Secretariat Briefing Paper 1

FINANCIAL SECTOR COMPLIANCE TO ADDRESS MODERN SLAVERY AND HUMAN TRAFFICKING

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LIECHTENSTEIN INITIATIVE

FOR A FINANCIAL SECTOR COMMISSION ON MODERN SLAVERY AND HUMAN TRAFFICKING

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ABOUT THE BRIEFING PAPER SERIES

This is the first of three Briefing Papers that the Secretariat will provide to the Financial Sector Commission on Modern Slavery and Human Trafficking. The Briefing Papers are intended to provide a starting-point for Commissioners ahead of their deliberations. The aim is to provide a common base of information, and to point to issues Commissioners may wish to address and some of the solutions they may begin to consider.

This first paper, available prior to the first meeting in New York on 20-21 September 2018, provides a basic introduction to the ways in which the financial sector encounters and relates to modern slavery, forced labour and human trafficking, and considers the compliance issues raised for different actors in the sector. These include anti-money laundering and counter-terrorist financing (AML/CFT) compliance concerns; and compliance with emerging anti-slavery supply chain transparency frameworks.

The second Briefing Paper will be available prior to the second meeting in Liechtenstein on 21 January 2019. It will focus on responsible lending and investment practices, exploring what guidance, tools and solutions are available to financial sector actors seeking to lend and invest in ways that reduce modern slavery and human trafficking risks.

The third Briefing Paper will be available prior to the third meeting in Australia in the second quarter of 2019. It will address financial innovation to prevent modern slavery and human trafficking, including innovation around inclusion, financial instruments and investments models, and technology.

INTRODUCTION

In September 2015, 193 Member States of the United Nations pledged to take immediate and effective measures to end modern slavery, forced labour and human trafficking by 2030, as one step in the UN's Agenda for Sustainable Development.[1] Soon after, the United Nations Security Council declared that human trafficking connected to conflict situations may threaten international peace and security,[2] and drew attention to the resulting risk of money-laundering and terrorist financing. The Security Council underlined the role of financial institutions, Financial Intelligence Units (FIU) and the Financial Action Task Force (FATF) in detecting and disrupting financial flows associated with this crime and encouraged the creation of public-private partnerships to this end. These risks have also been highlighted by both G-7 and G-20 leaders, who have underlined the importance of states and business working together to scale up action to end these crimes.[3]

The Liechtenstein Initiative for a Financial Sector Commission on Modern Slavery and Human Trafficking responds directly to these calls, and to calls from regulators and the sector for the formation of a multi-stakeholder working group, to drive forward knowledge and action.[4] Made up of leaders from the financial sector, regulators, survivors, non-governmental organizations and other stakeholders, the Commission will develop ideas for action by the global financial sector to combat modern slavery and human trafficking.

Public and private institutions in the financial sector can come into contact with modern slavery and human trafficking in various ways. Financial institutions may handle funds generated by or associated with these practices, as traffickers move proceeds illicitly generated through modern slavery and human trafficking into the formal sphere. The proceeds of modern slavery and human trafficking may also simply look like legitimate business revenue, where the illicit conduct is occurring within an otherwise legitimate operation. Financial institutions may also provide financial goods or services to, or otherwise be directly linked to, businesses or activities associated with modern slavery, forced labour and human trafficking. This Briefing Paper explains what is known about these risks, the compliance regimes that are emerging to address these risks, and the opportunities available to the financial sector to scale up action.

1. FINANCING AND BANKING MODERN SLAVERY AND HUMAN TRAFFICKING

Slavery and human trafficking are not new phenomena. Before these practices were formally prohibited, human bodies and labour provided lucrative sources of capital, and the trade in human beings was intimately linked to the financial sector.

While chattel slavery was permitted in the Americas and Western Europe, slaves offered important loan collateral throughout the Western financial system.[5] In some cases, such as defaults, this meant that banks became slave-owners and slave-traders.[6] Financial institutions on both sides of the Atlantic provided supply chain credit crucial to slavers' operations, helping them weather the cashflow stress implicit to the trade given the long gap between the initial capital outlays and expenses to fit-out or charter a vessel in Europe and to purchase slaves in Africa, and the final receipt of revenues from the sale of the slaves in the Americas, or commodities such as rum and American manufactures in Europe. Supply chain financing solutions were crucial to the industry's ability to operate.

Financial sector innovation was also crucial to the final abolition of chattel slavery in the UK. The implementation of abolition was only possible because of the arrangement in 1834 of what was then the largest syndicated loan in history, to the British government, to finance compensation packages – not to the slaves, however, but to the powerful slave-owners. The loan was worth a staggering 40 per cent of Britain's national public expenditure at the time. The last interest on this loan was only finally repaid in 2015. The Centre for the Study of the Legacies of British Slave-ownership explores *Some Potential Lessons from the British Financial Sector's Role in Perpetuating and Ending Chattel Slavery* in a companion paper prepared for the Commission.

