HIGH MEADOWS INSTITUTE

The Future of the 'S' in ESG

Contents

The Future of the ‘S’ in ESG

Increased attention is being paid to the ‘S’ in ESG. In this briefing note, we explore some trends that have moved social factors further up the action agenda of investors – from increased investor awareness to record-breaking social bond issuances. We identify six key challenges for investors navigating social issues and take a closer look at struggles with data resulting from the lack of standardization. We provide insights on how some of the world’s largest institutional investors are currently addressing social issues and offer an outlook on what the future holds: more standardization, a focus on social impact data, systemic solutions, more social regulations affecting investors and companies as policy actors. In addition, we put a spotlight on *human rights* and explore how investors can protect and respect human rights through investment processes.

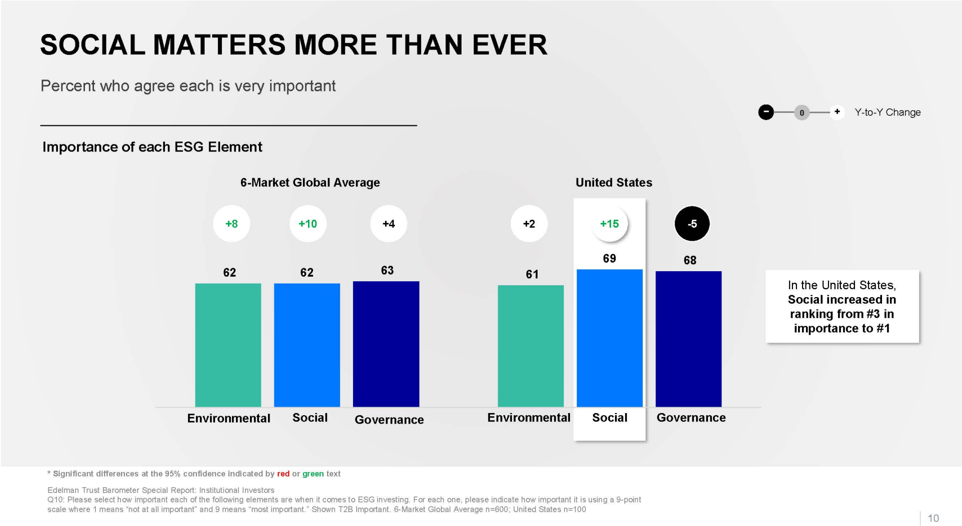
Are S issues climbing the agenda?

In recent years, ESG has grown immensely, with more than one fifth of U.S. assets today being invested with an ESG mandate. An overall consensus has emerged: ESG is here to stay – and is set to intensify. Until the world was hit by the Covid-19 pandemic, investor attention had been placed largely on addressing the 'E' (for "environmental") and 'G' (for "governance") in ESG – while the 'S' (for "social") fell behind. Issues such as climate change, biodiversity loss, water and waste management, board composition, executive remuneration and bribery were of top concern. Then, the virus outbreak and the global movement for racial and ethnic equity gave investors a new lens to consider social risks, as the health and safety of employees, customers and suppliers, diversity & inclusion at all levels of society, human rights concerns, and other social issues became an immediate priority. How companies responded to key ESG issues during the Covid-19 crisis was systematically linked to stock performance and corporate resilience, as research by State Street Associates and Prof. George Serafeim showed. The business case for proactively integrating social issues into the investment process continues to strengthen. For instance, the Principles for Responsible Investing (PRI) has found that the effective management of social factors can result in numerous benefits for companies, such as:

- securing access to environmental resources;
- building human capital to secure a motivated, productive and skilled workforce;
- benefitting from a competitive advantage in the market;
- strengthening supply chains.

Social issues are ranked higher than before by investors

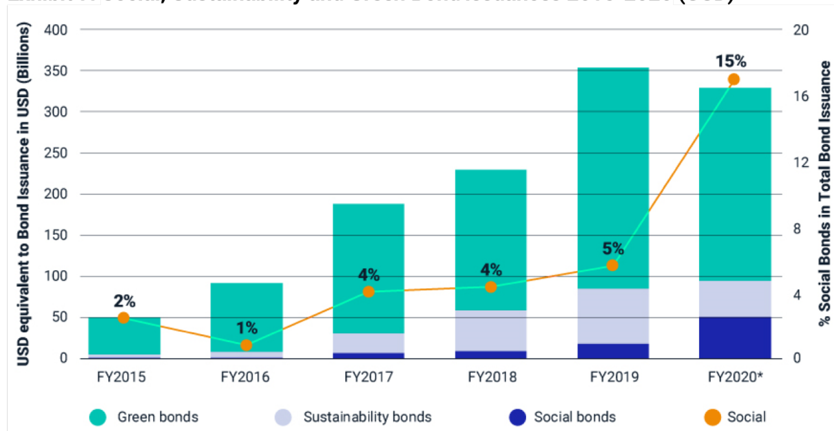
The results presented in Edelman's Institutional Investor Trust Report 2020 show that social issues are now ranking higher than before. When institutional investors were asked about the importance of the three elements of ESG, all were ranked as "very important", and the social category soared 15% compared to the previous year.



Social bonds on the rise

This trend is also represented in last year's significant growth of social bond offerings (bonds aiming to finance projects or operations with social benefits). Besides the ongoing, yet slightly diminished, appetite for sustainability and green bonds overall, social bonds have become the fastest-growing element in the space – many with Covid-19 relief objectives – as the figure by MSCI shows. The European Commission went big (the biggest ever) and issued social bonds for EUR 17 billion, for which investors bid more than 13 times as much: EUR 233 billion.

