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The Saliency Materiality Nexus

Addressing systemic risks to people and portfolios in a turbulent world

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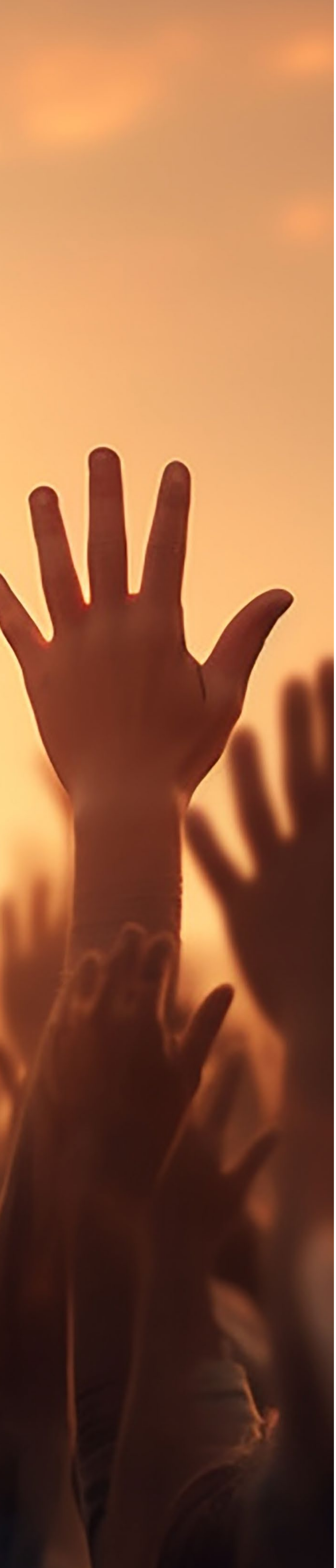
HEARTLAND INITIATIVE | Wespath BENEFITS | INVESTMENTS | Schroders



Executive summary

Corporate proximity[a] to human rights harms can create financial costs for companies, leading to myriad risks for their shareholders. This white paper describes how salient human rights and material risks intersect in an increasingly turbulent world.

The intersection of these risks, referred to as the "saliency-materiality nexus," can exist in any operating context, but human rights risks to people most often translate into financial impacts for companies and shareholders in conflict-affected and high-risk areas (CAHRA).[b] Recent geopolitical crises – such as the wars in Gaza and Ukraine, the military coup in Myanmar, and allegations of forced labor in Xinjiang, China – have triggered widespread human suffering, an array of corporate losses, and impacts to global markets. With geopolitical conflict and authoritarianism on the rise, many investors are seeking solutions that meet both their fiduciary duties and responsibilities under the United Nations Guiding Principles on Business and Human Rights (UNGPs) in these complex environments.

While CAHRA pose a higher degree, quantity, and frequency of risks, this paper is not meant to deter investment in these markets, as they depend on capital investment to spur economic growth, reduce conflict, and bolster human rights protections. Rather, the paper describes the saliency-materiality nexus as a practical, rights-based framework that can focus investors' analytical and engagement efforts on identifying and addressing the most severe and systemic social risks in their portfolios.

Part One of the paper examines the challenges faced by investors pursuing stewardship of human rights risks in the midst of an increasingly conflict-affected and fragile world. These challenges include widespread and diverse human rights impacts, lack of fit-for-purpose data on corporate proximity to harms, and under-resourced staff to interpret available data.

Part Two introduces the saliency-materiality nexus as a solution for conducting proactive and robust human rights due diligence (HRDD). This section uses case studies to show how corporate proximity to human rights harms in CAHRA can translate into regulatory, legal, operational, and reputational risks with tangible financial impact on companies and shareholders. The paper includes twelve case studies where companies that caused, contributed to, or were directly linked with human rights harms in CAHRA suffered financial losses totaling over $85 billion[c] through financial penalties, judgments, settlements, fines, loss in share price, or decreases in revenue or profit.

Finally, part Three details the ways in which Heartland Initiative (Heartland), a nonprofit investor advisory and creator of the saliency-materiality nexus, Wespath Benefits and Investments (Wespath), a global asset owner, and Schroder Investment Management (Schroders), a global asset manager, put the nexus into practice. These three institutions have long been involved in identifying and mitigating investment risks in CAHRA. This section describes how focusing HRDD on salient and material risks in CAHRA can meaningfully assist investors as they identify and address the most at-risk companies in their portfolios and, in doing so, can help fulfill their responsibilities to clients, fund mandates, emerging due diligence legislation, and vulnerable populations.

a. For the purposes of this paper, "corporate proximity" refers to instances where a company may cause, contribute to, or be linked with human rights harms, as outlined by the United Nations Guiding Principles on Business and Human Rights. *See* "Seven Questions to Help Determine When a Company Should Remedy Human Rights Harms under the UNGPS." *BSR*, Jan. 2021, https://www.bsr.org/reports/Seven_Questions_to_Help_Determine_When_a_Company_Should_Remedy_Human_Rights_Harm_under_the_UNGPs.pdf.
b. For the purposes of this paper, the term CAHRA is taken from the "OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas Second Edition." Conflict-affected areas are defined under the standards of international humanitarian law and identified using the Geneva Academy for International Humanitarian Law and Human Rights' RULAC platform. High-risk areas are identified using the findings of leading global indices measuring geopolitical conflict, repression, fragility, and other indicators of state health. A list of resources evidencing characteristics of conflict and high risk is provided in Annex 2 to support investors in determining their own thresholds and standards regarding CAHRA.
c. Note that $20 billion of this cost is linked to a TotalEnergies project that has been subject to a force majeure. The project has not been completely closed, but has been paused indefinitely since 2021.

Introduction

There is a growing awareness of how environmental and social harms can have financially material impacts on a business's performance. Evolving investor attention has expanded the concept of "materiality" — traditionally limited to information regarding a company's financial performance — to "double materiality."[1] This updated and expanded understanding of materiality includes other information that describes a company's impact on the environment, the economy, and the people associated with its operations and how these risks can affect financial performance.

Applying a double materiality framework analyzes information about how a company causes, contributes to, or is directly linked with human rights violations and where these risks intersect with financial results. This paper proposes investors focus their HRDD efforts on the saliency-materiality nexus to identify contexts where the most salient (or severe) human rights harms[2] intersect with the most financially material (or costly) impacts on companies.

Investors have made strides in systemic stewardship related to environmental risks (the "E" in ESG) over the last two decades, spurred on by increasing recognition of the broad economic risks of climate change and regulatory developments like the Sustainable Finance Disclosure Regulation (SDFR) in the European Union.[d] However, CAHRA and the array of human rights risks in these contexts have challenged institutional investors in making comparable progress in identifying, assessing, and addressing human rights risks within their portfolios.[e] The increasing integration of human rights and conflict in mandatory due diligence legislation,[3] sustainability accounting[4] and global reporting frameworks[5] and widespread commitments to the UNGPs have reinforced the responsibility of investors to consider these impacts when developing and implementing investment strategies. These trends have coincided with a significant escalation in conflict around the world causing many investors to seek solutions that meet their responsibilities to both human rights and financial returns. Investors are also seeking to address the long-term reality that human rights risks, left unmitigated, will result in increased human suffering and threaten the long-term economic stability needed for a healthy economy and stable financial returns.

d. Under the EU's Sustainably Finance Disclosure Regulation (SFDR), many financial market participants and advisors in the EU or those selling financial products to EU residents are required to disclose how they consider how "an environmental, social or governance event or condition that, if it occurs, could cause a negative material impact on the value of the investment."
e. The "S" within the ESG framework analyzes how a company impacts society, including information regarding human rights risks and other social issues, such as the welfare of employees and other internal stakeholders. *See* "Putting the S in ESG." *EPVA*, https://www.impacteurope.net/sites/www.evpa.ngo/files/publications/EVPA-Putting-The-S-In-ESG.pdf

1 The challenge

Advancing systemic stewardship for the benefit of rights holders and shareholders in a conflict-affected and fragile world

Geopolitical conflict and authoritarianism are spreading, global freedom has declined for the 16th straight year,[6] and the World Bank expects two-thirds of the world's poor to live in fragile and conflict-affected situations[7] by 2030. According to the Armed Conflict Location and Event Data Project ("ACLED") Conflict Index, a leading index on political violence and protest events, "12% more conflict occurred in 2023 compared to 2022, and ACLED recorded an increase of over 40% compared to 2020." ACLED also reports that "[o]ne in six people live in an actively conflicted area."[8]

These high-risk settings, also referred to as CAHRA, are characterized by "widespread human rights abuses and violations of national or international law." Polythreats,[9] or a convergence of related and compounding risk factors, such as the climate crisis,[10] proliferation of cyber-attacks,[11] and forced displacement of populations,[12] exacerbate CAHRA risks by increasing economic instability, state fragility, and human suffering.

