



ALLIANCEBERNSTEIN®

MODERN SLAVERY RISK IN AUSTRALIAN EQUITY PORTFOLIOS

How to Research It. How to Reduce It.



EXECUTIVE SUMMARY¹

- + Modern slavery is a pervasive social evil that encroaches upon Australians' lives every day, usually without their knowing it. (1)
 - + The Commonwealth Government's Modern Slavery Act 2018 seeks to make the risks more transparent by requiring companies to report on how they are managing them, both internally and in their supply chains. The legislation's guidance defines modern slavery risk as 'risk to people rather than risk to your entity'. (3)
 - + We believe that investors should not be content merely to report on risk to people, but they should aspire to reduce it, too. We say this not just because reducing the risk is the right thing to do, but also because researching the risk and proactively engaging with corporates to reduce it can lead to better investment outcomes. (4)
 - + Under the Act, corporates are required to assess how their operations can directly result in modern slavery practices, how they can be linked to such practices through third parties (such as tier-one suppliers) and how they can contribute to them—a requirement that potentially extends to some tier-two and tier-three suppliers. (5)
 - + When evaluating corporates' potential exposure to modern slavery, and deciding how to prioritise engagement with them, investors should consider high risk-to-people factors, including:
 - + vulnerable populations
 - + high-risk geographies
 - + high-risk products and services
 - + high-risk business models (7)
 - + The best corporates make reducing modern slavery part of their core values and even a source of sustainable competitive advantage. In collaboration with many leading Australian corporates, we have developed a comprehensive best-practice framework to evaluate corporate performance in this area. (10)
 - + We illustrate how this framework applies to four companies (Ansell, Woolworths, South32 and BlueScope Steel) and summarise the positives and possible areas for improvement. The companies were selected based on the progress they are making in managing modern slavery risk. (13)
 - + We conclude that, for corporates and investors, reducing risk to people requires long-term commitment and a willingness to innovate and continuously improve the processes required to identify, assess and act. (16)
 - + The positive response we have received from our engagement with corporates leads us to believe that over time, the investment industry can help reduce modern slavery risk. Engagement has also deepened our insights into which companies best manage their supply chains, and this has proven to be valuable input to our investment decisions. (16)
 - + We are confident that companies can, and will, increasingly embrace the challenge to 'collaborate, act and lead' in the fight against modern slavery. (17)
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¹ The number after each bullet point refers to the page on which the topic is discussed.

MODERN SLAVERY: A PERVERSIVE SOCIAL EVIL

Slavery was formally abolished in the US and Europe in the 19th century. Tragically, however, the abuse and exploitation of vulnerable people continue in many workplaces and other settings around the world today, depriving those people of their freedom, denying them their human rights and exposing them to risk of injury and death (see 'Forced Labour: a US\$150 Billion-Per-Year Industry', below). The term 'modern slavery' refers to this contemporary phenomenon.

Forced Labour: A US\$150 Billion-Per-Year Industry

The illegality of modern slavery means that it takes place covertly, supported by crime and corruption. While this makes the scale of the problem difficult to measure precisely, the International Labour Organization (ILO) and the Walk Free Foundation estimated in 2017 that 40.3 million men, women and children had been victims of modern slavery on any given day during the previous year. This was equivalent to one out of every 185 people throughout the world. Most of the enslaved (71%) were women and girls. The research also estimated that forced labour generated US\$150 billion (A\$220.5 billion) in profits annually.²

To put these numbers in context, the estimated number of modern slavery victims is three times that of the victims of the transatlantic slave trade, which lasted more than 300 years. Ending modern slavery by 2030, as envisaged by the United Nations (UN) Sustainable Development Goals, would require more than 10,000 people a day to be set free.

In addition to forced labour and marriage, modern slavery may consist of other abuses, such as deceptive recruiting, human trafficking and debt bondage. While the problem is regarded as most widespread in developing countries, it occurs in many developed countries, too. The Australian Criminal Code, for example, includes among modern slavery offences those involving noncitizens working in Australia.

² *Global Estimates of Modern Slavery*, ILO and Walk Free Foundation, 2017. The research focused on the forced labour and forced marriage aspects of modern slavery.

A good starting point to understanding the scale of modern slavery and our approach to researching it is to consider how pervasive the practice has become and how it affects nearly every aspect of daily life.³ One way to illustrate this is to look at how a routine shopping trip can bring ordinary Australian consumers into contact with products made by slave labour and lead them, through their purchasing decisions, to becoming unwitting beneficiaries of a crime (*Display 1*).

Most people drive to the shops. Depending on the make of the car, they could be exposed to modern slavery the moment they slide behind the steering wheel. At least four auto manufacturers—two from the US and one each from Europe and Japan—have used Brazilian pig iron to make their car doors. The supply chain for the pig iron begins with the burning of hardwood to make charcoal. In many instances, the trees are felled illegally, while the charcoal is made by slave labour in camps in the Brazilian rainforest.⁴

Another ingredient used in auto manufacture—mica, a silicate mineral that produces the shiny finish on a car's paintwork—has been linked to child labour and debt bondage in mines in India. Some of the children are as young as 10. If the car ride involves listening to music streamed on a mobile phone, there's a chance that it contains cobalt from the Democratic Republic of the Congo, where mining is widely linked to modern slavery.

Even the car park at the shops may not be free from taint: at least one Australian retail chain has discovered modern slavery practices, such as wage theft, among contractors supplying workers—many of them immigrants—to collect trolleys from car parks.

The weekly shopping list usually includes fresh food. More than 80% of garlic exported globally comes from China, where prison labour is common in supply chains (Chinese prisoners have been made to peel garlic, for example). Berries grown in Australia may also be suspect, as several cases have been reported of itinerant workers, hired to pick fruit and other crops, being abused.⁵ Fish from Thailand may be suspect, too: while several companies in the country's fishing industry treat their employees fairly, there are many instances of other companies using slave labour.

There are at-risk products in other shops, too. Rubber gloves from Malaysia have been associated with slave labour, and there are concerns that the practice continues. Clothes shops may contain Aussie beachwear—the designer and maker of one iconic brand has been associated with the use of North Koreans in slave-labour conditions in China. Clothing and other items made from cotton may deserve scrutiny, especially if sourced from Turkmenistan, where government support for modern slavery in the industry has attracted censure from the US government.

