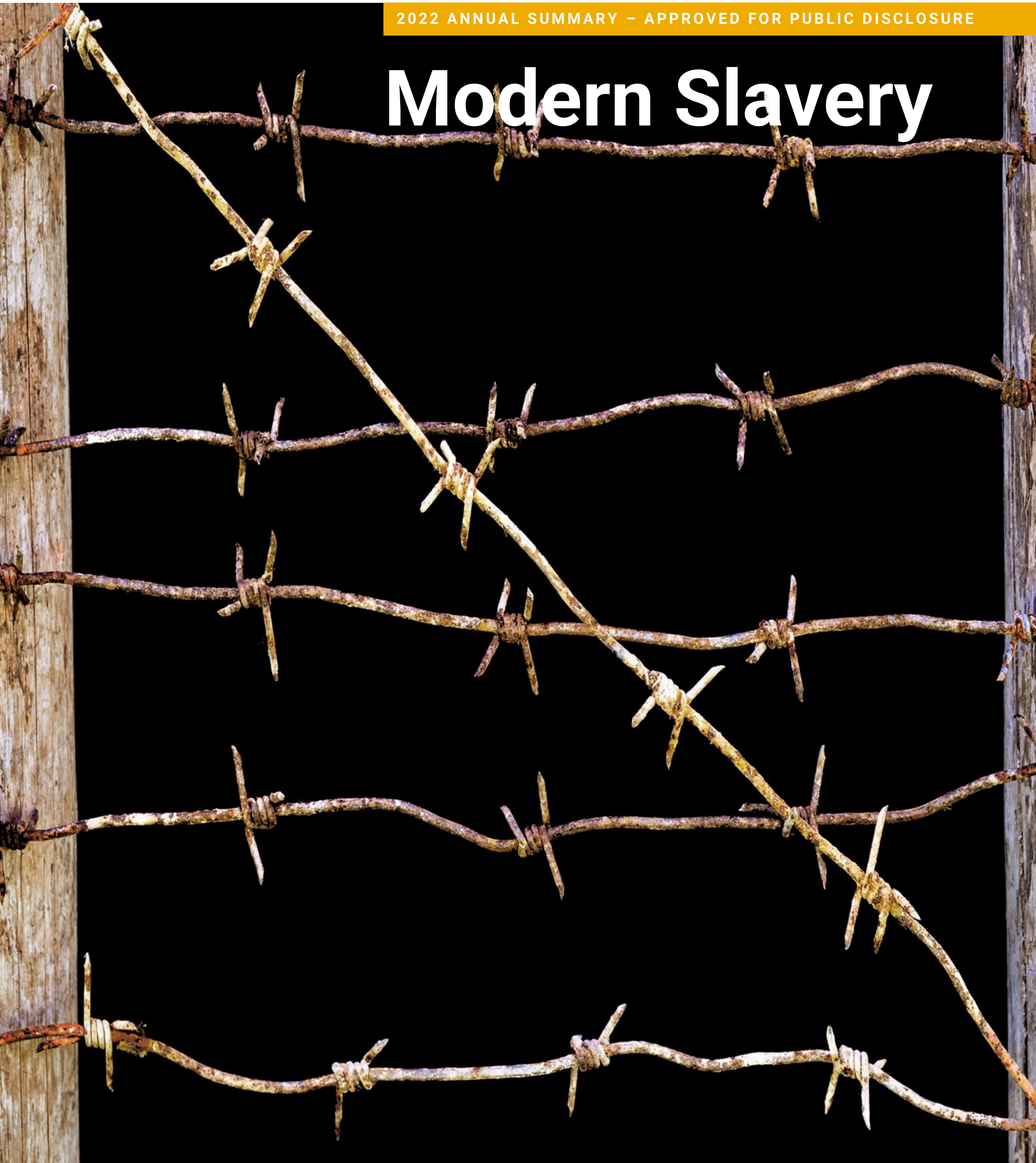
MORNINGSTAR | SUSTAINALYTICS

2022 ANNUAL SUMMARY – APPROVED FOR PUBLIC DISCLOSURE

Modern Slavery



Modern Slavery Thematic Engagement

Time and again modern slavery has impacted the bottom line of companies that have failed to ensure their due diligence efforts are robust enough to meets the risks.[1] Whilst regulation is a positive trend, arguably it is likely to only significantly affect those businesses that are worst performers.[2] One consequence of this is that many companies continue to underestimate the risks of modern slavery. Investors can play a critical role in changing this. Engagement has the potential to hold companies to account through a constructive and mutually beneficial dialogue. In addition, governments may be emboldened to pass tougher legislation where investors are in favor of raising the bar on human rights. This can help bring the level playing field nearer into sight.

To address investor concerns that modern slavery risks are insufficiently managed, Sustainalytics commenced a multi-year engagement project in 2021. This has focused on two sectors: (1) construction and (2) apparel. The aim of the engagement is to encourage companies to adopt fit for purpose strategies and includes six key performance areas: governance and reporting; purchasing practices; living wages and income; stakeholder collaboration; worker empowerment; and robust auditing and grievance mechanisms.

Developments in 2022

In 2022, the global estimates on modern slavery were revised upwards by the International Labour Organisation (ILO).[3] Of those in forced labour in the private economy (excluding commercial sexual exploitation), the figure now stands at 17.3 million people (16 million in 2016). It is this subcategory of modern slavery that is most associated with business, especially in complex global supply chains.