Today, of course, slavery and human trafficking are illegal. 'Chattel' slavery, in which a person is formally recognized by the law as property, does not officially exist. *Slavery* – the exercise of the powers of ownership over another person – is in fact subject to the strongest kind of ban known to international law: it is illegal at all times, in all places, without any exception whatsoever.[7] Strong bans also prohibit: *forced labour* – which refers to situations in which persons are coerced to work through the use of violence or intimidation, or by more subtle means such as accumulated debt, retention of identity papers or threats of denunciation to immigration authorities;[8] and *human trafficking* – which refers to the recruitment, movement and handling of people through coercion, deception or abuse of power, or payment of someone controlling them, for the purpose of exploitation (forced labour, commercial sexual exploitation or organ trafficking).[9]

These bans in international law overlap, and are transposed into domestic law in a variety of ways. Yet despite these official bans, these practices – even the exercise of control that *de facto* amounts to the exercise of the powers of ownership – remain astonishingly widespread, thought to touch almost every country on earth.[10] By the best available estimate, over 40.3 million men, women and children experienced one of these forms of exploitation in 2016 – 1 in every 185 people.[11] Proceeds from forced labour alone are estimated to generate over $150 billion annually.[12] It is the persistence of these practices, despite their formal abolition, that has led to increased reference to *modern slavery* – a non-legal umbrella term, encompassing several forms of severe exploitation, including forced labour, forced marriage, servitude, debt bondage and human trafficking.[13]

Modern slavery describes patterns of exploitation arranged in the gaps in the law and its enforcement, not on the solid ground of the law itself. It refers to the *de facto* hidden exploitation that our economic, legal and financial systems permit and acquiesce in, rather than a *de jure* system of chattel slavery in which people are formally treated as property. It takes myriad forms, from bonded labour in South Asian brick kilns to slave-like practices in Amazonian charcoal farms; from labour trafficking onto farms and nail salons in the US to sex trafficking from West Africa to Europe; from slavery on fishing vessels in South-East Asia to government-enforced labour in the cotton fields of Central Asia.

Modern slavery and human trafficking arise out of weaknesses in legal protections and their enforcement, so it is unsurprising that vulnerability to slavery and trafficking tracks broader socio-economic inequalities. Risks are broadly higher in poor and developing countries than in wealthier, developed countries. They are higher for marginalized and excluded groups, including women, girls, low-caste individuals, refugees, those displaced by disaster and conflict, and migrant workers. And risks are higher for low-skilled workers than skilled workers, for those with lower education levels – and the unbanked and those facing financial vulnerability, due to unexpected one-off financial burdens such as sickness, weddings or funerals.[14]

Understanding that modern slavery occurs *despite* formal prohibition is crucial to understanding how the financial sector is exposed to it – and may help to promote it, or to prevent and remedy it. The formal abolition of slavery means that our economic system no longer treats people as capital. Instead, our structures sometimes informally promote practices that render people akin to commodities or, as Professor Kevin Bales put it, "disposable people".[15] Strong incentives in the global political economy encourage the externalization of risk down long value-chains, often onto those most vulnerable. When the labour practices used to extract value from vulnerable workers involve violence, intimidation, coercion, fraud, abuse of power or the exercise of the powers of ownership, this may amount to forced labour, human trafficking or modern slavery.

Modern slavery and human trafficking thus raise two major questions for the financial sector:

1. first, is the sector doing all it can to comply with legal requirements intended to prevent, disrupt and remedy modern slavery and human trafficking, including anti-money laundering, counter-terrorist financing and anti-slavery-specific reporting and compliance regimes? The better that these regimes are enforced, the lower the risk of modern slavery and human trafficking.

And

2. second, going beyond compliance, is the sector doing all it can to identify and reduce the modern slavery and human trafficking risks to people generated by its own business practices, and the practices of the businesses, organizations and individuals it supports and serves?

The remainder of this Briefing Paper focuses on the first of these questions. The second Briefing Paper will turn to the second question, exploring how to identify and reduce risks to people. The third Briefing Paper will explore new innovations in financial instruments, inclusion and technology that may help the financial sector address both questions.

2. PATTERNS OF INTERACTION

Precisely because modern slavery and human trafficking are illicit and hidden, we need to understand how the financial sector's practices intersect with the phenomena, if the sector is to improve its management of risks – whether to business or to people. Modern slavery and human trafficking manifest in different ways in different sectors and at different points in the value-chain, depending on what loopholes and vulnerabilities are available to be exploited.

