

Sustainability and Climate On-Demand

“How to Manage Human Rights Risks”

Transcript, 16 January, 2025

Mike disabato (00:00):

What's up everyone, and welcome to the weekly edition of Sustainability Now, where we cover how the environment, our society, and corporate governance affects and are affected by our economy. I'm your host, Mike Disabato, and this week we take you through the world of businesses and human rights. Thanks as always for joining us. Stay tuned. This may sound bleak that I have to say this, but we at MSCI think measuring how companies deal with human rights is a useful thing to do. Now, we don't have our own standards of what human rights are. We follow standards set by the UN guiding principles and the OECD guidelines for multinational enterprises on responsible business conduct. Those in turn are based on foundational documents such as the International Bill of Human Rights. And to be clear, when we look at human rights, we don't limit to the off-discussed modern slavery issues, such as forced or child labor or some sort of abusive labor in direct operations or in a company's supply chain.

(01:08):

But human rights as we see them is broadened to also include, for example, the rights of indigenous people and privacy and security of an individual, something that is much more prominent as AI continues to creep into our daily lives. And we have a number of data points that look at all of this, so we obviously think it's important, but should investors. The demand still seems to be there. There are regulations around human rights, yes, but also it helps investors to identify companies that are possibly grappling with the intersection of business and human rights and where it's costing them money and where it's not, and trying to measure that and deal with it in sort of a systemic portfolio wide way. And to understand this dynamic and why that still seems to be the case, I called up my guests and colleague, Oradron, who has been focusing on human rights for much of her career at MSCI.

(02:00):

She and our colleague, Leslie Swingado, recently published an investor guide on human rights and a blog post along with it titled Human Rights Risks in Portfolios: From Oversight to Due Diligence, the link for which I put in the podcast description. And look, there is sort of a vibe here with this episode where I'm leading us into this discussion as to why we should care about human rights, which feels a bit odd as I'm doing it, but I'm doing it to set up a story. And so I decided I wanted my story to begin with a bit of a villainous intent. And I was

purposely glib in my first question to Aura to try to achieve that. And I asked her, wouldn't it just be more profitable if you were a company to pay a criminally low wage to your workers and do that until you were caught?

Aura dron (02:48):

Well, the simple answer is no, because if a company is found to use forced labor, its products may be banned under the US Force Labor Prevention Act or under the European forced labor ban, and that means loss of access to very large markets and loss of business. And large brands may not want to do business with suppliers that use forced or child labor that underpay workers that offer improper working conditions because they do not want the reputation to be affected and do not want the loss of consumer trust. Similarly, a mining company may just want to set operations where it's convenient and they might forcefully displace the locals that already live there to be able to access resources. But if this is done without proper consultation with the local people, if their voices are not heard, then people will protest and governments might step in and the mines will be closed.

(03:49):

And this is not the hypothetical example. We have real world examples to show this. The Chilean court ordered the permanent closure of Barraguld's Pasco Allama's mine because of their adverse impacts on natural ecosystems, public health and local indigenous people. And the company has already spent eight to 8.5 billion on this development, so it's a significant loss for them. And they're also not able to come back because they've lost their social license to operate and their ongoing protest preventing them from returning.

Mike disabato (04:23):

That made me think about how a lot of the ways the world engages with human rights abuses by companies often seems reactive, like the gold mine that Ora just mentioned. The company did not put in any systems in place to deal with the possible backlash from the community where a very intense mining project was being done and only tried to address it retroactively. But then the problems were already out in the open, the collapse had happened and the controversy was known. Now that doesn't remove the importance of a retroactive data point like a controversy because it can be an indication of fissures or breakdowns within the company, especially if that company had a policy in place that they communicated to the public that was supposed to address human rights issues. And it made me wonder what some of the more proactive data points are out there that we look at for human rights.

(05:15):

And I asked Aura about that and I wanted to play you a bit of our uncut conversation.

