VALUING RESPECT

BY Shift

Evaluating Human Rights Performance

The Role of ESG Ratings, Indices and Benchmarks in Driving Change

By Georgie Erangey

About Valuing Respect

Valuing Respect is a unique collaborative platform that will bring together all relevant voices in order to create smart tools and indicators that may help better evaluate the true human rights impact of business respect for human rights on affected stakeholders.

The project is a three-year effort during which we are working iteratively, collaborating with diverse experts and stakeholders to identify ideas and proposals that we can share as the project evolves. Shift has come together with three regional partners to help bring in perspectives and expertise, as well as an international advisory group with multi-stakeholder and cross-disciplinary participation to help steer our work.

Learn more: www.valuingrespect.org

About Shift

Shift is the leading center of expertise on the UN Guiding Principles on Business and Human Rights. Shift's global team facilitates dialogue, builds capacity and develops new approaches with companies, government, civil society organizations and international institutions to bring about a world in which business gets done with respect for people's fundamental welfare and dignity. Shift is a non-profit, mission-driven organization.

Abstract

The process of evaluating a company's behavior based on multiple criteria is not new. Historically, these criteria have been focused solely on financial return. However, in an increasingly globalized and transparent world in which the true cost of business can easily be exposed, the criteria of assessment have broadened in scope to account for the ethics and sustainability of the corporation. This is called ESG (environmental, social and governance). It is a term used in capital markets and by investors to evaluate corporate behavior and gain more insight into the future financial performance of companies[1]. In recent years, there has been an increase in the number of ESG products (ratings, indices and benchmarks) that seek to assess company performance.

[1] http://lexicon.ft.com/Term?term=ESG

This paper explores how effective these ESG ratings, indices and benchmarks are likely to be in driving corporate attention and investment into respect for human rights given the content of the indicators that they use.

ESG and human rights

The corporate responsibility to respect human rights has been accelerating up the legislative, investor and business agenda. In the last five years alone, there has been a significant increase in the number of laws aimed at requesting corporate disclosure relating to human rights in a company's direct operations and throughout its supply chain[2]. These transparency laws have increased the volume of human rights related information in the public domain, enabling deeper interrogation by investors and other stakeholders, and facilitating the production of benchmarks and assessments. This has happened in parallel to the development of new duty of care laws, which impose certain obligations on parent companies with regard to the human rights related behaviors of their subsidiaries and suppliers[3].

With a rapidly growing number of ESG products, and an increase in corporate disclosure relating to human rights, ESG assessments are now able to gather evidence of a company's behavior relating to human rights to present to external stakeholders in an easy-to-digest format. Stakeholders, ranging from asset managers and institutional investors, to governmental organizations and business customers, are increasingly relying on these reports and ratings as a way to understand and interrogate a company's ESG performance.

So, what's the problem?

Despite being theoretically effectual, in reality there is a problem. Many of the assessments ask similar questions requiring subtly different responses and look at the same types of human rights related information in fundamentally different ways. This leads to virtually no consistency in their conclusions.

There are a number of third party reports and ratings which seek to evaluate the ESG performance of companies. However, the scope, methodology, coverage, categorization and detail vary greatly among the various providers. This duplication (and sometimes contradiction) of questioning results in complete questionnaire fatigue for many corporations[4].

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[2] See the UK Modern Slavery Act, 2015; EU Non-Financial Reporting Directive, 2016; and the Australian Modern Slavery law.

[3] See the French Duty of Vigilance Law, 2017; the Swiss and Dutch initiatives

[4] https://corpgov.law.harvard.edu/2017/07/27/esg-reports-and-ratings-what-they-are-why-they-matter/; http://mitsloan.mit.edu/sustainability/aggregateconfusion; http://irle.berkeley.edu/files/2014/Do-Ratings-of-

So, can things be simplified? Over the last five years, I have worked with a number of major corporations that are struggling under the burden of information requests from the outside world. In this article, I will share how I have unpacked these many requests and unearthed some of the key trends in order to understand the true nature of the questioning. The article aims to highlight weaknesses and trends in current approaches, as well as gaps and future needs that can inform the evolution of companies' disclosure in support of more robust evaluation practices.

