INTEGRATING HUMAN RIGHTS INTO RESPONSIBLE INVESTMENT:

A SYSTEMATIC APPROACH TO ADDRESS SYSTEMIC RISKS

JANUARY 2024

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INTRODUCTION

The Church Commissioners for England is a unique investment body, with two duties. We must create long-term financial returns to fund the work of the Church of England and we must make sure that the way we invest, and what we invest in, brings benefits to the wider world in a way that consistently shows positive outcomes in its contributions to the common good. We are a long-term diversified investor with over £10bn in assets under management, of which approximately one third is allocated to public equities.

The Church Commissioners expect investee companies to respect human rights[1] as a foundation for ethical and responsible business conduct. We also recognise that social-inequality presents a systemic risk to economies and diversified portfolios, and that companies can best understand and address their links to inequalities by meeting their responsibility to respect human rights.

Most of the Church Commissioners previous stewardship activities focused on identifying and engaging individual companies on specific human rights issues, such as modern slavery or controversies concerning human rights. During 2023 we have been working towards a more systematic approach to address human rights in our portfolio, that aims to have impacts at the asset, manager and system level, with the long term aim of mitigating systemic risks to broader society and long-term returns.

This report sets out how we have approached the integration of human rights into asset, manager, and system level stewardship activities since the launch of our revised *Responsible Investment Policy* (RI Policy) in 2022. We hope it will support other asset owners and managers who are trying to take a more proactive approach to human rights and stewardship, or those wishing to focus on social inequality as a systemic risk.

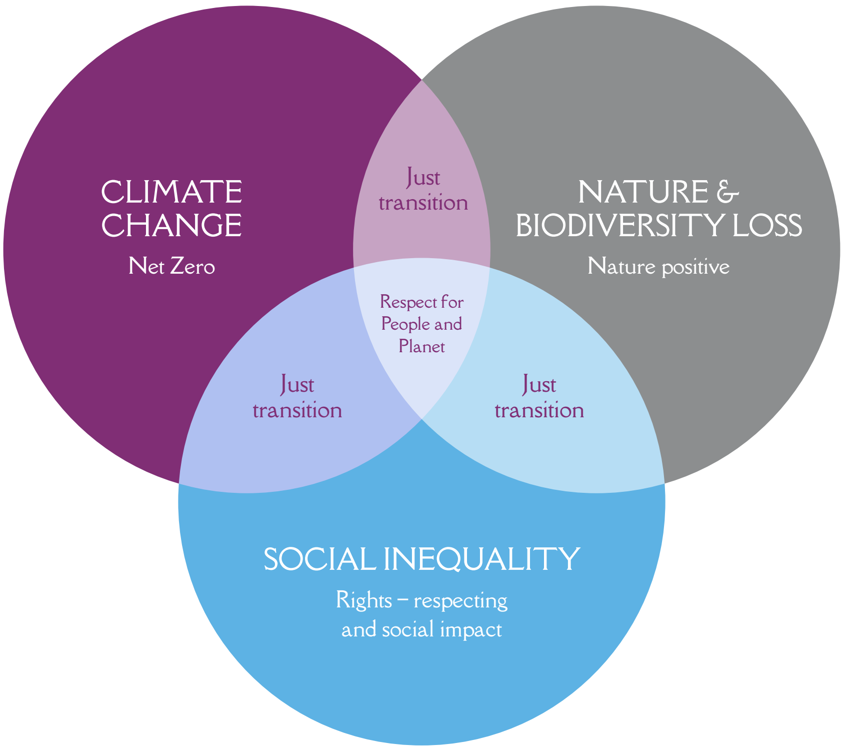
2. EIAG - Human Rights (churchofengland.org)

SYSTEMIC RISKS, SOCIAL INEQUALITY AND HUMAN RIGHTS

As set out in the Church Commissioners' RI Policy, climate change, nature loss and social inequality each represent systemic risks that will likely cause significant disruption to the economy, wider society and the financial system, in turn representing risks to our long-term investment goals. As a responsible investor we are committed to addressing these risks and see them as interconnected issues[2].

We believe that respect for human rights is critical to address the challenges of climate change and nature loss in a way that leaves no one behind (a just transition), and ensures that people's rights are respected when seeking to mitigate against or implement solutions to addressing the twin threats of climate change and nature loss.

