Moving towards meaningful and harmonised due diligence disclosure

13 February 2019, 9:00-11:00

Objective of the session

This session will explore how the industry can move towards meaningful and accessible public communication on due diligence by companies. It will also include a discussion with investors on harmonising human rights and environmental disclosure requirements for businesses in the sector. This session will draw on findings from the OECD and ISS-ESG consultation with 20+ investors on human rights and environmental disclosure requirements of companies in the apparel sector. (See Box below for summary findings of the consultation).

Background

The context facing apparel companies

Companies in the garment and footwear sector have been reporting on their efforts to identify and address labour, human rights, and environment risks in their activities and supply chains for years – even decades in some cases. Such reporting, which is primarily accomplished through annual sustainability or CSR reports, but also increasingly through blogs and company websites, has become fairly ubiquitous in the sector.

At the same time, the industry has likewise seen a rise in mandatory and voluntary disclosure requirements concerning labour and environmental supply chain due diligence. While investors play an important role in driving disclosure, they are not the only influencers; government regulations, multi-stakeholder and industry reporting requirements and third-party benchmarks likewise play a significant role in driving disclosure.

- Government regulation: Governments are increasingly focused on the role of companies in addressing human rights, labour and environmental risks in company supply chains. This has resulted in a rise of disclosure legislation in OECD countries including in California, France, the United Kingdom, the Netherlands, and Australia.

- Multi-stakeholder and industry initiatives: Partially in response to the OECD Guidelines and UN Guiding Principles and in an effort to hold member companies more accountable to commitments, multi-stakeholder and industry-led initiatives are increasingly requiring companies to report on how they are carrying out due diligence in their supply chains. In some cases, members are then evaluated on this reporting. In the majority of cases, reporting to multi-stakeholder and industry-led initiatives is not public.

- Civil society benchmarks: The past five years has seen an increase in third-party sustainability and due diligence indexes and benchmarks which seek to measure company performance vis-à-vis their supply chains. While indexes have traditionally been CSR focused, in recent years there has been a shift towards due diligence benchmarks, such as Know the Chain, Fashion Revolution, and the Corporate Human Rights Benchmark.

Businesses in the apparel sector raise concerns regarding the increasing frequency of disclosure requests and a lack of alignment on disclosure requirements across stakeholders including governments, multi-stakeholder and industry-led initiatives and investors. For example, in a review of methodologies by Stern School, the researchers found no consistent set of standards underpinning "S" among ESG frameworks. [1]

The context facing investors

Investors are increasingly assuming their role to seek to mitigate environmental, labour, and human rights risks in their underlying companies while recognizing the financial materiality that such risks may bring.[2] Within this context, investors are moving beyond only considering the environment, social and governance (ESG) performance of potential investees in relation to exclusion or divestment policies and increasingly integrating ESG performance into traditional financial analysis and impact investing. This is partially evidenced by statements from leading investment companies[3], but also by investor decisions to divest due to environmental or human rights concerns in underlying companies.

- **Broader understanding of fiduciary duty**: A broader understanding of fiduciary duty is increasingly being recognized in the context of institutional investors. Of 50 countries analysed by PRI, almost half have or are developing rules regarding pension funds and ESG criteria.[4] Furthermore, a core recommendation of the EU High-Level Expert Group[5] on sustainable finance recognises that incorporating information related to ESG factors into investment decisions is part of an investor's fiduciary duty.[6]

- **Due diligence expectations**: Recommendations of due diligence under the OECD Guidelines for Multinational Enterprises apply across all sectors, including the financial sector and commercial investment enterprises.[7]

This increased attention of the financial sector on ESG performance of investees has been accompanied by a flourishing of ESG products and benchmarks directly targeting investors. While traditionally ESG products have leaned towards environmental performance there is slowly a growing focus on social – in relation to labour and human rights – indicators. In addition to annual ratings and benchmarks, investors are also turning directly to companies to request information on specific issues or processes on a more ad-hoc basis.

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[1] Casey O'Connor and Sarah Labowitz, Putting the "S" in ESG: Measuring Human Rights Performance for Investors, https://static1.squarespace.com/static/547df270e4b0ba184dfc490e/t/58cad912e58c6274180b58b6/1489688854754/Metrics-Report-final-1.pdf

[2] For example, Harvard Kennedy School, Shift and the University of Queensland found that the 'greatest cost of conflict is lost opportunities for future projects, expansions, or sales."
Rachel Davis & Daniel Franks, Costs of Company- Community Conflict in the Extractive
Sector, Corporate Social Responsibility Initiative Report No. 66 (2014),
https://www.hks.harvard.edu/mrcbg/CSRI/research/Costs%20of%20ConflictDavis%20%20Franks.pdf.