The method

To assess what is being asked of companies, I deconstructed the questions from the following 12 indices or organisations: Bloomberg, Vigeo, FTSE4GOOD, DJSI, MSCI_ESG, Oxfam's Behind the Brands, Workforce Disclosure Initiative (WDI), Sustainalytics, Corporate Human Rights Benchmark (CHRB), MSCI_Corporate, Know the Chain, and RepRisk. In total, there were nearly 2,000 questions[5]. Following this, I split the questions into the three categories of E, S and G, and identified whether the question was relating to direct operations or the supply chain. Next, I broke the questions down into sub-themes (e.g. climate change, human rights and anti-corruption) and a further 'issues' list in the 'S' and 'G' categories.

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[5] These were the top-level questions. Many questions have multiple sub-points meaning the true question total is nearer 2,500.

What did it show?

My analysis showed that there was a balance between the three areas or Environment (31%), Social (38%) and Governance (31%). Each questionnaire asked questions within the categories differently. However, there was alignment across the main themes in 'E', 'S', and 'G'. Examples of such categories include:

- **Environment:** Climate Change, Water, Energy, Waste, Biodiversity and Packaging.
- **Social:** Human Rights, Health and Safety, Community, Labor, and Health and Nutrition.
- **Governance:** Board Level Accountability, Anti-Corruption, Risk Management and Tax Transparency.

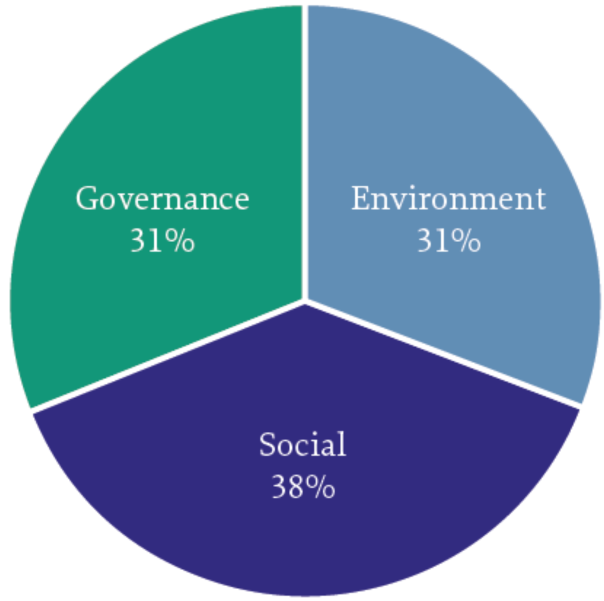


Figure 1: ESG questions proportional split

Were they interested in direct operations or the supply chain?

Overall, there was a slight bias in the ESG questionnaires towards direct operations (59%) over the supply chain (41%). It is no surprise to find Governance largely concentrated on direct operations, as the vast majority of these question focus on core corporate governance and the operation of the board. It was interesting to find a greater focus on direct operations in the environmental space, and a shift to the supply chain when asking social questions.

