THEMATIC ENGAGEMENT
THE THEMES

Asset owners and asset managers have the opportunity to consider their investments not only from a performance perspective, but also through the broader lens of environmental, social and governance stewardship. Whether the focus is on climate, clean water, plastics, business ethics, taxation or other sustainability themes, our Thematic Engagement services allow investors to align their interests in addressing specific issues with their engagement activities.

Our team of research analysts, engagement managers and advisers are knowledgeable about these issues and have extensive experience in helping companies to be better stewards of your investments, and of our society and the environment. Sustainalytics’ Thematic Engagement focuses on the following themes:

- Child labor in cocoa
- Climate Change – Sustainable Forests and Finance
- Feeding the future
- Governance of SDGs
- Human capital and the future of work
- Human Rights Accelerator
- Localized water management
- Modern slavery
- Plastics and the circular economy
- Responsible cleantech
- Sustainable seafood
- Taxation
- Tomorrow’s board

This brochure sets out each of the themes and briefly presents Sustainalytics’ methodology. The brochure also includes a mapping of the UN Sustainable Development Goals (SDGs) and their correlations with particular themes. The contact details of Sustainalytics staff responsible for each theme are listed at the end of each description and you are also welcome to contact your client manager if you would like to discuss any aspects of our engagement work.
A lot of effort has been carried out by companies, governments and other stakeholders to fight child labor in the cocoa supply chain. Côte d’Ivoire (Ivory Coast) and Ghana are the world’s leading cocoa producing countries, accounting for almost 70 per cent of cocoa production worldwide. However, it is estimated that in these countries combined, over two million children below 18 work in hazardous conditions in the cocoa supply chain alone.

**WHY?**

The Harkin-Engel protocol (a commitment from the cocoa industry to combat child labor in its supply chain) was introduced in 2001 and the sector has since then developed standards and made pledges to eliminate child labor. In 2010, the industry reaffirmed its commitment in a joint declaration to reduce the worst forms of child labor by 70 per cent by 2020. Various programs aimed at increasing productivity and improving the livelihood of cocoa-growing farmers have been scaled up over the years and targeted measures to combat cases of child labor have been developed. Across the supply chain, all parties involved – including the cocoa industry, governments and others – continue to make significant effort to address the issue.

Despite these developments, child labor has barely decreased and remains widespread among the millions of small-scale farms involved in cocoa farming in West Africa. Efforts must be scaled up to meet the Harkin-Engel protocol commitments. With the current pace of change, delays to eradicate child labor are highly likely.

Portfolio companies linked to child labor represent a reputational risk for both themselves and their shareholders. This is particularly true in cocoa production, where there are widespread and well-documented instances of child labor. Most major cocoa and chocolate companies, such as Nestlé, Mondelez, Hershey and Lindt & Sprüngli, are consumer-facing household names held by a large investor base. The issue of child labor in cocoa has also gained international attention from NGOs, media and other stakeholders. Stakeholder pressure on companies and investors is also increasing.

There is mounting evidence that environmental, social and governance (ESG) factors, including robust child labor policies, are associated with improved risk/return performance. This link creates a financial incentive for investors to ensure that companies address this issue. Studies show that companies that manage ESG issues are more likely to deliver superior long-term returns. This is particularly true for the cocoa sector, where portfolio companies must secure a stable farmer base to support demand. In recent years, macro trends such as urbanization and the aging farmer population in cocoa-producing countries have put a strain on the sector. Children are often brought in to work when their parents are not earning enough to sustain themselves and their families. By paying farmers adequately, the cocoa industry can ensure that cocoa farming is lucrative, thus retaining an active workforce and maintaining a stable supply of cocoa.

Most institutional investors explicitly address ESG issues, such as child labor, in their investment policies and/or acknowledge compliance with international human rights norms as the minimum requirements needed to invest in a company. Increasingly, investors expect companies to operate according to the UN Global Compact Principles, the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights. Child labor is also contrary to the ILO Convention No. 182 on the worst forms of child labor, as well as the UN Global Compact’s Principle 5. Finally, the eradication of child labor by 2025 is specifically mentioned under Sustainable Development Goal (SDG) 8 on Decent work and economic growth.

**WHAT?**

This engagement is founded on investors’ expectations for some of the largest companies in the cocoa sector, as outlined in 2017 and 2018 in dedicated reports by GES International, now part of Sustainalytics, presenting the issue of child labor in cocoa. These reports were shared with the various stakeholders in the cocoa industry and are available online. The expectations also form the KPIs against which the progress of engagement efforts will be measured and reported. They have been formulated with the aim of both identifying and remediating cases of child labor as well as addressing poverty, which is the underlying root cause in the cocoa supply chain.

The expectations for cocoa companies include:

- The communication by companies of a detailed plan, including an expected timeline, on:
  - How child labor identification and remediation systems are being/ will be rolled out/ across the majority of their farmer bases in Côte d’Ivoire and Ghana, along with a plan for a continuous roll-out so that a remediation system eventually covers their entire farmer base in the two countries;

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- How companies are contributing/will contribute to an environment that fosters children’s rights in cocoa growing communities, especially in areas such as education, child protection and health. This is particularly important for the most at risk communities in Côte d’Ivoire and Ghana.
  • Demonstrate progress towards a living income for farmers in Côte d’Ivoire and Ghana, by reporting on the impact of farmer programs and other initiatives on farmer income; and
  • Report to what extent current income levels match a living income for cocoa-growing farmers in the two countries.

The company selection for the engagement includes the trading, processing and chocolate brand companies Barry Callebaut, Cargill, Hershey’s, Lindt & Sprüngli, Mondelez, Nestle, and Olam International.

This engagement focuses on eradicating child labor in cocoa and thus contributes to SDG 8, which targets the elimination of child labor by 2025. In addition, the engagement objectives are aligned with SDGs 1 (No poverty), 2 (Zero hunger), 4 (Quality education) and 10 (Reduced inequalities).

HOW?
This thematic engagement has been ongoing for a number of years and will continue for an additional three years (from Q3 2019). Regular engagement meetings will be held with the target companies with the aim of fulfilling the above investor expectations. The expectations, in turn, continue to be informed by, and seek to utilize, the momentum of key initiatives in the sector being rolled out or in development (as of May 2019). Furthermore, finding synergies with organizations that share our goals is an important feature of this engagement.

Biannual follow-up reports on corporate performance and/or wider sector developments will be issued during the duration of this engagement project and participating investors will also have access to continuously updated company profiles detailing dialogue and progress.

There will also be opportunities to participate in meetings with the companies. Investors are encouraged to attend (jointly with Sustainalytics) key conferences related to the topic in order to a) increase investor knowledge on the topic, with focus on finding solutions; b) to get additional direct interaction with chocolate and cocoa companies and stakeholders in order to advocate further industry action and change; and c) encourage collaboration in the industry and the sharing of good practices beyond the cocoa sector. Sustainalytics will continuously highlight such events to participating investors.

FOR FURTHER INFORMATION PLEASE CONTACT:

Stina Nilsson
Director, Stewardship
stina.nilsson@sustainalytics.com
This thematic engagement will address climate risk and advocate for reductions in direct and indirect emissions in the context of global forest systems. Sustainalytics’ Sustainable Forests and Finance thematic engagement focuses on three key groups of actors: companies directly driving forest-related emissions, their customers, and their financiers. Building on insights gained from Sustainalytics’ Climate Transition engagement (2018 to 2021), this theme targets companies throughout forestry-linked value chains to promote science-based emissions reduction strategies, transparent climate-related disclosure and sustainable practices to mitigate impacts from climate change.

While we have seen positive developments since the signing of the Paris Agreement, active ownership on climate change has historically focused on direct emissions from highly exposed sectors such as fossil fuel and utility companies. At the same time, the less comprehensively addressed aspects of climate risk, including financial, have seen little progress. One such risk is increasing emissions originating in forest value chains.

Throughout this three-year engagement, Sustainalytics will promote corporate awareness and advocate for alignment with the latest developments in legislation globally, working to identify and catalyze cross-sectoral approaches to achieve positive change. The engagement is related to several UN Sustainable Development Goals (SDGs), in particular Climate Action (13), Responsible Consumption and Production (12), Life on Land (15) and Partnerships (17).

WHY?

Economic activity relating to forest systems has a significant impact on climate change. IPCC claims that AFOLU (Agriculture, Forestry & Other Land Use) is responsible for 23 percent of total net anthropogenic emissions. These emissions mean substantial transitional and physical climate risks for companies operating in this area. They are likely to result in financially material impacts, such as supply chain disruption, cost volatility, increasing legislation and litigation, pressures on natural resources, and additional costs and reputational damage to the directly and indirectly involved sectors. Also, as climatic changes materialise, the physical risks and vulnerability of forest biomes will be compounded. This compounding of impacts will in turn lead to an increase in financial risks for investors, not to mention reputational risks and the impact of changing consumer demands on addressing climate and other issues.

