

Human rights and ethical sourcing: Asia driving developments in ESG

An ESG perspective

November 2019

Ausbil Investment
Management Limited
ABN 26 076 316 473
AFSL 229722
Level 27
225 George Street
Sydney NSW 2000
GPO Box 2525
Sydney NSW 2001
Phone 61 2 9259 0200
Fax 61 2 9259 0222

Plastics: A seemingly overwhelming enemy of a sustainable planet

A recent visit to Asia by Ausbil's Head of ESG Research, Måns Carlsson-Sweeny, yields insights into changes across human rights, supply chains, and ethical sourcing, developments in the fishing industry which has been subject to significant labour abuse in the past, and developments in the war on plastics.

Trade war driving new types of ESG risks in the supply chain

The trade war between the United States and China is leading to a number of migration trends, and accelerating a shift in manufacturing out of China into other South-East Asian countries such as Cambodia, Vietnam and Myanmar. Ausbil highlighted this as an issue in 2018 - see www.ausbil.com.au/research-insights/esg.

This trend has been in place for a number of years, driven by tougher environmental regulation and enforcement in China as well as rising wages. Now, with the trade war, the trend has gained pace, led by Chinese capital as Chinese manufacturers simply shift production to countries with more beneficial wage and regulatory environments.

For Australian companies, and investors, this means new types of ESG risks in the supply chain that are different to those in China.

The Asian consumer is changing

Asia is important for Australian companies, not only from a supply chain perspective, but also as a major market with a burgeoning middle class.

The key economic drivers in Asia relate to population growth and technology. Every day in Asia, 11,000 people join the workforce and 12,000 move from rural and sub-urban centres into cities. The urbanisation trends we've seen in China are now occurring in other South-East Asian countries.

Connectivity is also accelerating with a huge number of unique mobile subscribers predicted in Asia where data costs are just a fraction of those in Australia. This new consumer in Asia will drive economic growth and represents an opportunity for Australian companies and investors.

While Chinese companies have been known for copying western technology, Chinese companies are also ramping up their R&D spend and the number of patent filings is growing fast. Moreover, there are indications that Chinese companies are increasingly willing to protect their patents.

Migration trends and rising human rights risks

The big migration trend to urban centres, and across countries to major employment hubs in Asia also means ESG risk in supply chains is shifting. Currently, approximately one person in seven, globally, is a migrant and a large proportion are international migrants in Asia, people typically vulnerable to exploitation in supply chains, particularly through forced labour.

In Asia, excessive labour recruitment fees are still commonplace in the trade for people, which can lead to modern slavery conditions such as forced labour and debt bondage. It is estimated that there are over 40 million people living in modern slavery conditions worldwide,

including under forced labour. The majority of those are found in Asia. Given that Australia recently passed its Modern Slavery Act, this is of great relevance to Australian companies and investors who are now required to report on the risk of slavery in across their operations and supply chains.

Prominent human rights lawyers are calling for more sanction-based laws on forced labour. Transparency legislation such as modern slavery acts in the UK and Australia raise awareness, but transparency is not accountability. European laws, such as the Duty of Vigilance Act in France, potentially opens the way for increased directors' liability. Combined, this will likely lead to increased investor interest in social issues. The potential liability of directors for issues in the supply chain might also extend to company officers, lawyers and other service providers.

Ethical sourcing continues to change but progress is slow

The Rana Plaza tragedy in 2013 in Bangladesh, which killed over 1,100 workers, catalysed a change in attitude among buying companies to eradicate some of the worst types of labour abuses in supply chains. However, despite these efforts and many decades of ethical sourcing initiatives, forced labour and other human rights issues in the supply chain remain rife.

In fact, forced labour is more prevalent than ever. This is partly due to different standards on labour recruitment fees in Asia. However, there are signs that there is greater understanding among governments of the links between recruitment fees and debt bondage, with more governments starting to accept the standards set by the International Labor Organisation (ILO).

Among corporates, there is also more evidence that investing in workers and labour rights have business benefits, for example, better retention levels and higher productivity. In other words, better labour rights risk management is not a cost but an investment.

One of the key challenges, however, is the political disruption combined with increased pressure on costs, which is leading to a short-term focus on reduced willingness to invest in factories, and job creation, more importantly. This increases the risk of subcontracting, which is where the worst issues are typically found.