Modern slavery and human trafficking risks may arise in non-commercial contexts (for example through forced marriage, domestic servitude, or in conflict contexts) and at multiple points along commercial value-chains:

- raw materials are often mined, harvested, fished and extracted in harsh and poorly regulated conditions;
- manufacturers are often forced by buyers to show maximum flexibility on deadlines and orders, and at the same time to reduce labour costs, in some cases creating extreme pressure on working conditions;
- transporters, suppliers and distributors may impose a range of logistical, health and safety and other operational risks on workers; and
- workers themselves often face trafficking and bondage risks in working with labour brokers and employment agencies to find employment, often overseas.

These factors combine in different ways along global value chains. In low-income countries, exploitation is particularly prevalent in sectors that are labour-intensive, and rely on migrant or seasonal labour, such as agriculture, extractives and construction. In high-income countries, modern slavery and human trafficking may occur in other sectors, such as entertainment, domestic care and personal services. Financial sector actors face a variety of different risks depending on their role in financing and banking the businesses, organizations and households involved.

Typologies

Researchers have begun developing national typologies of modern slavery and human trafficking. In the United States, Polaris, which runs the national anti-trafficking hotline, has used case data to identify 25 types of human trafficking and modern slavery.[16] And in the UK, researchers from the Home Office have identified 17 distinct types of modern slavery.[17] Sectoral typologies and risk maps are also emerging. Verité has developed a Forced Labor Commodity Atlas – which highlights commodities that are linked to human trafficking and modern slavery in global supply chains, such as cocoa, palm oil, sugar and cotton[18] – and a related Responsible Sourcing Tool.[19] The US Department of Labor provides a list of goods produced by child labour or forced labour,[20] and a *Sweat and Toil* app. Other organizations have mapped risk in palm oil,[21] food and beverage,[22] apparel and footwear,[23] and leather[24] supply chains.

In the financial sector, national, regional and global regulatory actors have published typologies based on existing financial sector reporting, perhaps most notably the Financial Action Task Force and Asia Pacific Group on Money Laundering joint report on *Financial Flows from Human Trafficking* in July 2018, which includes numerous real life case studies.[25] These typologies have drawn attention to the role that cash couriers, straw men and cash-intensive businesses typically play in human trafficking networks. In the US

and Europe, Thomson Reuters Foundation has worked with a number of commercial and retail banks to develop indicators and a toolkit that banks can use to improve risk identification, both through transaction data analysis and through training bank tellers to identify victims and those at-risk. As yet, however, many of these analytical frameworks remain largely untested in the field, and newer data analysis techniques – such as machine learning and natural language processing – are only just beginning to be applied to this problem set.

Working with survivors to strengthen risk analysis

The fact that these typologies have been built using self-reported data of courses raises a question about sample bias: has the sector been looking for the right things?

The recent FATF/APG report, *Financial Flows from Human Trafficking,* for example, notes that the analysis to date has uncovered patterns primarily at the level of interaction between the sector (especially banks) and victims, rather than at higher levels of trafficking organizations.[26] Survivor experiences may, however, be useful in helping financial sector actors understand where it interacts with or facilitates exploitative businesses. This is the approach that underpins emerging partnerships such as *Project Protect* in Canada, a public-private partnership between regulators, financial institutions, law enforcement and others that works to strengthen understanding of human trafficking among member institutions and to increase relevant reporting to the national financial intelligence unit (FIU), FINTRAC/CANAFE.[27]

Survivor experiences also underpin an important new analysis in the US from Polaris.[28] Drawing on over a decade of national hotline case data, supplemented by further research, Polaris mapped 22 different types of trafficking experienced in the US against six different types of financial services (personal banking, business banking, credit and debit cards, money service business, retail check cashing, and payroll), exploring the sector's role in recruitment, trafficking operations, and the maintenance of control over victims. The analysis also considers the sector's role in remedying harms done to survivors – including ensuring survivors' past association with trafficking does not lead to them being denied financial services. The study points to various patterns in the ways that the financial sector intersects with modern slavery and human trafficking, such as:

- handling, and lending migrant workers money to pay, improper recruitment fees;
- lending funds for visa purchases to people that, upon arrival in the US on those visas, are forced into commercial sexual exploitation;
- operating credit cards, debit cards, and bank accounts in the name of victims of commercial sexual exploitation that are in fact controlled by recruiters and managers;
- operating automatic teller machines (ATMs) on entertainment and service business premises (nail salons, massage parlours) that are in fact engaged in slavery and sex trafficking;
- facilitating transfers from illicit massage businesses to related businesses (restaurants, grocery stores, dry cleaners) which are used to launder the proceeds of crime; and
- operating the conversion of virtual currencies such as Bitcoin, used in illicit commercial sex businesses, to fiat currency.

Weak analysis of the financial footprint of global labour exploitation

Another issue that emerges from existing analyses is that to date reporting entities have struggled to identify cases involving labour exploitation, rather than commercial sexual exploitation, because of the difficulty of identifying proceeds of labour exploitation commingled with legitimate business revenue.[29] The risk is that the indicators and tools that are emerging, based on datasets skewed towards commercial sexual exploitation, may direct the attention and resources of financial institutions towards those crimes, and leave modern slavery and human trafficking involving forced labour unseen.

