



SUSTAINALYTICS

a Morningstar company

THE ESG RISK RATINGS

MATERIAL ESG ISSUE –
HUMAN RIGHTS



Sustainalytics' Material ESG Issue: Human Rights

Sustainalytics' ESG Risk Ratings capture how companies manage the impacts and risks related to human rights issues, which include child labour, forced labour or modern slavery within their own operations and/or their supply chains. Within the Risk Rating framework, Sustainalytics assesses two separate material ESG issues (MEI): 'Human Rights', speaking to the issue in relation to a company's own operations, and 'Human Rights – Supply Chain', focusing on a company's supply chain practices. Sustainalytics' assessments of these two material ESG issues inform investors about the degree of exposure companies face regarding human rights, and the extent to which this exposure is managed. This background piece will explore where exposure to this issue stems from, and how companies manage these risks.

The Importance of Human Rights

Human Rights has been a long-standing issue for companies across all industries, occurring either through their own operations or their value chain, as human rights violations pose not only reputational risks, but also can translate into financial and operational risks. The 2020 Uyghur for Sale Reportⁱ by Australian Strategic Policy Institute, brought the issue again on the global agenda, as it unveiled human rights breaches against the Uyghur minority in China, that were part of global supply chains for companies across multiple subindustries.

Over the past decade, to increase company due diligence on human rights issues, governments and international organizations developed new regulatory frameworks to address these issues that span across all industries. The UK (Modern Slavery Act) and US have drafted laws requiring companies to provide extensive disclosure on topics related to human rights issues (i.e. slavery or human trafficking) detected in their supply chains. The EU is following suit in aiming to introduce Europe wide regulations to hold companies and countries accountable for the social and environmental practices in their supply chains.ⁱⁱ The OECD through its different Due Diligence guidelines is providing directions for companies on how to best conduct their business and address existing human rights issues.

Consumers and investors are also becoming more aware of human rights issues in companies' operations and supply chains. The case of Boohoo PLC in 2020 is a good indication of investors more closely scrutinizing companies in their portfolios due to poor human rights practices in their supply chains. Further, Dutch investors have teamed up to address the issue of Fair Living Wages in the supply chain, through the Platform Financial for Living Wage, pushing the financial industry to act on the topic and pointing to the importance of human rights in several industries like, apparel, footwear and the entire food value chain.

Assessing the Unmanaged Risk of Human Rights by Industry

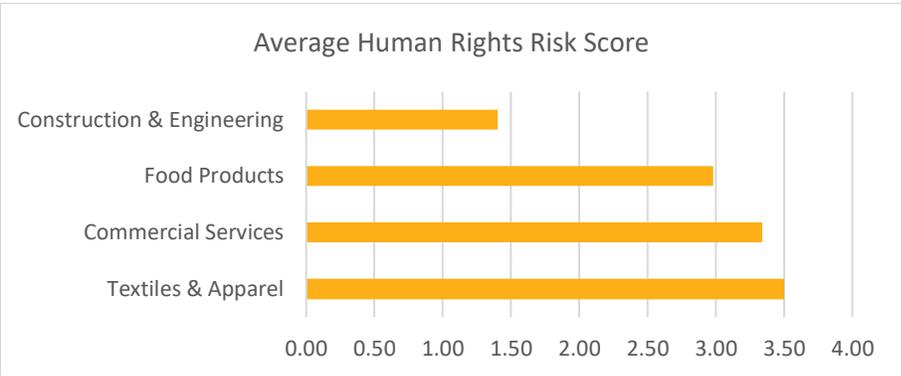
Industries like food, textile, and construction face issues around forced and bound labor quite frequently among the workforce working on sites, plantations or in textile factories or mills. Most of the companies, however, face human rights exposure through their supply chains, with issues ranging from forced and child labor to poor working conditions (i.e. wage issues, discrimination, harassment) and occupational health and safety.

The ESG Risk Rating for the Human Rights MEIs combines the risk a company cannot manage due to its business model and operations with the risk that it is not actively managing through lacking implementation of relevant programs and policies. Applying our consistent and comparable ESG Risk

Ratings model, we see that the MEI Human Rights is material for 138 companies in our comprehensive universe of more than 4,500 companies, spanning 4 industries and 4 subindustries. The MEI for Human Rights – Supply Chain applies to 1,872 companies in 16 industries and 36 subindustries.