Although these examples are all consumer-related, modern slavery is widespread in global industrial supply chains, including shipping and airlines. For example, Chinese prison labour is known to have manufactured headphones used by airline passengers. One positive aspect of this pervasiveness is that it has helped raise media and public awareness of the issue and prompted governments to act.

DISPLAY 1: THE MODERN SLAVERY RISKS OF A TRIP TO THE SHOPS



³ Examples on this page are sourced from *Addressing Modern Slavery*, Martijn Boersma and Justine Nolan, UNSW Press, 2019.

⁴ See <http://murninghanpost.com/2010/08/12/pig-iron-and-modern-slavery/>.

⁵ See ABC News, 7 February 2020.

THE BOTTOM LINE: IT'S A RISK TO PEOPLE

The Commonwealth Government's Modern Slavery Act 2018 seeks to make modern slavery risk more transparent by requiring companies to report on how they are managing it internally and in their supply chains. *Display 2, page 4*, shows how the Act defines modern slavery.⁶

While this is adequate for practical purposes, we believe that the legislation's 'Guidance for Reporting Entities' distils the issue to its essence as 'risk to people':

'The concept of risk in this context means risk to people rather than risk to your entity (such as reputational or financial damage). However, often these risks to people will intersect with risks to your entity. For example, potential forced labour in a clothing factory poses clear risks to the human rights of the workers (risk to people) but may also lead to reputational damage and legal liability for the clothing company (risk to the entity). This "outward-facing" and "people-focused" approach to risk may be different from how your entity normally deals with other types of risk'.⁷

We believe that investors should not be content merely to report on modern slavery risks, but they should aspire to reduce them, too. Indeed, the important role that investors can play in combating modern slavery has been recognised by the Australian Border Force:

'Modern slavery can occur in every industry and sector and has severe consequences for victims. Investors can play a vital role in combating modern slavery, such as by addressing modern slavery risks in their investment portfolios. The Australian Border Force welcomes multi-stakeholder collaboration within and across high risk industries and sectors to provide guidance on implementing the Modern Slavery Act, including to develop tools and resources to support compliance'.⁸



⁶ There is no official, globally agreed-upon definition of the term 'modern slavery'. This is not, in our view, an impediment to researching the issue and engaging with it.

⁷ See <https://www.homeaffairs.gov.au/criminal-justice/files/modern-slavery-reporting-entities.pdf>.

⁸ Modern Slavery Business Engagement Unit, Australian Border Force, <https://responsibleinvestment.org/wp-content/uploads/2019/11/ACSI-RIAA-Modern-Slavery-Reporting-Guide-for-Investors-November-2019-2.pdf>.

DISPLAY 2: HOW AUSTRALIAN LEGISLATION DEFINES MODERN SLAVERY

Modern slavery means conduct which would constitute:

- (a) an offence under Division 270 or 271 of the *Criminal Code*; or
- (b) an offence under either of those Divisions if the conduct took place in Australia; or
- (c) trafficking in persons, as defined in Article 3 of the Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children, supplementing the United Nations Convention against Transnational Organized Crime, done at New York on 15 November 2000 ([2005] ATS 27); or
- (d) the worst forms of child labour, as defined in Article 3 of the ILO Convention (No. 182) concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour, done at Geneva on 17 June 1999 ([2007] ATS 38).

As of 31 March 2020

Source: Commonwealth Modern Slavery Act 2018 and AB

Note: An explanation of Divisions 270 and 271 *Criminal Code* may be found at <https://www.cdpp.gov.au/crimes-we-prosecute/human-trafficking-and-slavery>.

The following types of offences are included:

- + slavery
- + servitude
- + forced marriage
- + forced labour
- + deceptive recruiting
- + trafficking in persons
- + debt bondage
- + organ trafficking
- + offences involving noncitizens working in Australia without the correct visa

Not only is reducing modern slavery the right thing to do, but researching the risks and proactively engaging with corporates to reduce them can also lead to better investment outcomes. This is because doing so provides an important enhancement to our fundamental research capability—the opportunity for us to talk directly to the global supply-chain managers at the companies within our investment universe.

Their knowledge and insights provide us with deeper understanding of this crucial aspect of a company's strategy and operations and help round out the views that we form as a result of talking to the

company's board, chief executive, chief financial officer, competitors and suppliers.

More importantly, the information that we glean from supply-chain managers may also prove helpful in determining whether we invest. That's because we believe that if a company can't manage modern slavery risk effectively in its global supply chains, it can't manage its supply chains.

THE CHALLENGE OF RISK ASSESSMENT

Under the Act, corporates are required to assess how their operations can result in modern slavery practices, how they can be linked directly to such practices through third parties (such as tier-one suppliers) and how they can contribute to them (*Display 3*).

Perhaps the most challenging aspect of the Act's scope is the extent to which it makes reporting entities responsible for assessing risks posed by third parties. Assessing the risks of one's own entity might be straightforward enough, but assessing those of one's suppliers is more difficult. And the responsibility is not easily shirked: the obligation to assess how one's entity might contribute to modern slavery, for example, extends down as far as tier-two and even tier-three suppliers. This rules out such potential ruses as an entity interposing a wholesaler between itself and a tier-one supplier with the aim of relegating the supplier to tier-two status, thereby absolving itself from having to assess that supplier's risks.

This is the background against which we have developed our own approach to researching modern slavery risk. Our objective in this respect has evolved beyond assessing risks to people; we are also actively helping reduce the risks, while potentially delivering better investment insights for our clients (and, as we shall discuss later, creating opportunities for corporates to turn their risk-mitigating efforts into a possible source of competitive advantage).

To support this objective, we have identified five key steps that serve as a framework for our research process. We regard each step as important, but the first two—evaluating risks in our portfolios and improving corporate behaviour—are decisive in determining the quality of the remaining three (*Display 4, page 6*).

DISPLAY 3: WHAT RISKS DOES THE LAW REQUIRE TO BE ASSESSED?

