Managing Modern Slavery Risks in Capital Markets

Background

In April 2021 the Independent Anti-Slavery Commissioner and the Liechtenstein Initiative for Finance Against Slavery and Trafficking co-organised a roundtable discussion on managing modern slavery risks in capital markets. The event explored developments in capital market expectations and regulation, drawing on the Finance Against Slavery and Trafficking (FAST) Blueprint, and recent research into the role of investors, asset managers, and capital markets. 50 senior participants from City of London asset owners, asset managers, funds and capital markets stakeholders, as well as government and other key stakeholders attended the roundtable. Formal contributions were provided by CCLA, Walk Free, EOS at Federated Hermes, and Refinitiv - an LSEG business.

H.E. Mr Christian Wenaweser, Ambassador and Permanent Representative of Liechtenstein to the UN in New York

"We are happy to see the strong positive response we are getting to our Finance Against Slavery and Trafficking initiative, our flagship SDG project and a global public-private partnership. We look forward to expanding its reach and our partnerships, both with financial institutions and with Governments."

Dame Sara Thornton DBE QPM, Independent Anti-Slavery Commissioner

"It is important to bring modern slavery from the margins into the mainstream. Given the data presented during the discussion, corporate entities should not be frightened to find modern slavery, rather thought needs to be given to how the most vulnerable workers across the globe can be protected."

Lord Mayor of the City of London, William Russell

"We have seen time and time again that when there is collective action from the financial and professional services sector, society can really benefit from their innovations… The work that has been done on environmental goals is a great template for progressing social goals like modern slavery."

Modern slavery risks and the roles of capital markets

With an estimated 40 million people in modern slavery worldwide[1], 25 million of them in labour exploitation, there is growing pressure on capital markets to identify and address modern slavery risks. Modern Slavery Acts in the UK and Australia, human rights due diligence regimes in Europe, and the adoption of ESG disclosure rules by stock exchanges worldwide are all forcing investors to consider their potential exposure to modern slavery risks. Respect for international labour standards is increasingly becoming a precondition for access to both capital and export markets. Learning from climate action, some investors are working together to exercise collective leverage to strengthen corporate respect for human rights and reduce modern slavery risks.

[1] ILO (2017) Global Estimates of Modern Slavery: Forced Labour and Forced Marriage: Report: Global Estimates of Modern Slavery: Forced Labour and Forced Marriage (ilo.org)

Prof. James Cockayne highlighted that, like climate change, much modern slavery is a capital market failure. That is a failure to reflect in the price of capital the true social costs of illegitimate and illegal labour management practices. Financial valuation practices tend to reward business models that drive down labour costs, even if this creates latent vulnerability, precarity and lack of resilience in the supply chain. The pandemic has made us more conscious that these risks can be realised and we are beginning to see a shift in the conception of what is financially materially risk.

There was broad agreement that the 'social' aspect of ESG was somewhat lagging behind environmental and governance issues. But it was also recognised that these matters are often interconnected. For example, both modern slavery and deforestation are often linked to complex supply chains. . Best practice and learning from different ESG issues should enable us to work smarter, not harder in order to set expectations and demystify complex supply chains.

Leverage: collaborative and unilateral engagement by investors

Speakers discussed the financial sector's role as an important lever to instigate change in international markets. In this instance leverage can be seen as using influence in business relationships to address modern slavery risks. This in itself provides an incentive for corporate entities.

There is a great appetite to work on ESG issues as well as a desire for collaboration. Investors are now leading a number of initiatives that engage with and encourage companies to identify and respond to modern slavery risks. Examples of such initiatives include CCLA's Find It, Fix It, Prevent It initiative, Investors Against Slavery and Trafficking Asia Pacific (IAST APAC), UN Principles for Responsible Investment and Votes Against Slavery, spearheaded by Rathbones to encourage FTSE350 companies to comply with Section 54 of the UK Modern Slavery Act.

CCLA Find It, Fix It, Prevent It: an example of collaborative engagement by investors

CCLA is a small asset manager in the City of London. Established by the Church of England in the 1950s, it looks after church investors, local authorities and charities. ESG has always been a key component of CCLA's work and questions around what the asset management community was doing to tackle modern slavery led to the development of Find It, Fix It, Prevent It. The initiative brings together investors in London to engage with specific sectors and companies in order to find modern slavery, do something about it, support those impacted and put in place policies, procedures and controls to prevent it.

Find It, Fix It, Prevent It is backed by 56 investors with over £7 trillion assets under management and advice. It has focused initially on UK listed hospitality companies and the initiative has applauded one company for identifying and disclosing modern slavery in their operations. There are now plans to extend engagement to the construction sector.

Over recent years the conversation has developed from talking about compliance, audits and basic policy statements to a more nuanced understanding of the realities of modern slavery. Some progress is now being seen with better performing companies. Engagers and stewardship providers have an important role to play in supporting companies to identify and address modern slavery, and provide remedy.

EOS at Federated Hermes: an example of the role of stewardship providers

Hermes EOS use their leverage as representatives of clients (global institutional investors representing about £1.3 trillion assets under advice) to engage with companies around the world on modern slavery and decent work. This is done both collaboratively through Find It, Fix It, Prevent It and unilaterally.

