourcing of FSC® certified furniture. Given the nature of the projects, Sustainalytics believes that OPEX directly linked to the procurement of sustainable textiles and furniture will be important to sustaining the positive social and environmental impacts associated with the associated certification schemes. The Otto Group is monitoring expenditures for sustainably sourced textiles and furniture and can allocate and match these expenditures specifically to the issuance proceeds, verifying that OPEX is directly tied to eligible assets (sustainable cotton products and responsibly sourced furniture).

Use of proceeds categories as per GBP:

# The Otto Group Sustainable Finance Framework

- |  |   |
|--|---|
| <input type="checkbox"/> Renewable energy  | <input type="checkbox"/> Energy efficiency  |
| <input type="checkbox"/> Pollution prevention and control  | <input checked="" type="checkbox"/> Environmentally sustainable management of living natural resources and land use |
| <input type="checkbox"/> Terrestrial and aquatic biodiversity conservation   | <input type="checkbox"/> Clean transportation   |
| <input type="checkbox"/> Sustainable water and wastewater management   | <input type="checkbox"/> Climate change adaptation  |
| <input type="checkbox"/> Eco-efficient and/or circular economy adapted products, production technologies and processes                             | <input type="checkbox"/> Green buildings  |
| <input type="checkbox"/> Unknown at issuance but currently expected to conform with GBP categories, or other eligible areas not yet stated in GBPs | <input type="checkbox"/> Other <i>(please specify)</i> :  |

If applicable please specify the environmental taxonomy, if other than GBPs:

**Use of proceeds categories as per SBP:**

- |  |   |
|--|---|
| <input type="checkbox"/> Affordable basic infrastructure   | <input type="checkbox"/> Access to essential services                                   |
| <input type="checkbox"/> Affordable housing  | <input type="checkbox"/> Employment generation (through SME financing and microfinance) |
| <input type="checkbox"/> Food security   | <input checked="" type="checkbox"/> Socioeconomic advancement and empowerment           |
| <input type="checkbox"/> Unknown at issuance but currently expected to conform with SBP categories, or other eligible areas not yet stated in SBPs | <input type="checkbox"/> Other (please specify):  |

If applicable please specify the social taxonomy, if other than SBPs:

**2. PROCESS FOR PROJECT EVALUATION AND SELECTION**

Overall comment on section (if applicable):

In alignment with market practice, the Otto Group has established a Sustainable Finance Committee, which is comprised of representatives from Corporate Finance, Corporate Responsibility and relevant subject matter experts from the Group’s subsidiaries. Projects to be refinanced through the bond will be selected from eligible categories as outlined by the Framework. Sustainalytics positively notes the Group’s application of its minimum environmental and social standards and its general risk management measures for capital allocation decisions to its process for project evaluation and selection.

**Evaluation and selection**

- |   |   |
|---|---|
| <input checked="" type="checkbox"/> Credentials on the issuer’s social and green objectives | <input checked="" type="checkbox"/> Documented process to determine that projects fit within defined categories |
|---|---|

## The Otto Group Sustainable Finance Framework

- |   |   |
|---|---|
| <input checked="" type="checkbox"/> Defined and transparent criteria for projects eligible for Sustainability Bond proceeds | <input checked="" type="checkbox"/> Documented process to identify and manage potential ESG risks associated with the project |
| <input checked="" type="checkbox"/> Summary criteria for project evaluation and selection publicly available                | <input type="checkbox"/> Other ( <i>please specify</i> ):   |

### Information on Responsibilities and Accountability

- |  |  |
|--|--|
| <input checked="" type="checkbox"/> Evaluation / Selection criteria subject to external advice or verification | <input type="checkbox"/> In-house assessment |
| <input type="checkbox"/> Other ( <i>please specify</i> ):  |  |

### 3. MANAGEMENT OF PROCEEDS

Overall comment on section (*if applicable*):

Proceeds from sustainable finance instruments will be managed by the Otto Group using a portfolio approach. The Group will track all proceeds to ensure they are managed until full allocation in accordance with the framework. The Group will review the Sustainable Investment Portfolio annually and determine new eligible projects, which have taken place in the calendar year prior to the issuance date of the oldest outstanding instrument in the framework, and in the years thereafter. Expenditures will be removed from the Sustainable Investment Portfolio when instruments mature, such that, at any time, the oldest expenditures included in the Sustainable Investment Portfolio will be those incurred in the calendar year prior to the issuance date of the oldest outstanding Instrument. Through this approach, the Otto Group has established an implicit look back period that extends to the beginning of the preceding calendar year of the issuance.