[3] Reference Larry Fink, Ask Barbara for other references.

[4] Principles for Responsible Investment (PRI) (2016), 'Global Guide to Responsible Investment Regulation', https://www.unpri.org/how-effective-are-responsible-investment-investor-regulations/212.article

[5] The 2017 interim report of the Expert Group likewise highlights that "[t]he responsibility of directors and investors to manage long-term sustainability risks should be enshrined in their relevant duties, whether it is through fiduciary duty in common law or its equivalent in other legal systems. Updates should make clear that managing ESG risks is integral to fulfilling these duties." Financing a Sustainable European Economy: Interim Report, July 2017 By the High-Level Expert Group on Sustainable Finance Secretariat provided by the European Commission. https://ec.europa.eu/info/sites/info/files/170713-sustainable-financereport_
en.pdf.

[6] OECD (2018), *Annual Report on the OECD Guidelines for Multinational Enterprises 2017*

[7] In 2017, the OECD launched a paper, *Responsible Business Conduct for Institutional Investors: Key Considerations for Due Diligence under the OECD Guidelines for Multinational Enterprises*, helps institutional investors implement the due diligence recommendations of the OECD Guidelines for Multinational Enterprises in order to prevent or address adverse impacts related to human and labour rights, the environment, and corruption in their investment portfolios.

SUMMARY FINDINGS

OECD – ISS ESG consultation with investors on human rights and environmental disclosure

*Prepared by ISS-ESG

There is a range of approaches to ESG analysis among investors. Many have dedicated ESG teams but also use data from external ESG data and analysis providers, as they are not experts on all ESG issues. Some investors have a more proactive approach on particular focus areas, including through targeted themed engagement, while others take more of a quantitative approach. The variety of approaches informs some of the different motivations for and extent of disclosure requests to companies.

Key findings

Many investors shared that the key driver for their information needs and requests is to be able to assess companies' risk exposure and management. In order to do this, investors review key metrics presented in benchmarks/indexes as well as by ESG data and analysis providers, at the very least as an initial screen of companies. Several investors noted that this data often needs to be complemented by more qualitative, forward-looking data (on strategy, collaborations, measures taken to roll out positive outcomes more broadly within the organisation, etc.) to provide a more nuanced picture of the company's risk management. Moreover, investors noted that there are some key areas, notably transparency on suppliers and the extent to which supply chain due diligence is supported by senior management, where there is a lack of adequate disclosure among many companies in the sector.

Several investors highlighted constraints to accessing quality and current data. Specifically, due to reporting and data collection cycles – the information available is sometimes dated. While there was a general agreement that there is still value to this type of data, as well as more historical data, as it can give an indication of trends, investors also noted that there may be a need for follow-up direct disclosure requests.

Investors noted scenarios in which there is a need for direct outreach to companies, regardless of the data in the initial screen. One such example is where investors proactively seek to engage with companies on focus themes of particular priority or concern to the investor. In addition, many investors (or their service providers) reach out to companies in response to specific incidents or controversies which point to a failure in the company's due diligence systems. There was a general agreement that some of the latter type of direct outreach could be reduced if companies communicated proactively on incidents.

There was a recognition among investors that they could possibly contribute to the relevance and quality of companies' disclosure by providing more context on the motivations for particular requests. For example, many investors shared that their motivation to request that companies publish lists of their suppliers is that they see this as a proxy for how confident the company is in its supply chain management systems. Similarly, investors highlighted that they look at the extent to which senior management is involved in the supply chain due diligence, as a measure of its robustness. Investors with a particular focus on living wages highlighted that the motivations for this are linked to their view of wages as a nexus within broader labour rights challenges in the supply chain, and that implementing living wages would also resolve many other concerns.

Discussion questions

- Where do gaps in public communication on human rights and labour due diligence exist in the sector? Are gaps primarily related to content or accessibility of the information?
- What practical steps are necessary to move the sector towards more meaningful and accessible communication on human rights and environmental due diligence?
- What challenges do investors face in relation to information deficits, including quality of information? What are potential solutions?
- How can information be provided to investors in a way that is reliable and accessible? What is your wish list?

For more information

- Casey O'Connor and Sarah Labowitz, Putting the "S" in ESG: Measuring Human Rights Performance for Investors, https://static1.squarespace.com/static/547df270e4b0ba184dfc490e/t/58cad912e58c6274180b58b6/1489688854754/Metrics-Report-final-1.pdf
- Principles for Responsible Investment (PRI) (2016), 'Global Guide to Responsible Investment Regulation', https://www.unpri.org/how-effective-are-responsible-investment-investor-regulations/212.article