Similarly, we believe businesses can play a significant role in tackling social inequality if they respect human rights, or otherwise risk entrenching inequality further if they fail to meet their human rights responsibilities.[3]



2. Church Commissioners for England - Responsible Investment Policy (churchofengland.org)
3. Flagship report – The Business Commission to Tackle Inequality (tacklinginequality.org)

INTEGRATING RESPECT FOR HUMAN RIGHTS INTO STEWARDSHIP

According to the UN Guiding Principles on Business and Human Rights (UNGPs), while governments have a duty to protect and enable human rights, businesses – including investors – have a responsibility to respect human rights. This means they should avoid infringing on human rights and appropriately address adverse human rights impacts that they cause, contribute or are linked to.

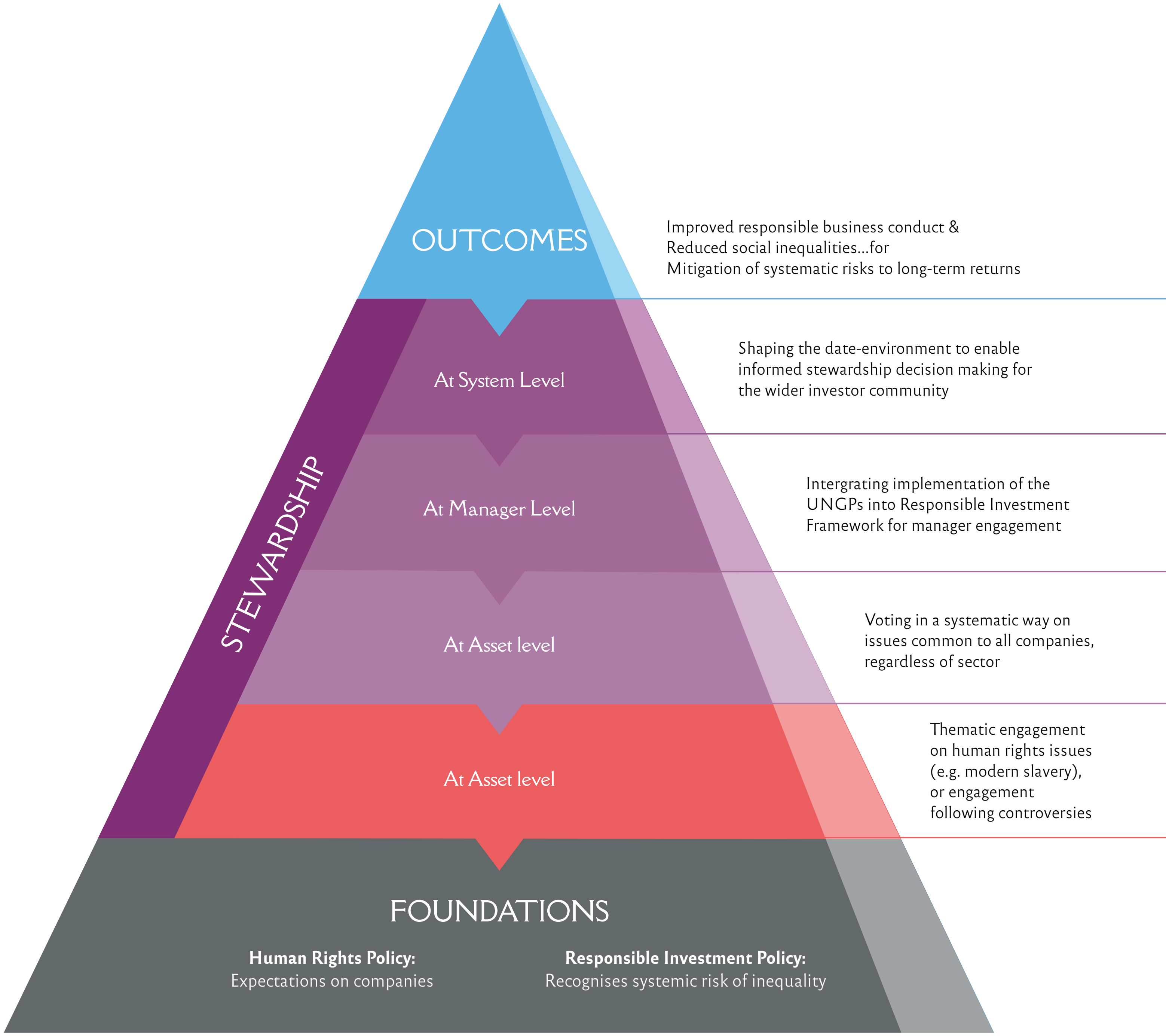
Companies and investors can meet this responsibility by establishing a policy commitment, conducting human rights due diligence (HRDD) to identify and mitigate any negative impacts they are involved in or linked to, and by providing or enabling remedy in situations where harm does occur. This approach is set out in the UNGPs[4] and the OECD Guidelines on Responsible Business Conduct.[5] The expectations in these global norms are being increasingly integrated into hard law[6].