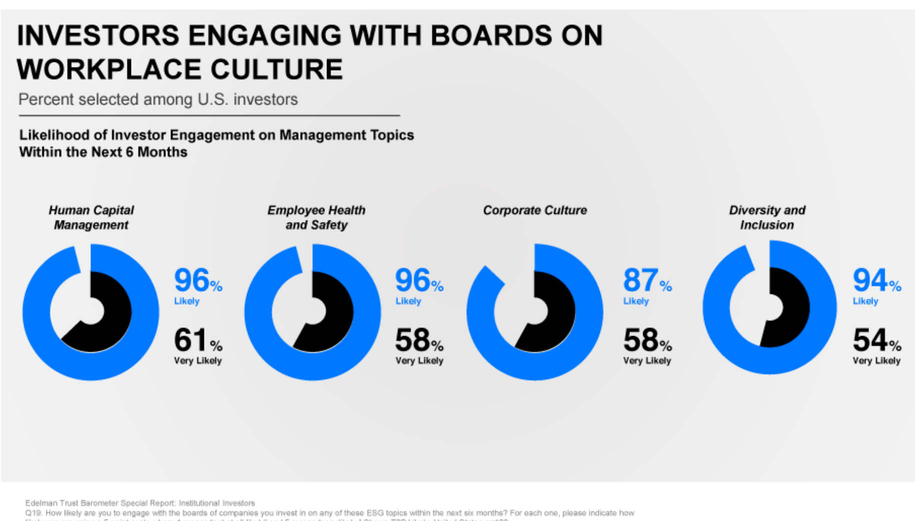
Exhibit 7: Social, Sustainability and Green Bond Issuances 2015-2020 (USD)



Social bonds aim to finance projects or operations with social benefits, as green bonds aim to finance environmentally beneficial projects. Sustainability bonds incorporate both social and environmental elements. Data as of Oct. 15, 2020. Source: Climate Bonds Initiative, MSCI ESG Research.

Engagement follows suit

The growing attention on social issues also translates into investors engagement practices. Edelman investigated which topics U.S. institutional investors would likely engage on over the next six months and found that workplace culture was high on the agenda. Human Capital Management, Employee Health and Safety, Corporate Culture, and Diversity and Inclusion are at least 87% likely to be an upcoming engagement topic. According to a recent attendee poll at NASDAQ's annual Investor Relations Forum, nearly 50% of issuers expect social factors to be of topic in future engagements. BlackRock's latest Annual Stewardship Report, for instance, states that in 2020, the investment major conducted 750 engagements where human capital management issues were discussed – a three times increase over the previous year.

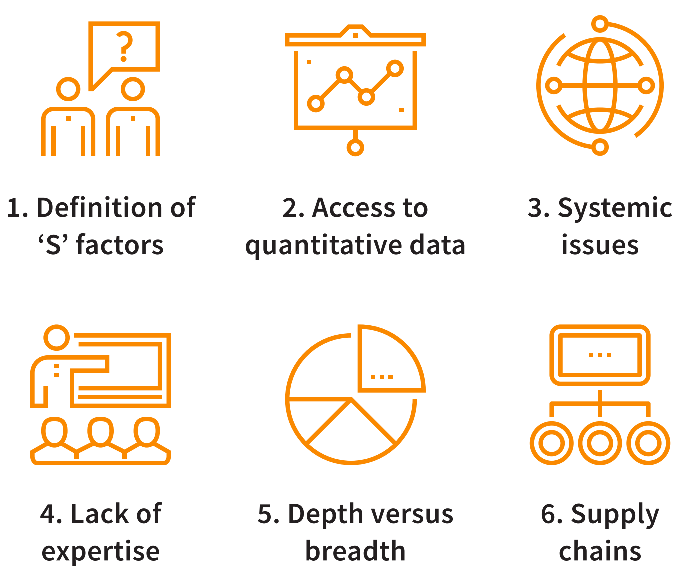


> **"We are observing a shift in awareness of the role companies must play in society in order to demonstrate they have earned their social license to operate. We expect scrutiny of companies on their societal impact and commitment to stakeholders to remain high in the coming year. This year, we engaged with just over 640 companies on human capital management issues and a further 125 on other social issues. We find companies are increasingly attuned to the need to invest in their workforces, and to provide their employees with opportunities for secure and rewarding employment. This interest is extending to the fair treatment of workforces by companies in supply chains, where sourcing companies increasingly expect standards that may be higher than legal requirements in some countries. Attention to health and safety of customers has never been stronger, whether it is dealing with re -opening of retailing in the context of COVID -19 or fundamental issues of product safety."**
>
> **BlackRock's 2020 Annual Stewardship Report**

Awareness is growing – but widespread practical implementation is not (yet)

Despite the trends presented above, investors are having a hard time with the social side of ESG. BNP Paribas' 2019 Global ESG Survey showed that a significant 46% of investors find social factors the most difficult to analyze and embed in investment strategies (out of 347 companies), compared to 30% for environmental, and 24% for governance issues. Further, the survey finds that for environmental issues, that sense of difficulty has decreased from 41% to 30%, whereas for social issues it increased from 41% to 46%.

Our research finds multiple challenges investors are struggling with:



1. Definition of 'S' factors

First of all, there is no clear definition of what exactly the 'S' entails – making it challenging not only for investors, but also for companies to fully grasp what is expected of them. Social factors can affect an organization's financial performance – but what are they? Bloomberg puts it like this: *"If the other aspects of ESG – environmental and governance risks and opportunities – are primarily concerned with a corporation's effects on the planet or on its internal and political functions, social factors are primarily those that will arise in the relations between a company and people or institutions outside of it."*

Traditionally, the 'S' covers factors such human rights, labor issues and employee health & safety, as well as product safety and quality. More recently, this range has expanded and today further incorporates issues such as bribery and corruption, diversity, automation, data privacy and security, tax payments and access to finance, as well as medicines and nutrition. Another layer of complexity is the understanding that all ESG components are intrinsically linked, and thus, must be addressed together. For instance, as the world moves to a low-carbon economy, the changes will have far-reaching impacts on society.