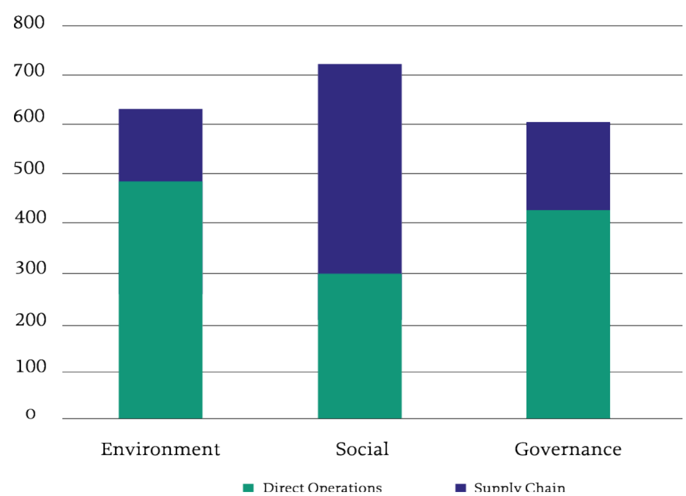
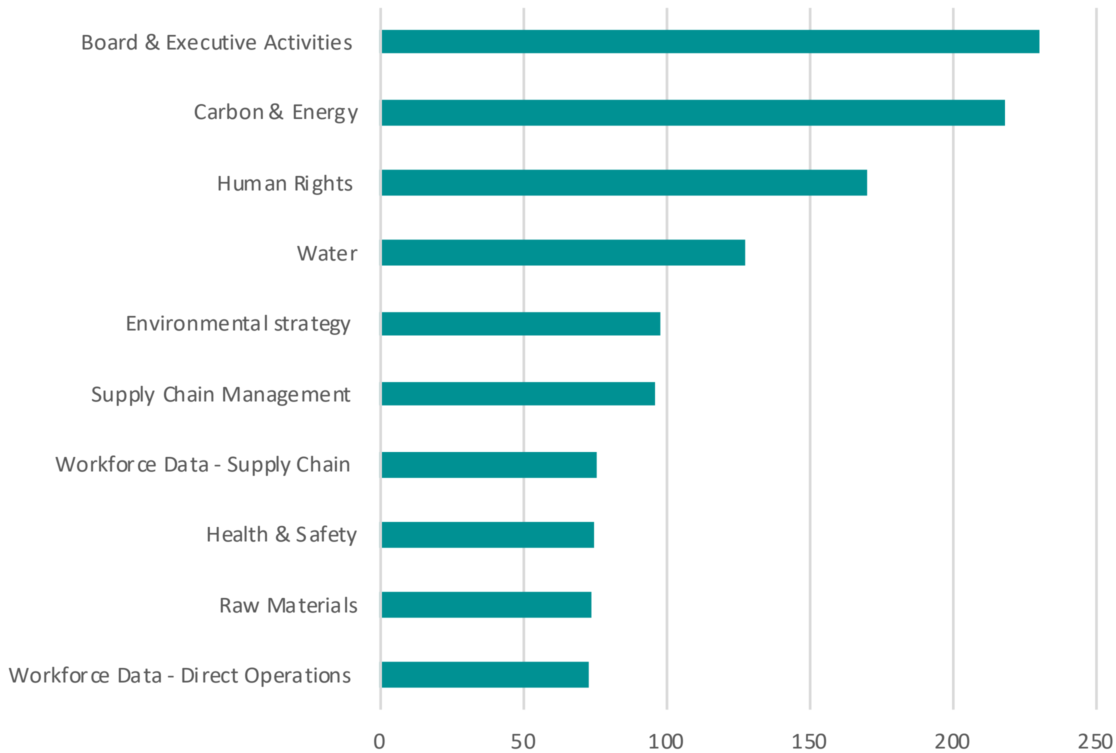


Figure 2: Direct operations vs. supply chain

What were the top ESG themes?

Governance came out at the top with 230 questions relating to the activities of the board. 'Environment' followed with 218 questions relating to carbon and energy, and the broader discussion of climate change. Based on the number of questions asked, human rights not only appeared in the 'top 10' but ranked third (of a total of 32 themes[6]). This is significant, and reflects the growing importance placed on managing and mitigating corporate human rights impacts.

Interestingly, there is also a hardening regulatory space surrounding these top three issues: boards and executive activities are heavily regulated; carbon and energy is increasingly so; and human rights legislation and regulation is now rising on the agenda across multiple jurisdictions.



[6] The 32 themes were identified through the categorisation of the issues by the ESG rating agency itself, and the synthesis and aggregation of other classifications. In many cases, a question could potentially satisfy multiple categories. For example, questions relating to purchasing practices can have an impact on human rights, but these were classified in 'Supply Chain Management'. Therefore, it is worth noting that with a number of items with human rights overlaps, it is possible that the total number of questions relating to or impacting on human rights could be much higher.

What were the main issues cross-cutting Social and Governance?

Within these 'S' and 'G' categories, I assessed the main issues in each question. Of the 922 questions that were relevant to human rights, unsurprisingly, 'Traceability and Risk Assessment' dominated all other categories, accounting for one in five questions. These questions sought to unearth whether a company had visibility of its supply chain, and whether it had assessed the risk within it - aligning with the directional movement of the legislation seeking greater transparency.