2022 was the deadliest year for conflict[13] since 1994.

Policymakers and company executives have struggled to develop systemic prevention, monitoring, or mitigation responses to increased levels of conflict, typically reacting to each new crisis as it emerges. During her January 2024 speech to world leaders in Davos, European Commission president Ursula von der Leyen said that humanity is facing its "greatest risk to the global order in the postwar era."[14] Many corporate leaders have voiced similar concerns regarding an increase in conflict and fragility. According to a KPMG survey of business executives, "[n]either boards or management teams feel confident in their internal capabilities to interpret fast-moving geopolitical events or judge how these might impact their firms."[15]

Investors are also increasingly concerned by portfolio exposure to material risks in an increasingly turbulent world. In the US SIF Foundation's 2022 Trends Report, 497 surveyed institutional investors with over $6.6 trillion assets under management identified "conflict risk" as their second leading ESG criteria for investment decision-making.[16] However, companies and investors have found themselves poorly equipped to deal with recent crises and have been forced to hastily react to complex geopolitical situations without the policies, practices, or governance measures to effectively address exposure to escalating and interrelated threats.[17]

Investors seeking to address CAHRA-related risks also face an absence of fit-for-purpose data, research, and analysis that incorporates both the impact of human rights harms and conflict on company performance and a company's impacts on rights holders and conflict dynamics. While organizations such as the United Nations Development Programme[18] and United Nations Working Group on Business & Human Rights[19] are developing resources to assist companies in conducting heightened HRDD for their direct and value chain operations in CAHRA, there has not been a corresponding increase in guidance for investors. Notable exceptions include Responsible Investor Association Australasia's Investor Toolkit on Human Rights & Armed Conflict[20] and UN PRI's Guidance on Responsible Business in Conflict-Affected and High-Risk Areas: A Resource for Companies and Investors.[21]

Furthermore, in contrast to environmental data, which often includes quantitative targets (e.g., maintaining temperatures at 1.5 degrees Celsius), key performance indicators (e.g., short-, medium-, long-term targets for emissions reduction), and indices on how well companies are meeting climate goals (e.g., Transition Pathway Initiative), the provision of social data is often under-resourced, highly subjective, and lacking quantitative rigor. In the absence of useful "S" data focused on human rights risks that can easily be integrated into financial portfolio analysis, investors are forced to either rely on inadequate data or spend significant time interpreting a wide range of human rights research and analysis. This problem is compounded by resource constraints among investors, which often includes a small number of staff responsible for managing a myriad of ESG risks in a globally diversified portfolio and with limited human rights expertise.

The combination of these realities leaves a significant gap in consistent, comparable, and decision-useful information and support for investors to identify and prioritize social risks. In light of these challenges, investors may find that current methods for identifying human rights and conflict risks are either too broad (e.g., encompassing all investments related to a country) or too narrow (e.g., focusing on a particular country or company).

However, applying the saliency-materiality nexus as a contextual lens can focus investors' risk analysis on business contexts with salient harms to people and material costs to companies and their shareholders. By doing so, investors will be better able to leverage existing guidance and data, maximize limited resources, and coalesce around the most pervasive and material human rights risks in their portfolios.

2 The solution

The saliency-materiality nexus is where the most severe human rights harms translate into financially material impacts

The saliency-materiality nexus refers to the intersection where the most severe human rights harms create significant regulatory, legal, operational, and reputational risks that can result in material financial impact. While the nexus exists in all operating contexts and across industries, it is in CAHRA where salient human rights risks to people and their communities most often translate into financially material risks for companies and their shareholders. Rights-holders in these countries and territories are at a greater risk of suffering physical harm by state and/or non-state actors. This risk is exacerbated by a lack of basic necessities and exposure to episodic violence, state-based repression, and vulnerability to exploitation. In addition, the unstable situations present in CAHRA often limit rights-holders' avenues for remedy.

Due to the prevalence of violence, corruption, weak governance, and other endemic risks in CAHRA, companies with operations and/or value chain relationships in these contexts are more likely to be implicated in human rights harms. For example, a lack of economic resources for individuals can make them more vulnerable to exploitative labor practices, increasing risks of forced labor for supply chains sourcing from these areas.

The individual characteristics of CAHRA also pose increased financially material risks for companies and their shareholders. The International Finance Corporation reports that companies operating in fragile and conflict-affected settings "face business risks that are much greater than those in other emerging markets," including destruction of physical capital, fatalities and injuries, weak state control, lack of security, and supply-chain disruptions.[22] Furthermore, state fragility, a weak or authoritarian central government, chronic or episodic violence, and the absence of the rule of law can increase the financially material risks associated with corruption, seizure of corporate assets, and conflict with local communities.

Case studies demonstrating the intersection of salient human rights harms and financially material risks in CAHRA

Figure 1: Impact from 12 case studies

$85bn
financial impact

Regulatory
- Sanctions
- Export Controls
- Anti-Money Laundering Regimes
- Import Restrictions

Legal
- Civil Liability
- Criminal Liability
- Human Rights Due Diligence Legislation

Operational
- Loss of access to value chain partners
- Conflict with local communities
- Operational disruptions

Reputational
- Advocacy Campaigns

Source: Heartland, Wespath, Schroders.

The financial costs of geopolitical conflict and fragility are often not straightforward or simple to quantify, particularly under the complex and disruptive circumstances present in CAHRA. These variables make it difficult to determine if any single conflict or human rights harm directly caused a decline in stock price or other type of financial loss at a company. However, the twelve case studies below demonstrate how proximity to human rights and conflict harms can contribute to material regulatory, legal, operational, and reputational risks and correlate with over $85 billion in combined financial losses for companies and shareholders.

Regulatory Risks

Governments are increasingly using their regulatory power to respond to state and non-state actors' complicity in conflict and human rights abuses. This has been demonstrated by the development of sanctions regimes targeting human rights abusers and corrupt actors (e.g., U.S. Global Magnitsky Sanctions[23]), import restrictions to address forced labor in high-risk jurisdictions (e.g., U.S. Uyghur Forced Labor Prevention Act[24]), export controls to curtail the availability of technology to actors involved in conflict (e.g., U.S. Disruptive Technology Strike Force[25]), and unwinding regulatory regimes to limit trade with an occupying power (e.g., European Court of Justice's rulings on trade treaties with Morocco[26]). Furthermore, legislators are developing regulations specifically designed to mandate corporate HRDD and advance accountability for connection to human rights harms (e.g., French Duty of Vigilance Law, German Supply Chain Act, EU Corporate Sustainability Due Diligence Directive[27]).

In addition to regulations designed to address conflict or human rights harms, operating in high-risk contexts increases the likelihood of being connected to conduct restricted by other non-rights specific regulations or transacting with a rights-violating entity that is subject to an administrative designation. For example, conducting business with individuals and entities with a track record of rights abuses in CAHRA may expose companies to violations of sanctions, export and import controls, data protection regulations, and anti-money laundering (AML) laws. The prevalence of corruption, lack of rule of law, abuses of state power, and violence in CAHRA can also correlate with an increased number of rights-violating actors in these contexts.