2. Access to quantitative data

Compared to governance and environmental factors, assessing the social component of ESG has been more challenging for investors. As social factors are less tangible, a long track record of data showing how social factors can impact an organization's performance has not yet been established. Social factors are hard to grasp and hard to quantify. A lot of focus has been placed on "input" metrics that are of a qualitative nature, as can be seen when looking into the methodologies of mainstream data providers and ESG rating agencies as well as reporting frameworks, rather than *output/impact metrics*. It is certainly easier to assess controversies (e.g., news reports on a company’s involvement in human rights breaches) rather than measuring good performance (e.g., the positive impact of companies always protecting and respecting human rights). For instance, companies may report on whether they have a human rights policy in place, instead of reporting on whether that policy has resulted in fewer human rights violations. Companies may report on the hours of training provided to employees, rather than how many internal promotions followed.

Research by MSCI has shown that social factors differ profoundly from environmental and governance ones in how they materialize. Governance failings usually materializes in incidents (e.g. scandals, resignations) while poor performance on environmental factors provokes a rather gradual erosion of competitiveness and stock price value. The poor management of ‘S’ factors like human capital management, in comparison, can end up in periodic negative events (e.g. lawsuits, strikes), but also, more gradually, in diminishing productivity levels and curbed innovation. Social factors – and their disclosure – are also rarely enforced by regulation. As such, not many companies have comprehensive reporting systems in place to collect vast amounts of social data and subsequently present it to investors.

3. Systemic issues

Following the murder of George Floyd in May 2020, the world experienced not only social and political unrest, but also a multi-national movement for racial equality. Not only individuals, but also a vast number of companies, took a public stance against discrimination, and called for more diversity and inclusion in the corporate world. Netflix, for instance, committed deposits to bolster financial institutions that serve Black communities and PNC committed $1bn to a broad range of programs seeking to help end systemic racism. While it is of great importance that companies take action, social issues such as inequality need systemic solutions.

4. Lack of expertise

The awareness for the ‘S’ has risen rapidly, but the widespread and in-depth upskilling of employees has yet to follow suit. Social issues are complex, diverse, and as seen above, difficult to assess. Many asset managers still need to provide training to their investment teams on not only what social issues are, but also on how they are to be assessed and engaged on.

5. Depth versus breadth

Nowadays, investors are expected to engage with companies on material ESG issues. There is only so much that can be covered by investment experts in their interactions with portfolio companies, as they face time, staff, and other resource constraints. This poses the question of whether the aim should be to engage broadly with more companies or engage with fewer companies but more deeply so that multiple ESG factors, including social concerns, can be addressed.

6. Supply chains

Many social topics are relevant within businesses’ in-house operations: ensuring that their employees are healthy and safe, offering sufficient training for their people to advance in their careers, providing paid leave in the case of maternity/paternity or sickness, setting up strong data security systems and more. However, multiple - and often severe - issues appear outside of a manager’s immediate field of vision: in supply chains. Yet, out of sight cannot mean out of mind. Supply chains can be a source of value creation and innovation, but also of immense risk, which can negatively impact financials and pose reputational risks. Each year, at least one in twenty companies has been hit by the reality of supply chain risks that cost them more than US$100 million, as McKinsey notes.

A closer look into the data challenge

Now, let us take a closer look at the data challenge outlined above. Below, we have collated the social issues that standard-setter SASB and two major data providers (MSCI and Sustainalytics) incorporate in their approaches. The five categories against which the issues are mapped were adapted from Neilan, Reilly, and Fitzpatrick.

Category	SASB	MSCI	Sustainalytics
Workforce, Engagement, and Training	• Labor Practices • Employee Health & Safety • Employee Engagement, Diversity & Inclusion	• Human Capital • Labor Management • Human Capital Development • Supply Chain Labor Standards	• Human Capital • Occupational Health and Safety
Customers	• Customer Privacy • Product Quality and Safety • Customer Welfare • Selling Practices & Product Labeling	• Product Safety and Quality • Chemical Safety • Financial Product Safety	
Data & IT Security	• Data Security	• Privacy and Data Security	• Data Privacy and Security
Human Rights	• Human Rights & Community Relations		• Human Rights • Human Rights - Supply Chain
Community & Society	• Supply Chain Management	• Stakeholder Oppositions • Controversial Sourcing • Health and Demographic Risk • Social Opportunities • Access to communications • Access to finance • Access to health care • Opportunities in Nutrition and Health	• Access to Basic Services • Community Relations • Social Impacts of Products and Services

Table 1. Social factors according to SASB, MSCI and Sustainalytics

Although certain issues are common across all three parties (e.g. data security and human rights), a lack of standardization is evident. In many instances, different terminologies are used for similar metrics. If companies are to disclose information that meets investors' needs and demands, standardization is vital. This will allow for a common understanding of what the 'S' entails for simple comparison of performance across organizations and as such, will create a foundation for real progress.

If we are to move towards common standards for the disclosure and assessment of social metrics in the coming years, a main consideration should be the inclusion of *impact*-focused metrics. While input-focused metrics (e.g., having a diversity & inclusion policy in place) provide a good initial indication of the company's areas of concern, real quality data is produced when the impact of social efforts are accounted for.

An additional concern with the current state of social data is that as many companies are only just becoming familiar with how social factors affect their operations and financial performance, relevant information may have not been publicized yet – or even collected. Such information gaps cause difficulties for data providers, which have to impute missing information to create ratings, and investors, who have to thoroughly assess their portfolio companies' social risks and opportunities.