Audits are only one piece of the puzzle and it is dangerous to rely on them alone. Audits need to be combined with other activities, such as increased collaboration between buyers, consolidation of supply chains, greater alignment between KPIs for responsible sourcing and procurement staff, and more. Also, we believe technology like Blockchain, and increased interaction between workers and brand companies, such as through worker voice, can be part of the solution.

As we highlighted in our paper on modern slavery last year www.ausbil.com.au/research-insights/research/modern-slavery-an-investment-and-social-risk, there is also a direct link between illegal activities such as slavery and money laundering, which means there will be increased legal focus on banks and other financial institutions going forward as well as supply chains.

Reducing the cash economy also reduces the risk of modern slavery. Slavery is a tough topic for governments to tackle alone and the criminal justice system is stretched, which means increased collaboration with corporates and other stakeholders such as investors, is needed to drive change.

Spotlight on rights abuses in the Thai fishing industry

Human rights abuses in labour and employment find a dark example in the Thai fishing industry. Thailand is a big seafood exporter worldwide, including to Australia. Reports in the past have shed light on extreme violations and exploitation of workers on fishing vessels, who are often vulnerable migrant workers from countries such as Myanmar and Cambodia, through poor working conditions, recruitment processes and inhuman terms of employment.

Shockingly, there have been reports that some workers who have attempted to escape such slavery conditions have been killed and thrown overboard. High risk practices are not the exclusive domain of Thailand, many other countries are high risk for labour abuses, as illustrated in the following chart.

Following such reports and international pressure, the Thai government introduced 'pink slips' which are registration documents for migrant workers. They instituted practices to inspect ships' crews when leaving and returning to port. However, despite these initiatives, human rights NGOs are concerned that many issues remain.

In recent years, the EU has put significant pressure on the Thai government. In 2019, Thailand ratified the ILO Forced Labour Convention (although it still has not ratified the conventions on freedom of association or collective bargaining), and became the

first Asian country to ratify ILO's Work in Fishing Convention, which sets basic standards for work in fishing.

Thailand has also introduced a new vessel monitoring system that allows for tracking of vessels and reduces the risk of unauthorised transfer of crews and catches at sea. 'Port-in, Port-out' inspection centres have also been implemented, which means vessels leaving and returning to port must first request authorisation and face possible random inspection protocols.

Ausbil recently visited a Thai seafood supplier that exports to Australia. We believe the Thai government's crackdown on poor practices in the fishing industry has led to fewer Thai fishing vessels operating. In turn, this seems to have led to higher prices and increased purchasing from Vietnamese fishing vessels instead. While the Thai government has acted, risk could remain, particularly when seafood processors mainly rely on only government certification and self-assessments provided by their suppliers.

It should also be noted that while the Thai government has acted on the fishing industry, other industries, such as agriculture, garments and construction, are plagued by similar issues to those described above. Approximately, 10% of Thailand's workforce is made up of migrant workers.



Photo credit: dashu83

Thai fishing boats, increasingly employing migrant workers from Myanmar and Cambodia in squalid, modern slavery conditions that impact global seafood supply chains, even in Australia.

Top 20 fishing countries by risk for the existence of modern slavery

High Risk	Medium Risk	Low Risk
<ul style="list-style-type: none"> • China • Japan • Russia • Spain • South Korea • Taiwan • Thailand 	<ul style="list-style-type: none"> • Chile • India • Indonesia • Malaysia • Mexico • Morocco • Peru • Philippines • Vietnam 	<ul style="list-style-type: none"> • Denmark • Iceland • Norway • United States

Source: Tickler, D., Meeuwig, J. J., Bryant, K., David, F., Forrest, J. A. H., Gordon, E., Joudo Larsen, L., Oh, B., Pauly, D., Sumaila, U.R., & Zeller, D. (2018). Modern slavery and the race to fish. Nature Communications, 9. Global Slavery Index.

Asia calling out developed nations on waste and plastics

Further observations in Asia centre on the war on plastics which has gained increased media attention in recent years as governments across the region began calling out developed nations on their waste practices.