Government guidance is provided on the scope of risk assessment for entities:

- + **Cause**—a risk that the entity's operations directly result in modern slavery practices
- + **Direct links**—risks that the entity's operations, products or services may be connected to modern slavery through the activities of another entity with which the entity has a business relationship (e.g., tier-one suppliers*)
- + **Contribution**—a risk that the entity's operations and/or actions in the supply chain may contribute to modern slavery, including acts or omissions that facilitate or incentivise modern slavery (e.g., some tier-two and -three suppliers)

* The official guidance to the Act indicates that modern slavery risk associated with customers does not need to be reported, but we note that these risks are not explicitly excluded within the Act. We research customer risks where we believe they are material either to people risk or investment risk.

As of 31 March 2020

Source: Australian Council of Superannuation Investors (ACSI), *Modern Slavery Risks, Rights and Responsibilities*, February 2019; ACSI and Responsible Investment Association Australasia, *Modern Slavery Reporting—Guide for Investors*, November 2019; and AB

Five Key Steps



MAPPING THE EXPOSURES IN AN AUSTRALIAN EQUITIES PORTFOLIO

Evaluating risks to people in our portfolios begins with creating a framework to help us prioritise companies—those that are already in, or have been in, our portfolios or are candidates for possible inclusion—according to their potential exposure. In doing so, we focus on what we consider to be four key risk factors:

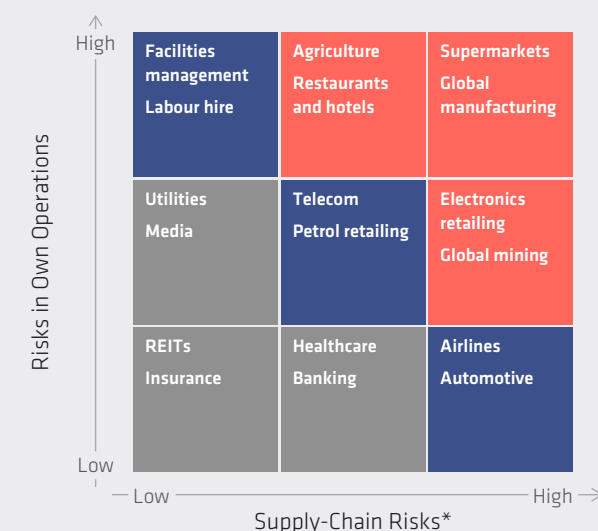
- + **Vulnerable Populations** (e.g., migrant workers, minorities, linguistically diverse backgrounds)
- + **High-Risk Geographies** (e.g., history of abuses, conflict-affected zones, limited or weak judiciary)
- + **High-Risk Products and Services** (e.g., raw materials, basic services, internal services, ‘sweat’ shops)
- + **High-Risk Business Models** (e.g., outsourcing, fraudulent recruiters, seasonal demand peaks, franchises)

Using our own fundamental research and leveraging third-party information as a guide, we map companies across a matrix that suggests the level of exposure in each company’s own operations and along its supply chains (note that this matrix measures their exposure only, not how well or badly they are managing the risk). *Display 5* uses industry sectors rather than individual company names to show how this works in practice.

Companies that appear in the red squares are those we consider to be higher risk; accordingly, we rank them as the highest priority for engagement. This should not be taken to mean that such companies are our sole focus, however. The colours of the matrix represent a spectrum of risk: while we might consider the companies in the grey zone to be low priority for engagement, we do not regard them as risk-free. A domestic owner of commercial real estate, for example, might be exposed to modern slavery risk through the migrant labour supplied by a cleaning contractor. (Note that this is for illustrative purposes only. Our stock-specific fundamental research might single out, say, a manufacturing company from its peer group and place it in a different square.)

Many third-party sources of high-quality modern slavery research are relevant to each of our four key risk factors. The Walk Free Foundation’s Global Slavery Index, for example, provides a country-by-country ranking of the number of people in modern

DISPLAY 5: FRAMEWORK TO ASSESS HIGH-RISK-TO-PEOPLE STOCKS



REITs: real estate investment trusts

* Supply-chain risks can include customers and extend to second- and even third-tier suppliers when the corporate’s behaviour contributes to modern slavery risks.

As of 31 March 2020

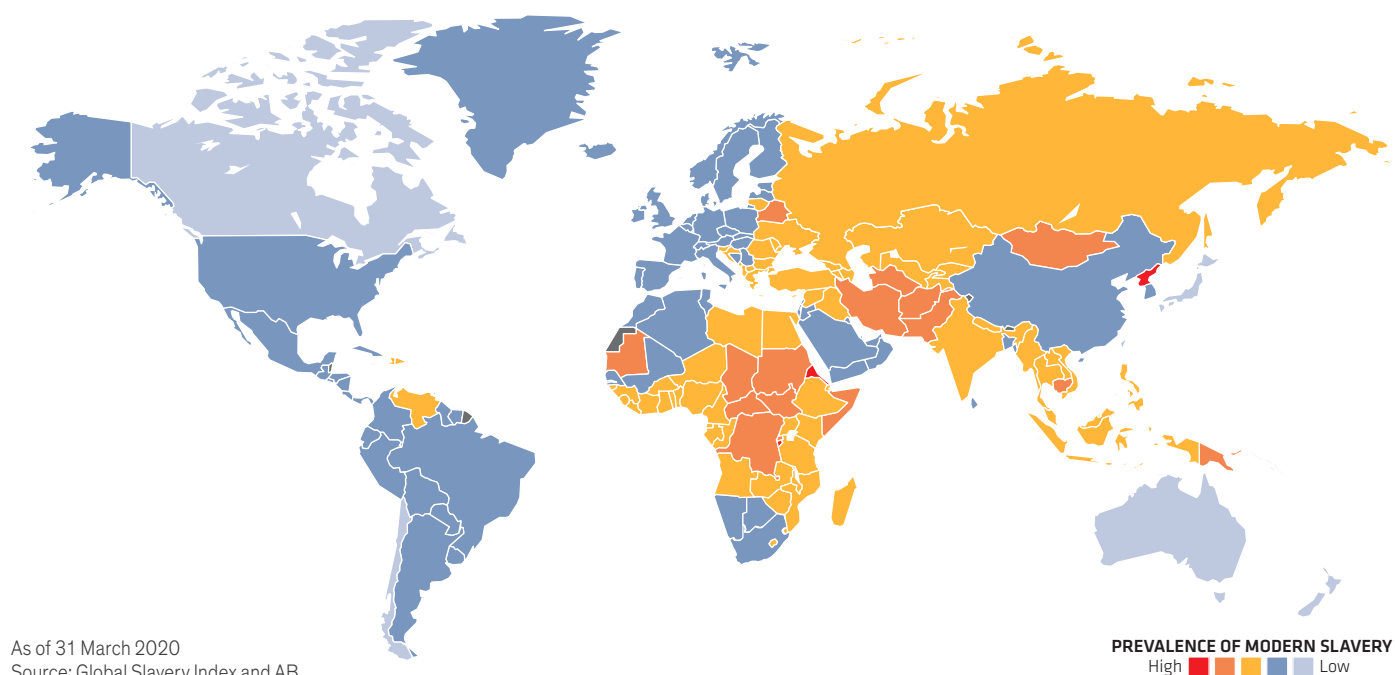
Source: ACSI, company interviews, company reports, industry research and AB