Sanctions Violations | BNP Paribas S.A. ("BNP")

BNP, a French multinational financial services institution, entered into a $8.9 billion settlement agreement with the U.S. Department of Justice (DOJ) for the company's violation of U.S. sanctions covering Sudan, Iran, and Cuba between 2004 and 2012.[28] According to the investigation, the majority of the violations occurred through BNP processing approximately $4 billion in transactions on behalf of the Sudanese government, which was subject to a sanctions embargo based on its role in enabling terrorism and committing human rights abuses. By facilitating these transactions, BNP made the transfer of $6.4 billion dollars on behalf of sanctioned Sudanese entities possible, granting the Sudanese government illegal access to U.S. financial networks and resourcing grave human rights abuses such as arbitrary arrest, torture, extrajudicial killings, sexual violence, and supporting international terrorism.[29]

BNP's business on behalf of the Sudanese government created significant financial risks and had an impact on shareholder value. In the wake of the DOJ $8.9 billion fine, BNP shares fell "6.1 percent — the largest intraday drop since February 2013."[30] BNP faces continued financial risks from its connection to human rights harms, such as a revived class action lawsuit from Sudanese refugees[31] in the United States and a criminal probe in France.[32]

Export Controls | ZTE Corp ("ZTE")

ZTE is a partially state-owned Chinese telecommunications company that provides information and communication technology products and services. In 2017, the U.S. Bureau of Industry and Security (BIS), DOJ, and ZTE entered into a $661 million settlement agreement related to ZTE's violation of U.S. export controls. According to the government's findings, ZTE unlawfully built, operated, and maintained telecommunications networks[33] in Iran[34] and North Korea,[35] which have extensive track records of exploiting telecommunications networks to unlawfully surveil and oppress their citizens, dissidents, marginalized groups, and human rights defenders (HRDs). ZTE also allegedly sold a powerful surveillance system that included U.S. telecommunications equipment to Iran in 2012.[36] By providing equipment to build, service, and maintain Iranian and North Korean telecommunications infrastructure, ZTE contributed to the harms committed through these systems.

Shortly after the settlement, BIS discovered ZTE had provided false information in the course of its investigation and failed to uphold the terms of the settlement agreement. In response, the U.S. government barred American companies from exporting products to ZTE without the proper license. This prevented ZTE from obtaining 25-30 percent of its necessary supplies, reportedly halting all operations, and "crippling" the $17 billion company.[37] Based on ZTE's inability to fulfill orders, credit ratings agency Jefferies downgraded ZTE to "underperform,"[38] analyst price targets fell 40 percent, and the company lost $7 billion in market cap[39] by mid-2018. To lift the ban, BIS and ZTE agreed to an additional $1 billion settlement that included remedial measures such as new executive management and a lengthy probation period.[40] Today, ZTE is again subject to regulatory restrictions[41] in several countries[42] for its connection to Chinese state surveillance programs.

Import Restrictions

The U.S. Uyghur Forced Labor Prevention Act (UFLPA) came into effect in June 2022, establishing a "rebuttable presumption" that any product originating from the Xinjiang region of China had been made with forced labor. Importers must overcome a high threshold of "clear and convincing evidence" that their goods were not mined, produced, or manufactured using forced labor when shipping from this region. To date, more than 9,000 shipments of imports have been detained by the U.S. Customs and Border Protection.[43] Of these shipments, 3,596 have been outright denied and 479 are pending, the value of which collectively comes to $870 million.

Chinese multinational Jinko Solar has come up against these import restrictions.[44] Even in the cases where companies have been able to provide sufficient documentation such that shipments are ultimately released, there are still meaningful delays and backlogs in delivery.[45] In May 2023, the company sold its subsidiary, Xinjiang Jinko.[46] While the company stated the sale was carried out to "reduce Jiangxi Jinko's operational costs, improve its production efficiency and optimize its facility mix," the financially material scrutiny from UFLPA enforcement officials is very likely to have played a role.[47] This is indicated in the Business Risks section of the company's Securities and Exchange Commission FY23 20-F Report, where Jinko highlight that direct sales to the US market accounted for 4.5% and 8.8% of total revenues in 2022 and 2023 respectively. This is followed by narrative stating: "*Given the fact that we had a manufacturing facility in Xinjiang in the past, we cannot assure you that the relevant U.S. authorities will not decide that forced labor exists in the manufacturing of our products or in our supply chain and, put our facilities or their affiliate companies on the list of entities to be issued pursuant to UFLPA. We have disposed of 100% equity interest in the manufacturing facility in Xinjiang... importation of our products to the United States may be partially or entirely suspended or blocked. Either of these types of regulatory or legislative action would adversely affect our business, financial condition and results of operations.*"[48]

Anti-money Laundering | Westpac Banking Corporation ("WBC")

In November 2019, an Australian federal court publicly launched an investigation into WBC[49] for failing to identify and report on suspicious transactions linked to high-risk jurisdictions, such as Lebanon, Ukraine, Zimbabwe, and the Democratic Republic of Congo in violation of AML and financing of terrorism regimes. The investigation resulted in a $1.3 billion penalty against the company and uncovered that WBC's failure to abide by its regulatory requirements facilitated over 3,000 transactions[50] allegedly linked to the sexual exploitation of children in the Philippines.[f]

In addition to the country's record-setting fine, WBC also saw a significant loss in shareholder value, increased shareholder pressure, and legal risks associated with being linked to child abuse in the Philippines. Between the release of the allegations and the company's annual general meeting (AGM), WBC's valuation fell by $8 billion.[51] At the company's December 2019 AGM,[52] 35 percent of shareholders

f. According to the Geneva Academy's analysis of international humanitarian law available through the RULAC tool, The Philippines is currently "involved in multiple non-international armed conflict (NIACs) in Mindanao against the Moro National Liberation Front, the Moro Islamic Liberation Front, the Bangsamoro Islamic Freedom Fighters, the Maute Group, and the Abu Sayyaf Group." *See* "The Philippines." *RULAC,* https://www.rulac.org/browse/countries/the-philippines.

voted against remuneration, automatically triggering an opportunity to remove the board, while one of the bank's directors, Peter Marriott, received a 42 percent vote against re-election. WBC's former chief compliance officer and chairman were both forced to resign under shareholder pressure.[53] Finally, a large group of shareholders brought a class action lawsuit against the company for damages based on the significant losses in shareholder value.[54]

Legal Risks

Historically, legal accountability for multinational companies has been limited by jurisdictional, procedural, and evidentiary challenges.[55] However, companies operating in CAHRA are at a greater risk of facing criminal and civil liability for causing or contributing to salient human rights harms. The viability of legal action depends on the national laws that are applied, if international law can be integrated into the claims, and the ability of judicial mechanisms to provide an adequate remedy. The nature of CAHRA, and the egregious human rights abuses that characterize these contexts, provide greater opportunities to extend jurisdiction,[g] often apply widely accepted legal standards enshrined in international humanitarian law[56] to companies, and uncover evidence connecting corporate activity to systemic and salient human rights impacts.

According to data from Trial International,[57] the number of universal jurisdiction cases against corporate and non-corporate actors increased by 40 percent between 2018-19.

National tribunals are also moving towards establishing precedent for corporate accountability based on violations of international law in CAHRA. For example, Swedish prosecutors brought criminal claims against two executives of Lundin Mining Corporation for complicity in war crimes in Sudan during the armed conflict between 1997-2003.[58] If the executives are found guilty, the Swedish government may issue a forfeiture of $384 million for economic benefits of the illegal conduct and impose a separate $300,000 fine.[59] Similarly, courts are moving towards extending civil liability for extraterritorial violations of norms rooted in customary international law.[60] In a landmark case, the Canadian Supreme Court ruled a group of workers who suffered cruel and degrading treatment at a Canadian-owned mine in Eritrea could bring claims against the mining company in Canada based on Customary International Law.[61]

Civil Liability | Chiquita Brands International ("Chiquita")

In 2007, Chiquita Brands International (Chiquita) pleaded guilty to criminal charges[62] of making payments to a designated terrorist organization, United Self-Defense Forces of Colombia (AUC), to protect its assets in Colombia. The settlement agreement resulted in a $25 million fine and required Chiquita to develop an effective compliance and ethics department. Shortly thereafter, the family members of eight victims murdered by AUC brought civil suits against the company. After 17 years of litigation, a Florida jury awarded a $38.3 million verdict,[63] holding Chiquita liable for its role in facilitating the harms of AUC through $1.7 million of protection payments.[64] During the proceedings, the Florida court rejected a procedural argument to dismiss the case under the doctrine of *forum non conveniens*, which is commonly used to end lawsuits concerning corporate conduct abroad based on the legal theory that the United States is not the appropriate forum. However, the Florida court rejected this argument, reasoning the court system in Colombia would not be able to provide the plaintiffs with a suitable remedy.[65] Though brought under U.S. domestic anti-terrorism statutes, this case demonstrates how issues surrounding CAHRA can overcome procedural barriers that traditionally prevented corporate liability.