The Otto Group will aim to ensure that allocated proceeds for the Sustainable Investment Portfolio will match or exceed the balance of proceeds from its outstanding instruments issued under this framework. Additional projects will be selected and added to the portfolio until net proceeds from outstanding instruments are fully allocated. Until all proceeds are fully allocated, the Otto Group may opt to invest unallocated funds in its treasury liquidity portfolio or use them to pay off outstanding debt. However, the Group has indicated that it fully intends to allocate all proceeds from the Framework at the time of issuance, refinancing sustainable procurement that took place up until the beginning of the calendar year preceding the year of issuance. Sustainalytics views this management process to be in alignment with market practice.

#### Tracking of proceeds:

- |   |
|---|
| <input checked="" type="checkbox"/> Sustainability Bond proceeds segregated or tracked by the issuer in an appropriate manner |
| <input checked="" type="checkbox"/> Disclosure of intended types of temporary investment instruments for unallocated proceeds |
| <input type="checkbox"/> Other ( <i>please specify</i> ):   |

#### Additional disclosure:

- |   |  |
|---|--|
| <input type="checkbox"/> Allocations to future investments only | <input type="checkbox"/> Allocations to both existing and future investments |
|---|--|

## The Otto Group Sustainable Finance Framework

- |  |  |
|--|--|
| <input type="checkbox"/> Allocation to individual disbursements                  | <input checked="" type="checkbox"/> Allocation to a portfolio of disbursements                               |
| <input type="checkbox"/> Disclosure of portfolio balance of unallocated proceeds | <input checked="" type="checkbox"/> Other ( <i>please specify</i> ): allocation to existing investments only |

#### 4. REPORTING

Overall comment on section (if applicable):

The Otto Group will report annually on both allocation and impact. Allocation reporting will provide a full break down of the total amount of expenditures selected for the Sustainable Investment Portfolio, including a breakdown of expenditures by eligible category, the amount of expenses by calendar year and the balance of unallocated proceeds. The allocation report will be made available on the Group's creditor relations website.

Additionally, the Otto Group intends to track and report on progress achieved towards sustainability goals related to sourcing sustainably certified cotton and forest products. This will be included in the Sustainability Report which is published as part of the Annual Report, which is available on the company website. Sustainalytics views this reporting approach as aligned with market practice. The Otto Group will report on the following impact indicators: volume (tonnes) of CmiA cotton / cost (€) of purchases for CmiA labelled textiles for own and licensed brands; Number of farmers benefitting from the initiative; number of CmiA labelled textiles; kg CO2-eq saved per 1kg/CmiA lint cotton (vs conventional cotton); percentage of sustainable cotton for own and licensed brands, number of articles / cost (€) of purchases that are FSC® certified; percentage of FSC® certified articles.

Sustainalytics notes that the Otto Group intends to request a limited assurance report covering allocation of proceeds from an external auditor for any instruments issued under the framework, which is a best practice approach to reporting.

#### Use of proceeds reporting:

- |  |  |
|--|--|
| <input type="checkbox"/> Project-by-project            | <input checked="" type="checkbox"/> On a project portfolio basis |
| <input type="checkbox"/> Linkage to individual bond(s) | <input type="checkbox"/> Other ( <i>please specify</i> ):        |

#### *Information reported:*

- |   |   |
|---|---|
| <input checked="" type="checkbox"/> Allocated amounts     | <input type="checkbox"/> Sustainability Bond financed share of total investment |
| <input type="checkbox"/> Other ( <i>please specify</i> ): |   |

#### *Frequency:*

- |  |                                      |
|--|--------------------------------------|
| <input checked="" type="checkbox"/> Annual       | <input type="checkbox"/> Semi-annual |
| <input type="checkbox"/> Other (please specify): |                                      |

#### Impact reporting:

- |   |  |
|---|--|
| <input type="checkbox"/> Project-by-project | <input checked="" type="checkbox"/> On a project portfolio basis |
|---|--|

# The Otto Group Sustainable Finance Framework

- Linkage to individual bond(s)  Other (please specify):

**Frequency:**

- Annual  Semi-annual  
 Other (please specify):