slavery, analyses governments’ responses and explains the factors that make people vulnerable.⁹ The data, presented as a map in *Display 6*, page 8, help us to assess individual company exposures based on countries where the company conducts operations and/or sources supplies (individual country rankings are provided in *Display 9* in the Appendix).

⁹ See <https://www.globalslaveryindex.org/>. The index includes forced marriage as well as forced labour in its definition of modern slavery.

DISPLAY 6: A STAIN THAT COVERS HALF THE WORLD

Estimated Prevalence of Modern Slavery



Modern Slavery in Australia: The Horticultural Sector

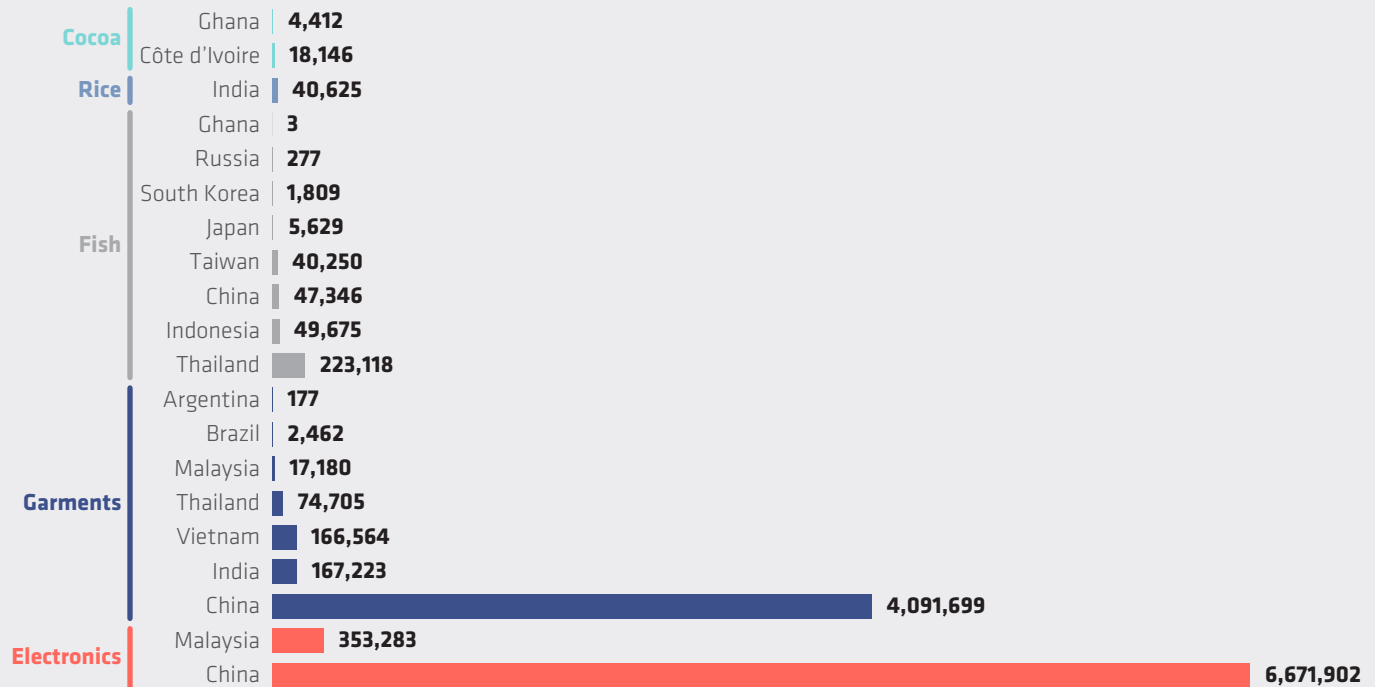
The Australian horticultural sector is one of the most at-risk industries for modern slavery. On 22 July 2019, the National Union of Workers (NUW) released a report on the exploitation of workers on Australian farms. The report surveys 655 farm workers across Australia and finds persistent and widespread labour abuses in the Australian horticultural industry. From severe underpayments and withholding of wages, excessive overtime, retention of identity documents, threats of and actual physical and sexual violence, coercive and excessive payments for transport and board, the survey responses raise red flags for the occurrence of modern slavery. Modern slavery occurs on a spectrum of labour exploitation. What often starts off as wage theft and excessive working hours can quickly deteriorate into modern slavery through threats and coercion.

—Martijn Boersma and Justine Nolan, *Expert Statement: Modern Slavery in Australian Horticultural Supply Chains*, an open letter circulated by the authors of *Addressing Modern Slavery*, UNSW Press (2019), and signed by more than 50 academics¹⁰

¹⁰ See <http://www.martijnboersma.com/coles-woolworths-open-letter-modern-slavery>.