Criminal Liability | Holcim Limited (Lafarge)[h]

In 2016, civil society organizations filed a criminal complaint against French multinational industrial company Lafarge for complicity in crimes against humanity committed by the Islamic State in Syria (ISIS).[66] The complainants specifically allege that Lafarge made payments to armed groups to protect its cement facility in exchange for commodities and to obtain permits. In 2018, the French prosecutor formally indicted Lafarge; in September 2021, the French Supreme Court upheld the indictment for complicity in crimes against humanity.[67] As of January 2024, France's highest court confirmed the charges for complicity in crimes against humanity can proceed.[68] In addition, Lafarge pled guilty to criminal charges of conspiring to provide material support to terrorism[69] with the DOJ, agreeing to pay a $778 million fine.[70] While this complaint was proceeding through the French court system in December 2023, Yazidi plaintiffs initiated a separate lawsuit against Lafarge for its role in facilitating ISIS's severe human rights abuses against this ethnic minority that allegedly included providing cement to build tunnels and bunkers in which Yazidis were held captive.

g. Universal jurisdiction, a concept rooted in international law, allows domestic legal systems to prosecute perpetrators regardless of traditional jurisdictional constraints based on the egregious nature of the international crime at issue. The types of human rights harms that occur in CAHRA, which can amount to crimes against humanity, war crimes, and/or genocide, are more likely to support extending universal jurisdiction than other types of human rights harms.

h. In 2015, Lafarge S.A. and Holcim LTD merged to establish a new entity, LafargeHolcim. Today, LafargeHolcim, operates under the Holcim Group, legally known as Holcim Limited. *See* "Holcim and Lafarge Complete Merger and Create LafargeHolcim, a New Leader in the Building Materials Industry." *Holcim*, 10 July 2015, https://www.holcim.com/media/media-releases/holcim-and-lafarge-complete-merger-and-create-lafargeholcim-a-new-leader-building-materials-industry; "Stock Market Name Change: We are now Holcim LTD." *Holcim*, 14 May 2021, https://www.holcim.com/media/media-releases/stock-market-name-change-we-are-now-holcim-ltd

Civil Liability | Shell Plc ("Shell")

Shell is a British multinational oil and gas company, developing and operating facilities around the world. The company and its subsidiaries have been the subject of litigation in several jurisdictions based on alleged connections and contributions to environmental and human rights harms in Nigeria.[i] For example, Shell's operations in the country have been connected with the extrajudicial killings of human rights defenders and severe environmental damage with adverse health and economic impacts for local communities. In 2009, Shell paid $15.5 million to compensate the family of Ken Saro-Wiwa and eight other leaders based on allegations the company collaborated in the leaders' execution.[71] In addition, Shell paid an $84 million settlement in 2015[72] for the 2008 Niger Delta oil spills, an $111 million judgment in 2021[73] for an oil spill during the Biafran War, and a $16 million[74] judgment in 2022 for pipeline leaks.

Liability Under HRDD Laws | Électricité de France SA ("EDF")

EDF is a recently nationalized French multinational utility company operating nuclear, gas, coal, and renewable energy projects around the world. In 2017, EDF sought to build the €310 million Gunaa Sicaru wind park on the land of the indigenous Zapotec community of Union Hidalgo[75] in Oaxaca, Mexico.[j] During the development of the project, there were allegations that the company failed to properly gain the Free, Prior, and Informed Consent (FPIC) of the indigenous community and adequately assess the potential adverse impacts of the proposed operations.[76] As a result, a rift emerged within the community, with violent conflict erupting[77] between residents in favor of the promise of jobs and investment and those who feared environmental degradation and loss of access to their lands. Based on EDF's failure to properly conduct HRDD, which should have included more effective consultation with the community and consideration of the pre-existing social tensions and divide, representatives of Union Hidalgo subsequently filed a civil lawsuit under the French Duty of Vigilance law in October 2020.[78] As a result of the continued conflict with the community, Mexico's state power utility canceled[79] the EDF contract. According to the company's annual report in 2022, this incurred a $42 million impairment cost.

Operational Risks

Companies associated with proximity to human rights harms in CAHRA can experience material operational impacts from a loss of social license to operate in the community, physical damage to company assets, seizure of assets by the state, or limitation or loss of value chain partners, including customers. For example, a company's loss of social license to operate can arise from protests, roadblocks, confrontations with community members, or advocacy campaigns. In addition, a company can lose its legal license to operate through regulatory constraints that limit a company's ability to produce goods, provide services, or otherwise generate revenue.[k] Companies can also experience physical damage to assets in conflict situations as a result of being perceived as directly or indirectly supporting armed state or non-state actors involved in ongoing conflict.

Government constraints or intervention in CAHRA can further delay operations through the revocation or suspension of necessary permits and limitations on a company's ability to access necessary value chain partners or customers. In more severe situations, these risks can extend to governments issuing orders to stop operations amidst conflict, or government appropriation, nationalization, or seizure of company assets. While these types of operational impacts and the corresponding financial risks can occur in many contexts, they are particularly acute in CAHRA given the underlying social tensions, prevalence of violence, and instability in government regulations that characterize these environments.

97 percent of 1,200 CEO's surveyed altered investment plans[80] due to geopolitical volatility.

Loss of Access to Value Chain Partners | Hangzhou Hikvision Digital Technology Co. Ltd. ("Hikvision")

Hikvision is a partially state-owned Chinese technology company that has been subject to operational constraints based on regulatory and administrative action taken by the United States, United Kingdom, Australia [81] and EU[82] due to its connection to the Chinese government's alleged unlawful

i. According to the Geneva Academy's analysis of international humanitarian law available through the RULAC tool, Nigeria is currently involved in non-international armed conflict against Boko Haram. *See* "Nigeria." *RULAC*, https://www.rulac.org/browse/countries/nigeria.

j. According to the Geneva Academy's analysis of international humanitarian law available through the RULAC tool, Mexico is currently involved in non-international armed conflict against the Cartel Jalisco Nueva Generación and the Sinaloa Cartel. *See* "Mexico." *RULAC* https://www.rulac.org/browse/countries/mexico. Furthermore, Heartland's Conflict-Affected and High-Risk Index identifies Mexico as a CAHRA based on the Uppsala Conflict Data Program's 2023 reporting of over $13,000 battles related deaths. *See* "Mexico." *UDCP*, https://ucdp.uu.se/country/70.

k. This paper classifies regulatory designations that limit a company's ability to access value chain partners or markets and may result in financial losses as an operational risk. For example, as described above, ZTE saw a significant regulatory impact for violating export controls when it shipped goods to Iran and North Korea and was forced to pay a fine (regulatory risk). However, ZTE faced a significant operational risk resulting in a financial loss when it was designated under the US Entity List and was unable to access 25-30 percent of its suppliers (operational risk).

surveillance and oppression of Uyghur minorities in China. For example, since 2019, the United States has imposed several regulatory restrictions on Hikvision, preventing federal agencies[83] from purchasing its products, banning U.S. investment[84] in the company, prohibiting U.S. companies[85] from exporting technology to the company without a license, and refusing authorization[86] for Hikvision devices. These actions have severely restricted how Hikvision can finance, manufacture, sell, and operate its products in several notable markets, negatively impacting the company's revenue, profitability, and share price.