Respect for human rights is essential for addressing the major global challenges of the 21st century. It underpins responsible business conduct and enables just-transitions which leave no-one behind. Through identifying and assessing the risks and impacts on people linked to business activities, human rights due diligence (HRDD) is a key tool to understand sustainability related risks and opportunities and should underpin financial and impact materiality analyses. Without a proper understanding of the risks and impacts to people a materiality analysis will be incomplete, which may hinder sustainable value creation.[7] It will also limit the ability of companies to prevent or mitigate any harms arising from their operations or business relationships.

The Church Commissioners' integrates respect for human rights into its stewardship activities at the asset level, manager level and system level, summarized in Figure 1. This report will elaborate further on the specific actions undertaken at each of these steps.

4. GuidingPrinciplesBusinessHR_EN-7.pdf (shiftproject.org)
5. MNE Guidelines – Organisation for Economic Co-operation and Development (oecd.org)
6. Mandatory Due Diligence – Business & Human Rights Resource Centre (business-humanrights.org)
7. Church Commissioners' feedback to IFRS on ISSB's Agenda Priorities download-file (azuremicroservices.io)

FIGURE 1. HUMAN RIGHTS STEWARDSHIP IN SUPPORT OF HIGH LEVEL OUTCOMES



MANAGER STEWARDSHIP – RESPONSIBLE INVESTMENT FRAMEWORK

As an asset owner, we rely on managers to select the public companies we invest in. As such, our managers are key stakeholders when it comes to realising our human rights expectations of investee companies. In 2023 we began revising our fund manager Responsible Investment Framework to include a specific sections on human rights. The changes will be used to support both investment due diligence and engagement with managers on the topic in 2024 and beyond.

ASSET STEWARDSHIP – VOTING

Much investor due diligence on human rights involves screening for controversies and significant harms on individuals and communities. Resulting actions might entail engagement programs, specific voting, shareholder resolutions and even divestment. These approaches, while useful, are typically reactive by nature and are limited in scope – often used to address discrete issues arising from specific holdings. To address these limitations, we proposed an approach, aligned with the UNGPs, which sets expectations of companies on human rights and integrates those expectations into systematic stewardship (e.g. voting) so that all investee companies are encouraged to identify and prevent impacts before they happen. In support of this enhanced approach, in December 2022 we announced our intention to systematically vote against companies who did not meet our human rights expectations[8].

It is important to recognize that systematic voting is not a new approach to stewardship; for example the Church Commissioners already employ a standardized voting policy on a range of issues (e.g. voting against the re-election of company 'chair-CEOs'[9]). However, by incorporating expectations on human rights risk management into our voting criteria, the Church Commissioners seek to elevate the issue and communicate to corporate management that the approach taken to respecting human rights is a financially material issue for all companies[10].

We piloted this new voting approach in 2023. The process followed and lessons learned are set out in the Human Rights Voting Pilot chapter of this report.

8. Church Commissioners to vote against companies that fail to meet expectations on human rights | The Church of England
9. Church Investors Group | Voting Guidelines 2022 p3
10. Church Commissioners Feedback on ISSB Agenda Priorities download-file (azuremicroservices.io)

SYSTEM STEWARDSHIP – SHAPING THE DATA ENVIRONMENT AND HAVING CATALYTIC IMPACT

In implementing its voting policy, the Church Commissioners use a service provider to furnish bespoke recommendations for each company within its portfolio. This streamlined approach is possible on issues like executive remuneration or board composition, where there is consistent and robust data readily available in the public domain. When it comes to information concerning human rights risk management however, there are significant gaps in the current data environment – with service providers reluctant to provide similar bespoke offerings as a result.

To roll out a systematic voting approach, the Church Commissioners could feasibly have commissioned research for our entire holdings on a series of human rights data points. However, this would be very costly. Additionally, while purchasing bespoke data would have enabled our own systematic voting, it would have likely had limited impact, especially in elevating the topic of responsible business conduct as a means to address the systemic risks of climate change, nature loss and social inequality.

Instead by changing the human rights data environment (e.g. improving the depth and breadth of corporate human rights data), we saw an opportunity to ensure the cost-effective creation of data to inform voting decisions for all investors, which could have a potentially catalytic effect in the wider market.

The corporate human rights data project chapter sets out our efforts in 2023 and how we intend to go forward in 2024.

HUMAN RIGHTS VOTING PILOT

The human rights voting pilot for 2023 ("voting pilot") was designed to bring to life our Human Rights Policy commitments and our expectations that companies demonstrate their respect for human rights, in support of improving responsible business conduct and addressing systemic risks. This voting pilot will inform a more systematic stewardship approach which elevates the topic of human rights onto the agenda of all companies that the Church Commissioners hold voting shares in.