Beyond these risks, the scientific community is warning that we may be approaching some climate tipping points1 in the Earth system – for example, relating to the loss of tropical rainforests. A tipping point is a threshold of change in a system which, when exceeded, can lead to extensive and irreversible changes to that system, with the potential for domino effects on other systems. The risk of reaching a tipping point in forest biomes is growing through rising temperatures, forest fires, spraying deforestation and forest mismanagement. It is estimated that a tipping point caused by deforestation of the Amazon could be reached at a forest-cover loss of between 20 and 40 percent.

The current loss stands at 17 percent, and the year-on-year rate of loss increased by 134 percent in 20192. Irreversible changes to natural systems are expected if a tipping point is reached and will lead to severe consequences for society. The Climate Change – Sustainable Forests and Finance engagement aims to ensure financiers, companies using forest resources and their customers improve on several aspects that are financially material and include:

• Building an understanding of materiality and reducing operational, transition and physical risks from climate change in their business models
• Highlighting best practice in terms of sustainable value chains, contributing to the development of more resilient, long-term value chains, thus preventing widespread business disruptions
• Encouraging the establishment of long-term carbon strategies underpinned by science-based targets
• Facilitating better understanding and collaboration between key industries across the value chain on global challenges to forest biomes
• Driving action in opportunities for companies leading the way, highlighting potential competitive advantages in new regulatory playing fields, securing supply chains and catering to developing customer expectations.

WHAT?

By engaging with key actors throughout the forest value chain, this engagement will strive to bring about cross-sectoral dialogue and to identify, propagate and enable strategies for production and consumption within planetary boundaries. We see collaboration as a key part of achieving this. These challenges require entire value chains to work together to reduce risks, produce long-lasting sustainability and achieve transformative systemic change. We will be engaging with three interconnected parts of this value chain:

• For companies directly involved in producing forest commodities, potential instability of these systems is a direct risk to business models. Disruption and negative impacts from heat and drought, reduced biodiversity, reduced carbon cycling and reduced water cycling lead to a lack of stability and resilience of forest biomes. This will affect the availability and cost of forest resources and

1 https://www.nature.com/articles/s41467-019-03595-0
contribute further to climatic imbalance. Companies producing and trading in forest commodities, such as biomass, rubber, soy, timber, beef, or palm oil, face a high-risk future. Accordingly, the Climate Change - Sustainable Forests and Finance engagement will highlight the risks and impacts, due diligence on sourcing and management of resources and practical actions to address damaging practices.

- **Companies using forest resources in their supply chain** are more removed from the problem but still face significant risks. Industries where greenhouse gas (GHG) emissions from supply chains are on average four times as high as those from direct operations (Scope 1 & 2) include forestry. Companies may be subject to sourcing disruptions, increased costs or customer demands for sustainably sourced products. However, due to their indirect exposure, these companies can be better positioned to take a proactive approach to address risks – for example, by substituting at-risk materials or implementing responsible sourcing. These companies can be critical agents for change. The engagement is intended to help companies understand the impact that their supply chains have on forest systems and the corresponding physical and transition risks, and reduce emissions.

- **Financiers** are another critical agent. Since 2015, global banks have committed USD 154 billion in loans and underwriting into the production and trade of commodities driving deforestation and land degradation in the three major tropical forest regions.³ With the launch of UNEP Finance Initiative Principles for Responsible Banking⁴ amongst other initiatives, there is an increasing expectation of transparency on the banking sectors’ sustainability credentials. The engagement dialogue aims to harness this momentum focusing on credit and loan portfolios to explore the policies and actions banks are taking to address exposure to business practices degrading forest biomes.

With this approach to engagement, we aim to support participating investors by

- Ensuring portfolio companies are working to mitigate transition risk and build resilience.
- Proactively addressing deforestation and other threats to forest resources from companies throughout the financial system.

- Increasing the availability of relevant corporate data, including physical risk and the financial impacts of climate change.
- Enabling greater alignment with incoming legislation, such as the EU Sustainable Finance Disclosure Regulation, the UK Stewardship Code, the TCFD and the IIGCC Net Zero framework.
- Engaging in more effective and accurate reporting of scope 3 emissions within portfolio companies.

**HOW?**
The three-year engagement will target approximately 20 companies across three categories driving climate change within the forest value chain:

- Producers and traders in forest risk commodities (for example timber, palm oil, rubber & soy).
- Banks financing these operations, with a focus on the lending arm.
- End-users of forest commodities

Since the engagement will address structural challenges across sectors, the aim is to create a ripple effect that extends beyond targeted companies to the trading system more widely.

To measure progress and engagement impact, a set of KPIs and sub-indicators will be applied, reflecting the key topics where more forward-looking action is required:

- Financing of forestry and other industries heavily linked to deforestation and forest management.
- Increased transparency & disclosure
- Long-term science-based targets
- Innovation
- Mapping of physical risk throughout supply chains

The company selection will take into account participating investors’ interests and priorities, and the synergies and interlinkages throughout the value chain. Given the need for holistic and collaborative responses, Sustainalytics will also engage with other relevant stakeholders, institutions and experts.

³ [https://www.banktrack.org/article/banks_funneled_over_usd_150_billion_into_companies_driving_deforestation_since_paris_agreement_new_data_analyses_shows](https://www.banktrack.org/article/banks_funneled_over_usd_150_billion_into_companies_driving_deforestation_since_paris_agreement_new_data_analyses_shows)

⁴ [https://www.unepfi.org/banking/bankingprinciples/](https://www.unepfi.org/banking/bankingprinciples/)

**FOR FURTHER INFORMATION PLEASE CONTACT:**

**Henry Pallister-Dixon**
Manager, Stewardship
[henry.pallister-dixon@sustainalytics.com](mailto:henry.pallister-dixon@sustainalytics.com)

**Ivan Gjoshevski**
Manager, Stewardship
[ivan.gjoshevski@sustainalytics.com](mailto:ivan.gjoshevski@sustainalytics.com)
The global food system is in need of transformation. While the technical and structural developments in the past decades have resulted in significant positives on some fronts\(^1\), they have also contributed to various environmental, social and economic challenges.\(^2\) The two megatrends of population growth and climate change will further exacerbate existing pressures and drive unsustainable patterns of food production. A continued over-exploitation of natural capital will not only result in irreversible ecological damage but could also accelerate food insecurity and inequality.\(^3\) Without a change of course in how we produce and consume food, the world is on a path to fall short on several Sustainable Development Goals (SDGs). For companies in the food sector, resource constraints can make it challenging to grow and source many commodities currently taken for granted, while concerted effort is required to also address the structural vulnerabilities in the food system.

This engagement theme aims to contribute to a more sustainable trajectory for the future of food. Business-as-usual is not a viable or competitive long-term option and Sustainalytics will encourage food companies to develop holistic responses to the environmental challenges linked to food production. Feeding the Future engagement will help participating investors assess and improve the resilience of their food-related investments and provides insight into systemic pressure points. The engagement is related to several UN Sustainable Development Goals (SDGs), particularly SDG 2 on Zero Hunger, SDG 12 on Responsible Consumption and Production, and SDG 15 on Life on Land.

**WHY?**

The food sector has a massive environmental footprint and is critically dependent on natural resources. Agriculture is estimated to account for one-quarter of the world’s greenhouse gas (GHG) emissions, 80 percent of deforestation, 70 percent of water use and 78 percent of ocean and freshwater pollution.\(^4\) In addition, land conversion can often have significant and irreversible implications for biodiversity. As such, current agricultural practices not only place unsustainable demands on global ecosystem services but also jeopardise the food sector’s own future through contributing to the diminishing quality and availability of land and other natural resources.

Given the number and variety of material environmental issues affecting the food sector,\(^5\) the failure to manage related impacts comes with significant business risks and potential costs. For instance, companies should prepare for environmental depletion and climate change which could make the cultivation and sourcing of certain commodities more complicated, unpredictable or expensive. Indeed, of the many deep-rooted structural problems in the global food system, supply chain vulnerability has been among the ones drawing most attention amidst the COVID-19 pandemic.\(^6\)

Moreover, the food sector’s GHG emissions need to align with a scenario where the temperature increase stays well below two degrees Celsius. Companies have to adapt and potentially significantly adjust their ways of doing business. The concept of stranded assets does not only apply to fossil fuels: land and forest investments risk decreasing in value or becoming liabilities because of environmental or regulatory developments affecting their intended use.

Going forward, the global population growth coupled with rising incomes and changing consumer preferences is set to place additional demands on natural resources and the food supply chain. This makes sustainability and agility both essential and beneficial for companies’ long-term prospects, since demographic shifts can also create sustainable revenue streams. For instance, the global demand for plant-based foods is projected to continue increasing rapidly, with alternative meats market estimated to reach USD 140 billion by 2029.\(^7\)

Likewise, the EU Green Deal and the associated Biodiversity and Farm to Fork\(^8\), designed to accelerate food systems towards a more sustainable model, are intended to be growth strategies. The proposed regulation and taxes\(^9\) therefore do not only pose risks but also provide incentives and opportunities for companies aligning their products and practices with the sustainability aims.