DISPLAY 7: HIGH-RISK PRODUCTS AMONG AUSTRALIA'S IMPORTS

Annual Imports of Products at Risk of Modern Slavery, USD Thousands



As of 31 March 2020

Source: Walk Free Foundation, *Global Slavery Index*, 2018 and AB

The fact that Australia is ranked low on these criteria is, unfortunately, no cause for complacency. As is often documented in our national and local media, cases of modern slavery exist here, too (see 'Modern Slavery in Australia: the Horticultural Sector', previous page).

Third-party sources also provide information about high-risk products and services. *Display 7*, for example, ranks Australia's annual imports of such products by US-dollar value. Electronic goods, garments and fish are the most at-risk product categories, particularly when they are sourced from China and other Asia-Pacific countries.

Our awareness of modern slavery risk at a global level can inform us of how companies outside Australia are responding to the issue. This can be instructive in helping us assess how their Australian

counterparts compare in this respect. It's notable, for example, that supermarket chains in Europe and the US have joined an initiative to help reduce risks to people in Thailand's fishing industry.¹¹

Similarly, electronics, retail, auto and toy companies are working to support the rights and well-being of workers in their global supply chains through the Responsible Business Alliance, a not-for-profit organisation.

Mapping companies according to risk in this way helps us determine which companies we need to engage with most deeply or most urgently on how they are reducing risks to people.

¹¹ See "Walmart, Tesco and Costco among retailers responding to revelations of slavery in prawn supply chains", The Guardian, 10 June 2014.

WHAT IS CORPORATE BEST PRACTICE?

Our primary objective in engaging with corporates is to assess how good they are at reducing modern slavery risk. To this end, we have collaborated with Australian corporates to identify five criteria that together might be considered a benchmark for corporate best practice in this area. They can be summarised as:

- + **Governance Framework:** What steps are the board and senior management taking—through policies and procedures, as well as the company's culture and values—to align the business with the goal of reducing modern slavery risk?
- + **Risk Identification:** The criminal and covert nature of modern slavery practices makes this a difficult and delicate task. How well does the company understand the challenge, and how robust are the techniques and processes that it uses to identify the risk?
- + **Action Plan to Mitigate Risks:** Is the plan a realistic solution to reduce the risk to people within the company and its supply chains? Does the company appropriately identify the risks and effectively train and empower employees and suppliers to engage with them and reduce them?
- + **Action Plan's Effectiveness:** To what extent have the company's actions reduced risk, and how are the board and senior executives measuring the progress being made? What procedures are in place to ensure that follow-up actions are implemented and monitored?
- + **Future Improvement:** For many companies, the road to reducing modern slavery risk will be a long one, through unfamiliar territory. The best of them will be able to evaluate their progress each step of the way and make changes with an eye to continuously improving their performance against each of the criteria.

The criteria are discussed in detail on the next two pages (see 'Examples of Corporate Best Practices to Reduce Modern Slavery Risks'). Not all of them will apply to all companies equally in all situations; they provide a useful framework, however, for thinking about how corporates might respond to modern slavery risk and for helping us to engage with them on the subject.

The point about this framework—and the 'future improvement' component, in particular—is that it recognises best practice in this area to be a process of continuous learning and improvement. We see corporates engaged in this experience as typically moving through four phases. From an initial 'laissez-faire' attitude, they move to one in which they acknowledge modern slavery as a risk that needs to be managed (primarily as a reputational issue). In the third phase, they become involved in the cause as a form of charitable activity. Finally, they accept that the risk of modern slavery in their supply chains goes to the heart of what they stand for as a company and that reducing the risk should be part of their core values. It is at this point that the fight against modern slavery becomes part of their brand identity and a source of competitive advantage.

For example, In-N-Out Burger, a California-based fast-food chain, has set up the Slave 2 Nothing Foundation to try to reduce modern slavery. Outside the retail sector, US industrial supplies company Grainger uses modern slavery risk management as a factor in evaluating and selecting its suppliers.

Five Examples of Corporate Best Practices to Reduce Modern Slavery Risks

1. Governance Framework

- + Action on modern slavery seen as an important corporate value and a potential source of competitive advantage
- + Public commitment with clear policy statements and codes of conduct available to stakeholders in relevant languages and consistent with legislation and global frameworks (e.g., the UN's Guiding Principles on Business and Human Rights)
- + Focus on labour risk to people, not just risk to the entity
- + Board takes accountability and has information to ensure that management is managing risks properly
- + 'Focus teams' or 'ambassadors' who champion action on modern slavery within the business
- + Evidence that senior management takes accountability, with clear consequences for inaction or failure, as well as evidence of improved outcomes (e.g., changes in supplier relationships)
- + Accountability across the company's own operations, its value chain, joint ventures and assets that are owned by the company but operated by other entities
- + Disclosure of relevant and timely targets for modern slavery and reports of violations

2. Risk Identification

- + Robust process to identify risks and prioritise exposures across high-risk populations, geographies, products, services and business models
- + Risks identified across the company's operations and supply chain where the company's own behaviour may contribute to risks to people; analysis based on detailed supply-chain maps
- + Frequent risk analysis that includes supplier audits, site visits, third-party assessments, safe whistle-blower hotlines, victim advocates, and working with industry groups and relevant experts (e.g., 'Global Slavery Index' and US 'Trafficking in Persons' report)
- + A central registry of risks, and use of artificial intelligence to analyse financial transactions
- + Own operations and supplier audits include unscheduled visits, off-site worker interviews, broad worker consultation and assessment of worker housing
- + Low-quality 'tick the box' third-party audits are avoided and use of hotlines is ensured
- + Company actively seeks to learn lessons from industry peers and other industries
- + Company assesses risks beyond tier-one suppliers
- + Risk assessment is disclosed, including the percentage of suppliers evaluated

3. Action Plan to Mitigate Risks

- + Train employees and suppliers on the code of conduct, in relevant languages, and how to identify, monitor and manage modern slavery risks.
- + Ensure that workers have a fair living wage, with fair terms and conditions, and ensure they understand their rights and how to safely escalate grievances.
- + Ensure effective grievance resolution processes are in place.
- + Collaborate with relevant stakeholders (e.g., workers' rights organisations, corporates, industry bodies and local nongovernment organisations).
- + Develop appropriate, timely and measurable action plans to manage risks and high-risk exposures. For operations and suppliers that violate policies, create corrective/development action plans to improve conditions.
- + Respond to allegations by engaging directly with affected stakeholders. Disclose findings, and, if required, actions taken to remediate and prevent reoccurrence.
- + Ensure action plans and their impact are appropriately disclosed, with aim to improve outcomes. Where material change is required, lay the foundation for longer-term structural changes.