Aura dron (05:19):

So there's a lot of data that we can look at to measure what companies are doing on human rights outside of controversies. And I think there's a bit of a common misconception that social issues cannot be measured, but climate issues can. And I disagree with that. I think we have a lot of data that we can look at and that can be measured. For example, wages are

numbers that can be analyzed and benchmarked. You can measure whether someone receives a living wage or not. Same as injury and fatality rates. You can see which companies had the highest recorded fatality rate or injury rates. You can also measure how many people were impacted by a food safety incident as easily as you can measure the surface area from environmental destruction. You can also estimate, and we have done, what proportion of a company's revenue is linked to modern slavery issues, and probably you can do that as well as you can estimate carbon emissions.

(06:24):

So there's a lot of data there that can give us an insight into what companies are doing towards human rights, to ensure human rights.

Mike disabato (06:32):

What is the insight that that would give you? What is the insight?

Aura dron (06:35):

Well, if you don't measure something, you can't address it and you can't see progress against it. So if, for example, we are looking at living wages, we need to first measure how much people are paid and to evaluate whether there is a living wage or not, and then to measure progress over time to see if companies are improving.

Mike disabato (06:58):

And it's likely if they're not paying a living wage, you could argue that's a precursor to look deeper into it. I mean, maybe what these factors show investors is, let's say you have outliers, you're going to have a middle of the pack where kind of industry standards, and sometimes that industry standard is quite horrifying, but still you could say, "Well, maybe I want to avoid that industry or something." But let's say you have an industry standard that's set and you can look at it in terms of how they look at human rights and you could see outliers maybe on the negative.

Aura dron (07:30):

Yes, exactly. So data is really important to establish what is normal for an industry and identify outliers and then see who does better, who does worse, and engage with those companies that do worse and engage with them to address these issues. Also, what might be the standard for an industry doesn't mean that is necessarily where we want to be. So what we want to see is progress for the industry as a whole on certain metrics and not just living wages, but also improvements in many other areas.

Mike disabato (08:07):

And those areas will depend on the industry. Like the shipping industry, you would focus on working conditions like child or forced labor, things like that. For mining companies, you'd want to add in also how much they respect the civil rights and political rights of a community, the indigenous people's rights in that community, cultural rights, things that can become flashpoints if you ignore them as you begin to raise homes and earth in search of profitable

metals. And tech companies would need to focus on privacy and freedom of expression, access to quality information, and personal safety and the like. And there are ways that companies signal that they already are trying to pay attention to these salient human rights risks. And those are through publicly available policies and whistleblower protections and things like that, where it shows an overview of how the company is thinking about human rights.

(09:00):

But we argue it's not enough to just say that a company is paying attention. It's vital for investors to understand what sort of mechanisms for monitoring the companies have in place to actually understand how human rights risks are being played out on the ground of where they're operating. And this is especially true when it comes to supply chains, because you can have a company that treats its white collar workers very well, but it has suppliers who use suicide nets at their factories to stop people from jumping to their death to avoid going to work. So in that vein, I asked Ora if she thought about the importance of human rights standards for a company supply chain, and if so, what she looked at.

Aura dron (09:44):

Yes, absolutely. And that is potentially the area that is most complex, especially if you're looking at the large companies that have global footprints. They have employees all over the world and the issues that they are facing, the human rights violations are most likely to happen very upstream in the supply chain at the mine level or at the farm level where these large brands may not have a lot of visibility into. And the first step would be knowing their supply chains. And a lot of companies haven't mapped their supply chains and don't know which countries their suppliers are in. So that will be the first step. And once they know where their suppliers are located, then they can start addressing working conditions, wages, et cetera.

Mike disabato (10:36):

Do you know the percent of companies that have actually mapped their supply chain?

Aura dron (10:40):

Very few companies report on where their suppliers are located, and it will be mostly direct business relationships, direct suppliers. Very few have full insight into their full value chain all the way upstream.