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\(^1\) For example, productivity gains, access to a wider choice of foods (at lower prices) and employment opportunities.
\(^4\) https://www.oecd.org/industry/environmental-impacts-of-agriculture/; https://globalforestrates.yale.edu/land-use/industrial-agriculture
\(^5\) See, for example, www.oecd.org/industry/environmental-impacts-of-agriculture/; https://globalforestrates.yale.edu/land-use/industrial-agriculture
\(^6\) See, for example, www.oecd.org/environmental-impacts-of-agriculture/; https://globalforestrates.yale.edu/land-use/industrial-agriculture
\(^8\) https://www.sasb.org/standard-setting-archive/food-and-beverage-industry-briefs/

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9 For instance, it is proposed that EU tax systems should aim to ensure that the price of different foods reflects their real costs in terms of use of finite natural resources, pollution, GHG emissions and other environmental externalities.
WHAT?
This engagement focuses primarily on the environmental impacts in the food production stage. As outlined above, there is a clear business imperative for food companies to both mitigate their own environmental impacts on land, air and water resources, and to improve their resilience to related natural, regulatory and societal changes. Business preparedness and reporting appears limited, however, with many food companies not even having an environmental policy. Sustainalytics’ Feeding the Future engagement aims to ensure that current and impending externalities connected to food production are proactively internalized and that companies embark on a transition towards more sustainable practices.

In particular, companies need to:

- Undertake science-based scenario planning and consider structural vulnerabilities, further accentuated by COVID-19, to evaluate the resilience of their business models. This should include contingency planning and costs of externalities.
- Accept responsible stewardship of land as imperative. More needs to be done with less to sustainably increase yields and prevent deforestation, biodiversity loss, water scarcity, and soil degradation. Business plans should include corresponding measures.
- Eliminate food waste along all stages of production and consumption. Food waste is responsible for around 6 percent of global GHG emissions. It presents a clear opportunity for environmental gains and cost savings.
- Align with shifting consumer preferences, including alternative and sustainable proteins. Assessing and adapting to emerging trends will improve companies’ long-term competitiveness.
- Support a sector-wide transition to sustainable business models through e.g. ensuring that suppliers have access to relevant technology and resources.

With less than ten years left to reach the SDGs, agriculture plays a pivotal role. This thematic engagement seeks to directly contribute to SDG 2 on Zero Hunger, SDG 6 on Clean Water and Sanitation, SDG 12 on Responsible Consumption and Production, SDG 13 on Climate Action, SDG 14 on Life Below Water and SDG 15 on Life on Land. It is indirectly connected to several others.

HOW?
The three-year engagement will target approximately 20 companies in the food sector. The selection will take into account participating investors’ interests and priorities. The engagement focus will be on how companies are transforming their business models to address the new realities for production and consumption. Given the need for holistic and collaborative responses, Sustainalytics will also engage with relevant stakeholders, institutions and experts.

To measure progress and engagement impact, a set of KPIs and sub-indicators in five areas will be applied, reflecting the key topics where more forward-looking action is required:

- Governance and reporting
- Land use and biodiversity
- Non-land resources and food waste
- Sustainable product portfolio
- Supply chain resiliency

Investors will be invited to participate in regular conference calls with target companies. Sustainalytics will provide ongoing updates and bi-annual reporting on company responses and KPI progress.

FOR FURTHER INFORMATION PLEASE CONTACT:

Jonathan Kellar
Manager, Stewardship
jonathan.kellar@sustainalytics.com

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10 Sustainalytics’ research shows that an environmental policy is missing or weak at 56 percent of food companies. This covered 578 companies under agriculture; packaged foods; beer, wines and spirits; and soft drinks.
11 FAO estimates each year approximately 30% of food produced for human consumption is lost or wasted. The calorie loss from food waste is enough to feed every undernourished person in the world. The economic costs come to USD1 trillion.
12 https://ourworldindata.org/environmental-impacts-of-food
WHY?
As companies align their strategy with the fulfillment of SDGs, they should create a win-win situation in which shareholders and other stakeholders all benefit. Bringing about positive societal change usually goes hand in hand with more meaningful shareholder value. From the company perspective, a clear strategy firmly focused on the SDGs is essential because:

- The SDG framework provides a roadmap that helps companies identify issues and opportunities that are relevant on a global scale, and for which there is consensus that they must be addressed. By targeting the goals, companies should automatically improve their sustainability and align with the global consensus of what a desirable future should look like. Furthermore, because the challenges are ever more daunting – climate change, water crises, income inequality, to name a few – a global, coordinated effort is necessary.

- The expectations from the public have never been greater. Today, companies must show that they recognize their societal responsibilities and make a positive contribution to shared challenges. Younger generations of customers and employees, those who came of age after the year 2000 and known as Millennials, are demanding more when it comes to companies’ social positioning. This notably dictates how and where they invest their money. Millennials are also more active in expressing their concerns via campaigns, demonstrations or boycotts.

- A credible SDG strategy has multiple advantages. On the one hand, it demonstrates a long-term vision and affords companies time to invest in employee development, innovation and capital assets, among other things. On the other hand, a clear commitment to customers, suppliers and communities can bridge the gap between declared corporate values and actual behavior. Companies engaging in this transformation, setting standards for themselves and the industry based on sustainable growth, are the ones that will thrive in the long run. By aiming to contribute to the SDGs, they position themselves to deliver sustainable financial returns to investors.

GOVERNANCE OF SDGS
In recent years, companies have been confronted with a range of disruptive forces, including increased geopolitical risks1, a revolution in technology, enhanced competition for raw materials and natural resources, globalisation, and increased urbanisation. Governments’ difficulties in providing solutions have led stakeholders to turn to companies, asking them to address complex environmental, social and economic issues2.

Equally, many investors are increasingly concerned with finding ways to invest their capital to make a positive impact on society. They expect companies not simply to yield a good return on their investment and do no harm, but also to uphold high ethical standards and to contribute to making the world a better place. The United Nations’ Sustainable Development Goals (SDGs) present a unique opportunity for both investors and companies to focus their efforts on concrete ways to achieve this3.

The SDGs provide a framework for understanding how companies contribute to or detract from certain societal objectives and thereby help identify related risks and opportunities. Delivering on the SDGs is also a formidable governance challenge, as companies are tasked with making sense of differing priorities and policies at the country level. This thematic engagement is aimed at encouraging companies to define meaningful SDG strategies that align with their business plans. It aims to influence them to address their negative impacts and seek out opportunities to produce positive outcomes in line with the 2030 SDG agenda, while contributing to a more stable long-term operating environment for themselves.

1 These risks include global trade tensions, gulf tensions, European fragmentation (i.e. Brexit), U.S.-China competition, LatAm political instability, Russia-NATO conflict, South Asia Tensions, major cyberattacks, Central Africa political instability and major terror attacks
2 S. Kaplan, Toronto’s Rotman School of Management, https://www.ft.com/content/c998cc32-d93e-11e9-8f9b-77216ebe1f17
3 https://www.responsible-investor.com/articles/wba-gh
WHAT?
The SDGs provide a useful backdrop to steer responsible business activities and help set new standards for responsible investing. At the same time, in order to avoid “SDG-washing”, it is essential to ask companies to clearly identify which of the goals are the right ones for them to prioritise and what the strategic alignment for their business might be. This engagement aims to elicit meaningful corporate responses to the global challenges targeted by SDGs, whereby we expect companies to back up their strategies with practical efforts and evidence. To this end, we will seek information and engage with companies on:

- Targets and impact measurement: Do companies have targets in relation to SDGs? What set of metrics and associated goals do they use to judge their ability to contribute to meeting the SDG objectives and measure impacts?
- Transparency and reporting: Do companies provide information on a regular, voluntary and public basis on their alignment and progress related to the SDGs? What is the quality of reporting? Do the companies articulate a social purpose, and if they do, how does this social purpose complement the commitment on SDGs?
- Business model that embodies SDGs: How are company boards moving away from the shareholder-centric view that has dominated corporate thinking for decades? Are companies successfully articulating the link between SDGs, purpose, strategy and culture with financial performance? Are they specifically aiming to expand their activities that contribute to meeting the SDG objectives? How are they further advancing and advocating the incorporation of the SDGs beyond their direct operations? To what extent are companies able to turn SDG-related goals into a future competitive advantage through innovation, process improvements and operational efficiencies? What tools do they have in place to attract and retain the best talent to support the achievement of the stated goals? How are they meeting Millennials’ expectations?

HOW?
The ultimate objective of this engagement is to encourage companies to clearly identify which SDGs are the right ones for them to prioritise. In addition, they should demonstrate that their decision-making considers SDG impacts, guides culture and maintains their license to operate, and is geared towards achieving concrete impacts.