Investors are stepping up

Despite the challenges and draw-backs presented, investors are stepping up to address the ‘S’ in ESG through a variety of actions. Below are leading examples of what some of the world’s largest investors are getting up to and what kind of expectations they have communicated to companies. The examples below are grouped under five categories: 1. Collective action, 2. Stewardship, 3. Measurement, 4. Voicing expectations, 5. Voting and 6. Alternative data sources.

1. Collective action

Amidst the Covid-19 outbreak, more than 300 long-term institutional investors representing over US $9.5 trillion in assets under management and global capital markets exposure took a collective stance on how companies should act to protect their stakeholders. The group urged companies to take certain actions: 1) Provide paid leave, 2) Prioritize the health and safety of employees, 3) Maintain employment, 4) Maintain suppliers/customer relationships and 5) Demonstrating financial prudence.

2. Stewardship

Federated Hermes

Federated Hermes EOS undertakes stewardship activities for their clients representing assets under advice of US$1.2 trillion (as of September 30, 2020). Along with environmental, governance and strategy, risk & communication themes, their engagement plan for 2021 to 2023 focuses on specific social concerns.

According to their public engagement report for Q3 2020, social and ethical topics were featured in 22% of their engagements (environmental topics were featured in 31%). Engagements are conducted on important social themes affecting the company, such as human capital management, in addition to wider societal challenges, such as human rights and tax, with engagement teams identifying the most material topics for the company.

Environmental topics featured in 31% of our engagements over the last quarter.

- Climate Change **78.8%**
- Forestry and Land Use **2.9%**
- Pollution and Waste Management **13.5%**
- Supply Chain Management **2.6%**
- Water **2.2%**

Social and Ethical topics featured in 22% of our engagements over the last quarter.

- Bribery and Corruption **1.5%**
- Conduct and Culture **14.9%**
- Diversity **19.6%**
- Human Capital Management **25.3%**
- Human Rights **30.4%**
- Labour Rights **6.2%**
- Tax **2.1%**

3. Measurement

Legal & General

Legal & General has a track record of assessing how businesses manage their ESG impact. To enhance their efforts on diversity & inclusion, the firm created the UK Gender Diversity Score, which assesses approximately 350 of the UK's largest companies on the percentage of women on the company's board and executive team and within senior management and the overall workforce. The scores are disclosed on Legal & General's website.

4. Voicing expectations

STATE STREET GLOBAL ADVISORS

Amplifying their stance on diversity & inclusion, in August 2020, State Street published an open letter to public company board chairs informing them that from 2021, the investment firm will ask portfolio companies "to articulate their risks, goals and strategy as related to racial and ethnic diversity, and to make relevant disclosure available to shareholders." State Street clarifies that they will be looking out for more than high-level statements published on a company website. Instead, it is asking for portfolio companies to communicate on five key areas: 1) How diversity contributes to the corporate *Strategy*, 2) Diversity *Goals* and how goals link to strategy, 3) Diversity *Metrics*, such as diversity ratios in the workforce and the board, 4) Goals and strategy for balanced diversity on the Board, and 5) Execution of *Board oversight* for diversity & inclusion.

BlackRock.

Filling existing data gaps is also in the interest of other prominent money managers. Transparency expectations were recently raised by investors such as BlackRock. BlackRock is asking firms to make their so called "EEO-1" data on the racial, ethnic and gender makeup of their workforce publicly available.

5. Voting

Legal & General

In October 2020, Legal & General sent a powerful ultimatum to its FTSE 100 peers. It announced that if the companies do not introduce BAME (Black, Asian or other minority ethnic) leadership representation by January 2022, Legal & General would vote against them.

Vanguard®

Among other money managers, Vanguard announced that starting in 2021, it would concentrate on boards and may vote against directors at companies where progress on diversity falls short. As of 2022, BlackRock will follow this approach, but mentioned plans to pressure companies on the release of overall ethnic and racial data from 2021.

6. Alternative data sources

To overcome the current data scarcity on social issues, for instance in relation to human capital management, investors are exploring alternative ways to draw conclusions on a firm's performance and data integrity. We have spoken with investors who try to harness Artificial Intelligence to put their own lens on information provided by ESG ratings companies. With caution, some consider social media sentiments to assess employee satisfaction levels, yet they warn about the possibility of employers to manipulate reviews. Investors also reported that company information provided by NGOs working to solve societal issues are useful resources (e.g. survey results published by the Workforce Disclosure Initiative Coalition).

Emerging Solutions

All investor action is welcome, but we need more solutions to make substantial progress on social issues. We have been observing the emergence of a variety of initiatives – many of which are backed by a powerful amount of assets under management and are oriented towards driving positive change. Below we feature a selection of initiatives and their efforts:

1. Awareness raising

Workforce Disclosure Initiative (WDI) Coalition: The WDI Coalition was created in 2017 to improve corporate transparency and accountability on workforce issues. Today, it counts 65 organizations among its members, with US$6.5 trillion in assets under management. In a nutshell, the initiative works towards more consistent, reliable 'S' data. With an aim to provide both companies and investors with improved data and help increase the number of 'good' jobs provided worldwide, the improvement of corporate transparency and accountability on workforce issues (e.g., equal pay, diversity & inclusion, climate change responses) are of key concern. Companies are encouraged to disclose workforce issues directly on the WDI platform by completing a survey that is aligned with other reporting frameworks including DJSI, GRI, the UNGPs and the SDGs, and offers a comprehensive and comparable reporting system which, in turn, allows members to demonstrate to investors, clients and other stakeholders how their staff and supply chain workers are managed and how their approach to workforce management is aligned with the overall business strategy.

2. Improving disclosure

The Human Capital Management Coalition: The Human Capital Management Coalition (HCMC) was formed by 32 institutional investors representing US$3 trillion in assets under management. Prominent members include BNP Paribas, Calvert Research and Management, Legal & General and Trillium Asset Management. The HCMC's key objective is to promote the importance of human capital as a long-term value driver. The coalition provides an environment for open communication between asset owners and managers and establishes resources on how members can identify and assess human capital management practices and performance in companies and how to engage on those issues. It also advocates for more advanced disclosure and encourages boards to actively oversee human capital.