Mike disabato (10:59):

In fact, Ora and her co-author, Leslie, found that only 15% of the firms that they looked at adopted a living wage commitment or had a comprehensive grievance and remediation mechanism in place for their supply chain workers, despite these measures being critical to addressing root causes of human rights abuses, and even fewer conducted labor audits across the entirety of their supply chain. And this absence not only impacts the ability for a company to actually do what they say they want to do with regards to human rights, but it impacts their bottom line as well. Looking back over the past decade, Ora and Leslie found

that companies with stronger supply chain labor practices tended to achieve higher cumulative returns than their peers with weaker practices. That suggests that stronger human rights practices signal greater financial resilience over the long term. But is that true for every region?

(11:54):

Their analysis was on a representative group of global companies, but the findings made me wonder if some companies in some regions were maybe more impacted than others when it came to human rights requirements, because it's no secret that the EU is much further along in enshrining human rights as a norm through collective regulation than anywhere else in the world. Does that mean it's impacted more than other areas? I asked Aura.

Aura dron (12:19):

Regulations on human rights have increased. We've seen an increase from 42% of our MSCI ACWI index covered by regulation 10 years ago to 70% now. So even though we might think that there isn't a lot of progress, there is, and the EU is leading the way, even though the scope of the due diligence regulations has been simplified and reduced. But it's not only the EU, Australia with their Modern Slavery Act is very ambitious on human rights as well, and they require due diligence, not only for corporates, but also for financial institutions.

Mike disabato (13:02):

And is it mostly the EU, do you know?

Aura dron (13:04):

It's the EU is the US. The California has a Modern Slavery Act. Canada has a Modern Slavery Act, Australia. So all these big regions where a lot of corporates derive revenue and are covered by some form of human rights regulations.

Mike disabato (13:23):

They all have extensive purchasing power as well. California's economy alone fluctuates between the fourth and fifth largest in the world, usually trailing Japan. It's a Pacific giant in its own right that requires both sellers and manufacturers in the state to disclose their efforts to eradicate slavery and human trafficking from their supply chains. And that's through a regulation called the California Transparency and Supply Chains Acts. However, the regulation stops short from including a requirement that companies implement specific on the ground mechanisms to ensure that those policies are actually being implemented. Those are the type of mechanisms that we would like to see if it's going to be best in practice in terms of human rights. So there's room for the regulation to grow there. Now, when I was talking to Ora about that and about the future and what it might hold for businesses and human rights and all that, she mentioned the obvious ones I was thinking about, armed conflict and the prominent role defense companies are sure to play in 2026 and beyond, climate change and everything involved with that.

(14:26):

But she also focused on something that I will be honest, completely escaped me when I was thinking about labor abuse and modern slavery and bombs and the like. She started discussing AI.

Aura dron (14:37):

We are starting to see how the rise of AI can harm people's privacy and security, and this harm is likely to increase as the technology develops further. So for example, some governments are using facial recognition technology to identify people that protest against their governments and human rights activists, and some are also using AI to search for what is believed to be anti-government sentiments, and that can potentially have very serious repercussions. So these use cases of AI can suppress freedom of expression and the right to protest. Also, some police departments have started experimenting with predictive policing that uses algorithms to analyze historical crime data and to forecast potential future crime. And the intent is to optimize police efforts, but there are concerns about reinforcing existing biases given that these algorithms operate based on historical data. And this means that law enforcement is now directed back to the same communities that have been overpoliced in the past.

(15:50):

So because of all these factors, I do think that human rights will get more attention this year from society as a whole, but also from investors that want to minimize risks in their portfolio.

Mike disabato (16:02):

Very true. And while it was nice for a moment to forget about AI, this is definitely spot on. And not only for what AI is doing to our human right to be left alone, but also the community backlash AI companies are already seeing due to the extractive nature of data centers that they rely on and the outsize impact of those centers on local communities. It's a reality that investors cannot be ignorant to if they don't want to worry over the sky-high debt rates and projections of growth AI companies have in the coming year. And that's it for the week. I want to thank Aura for talking to me about the news with a sustainability twist, and I want to thank you so much for listening. If you like what you heard, don't forget to rate and review us wherever you get your podcast. That helps moves us up on all the podcast lists and subscribe if you would like to hear myself, Bentley, or Gabby on Sustainability Now.

(16:57):

Thanks again and talk to you soon.

Speaker 3 (17:11):

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