This engagement will run for three years and will focus on approximately 20 companies in the financial services, consumer goods and ICT sectors. While facing formidable challenges, we believe these sectors hold the potential to contribute significantly to the SDGs. The ultimate selection will consider the interests and holdings of the participating investors and will include an analysis of the engagement potential of individual companies.

We will assess the companies against key performance indicators (KPIs) that address the governance systems as well as SDG alignment in the following areas:

1. SDG governance and strategy
2. Board oversight of SDG strategy framework
3. Risk and impact assessment and management
4. Reporting
5. Stakeholder engagement

Sustainalytics will provide bi-annual reporting outlining the key developments connected to SDGs and summarising the engagement status of each company. The reports will also include an update on the progress the companies are making against the KPIs and engagement goals.

FOR FURTHER INFORMATION PLEASE CONTACT:

Josiane Fanguinoveny
Director, ESG Products, Stewardship
josiane.fanguinoveny@sustainalytics.com

Aleksandra Kretkowska
Manager, Stewardship
aleksandra.kretkowska@sustainalytics.com
HUMAN CAPITAL AND THE FUTURE OF WORK

The Fourth Industrial Revolution is accelerating. Technological progress, globalization and demographic shifts, will bring structural changes and disruptions to society and labor markets.1 Several sectors across the economy will be impacted by these changes, with the key ones being consumer goods, manufacturing, aviation, travel and tourism, information and telecommunications, and financial services. Companies are working to benefit from emerging technologies to improve productivity, expand into new markets, and develop products that meet the demands of the future.2 Furthermore, globalization has set the stage for increasingly interconnected economic and labor markets, and demographic changes are challenging the status quo for a more diverse and inclusive workforce. Consequently, the challenge of remaining competitive in a globalized world poses significant risks for any business today, and human capital strategy lies at the core of a successful management response.

WHY?

A major labor market transition is underway where jobs are increasingly being replaced by machines, while new kinds of jobs are also being created. The OECD estimates that automation could result in the disappearance of 14 percent of existing jobs over the next 15-20 years with a further 32 percent likely to change radically as individual tasks are automated.3 Technological advances with artificial intelligence (AI), automation, and robotics will contribute to increased productivity and better services and may have a positive impact on people’s wellbeing. In parallel, companies looking to be at the leading edge of innovation will need to prioritize attracting, retaining, and developing workers with the skills necessary to help them compete in the future.

As these technologies replace certain basic tasks and threaten to replace jobs altogether, the roles and skills needed in organizations will evolve. The advance of robotics and AI in the workplace has mainly focused on manual labor, but software can also improve the output of some office jobs: a wide range of industries is impacted, and white-collar workers are no less at risk of disruption than blue-collar ones. Employees will need lifelong learning that enable them to skill, reskill and upskill. A major challenge for companies is to identify the desirable future skillsets for their workforce and offer the training and support required in the transition to new roles and jobs. The lack of a skilled workforce and inability to attract necessary talent could jeopardize the implementation of emerging technologies, resulting in companies missing out on the related benefits, including improved market share, productivity and service offerings. Similarly, managing turnover and employee mobility comes with an opportunity cost.

The stress of transitioning to new roles and jobs will be accentuated for those workers that are already disadvantaged or marginalized. The highest risk of job automation is concentrated in routine jobs with low skill requirements and often low wages.4 These also commonly have lower education levels. Across OECD countries, only 17 percent of workers in low-skilled occupations participate in job training each year, compared to an overall average of 40 percent.5 Women also experience additional barriers: they often have less time to reskill or search for employment due to disproportionate time spent doing unpaid care work and have poorer access to digital technology.6 Additionally, temporary and part-time workers are also more vulnerable since they might not be entitled to all work benefits including the rights to training. The OECD estimates that at least one in nine employees across OECD countries are either self-employed or have a temporary contract.7 At the same time, research shows that companies with lower gender and ethnic diversity are more likely to underperform their industry peers on profitability.8

The future of work is unclear. Companies that proactively engage with the challenges and opportunities inherent in the Fourth Industrial Revolution are likely to better position themselves competitively to manage the uncertainty. Forward looking human capital strategies that understand the needs of the organization and that support employees through difficult changes make companies better placed to attract diverse talent, mitigate potential staff shortages, and create a strong culture.

WHAT?
This engagement considers the recommendations provided by the World Economic Forum (WEF) and the ILO’s Global Commission on the Future of Work to strengthen companies’ future labor market resilience and adaptability. It focuses on industries with elevated exposure to drastic changes in the workforce composition.

The overall objective of the Human Capital and the Future of Work engagement is to encourage companies to create, update, and maintain a human capital management approach to hire, develop, and retain talent to address the transformations posed by emerging trends. It is also imperative to promote the development of diversity, equity, and inclusion strategies and programs to create an inclusive corporate environment and meet the demands of the future. Expected company outcomes after 3 years:

- Better awareness of the risks and impacts of globalization, technological change, and demographic shift on the current and future workforce.
- Improved strategies and programmes to hire, develop, and retain human capital and support the transition of employees to new roles and responsibilities due to transformations posed by emerging trends.
- Advanced diversity, equity, and inclusion strategies and programmes.
- Enhanced human capital management related disclosures.

This engagement supports investors in understanding how companies can proactively manage workforce needs and transitions for a sustainable labor market. It will contribute to the achievement of the Sustainable Development Goals (SDGs) such as Quality of Education (SDG4), Gender Equality (SDG5), Decent Work and Economic Growth (SDG8), Industry Innovation and Infrastructure (SDG9), Reduction of Inequalities (SDG10) and Stronger Institutions (SDG16).

HOW?
The engagement will include approximately 20 companies in the Industrials and Financial Services sectors. The sectors were selected to capture a diversity of job types; so-called “blue-collar” and “white-collar”. The final company selection considers the interests and holdings of the participating investors.

To measure progress and the engagement impact, a set of KPIs and sub-indicators will be applied. We will also engage in dialogue with relevant institutions, such as the ILO, OECD and WEF where appropriate. Five KPI areas have been identified to track progress and to compare developments within the target group:

- Governance and reporting
- Risk and opportunity assessment of emerging technologies and their human capital impact
- Strategic workforce planning, talent development and recruitment practices
- Diversity, equity, and inclusion
- Collaboration

The program will last three years. Investors will be invited to participate in conference calls with the selected companies. Sustainalytics will provide biannual reporting on how companies are responding to the engagement and the progress they are making against the KPIs.

FOR FURTHER INFORMATION PLEASE CONTACT:

Enrique Figallo
Manager, Stewardship
enrique.figallo@sustainalytics.com
HUMAN RIGHTS ACCELERATOR

This thematic engagement aims to improve the adoption of globally agreed corporate standards for managing and promoting human rights, as defined by the UN Guiding Principles on Business and Human Rights (UNGPs) and mirrored in the OECD Guidelines for Multinational Enterprises. Specifically, through collaborative investor dialogue, it will encourage companies to meet the UNGPs’ three fundamental expectations:

1. A commitment to respect human rights,
2. The adoption of a human rights due diligence process, and
3. The implementation of an operational-level grievance mechanism.

Leveraging Sustainalytics’ extensive experience in the field of human rights, it will bring together effective and scalable solutions for business activities and relationships that are particularly high risk from a human rights perspective.

In 2020, the UNGPs celebrated its 10th anniversary. The initiative made enormous progress in helping to gather momentum on business and human rights issues. Now is the time to accelerate efforts as numerous people are still deprived of their basic rights and needs. Investors have a key role to play. Through active ownership and related activities, they can use their leverage to mitigate human rights risks while positively contributing to people’s lives and their communities.

Throughout this three-year engagement, Sustainalytics aims to meaningfully support the second decade of the UNGPs. We will encourage companies to develop policies and practices that can help them better prepare for and manage some of the most commonly faced human rights challenges.

This engagement is related to several UN Sustainable Development Goals (SDGs), namely No Poverty (1), Decent Work and Economic Growth (8), and Reduced Inequalities (10).

WHY

Private sector activities positively and negatively impact the rights of millions of people across the globe. Not adequately managing these impacts constitute a material risk to companies and by extension to investors. Numerous projects and operations have been disrupted by protests, legal proceedings and other actions that resulted from human rights concerns.

Human rights issues are central to a company’s “social license to operate”, or simply “social license”. Social license refers to society’s ongoing acceptance of the companies’ activities and the trust it builds with the communities where it operates. This includes the company’s own workforce as well as its supply chain. When this trust is broken or eroded, companies run the risk of becoming less resilient with costly strikes, delays and short- and long-term supply shortages, which would impact its growth and productivity.

According to Sustainalytics’ research on companies’ preparedness to manage human rights risks and adverse impacts, almost 20 percent of companies involved in adverse human rights incidents do not even have a human rights policy commitment in place. Moreover, almost 60 percent of the companies have very limited human rights due diligence practices, and two thirds have poor processes to remediate human rights grievances, or even to identify them.