**Information reported (expected or ex-post):**

- GHG Emissions / Savings  Energy Savings  
 Decrease in water use  Number of beneficiaries  
 Target populations  Other ESG indicators (please specify):

- volume (m/tonne) / cost (€) of purchases that are CmiA certified for own and licensed brands
- number of smallholder cotton farmers under CmiA
- number of CmiA labelled textiles
- kg CO<sub>2</sub>-eq saved per 1kg/CmiA cotton vs conventional cotton
- percentage of sustainable cotton for own and licensed brands,
- number of articles / cost (€) of purchases that are FSC® certified for own and licensed brands
- percentage of FSC® certified materials for own and licensed brands

**Means of Disclosure**

- Information published in financial report  Information published in sustainability report  
 Information published in ad hoc documents  Other (please specify):  
 Reporting reviewed (if yes, please specify which parts of the reporting are subject to external review):

Where appropriate, please specify name and date of publication in the useful links section.

**USEFUL LINKS** (e.g. to review provider methodology or credentials, to issuer's documentation, etc.)

<https://www.ottogroup.com/en/verantwortung/Nachhaltige-Unternehmensfuehrung/CR-Strategie.php>

<https://www.ottogroup.com/en/die-otto-group/daten-fakten/Creditor-Relations.php>

**SPECIFY OTHER EXTERNAL REVIEWS AVAILABLE, IF APPROPRIATE**

**Type(s) of Review provided:**

- |  |  |
|--|--|
| <input type="checkbox"/> Consultancy (incl. 2 <sup>nd</sup> opinion) | <input type="checkbox"/> Certification |
| <input type="checkbox"/> Verification / Audit                        | <input type="checkbox"/> Rating        |
| <input type="checkbox"/> Other ( <i>please specify</i> ):            |  |

**Review provider(s):**

**Date of publication:**

**ABOUT ROLE(S) OF REVIEW PROVIDERS AS DEFINED BY THE GBP AND THE SBP**

- i. Consultant Review: An issuer can seek advice from consultants and/or institutions with recognized expertise in environmental and social sustainability or other aspects of the issuance of a Sustainability Bond, such as the establishment/review of an issuer's Sustainability Bond framework. "Second Party Opinions" may fall into this category.
- ii. Verification: An issuer can have its Sustainability Bond, associated Sustainability Bond framework, or underlying assets independently verified by qualified parties, such as auditors. In contrast to certification, verification may focus on alignment with internal standards or claims made by the issuer. Evaluation of the environmentally and socially sustainable features of underlying assets may be termed verification and may reference external criteria.
- iii. Certification: An issuer can have its Sustainability Bond or associated Sustainability Bond framework or Use of Proceeds certified against an external green and social assessment standard. An assessment standard defines criteria, and alignment with such criteria is tested by qualified third parties / certifiers.
- iv. Rating: An issuer can have its Sustainability Bond or associated Sustainability Bond framework rated by qualified third parties, such as specialized research providers or rating agencies. Sustainability Bond ratings are separate from an issuer's ESG rating as they typically apply to individual securities or Sustainability Bond frameworks / programmes.

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## Sustainalytics

Sustainalytics is a leading independent ESG and corporate governance research, ratings and analytics firm that support investors around the world with the development and implementation of responsible investment strategies. With 13 offices globally, the firm partners with institutional investors who integrate ESG information and assessments into their investment processes. Spanning 30 countries, the world's leading issuers, from multinational corporations to financial institutions to governments, turn to Sustainalytics for second-party opinions on green and sustainable bond frameworks. Sustainalytics has been certified by the Climate Bonds Standard Board as a verifier organization, and supports various stakeholders in the development and verification of their frameworks. In 2015, Global Capital awarded Sustainalytics “Best SRI or Green Bond Research or Ratings Firm” and in 2018 and 2019, named Sustainalytics the “Most Impressive Second Party Opinion Provider. The firm was recognized as the “Largest External Reviewer” by the Climate Bonds Initiative as well as Environmental Finance in 2018, and in 2019 was named the “Largest Approved Verifier for Certified Climate Bonds” by the Climate Bonds Initiative. In addition, Sustainalytics received a Special Mention Sustainable Finance Award in 2018 from The Research Institute for Environmental Finance Japan for its contribution to the growth of the Japanese Green Bond Market.

For more information, visit [www.sustainalytics.com](http://www.sustainalytics.com)

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