Polaris notes that

> *The fractured nature of the labor supply chain… makes it difficult to see a comprehensive picture of the finances of all parties associated – especially when each entity in the chain may utilize different financial institutions… red flag indicators of labor trafficking are so elusive that bank investigations rarely advance far enough to warrant a [request for information from other financial institutions under section 314B of the USA PATRIOT Act] … As AML professionals pioneer new ways to overcome barriers to detecting labor trafficking through financial activity, it would be wise to focus on industries like agriculture that employ large numbers of foreign national low-wage workers, have non-unionized workforces, and/or utilize labor contractors rather than direct hire workers. All of these factors are associated with structural issues that make workers vulnerable to trafficking [as is reliance on employer-tied visas].*[30]

Polaris points to a range of potential labour trafficking indicators that may need to be researched and incorporated into existing guidance and toolkits;[31] and the recent FATF report also provides some insights on financial patterns specific to human trafficking for forced labour.[32] Yet most of this analysis has focused, to date, on transactions intersecting with financial institutions primarily in developed countries. There may be less coverage of – and learning from – the experience of, for example, victims of bonded labour in South Asia, victims of slave-like practices in Brazil, or migrant workers in the Gulf. New risk analysis tools and methods may be needed to better understand how modern slavery and human trafficking intersect with the remittance sector, money service businesses, and microcredit organizations in those contexts. We explore this question further later in the Briefing Paper.

Similarly, the existing financial sector typologies have drawn heavily on anti-money laundering and counter-terrorist financing (AML/CFT) reporting. As we discuss in the next section, this plays an important role in fighting modern slavery and human trafficking. But it also means that this analysis has largely focused on how the financial sector handles proceeds of modern slavery and human trafficking – and has therefore focused on retail banking, credit card transactions and money service businesses. That risk analysis has not yet been connected up to analysis of the ways in which the financial sector may, through lending and investment, facilitate the commission of modern slavery or human trafficking in the first place. However, as we see in later sections of this paper, new reporting and due diligence frameworks are beginning to push the sector in this direction.

3. ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING (AML/CFT) REGIMES

One regulatory regime that has already proven significant in the sector's efforts to understand and manage modern slavery and human trafficking risks is the anti-money laundering and counter-terrorist financing (AML/CFT) regime. Most jurisdictions require that financial service providers take due diligence ('Know Your Customer' or KYC) and reporting steps intended to prevent laundering of funds arising from or associated with certain types of crimes, or terrorism.[33] In the US, for example, these obligations apply to banks, securities and commodities firms (brokers/dealers, investment advisers, mutual funds, hedge funds, commodity traders), money service businesses (check cashers, forex dealers, prepaid access card providers, postal services), insurance companies, credit card system operators, certain commodity dealers, pawn brokers, casinos, and in some cases other non-bank financial institutions.

Even where jurisdictions do not specifically identify modern slavery, forced labour and human trafficking as predicate crimes to which AML/CFT obligations attach, in most cases slavery and trafficking meet the relevant threshold criteria. Both modern slavery and human trafficking are "crimes of crimes": the conduct that constitutes slavery, forced labour or human trafficking will almost always amount to some other crime – such as assault, fraud, bodily harm or kidnapping. A survey by Clifford Chance and LibertyAsia of 18 jurisdictions worldwide found that human trafficking would be a predicate offense in all of them, though it was nominated as such in only some of them.[34] And CFT obligations may come into play where certain designated terrorist groups are involved in the trafficking, as ISIL and Boko Haram have been in the past.[35]

Compliance with these AML/CFT regimes is important to the fight against modern slavery and human trafficking in three ways: reporting, law enforcement and risk analysis. Financial intermediaries are obliged to report suspicious activity to national financial regulators (usually Financial Intelligence Units). These 'Suspicious Activity Reports' (SARs) or 'Suspicious Transaction Reports' (STRs) allow national regulators to work with law enforcement to disrupt modern slavery and human trafficking. Financial data can be a powerful evidentiary tool in securing justice for victims, not least because it can reduce prosecutors' reliance on victim testimony. SARs/STRs also allow the reporting entity to better understand its own risk exposure, by discharging its KYC obligations.[36] The resulting data holds significant potential not only for compliance and reporting but also for informing these entities' lending and investment practices, a point that will be explored further in the second Briefing Paper.

Nonetheless, effective use of AML/CFT regimes faces several obstacles.