Several countries across the world have already adopted laws that mandate human rights due diligence and disclosure. This regulatory trend is expected to continue, which increases the urgency for engagement on this topic. Most significantly, the European Union is expected to propose mandatory corporate human rights due diligence legislation in 2021. This type of legislation is supplemented with additional issue-specific regulation that addresses human rights in different contexts, for example, EU and US regulations on conflict minerals.1

Marginalization and poverty are often accompanied by human rights abuses and further hamper people’s ability to participate and contribute to society and the economy at large. This comes at high humanitarian, societal and economic costs. Even before the Covid-19 pandemic, almost 700 million people lived in extreme poverty. According to World Bank estimates, this increased by an additional 120 million people in 2020 alone. Conflicts, marginalization, discrimination and other inequalities, as well as difficulties to access a decent work, are part of everyday life for millions of people. In many cases, there are clear links with the private sector. Initiatives such as the UNGPs have helped to make companies more aware of this connection and in the investor community there is a growing emphasis on addressing the ‘S’ in ESG.

WHAT

The Human Rights Accelerator engagement aims to ensure that companies respect fundamental human rights and, in doing so, also mitigate financially material risks. In short, this engagement seeks to:

- Accelerate the implementation of a fundamental human rights framework that addresses UNGP expectations through a human rights policy commitment, a human rights diligence process and an operational-level grievance mechanism. The aim of this framework would be to proactively identify and address human rights risks and adverse impacts across a company’s operations and activities.

The engagement focuses on specific issues and sectors that are deemed especially high-risk from a human rights perspective:

- Situations where there is harm, or the risk thereof, to community members, especially near large-scale mining and infrastructure projects where the company’s operations or license to operate may become at risk due to human rights concerns.
- Instances where a failure to provide a decent income and livelihood to the company’s workforce, or the workforce of its suppliers, risks impacting their ability to access basic goods and services. This may, in turn, also have a business impact due to supply chain disruptions. Depending on the participating investors’ interests, the engagement

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could focus on different sectors where these risks are especially pronounced, including electronics, food production and low-paid service jobs. In the US, for example, the business impact was especially pronounced for low-paid service jobs where labor shortages resulting from pandemic restrictions were exacerbated by workers using the opportunity to switch to jobs with better wages and working conditions. This highlights the importance of having a decent wage strategy to not only address human rights concerns but also to support growth and gain a competitive advantage over peers by building a stronger workforce.²

Our objective is to contribute to building resilient sectors and companies which will be crucial in a post-pandemic economy, upholding basic human rights of communities, workers and producers.

**HOW**

The three-year engagement will target approximately 20 companies involved in metals and mining, infrastructure developments, electronics, food industry and/or services.

To measure progress and engagement impact, a set of KPIs and sub-indicators will be applied in the following areas:

- The implementation of robust human rights due diligence process (including a human rights policy commitment, human rights risk assessment of the companies’ own operations and of its business partners, stakeholder engagement etc.).
- The implementation of strong human rights remedy mechanisms, in particular operational-level grievance mechanisms.
- Depending on the industries selected for this engagement, measures addressing sector-specific risks and impacts:
  - For mining and metals and infrastructure companies: risk assessment and mitigative measures around community rights, such as consultation processes, compensation to affected people, free, prior and informed consent for indigenous people etc.
  - For companies involved in electronics, food production/retail, and low-paid service jobs: decent income risk assessments and corresponding mitigative and collaborative actions to enable workers, producers, and their families, obtain a decent income enabling them to enjoy basic human rights, such as food, housing, healthcare, education etc.

Sector and company selection will ultimately be determined by the interests and holdings of participating investors, and will also include:

- A mix of leading, mid-level and lagging companies from a corporate and human rights preparedness perspective. This is a deliberate strategy as it will allow for peer and cross-sectorial learning among companies.
- Companies both in high, middle- and low-income countries, as human rights risks and adverse impacts are highly relevant and present regardless of a country’s level of economic development. This is also evident in human rights incidents picked up in Sustainalytics’ norm-based screening services.
- Companies that have the highest potential impact - either positive or negative - on human rights. This can relate to the impact on their own workforce, in the communities where they operate, and/or where the company can leverage its position to prevent harm and build a stronger respect for human rights beyond its direct sphere of influence.

To further accelerate companies’ respect for human rights, we will seek collaboration and alignment with the UN-led initiative UNGP10+, currently under development, constructing a ‘roadmap for the next decade’ with regards to implementing the UNGPs.³

With this approach to engagement, we aim to support participating investors by:

- Assisting portfolio companies to develop a strong fundamental human rights due diligence framework, aligned with the UNGPs, the OECD Guidelines on Multinational Enterprises, and relevant existing and emerging legislation.
- Proactively addressing human rights risks throughout a range of sectors and companies, raising the bar for what is considered leading practices in the area.
- Collaborating with like-minded investor groups and expert organizations to ensure broader private sector acceleration of human rights.
- Seeking synergies with other Sustainalytics human rights engagement offerings through joint engagement activities in order to accelerate more effective and broader private sector impact (e.g. multi-stakeholder roundtables, training sessions, engagement trips, investor letters and statements).

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Localised Water Management

Water-related challenges cut across the global risks landscape identified by the World Economic Forum. Apart from the impacts most commonly associated with water – droughts, floods, extreme weather events and rising sea levels – it is inherently connected to various other key challenges including climate change, food security, infectious diseases, biodiversity loss and energy production. Lack of water or disputes over access can also quite feasibly spur social instability and even interstate conflict and contribute to large scale migration. Without an appropriate supply of water and sanitation, fundamental societal functions cannot be fulfilled and development is likely to stall. Indeed, ensuring availability and sustainable management of water and sanitation for all is UN’s Sustainable Development Goal (SDG) 6. Given the all-encompassing nature of water-related implications, it is a risk that requires prompt and comprehensive action from companies and investors too.

Why?
Sustainable management of water resources is emerging as a key commercial issue for companies. Severe water stress can create an extremely inhospitable operating environment and failure to mitigate the related risks can have material consequences. In milder cases, this may involve companies having to adjust operational costs upwards and production levels and revenues downwards, compared with the business-as-usual scenario. In more severe cases, relocations and revising the sourcing structures may become topical, and it could become very difficult, significantly more expensive or outright impossible to carry on with the intended strategy.

Most affected are those industries which directly withdraw a lot of water and some are already facing two choices: investing significant amounts of capital to expand water access or abandoning certain sites. However, companies that think that they are not exposed to water risks because they do not consume a lot of it themselves need to broaden their view. Downstream users may see a decrease in the amount or quality of water available as a result of upstream activities; supply chains may be far more dependent on water than the company selling the end product; and without water, there is unlikely to be electricity, hygienic working conditions or a healthy local market to sell to, regardless of the nature of operations.

Furthermore, many governments will have to act on water scarcity and find financing for the ageing or otherwise substandard utilities infrastructure. For many, introducing quotas, fines and price increases for corporate water users may be an easier political sell than increasing the household costs. Across the world, more regulation and scrutiny of companies’ water practices looms ahead.

While the risks are global, the impacts hit hardest at the local level, and this is where Sustainalytics’ water engagement accordingly focuses on. Users in the same river basin or catchment area competing for scarce water resources can easily lead to winners and losers, and contextual due diligence and cooperation is not only a responsible way to conduct business but also likely to make operations more resistant to disruptions.

What?
This engagement builds on the learnings from Sustainalytics’ first thematic water engagement, which included broad benchmarking exercises on companies’ water risk management and stewardship in 2017 and 2019. Our previous dialogues and research show that while companies acknowledge collaboration and basin-level efforts to be the most effective and (cost-)efficient ways to tackle water risks, these remain areas where management responses have yet to be fully actualized.

Integrated water resources management (IWRM), involving all relevant stakeholders working together rather than in silos, is also one of the SDG6 targets. SDG6 clearly illustrates that sustainable development and responsible corporate water management are closely linked and, apart from IWRM, companies are expected to play a role in objectives relating to, for example, water quality, freshwater supply, sanitation and hygiene, capacity-building, and water-related ecosystems. They must be aware of the impacts that their activities can have on access to water, livelihoods and socioeconomic development.

Indeed, as with risks, while the SDGs are global, the need for action and improvements are often most acute in certain locations, and hence the companies present in or sourcing from those places should be particularly mindful of their related responsibilities.

2. In many places, water is currently provided free of charge or at a very low cost both to domestic and commercial users.
Accordingly, this thematic engagement focuses on a selection of companies that share a water catchment. With this approach, we expect to:

- improve companies’ awareness of the importance and benefits of adapting their water management to the local risks and realities
- encourage concrete opportunities for companies linked to the same catchment to find corporate and other partners for joint efforts
- have the best chances of the engagement contributing to tangible impacts on the ground
- strengthen the role of investors as a pertinent stakeholder in integrated responses to water crises

Aligning with a broad range of stakeholders is a fundamental element in this engagement project. Sustainalytics will cooperate with CEO Water Mandate to leverage and support the latter’s efforts towards an improved corporate understanding of shared water challenges and the development of site-based targets, with the view of reducing company risks and enhancing water security for all. The focus catchment(s) will therefore be one(s) in Brazil, India, South Africa and/or the USA, where CEO Water Mandate and its partners are piloting their site-based approach.