Moves towards greater regulation by governments was a key activity in 2022. In February, the EU Commission published its draft Corporate Sustainability Due Diligence proposal, which aims to create an EU-wide directive on mandatory human rights and environmental due

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[1]Recent examples include a Belgium construction project where in July 2022 alleged cases of human trafficking led to project delays. See: https://www.borealisgroup.com/news/borealis-restarts-pdh-construction-site-in-kallo-with-ponticelli-as-contractor; in Qatar, it has been reported that over 250 contractors reimbursed workers over QR 85 million for illegal recruitment fees. See: https://www.business-humanrights.org/en/latest-news/qatar-2022-latest-supreme-committee-figures-show-increased-audits-health-safety-inspections-and-recruitment-fee-reimbursement-throughout-tournament/; several Malaysian glove manufacturers' products were banned from entry into the US, including Top Glove, which paid out more than USD 36 million to reimburse workers.

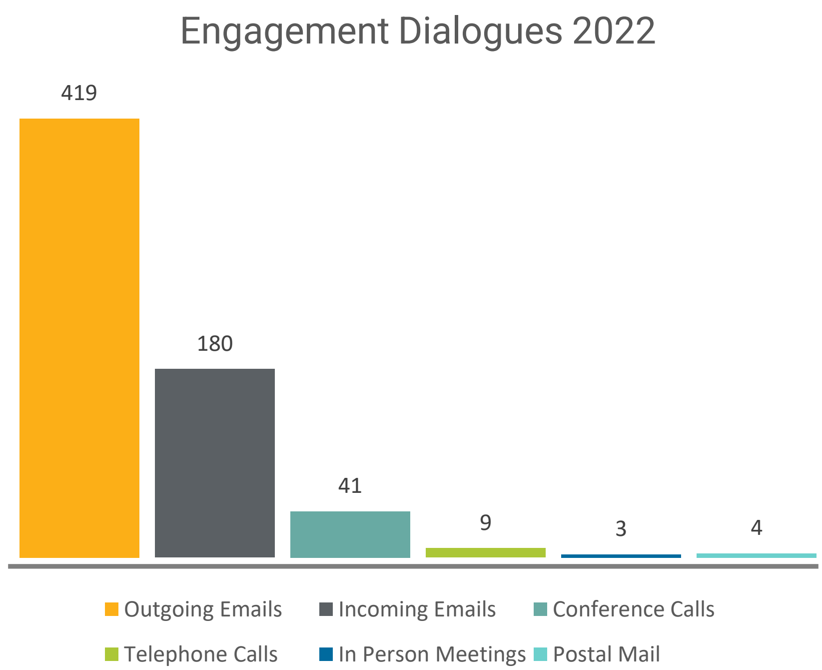
[2] The EU Corporate Sustainability Due Diligence draft (CSDD) directive has been welcomed but criticised by stakeholders. See analyses of the CSDD by Shift: https://shiftproject.org/wp-content/uploads/2022/03/Shift_Analysis_EU_CSDDProposal_vMarch01.pdf and the European Journal of International Law: https://www.ejiltalk.org/the-european-commissions-proposal-for-a-directive-on-corporatesustainability-due-diligence-two-paradox . US Customs and Border Protection has reported on efforts to enforce the Uyghur Forced Labour Prevention Act (UFLPA). It has asserted that 'Enforcement is an ongoing challenge as bad actors continue to seek to benefit financially by circumventing the UFLPA to introduce goods made with forced labor into U.S. markets.' See https://www.cbp.gov/frontline/implementing-uyghur-forced-labor-prevention-act