To run the pilot, there were several critical steps:

1. Identify data to inform voting
2. Establish baseline criteria for company selection
3. Identify target companies and watchlist
4. Establish voting hierarchy
5. Select and action votes
6. Inform and engage with companies
7. Identify lessons learned

1. IDENTIFY DATA TO INFORM VOTING

As previously mentioned, there are gaps in the current availability of company human rights data in terms of specificity and scale, whereby we did not see a way to utilise existing ESG data provider products to inform our voting. To address this, following the guidance in the Platform on Sustainable Finance's 'Final Report on Minimum Safeguards'[11] we used elements of the World Benchmarking Alliance's 'Core Social Indicators'[12] which were designed to provide a baseline understanding of corporate implementation of the UNGPs.[13]

2. ESTABLISH BASELINE CRITERIA FOR COMPANY SELECTION

In deciding whether to vote against the re-election of company management, we chose to focus on two narrow criteria: whether a company had made a policy level commitment to respect human rights and whether they disclosed how they identified, assessed and acted on human rights risks and impacts. We chose these criteria for multiple reasons including:

- The relevance of these criteria to all companies, regardless of sector.
- The fundamental role that human rights policy commitments and due diligence play in responsible business conduct.
- Our belief that failure to meet these criteria would undermine a company's claim to be operating in accordance with the UNGPs, OECD Guidelines, UN Global Compact Principles, mandatory due diligence legislation, or the 'Minimum Safeguards' under the EU Taxonomy[14].
- Recognition that assessing corporate human rights performance is a contested and complex topic, whereas company risk and impact management frameworks are more easily assessable.
- Understanding that our internal Controversies Process already identifies significant breaches of international human rights norms, leading to direct engagement with companies, so norms breaches were less of a priority to integrate into this voting pilot.

11. Final Report on Minimum Safeguards (europa.eu)
12. The World Benchmarking Alliance (WBA) creates public methodologies and assessments. The Core Social Indicator assessment of the largest and most influential global companies, provides information and company scores at the data point level, with justifications and links to relevant public documents. Social Transformation Framework | World Benchmarking Alliance
13. Core social indicator assessments of 2,000 of the largest and most influential companies globally | World Benchmarking Alliance
14. Final Report on Minimum Safeguards (europa.eu)

To identify companies who failed to meet the criteria for a clear and public policy commitment to respect human rights we used WBA's Core Social Indicator 1 (CSI 1):

World Benchmarking Alliance Core Social Indicators (CSIs)	
CSI 1: Commitment to respect human rights	
Indicator element(s)	The company has a publicly available policy statement committing it to respect human rights, which is approved by the highest governance body.

To identify whether a company discloses how it finds, assesses and acts on human rights risks and impacts we used WBA's Core Social Indicators 3-5 (CSI 3, 4 and 5):

World Benchmarking Alliance Core Social Indicators (CSIs)	
CSI 3: Identifying human rights risks and impacts	
Indicator element(s)	The company describes the process(es) to identify its human rights risks and impacts in specific locations or activities covering its own operations. **AND** The company describes the process(es) to identify its human rights risks and impacts in specific locations or activities through relevant business relationships.
CSI 4: Assessing human rights risks and impacts	
Indicator element(s)	The company describes its process(es) for assessing its human rights risks and discloses what it considers to be its salient human rights issues. This description includes how relevant factors are taken into account, such as geographical, economic, social and other factors. **OR** The company publicly discloses the results of its assessments, which may be aggregated across its operations and locations.
CSI 5: Integrating and acting on human rights risks and impacts	
Indicator element(s)	The company describes its global system to take action to prevent, mitigate or remediate its salient human rights issues, AND this includes a description of how its global system applies to its supply chain. **OR** The company provides an example of the specific conclusions reached and actions taken or to be taken on at least one of its salient human rights issues as a result of assessment processes in at least one of its activities/operations in the last three years.