According to an analysis of the company's financial disclosures, Hikvision stated its net profit fell 23 percent in 2022 -- its worst performance in 20 years.[87] Furthermore, in response to the Biden Administration considering increased sanctions, Hikvision's shares immediately fell 10 percent.[88] Hikvision's[89] historic market cap reporting demonstrates a $26 billion dollar loss of value, falling from $73 billion in January 2022 to $47 billion one year later. While the company recouped a portion of the loss, since April 2023, Hikvision value has continued to fall with a current market cap of roughly $42 billion as of the date of this paper.

Conflicts with Communities | Excellon Resources ("Excellon")

Excellon is a Canadian mining company operating platinum and silver mines in Mexico. The company and local community members in Mexico have engaged in a protracted struggle based on the company's alleged failure to obtain land with adequate consultation and through intimidation of human rights defenders.[90] In 2008, the company and community members executed a land rental agreement that was designed to protect local community buildings and sought to resolve tension. However, after the company allegedly failed to honor the agreement, the community members initiated a blockade in protest.[91]

Despite peaceful demonstrations, Excellon threatened protesters with criminal action and other retaliation, and the Mexican government sent in armed forces to remove the blockade.[92] For nearly two months,[93] the blockade interrupted operations at the mine and forced the company to invoke *force majeure* clauses in its supply contracts. In addition, community members filed a complaint with the Ontario Securities Commission for Excellon's failure to properly disclose the community's motivation for the blockade. Excellon shares fell by more than 27 percent within seven business days of the blockade making public headlines.[94]

Operational Disruptions Based on Conflict | TotalEnergies SE ("TotalEnergies")

TotalEnergies is a French multinational energy company, developing and operating oil and gas facilities throughout the world. In 2019, TotalEnergies began construction of a liquefied natural gas (LNG) plant in the Cabo Delgado region of Mozambique that has been plagued by conflict between the state and the non-state armed group Al-Shabaab.[95] Since the development of the facility, hostilities from non-state armed groups have increased. In 2021, Al-Shabaab attacked the local community near the company facility.[96] In response, the Mozambique government sent in troops to protect the LNG plant, which has contributed to the militarization of the region and connected the company to salient human rights harms against the local community. As a result of the rising tensions, the company declared *force majeure* on the $20 billion project and agreed to provide a local nonprofit with $200 million to address the impact of the company's regional operations.

TotalEnergies has faced additional operational impacts based on activities in other CAHRA. In response to the Russian invasion of Ukraine, the company suspended operations of its LNG facilities in Russia, removed its representation of directors from the Russian gas producer PAO Novatek, and wrote down over $7 billion in assets.[l] The company also sold its majority 31 percent stake in the Yadana natural gas field following the 2021 military coup in Myanmar and reported a $506 million impairment.

Reputational Risks

Companies operating in CAHRA with proximity to human rights and conflict-related harms can also be exposed to reputational risks that result in negative financial impacts. These risks can lead to additional legal, regulatory, or operational impacts, such as losing value chain partners, increased regulatory scrutiny, or limited access to capital based on harm to their reputation. However, companies can also experience direct financial costs specific to reputational harm through divestment decisions, advocacy campaigns, and consumer boycotts.

Advocacy Campaigns | NSO Group Technologies Ltd ("NSO")

NSO is an Israeli spyware company designing, manufacturing, and selling intrusion software that remotely enters an individual's device, extracts data, and transmits this information back to a user.[97] These tools have been used by

l. TotalEnergies began construction on its Yamal LNG facility in 2013 and acquired an interest in the Arctic LNG facility in 2018. While this occurred before the 2022 Russian invasion of Ukraine, Russia had been a high-risk geography for several years prior to TotalEnergies' entry into these projects. The purpose of this example is not to propose that TotalEnergies should not have invested in these projects. Rather, the cost associated with TotalEnergies response to the latest advancement of Russian aggression demonstrates the human rights and financial risks associated with high-risk markets, such as Russia.

2 The solution (continued)

regimes and non-state actors in CAHRA, including Mexico, Saudi Arabia, Bahrain, Azerbaijan, Palestine, and Morocco to unlawfully surveil citizens, oppress HRDs and marginalized groups, and control freedom of expression.[98] Advocates have conducted in-depth investigations, drafted detailed exposés, and presented their findings to regulators, government officials, and global information and communication technology companies whose customers' privacy was violated by the software. These advocacy efforts have prompted government action against the company, including the U.S. government adding NSO to the BIS Entity list, and enabled victims to file complaints, petition for criminal investigations, and bring civil lawsuits.[99]

In addition, WhatsApp[100] and Apple[101] have also initiated civil lawsuits seeking damages for the impact NSO's spyware tools have on their products, including violations of customer privacy. While these suits are pending, a recent judgment required NSO to turn over its coding in the discovery process, jeopardizing the company's intellectual property.[102] As a result of advocates' efforts and stakeholders' responses, NSO suffered a devastating financial impact, including loss of investors,[103] severe downgrading of its credit rating,[104] company reorganization,[105] and a fall in valuation from over $2 billion to "worthless."[106]

3 The practice

Applying the saliency-materiality nexus to the most severe and systemic human rights and material risks

The case studies above demonstrate approximately $85 billion in financial impacts for companies and their shareholders based on proximity to severe human rights harms in CAHRA. These case studies demonstrate the ethical and fiduciary need for investors to conduct robust HRDD in an increasingly conflict-affected and fragile climate. Contextualizing HRDD through the saliency-materiality nexus can enable resource-constrained investors to identify the most severe and systemic human rights and material risks within their portfolios, allowing for a consistent, global approach to identifying and assessing human rights risks within portfolios, helping investors address the sensitive and complex political landscape that characterize CAHRA.

Moreover, leveraging the saliency-materiality nexus in investors' due diligence efforts supports institutional best practice in the identification, assessment, and mitigation of social risks within portfolios. This will look different in practice depending on the nature of the portfolio management and stewardship programs of the investor.

However, the nexus is designed to empower investors to maximize existing data, capacity and resources in a standardized and holistic manner.

Applying this CAHRA-focused lens can help create a relative rank for the various companies' risks in a portfolio, allowing investors to concentrate analysis and engagement efforts on the most severe risks within the portfolio. Institutions with processes and examples that are consistent across various regions are better equipped to navigate controversies, crises, and accusations of bias against or preference for certain regions as they arise.

The nexus simultaneously incorporates human rights, conflict, and material risks, helping investors focus on the most material risks present for a company across operations in CAHRA. This approach aligns with both normative (e.g., UNGPs, OECD Guidelines for Multinational Enterprises, SASB materiality model[107]) and legal (e.g., SFDR, EU Corporate Sustainability Reporting Directive) frameworks, and therefore can help enable investors to better meet their ethical and fiduciary responsibilities.

Figure 2: Saliency-Materiality Matrix

Source: Heartland.

3 The practice (continued)

The Nonprofit Investor Advisory | Heartland Initiative

Heartland is a U.S.-based nonprofit advisory dedicated to transforming how institutional investors advance human rights in an increasingly turbulent world. Heartland developed the saliency-materiality nexus to enable investors to identify portfolio companies with the most severe and systemic social risks in their portfolios. By focusing on those contexts that pose the greatest risks, investors can fulfill their responsibilities under the UNGPs to address the most salient human rights harms in their portfolios as well as their fiduciary duties to manage their most significant actual and potential financial costs. The nexus is a rights-based and pragmatic response to a lack of fit-for-purpose social risk data and analysis, guidance on HRDD for investors, and institutional resources to manage rising global human rights risks.

Heartland's operationalization of the nexus relies on a methodology to identify and assess the geographical, relational, and operational proximity of portfolio companies to human rights harms in CAHRA and how this proximity translates into material impacts. Through analysis of operational contexts, value chain partnerships, and business activities, Heartland provides investors with a fuller human rights and material risk profile and avoids limiting the focus to a single issue, geography or controversy.

Figure 3: Heartland's methodology

Source: Heartland.