4. Action Plan's Effectiveness

- + Management reports include timely key performance indicators and relevant metrics to evaluate progress and shortfalls against modern slavery operational targets.
- + Assessment extends across the company's own operations globally and the supply chain, including key service providers such as recruiters.
- + Objective third-party analysis and verification of internal management reporting is performed. The company has the ability to provide audit results to line management, 'independent' executives and directly to the board.
- + Modern slavery successes, failures and risks, including where corrective actions have failed and what further steps are required, are reported.
- + There are clear accountabilities for performance measurement and targets, with relevant linkage to incentives for C-suite and management in supply-chain human resources, operations and marketing.
- + Performance against modern slavery targets are appropriately disclosed.
- + Management of risks to people extends broadly across the supply chain, particularly to high-risk suppliers (tier-two and lower).

5. Future Improvement

- + Conduct analysis of the company's approach to modern slavery versus best practice. Develop a strategy for continuous improvement and, where needed, step change.
- + Focus on root causes, such as why certain people are more vulnerable to human trafficking.
- + Disclose a strategy to enhance the company's approach to modern slavery.
- + Provide a public response to material modern slavery violations, including remediation and recommendations to enhance the board and management's strategy to reduce future risks.
- + Shape corporate and, potentially, industry best practice. For example, ResponsibleSteel aims to set a new standard in the steel industry with external certification.
- + Risks to people are integrated into strategy process. This, for example, contributed to a company reconfiguring its factory network to reduce risks.
- + Engage in public-policy dialogue to enhance the approach taken by a broad range of stakeholders within the relevant industry and broader community.

MANAGING MODERN SLAVERY RISK: FOUR AUSTRALIAN CASE STUDIES

The information and insights that we acquire as a result of engaging with corporates enable us to assess where the companies stand on our best-practice criteria. We produce a scorecard for each corporate, containing a detailed appraisal of its performance against each criterion.

Display 8, page 14, shows assessments for four Australian companies, which we have selected as case studies based on their progress on managing modern slavery risk. They are Ansell, a manufacturer of industrial and medical gloves and other personal protective equipment; Woolworths, the country's biggest retailer; mining and metals company South32; and steelmaker BlueScope Steel. The left-hand display shows where the companies stand on our risk-assessment matrix; the right-hand display summarises how, following our engagement with the companies, we have ranked them against our best-practice criteria.

We have, in fact, engaged with many companies other than these, including current, past and potential future holdings. We summarise some of the key findings regarding the four case studies below; they provide only a flavour of our research conclusions, which are based on extensive, in-depth analysis.

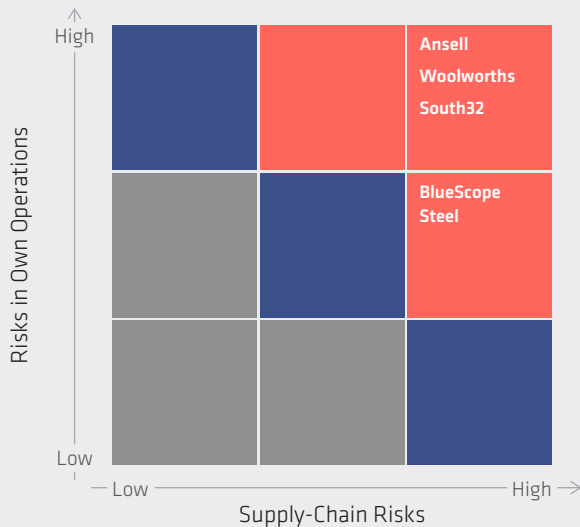
As a manufacturer of personal protective equipment with supply chains in Southeast Asia, Europe and South America, Ansell is exposed to high-risk products and geographies. During 2018, the company became aware of potential labour abuses by a supplier in Malaysia. Since then, the CEO and board have been very proactive in evaluating and managing the risk. The company has introduced a programme of independent audits every two years at factories

and tier-one suppliers, and has implemented digital technology within its operations to monitor the working hours of employees to ensure that they receive days off and holidays and are not subject to excessive overtime demands. In 2019, Ansell closed three factories for strategic and operational reasons, and we believe this will help to reduce modern slavery risk. Insourcing has reduced the company's reliance on outsourced products to 40% of sales.

Ansell is a leader in acting on modern slavery. Even so, like nearly all other companies that are engaging with the issue, it has scope for improvement. In Ansell's case, we see potential for the company to continue growing the modern slavery risk-management capabilities of its suppliers.

Wage theft is an issue commonly associated with modern slavery. Woolworths became associated with it when, in 2019, the company was discovered to have underpaid 5,700 salaried staff between \$200 million and \$300 million (as of June 2020, the estimated figure had increased to \$500 million). While we take wage theft seriously, we don't consider it to have been, in Woolworths' case, an instance of modern slavery—there was no evidence of ill intent, and both the CEO and the chairman made themselves accountable by electing to reduce their compensation.

DISPLAY 8: FOUR AT-RISK COMPANIES AND HOW THEY ARE RESPONDING



	Governance Framework	Risk Identification	Action Plan to Mitigate Risks	Action Plan's Effectiveness	Future Improvement
Ansell	✓✓✓	✓✓✓	✓✓✓	✓✓	✓✓✓
Woolworths	✓✓✓	✓✓	✓✓	✓✓	✓✓
South32	✓✓✓	✓✓✓	✓✓	✓	✓✓
BlueScope Steel	✓✓	✓✓	✓✓	✓	✓✓✓

Three ticks = very good progress; two ticks = good progress; one tick = developing progress
 As of 31 March 2020
 Source: ACSI, company interviews, company reports, industry research and AB

On a more positive note, Woolworths has a 'Responsible Sourcing Policy' and processes in place to assess risks in its supply chains and to prioritise suppliers for scrutiny. The company has more than 1,500 suppliers across 50 countries, including high-risk locations such as China, Bangladesh and Thailand. In 2019, it conducted 26 site visits in China, of which 23 showed need for significant improvement on issues such as overtime, wages and safety. By June 2019, corrective action had been taken in 21 of the 23 cases. The company is proactive in helping improve the lives of workers in its supply chain through, for example, the Shobola Project in

Bangladesh, which helps women in the country's ready-made garment sector to consider pathways into supervisory positions.