The trade in global recycling waste changed fundamentally in 2018 as China implemented its National Sword policy and began stringently

enforcing restrictions on waste imports. Until China began curbing recyclable waste materials it was importing some 30 million tonnes annually, of which around 1.25 million tonnes was from Australia.¹ The China National Sword policy, while creating a major short-term waste issue globally, is also forcing developed countries to become more accountable for how they process and manage waste, and more efficient and clean in their industries. The alternative is increasingly becoming a glut and stockpile problem that will become riskier for industry the more critical any government response becomes.

The recent crackdown on waste recycling exports by Malaysia², where 3,000 tonnes of non-recyclable plastic was returned to Australia; the Philippines³, in returning 69 containers of mislabelled waste to Canada; and in Indonesia⁴, where they found containers of recycling paper contaminated with oils, plastics and electronics; has further politicised global waste, plastics and recycling.

Increased consumer awareness combined with Asian governments putting a halt to many types of waste export from Australia, poses challenges but also opportunities for a wide range of Australian companies, most notably recycling companies, food and beverage as well as packaging companies.

In Asia, there is a lot of political will to reduce the plastic waste into oceans and many governments are working on the problem, seeking opportunities such as waste to energy conversion. Importantly, there is an opportunity for Asia to leapfrog the west which is a popular electoral idea.

The topic is also gaining traction among investors. For instance, Ausbil recently became the first Australian signatory to the Plastic Solutions Investor Alliance (PSIA), and the landmark Investor Declaration on Plastic Pollution (IDPP), which calls for increased transition of plastic packaging to becoming recyclable, reusable or compostable, improved disclosure of annual packaging use, setting plastic use reduction goals, developing alternatives to plastics for packaging purposes, and more. To read more about the IDPP please visit www.ausbil.com.au/esg/research-insights/esg.

Conclusion: Focus for Ausbil's ongoing engagement

Our recent visit across Asia highlighted some major changes that can lead to new types of ESG risks, particularly in the human rights space, which are relevant to Australian companies sourcing from across Asia. While we have reported some progress, there is a lot to be achieved, in engagements here and abroad.

Ausbil continues to engage on human rights in supply chains, and ethical sourcing through education, primary research, and company engagement. On education, Ausbil's Head of ESG Research Team, Måns Carlsson-Sweeny, recently attended the PRI in Person Conference in Paris in September 2019, the world's biggest responsible investment conference, and also presented at the CSR Asia Conference in Bangkok, which focuses on key sustainability trends.

On company engagement, Ausbil's active ESG engagement program involves some 170 focused contact meetings a year, with boards and CEOs, with companies representing more than half of the market capitalisation of the Australian Stock Exchange, over \$1 trillion in value.

Our ESG engagement covers multiple areas of environment, social and governance activity, including human rights and modern slavery, climate change, and corporate governance. The issues of focus in this note will form part of our engagements going forward, with the aim of achieving greater scrutiny, transparency, and change.

- 1 NSW EPA. (2018, November 28). Response to the enforcement of the China National Sword Policy. Retrieved from <https://www.epa.nsw.gov.au/your-environment/recycling-and-reuse/response-to-china-national-sword>
- 2 ABC News. (2019, May 29). Malaysia to send plastic waste back to Australia and other developed nations. Retrieved from <https://www.abc.net.au/news/2019-05-29/malaysia-to-send-tonnes-of-plastic-waste-back-to-foreign-nations/11159208>
- 3 Bautista, R. (2019, May 30). Philippines sends trash back to Canada after Duterte escalates row. Reuters. Retrieved from: <https://www.reuters.com/article/us-philippines-canada-waste/philippines-sends-trash-back-to-canada-after-duterte-escalates-row-idUSKCN1T10BQ>
- 4 Lipson, D. (2019, July 10). Indonesia to send back Australian paper waste 'contaminated' by dirty nappies and electronics. ABC News [website]. Retrieved from: <https://www.abc.net.au/news/2019-07-09/indonesia-to-ship-back-contaminated-australian-waste/11292540>

Spotlight on the human rights abuse of sexual harassment



Cambodian garment workers: The ILO has just voted to define sexual harassment abuses as human rights abuse.

The impact of sexual harassment has been rightly elevated in importance by the recently ratified ILO C190 Convention on Violence and Harassment, a major breakthrough as it acknowledges and defines sexual harassment as a human rights issue.