By framing human rights analysis in the CAHRA-focused nexus, investors are able to maximize staff capacity and leverage existing data to identify and address the most severe risks. The approach can also be tailored by particular investor mandates to produce a comprehensive risk profile of portfolio companies that encompass a higher percentage of their global revenue, operations, and a wider spectrum of at-risk rights-holders and countries. The nexus informs all of Heartland's work, from evaluating investment portfolios, engaging companies, and developing guidance for investors concerning high-risk countries, industries, and value chains.

When used to evaluate an investment portfolio, the nexus can orient investor staff attention around the social risks that present the greatest risks to people and financial performance, leading to a focus on vulnerable rights holders, improved resource efficiency, and a tailored analysis to assist in decision-making around continued investment, engagement, monitoring, and in certain cases, exclusion.

Applying the nexus during engagements enables investors to highlight a broader array of salient and material risks to their portfolio companies – those associated with their activities across CAHRA. Describing a larger risk universe incentivizes participation by companies and coalitions of like-minded investors and can result in the development of corporate policy, practice, and governance that addresses these systemic and simultaneous threats to rights-holders and the business model.

Working in partnership with investors and civil society organizations, Heartland has leveraged the nexus to support emerging best practices in risk prevention and mitigation for at-risk communities, countries, industries, and value chains. For example, the nexus was used to develop collective investor responses to the conflicts in Ukraine[108] and Myanmar,[109] investor guidance on surveillance technologies,[110] semiconductors,[111] and tech and conflict,[112] and a pilot project on rights-respecting investment in CAHRA.[113] Heartland believes that by identifying areas of shared risks and interests among communities, workers, companies, and investors, meaningful progress can be made in the protection of fundamental rights and freedoms.

Case Study | Mondelez International ("Mondelez")

Following the full-scale military invasion and occupation of Ukraine, Heartland identified the ways in which Mondelez's continued operations in the Russian market exposes the company and its shareholders to salient and material risks. Heartland provided technical support to Wespath during an engagement with Mondelez, specifically seeking to understand how the company was managing these risks. After a dialogue that failed to adequately address investor concerns, Wespath filed a shareholder resolution seeking a third-party review of Mondelez's human rights due diligence system, particularly as it applies to identifying CAHRA-related risks. The resolution received a strong 31 percent vote in favor, which Heartland and Wespath are hopeful will eventually result in the development and implementation of policy, practices, and governance measures that will prevent and mitigate the company's risks in Russia and across CAHRA.

The Asset Owner | Wespath Benefits & Investments

As one of the largest faith-based pension funds in the world, Wespath has a long-standing commitment to sustainable investment.[114] Wespath implements its sustainable investment focus through its Sustainable Economy Framework (SEF). The SEF reflects Wespath's belief that, in order to preserve the healthy economic conditions upon which long-term financial returns rely, there must be a transition to a sustainable global economy. Wespath defines a sustainable global economy as one that supports social cohesion, long-term prosperity for all, and environmental health. This commitment to the SEF, in particular the pillar of social cohesion, was a key driver of Wespath's partnership with Heartland to work on CAHRA and systemic human rights risks.

Additionally, as an asset owner deploying capital through external asset managers, Wespath's managers are key partners for furthering the SEF. This includes relying on asset managers to help identify, assess, and address many human rights risks related to securities within Wespath's portfolio.

The saliency-materiality nexus applied through invest, engage, avoid model

Wespath deploys an invest, engage, avoid model ("model") in seeking to analyze and mitigate human rights risk in the portfolio in collaboration with managers. Wespath systematized the saliency-materiality nexus in the context of the model by partnering with Heartland to develop a methodology that identifies the most severe human rights and financial risks within its holdings. To focus its due diligence efforts, Wespath utilizes the nexus to prioritize stewardship and engagement on companies with exposure to CAHRA.

As a preliminary step, Wespath's methodology, developed in partnership with Heartland, reviews the geographic, operational, and relational exposure of its existing portfolio companies to CAHRA-related risk. Once Wespath has assessed the risk present through this data-driven approach, it sorts companies into three categories – avoid, engage, and hold – based on the relative risk of different portfolio companies. Those that present relatively low exposure to CAHRA-related risks require no further action.

For companies that present higher risk, Wespath conducts a nuanced analysis to understand the risks holistically. One of Wespath's first steps in the case of high CAHRA risk will be to identify which asset manager holds the security and to reach out to that manager for its opinion, especially if the security is an actively managed portfolio. Wespath also considers multiple qualitative factors in this analysis, including prior engagement with the company, reports from peer investors or other stakeholders about previous outreach, or analysis of the ownership structure of the company.

Wespath uses exclusion selectively, preferring engagement as a means of both managing material financial risk and encouraging alignment with the SEF. However, Wespath will consider exclusion if a company is found to present unmitigable risk(s) and presents a low likelihood of successful engagement. This likelihood is higher if the security is held in passive investment strategies and thus is less likely to have been actively analyzed for CAHRA risk by asset managers.

The saliency-materiality nexus in company and asset owner engagement

Engaging on the emerging topic of CAHRA comes with challenges, including a lack of established data, which can make it difficult to point to clear, data-driven examples of how companies rank compared to peers or what best-in-class looks like. However, these engagements also create opportunities to help define an emerging and important risk management framework in collaboration with asset manager partners and portfolio companies.

In choosing company engagements, Wespath considers how a successful outcome of a particular company engagement can help support a more systemic shift to respect for human rights. This could include setting a new best-practice in an industry through engagement or encouraging enhanced accountability and industry standards around a problematic behavior that carries wider risk for the industry or economy.[m]

The saliency-materiality nexus also supports Wespath's work engaging asset managers on risks and opportunities associated with the SEF and CAHRA risks specifically. Wespath is outspoken about the need for asset owners to work with their managers to ensure that they are reflecting their asset owner client's long-term interests in sustainable investment activities. Wespath sees their leadership on this topic through coalitions like the Net-Zero Asset Owner Alliance as also relevant for asset owner's work on social risks in CAHRA.[115]

m. While Wespath is confident from its experience that these efforts make a difference, as with all investor engagement, gauging success in these efforts often lies along a spectrum whereby attributing rights-respecting corporate conduct to our intervention is difficult.

Given some of the data challenges present in CAHRA and the still-emergent investor focus on this area, Wespath seeks to begin conversations with managers by acknowledging that these are complex, ever-evolving topics and emphasizing it is not seeking the "right" answer or response. Wespath also seeks information regarding a manager's process for addressing CAHRA risks at the firm-level, eventually drilling down to questions on how this approach is applied in different regions, sectors, and with specific holdings. Having an informed opinion and supporting data about a specific holding's CAHRA risks make conversations with asset managers more detailed and actionable. This exercise is especially informative when manager responses can be compared to information gleaned through independent research or direct engagements with said company.

Case Study | Engaging Asset Manager on Forced Labor in CAHRA

As part of Wespath's due diligence process for security purchase approval, Wespath identified an international asset manager that was considering the purchase of a company that Wespath's analysis flagged for exposure to forced labor in CAHRA. Wespath reached out to the manager to discuss these risks and received several rounds of unsatisfactory written responses. During a subsequent phone call that Wespath scheduled to discuss the risk-analysis process for this holding, the manager provided substantive examples of how they were productively engaging on the risks identified. The manager explained that it was reluctant to share examples in writing because the complex geopolitical environment in which the company was operating meant that information related to the asset manager's engagement becoming public could lead to reprisal for the company from their home country government. While these responses highlighted the complex circumstances around CAHRA, they also gave a more robust picture of the challenges and opportunities facing managers engaging on these topics that would not have been evident with an overly simplistic or high-level approach to risk analysis. Wespath continues to engage the manager on this topic.

The Asset Manager | Schroders

As an asset manager with dedicated sustainability resources, Schroders has a clear public commitment to uphold the ideals of the UNGPs throughout its investment strategies and is equipped with proprietary tools and in-house expertise to identify and assess human rights risks with the ultimate goal of enhancing shareholder value. As part of its HRDD approach, the sustainable investment team at Schroders identifies company exposure to CAHRA, including an analysis of both salient and financially material risks.