Following the questions driving for greater knowledge of the supply chain and risk assessment were questions relating to the regulated space of health and safety (9.5%). Questions relating to the sourcing of raw materials came third (7%)[7], followed by issues of gender (6%) and impact assessment (5%).

What was the human rights coverage?

Due to the sampling of ESG ratings, indices and benchmarks assessed in this study, there was a variance in the sophistication and degree to which human rights were incorporated into the questioning. Only two of the benchmarks were solely focused on evaluating corporate human rights performance and driving change. However, where there are full ESG assessments, it is notable to see the prevalence of human rights in the questioning. All 12 ratings and benchmarks had at least 20% of questions relating to human rights.

[7] The proportion of raw material questions could be due to Oxfam's Behind the Brands ranking, in which raw material-based questions account for nearly 15% of all questions.

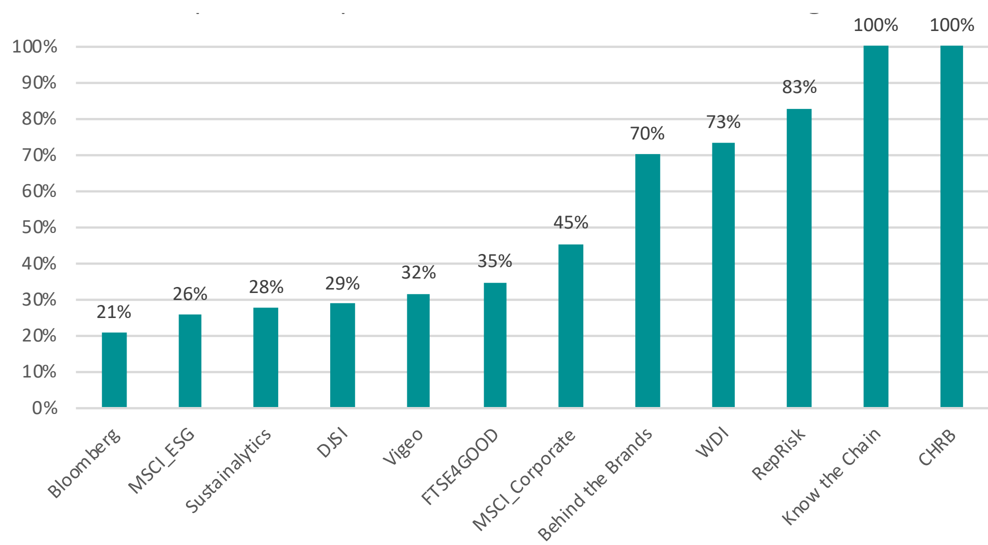


Figure 5: Proportion of questions with relevance to human rights

Are these questions getting to what's important?

While an investor should consider additional elements when evaluating a possible investment and company engagement strategy, these benchmarks can help inform decision-making processes and identify specific entry points for engagement. However, as the Corporate Human Rights Benchmark emphasises, these results will always be a proxy for good human rights management, and not an absolute measure of performance. This is because there are no fundamental units of evaluation for human rights.

Without these commonly agreed units of evaluation, the application of human rights related indicators and metrics in these ESG products will be flawed and inaccurate. Currently, the questions gravitate towards inputs or activities that are at best weakly indicative of outcomes for people or business, and in some cases can be satisfied by the use of certain phrases in policies or public reporting. Although we will always need to rely on proxy measures to be able to assess outcomes for people or business, we must strive to develop forms of evaluation that are indicative of actual performance. Currently, metrics that are serving as human rights indicators are simply measuring the financial, human or material resources that a company uses for an activity (e.g. number of people trained or number of audits conducted), they are not currently able to indicate the positive and negative outcomes for the business and affected rights holders.

Without more clarity as to what constitutes a meaningful indicator of outcomes for people (and related outcomes for business), the application of human rights related indicators and metrics in these ESG products will continue to be flawed. In a recent discussion paper[8], Shift proposes a causal pathway model to help distinguish the various types of indicators; from inputs, activities and outputs to behaviors/practices, outcomes for people and outcomes for business. While proxy indicators have great value where they are reasonably predictive of outcomes, too often those used are easy for companies to play to once they are included in a ranking, further eroding their already weak predictive value. Questions and metrics that get to what's important would focus on factors that are reasonably and reliably predictive of outcomes for people and related outcomes for business, or that directly measure those outcomes. These metrics, however, are still weakly represented both in ESG products and company reporting. Some are in the process of being developed and not yet mainstream.