CARE estimates that sexual harassment costs Cambodia's main export industry, the garment industry, approximately US\$90m annually in lost productivity, driven by staff turnover, sick leave, absenteeism and lower morale.

It is partly a normative issue, which means it can be difficult to change without awareness training. However, the issue is also exacerbated by buying company behaviours (such as high pressure on lead times, lack of coverage on sexual harassment and a lack of collaboration with NGOs), usage of piece-rate payment systems and misaligned pay structures, and lack of complaint mechanisms.

Awareness training is a good starting point, particularly for supervisors and managers, but not enough. Key for progress on the issue is organisational leadership and having accessible channels for reporting as well as adequate follow-ups and remediation processes.

This issue is hardly confined to Cambodia, or the garment industry, and is an international issue that requires global response.

In addition to the new ILO Convention, the issue of sexual harassment ties in with a number of UN Sustainable Development Goals and as such we believe it will be an area for increased regulatory and consumer focus in the future.

In October 2019, Ausbil presented at the Women in Business Conference in Phnom Penh, Cambodia. This was a regional conference organised by CARE, Australian Aid and Better Factories Cambodia, focused on the issue of sexual harassment (please see our note on this topic from last year - www.ausbil.com.au/research-insights/research/the-modern-slavery-in-supply-chains-investment-ij). We continue to engage on this issue.

For further information please contact:



Måns Carlsson-Sweeny,
Head of ESG Research
Phone: 02 9259 0262
Email: mans.carlsson-sweeny@ausbil.com.au



Nicholas Varcoe,
Equities Analyst, ESG
Phone: 02 9259 0276
Email: nicholas.varcoe@ausbil.com.au



Janelle Morrison,
Associate Analyst, ESG
Phone: 02 9259 0279
Email: janelle.morisson@ausbil.com.au

About Ausbil Investment Management

Ausbil Investment Management (Ausbil) is a leading Australian based investment manager. Established in April 1997, Ausbil's core business is the management of Australian and global equities for major superannuation funds, institutional investors, master trust and retail clients. Ausbil manage over \$12.0 billion* in active Australian and global equity investments. Ausbil is owned by its employees and New York Life Investments (NYLIM), a wholly-owned subsidiary of New York Life Insurance Company. NYLIM has more than US\$561* billion in assets under management. NYLIM has a number of boutique affiliates including MacKay Shields, Candriam Investors Group, Private Advisors and GoldPoint Partners.

*as at 30 September 2019.

Ausbil Investment Management Limited

Level 27
225 George Street
Sydney NSW 2000
GPO Box 2525
Sydney NSW 2001
Phone 61 2 9259 0200
Email contactus@ausbil.com.au

General The information contained in this document is given by Ausbil Investment Management Limited (ABN 2676316473) (AFSL 229722) (**Ausbil**) and has been prepared for informational and discussion purposes only and does not constitute an offer to sell or solicitation of an offer to purchase any security or financial product or service. Any such offer or solicitation shall be made only pursuant to an Australian Product Disclosure Statement or other offer document (collectively Offer Document) relating to an Ausbil financial product or service. A copy of the relevant Offer Document may be obtained by calling Ausbil on +612 9259 0200 or by visiting www.ausbil.com.au. You should consider the Offer Documents in deciding whether to acquire, or continue to hold, any financial product. This document is for general use only and does not take into account your personal investment objectives, financial situation and particular needs. Ausbil strongly recommends that you consider the appropriateness of the information and obtain independent financial, legal and taxation advice before deciding whether to invest in an Ausbil financial product or service. The information provided by Ausbil has been done so in good faith and has been derived from sources believed to be accurate at the time of completion. While every care has been taken in preparing this information, Ausbil make no representation or warranty as to the accuracy or completeness of the information provided in this video, except as required by law, or takes any responsibility for any loss or damage suffered as a result of any omission, inadequacy or inaccuracy. Changes in circumstances after the date of publication may impact on the accuracy of the information. Ausbil accepts no responsibility for investment decisions or any other actions taken by any person on the basis of the information included. Past performance is not a reliable indicator of future performance. Ausbil does not guarantee the performance of any strategy or fund or the securities of any other entity, the repayment of capital or any particular rate of return. The performance of any strategy or fund depends on the performance of its underlying investments which can fall as well as rise and can result in both capital gains and losses.