3. Call to Action on Equity and Opportunity

Coalition for Equity & Opportunity (CEO): In September 2020, the Ford Foundation and Connecticut State Treasurer jointly launched a partnership to convene a coalition of corporate leaders to address economic and racial disparities both within and outside their organizations. The working group's members represent more than US$21 trillion in assets under management and nearly 400,000 employees. Actions to be undertaken by members internally include increasing the diversity on their boards and at all levels of the workforce, addressing racial pay and opportunity disparities and creating pipelines for the talent development of diverse staff. Further, members are encouraged to take their efforts beyond their own internal operations, by advancing capital investments into communities of color and minority-owned businesses and establishing more diverse supplier bases.

In February 2021, the 14 asset manager members committed to disclosing gender, race and ethnicity data found in their EEO-1 reports – such specific intersectional data disclosure is currently only provided by 6.3% of America's biggest companies. This commitment inspires a new "gold standard" for disclosure and reflects the investors' shared commitment to racial equity.

4. Advocating for organizational change

The Thirty Percent Coalition: Founded ten years ago on the understanding that there is a correlation between board diversity and company performance and shareholder value, the Thirty Percent Coalition's members today represents US$7 trillion in assets under management. Membership in this coalition for US board diversity provides access to collaboration through group meetings, conferences and bi-annual events, a deep knowledge base, training offerings, peer networking groups and more. According to the initiative's website, institutional investor members have engaged with nearly 400 companies that have added a woman to the director's board since 2012.

Future Predictions

This space is evolving rapidly. What are some of the trends that will shape the coming years?

1. Standardization of social factors

One of the major challenges with the 'S' in ESG is the lack of common agreement among data providers and standard setters on what social factors entail. For companies, this results in confusion about disclosure expectations. For investors, this results in difficulties drawing conclusions from the information provided. For both investors and corporates, this results in lower levels of comparability on social performance across organizations. For everyone, this results in frustration and overwhelmed staff.

However, improvement is in sight. In the last few months of 2020, leading sustainability and integrated reporting organizations made some big announcements. First, the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC) announced their upcoming merger. Second, together with the Carbon Disclosure Project (CDP), Carbon Disclosure Standards Board (CDSB) and the Global Reporting Initiative (GRI), IIRC and SASB published an ambitious joint statement of intent to bring a single, coherent, global ESG reporting system to life. Third, help has been offered by the International Financial Reporting Standards (IFRS) Foundation, which asked the public to comment on a consultation paper released in September 2020. Further, there have been efforts by the private sector in bringing insights from multiple frameworks together into one succinct guide. In partnership with the World Economic Forum, the Big4 developed a corporate sustainability reporting framework that collates reporting metrics from GRI, Integrated Reporting (IR), SASB, the Task Force for Climate-Related Disclosure (TCFD), the Science Based Targets initiative and more. Whether any of these convergences will come to real fruition is still up in the air. Should they do so, this would provide a good and essential basis for much improved reporting on social factors.

In the last decade, there has been much Merger & Acquisition activity across ESG data providers, as a recent study by the European Commission on sustainability-related ratings, data and research has shown. One of the key trends observed is the consolidation of well-established data providers through acquisition by financial investment research firms. New markets entrants, in turn, are having a more difficult time finding their stance. More consolidation across data providers allows for hope that rating methodologies will also align on social factors.

2. Social Impact Data

Following the mounting pressure on companies from investors and other stakeholders to report social metrics, we can expect an increase in overall information availability. Disclosure on social factors will become as common as disclosure on environmental and governance factors, yet there is a concern that the breadth of data will remain *input* focused and qualitative. Efforts to address this are under way. Up and coming data firms are working to establish the next generation of ESG data and analytics, which will enable the transition from traditional ESG to "ESG 2.0."

ESG 0.0	ESG 1.0	ESG 2.0
• Focus on principles • Immaterial information • Focus on business involvement	• Focus on policies • Opaque scores • Focus on firm operations	• Focus on impact • Science-based data • Focus on products and services

Figure 1. Evolution of the ESG data landscape. Adapted from RGS

In February 2021, the pioneering start-up Richmond Global Sciences (RGS) launched RIFT™ – Real Impact in Financial Terms. RIFT™ is the first-ever financial assessment of environmental and social impact at a company's product level and aligns with the groundbreaking work of the Harvard Business School's Impact-Weighted Accounts Initiative.

RGS prizes outcomes over intentions and is focused on outcome metrics over company policies and disclosures. Their proprietary methodology allows them to translate all types of 'E' and 'S' impacts into a comparable unit – a currency. For instance, by examining the Packaged Foods & Meats industry, RGS identified that one firm's *Chocolate Chip Edible Cookie Dough* ice cream has a negative impact in financial terms (RIFT $ -0.96^), while another firm's *peanut butter* has positive overall product impact (RIFT $ 0.27^).

Social impacts at the product level can also be aggregated at the company level. The graph on the right offers a sneak peek into the companies identified as having the highest 'sugar impact' through commercializing a wide range and large quantities of high-sugar products – and thus, are fueling the obesity crisis?

Social (and environmental) impact data is expected to be a game changer for investors and other stakeholders alike as it will bring transparency to the real impact that investment/purchase decisions have on people (and the planet).