KYC does not necessarily reveal modern slavery and human trafficking risk

Despite complying with existing KYC obligations, reporting entities may not, in fact, know their customers' exposure to modern slavery and human trafficking risks. Reporting entities may not be routinely looking for behaviours, practices or indicators of modern slavery and human trafficking, which may be buried in their customers' supply chains, or intermingled with legitimate business. Regulators can encourage reporting entities to pay attention to these issues by issuing formal advisories on identifying activity indicative of modern slavery and human trafficking (as the US, Canada and UK have),[37] through regular updates on the latest intelligence on modern slavery and human trafficking threats, or through requiring reporting entities to indicate on SARs/STRs whether the suspicious activity may be indicative of modern slavery or human trafficking – as is the case in Hong Kong.

New toolkits and indicators, such as those developed through the banking Alliances supported by the Thomson Reuters Foundation, may also help financial sector actors understand how to better know their customers.[38] And some financial institutions have started working with specialist anti-trafficking NGOs to conduct open source and media monitoring to strengthen their KYC systems. There may also be opportunities for financial service providers to integrate modern slavery and human trafficking considerations into their KYC processes, as part of their efforts to keep credit risk and capital costs low. This may help lower financial actors' costs: there is some evidence, already, of a correlation between a company's performance on environmental, social and governance (ESG) factors such as modern slavery and human trafficking, and its credit risk.[39] And there is a growing effort to incorporate ESG factors into KYC processes, including by the International Chamber of Commerce Banking Commission's Sustainable Trade Finance working group.[40]

To date, however these efforts have not been tailored to reflect state of the art knowledge on human trafficking and modern slavery risks.

The strength of risk analysis depends on the data available

Even if they actively look for slavery and trafficking risks, reporting entities may struggle to find reliable data and information, and to share the information they do find. Access to reliable information about the supply chains and business practices of their customers will be key.

A variety of audit firms, data providers and reporting frameworks has emerged to inform environmental, social and governance (ESG) investors on human rights risks.[41] Investors, especially on the private equity side, are also exploring new methods for sourcing and aggregating data, including from workers themselves, and from firms and NGOs working with vulnerable populations. Several efforts focused specifically on anti-slavery and anti-trafficking are of note:

- the Victim Case Management System developed by LibertyAsia, Salesforce and the US Department of State allows frontline anti-trafficking NGOs to organize, store, share and analyze case management records, in some cases with financial institutions;
- a UK-based NGO, Stop the Traffik, has worked with law enforcement, intelligence specialists and technology providers to create a platform generating intelligence-style products from large-scale anti-trafficking data aggregation;[42] and
- the Sustainability Incubator has developed a screening system that combines technology in existing platforms with the collection of industry data and authoritative human rights data to improve the visibility of slavery in seafood supply chains.[43]

But constraints on how financial sector actors share information with each other – intended both to protect the privacy of their customers, and to prevent cartel behaviour – as well as constraints on sharing information with regulators and law enforcement, continue to limit our understanding of risks for the financial sector.[44] Some jurisdictions have taken steps to facilitate information-sharing. In the US, sections 314 (a) and (b) of the USA PATRIOT Act allow two or more financial institutions to "share information with one another regarding individuals, entities, organizations, and countries suspected of possible terrorist or money laundering activities," and establish a safe harbor from liability that might otherwise arise from such information-sharing with peers.[45] In the UK, the Joint Money Laundering Intelligence Taskforce (JMLIT) brings together government actors, law enforcement

and financial institutions to share information to better understand and disrupt various crimes, including human trafficking and modern slavery.[46] Australia, Singapore and Hong Kong have also developed public-private financial information-sharing partnerships, and more than 20 jurisdictions have committed to doing so.[47] The Financial Action Task Force (FATF) has also issued guidance for information-sharing, providing guidance on how financial institutions can best implement FATF Recommendations 18, 20 and 21.[48]

Even with national information-sharing partnerships, however, borders hamper understanding the risks in global value-chains. Regulators face challenges in cross-border information-sharing, due to weaknesses in mutual legal assistance arrangements, data protection rules and banking secrecy frameworks.[49] There may be a need for multi-country financial information-sharing partnerships focused on modern slavery and human trafficking.

Over-zealous de-risking may be counter-productive

Financial institutions and other businesses that discover risks of modern slavery and human trafficking in their value chains may choose to "de-risk" – in other words, to terminate the relationship with the business partner in question. This does nothing to remedy the situation of the *people* at risk of modern slavery and human trafficking – and may, as a result, fall short of the institution's responsibilities under the UN Guiding Principles on Business and Human Rights, a matter to which we will return in the second Briefing Paper.