In our view, Woolworths would benefit from integrating the reduction of modern slavery risk into its senior-management compensation system. One incentive to do this could be the potential risks posed by the growth in consumer awareness and activism in relation to modern slavery. Mobile phone apps are now available to help consumers check, at point of sale, the modern slavery risks associated with products sold at Woolworths and other retailers.



South32: Independent Labour Audits

The independent labour audit performed by South32 was a great opportunity to improve our internal processes to respect human rights. From the observations of the auditors we learnt a lot about social responsibility and some labour issues. We are implementing some changes in our company to improve communication with communities surrounding our projects, and improving our procedures.

—Feedback from CEO of Kluane Drilling.
This supplier was audited in 2019 as part of South32's independent labour audit programme. Kluane provides drill core—diamantine exploratory services at South32 operations in Colombia.

South32, once part of BHP Billiton, has a heritage of mining in Africa, Colombia and Australia spanning many decades. Unlike most Australian companies—which, to date, have reported once, if it all, on modern slavery risk management—South32 has been doing so for the last four years. The company has a good governance framework and a solid prioritisation process for engagement with suppliers. A particularly strong point in the company's favour is its emphasis on building the capability to manage modern slavery risk in its supply chain, as reflected in feedback from one of its suppliers, Colombian-based contractor Kluane Drilling, which was subject to an independent labour audit during 2019 (see 'South32: Independent Labour Audits'). Among areas of improvement for South32, we would like to see the company conduct more audits of its supply chain each year, given that it has about 6,000 suppliers from 50 countries. Pleasingly, our most recent engagement with management indicates that they already have plans in place to engage further with tier-one and tier-two suppliers.

Globally, the steel industry tends to lag many others in the steps that it has so far taken to combat modern slavery risk, but that could be about to change, thanks largely to an initiative closely associated with BlueScope Steel. In 2019, the industry launched ResponsibleSteel, a global multi-stakeholder standard and certification initiative. The programme, developed over a decade by BlueScope and launched by a group of global industry leaders brought together by the company, creates the basis for industry-wide audits of corporate best-practice behaviours on a range of issues, including climate impact and, importantly, human rights.

This initiative, in our view, has the potential to change the US\$1 trillion-a-year steel industry profoundly—given the interest expressed to date by global automakers, we think it's likely that cars will be made of ResponsibleSteel in the future. In the case of BlueScope, if the company were to receive the programme's certification for its steel products, the effect could be to create an important brand differentiator and further strengthen the products' competitive position in Australia and other markets.

While BlueScope has a system in place to manage risk to people, it remains at an early stage of implementation. The company has thousands of suppliers across 30 countries. To date, it has evaluated 800, which account for 85% of supplies by value. From these, the company has identified 25 priority-one and 163 priority-two suppliers. Company information shows that while 57 of these have been evaluated in total in 2019, only two of the evaluations were based on on-site assessments (the remainder were either conducted as desk research or supplier self-assessments). While this is a good start, we believe that the company should conduct more audits across its supply chain, and we note that BlueScope now has a clear programme of work to conduct additional supply chain and own-site audits.

RESEARCH: THE IMPACT SO FAR



A waterfall begins from only one drop of water, sir. Look what comes from that...

—From the film ‘The Power of One’ (1992).

In the case of many companies required to report under the legislation, shareholders are engaging with senior executives on modern slavery risk for the very first time. It remains to be seen how this engagement, and its results, will evolve over time. From our perspective as an asset manager, we see research and engagement in this area as having a potential impact in two ways: potentially reducing modern slavery risk and helping to enhance our investment process.

For example, the nature and timeliness of the subject has resulted in our having broader and deeper conversations with companies—those outside our portfolios as well as those within them. And, as noted earlier, we are talking to a wider range of corporate officers, including, for example, global supply-chain managers.

This is positive not only from the point of view of enhancing our fundamental research capability but also for our aspirations of helping to reduce modern slavery risk over time.

Our experience of engaging with corporates on the issue has been overwhelmingly positive. One of the most heartening aspects has been to discover the shared conviction of boards and executives that modern slavery is a social evil and a business risk and that all of us—companies, investors and consumers—have an obligation to do what we can to confront and, where possible, eradicate it.

This is not to understate the scale or complexity of the challenge. If we are to rise to it, however, we must start somewhere.

During a meeting with a major Australian retailer, for example, one of our analysts was talking to the CFO about the company’s launch

of an own-brand version of a popular snack. The analyst noticed that the product was made in a country that was potentially at high risk for modern slavery. He asked the CFO how sure she was that this did not expose the company to modern slavery risk and to possible adverse media coverage. She replied that she didn’t know, but that she would find out.

In another instance, the chair of a large financial institution with whom we engaged said that our focus on modern slavery could result in the issue gaining a higher priority on the entity’s risk map. Part of our engagement process with all corporates is to follow up on such comments and monitor progress. This is, after all, a long-term process, inspired by the idea that ‘from little things, big things grow’.

The benefit to our fundamental research capability has been immediate, and we expect it to increase as our research and engagement in the area continue. While we have removed stocks from our portfolios where our assessment of modern slavery risk worked against our investment thesis, such instances have been rare. More commonly, the benefit has manifested itself in the form of an investment process that delivers even higher conviction in our stock selections than was the case previously.

We expect our investment insights to continue improving in quality and number as we maintain engagement with corporates over the long term. Indeed, our modern slavery research has given rise to what might be regarded as a new investment principle: ‘If a company can’t manage modern slavery risk in its supply chain, it can’t manage its supply chain’.

THE PATH FROM HERE

In the short term, the development path for our modern slavery research is quite clear: we will continue to evaluate risk in our portfolios and engage with corporates, all the time extending our knowledge base and analytical capabilities for the benefit of our clients and our own modern slavery reporting requirements.