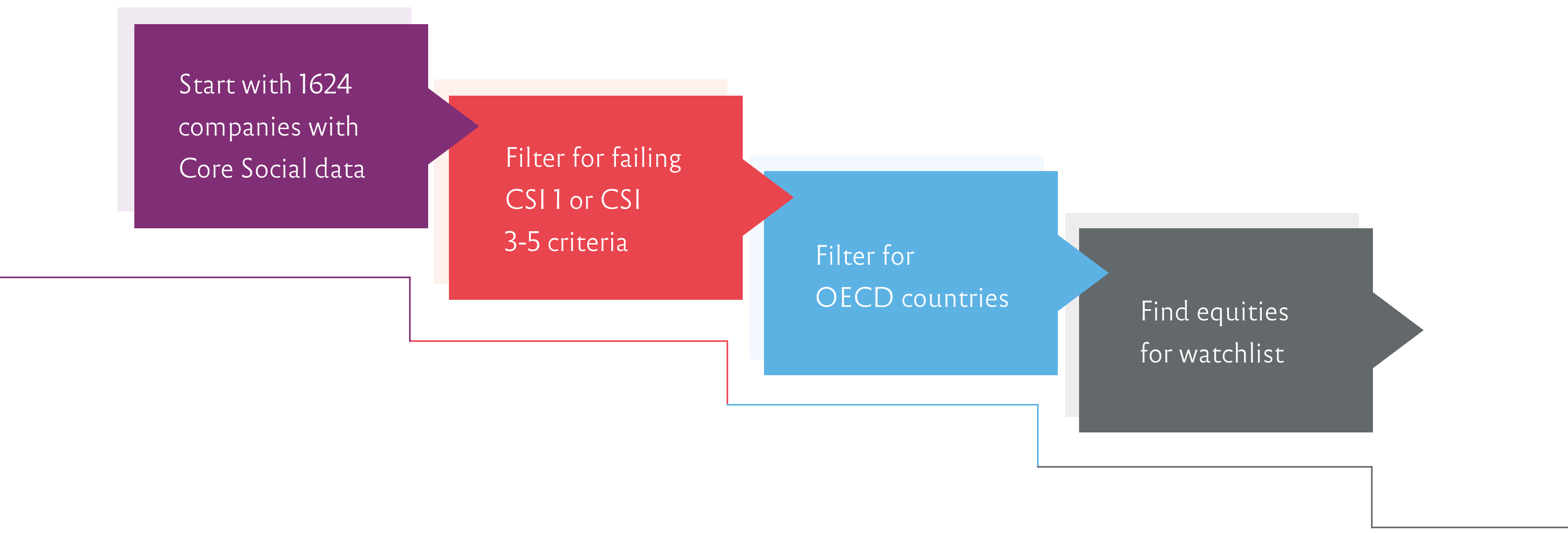
3. IDENTIFY TARGET COMPANY AND SETUP WATCHLIST

At the beginning of 2023, there was relevant data available for over 1600 companies, not all of whom were publicly listed and not all of whom we held positions in. However, our positions in companies change throughout the year, so it made sense to create a watchlist on the voting platform, based on the eligible companies, and then take voting action if they were in our portfolio for the appropriate time.

Due to this being a new approach, we were not able to write to companies to inform them of our voting intention. However, since 2011, the OECD Guidelines have incorporated the UNGPs and adherent governments have recommended companies implement them.[15] As such companies in countries which adhere to the OECD Guidelines should already be demonstrating their respect for human rights as part of their approach to responsible business conduct. To address the fact that we could not write to companies beforehand, we chose to restrict voting in 2023 to companies headquartered in countries that adhere to the OECD Guidelines.

After filtering for available data, failure against the watchlist criteria and geography, we were left with a watchlist of 382 companies.

FIGURE 2 – CREATING THE WATCHLIST



15. All 51 governments adhering to the OECD Guidelines must set up responsible business conduct National Contact Points (NCPs) to promote the Guidelines and act as a grievance mechanism. National Contact Points – Organisation for Economic Co-operation and Development (oecd.org)

4. ESTABLISH VOTING HIERARCHY

Accountability for respect for human rights should lie at the highest level of the company. For the pilot we targeted our voting action at the individuals with responsibility for the issue where possible. Our voting hierarchy was as follows:

