Due diligence, disclosure and risk metrics relating to modern slavery and human trafficking

About FAST

Finance Against Slavery and Trafficking (FAST) is a global public-private partnership mobilizing the financial sector to fight modern slavery and human trafficking. The FAST Blueprint (September 2019) sets out five Goals and thirty Actions for financial sector actors to address modern slavery and human trafficking. This Insight focuses on current efforts to strengthen due diligence, disclosure and risk metrics arrangements, in line with FAST Goal 2.

Disclosure of modern slavery risks is crucial to correcting the market failure of modern slavery

- At present, a firm’s cost of capital is not tightly tied to whether the firm’s operations or business relationships rely on forced labour or modern slavery. Firms are rewarded with lower costs of capital for low labour costs, regardless of whether the resulting workforce management practices amount to modern slavery.

- This leads to social externalities that are not reflected in the firm’s cost of capital, generating suboptimal macroeconomic outcomes (see Insight 4).

- Disclosure of modern slavery risks in firms’ businesses and relationships will be crucial to allowing capital markets to better assess and price in the true costs of labour management practices.

More Information

- FAST Blueprint, pages 72-84.

Disclosure expectations are becoming more stringent

- A growing number of jurisdictions require companies to know and show their connections to modern slavery risks.

- Both Australia and the UK have adopted a Modern Slavery Act that requires disclosure of such risks to the Government. Similar legislation is under consideration in Canada, New Zealand and Norway.

- These regimes typically require companies to disclose the existence of such risks in their operations and business relationships. The regimes have lacked significant penalties for non-compliance, instead relying on reputational risk as the primary incentive for compliance.
A lack of harmonization and standardization in disclosure requirements has made it difficult for third parties to identify non-compliance and compare data across jurisdictions, and have fragmented efforts by businesses themselves.

Research suggests that much compliance with these Acts is largely ceremonial, and does not point to significant change in business practice. In the UK, the Business and Human Rights Resource Centre (BHRRC) concluded in February 2021 that the Modern Slavery Act 2015 (UK) “has failed in its stated intentions” because its reporting requirements had not necessarily led to changes in business practice. BHRRC puts this down to a lack of enforcement and penalties.

Walk Free found that 53 per cent of asset managers’ statements failed to meet minimum reporting standards under the Modern Slavery Act 2015 (UK), and only 27 per cent disclosed conducting some form of due diligence on modern slavery in their portfolio.

Compliance rates in Australia, where the Government has given more specific guidance to businesses, appear to be higher.

At the same time, there is a growing demand from investors for companies to know and show these risks, regardless of statutory compliance obligations (see Insight 2).

And there are also signs that stock and commodities exchanges will look more carefully at listed companies’ links to modern slavery risks in the future, with initiatives under way in Thailand, the UK and the US.

More Information
- Australia Modern Slavery Act 2018 (Cth) - legislation, reporting register, business guidance, lessons learned.

MHRDD is coming

Existing modern slavery disclosure regimes have been characterized by extreme constraint by the State on enforcement, and a very light-touch approach to oversight. Some jurisdictions are moving to make it mandatory to not only identify these risks, but also to take positive steps to respect the right to be free from slavery, through due diligence, leverage and remedy. These laws are often known as ‘mandatory human rights due diligence’ or ‘mHRDD’ laws.

Laws based on this approach are already in place in France (the droit de vigilance law) and the Netherlands.

Legislative processes are well under way in Austria, Denmark, Switzerland, Germany and Norway.

Government commitments have been made in Finland, Italy and Luxembourg, and policy debates are under way in Belgium, Spain, Sweden.

At the European level, three separate processes are under way:

- The European Commission’s DG Justice Sustainable Corporate Governance initiative is exploring introduction of new corporate mHRDD duties and reform of company directors’ duties. A proposal for legislative action is expected in June 2021.
The EU Parliament, on its own initiative, has called for such mHRDD rules – but also for new civil liability. The Parliament will respond to the Commission’s proposal and work with the Commission and European Council to shape any resulting EU law.

Separately, the Commission’s DG Financial Stability, Financial Services and Capital Markets Union is exploring a new EU sustainability reporting standard. This will develop further in later 2021.

In addition to new disclosure obligations, the EU Commission is considering amending company directors’ duties, with the aim of lengthening the time-horizon of corporate decision-making, and ensuring that human rights risks such as modern slavery risks posed by a company’s operations and throughout its supply-chain are factored into that decision-making.

Some commentators, including the former Chief Judge of Delaware, argue that existing fiduciary duties already require attention by company directors to certain aspects of the social impact of company business.

More Information

- EU Parliament, “MEPs: Hold companies accountable for harm caused to people and planet” (27 January 2021).
- Shift, Mandatory Human Rights & Environmental Due Diligence –What is Happening in Europe (1 March 2021).

There are signs of regulatory convergence

Though the regulatory processes described above are proceeding at different speeds, there are signs of increasing convergence in regulatory arrangements around shared expectations of corporate identification, disclosure and management of modern slavery and other human rights related risks.

In particular, there is a growing acceptance that the framework set out in the UN Guiding Principles on Business and Human Rights (UNGPs), which is also reflected in the OECD Guidelines for Multinational Enterprises, should form the basis for market regulation.

There is also a growing acceptance that human rights impacts can be material.

As a result, even as formal legislative processes continue, some industry groups are moving to standardize systems for identifying, categorizing and measuring social impacts and risks, including those relating to modern slavery.

In recent months, the Sustainability Accounting Standards Board (SASB) has emerged as the front-runner in this process. Already backed by the largest asset managers, both securities regulators (the International Organization of Securities Commissions [IOSCO]) and accounting standards setters (the International Financial Reporting Standards Council [IFRS]) have signalled they will look to SASB in setting their own ESG reporting and accounting expectations. Significantly, Biden Administration nominees for financial regulatory roles at the US Securities and Exchange Commission have also signaled support for this approach.
SASB is currently undertaking a consultation to strengthen its reporting standards’ treatment of human capital and labour management. A civil society group, in which FAST participates, has been providing input to ensure modern slavery risks are appropriately considered in this process. This input has encouraged SASB to include workers in supply chains in its Human Capital Management Preliminary Framework.

Another set of actors is also beginning to advance consideration of modern slavery risk management through the international standardization system. A draft standard is currently under consideration by the British Standards Institution. National standards often lay the groundwork for later discussion of international standards.

Meanwhile, many firms are pushing ahead, regardless

Many financial sector firms are not waiting for perfect regulatory clarity, but moving to strengthen modern slavery risk management systems, confident that this will position them well to handle whatever disclosure and mHRDD rules emerge.

Norway’s Government Pension Fund Global, the world’s largest sovereign wealth fund, is currently reviewing its investments for ties to forced labour.

BlackRock, the world’s largest asset manager, recently published a statement setting out its approach in this area, aligning with the UNGPs.

A wide range of financial institutions, from investors with USD 5.3T assets under management, to banks including ABN Amro and Citi, have committed to the UNGPs Reporting Framework.

Principles for Responsible Investment (PRI) has introduced new human rights questions into its own reporting framework.

A growing number of financial institutions are using screening tools and vendor management systems to manage modern slavery risk as part of wider enterprise risk management processes.

As a consequence, there are growing efforts by civil society actors to benchmark financial institutions’ human rights and modern slavery performance.