In 2012 Hermes EOS began engaging with Kuala Lumpur Kepong on behalf of many of their clients following allegations of forced labour at their plantations. Specific concerns included lack of freedom of movement and withholding of ID documents. The company was initially quite defensive but has now become more open to acknowledging the problem, addressing it, working with experts and representatives to create remedy.

Incentives, nudging the sector and legislative force

Speakers and participants discussed the need for incentives if corporate entities are to take action. Some companies are already on board, but there are also some that still need convincing of the need to take immediate and direct action. The media response can either be an incentive or disincentive. If a firm is vilified every time they identify slavery, they just won't look. Conversely, the response may be positive or encourage change.

There was some debate about the strength of the business argument that engaging in anti-slavery efforts is in the best interests of investors. There are examples of only short-term impact on share prices where poor working practices have been identified. However, research on corporate resilience and due diligence during COVID-19 by Harvard Business School suggests that stocks perceived as having invested more in strong workforce management outperformed others during the pandemic. The very real risks to financial sector actors were highlighted during the discussion. For example, the largest corporate fine in Australian history was recently levied on a bank, due to AML infractions connected to human trafficking. And in the US, 20% of global supply of cotton is now cut off from the market due to forced labour restrictions.

Walk Free recently undertook a review of statements produced by asset managers under the UK Modern Slavery Act in partnership with WikiRate and the Business and Human Rights Resource Centre. The review has three key findings:

- **Compliance with minimum legal requirements was incredibly low** – over 50% of those asset managers whose statements could be found were not meeting the three minimum compliance requirements: signed by a CEO, approved by the board and appears on the company's homepage
- **Over 50% didn't disclose any action or due diligence in supply chains**
- **Over two thirds didn't disclose that they were conducting due diligence on modern slavery or human rights in their portfolios.** Whilst this isn't a requirement, any understanding of risk for asset managers should include investment and their portfolio

It was suggested that whilst there haven't traditionally been incentives, they are now developing on two fronts. Firstly, when regulators used to think about the role of the financial sector in tackling human trafficking their focus was on banks, AML and compliance. There is beginning to be a shift towards investors. Secondly, there is a commercial incentive for investors to develop new financial products, tools and analysis that allow them to capture parts of the huge volume of money moving into ESG investing.

Whilst participants agreed that the financial sector has a vital role to play and that the social aspect of ESG is underrepresented, it was suggested that we need to do more than trying to nudge the financial sector to commit to tackling modern slavery. Even when there is a degree of legislative force, for example Section 54 of the Modern Slavery Act, the response may be pretty poor. Internationally, there are some powerful tools that allow for a more punitive approach. There are so many statutory responsibilities on banks where the implications of failing are meaningful, that if we are trying to nudge people to do yet another thing we may not get very far.

Important questions were also raised around international regulation:

- How can the financial community work with public bodies to contribute to international systems for monitoring risk?
- What is the role of global financial regulators in this space?
- What needs to happen to ensure labour is priced in?

Metrics development, data and tools

A common theme during the discussion was the need for metrics, data and tools to support mitigation of social risks such as modern slavery. Several participants raised the issue of lack of standard metrics on the social aspects of ESG. It was highlighted that whilst the same simple environmental metrics that have developed over the last 20 or 30 years are not available in relation to modern slavery, there are some good basic tools such as the ILO indicators of forced labour being developed in a range of ways. There were also felt to be opportunities for collective action between governments and the private sector in developing more robust and reliable means of assessing social risk.

There was general agreement about the need for better data. It was suggested that lack of data wasn't the issue, rather it needs to be transformed into a useable format. Capital markets systems are not built for compliance, screening and understanding risks. Investors need better tools for portfolio screening and investment management in real time and for deal analysis to identify modern slavery at the stock, firm and worksite level. There is a role for investors to help develop these tools and for business information providers, ESG metrics analysts and regulators in thinking about how they structure disclosure and listings rules to generate useful information.

Participants and speakers agreed on the importance of including worker voice and affected stakeholders in data and metrics. A number of forthcoming products that use quite well recognised and scalable analytical measurement tools, particularly around worker voice, look promising.

Resources on ESG social metrics and worker voice highlighted by participants during the discussion:

- Amplifying the "S" in ESG
- What is 'worker voice' in the context of supply chains?
- Worker Engagement Supported by Technology (WEST) Principles

Challenges for the financial sector more broadly

- It was suggested that there needed to be absolute clarity about the issues faced by different sub-sectors. There needs to be better guidance on the channels used to enable much more forceful targeting and maximum impact.
- Rules and guidance may vary across geographies, posing significant challenges for international banks. Dame Sara Thornton (Independent Anti-Slavery Commissioner) noted the importance of multilateral agreements across the world.
- Several participants raised the vital importance of public-private partnerships and information sharing. The challenge currently being debated is how to share information in as close to real time as possible in order to stop the movement of money and identify those who are vulnerable. This raises legislative challenges but also important questions around law enforcement resourcing and capability to respond.