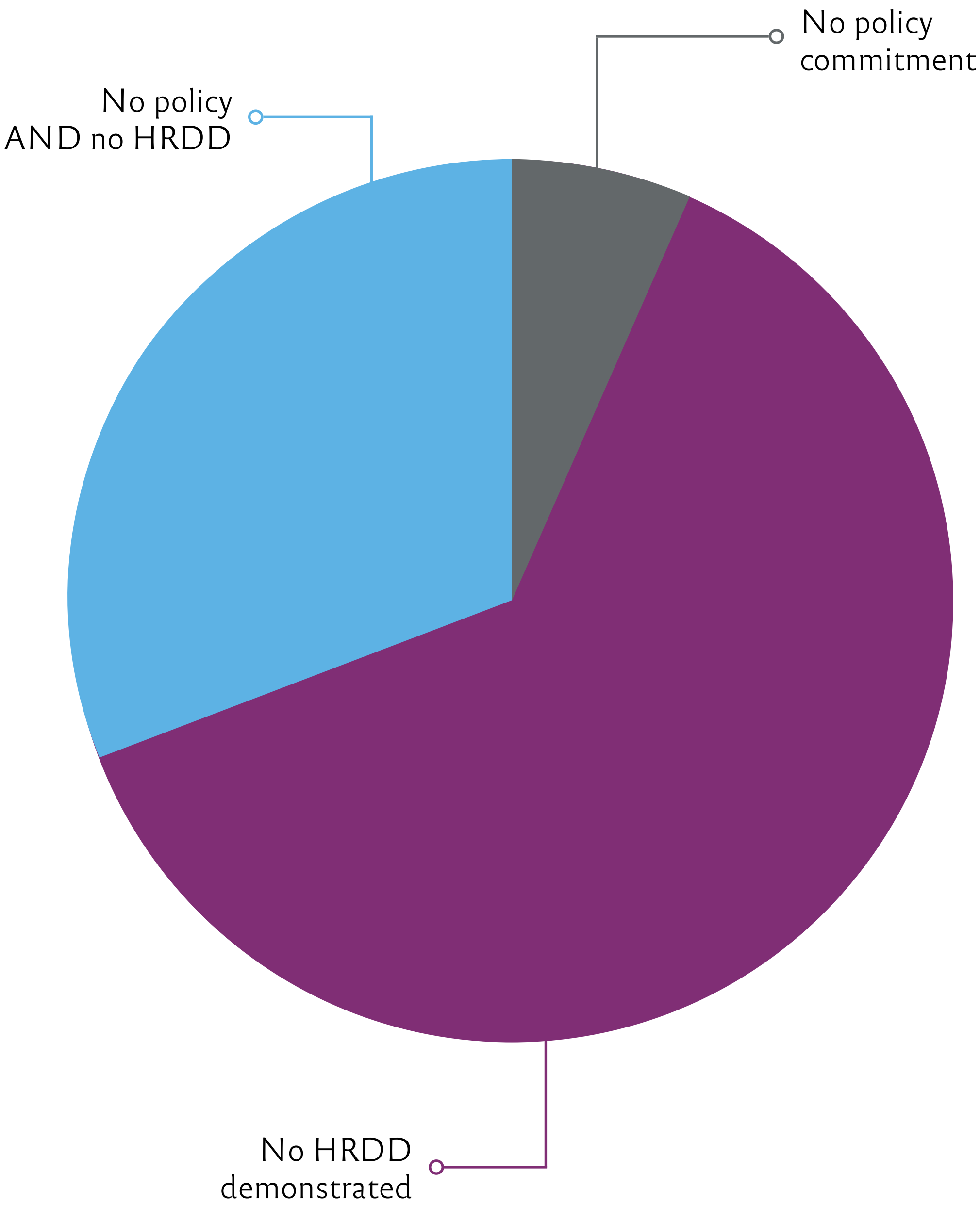
- Where there was a board committee whose remit included sustainability or human rights issues – vote against the chair of the committee.
- Where no such committee existed, or the committee chair wasn't up for re-election – vote against the re-election of the company chairperson.
- If the company chair was not in line for re-election – vote against the relevant lead independent director.
- In the absence of any of the above options – vote against the company's financial reports and accounts.

5. SELECT AND ACTION VOTES

Of the 382 companies on the watchlist, we held approximately one quarter through our managers. These were subsequently reviewed (for new disclosures, involvement in controversies or engagement programs etc.) before final voting decisions were made. Voting runs throughout the year, but for the busiest period of voting in 2023 (April-August) we voted against 91 companies on the basis of their failure to meet our human rights expectations.

Of those, approximately two thirds failed because of a lack of demonstrated due diligence (despite having made a commitment to respect human rights). Just under one third failed on the basis of no policy and no due diligence, while a handful disclosed details of their due diligence, but failed on the policy (i.e. they showed they could find issues, but made no commitment to addressing those issues):

FIGURE 3 – REASONS FOR VOTING AGAINST COMPANY



We voted against 91 companies based on human rights expectations in this period but found that roughly 50% of these companies would have been voted against anyway. Most of these overlapping votes against management were on the basis of joint Chair-CEO roles and a lack of board gender diversity.

6. INFORM AND ENGAGE WITH COMPANIES

We were not able to send letters to companies in advance of the 2023 AGM season, and we therefore limited our voting to companies in OECD adherent countries. After taking this voting action, we then sent letters to the chairperson of each company to explain the rationale behind our decision and outline expectations moving forward regarding the management of human rights risks. The purpose of these letters was to spark a dialogue, in the hope of generating awareness within the company and putting it on the agenda of executive management. About 10% of the companies have so far meaningfully responded and we are now in dialogue with them.