We expect, however, that the environment in which we do so will change as the world becomes more aware of modern slavery, better informed about it and increasingly motivated to act. The potential for popular activism in this area should not be underestimated, in our view, particularly given the influence of social media and the power put into the hands of consumers at the point of sale by ethical-purchase mobile phone apps.

Indeed, we believe that modern slavery has the potential to become a moral issue as big and as urgent in the public imagination as climate change is today.

We are seeing the level of consciousness among corporates and investors about this issue moving beyond the stage of 'unaware and unaccountable' to one of developing awareness and an understanding that modern slavery poses a real threat to business sustainability.

It needs to be said: this is a journey for all of us, but the pace is quickening and those who embark on the journey most successfully will be those, in our view, who willingly embrace the challenge to collaborate, act and lead in the fight against modern slavery.



APPENDIX

DISPLAY 9: THE HIGHEST-RISK COUNTRIES FOR MODERN SLAVERY

Estimated Victims per 1000 of Population

1	North Korea*	104.6	30	Philippines	7.7	59	Lithuania	5.8
2	Eritrea	93.0	31	Timor-Leste	7.7	60	Zambia	5.7
3	Burundi	40.0	32	Nigeria	7.7	61	Venezuela	5.6
4	Central African Republic	22.3	33	Uganda	7.6	62	Haiti	5.6
5	Afghanistan	22.2	34	Madagascar	7.5	63	Egypt	5.5
6	Mauritania	21.4	35	Malawi	7.5	64	Russia	5.5
7	South Sudan	20.5	36	Guinea-Bissau	7.5	65	Moldova, Republic of	5.5
8	Pakistan	16.8	37	Liberia	7.4	66	Benin	5.5
9	Cambodia	16.8	38	Syrian Arab Republic*	7.3	67	Mozambique	5.4
10	Iran, Islamic Republic of	16.2	39	Angola	7.2	68	Armenia	5.3
11	Somalia	15.5	40	Djibouti	7.1	69	Uzbekistan*	5.2
12	Democratic Republic Congo	13.7	41	Kenya	6.9	70	Sierra Leone	5.0
13	Mongolia	12.3	42	Malaysia	6.9	71	Ghana	4.8
14	Sudan	12.0	43	Albania	6.9	72	Iraq*	4.8
15	Chad	12.0	44	Cameroon	6.9	73	Gabon	4.8
16	Rwanda	11.6	45	Togo	6.8	74	Indonesia	4.7
17	Turkmenistan*	11.2	46	Niger	6.7	75	Tajikistan*	4.5
18	Myanmar	11.0	47	Zimbabwe	6.7	76	Burkina Faso	4.5
19	Brunei Darussalam	10.9	48	Turkey	6.5	77	Vietnam	4.5
20	Belarus	10.9	49	Ukraine	6.4	78	Bulgaria	4.5
21	Papua New Guinea	10.3	50	Equatorial Guinea	6.4	79	Azerbaijan*	4.5
22	Lao People's Democratic Republic	9.4	51	Tanzania	6.2	80	Georgia	4.3
23	Thailand	8.9	52	Ethiopia	6.1	81	Romania	4.3
24	Swaziland	8.8	53	India	6.1	82	Cyprus	4.2
25	Macedonia	8.7	54	Croatia	6.0	83	Kazakhstan*	4.2
26	Congo	8.0	55	Nepal	6.0	84	Lesotho	4.2
27	Greece	7.9	56	Côte d'Ivoire	5.9	85	Kyrgyzstan*	4.1
28	Guinea	7.8	57	Montenegro	5.9	86	Cape Verde	4.1
29	Libya	7.7	58	Gambia	5.8	87	Dominican Republic	4.0

88	Kosovo	4.0	115	Algeria	2.7	142	Brazil	1.8
89	Latvia	3.9	116	Guyana	2.6	143	Netherlands	1.8
90	Israel	3.9	117	Jamaica	2.6	144	Austria	1.7
91	Cuba	3.8	118	Peru	2.6	145	Lebanon*	1.7
92	Bangladesh	3.7	119	El Salvador	2.5	146	Switzerland	1.7
93	Hungary	3.7	120	Portugal	2.5	147	Ireland	1.7
94	Estonia	3.6	121	Morocco	2.4	148	United Arab Emirates*	1.7
95	Mali	3.6	122	Italy	2.4	149	Finland	1.7
96	Botswana	3.4	123	Ecuador	2.4	150	Denmark	1.6
97	Singapore	3.4	124	Spain	2.3	151	Paraguay	1.6
98	Bosnia and Herzegovina	3.4	125	Suriname	2.3	152	Sweden	1.6
99	Honduras	3.4	126	Tunisia	2.2	153	Qatar*	1.5
100	Poland	3.4	127	Slovenia	2.2	154	Luxembourg	1.5
101	Serbia	3.3	128	Oman*	2.1	155	Kuwait*	1.5
102	Namibia	3.3	129	Bolivia	2.1	156	Hong Kong, China*	1.4
103	Yemen*	3.1	130	Sri Lanka	2.1	157	Argentina	1.3
104	Trinidad and Tobago	3.0	131	Iceland	2.1	158	United States	1.3
105	Slovakia	2.9	132	United Kingdom	2.1	159	Costa Rica	1.3
106	Guatemala	2.9	133	Panama	2.1	160	Uruguay	1.0
107	Nicaragua	2.9	134	Germany	2.0	161	Mauritius	1.0
108	Czech Republic	2.9	135	Belgium	2.0	162	Chile	0.8
109	Senegal	2.9	136	France	2.0	163	Australia	0.6
110	South Africa	2.8	137	South Korea*	1.9	164	New Zealand	0.6
111	China*	2.8	138	Saudi Arabia*	1.9	165	Taiwan, China*	0.5
112	Barbados	2.7	139	Bahrain*	1.9	166	Canada	0.5
113	Colombia	2.7	140	Norway	1.8	167	Japan*	0.3
114	Mexico	2.7	141	Jordan*	1.8			

* Estimates could be understated due to data limitations.
As of 31 March 2020
Source: Global Slavery Index



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