Exhibit 1.1 and Exhibit 1.2 indicate the average unmanaged risk score on Human Rights and Human Supply Chain at the industry level in Sustainalytics ESG Risk Rating. For own operations, Textile and Apparel has the highest unmanaged risk score, while companies in the Household Products industry have the highest unmanaged risk score on Human Rights-Supply Chain.

Exhibit 1.1. Human Rights: Unmanaged Risk by Industry



Source: Sustainalytics, data as of December 2021

Exhibit 1.2. Human Rights -Supply Chain: Unmanaged Risk by Industry



Source: Sustainalytics, data as of December 2021

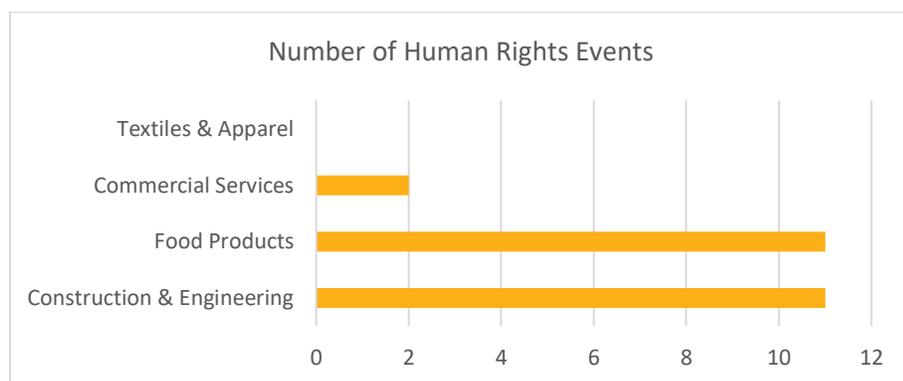
Within our research we also analyze the involvement of companies in controversies, to ensure that our ratings capture both the company reporting (through the management indicators), as well as third party external data (through our incidents and controversy research) to provide a full picture of a company's ESG performance. Events are assessed on a scale of 1-5 (5 being the most severe) based on impact on stakeholders and business risk. The information is captured through our news screening of more than 700,000 news items, third party sources or company and regulator reporting.

As of December 2021, Sustainalytics recorded a total of 24 controversies on Human Rights and 841 on Human Rights Supply Chain. We used the following data points as part of our analysis:

- Human Rights MEI: Society - Human Rights and Employees - Human Rights
- Human Rights – Supply Chain MEI: Society - Human Rights -SC, Employees - Human Rights- SC, Occupational Health and Safety - SC, Labour Relations – SC

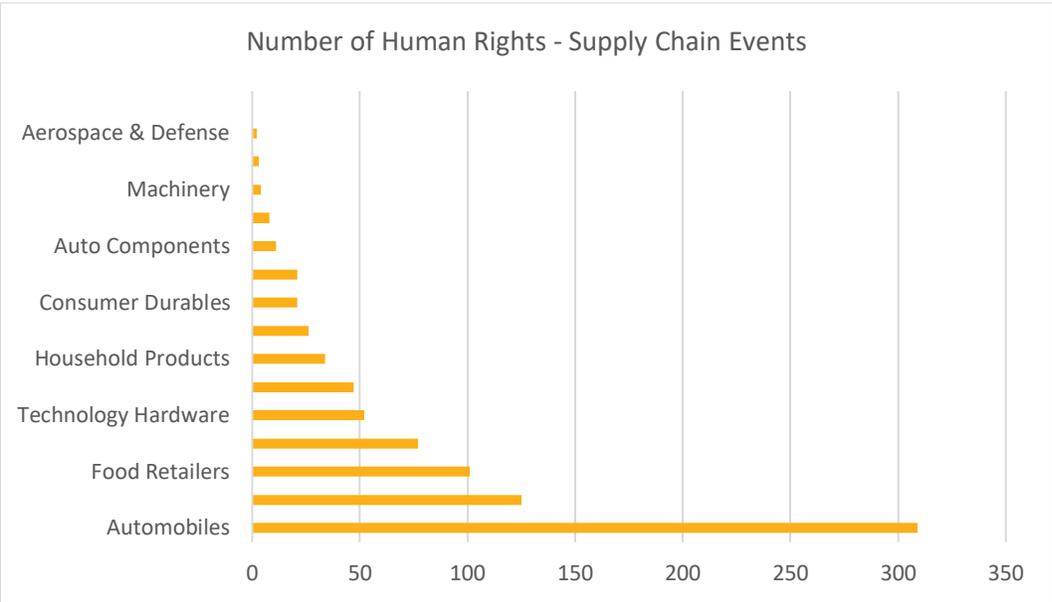
Most of the recorded events are related to human rights breaches on construction sites or plantation level, migrant workers and bound labour within a company's own operations. At the supply chain level, most events are related to workers strikes, poor wages, child labour and unsafe working conditions particularly for the Food, Retailing and Telecom Industries.