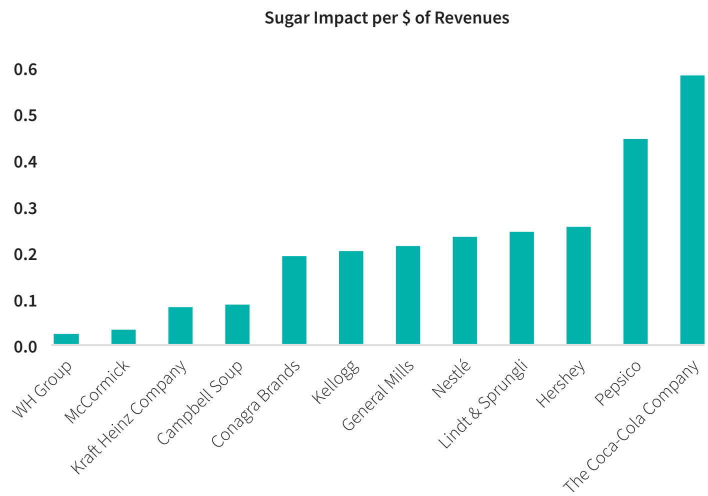


Figure 2. Sugar impact. Adapted from RGS.

3. Systemic Solutions

In their *ESG 2021 Trends to Watch* report, MSCI describes an expectation for investors to target social inequalities that will require "more creative, systemic approaches, with those in the vanguard willing to risk a few failures in pursuit of solutions." At this point in time, there is a lack of certainty over whether desired social outcomes of an investments can be achieved – particularly given that commonly accepted definitions and assessment criteria for social factors are yet to be developed. In 2020, we have seen some bold actions, as social bonds of previously unimaginable scale were issued. In 2021, we expect to see more of that – despite the stumbling blocks on the way.

4. More Social Regulations Affecting Investors

In a push for more standardization, we may also see regulators step in with social taxonomies akin to the EU Sustainable Finance Taxonomy Regulation, which defines criteria that are to be met for a financial product to be labelled as "environmentally sustainable." With preparations for the first EU taxonomy disclosures coming up, dealing with the 'S' will be necessary, as investors are asked to report on social indicators too. In the US, the Biden administration will likely reshape the ESG landscape and even ESG-adverse investors will be unable to look the other way. Social indicators will continue to be an important part of discussions on disclosure regulations and investor interest in better workforce data will likely be an important part of the picture.

While companies in numerous jurisdictions are already affected by reporting requirements on specific 'S' issues (e.g., reporting on the UK Modern Slavery Act and gender pay gap reporting in the UK), we expect more such regulations to be implemented globally, affecting both companies and asset managers.

5. Companies as policy actors

The backbone of all these developments and trends is that companies are increasingly acknowledging their societal responsibilities and their leading role in the shift towards a more inclusive and sustainable model of capitalism: stakeholder capitalism.

> **"Pivoting 180 degrees from the Milton Friedman doctrine that the only social responsibility of business leaders is to maximize returns to shareholders, leaders of large firms in particular now find themselves as leaders of "social" institutions taking on "political" and statesmen roles and sharing responsibility for the health and "governance" of the society on which their economic success depends."**
>
> **Chris Pinney, President & CEO, High Meadows Institute**

Going forward, we expect to see more of the following:

- **Moral Leadership:** Whether it is taking a stance on racial justice, systemic inequality or protecting human rights at all costs, there will be an uptick in CEOs speaking out on social issues in the public sphere and inspiring peers to follow suit. Within firms, we expect more leaders to formalize a distinct social purpose statement and encourage their staff to uphold these social value propositions.

- **Industry self-regulation:** Sustainability issues are far too complex and broad in scale for individual governments to address them alone. To fill such governance gaps and respond to the absence of 'hard law' mechanisms, new forms of global non-state governance are emerging in the private sector. These new 'soft law' mechanisms (Industry self-regulation through 1. Individual firms establishing principles or policies; 2. Groups of firms within an industry voluntarily regulating their conduct; 3. The creation of industry-wide minimum performance standards; and 4. Voluntary quality assurance schemes and the adoption of globally recognized initiatives) have been emerging as legitimate and impactful parts of ensuring a more sustainable future. Initiatives such as the UN Principles for Responsible Investment (PRI) and the Workforce Disclosure Initiative (WDI) will gain prevalence and importance.

- **Social engagement:** Corporate engagement with civil society has moved on from being mainly philanthropic to the establishment of strategic partnership approaches that utilize both the company's capabilities and resources and external expertise. Cases of multi-stakeholder engagement between companies, non-profit organizations and governments is anticipated to multiply in the coming years and investors are urged to track the results of such engagements.

- **Business model transformation:** Nowadays, the majority of business models are counteracting a sustainable future, but movements like that of the "B-Corporation" indicate a transition beyond conventional business models with a net-negative impact on society and the environment. Remember: Companies are now being publicly scrutinized for their overall social and environmental impacts (see prediction #2.) and investors will favor net-zero/net-positive impact firms.

Spotlight: Human Rights

In this section of the briefing note, we place a spotlight on the social issue of human rights as recent developments in the space have caused a renewed emphasis. Regulatory changes, as well as corporate and investor action commitments, allow for a promising outlook on substantial improvement of human rights across the world in the coming years.

> **"Human rights are rights inherent to all human beings, regardless of race, sex, nationality, ethnicity, language, religion, or any other status. Human rights include the right to life and liberty, freedom from slavery and torture, freedom of opinion and expression, the right to work and education, and many more. Everyone is entitled to these rights, without discrimination."**

Human rights are so fundamental that every action taken by participants of society is only to receive approval if human rights are protected along the way. The same applies to the way business is done. A business's social license to operate should be dependent on meeting minimum human rights standards. Institutional investors, too, have a responsibility to respect and protect human rights, driven forward by a better understanding of investment risks linked to human rights violations, growing asset owner expectations of responsible investment and a changing regulatory environment. Additional reasons, as mentioned by the PRI, include:

- "Failure to respond to [public] expectations [on human rights] can erode trust, jeopardising the financial industry's social license to operate";
- "Meeting human rights expectations leads corporates and investors to more effectively and proactively manage a range of complex environmental, social and governance (ESG) issues [as] social issues [such as] employee relations, diversity issues, health and safety, community relations and forced labour [...] are reflected in well-established international human rights instruments."