[3]The estimates were compiled by the ILO, International Organisation for Migration and Walk Free Foundation. See: https://www.ilo.org/wcmsp5/groups/public/---ed_norm/---ipec/documents/publication/wcms_854733.pdf

diligence. Sanctions are expected to apply to businesses that fail to adhere to new duties. It is also anticipated that victims of modern slavery will be able to sue companies for compensation. Later in 2022, the EU Commission put forward a draft instrument to ban goods made with forced labour from being placed within its internal market.

In the US, the rebuttal presumption of the Uyghur Forced Labor Prevention Act came into effect in June 2022. Consequently, imports from the Xinjiang Uyghur Autonomous Region (XUAR) will be assumed to have been made using forced labour and be banned from entry into the US market, unless strong evidence to the contrary is provided. Potentially, this could have a financially material impact where companies violate the law. Other key developments in 2022 include a pending law in Canada to combat forced labour[4], and Japan's guidelines on responsible supply chains. The latter is not legally binding but an important step nonetheless in the APAC region.

Engagement Update



The number of engaged companies increased to 16 at the end 2022 (12 in 2021), with an equal split between the two sectors. Companies are geographically based in: Asia (4), Europe (10) and North America (2). In total, 44 engagements were held in 2022 (comprising 41 conference calls and 3 in person meetings). Of the overall number, 20 involved a structured dialogue (including two in-person meetings in Sweden and Denmark), seven were introductory calls, eight represented companies that attended the roundtable (see below) and there were nine additional engagements.[5] Sustainalytics continued to establish and build trust with companies. Dialogue was focused on the key

[4]Canada's Fighting Against Forced Labour and Child Labour in Supply Chains Act will apply to both public and private entities and will have reporting obligations. See: https://www.parl.ca/legisinfo/en/bill/44-1/s-211

[5]These included participation in stakeholder forums, a meeting with one company and its supplier to discuss modern slavery risks and company engagements in preparation for the roundtable.

performance areas and, in addition, gender-based violence (apparel companies) and heat stress (construction firms). Potential links to forced labour of Uyghurs in China's XUAR region was also a topic.

Sustainalytics took escalation measures by sending investor letters to four apparel companies that either did not respond (or only insufficiently) to requests to engage. This led to recommendations to vote against the board directors of three of these firms, and responses were subsequently received from all three.

Parallel to company engagements, Sustainalytics continued to reach out to stakeholder experts from a range of organizations, including trade unions, civil society organizations, an intergovernmental body, relevant investor coalitions and academics. For example, Sustainalytics spoke to stakeholders about Uyghur forced labour risks.

