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ALERT ▪ ESG, CSR and Business and Human Rights

July 11, 2022

Ratings Firm Scrutiny of Modern Slavery Risks Increases – ISS ESG Launches New Modern Slavery Scorecard

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Last month, ISS ESG, the responsible investment arm of Institutional Shareholder Services, introduced its Modern Slavery Scorecard. The Scorecard evaluates 25 quantitative and qualitative factors to assess modern slavery risk at over 7,400 publicly traded companies. In this Alert, we describe the Scorecard and its assessment methodology and discuss considerations for issuers.

Modern Slavery – A Brief Overview

"Modern slavery" is an umbrella term covering, among other things, forced labor, debt bondage, human trafficking and forced marriage. According to some estimates, 40 million people are victims of modern slavery, including 25 million people that are victims of forced labor. Modern slavery occurs in every region of the world and is a risk in many supply chains. Modern slavery in corporate supply chains is an increasing area of focus globally by regulators, investors, consumers and other stakeholders.

Corporate modern slavery-related legislation largely breaks down into four broad categories: (1) disclosure-only; (2) due diligence-based; (3) trade-based; and (4) contract-based.

The first corporate disclosure-only modern slavery legislation, California's Transparency in Supply Chains Act, was adopted over a decade ago in 2010. That Act was followed by the U.K.'s Modern Slavery Act in 2015 and Australia's Modern Slavery Act in 2019. Disclosure-only modern slavery legislation also has been proposed in Canada and New Zealand. In addition, the United Kingdom has announced plans to significantly strengthen its Modern Slavery Act. More recently, last month, the EU Council and Parliament announced they have reached a provisional political agreement on the EU's Corporate Sustainability Reporting Directive, which will, among other things, require enhanced disclosure concerning the impact of businesses on human rights, which would include but be broader than just modern slavery impacts.

In the last year, momentum behind mandatory human rights due diligence legislation also has increased. These instruments generally address adverse human rights impacts broadly, including adverse impacts from modern slavery. In the last year, broad-based mandatory human rights due diligence legislation has been adopted by both Germany and Norway and proposed by the European Union, among other jurisdictions.

Support for trade-based regulatory solutions to address modern slavery also has been increasing. Both the United States and Canada have legislation prohibiting the importation of products produced with forced labor. Legislation also has been proposed in Australia and is expected to be proposed at the EU level. U.S. enforcement of its forced labor import prohibition has increased exponentially over the last few years and the first Canadian enforcement action has been reported. Most recently, the operative corporate provisions of the U.S. Uyghur Forced Labor Prevention Act took effect on June 21.

Alerts and articles on most of these developments can be accessed here (modern slavery) and here (mandatory human rights due diligence).

As part of ESG integration, many institutional investors are focused on human rights risks in their publicly traded portfolios, including risks relating to modern slavery. For example, in its February 2022 commentary, BlackRock Investment Stewardship noted its conviction that long-term shareholders benefit when companies operate their businesses responsibly, since unmanaged potential or actual adverse human rights issues can not only harm the people directly affected, but also expose companies to significant legal, regulatory, operational and reputational risks. Forced labor is among the human rights risks noted in the commentary. At the asset management industry level, Principles for Responsible Investment has been focused on modern slavery for several years. Individual asset manager focus on modern slavery risks is increasing due to, among other things, new modern slavery legislation affecting investee companies, more enforcement of legislation and greater awareness of modern slavery risks, including due to more reporting on modern slavery by mainstream media.

Although leading ratings that are focused on ESG more generally take modern slavery into account as part of the "S" pillar, they generally do so at a high level, looking at a limited number of indicators. There also have been numerous NGO surveys assessing modern slavery risk mitigation practices and compliance with modern slavery legislation, but these have covered a narrower range of companies and laws and generally have not been investor-focused.

The ISS ESG Scorecard Methodology

The Scorecard assesses issuers on 25 proprietary quantitative and qualitative factors developed by ISS ESG, focusing on operations and supply chains. ISS ESG has indicated it intends to revise these factors as applicable domestic and international modern slavery regulations and guidance evolve.

The Scorecard pulls data from three proprietary ISS ESG solutions:

- **ESG Corporate Rating:** This solution analyzes companies' management of environmental, social and governance issues against 100 sector-specific rating criteria. It relies on information gathered through media and other public sources, interviews with stakeholders and company policies and practices.

- **Norm-Based Research:** This solution assesses companies' adherence to international norms on human rights, labor standards, environmental protection and anti-corruption as set out in the UN Global Compact and OECD Guidelines for Multinational Enterprises.

- **ESG Country Rating:** This solution analyzes the sustainability performance and risks of all countries within the European Union and the OECD, as well as Brazil, Russia, India, China, South Africa and other sovereign issuers from Asia and South America.

Scorecard Components

The Scorecard has three components:

- **Modern Slavery Risk Assessment:** Provides issuer- and industry-specific risk assessments, as well as data on high-risk locations and products.

- **Modern Slavery Disclosure and Performance:** Assigns issuers a score from 0 to 100 based on the issuer's preparedness to identify and mitigate modern slavery risks. Based on that score, issuers are categorized as a "Modern Slavery Leader" (75-100), "Modern Slavery Outperformer" (50-74), "Modern Slavery Medium Performer" (24-49) or "Modern Slavery Laggard" (0-24). In determining this score, ISS ESG's operational and supply chain indicators include policies and procedures, supply chain monitoring practices, supplier non-compliance, training, living wages, working hours and respect for union rights.

- **Modern Slavery Controversies:** Identifies potential involvement in modern slavery controversies. In addition, broader labor rights controversies are considered as a stress test of an issuer's policies and procedures and an indicator of modern slavery risk.

ISS ESG Modern Slavery Thematic Engagement

ISS ESG's Thematic Engagement Solution enables investors to participate in joint outreach and dialogue facilitated by ISS ESG with a select list of target companies. The press release announcing the Modern Slavery Scorecard indicates that ISS ESG will have Thematic Engagement specific to modern slavery for food and healthcare, which the press release describes as "high risk supply chains groupings." According to the press release, the engagements will focus on both buyers and suppliers. Forty companies have been identified for engagement on modern slavery issues in the next two-year engagement cycle.

Considerations for Issuers

The ISS ESG Modern Slavery Scorecard—and the other enhanced modern slavery assessments and ratings that will undoubtedly be introduced by ISS ESG competitors—will be used by many institutional investors to help determine and frame their issuer engagement around modern slavery. Issuers in at least higher risk sectors should be aware of their Modern Slavery Disclosure and Performance score. Issuers also should assess whether the Scorecard's modern slavery risk assessment is aligned with that of the issuer.

Since Scorecard modern slavery risk assessments and scores (and, more generally, scoring of modern slavery indicators in other ratings) are in part based on issuer disclosure, issuers should consider whether enhanced disclosures relating to their risk assessments and initiatives to address modern slavery are merited. As a general matter, at present, most issuer modern slavery disclosure is geared toward meeting regulatory requirements, rather than investor informational interests. For example, issuer modern slavery risk assessments and policies and procedures to address modern slavery often are substantially more robust than publicly disclosed.

This Alert is focused on modern slavery ratings and, to a lesser extent, investor expectations and legal compliance. Although beyond the scope of this Alert, there are of course important ethical and additional commercial reasons for businesses to respect human rights. Even though designed for a different purpose, investor-focused modern slavery ratings will in many cases be a useful part of an issuer's toolkit for identifying and addressing adverse human rights impacts relating to modern slavery.

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