Are ESG ratings, indices and benchmarks driving change?

Currently, over 50% of the questions likely to be found in an ESG questionnaire or benchmark will relate to[9] human rights[10]. Arguably, this figure could be much higher if companies accounted for the secondary impacts of their processes and decision making. Nonetheless, this demonstrates the importance of engaging with human rights risks, and taking the corporate responsibility to respect human rights seriously.

As far as evaluating this performance, increasingly companies will be forced to disclose the steps they are taking to enhance the transparency and risk assessment of the supply chain. Although we are still in the 'early days' of this transparency revolution, the sophistication of the corporate responsibility to respect human rights will only increase. We are faced with a challenge, however, if ESG evaluation continues to focus on questions that can be answered in a definitive binary 'yes' or 'no' answer (so that responses can be translated into ones and zeroes) or involve researchers or analysts offering a rating against a scale. All of this allows for a simplified message to be communicated in numerical form and allows for clear comparability. But with this increasing sophistication on the behalf of companies, the desire for numerical conclusions and the ability to assess and evaluate more nuanced indicators like changes in behaviors, practices or experiences of affected stakeholders will be in greater conflict. There is the need for innovation to allow us to simultaneously gain more meaningful insight about performance while retaining valuable simplicity.

Furthermore, there will be more information in the public domain and examples of how companies have tackled negative human rights impacts. For now, the indicators of actual outcomes for people will likely remain dominated by negative outcomes rather than evidence of harms prevented, or

[8] Shift's discussion paper on Shift, "Evaluating Business Respect for Human Rights: Towards a Shared Way of Thinking." New York, 2018.

[9] Some of these questions won't be specifically labelled as 'Human Rights' by the ESG product provider, but have been identified as having a direct impact on the enjoyment of human rights.

[10] 53.5% is the average percentage coverage of human rights issues across the 12 reports/benchmarks.

positive outcomes achieved by tackling risks to people's human rights. Many of the ESG products have a 'controversies' section to the analysis, and some look at companies' responses to allegations, but this information is often patchy and hard to interpret or contextualize. Therefore, the insight it offers into the effectiveness of policies and processes being assessed is uncertain. Future challenges will be to find better ways to connect these information sets, and to develop more balanced insights into positive as well as negative outcomes for people that can reasonably be attributed, in some degree, to company performance.

There is a collective need to find better evaluation approaches so that these ESG tools can remain a positive impulse for business to look carefully at human rights, and so the things they cover are truly indicative of good (or poor) performance on human rights. This would not only create the right rewards and incentives for progress but would also serve as a more accurate assessment of risk.

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Appendix

Source	Description
Bloomberg	Bloomberg ESG Disclosure Scores rate companies annually based on their disclosure of quantitative and policy-related ESG data. Bloomberg collects ESG data for over 10,000 publicly-listed companies globally. It evaluates companies on an annual basis, collecting public ESG information disclosed by companies through corporate social responsibility (CSR) or sustainability reports, annual reports and websites, and other public sources, as well as through company direct contact. Bloomberg ESG rating will penalize companies for 'missing data.' ESG data is integrated into Bloomberg Equities and Intelligence Services. Bloomberg ESG Disclosure Scores rate companies annually based on their disclosure of quantitative and policy-related ESG data. **Rating Scale:** Out of 100.
FTSE4GOOD	The FTSE4Good Index Series includes more than 15 benchmarks, based on research of over 3,000 securities in 46 developed and emerging markets. There are over 15 years of index level returns, and over that time the ESG assessment process and inclusion criteria has evolved to keep them aligned with industry trends and investor needs. The FTSE4Good Index Series supports alignment with the UN Sustainable Development Goals (SDGs). All 17 SDGs are reflected in the 14 ESG Themes that companies are assessed on in order to be included in the index series.
DJSI	DJSI was one of the first global indices to track sustainability-driven public companies based on RobecoSAM's ESG analysis. S&P Dow Jones Indices has partnered with RobecoSAM for publication and calculation of ESG indices. **Rating Scale:** Out of 100, and ranked against other companies in their industry. Updated annually.