Company Performance

Nine companies improved their scores in 2022[6]. Notable achievements included:

- One construction company adopted a policy on responsible recruitment, which Sustainalytics had advocated for during the engagement. It also joined a business initiative on human rights.
- Similarly, an apparel company became a member of an industry body that collaborates to address sustainability challenges, including human rights.
- Another apparel company fully disclosed its list of first tier suppliers, in line with best practice.
- Four companies requested feedback regarding their human rights and ESG risks, which provided Sustainalytics opportunities to influence their approach to human rights due diligence.

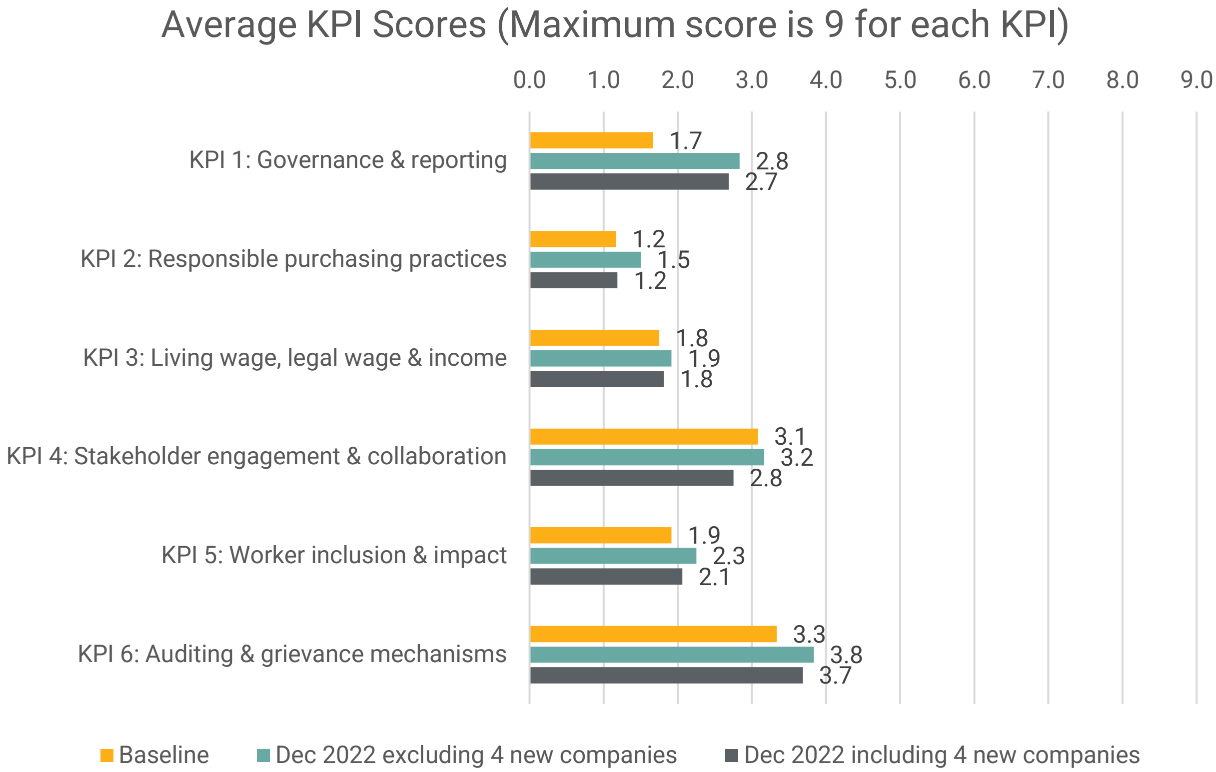
However, progress of many companies was sluggish. Whilst recognizing the year brought a number of challenges, including the war in Ukraine, a slowdown in global economic growth and the continued urgency of climate change, there is an underlying concern that the lack of momentum reflects a lack of priority afforded to the subject by those at the top. Similar disquiet was expressed by the UK's former Anti-Slavery Commissioner, Dame Sara Thornton, about the findings of a separate study published in 2022 on the quality of reporting of modern slavery by