Making the case on that clear, numerous voluntary standards and mandatory regulations have emerged over the years. Noteworthy international voluntary standards include:

- UN Guiding Principles on Business and Human Rights (UNGPs): Endorsed in 2011, the UNGPs were the first global guidelines that define the key duties and responsibilities of states and corporations with regard to business-related human rights abuses. The guidelines are based on Prof. John Ruggie's *Protect, Respect, and Remedy* framework.
- OECD Guidelines for Multinational Enterprises (MNEs): These guidelines were first launched in 1976 with an aim to encourage multinational enterprises to make positive contributions to their economic, environmental and social impacts. In 2011, they were expanded to incorporate guidelines to protect human rights and social development.
- International Labour Office (ILO) Tripartite Declaration of principles concerning multinational enterprises and Social Policy: This declaration was initially formulated in 1976. The last update, in

2011, incorporated a chapter about Human Rights in line with the UNGPs.

- International Labour Standards of the ILO: These standards cover several topics such as child labor, forced labor, equal opportunities and trade union rights.

- UN Global Compact (UNGC): The UNGC is a United Nations principle-based framework that asks companies to embrace, adopt and accept a set of 10 core principles pertaining to human rights, labor standards, anti-corruption and the environment. Its objectives are to a) Mainstream the ten principles in business activities around the world and b) Catalyze actions in support of broader UN goals.

Further, mandatory regulations concerning business and human rights have been passed, as the following examples show:

- U.S. - Dodd-Frank Act section 1502 (2012): This regulation requires public companies in the U.S. to disclose their use of tin, tungsten, tantalum and gold (3TGs) in their products and determine if they are sourced in an ethical manner.

- The Netherlands - Child labour due diligence law (2019): According to this legislative initiative, Dutch companies must address child labor in their supply chains.

- U.K. - Modern Slavery Act (2015): This law, which is applicable to firms doing business in the UK and achieving sales worth more than £ 36 million, requires firms to annually publish a statement on how the prevention of slavery and human trafficking is managed.

- France - Law on the duty of vigilance (2017): Requires all large French companies to undertake due diligence to the companies they control and their contractors and suppliers.

Although respecting human rights seems like the obvious thing to do, we are constantly confronted by the fact that globalized business is very often not doing so. News on the use of child labor and modern slavery is not uncommon and closer to our doorstep than we would expect, as the UK examples of fashion giants Boohoo and Misguided recently reminded us. It's been ten years since the UNGPs were endorsed, and although some progress has been achieved, the state of human rights across the world continues to show a grim picture. Throughout global supply chains, intolerable labor conditions remain as common practice, and in some instances have even worsened throughout the Covid-19 crisis. As the 2020 Corporate Human Rights Benchmark Report – an assessment of 230 global corporations across five sectors against the UNGPs – shows, business needs to urgently step up its game. The study found that only a handful of companies show a real willingness to improve human rights standards and that there is great disparity between the commitments made and their practical execution.

Are Investors Acting on Human Rights?

Despite major investors claiming their commitment to the protection of human rights, reports show that only a few have been walking the talk so far. A report by ShareAction released in 2020 on the 75 largest asset managers' approaches to human and labor rights identified some gloomy numbers:

- Over 70% of asset managers make no commitment to exclude or engage with companies in line with international human and labor rights frameworks;

- 47% of the world's largest asset managers with over US$45 trillion in assets under management lack policy commitments prohibiting investments in controversial weapons banned by international arms treaties;

- 84% of asset managers have no public policy against purchasing sovereign bonds from countries under international sanction for human rights abuses.

ShareAction's Ranking of the Top 10 Asset Managers Leading on Human Rights

1. Robeco
2. BNP Paribas Asset Management
3. Legal & General Investment Management
4. APG Asset Management
5. Aviva Investors
6. Aegon Asset Management
7. Schroder Investment Management
8. NN Investment Partners
9. M&G Investments
10. PGGM

What can investors do?

So, investors need to act. But how? As investors are still finding their feet, a number of initiatives have volunteered to help out.

1. Guidance on implementing human rights by the PRI
Importantly, the UN PRI has recently positioned itself at the forefront in the fight for human rights. In October 2020, the initiative released a report on "Why and how investors should act on human rights," and set out a multi-year agenda for the implementation of human rights in the financial system. The report also contains guidance on implementation of human rights into the investment process. The PRI set out a "three-part responsibility to respect human rights" for institutional investors, which is based on the *"Protect, Respect, Remedy"* framework set out in the UNGPs. In alignment with the basic concepts of that framework, the PRI suggests that institutional investors should 1. Publishing a policy commitment on human rights, 2. Have due diligence processes in place, and 3. Enable or providing access to remedy, as shown in the table below.

Signatories of the PRI can soon expect questions on human rights to be incorporated into the PRI's reporting framework. By 2022, it will include human rights questions in its Reporting Framework – first on a voluntary basis, but expected to become mandatory in the years to come.

2. Framework for more corporate disclosure driven by the GRI
As an independent standard-setting organization, the Global Reporting Initiative (GRI) helps companies and other organizations report substantial impacts on the economy, environment and surrounding society, including impacts on human rights. Alongside other adjustments to the standards, the GRI is currently working to, firstly, align their *Universal Standards* with key authoritative standards on human rights, including those featured above (e.g., UN Global Compact). Secondly,

1. Policy	2. Due Diligence Processes				3. Access to Remedy
Adopt a policy commitment to respect internationally recognized human rights	Identify actual and potential negative outcomes for people, arising from investees	Prevent and mitigate the actual and potential negative outcomes identified	Track ongoing management of human rights outcomes	Communicate to clients, beneficiaries, affected stakeholders and publicly about outcomes and the actions taken	Enable or provide access to remedy

the GRI is revising its existing *Human Rights Topic Standards* (e.g., GRI 408: Child Labor, GRI 409: Forced or Compulsory Labor, GRI 411: Rights of Indigenous Peoples) to ensure that they reflect best practice and that the development of new standards is initiated as needed. Those updates are expected to improve issue-specific disclosure by corporates aligning their reporting with GRI, and consequently, enhance investors' ability to scan for potential human rights risks.