Vigeo	Vigeo Eiris is a global provider of environmental, social and governance (ESG) research to investors and public and private corporates. The rating looks at relevance of policies, coherence of implementation and efficiency of results. It uses nine angles of analysis: visibility; exhaustiveness; ownership; means; scope; coverage; indicators; stakeholder feedback; company responsiveness. **Rating Scale:** Out of 100 and ranked from 'weak' to 'advanced' (on a 4-level scoring scale.)
Sustainalytics	Sustainalytics is the 2008 consolidation of DSR (Netherlands), Scoris (Germany) and AIS (Spain). Sustainalytics now covers over 6,500 companies across 42 sectors, and has an international presence. It provides qualitative analysis and commentary on companies' ability to manage ESG issues, and an overview of ESG controversies. It also partners with other sustainability rankings (e.g. KnowTheChain, Ranking Digital Rights and Access to Nutrition Index.) **Rating Scale:** Out of 100, sector/industry-based comparison.
MSCI	MSCI ESG RATINGS is designed to identify ESG risks or opportunities, and provide institutional investors with a comprehensive ESG integration solution. MSCI ESG Research provide ESG ratings for over 6,000 global companies and more than 400,000 equity and fixed income securities. **Rating Scale**: AAA-CCC scale.
RepRisk	RepRisk provides ESG reports for more than 84,000 private and public companies in 34 sectors globally. RepRisk also provides ESG reports for over 14,000 NGOs, 10,000 governmental bodies, and 20,000 projects. RepRisk reports are updated daily and provide an overview of the ESG risk exposure of an individual company for the past two years and ten years. The ratings are crested from a combination of quantitative data – RepRisk's proprietary risk analytics and metrics. **Rating Scale**: AAA to D (being the worst).
CHRB	The Corporate Human Rights Benchmark was the first benchmark to evaluate the human rights performance of companies from a range of sectors. The benchmark assesses in five criteria: Governance and policies; embedding respect and human rights due diligence; remedies and grievance

	mechanisms; performance in company human rights practices and responses to serious allegations. Underpinning this whole benchmark is transparency. It clearly states that the assessment excludes: geography; consumption of products and services; positive impacts; collective impacts (such as climate change). **Rating Scale**: Out of 100.
WDI	The Workforce Disclosure Initiative (WDI) collects information relating to the quality of jobs for employees in a company's global operations and for workers in their supply chains. WDI is modelled on the Carbon Disclosure Project (CDP). Companies are requested to provide information on the composition of the workforce, workforce stability, workforce development and worker engagement. The WDI builds on existing reporting standards such as the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB).
Know the Chain	KnowTheChain is a resource for companies and investors to understand and address forced labour risks within their global supply chains. Through benchmarking current corporate practices and providing practical resources that enable companies to operate more transparently and responsibly, KnowTheChain drives corporate action while also informing investor decisions. KnowTheChain is committed to helping companies make an impact in their efforts to address forced labour. The benchmark highlights key areas in which investors can engage with companies on this issue, which include recruitment practices, worker empowerment, and purchasing practices. The benchmarks further provide company-specific recommendations for engaging companies that are covered by the benchmark. **Rating Scale**: Out of 100.
Behind the Brands	Oxfam's Behind the Brands campaign aimed to provide stakeholders (particularly customers) with the information they need to hold the Big 10 to account for what happens in their supply chains. The ten companies ('the Big Ten') assessed in the Scorecard (in order of company size) are: Nestle, PepsiCo, Unilever, Mondelez, Coca-Cola, Mars, Danone, ABF, General Mills, and Kellogg's. Within the seven benchmark themes (land, women, farmers, workers, climate, transparency, water), the indicators are grouped into four indicator categories (each worth one quarter of the score available for

	that theme): (i) awareness; (ii) knowledge; (iii) commitments; and (iv) supply chain management. These indicator categories rely on publicly available documents to address the benchmark questions. **Rating Scale**: Out of 70 (10 points per section).