To address the varying degree of severity of exposure to human rights risks in CAHRA, Schroders deploys a tier risk approach based on the type of presence in the area to prioritize enhanced due diligence of investee companies.

The spectrum of exposure can range from more minor exposure in CAHRA (i.e., limited direct impact on the conflict dynamics) to direct severe human rights and material risks, such as shared revenue generating activities with a government or military entity that is causing human rights abuses.

In the case of the latter, Schroders will consider gross misconduct within the topic of human rights through its 'Global Norms Framework.' This proprietary framework was created to identify, assess, and engage companies that have potentially breached Global Norms.[116] The ultimate output of this framework is a 'Global Norms Breach List' composed of companies that have been identified as causing significant damage; have not sufficiently addressed the issue in question through transparent communications and action; and have not provided sufficient remedy for affected stakeholders. Schroders will then exclude companies on the Global Norms Breach List for relevant sustainable funds.

As part of the Global Norms framework, Schroders has developed an in-depth due diligence questionnaire to assess the most severely exposed companies on their anticipation and mitigation of human rights risks. This questionnaire addresses: willingness of company to address and engage on its exposure to CAHRA; policies and governance around human rights; evidence of enhanced HRDD; assessment of feasibility of responsible exit; and access to remedy. The answers to this questionnaire can be used by investors to identify where companies are taking inadequate action to address their potential and actual human rights impacts when operating in CAHRA.

Process Matters

Schroders' Global Norms seeks to ensure that it has visibility of decision-making around identifying and acting on breaches, drawing on information from engagements and further due diligence. Often third-party data providers base decisions principally on limited public information and can be slower to react in the face of updates. This ultimately leads to the belated de-classification of companies as UNGC Violators.

Since moving to the Schroders Global Norms Framework, there have been multiple instances where forced labor incidents in CAHRA were actively reviewed and ultimately companies were not included on its proprietary Breach List. Subsequently, a third-party research provider removed these companies from its own UNGC Violator List for very similar reasons to Schroders Global Norms Committee decisions. This approach has helped Schroders to avoid transaction costs, minimize potential losses from rapid divestment, capture potential market upticks, and maintain independence in incorporating its own understanding and insights into its investment decisions.

Double Materiality

Schroders also has dedicated tools and resources for identifying double materiality within the investment process, including its proprietary model, SustainEx™,[n], which estimates

n. Please see additional information section for more information on SustainEx.

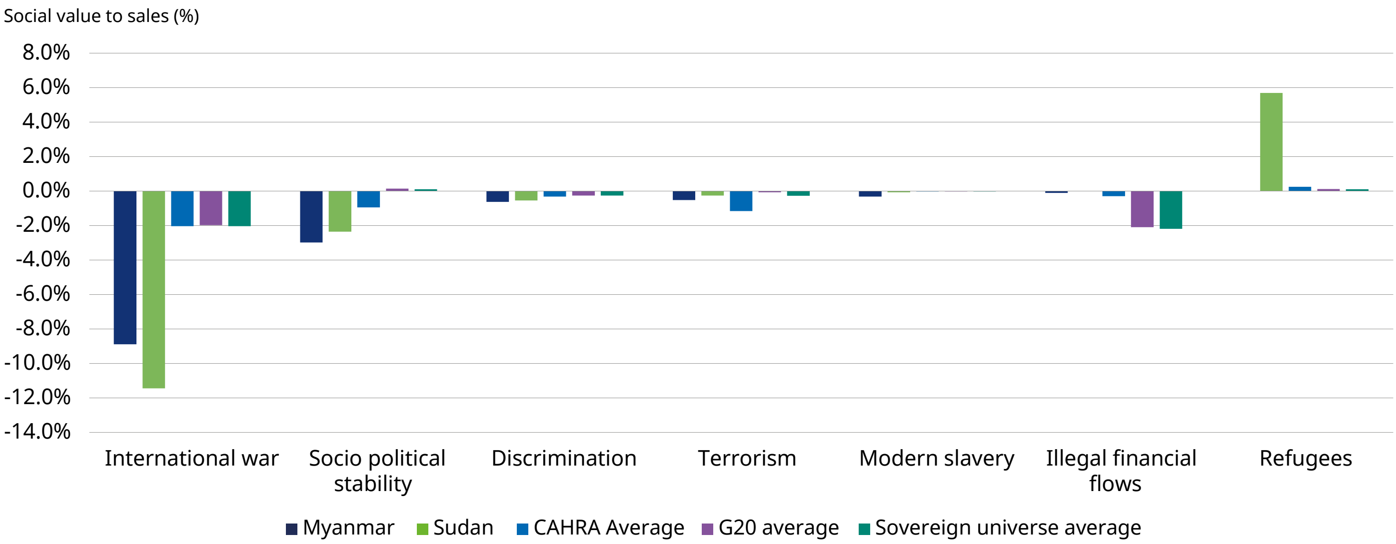
positive and negative externalities that companies and countries may create for society using a dollar value. In short, if a company were to be handed a bill or a credit note at the end of the year for the net costs or benefits they created for society, SustainEx™ estimates what that would be.

For companies, positive benefits (e.g., fair wages, connectivity, power provision) are measured against negative costs (e.g., waste, emissions, corruption, injuries), expressed as a notional percentage of sales. For countries, global costs and benefits that stem from government activities, such as spending on education and infrastructure, taxation, modern slavery, and biodiversity loss, are measured as a percentage of GDP.

The analysis of negative externalities driven by modern slavery and forced labor, for example, considers that many industries have become dispersed along increasingly international value chains, and therefore those negative costs are driven by global as much as national pressures. The economic costs from this encompass the sum of the resulting lost time and output, among other costs to victims, including health services. The research seeks to help investors to anticipate negative impacts before they become financial costs, which can materialize through regulation on these salient issues.

Figure 4: Sovereign SustainEx

Relevant CAHRA SustainEx metrics for Sudan & Myanmar



Source: Schroders as at April 2024. Schroders uses SustainEx™ to estimate the net social and environmental "cost" or "benefit" of an investment portfolio having regard to certain sustainability measures in comparison to a product's benchmark where relevant. It does this using third party data as well as Schroders own estimates and assumptions and the outcome may differ from other sustainability tools and measures.

Active Engagement

Schroders has engaged with companies on ESG-related items for more than 20 years with the goal of preserving or enhancing shareholder value. In 2022, Schroders released its inaugural engagement blueprint, which sets out where the organization intends to focus its active ownership efforts.[117] The Engagement Blueprint is organized in a thematic fashion, with human rights as one of these themes. Within the human rights section, Schroders highlights desired company actions when it comes to operations in CAHRA. These include:

- Taking adequate steps to identify the interaction between a company's core business operations and conflict dynamics to prevent causing harm.
- Adapting existing policies and due diligence measures to the specific needs of conflict-affected and high-risk contexts (including enhanced due diligence and responsible exit where human rights risks cannot be mitigated).

In addition, to equip investors with additional knowledge and capacity to engage in this area, the sustainable investment team at Schroders has developed an in-depth engagement toolkit which sets out specific questions around enhanced HRDD in the context of CAHRA. Schroders also sets out several means through which engagement can be escalated, one of which is voting.

Case Study | Russia-Ukraine: Investment Considerations of Human Rights Risks driven by War

The war in Ukraine has raised concerns about human rights and the social and financial impact of conflict. This includes the increased risks of modern slavery and forced labor, particularly among vulnerable refugees affected by changing labor migration patterns. It is important for investors to be aware of these risks.

3 The practice (continued)

Since the Russian invasion began, Ukraine has witnessed one of the fastest exoduses of people in recent history. The war has led to a potential reorientation of migrant labor flows – companies and countries that have traditionally relied on importing seasonal labor from conflict zones like Ukraine may face pressure to find alternative sources of labor. This trend of labor shortages could persist even after the war ends, as geopolitical dynamics and relationships continue to evolve.