A tightening of SASB's reporting requirements on human rights may also occur in the near future, following recent urging from a coalition including Domini Impact Investments, As You Sow and Oxfam.

What are investors doing?

Although we are waiting for investors to go bigger on promoting the integration of human rights into business decisions and on widely implementing policies and due diligence mechanisms, some investors have already gone ahead as these examples show:

1. Engagement, engagement, engagement
Screening companies for their compliance with internationally recognized human rights standards (such as the UN Global Compact) and internal policies is an important first step. Yet, to adequately assess human rights risks in a firm's internal operations as well as supply chain, engagement with investees is key. As demonstrated by Federated Hermes EOS, *human and labor rights* should be a focus engagement area for 2021 and onwards, particularly in the current context of the pandemic. A systematic and transparent approach to engagement that tracks, quantifies and measures the progress of engagements on human rights concerns is fundamental to positive outcomes. A milestone strategy that broadly entails raising the concern to the company, receiving acknowledgement, bringing the company to commit to credible change and ensuring the change is implemented can be very useful here.

2. Looking beyond ESG ratings
Investors who are serious about identifying human rights issues within their holdings will go beyond simply relying on traditional ESG ratings providers such as MSCI, Sustainalytics, RepRisk, Vigeo Eiris, Bloomberg and so on. Based on conversations with a range of asset managers, other sources are found to be potentially more fruitful. There is a common consensus that NGOs such as the Business and Human Rights Resource Center, Amnesty International and Oxfam have a well-established history of tracking human rights violations. Some investors also consider searching for controversies in the news or using wider indices such as the World Bank and Transparency International helpful in their assessments.

However, there is concern about the *reactionary* nature of this information. To avoid being confronted by human rights abuses occurring in investments, information on *proactive* management is necessary. At this point in time, the forward-looking elements of due-diligence frameworks and the UN Guiding Principles are widely appreciated.

Rathbones
Look forward

3. Investors enforcing human rights laws
Rathbones, Legal & General, Aberdeen Standard Investments and Aviva: In early 2020, 23 FTSE 350 companies were called out by campaign leader Rathbones and more than twenty other investment firms with a collective £3.2 trillion in assets under management for their non-compliance with the UK Modern Slavery Act and urged to identify what actions have been taken to recognize and eliminate slavery in their supply chains.

INVESTOR ALLIANCE FOR HUMAN RIGHTS
AN INITIATIVE OF ICCR

4. Collective action for wide-reaching awareness and impact
Investor Alliance for Human Rights (IAHR): In 2018, a chunk of investors came together to form the Investor Alliance for Human Rights (IAHR). Today, the initiative

counts more than 160 global institutional investors from 18 countries as their members, including the money makers Avesco, Aviva, Federated Hermes, Nordea, Robeco and more. Backed by a combined US$5 trillion in assets under management, the IAHR aims to put the investor responsibility on human rights into practice and pursues different actions to do so.

One, the alliance exerts public pressure on companies to tackle their human rights issues. For instance, in March 2020, the IAHR group publicly criticized 95 companies that failed to score any points on the human rights due diligence indicators in the 2019 Corporate Human Rights Benchmark report. Two, the IAHR works to provide investors with the practical knowledge to deal with human rights in the investment process. They released an *Investor Toolkit on Human Rights* as well as a *The Human rights impact assessment guidance and toolbox* last year, and have a resource hub for human rights due diligence in place.

NN investment partners

5. Practical investment tools for human rights

NN Investments: An early-mover on integrating human rights in the investment process, NN Investments published a paper in 2016 on *"Investment Guidance on Human Rights"* that discusses their approach to human rights in their role as an investor. According to the paper, the firm developed a proprietary tool to assess human rights risks. For this tool, they looked at the human rights risks faced by key sectors, as summarized in the table. According to their findings, sectors at highest risk of human rights issues include the energy, materials, and industrial sectors. Today, NN Investments are ranked among the top 10 investors by ShareAction for their approach to human rights.

Table 1: Human Rights Sector Matrix

Sector	Human Rights Risks	
	Principle 1	Principle 2
Consumer Discretionary		
Consumer Staples		
Energy		
Financials		
Health Care		
Industrials		
Information Technology		
Materials		
Telecommunication Services		
Utilities		

Notes: (i) This sector breakdown is based on the Global Industry Classification Standard (GICS). (ii) A darker colour indicates higher risk.

About the Authors

The **High Meadows Institute** is focused on the role of business leadership in society. Our mission is to contribute to sustainable economic and social progress in a global economy and society. The High Meadows Institute was founded in 2013 by a small group of senior business and finance leaders with deep experience in the private and non-profit sectors. The Institute works in close partnership with other leading think tanks and academic and business organizations to advance its mission.

KKS Advisors is a leading consultancy firm providing innovative solutions that enable organizations to capture the enduring benefits of a sustainability approach. Applying our unique, research-backed approach, we work with corporations, foundations, NGOs and investors on sustainable strategies that deliver lasting impact. Our vision is to reshape markets, creating a world where business and investment decisions are made for the long term, taking environmental, social and governance factors into account. With offices in London, Boston and Athens, and associates around the world, our reach is global, and our focus is on efforts which foster systemic change.

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