The engagement is underpinned by companies’ role in realizing the SDGs. In addition to SDG6, this initiative is aligned with SDG12 (Responsible Consumption and Production), SDG15 (Life of Land) and SDG17 (Partnership for the Goals).

HOW?
The Localized Water Management engagement is a three-year project targeting approximately 20 companies that share the same water catchment in the Tiete (Brazil) and/or Vaal (South Africa) river basins. We particularly focus on beverage, chemicals and mining companies, complementing the selection with certain key corporate actors in each location. The engagement runs from Q1/2020 to Q1/2023.

Apart from aiming to draw companies’ attention to their contextual risks, responsibilities and opportunities, engagement objectives include improving their macro-level understanding of the material implications associated with water and encouraging an appropriate management response. We recommend companies extend learnings from Vaal/Tiete to other locations. The intended results cover both strategic integration and concrete actions.

To measure progress and ultimately the engagement impact, a set of Key Performance Indicators (KPIs) and sub-indicators will be applied. The assessment framework is aligned with SDG6 and draws from Sustainalytics’ previous experiences of engaging on water. There is a strong emphasis on contextual and site-level aspects across the KPIs, and we will also promote science-based targets where appropriate. Six KPIs have been assigned to the companies, as follows:

1. Water governance
2. Risk and opportunity management
3. Water quantity
4. Water quality
5. Integrated water resources management
6. Public water management.

Aligning with a broad range of stakeholders is a fundamental element in this engagement project. Sustainalytics will explore synergies with actors that have an interest in enhanced water management in our focus locations in order to leverage existing initiatives and maximize impacts. For example, we will cooperate with CEO Water Mandate to support its efforts towards an improved corporate understanding of shared water challenges and the development of site-based targets, with the view of reducing company risks and enhancing water security for all. Our focus river basins are among the locations where CEO Water Mandate and its partners are piloting their site-based approach.

Investors will be invited to participate in regular conference calls held with target companies. Furthermore, Sustainalytics will provide ongoing updates and bi-annual reporting on company responses and KPI progress, as well as on developments in the relevant catchments. As part of the project, an engagement trip will be arranged to obtain first-hand knowledge of water-related challenges and efforts in a focus catchment.

FOR FURTHER INFORMATION ON THE LOCALIZED WATER MANAGEMENT ENGAGEMENT, PLEASE CONTACT:

Dayna Linley-Jones
Director, Stewardship
dayna.linley-jones@sustainalytics.com

Ivan Gjoshevski
Manager, Stewardship
ivan.gjoshevski@sustainalytics.com
Companies are not doing enough to address modern slavery and human rights risks within their spheres of influence, according to the findings of several recent studies. This failure could expose investors to unexpected risks. Businesses associated with abusive practices may be vulnerable to material costs and losses owing to a number of developments. This includes emerging regulation, government initiatives, recent judicial rulings and societal expectations. It is anticipated that modern slavery will increasingly put companies at a competitive disadvantage through, for example, operational disruptions, compliance risks and loss of business due to damage to reputation. Sustainalytics' Modern Slavery engagement seeks to mitigate this. The engagement's objective is to ensure high-risk portfolio companies adopt rigorous strategies on modern slavery. Participating investors will be able to join an approach that takes an integrated view of financial and human rights risks.

This engagement seeks to contribute to UN Sustainable Development Goal (SDG) 8 on Decent Work and Economic Growth and target 8.7 on the Eradication of Modern Slavery. The engagement also relates to SDG 5, 10 and 16 on Gender Equality; Reduced Inequalities; and Peace, Justice and Strong Institutions, respectively.

WHY?
Modern slavery is a severe form of exploitation. A term that is commonly used to refer to a number of coercive practices, modern slavery typically includes forced labor, human trafficking, forced marriage and worst forms of child labor. Globally, the number of people believed to be in modern slavery is estimated at 40 million. Given the magnitude of the problem, leadership from governments is clearly needed, but decisive action by businesses is also called for. Forced labor is the largest sub-category under modern slavery, accounting for 25 million workers, most of whom are in Asia and the Pacific. Of those in forced labor, some 16 million work in the private sector and over 4 million are under state-imposed conditions. Businesses may be connected to these abuses, especially in poorly regulated supply chains where rights can mean little.

Under the UN Guiding Principles on Business and Human Rights, investors and portfolio companies have responsibilities to respect human rights and address their related impacts. There are growing reasons why this makes good business sense. Firstly, several countries are recognizing the need to move away from a voluntary approach on business and human rights rights. Foremost amongst these is the recently announced EU regulatory proposal on mandatory corporate human rights due diligence. The initiative is in its early stages, but it is envisioned that the draft proposal will include sanctions for non-compliance. Secondly, companies could find themselves excluded from public sector contracts. The Principles to Guide Government Action to Combat Human Trafficking in Global Supply Chains is an initiative that the US, UK, Canada, Australia and New Zealand endorsed in 2017. With a combined central government spend of USD 600 bn, these countries have committed to eliminate slavery from their economies. Companies could therefore lose out on government outsourcing opportunities if they fail to manage these impacts.

Thirdly, recent landmark rulings in the Supreme Courts of Canada and the UK could trigger more litigation brought against parent companies for harm caused by their foreign subsidiaries or third parties. These cases underscore the need for robust due diligence to avoid allegations of complicity in violations of workers’ and communities’ rights. In doing so, businesses will be better placed to avoid potential liabilities.
Fourthly, reputational damage from human rights mismanagement can inflict severe losses on businesses. The stock price of UK fast-fashion retailer, Boohoo, almost halved following allegations of exploitative working practices and concerns of modern slavery. Arguably, the warning signs went unheeded for years by Boohoo.

Lastly, the Australian Modern Slavery Act requires investors to report on modern slavery risks in their portfolios. Australian asset owners will likely expect asset managers, both in Australia and overseas, to integrate modern slavery risks into their investment strategies. In this way, the Act will impact investors beyond Australia.

WHAT?
The above developments illustrate the need to better align good business practice with robust due diligence on human rights.

As part of this thematic engagement, Sustainalytics will engage with companies to implement strategies that are effective in addressing modern slavery-related risks. In particular, the engagement aims to ensure companies adopt:

- Measures that address root causes of modern slavery, e.g. fairer procurement practices and support for freedom of association and living wages.
- Rigorous due diligence procedures that are effective in identifying concerns, especially beyond first-tier suppliers.
- Steps that leverage the insight of worker experience and expert stakeholder opinions.
- Improved disclosure of actual and ‘near misses’ of modern slavery cases. This can help increase knowledge sharing and drive more effective responses.

HOW?
The engagement will target approximately 20 companies from two industries with the greatest share of forced labor: construction and manufacturing (e.g. apparel, medical supplies, electronics). Depending on the interests and holdings of participating investors, Sustainalytics can also consider a geographical angle.

To measure progress and engagement impact, a set of KPIs and sub-indicators will be applied. Sustainalytics has identified five KPI areas to track progress and compare developments within the target group:

- Governance and reporting
- Risk and impact assessment
- Commercial terms and procurement practices
- Pay and recruitment
- Worker voice and stakeholder engagement

Investors will be invited to participate in regular conference calls with companies. Sustainalytics will provide ongoing updates as well as bi-annual reporting on KPI progress. Reflecting the need for concerted efforts to tackle the root causes, this engagement will also leverage the knowledge of relevant experts.

FOR FURTHER INFORMATION PLEASE CONTACT:

Anita Nagarajan
Associate Director, Stewardship
anita.nagarajan@sustainalytics.com
Climate change poses a severe threat to people and the planet and demands an accelerated transition towards a low-carbon economy.\(^1\) Cleantech\(^2\) can play a significant role in enabling this transition, and the sector has already seen strong growth in recent years. For example, renewable power capacity is set to expand by 50 per cent within the next five years, led by solar photovoltaic (PV) and onshore wind technology.\(^3\) Similarly, announcements by automobile manufacturers and major investments in production expansion of vehicle batteries confirm the escalating momentum for the electrification of transport.\(^4\)

However, while being a vital part of the response to climate change as well as other economic and societal needs, the growing supply of cleantech products also entails environmental and social challenges within the various processes across the value chain. Besides maximizing the benefits of their products, companies should therefore address the challenges at mining sites, in factories, and during and after product use. Tackling this is vital to securing a transition that is not only timely but also holistically sustainable.

By encouraging and enabling the cleantech industry to grow in a more responsible manner, investors can contribute to multiple Sustainable Development Goals (SDGs)\(^5\) by boosting positive environmental and social impacts as well as mitigating negative ones.