When assessing the food and agriculture value chain, for example, Schroders analysis suggests that the strength of policies related to human rights, health and safety, and forced labor tends to weaken as you move up the supply chain. Red flags are raised when poor supply chain management policies are combined with low profit margins. As investors, it is important to ask whether companies operating in these contexts have implemented enhanced human rights due diligence measures.

As it relates to engaging on human rights issues, Schroders has broadly set out requests for companies to establish and implement a human rights policy in line with the UNGPs, International Labor Organization, and other international frameworks, and commit to respect human rights. However, due to the heightened risk associated with human rights in and around conflict-affected areas, Schroders expects companies to go beyond this. That entails adapting existing policies to the specific needs of conflict-affected areas and performing enhanced due diligence in these contexts. Such action comprises: assessing actual and potential human rights impacts; integrating and acting upon the findings; tracking responses; and communicating how impacts are addressed.

As a starting point, there are two simple questions investors seeking to engage on this issue should ask companies:

How have your supply chains been impacted by the influx of migrant labor, and how are you assessing the associated risks of modern slavery?

What enhanced due diligence processes are you undertaking given this heightened risk?

Case Study Collaboration with the Nexus | Caterpillar: When active ownership, management, and advisory move toward the same goal

Through its HRDD process and with technical support from Heartland, Wespath identified Caterpillar Inc.'s ("Caterpillar") exposure to severe human rights and material risks in numerous CAHRA, including Belarus, Israel/Occupied Palestinian Territory, Iran, Myanmar, Russia, Syria, Western Sahara, and China (Xinjiang).[118] After a failed company engagement, Wespath put forth a shareholder resolution at Caterpillar's AGM in 2023, asking the company to "commission an independent third-party report, at reasonable expense and excluding proprietary information, assessing the effectiveness of the company's due diligence process in determining if its operations or customer's use of its products contribute to violations of its Code of Conduct and Human Rights Policy."[119]

Wespath sought further disclosures surrounding how human rights risks in CAHRA are assessed and addressed and whether additional policies are needed to avoid causing or contributing to violations in CAHRA. Wespath believed this escalation was necessary because investors lacked clarity on how the company complies with its policies related to its subsidiaries and distributors in Russia, value chain risks to forced labor, and broader legal and reputational risks related to mandatory HRDD laws in the EU.

After examining this resolution, Schroders decided to vote "For," publishing a pre-declared intention memorandum with its analysis on why it was in support of the request. Schroders reasoned that under its Engagement Blueprint companies are asked to "adapt existing policies and due diligence measures to the specific needs of conflict-affected and high-risk contexts, performing enhanced due diligence in these contexts and ensuring responsible exit where human rights risks associated with remaining in a location cannot be mitigated." Caterpillar disclosed that its global operations are "dependent upon products manufactured, purchased and sold in the U.S. and internationally, including in countries with political and economic instability or uncertainty,"[120] identifying this reality as a risk factor and leading Schroders to conclude that a report which assesses how effectively the company's current processes are working would help the company to manage related risks.

In this case, Schroders' and Wespath's methodologies aligned in prioritizing a company that had operations or business relationships in CAHRA, faced a higher risk of becoming involved in grave human rights violations, and therefore required heightened due diligence to manage human rights harms as well as financial and reputational risks to the company and its shareholders. While the resolution fell just under the threshold of support necessary for re-filing, it demonstrates an area of alignment among asset ownership and management in prioritizing the most severe and systemic human rights and material risks and also highlights the need for continued investor education and coalition building on this topic.

Conclusion

Leading international indices focused on conflict, violence, fragility, corruption, and other indicators of state health point to an increasingly chaotic geopolitical environment and a growing array of risks to rights holders and shareholders. It is imperative investors develop policies, practices, and governance measures for addressing these severe and systemic social risks across their holdings to better protect and enhance the value of their investments. In the absence of sufficient data, tools, guidance, and internal resources, the saliency-materiality nexus serves as a contextual framework that helps enable investors to identify and prioritize risks to people and portfolio performance. As investors seek to make decisions aligned with their legal, normative, and fiduciary responsibilities — investment, company engagement, integration, and exclusion – the nexus serves as a standard and holistic best practice.

About the authors

Heartland Initiative

Dedicated to transforming how investors advance human rights in an increasingly turbulent world. Today's investment portfolios span borders and industries, exposing investors to a rising tide of geopolitical conflict and fragility accompanied by an array of interconnected human rights and financially material risks. Heartland connects investors, civil society, policymakers, and other stakeholders to develop tailored solutions that simultaneously address these threats to rights holders and shareholders.

Wespath Benefits & Investments

Serving The United Methodist Church for over 100 years. Wespath and its subsidiaries maintain one of the largest faith-based pension funds in the world, serving more than 100,000 active and retired clergy and lay employees of the Church. As a sustainable investor, Wespath incorporates consideration of environmental, social and governance (ESG) factors in investment decision-making and aspires to make a positive impact on the environment and society.

Schroders

Leading provider of active asset management, advisory and wealth management services. Recognized as a leader in sustainability. Few investment managers can match the combination of capabilities and global reach that we offer.

This breadth of services across public and private markets allows us to design distinctive solutions for the diverse needs of clients. They look to us to provide excellent long-term investment outcomes, and it is our duty always to act in their best interests. That is a responsibility we take seriously – and we believe that when we succeed for clients, society and the wider world benefit too.

Annex

Resources for Identifying Conflict-Affected and High Risk Areas

- Armed Conflict Location and Event Data (ACLED)
- Assessment Capacities Project | Global Emergency Overview
- Council on Foreign Relations | Global Conflict Tracker
- Economist Intelligence Unit | Country Index
- Freedom House International | Freedom in the World Index
- Heidelberg Institute for International Conflict Research | Conflict Barometer
- International Crisis Group | CrisisWatch Conflict Tracker
- Geneva Academy for International Humanitarian Law & Human Rights | Rule of Law in Armed Conflicts (RULAC)
- Responsible Minerals Initiative | Conflict Affected and High-Risk Areas (CAHRAs).
- The Fund for Peace | Fragile States Index
- Transparency International | Corruption Perception Index
- Uppsala Conflict Data Program — Georeferenced Event Dataset
- United States Department of State | Country Human Rights Reports
- Varieties of Democracy Index
- Vision of Humanity | Global Peace Index
- Walk Free | Global Slavery Index
- World Bank | Classification of Fragile and Conflict-Affected Situations (FCS)

Additional information

SustainEx™

SustainEx™ provides an estimate of the potential "externality" that an issuer may create in terms of net social and environmental "costs" or "benefits" of that issuer. It does this by using certain metrics with respect to that issuer, and quantifying them positively (for example by paying 'fair wages') and negatively (for example the carbon an issuer emits) to produce an aggregate notional measure of the relevant underlying issuer's social and environmental "costs", "externalities" or "impacts". SustainEx™ utilises and is reliant on third party data (including third party estimates) as well as Schroders' own modelling assumptions, and the outcome may differ from other sustainability tools and measures. Where SustainEx™ relies on data and estimates produced by third parties, Schroders seeks to ensure that such data and estimates are accurate, but Schroders cannot and does not warrant the accuracy, completeness and adequacy of such third party data and estimates. Like any model, SustainEx™ will evolve and develop over time as Schroders continues to assess, refine and add to the metrics and their relative contributions. Generating SustainEx™ scores involves an element of judgment and subjectivity across the different metrics chosen by Schroders, and accordingly Schroders does not accept any liability arising from any inaccuracy or omission in, or the use of or reliance on, SustainEx™ scores. As the model evolves, changes made to how metrics are applied may result in changes to the SustainEx™ score of any issuer and ultimately the overall fund/portfolio score. At the same time, of course, the issuer's SustainEx™ performance might improve or deteriorate. Schroders' proprietary sustainability tools including SustainEx™ may not cover all of a fund/portfolio's holdings from time to time, in which case Schroders may use a range of alternative methods to assess the relevant holding. In addition, certain types of assets (such as cash and certain equivalent securities) are treated as neutral and are therefore not considered by our proprietary tools. Other types of assets such as equity indices and index derivatives may not be considered by our proprietary tools and in such case would be excluded from a product's sustainability score.

Endnotes

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