7. LESSONS LEARNED

Data limitations – Beyond the general problem of data availability, there is a challenge in ensuring that the most up-to-date data is used to inform voting watchlists, not least because companies frequently update their public reports close to their annual general meetings, requiring additional resources to review company material in a short time frame (or risk voting on outdated disclosures). Proxy voting services are best placed to efficiently manage this issue. This reinforces the importance of improving the ESG data provider products which feed the proxy voting research.

Usefulness of Voting Hierarchy – For in-house voting, the identification of a lead-director for human rights is time consuming and only one third of the votes were directed at a director other than the chair. In addition, there is a concern that sustainability and human rights ‘lead directors’ may not have sufficient influence on the board, in terms of ensuring a culture of respect for human rights, to justify their targeting for voting action. We will consider prioritizing voting at chair and reports and accounts over specific ‘lead directors’ for 2024.

Pre- vs. Post-Engagement – The pilot process involved voting and then informing companies of the vote. The resources required to communicate tailored messages to the watchlist companies before and after the vote prevented us from sending letters in advance in 2023. In the future we intend to develop a set of social-expectations and will include how these expectations relate to our voting policy. This information should then be communicated to relevant holdings for each proxy-voting season.

CORPORATE HUMAN RIGHTS DATA PROJECT

OVERVIEW

In 2022 the Church Commissioners, Aviva Investors, and Scottish Widows came together, as part of the World Benchmarking Alliance's Social CIC (Collective Impact Coalition), to equip investors in taking systematic action against businesses who fail to meet societal expectations on human rights. Building on the work of the Corporate Human Rights Benchmark (CHRB) and the Investor Alliance for Human Rights (IAHR), in 2023 we convened a multi-trillion dollar collaboration of investors who all agreed that:

- Corporate respect for human rights is intrinsic to advancing sustainable development, achieving just transitions to net zero, nature positive systems, and addressing systemic risks like social inequality.
- Companies should demonstrate respect for human rights across their operations and value chain, and we should be able to distinguish between leaders, compliers and laggards using analysis fed by public disclosures.
- The lack of consistent, decision useful, human rights data at scale (and beyond just what is currently considered as high risk sectors) will impact the ability of investors to carry out effective stewardship and meet emerging regulatory requirements such as the Sustainable Finance Disclosure Regulation (SFDR).
- As clients of the major data providers and proxy advisors, we could – and should – try to use our collective influence to ensure service providers meet our growing needs for high quality human rights data at scale, and for proxy advisors to have clear vote recommendations related to routine votes on lack of disclosures and performance on Human Rights.
- This will enable investors to conduct better due diligence, meet their own responsibilities to respect human rights, respond to expanding regulatory expectations and – ultimately – create the conditions where the market can reward or penalise companies based on their success or failures to respect human rights.

Data provider engagement:
As a collaborative engagement, the group wrote to and subsequently engaged with key ESG data providers and proxy advisors setting out our long-term requirements regarding the quality, transparency and useability of corporate human rights data.

During the engagement with the providers, we discussed key messages including:

ESG data providers should agree on fundamentals – Some ESG issues should be universal across providers. The fundamentals around business and human rights fall into this category.

Data providers should not be in disagreement on whether a company has made a commitment to respect human rights or conducted a human rights impact assessment because they reflect global norms and because assessment of the fundamentals should focus on the policies and processes companies have in place. ESG data providers may reasonably have different interpretations of corporate human rights performance. But those fundamentals are often hidden within aggregated ESG scores. To move past this, transparency about the individual human rights related data points that make up aggregate scores would be needed.

Trust in the materiality process is vital – The EU's Corporate Sustainability Reporting Disclosure standards and the International Sustainability Standards Board's IFRS S1 & 2 standards both rely on materiality assessments to determine what needs to be disclosed. Human rights due diligence, as detailed in the UN Guiding Principles and the OECD Guidelines, is the way to identify the risks and impacts on people and is the best way to develop an understanding of a company's impacts and dependencies or the resources and relationships it depends upon in its value chain. If a company is not disclosing how it undertakes human rights due diligence, the impact and financial materiality assessments will accordingly be flawed.

The absence of data is data – We believe fundamental human rights expectations should apply to all companies, however data providers are reluctant to apply indicators to sectors with poor data availability. The presents a challenge, as often the absence of a human rights policy commitment or lack of detail on how it is implemented is the essential piece of data used to inform stewardship decisions.