**WHY?**

Increased investment in cleantech is essential to meet the climate and energy-access ambitions set out in the Paris Agreement and the SDGs. At the same time, the rapidly growing demand for these products poses new environmental and social challenges:

- Just like the products it aims to replace or make more efficient, cleantech requires space and natural resources. Companies have a responsibility to respect local communities’ human rights and consider the environmental impacts in and around sites where raw materials are sourced, products made and/or renewable energy generated.
- Similarly, the cleantech supply chain relies on human resources. The labor rights of workers in mines and factories need to be respected, including healthy and safe working conditions, freedom of association and collective bargaining, and avoidance of child labor and forced labor.
- Recycling of products such as solar PV panels, wind turbine blades and vehicle batteries has received much less attention than the upside benefits of these technologies. It is advantageous to promote circular\(^6\) business models for recovering materials when products reach the end of their lifecycle.

For responsible investors looking to foster improved production and sourcing practices, contribution to the SDGs and expanded corporate disclosures, the need for a more responsible cleantech industry is evident. Without addressing the environmental and social challenges in the underlying processes and throughout the entire value chain, responsible investors may face scrutiny for too loosely labeling cleantech stocks as positive impact investments. Furthermore, the challenges emerging from the rapid growth of the cleantech industry are similar to those in more established value chains that the industry is bound to replace, indicating that these problems will remain if not properly managed. It is squarely in the interest of both companies and their investors to be prepared, as failure to respect the environment and human rights can result in reputational and financial damages, and sometimes even operational disruptions. A proactive approach to managing ESG risks and opportunities throughout the product lifecycle may also yield competitive advantage, as well as a more balanced alignment with the SDGs.

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1. Even if irreversible tipping points in the climate system are surpassed, it remains critical to decarbonize the global economy in order to prevent negative impacts from escalating further and becoming entirely unmanageable.
2. The term cleantech is used to refer to an investment asset class as well as products and services that reduce negative environmental impacts through the sustainable use of resources, energy efficiency improvements, or environmental protection activities.
3. Source: IEA Renewables 2019
4. Source: IEA Global EV Outlook 2019
6. “A circular economy entails gradually decoupling economic activity from the consumption of finite resources and designing waste out of the system. Underpinned by a transition to renewable energy sources, the circular model builds economic, natural, and social capital” (source: The Ellen MacArthur Foundation)
WHAT?

The objective of this investor engagement is to instigate a holistic approach to assessing and managing ESG risks associated with cleantech development. This engagement contributes to the achievement of Sustainable Development Goals such as Affordable and Clean Energy (SDG 7), Decent Work and Economic Growth (SDG 8), Industry, Innovation and Infrastructure (SDG 9), Responsible Consumption and Production (SDG 12) and Climate Action (SDG 13).

Considering where business growth is strongest, as well as relevance for the transition towards a low-carbon economy, we will engage with companies that manufacture wind turbines, solar PV panels, electric vehicles and/or vehicle batteries.

Given the benefits of robust environmental and human rights management, the engagement seeks enhanced corporate measures and disclosures with respect to, for example, how raw material inputs are produced; how the product is manufactured; and how products can be recycled after use.

HOW?

The engagement will target up to twenty companies that manufacture wind turbines, solar PV panels, electric vehicles and/or vehicle batteries, based on Sustainalytics’ assessment of the corresponding risk and opportunity perspectives and engagement potential. The ultimate selection also considers the interests and holdings of participating investors.

We will score companies against KPIs that address environmental, social and governance aspects in the following areas:

1. Governance
2. Operational risk management
3. Supply chain risk management
4. Circularity
5. Stakeholder engagement

The engagement program will last three years and Sustainalytics will provide biannual reporting. This will include an analysis of external developments in the field, how companies are responding to engagement, and an update on the progress the companies are making against the KPIs and engagement goals.

FOR FURTHER INFORMATION PLEASE CONTACT:

Joris Laseur
Associate Director, Stewardship
joris.laseur@sustainalytics.com
TAXATION 2.0

There has been an increasing focus on business taxation and ‘companies paying their fair share’ in recent years. A number of high-profile cases include Amazon's, Google's and Starbucks’ tax structures that helped them to avoid paying tax in the UK despite reporting high profits, as well as the Panama Papers and Paradise Papers leaks. As a result, aggressive tax planning and avoidance is increasingly under scrutiny by governments, investors, media and NGOs, with many taking steps to regulate against such behavior. Examples include the OECD’s work on Base Erosion Profit Sharing (BEPS)1 and the EU’s recent proposal in its Accounting Directive for country-by-country reporting of tax paid in different jurisdictions by public interest entities2. In the US, the tax reform referred to as the Tax Cuts and Jobs Act (TCJA) from 2017 has reduced the statutory tax rates from 35 to 21 per cent and created a new repatriation tax. We will be engaging with a number of companies to encourage them to approach tax as a governance and risk management issue and to ensure that companies have an appropriate tax policy in place to preserve and sustainably grow shareholder value.

The engagement will focus on creating awareness among companies around the investor interest in taxation, and therefore centres more on tax avoidance than tax evasion, which is illegal.

WHY?

Aggressive corporate tax planning and avoidance is problematic because:

• It can cause economic and societal distortions and perpetuate inequality: Tax payments from corporates are an important revenue stream for governments in both developed and developing countries. These payments enable governments to provide investment in infrastructure and social programs, such as healthcare, education and research, which in turn can benefit the companies themselves. The European Union estimates that it loses EUR 50-70 billion in tax revenues each year due to the corporate income tax avoidance3. Furthermore, aggressive tax planning can distort competition in markets by providing an unfair advantage for those with cross border operations (who can shift profits to avoid paying taxes in jurisdictions with higher tax rates) over those with only domestic operations.

• It can create corporate governance risks: Companies that attempt to aggressively minimize their tax bill can be subject to strategic and earnings risks, as those that are overly reliant on tax planning rather than organic growth are more exposed to changes in tax regulation and the approach of tax authorities. This can leave them open to tax authority investigations and penalties; criminal penalties; increased legal and compliance costs; delays to mergers; loss of key projects; loss of the ability to tender for government projects; requirements to restructure their organizations (such as the location of subsidiaries); effective tax rate volatility and more. Furthermore, certain remuneration structures could inadvertently incentivize management to focus on minimizing tax paid, such as including a metric on earnings after tax in a short-term incentive plan.

• It can damage corporate reputation: Increased media and public attention on tax can negatively impact companies’ share price by damaging their corporate and brand reputation. Whilst companies may be complying with rules in terms of tax planning, many view the amount of tax paid subjectively, as a moral and ethical issue, rather than one that is purely compliance based. As a result, companies subject to consumer boycotts over their tax arrangements could have millions wiped off the value of their company. The UK Reputation Dividend Report indicates that 38 per cent of the market value of the FTSE 100 is attributable to reputation4. In the US, corporate reputations are contributing USD 4,561 billion of shareholder value across the S&P 500, 20 per cent of the total market capitalization5.

• It can lead to expensive fines and other payments. In one example, the European Commission ordered Apple to pay EUR 13 billion, plus interest, in unpaid Irish taxes from 2004–14 to the Irish state6. Generally, both the EU and individual countries are more determined to crack down on companies regarding taxation issues.

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1 https://www.oecd.org/tax/beps/
6 https://ec.europa.eu/competition/state_aid/cases/253200/253200_1851004_674_2.pdf
WHAT?
This engagement will run for three years and focus on approximately 20 companies in the technology and pharmaceutical sectors. Taxation presents a material risk to companies in these sectors, which tend to be highly mobile industries that operate cross border and have a global reach. The engagement is based on a baseline assessment conducted in early 2020, after which Sustainalytics reaches out to the selected companies, based on the gaps we have identified between their current policies and practices on tax and the best practice examples.

Our key objective in conducting this engagement is to encourage companies to approach tax as a corporate governance and risk management issue.

With this focus we want to:
• Improve companies’ awareness of investor interest in corporate taxation.
• Engage on strategies to improve transparency around tax policies, reporting and governance.
• Encourage participation in multi-stakeholder collaboration to create conditions conducive to a fair and well-functioning market.
• Strengthen the role of investors as a stakeholder in integrated responses to tax-related risks and opportunities.

This engagement supports investors in better understanding how investee companies can proactively manage corporate taxation as a governance issue. This will contribute to the achievement of the Sustainable Development Goals (SDGs), most importantly the SDG on Peace, Justice and Good institutions (SDG 16).

HOW?
To measure progress and ultimately the engagement impact, a set of key performance indicators (KPIs) indicators will be applied. Five KPI areas have been identified to track progress and to assess developments:
• Transparency – Has the company published its approach to tax? Are tax risks discussed in its disclosures? Is the company preparing for country-by-country reporting? If so, how?
• Tax Oversight – Does the board discuss tax-related issues? What is the organizational structure of the tax strategy and tax compliance functions?
• Tax Evasion – How is tax evasion managed? Does the company report subsidiaries’ locations?
• Effective Tax Rates – How does the company’s two-year average effective tax rate compare to other large corporations? Does the company explain how it reached its effective tax rate?
• Management History – Has the company had any tax-related controversies in the past five years? Were the controversies related to ongoing tax litigation or accusations of tax evasion?