What is more, even as it reduces the institution's risk exposure, over-zealous de-risking may actually *increase* the overall risk of modern slavery and human trafficking, since it may push the jettisoned business into informal and illicit financing arrangements. It may also hurt financial inclusion, especially where financial institutions terminate correspondent banking relationships (CBR).[50] CBRs allow local banks to gain access to foreign financial markets and carry out cross-border transactions.[51] Terminating these relationships – to reduce AML/CFT risk – may have a particularly negative impact on migrant worker remittances, pushing them out of the formal sector, into informal channels where workers may be exposed to greater risks of exploitation.[52]

De-risking may represent a market failure that increases systemic risks of modern slavery and human trafficking, and jeopardizes achievement of numerous Sustainable Development Goals. Financial sector actors may need to consider whether AML/CFT and other regulatory frameworks need to be adjusted to avoid this unintended outcome. It may, ultimately, prove more useful for financial sector actors *not* to claim there is "no slavery, forced labour or human trafficking" in their value chains, but rather to improve their awareness of the labour conditions in their customers' businesses and engage with their customers to steadily reduce and remediate slavery and trafficking risks, including by using new techniques and technologies to promote financial inclusion and social finance.[53] We return to this question in the second and third Briefing Papers.

4. SUPPLY CHAIN TRANSPARENCY AND DUE DILIGENCE REGIMES

AML/CFT frameworks offer an important mechanism for reducing the risks that financial institutions will handle and launder the proceeds of modern slavery and human trafficking. Beyond AML/CFT, financial institutions must also comply with an emerging array of human rights transparency and due diligence regimes that have emerged in recent years, many of them focused on business supply chains. NGOs have started to provide guidance on compliance with these regimes – which affect all parts of the financial sector, not just banking practices.[54]

Brazil's 'Dirty List'

One of the oldest such regimes is that of Brazil. Brazil was the destination of around 40 per cent of all slaves trafficked across the Atlantic (compared to around 3.5 per cent to the US). It formally abolished slavery only in 1888, and continues to wrestle with slave-like practices, especially in rural agriculture and mining, but also in manufacturing, construction and urban services. Brazil has one of the most sophisticated slavery monitoring systems in the world, including a digital Observatory,[55] Special Mobile Inspection Groups (GEFM), and, since 2003, a multistakeholder National Commission to Eradicate Slaver Labour (CONATRAE) which issues and updates a National Plan for the Eradication of Forced Labour.[56]

In 2004, the Brazilian government created a government-operated register of names of employers caught by GEFM exploiting workers in conditions analogous to slavery. This national, public 'Dirty List' (*lista suja*) included information about the offending company, the location of the offense, the product cultivated and the number of workers affected. From 2004, the system was also accompanied by a multi-stakeholder National Pact for the Eradication of Slaver Labour, with participants agreeing not to collaborate with companies on the Dirty List. In 2013, 380 corporations, accounting for 30 per cent of Brazilian gross national product, had signed onto the Pact. Listed companies were also barred from certain public contracts, and listing became a key indicator by which Brazil's financial sector assessed social risk in their actual and potential relationships, with the government formally recommending this approach.[57] Public and private financial institutions, Including the Banco do Brasil, the Banco da Amazônia, the Banco do Nordeste and the Brazilian Development Bank (BNDES) all refused credit to companies included on the Dirty List,[58] protected from legal action by the fact that the list was government issued.

Other steps followed. In 2014, Brazil adopted a constitutional amendment to allowing the confiscation of proceeds of slavery. The state of São Paulo adopted a law preventing companies on the list from collecting state-mandated sales tax, essentially barring them from commerce in Brazil's most populous state. Some observers believe that these measures began to translate into measurable impacts on company stock prices, with listing corresponding to drops in stock price.[59] Perhaps unsurprisingly, the Dirty List met increasingly organized political and legal opposition from major business interests.

In 2013, one of the companies constructing stadiums for the World Cup, OAS SA, was placed on the Dirty List, based on allegations of forced labour in Minas Gerais. The Caixa Econômica Federal, a federal bank, suspended financing to OAS SA. But OAS SA obtained a court order forcing its removal from the list. Following a broader business campaign and legal action brought by the Brazilian Association of Real Estate Developers in December 2014, the President of the Brazilian Supreme Court suspended the list on constitutional grounds.[60] Civil society organizations quickly organized a successful request to release the list under the Brazilian Freedom of Information Act. Considerable controversy followed, until in May 2016, the government adopted a new Dirty List framework. The Temer government, once in office, sought to significantly narrow the scope of what would be considered slave labour, but its efforts failed in the Supreme Court.[61]

The Dirty List is unique in the world in providing a government-approved register of commercial organizations found to have violated modern slavery or human trafficking standards. The provision of this list has, however, greatly facilitated financial actors' assessments of slavery and trafficking risks in Brazil. That has equally made the Dirty List a target for resistance and a magnet for political controversy in Brazil. And while the Dirty List provides a good example of using divestment to promote compliance, financial sector actors, in particular investors, may also use their role as active owners, and other forms of leverage, to promote good practice in their own supply-chains, amongst their client bases and investments, and amongst their peers. The second Briefing Paper in this series, which will be made available prior to the January 2019 consultation of the Commission, will look at these issues in more depth.