[6]It should be noted that two companies joined the project late in 2022 and were only assessed once in 2022.

major UK companies. She remarked that insufficient disclosure suggested '…*modern slavery considerations are still not a mainstream concern for many boardrooms.*'[7]

Most companies in the engagement have not found modern slavery, although two reported supply chain workers paid recruitment fees (reimbursement had either occurred or was in progress). It may be that forced labour is not present in companies' operations or supply chains but both manufacturing and construction are sectors with a high prevalence of forced labour (18.7% and 16.3% respectively of the overall total[8]). The ILO points out that, '*People in forced labour are more likely to be in manufacturing, and much more likely to be in construction, than workers in the overall labour force*.'[9] Companies typically have extensive supply chains, involving hundreds or thousands of suppliers, which is usually just tier one. Further, modern slavery is often concealed and audits – commonly used to monitor supply chains – have been deemed unsuitable to spot violations. The Ethical Trading Initiative has asserted '*The worst forms of human rights violations such as child labour or modern slavery are well understood to be 'hidden crimes' and are highly unlikely to be picked up by audits*.'[10] Certainly, some companies recognize there are challenges. One European construction company explained it will need to look deeper into subcontracting practices of its manpower agencies and in another case a global apparel retailer shared that it needs to navigate the subject with sensitivity to avoid wrongly accusing suppliers of gross human rights violations. However, there were others that expressed that they did not consider the risks to be relevant or material. Sustainalytics has sought to challenge this.

[7]This study looked at 100 listed UK companies' disclosure on modern slavery. See link: https://www.frc.org.uk/getattachment/77c053d9-fe30-42c6-8236-d9821c8a1e2b/FRC-Modern-Slavery-Reporting-Practices-in-the-UK-2022.pdf
[8]See Global Estimates on Modern Slavery, p.31 (footnote 3 for link).
[9]See Global Estimates on Modern Slavery, p.3 (footnote 3 for link).
[10]The Ethical Trading Initiative is a UK based multi-stakeholder organisations that works to address labour abuses in business supply chains. See: https://www.ethicaltrade.org/audits-and-beyond



Case Study

In December 2022, Sustainalytics held a roundtable to raise greater awareness of modern slavery risks in the global construction sector. Speakers included a European Parliamentarian, who spoke about upcoming regulation, an institutional investor who provided an investor perspective on the need for companies to manage risks, an academic and industry experts. The event was moderated by an investor client and attended by over 40 people from the construction sector and investors participating in the theme. Risks in developed markets were a key focus of the event. There are considerable concerns of modern slavery and similar abuses in the UK, Europe and key parts of the US construction market. Forced labour in Qatar was also highlighted. Speakers shared ways to achieve progress in combatting the risks through practical steps that could be taken. Following the event, a European construction company, which attended the event, reached out to Sustainalytics and asked to join the project (Sustainalytics had earlier had an introductory call with the company in 2021). The company is keen to engage and learn from the project as it recognizes the subject is of growing importance. Sustainalytics welcomes their inclusion in the theme.

About Morningstar Sustainalytics

Sustainalytics, a Morningstar Company, is a leading ESG research, ratings, and data firm that supports investors around the world with the development and implementation of responsible investment strategies. For 30 years, the firm has been at the forefront of developing high-quality, innovative solutions to meet the evolving needs of global investors. Today, Sustainalytics works with hundreds of the world's leading asset managers and pension funds who incorporate ESG and corporate governance information and assessments into their investment processes. Sustainalytics also works with hundreds of companies and their financial intermediaries to help them consider sustainability in policies, practices, and capital projects. With 17 offices globally, Sustainalytics has more than 1,800 staff members, including more than 800 analysts with varied multidisciplinary expertise across more than 40 industry groups. For more information, visit www.sustainalytics.com.

Sustainalytics
info@sustainalytics.com
www.sustainalytics.com