The engagement program will run from Q1/2020 until the end of Q4/2022. Investors will be invited to participate in conference calls with the selected companies. Apart from the ongoing updates on the client platform, Sustainalytics will provide biannual reporting on how companies are responding to the engagement and the progress they are making against the KPIs.

FOR FURTHER INFORMATION PLEASE CONTACT:

Mihnea Gheorghe
Manager, Stewardship
mihnea.gheorghe@sustainalytics.com
WHY?
A decade of intensifying stewardship has shown that leadership as provided by the board of directors is critical for the company. Technology is a prime example of the rapid changes and uncertainties requiring boards to constantly assess available options and drive decisive action; companies need to stay current to remain attractive and competitive. Risks are changing too; some are brought by progress, such as cyber-criminality or anti-microbial resistance, others have always been around, such as fraud or corruption, only to manifest themselves in more sophisticated ways. Financial returns remain essential, but not at any cost, for investors who increasingly express their discontent via class actions or support for shareholder proposals at companies’ annual meetings.

Today’s companies need to be more virtuous, more responsive, more in tune with society’s priorities such as equality, a clean environment, and a better future. In short, today’s companies need to be sustainable. They need to marry sound financial practices with solid Environmental and Social policies and a performing Governance (ESG). The board of directors is the forum where these constraints and realities are debated. It must therefore adapt, remain in tune with all stakeholders’ expectations and ensure that it can respond to the present’s challenges while considering future risks and opportunities.

WHAT?
This engagement aims to establish a dialogue with companies with the view of encouraging them to understand and prepare today for the challenges that their boards will face tomorrow. Sustainalytics has identified four areas in which we feel change is particularly essential.

First of all, the board needs to change its nature. It must still be the forum where the business strategy is debated and decided, but this mandate should be expanded to incorporate the reflection on emerging risks and opportunities, and stakeholders’ demands and expectations. Its composition should be diverse – in skills, experience, gender and background, to name a few – reflecting society’s requirements as much as it is a sound business decision. The board should be equipped with a process to evaluate its effectiveness and to communicate the results of that assessment.

Secondly, the board needs to promote itself as the moral conscience of the company as it ensures that all laws, rules and regulations are observed. It gives the impulse to enhance or implement policies that demonstrate the company’s righteousness, be they to prevent corruption, bribery or other lapses. This includes the board needing to consider ethical and environmentally sound practices. By its decisions on what is acceptable or not inside the company, the board will shape a sound, forward-looking and effective corporate culture.

Thirdly, the board will need to think beyond existing markets, technology and products. Indeed, tomorrow’s company will need to be efficient in the way it identifies and manages both immediate and long-term ESG risks and opportunities. The board has a time horizon and leeway that the executive team does not. It will need to call on advice and identify trends to avoid the most dangerous risks (e.g., taxation, scarcity of resources, litigation) and benefit from emerging opportunities (such as better technology, new markets and products).

Finally, the newest, rapidly evolving function of the board relates to engagement, mutually beneficial exchanges with not only shareholders but all stakeholders. The board can learn from civil society, responsible investors and consumers what is expected of the company. It can in return explain the company’s choices and how they contribute to the Sustainable Development Goals (SDGs), for example. Furthermore, the board will need to proactively engage with lawmakers, regulators and trade groups if it wants to shape its operating environment rather than feel its burden.

Associated SDGs are Decent Work and Economic Growth (SDG 8), Industry, Innovation and Infrastructure (SDG 9), Responsible Consumption and Production (SDG 12).
HOW?

The goal of this engagement is to raise awareness of the issues the company board is currently facing and to support those we engage with to start the process of preparing themselves for tomorrow’s challenges.

This engagement will run for three years and focus on approximately 20 companies in the financial services, pharmaceutical and extractives sectors.

These sectors have been under scrutiny by the public and activists alike. Finance needs to reform itself following numerous scandals and decide on how it supports controversial activities. Pharma faces, among others, the ethical challenge of supplying new remedies at affordable prices while remaining financially viable. It equally needs to address the issue of ever-resistant organisms resulting from an unreasonable use of antibiotics. Extractive sector companies must think about their survival, no less, in a world that is compelled to tackle emissions in a drastic way. They also need to prove that the process of extracting resources from the earth preserves the safety and dignity of those who work and does not harm the environment.

We suggest selecting two virtuous companies in each sector, with whom Sustainalytics has already been interacting or which we know to be leaders in their approach to governance. Five companies per sector will be added, where we believe improvements are essential and we can effect change.

We have identified four KPIs to measure and track progress throughout the engagement and to compare developments within the target group:

1. Implementation: Establishment of a structure, possibly a board committee, tasked with debating sustainability on an ongoing basis and overseeing the related efforts.

2. Definition: Developing a sustainability strategy that is clearly integrated in the company’s documents defining its vision and goals.

3. Measurement: Definition of metrics aimed at measuring the company’s progress against its sustainability goals.

4. Communication: Creating a clear and regular communication process to report on the company’s progress.

Sustainalytics will provide bi-annual reporting over the scheduled three years. This will include an analysis of external developments in the field and how companies are responding to engagement, including an update on the progress they are making against the KPIs and the engagement goal of preparing their boards for the future.

FOR FURTHER INFORMATION PLEASE CONTACT:

Josiane Fanguinovery
Director, ESG Products, Stewardship
josiane.fanguinovery@sustainalytics.com

Folorunsho Atteh
Manager, Stewardship
folorunsho.atteh@sustainalytics.com
# U.N. Sustainable Development Goals

### Child Labor in Cocoa
- **Goal 1**: No Poverty
- **Goal 2**: Zero Hunger
- **Goal 4**: Quality Education
- **Goal 8**: Decent Work & Economic Growth
- **Goal 10**: Reduced Inequalities

### Climate Change – Sustainable Forests and Finance
- **Goal 12**: Responsible Consumption & Production
- **Goal 13**: Climate Action
- **Goal 15**: Life on Land
- **Goal 17**: Partnerships for the Goals

### Feeding the Future
- **Goal 2**: Zero Hunger
- **Goal 6**: Clean Water & Sanitation
- **Goal 12**: Responsible Consumption & Production
- **Goal 13**: Climate Action
- **Goal 14**: Life Below Water
- **Goal 15**: Life on Land

### Governance of SDGs
- **Goal 1**: No Poverty
- **Goal 2**: Zero Hunger
- **Goal 3**: Good Health & Well-being
- **Goal 4**: Quality Education
- **Goal 5**: Gender Equality
- **Goal 6**: Clean Water & Sanitation
- **Goal 7**: Affordable & Clean Energy
- **Goal 8**: Decent Work & Economic Growth
- **Goal 9**: Industry, Innovation & Infrastructure
- **Goal 10**: Reduced Inequalities
- **Goal 11**: Sustainable Cities & Communities
- **Goal 12**: Responsible Consumption & Production
- **Goal 13**: Climate Action
- **Goal 14**: Life Below Water
- **Goal 15**: Life on Land
- **Goal 16**: Peace, Justice & Strong Institutions
- **Goal 17**: Partnerships for the Goals

### Human Capital and the Future of Work
- **Goal 4**: Quality Education
- **Goal 5**: Gender Equality
- **Goal 8**: Decent Work & Economic Growth
- **Goal 9**: Industry, Innovation & Infrastructure
- **Goal 10**: Reduced Inequalities
- **Goal 16**: Peace, Justice & Strong Institutions

### Localized Water Management
- **Goal 6**: Clean Water & Sanitation
- **Goal 9**: Industry, Innovation & Infrastructure
- **Goal 12**: Responsible Consumption & Production
- **Goal 13**: Climate Action

### Human rights accelerator
- **Goal 1**: No Poverty
- **Goal 5**: Gender Equality
- **Goal 8**: Decent Work & Economic Growth
- **Goal 10**: Reduced Inequalities

### Modern Slavery
- **Goal 5**: Gender Equality
- **Goal 8**: Decent Work & Economic Growth
- **Goal 10**: Reduced Inequalities

### Responsible Cleantech
- **Goal 7**: Affordable & Clean Energy
- **Goal 8**: Decent Work & Economic Growth
- **Goal 9**: Industry, Innovation & Infrastructure
- **Goal 12**: Responsible Consumption & Production
- **Goal 13**: Climate Action

### Taxation 2.0
- **Goal 1**: No Poverty
- **Goal 8**: Decent Work & Economic Growth
- **Goal 10**: Reduced Inequalities
- **Goal 16**: Peace, Justice & Strong Institutions

### Tomorrow’s Board
- **Goal 8**: Decent Work & Economic Growth
- **Goal 9**: Industry, Innovation & Infrastructure
- **Goal 12**: Responsible Consumption & Production
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 more than 25 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 16 offices globally, Sustainalytics has more than 1,000 staff members, including more than 350 analysts with varied multidisciplinary expertise across more than 40 industry groups. For more information, visit www.sustainalytics.com.