US steps towards supply chain transparency

In 2010, US Congress adopted the ***Dodd-Frank*** Wall Street Reform and Consumer Protection Act, implemented by the Securities and Exchange Commission (SEC) in 2012. Section 1502 of the act requires companies registered on the US stock market to report annually whether gold, tin, tungsten or tantalum in their supply chains come from the Democratic Republic of Congo or an adjoining country and, if so, to carry out a due diligence review of the supply chain.[62] The Enough Project has concluded that this provision underpinned significant improvements in the transparency of corporate supply chains and a reduction of mines controlled by conflict actors in eastern DRC.[63]

In 2012, ***California*** legislators enacted the California Transparency in Supply Chains Act. The act requires retail sellers and manufacturers operating in or headquartered in California with worldwide annual revenues of $100 million or more to report (but only one time) on their efforts to eradicate modern slavery and human trafficking from their direct supply chains, whether the supply chains be in California or abroad. Businesses subject to the Act must disclose on their website:

- their processes for verifying product supply chains to evaluate risks;
- their auditing efforts to evaluate their suppliers' compliance with the law;
- direct (i.e. first-tier) suppliers' certification that materials incorporated into the products they provide comply with the laws;
- steps taken to ensure internal accountability for employees or contractors who fail to meet compliance standards; and
- training provided to employees and managers.

The Act was specifically designed to improve market transparency and relies on purchasers and investors to punish poor preventive and remedial action. It does not provide for significant government penalties either for failure to report, or, indeed, for not taking serious preventive or remedial action. In 2015, Californian Attorney-General Kamala Harris issued guidance for businesses on how to comply more effectively with the act.[64] Yet reviews of its effect have found only limited compliance (31 per cent for the first five years).[65]

Other important steps towards supply chain transparency, due diligence and compliance have been taken by the US government through measures targeting ***federal government contracts*** – including those issued by federal lending, investment and financing agencies.[66] Since 2015, these rules have imposed measures preventing the federal government from hiring contractors involved in human trafficking, with flow-down to subcontractors. They require contractors and subcontractors to notify government procurement personnel whenever they receive credible information of human trafficking or violations of the prohibited practices associated with trafficking, and permit federal agencies to impose remedies, including termination, for failure to comply with the requirements.

In some cases they also require that US government contracting personnel check the Department of Labor's "List of Goods Produced by Forced or Indentured Child Labor" when issuing a solicitation for supplies. If the product appears on the list, the contractor is required to certify that it will not supply any end product from countries (subject to certain exceptions) that appear on the list; or to certify that it has made a good faith effort to determine whether forced or indentured labor was used to mine, produce, or manufacture any end product to be furnished under the contract. Non-compliance can also lead to contract termination, and penalties.[67]

Western European regimes

In 2013, the ***European Union*** adopted a Directive (2014/95/EU) on Non-Financial Reporting requiring businesses with more than 500 employees to disclose their management of human rights impacts. In 2017, the European Commission adopted Guidelines on company reporting under the Directive, highlighting human trafficking.[68] The Guidelines make clear that companies may consider disclosing material information and key performance indicators on processes and measures for preventing trafficking in human beings. The EU also imposes human rights due diligence obligations for importers of conflict minerals,[69] timber and timber product operators,[70] and the Commission is assessing introducing further due diligence requirements for corporate boards.[71]

In 2015, the ***UK*** government passed the *Modern Slavery Act,* which is modelled after the Californian act discussed above.[72] The *Modern Slavery Act* applies to any business, or part of a business, that supplies goods or services in the UK and has a global turnover of GBP 36 million or more. These businesses must publish an annual board-approved statement, signed by a director (or equivalent) in a "prominent" place on their website, setting out what the organization has done to ensure there is no slavery in any part of its business, including (but not limited to) its supply chains. This may include information on internal training, company-wide policies and governance structures.

These requirements are significant. Board approval ensures strategic-level attention to the company's efforts to identify and reduce slavery and trafficking risks. A director's signature creates accountability. Publication of the statement improves market information for consumers, investors, and others stakeholders. Yet as with the California Supply Chains Transparency Act, the UK *Modern Slavery Act* promotes transparency without mandating specific due diligence steps, and relies on reputational risk to incentivize action. There is nothing, in theory, to prevent a company reporting that it has decided not to address the slavery risks it found, or even that it has done nothing to look for those risks. It does not impose criminal or financial penalties apply for non-compliance. Moreover, companies are not required to deposit their statements in a central database, or even to report on specific due diligence factors or prevention measures, so it has fallen to non-governmental organizations to collect and make sense of these statements. The Modern Slavery Registry, organized by the Business and Human Rights Resource Centre, has collected over 6,000 statements – of which only 19 per cent meet the minimum requirements of the Act.[73] An analysis of electronics sector compliance with the Act found similar compliance rates.[74] The UK government has recently launched an independent review of the Act.[75]

In ***France***, the *Devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre,* enacted in 2017, establishes a reporting threshold based not on annual turnover, but on personnel numbers: any business with more than 5,000 employees registered in France, or more than 10,000 employees working in direct or indirect subsidiaries globally, must comply.[76] These companies must establish, publish and implement a human rights due diligence (*vigilance*) plan, and set out how the plan will mitigate and address negative human rights impacts.