OUTCOMES AND PROGRESS

Engagements:
The first round of engagement with the data providers and proxy advisors generated a strong and positive response. The group prioritized and divided secondary engagements with a sub-set of the key companies based on existing relationships. These data and proxy companies have all been receptive to continued engagement but there has been varying degrees of receptiveness to our key messages.

It became clear that the companies have been very busy addressing the rapidly changing regulatory and disclosure landscape to keep pace with client demands. A third round of engagements is being planned for the next quarter.

Feedback from data providers:
We found that some of the data providers expressed surprise that the group of investors – often being significant existing clients – were not as interested in the ESG risk scores of companies relative to peers, or opinions based on aggregated scores, compared with the data which fed the scores. We pressed that while aggregated scores may be suitable for use in the future, we considered that there needs to be much greater transparency of the individual components. This includes explaining the guardrails used in building those scores.

We spoke with the data providers about our need for this granular data across their assessment of all sectors. This was taken onboard, but some expressed a preference to remain aligned with frameworks such as the SASB Materiality Matrix, which attempts to identify sectors for which sustainability issues are financially material. This results in a subset of sectors being assessed for issues such as human capital and human rights in the supply chain. There is an opportunity for investors who believe in the financial materiality of human rights to make this clear to their own service providers. This will help ensure that the products best serve the clients' needs.

Assessing methodologies:
The companies shared elements of their assessment methodologies with the group, but in most instances we require a deeper insight into the data points behind the indicators. This will enable us to determine whether they:

- are already able to provide the data we are looking for (by packaging it in a different way), or;
- need to adjust their methodologies to create the relevant data points.

We are still engaging to try and better understand the component parts. We also stressed to data providers that any current market products which claim to assess compliance with 'minimum safeguards' based on an absence of 'violations' or 'norms breaches' may not be fit for purpose. This is because the presence of a norms breach does not equate to the absence of due diligence systems and the presence of a due diligence process does not preclude a norms breach. Additionally, the data providers have different approaches to assessing companies on norms breaches. This results in disagreements on data points which may in turn have impact on things like the construction of sustainability-linked funds. This reinforces the need for consistent approaches to understanding the fundamentals of corporate human rights practices.

EVOLVING AND EXPANDING INVESTOR EXPECTATIONS – THE INVESTOR PROJECT ON HUMAN RIGHTS DATA

The investor project on human rights data will be a multi-year programme and moving forward, we intend to formalise this engagement workstream. In the upcoming years we intend to:

1. Generate insights into company implementation of the UNGPs, OECD Guidelines and minimum safeguards at a portfolio level (to support asset and manager level stewardship).
2. Facilitate systematic voting across our portfolio against companies not meeting our expectations (asset level stewardship).
3. Enable the wider investment community to take systematic action against companies who are not demonstrating their respect for human rights (system level stewardship to have a catalytic impact).

We will continue the engagement in 2024 and expand the group of investors involved. Investors wishing to take part are invited to contact *dan.neale@churchofengland.org*. We will look to convene multi-stakeholder roundtables to explain the group expectations to the growing group of ESG data providers and aim to get clarity on the methodologies being used.

CONCLUSION & TAKEAWAYS

The 2023 pilot has demonstrated the feasibility of taking a systematic approach to holding company management accountable to investor expectation on human rights. But without changes to the data environment, the ability to drive improvements in company behaviour will be limited. There is still a need for better human rights data at scale which can be integrated into proxy-voting services.

- Company level engagement on human rights issues is an important part of investors meeting and ensuring the responsibilities to respect human rights. But it is only one of the stewardship tools available.
- Voting is not only the most systematic stewardship tool for listed equities (i.e. it cuts across all geographies and sectors), it is also likely to be the most frequent touch-point with the holdings of an institutional investor. Company implementation of the respect for human rights should be driven by the board and it is appropriate for human rights considerations to be integrated into voting policies. When we clearly follow this up with letters and engagement, we encourage companies to put in place the necessary changes we are seeking through the voting process.
- Asset owners can and should work with their managers to cascade their expectations to companies. Where owners do not vote themselves, the engagement with managers is crucial to ensuring that owner expectations are integrated into the manager's thinking.
- As clients, investors are well placed to shape the products of ESG data providers and proxy advisors. This could help address the current gaps relating to assessments of companies under various sustainability reporting regimes. Shaping the data environment can also help create a catalytic impact at the system level by raising the bar on corporate human rights performance at scale.

The Church Commissioners will further develop our approach to integrating respect for human rights into our voting. We will also continue to lead on efforts to normalize the use of human rights data in investor stewardship through the ESG data-provider and proxy-advisor engagements in 2024.