Exhibit 2.1 Human Rights: Controversies by Industry



Source: Sustainalytics, data as of December 2021

Exhibit 2.2 Human Rights- SC: Controversies by Industry



Source: Sustainalytics, data as of December 2021

How Sustainalytics’ Evaluates Companies on Human Rights

Our ESG Risk Rating framework scores companies on a set of subindustry-specific exposure and management indicators. We consider whether a company’s operations or supply chain are prone to human rights breaches, through the activities that they perform or the geographical location that they operate. Depending on the subindustry, we assess management practices related to human rights policies, conflict minerals, supply chain programmes and examine how companies address the issues in the supply chain through audits, monitoring and evaluation. We also look at the codes of conduct that are implemented, which set the scene for the application of programs and enhance strong human rights practices.

Golden Agri-Resources Ltd (GAR), an integrated palm oil plantation company, is a good example of a company with strong management of Human Rights issues. The company identified Human Rights as being one of its most material issues, with a high potential impact on the business. GAR implemented strong programs to address human rights and performs regular human rights risk assessment, while also monitoring its human rights performance, including incidents investigation and ensuring well-functioning grievance mechanisms to report misconduct.

Management Indicators	Raw Score	Weight	Weighted Score
Human Rights Policy	100	13.5%	13.5
Scope of Social Supplier Standards	100	38.2%	38.2
Supply Chain Management	50	38.2%	19.1
 Employees - Human Rights - SC	Category 2	10.0%	0.0
 Labour Relations - SC	Category 0	0.0%	0.0
 Occupational Health and Safety - SC	Category 0	0.0%	0.0
 Society - Human Rights - SC	Category 0	0.0%	0.0
Weighted Sum			70.9

Source: Sustainalytics ESG Risk Rating Report, Golden Agri-Resources Ltd

One example of a company with leading human rights supply chain practices is Compagnie Financière Richemont SA (Richemont), a Swiss luxury goods conglomerate. Relying heavily on raw materials like gold, diamonds, and other precious metals, that are often linked to human rights beaches, the company is committed to address the issues in the supply chain. One step was rolling out their Supplier Code of Conduct, a set of mandatory prerequisites for Richemont to conduct business with their suppliers. The Code addresses relevant issues like minimum living wages, child labour, forced labour, corporal punishment or discrimination. Richemont's maison business model is reflected in the relationship that group maisons have with suppliers, each of them conducting their own supply chain due diligence, based on the Kimberly Process (an international certification scheme) and is applicable to both tier 1 and tier 2 suppliers. Further, in line with the industry best practice, the company's board of directors together with the CFO and the CR Director are directly responsible for issues related to human rights. Also, the company is focusing now on strengthening their due diligence on supply chain topics that are directly related to human rights, as they identified this issue as material for their business.

Management Indicators	Raw Score	Weight	Weighted Score
Scope of Social Supplier Standards	100	35.0%	35.0
Supply Chain Management	100	45.0%	45.0
Human Rights Policy	40	20.0%	8.0
⚠ Employees - Human Rights - SC	Category 0	0.0%	0.0
⚠ Labour Relations - SC	Category 0	0.0%	0.0
⚠ Occupational Health and Safety - SC	Category 0	0.0%	0.0
⚠ Society - Human Rights - SC	Category 0	0.0%	0.0
Weighted Sum			88.0

Source: Sustainalytics ESG Risk Rating Report, Compagnie Financière Richemont SA

As investors, regulators and consumers become more aware of the risks relating to human rights and how they are transferred into investment portfolios or the goods that they are purchasing, companies will face increased scrutiny on how they are addressing these issues both in their own operations and supply chains. Using our ESG Risk Rating framework, investors can clearly see which companies are most exposed to this important issue and how well they are managing their related risks.

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ⁱ <https://www.aspi.org.au/report/uyghurs-sale>

ⁱⁱ <https://www.consilium.europa.eu/en/press/press-releases/2020/12/01/human-rights-and-decent-work-in-global-supply-chains-the-council-approves-conclusions/>