As we will explore more in the second Briefing Paper, similar arrangements may now be emerging in other Western European jurisdictions. In ***the Netherlands,*** the government has initiated a process for the formation of a series of sectoral 'covenants' between government, business and civil society actors – including a *Dutch Banking Sector Agreement on international responsible business conduct regarding human rights.*[77] This agreement, which focuses on corporate loans and project finance, sets out arrangements not only for transparency and reporting, but also human rights due diligence, client engagement, and enabling remediation. Dutch Parliament has also been considering a new law imposing due diligence obligations specifically relating to child labour.[78] In ***Switzerland,*** a citizen-led Responsible Business Initiative and a counter-proposal emerging out of the Swiss parliament explicitly link human rights due diligence to (civil) corporate civil liability.[79] And in ***Germany,*** the National Action Plan on Business and Human Rights makes clear that if more than 50% of all German-based companies with over 500 employees have not taken credible action to integrate human rights due diligence in their operations by 2020, the government will examine further steps, including legislative measures providing for mandatory human rights due diligence.[80]

Australia

Finally, not one but two similar supply chain transparency and due diligence regimes are now emerging in Australia. The ***Commonwealth*** (federal) parliament looks set in coming months to adopt a Modern Slavery Act that will create a reporting regime for businesses that have an annual turnover of more than AUD 100 million. To encourage greater compliance, the government would publish a list of the over 3,000 businesses that would be required to report in line with the new legislation. Additionally, the government would also create a central, publicly accessible repository of all submitted disclosure statements. To achieve this, the act foresees creating a business unit, which would manage the repository and "advise businesses on modern slavery risks in their supply chains". The legislation would also require federal government entities – including public sector financial institutions – to comply with the Act.[81] Meanwhile, one of Australia's constituent states, ***New South Wales,*** has already adopted its own *Modern Slavery Act*. This covers businesses with an annual turnover of AUD 50 million and an employee in NSW, imposes reporting requirements, creates a registry of reporting statements, and institutes penalties of up to AUD 1.1. million for failure to comply. Implementing regulations will also set out more detailed reporting requirements.[82]

Growing roles for government and for engagement

Two themes emerge from this review of recent transparency and due diligence frameworks.

First, regimes with weak penalties have met with poor compliance and have not generated coherent bodies of information allowing consumers and investors to effectively differentiate good performance from bad. And a proliferation of unharmonized regimes has led to a fragmented compliance landscape. Enterprising actors have emerged to help make sense of this dispersed information, on both a non-profit model (such as the Modern Slavery Registry) and a for-profit model (such as FRDM.co, a company that sells supply-chain risk analysis and compliance services to large procurement entities). And there are clear signs now that governments are taking on a growing role, whether in compiling risk analysis and reporting statements, offering advice to business or providing risk assessments or, increasingly, making human rights due diligence mandatory. The move towards mandatory human rights due diligence will arguably make it even more important for financial sector actors to adopt responsible lending and investment practices.

Second, we also see signs that, as Verité put it in reviewing compliance with the California *Transparency in Supply Chains Act,* "compliance is not enough".[83] Effective efforts to reduce modern slavery and human trafficking risks require organizations to undertake direct client and supplier engagement and to proactively manage risks down through partnership and remediation. This resonates with the approach emerging around de-risking in the AML/CFT sphere.

How is the sector to achieve these goals? We turn to those questions in the second Briefing Paper.

5. CROSS-CUTTING ISSUES FOR THE COMMISSION'S CONSIDERATION

Four cross-cutting issues emerge from this overview:

1. How to **strengthen financial sector understanding** of modern slavery and human trafficking risks in different places, sectors and populations, especially around 1) labour trafficking risks; and 2) the role of non-banking financial services.
2. How to **improve the risk data available** to the financial sector, including through: 1) KYC arrangements; 2) scaling up promising analytical techniques, including by piloting, iteration and scaling up of effective analytical tools and frameworks,; 3) promotion of effective transparency and due diligence regulatory frameworks; and 4) a governmental role in compiling, analyzing and publishing information about organizations, hotspots, routes or flows associated with these risks;
3. How to **strengthen information-sharing partnerships** between the financial sector, regulators and civil society, including: 1) addressing regulatory and policy barriers; and 2) creating or scaling up safe and reliable platforms for multi-country, multi-sectoral information exchange; and
4. How to encourage the financial sector to **move from a de-risking stance to an approach based on client engagement and remediation.**

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