



Downstream human rights due diligence

Musical intro

Host:

Hello, and welcome to another episode of ESG Voices. This podcast series addresses the opportunities and challenges within ESG through interviews with ESG specialists from KPMG and beyond.

Throughout this series, we will discuss a broad range of environmental, social, and governance issues, aiming to support governments, businesses, and communities in creating an equitable and prosperous future for all.

The past 10 years have seen a steady shift in human rights legislation away from basic supply chain reporting requirements towards mandatory supply chain due diligence. As part of this hardening of the legislative landscape with regard to human rights, private sector organizations are coming under increasing pressure to conduct due diligence, not only in their supply chain but also along their broader value chain. This broader value chain due diligence covers more than just the upstream relationships associated with supply. It can also cover downstream relationships. This extension of due diligence obligations to downstream relationships is likely to be one of the key areas of focus in the coming years, as global human rights laws are aligned more closely with the requirements of international guidance, such as the United Nations Guiding Principles on Business and Human Rights, and the OECD guidelines for multinational enterprises.

In this episode, we will examine how organizations may respond to these increasing requirements in the area of downstream due diligence. To discuss this, I am joined by Fernanda Farina, a senior manager with KPMG in the UK's sectors consulting team, and Michael Pollitt, a manager with KPMG in the UK's financial services forensic team.

To kick off our conversation, Michael, could you describe to our audience what downstream due diligence is? Could you share a few examples of the risks we might identify in this area?

Michael Pollitt:

Thanks very much for having us. I think this is a really good question to get us kicked off. Downstream due diligence is just the term used to describe an organization's efforts to understand and mitigate the human rights risks associated with its downstream relationships. And when we say downstream relationships, we're talking about our relationships with entities responsible for everything that happens to a product after it has been made. Downstream due diligence, therefore, often covers entities responsible for the sale, distribution, transport, storage, and disposal of products.

You asked for a few examples of the risk in this area of the value chain. Well, we set out a few examples of the risks in our recent blog on this subject, but to summarize, examples of downstream risk could include things like the risk of excessive contracted working hours, lack of health and safety, low wages, debt bondage in the transport, logistics, and distribution sectors; the risk of negative impacts arising from marketing activities — for example, if harmful products such as tobacco or alcohol are marketed to vulnerable customers; and the risk of technology products being associated with negative impacts, such as illegal surveillance; right up to the risk of negative impacts on surrounding communities whose health or safety might be affected by the improper disposal of a product after it's been used.

This is in contrast with upstream due diligence, which is what we traditionally envisage when we think about human rights due diligence. Upstream due diligence focuses on third parties working in the area of supply, i.e., the entities responsible for perhaps extracting raw materials, exporting these raw materials to us, processing these raw materials if necessary, and manufacturing them into the products we sell.

For a long time, human rights legislation has focused on requiring private sector organizations to report on their efforts to address negative impacts in the upstream area of the value chain, often referred to as the supply chain. This is the case, for example, with the UK's Modern Slavery Act 2015.

However, what we're seeing now is a shift in due diligence requirements towards downstream relationships, meaning that private sector organizations need to get a good understanding of the human rights impacts associated with everything that happens to their products after they have been made.

Host:

Thanks, Michael. Fernanda, the corporate sustainability due diligence directive, or CSDDD, is primarily focused on Europe. But will it impact global companies?

Fernanda Farina:

The short answer is yes — global companies will be affected, both directly and indirectly, by the EU's CSDDD. Directly because the legislation casts a wide net. According to the latest amendment to the text, the directive will apply to European organizations with over 250 employees and a global turnover of over €40 million, but it will also apply to non-EU organization if they generate over €150 million, out of which [€]40 million generated in the EU. So directly, yes, it applies to non-EU companies as well. It is estimated that the CSDDD will affect approximately 17,000 businesses in total, out of which 4,000 are companies incorporated outside the EU. But even for companies that are not in scope of the European legislation, the trickle-down commercial effect of this law will quickly be felt by companies of all sizes across the globe. This is because when companies that are in scope are undertaking their due diligence, they will map their supply chain, both up and downstream. As part of their risk mitigating measures, they will reach out to their suppliers and their commercial partners, in which they identified a high-risk area, and make sure that these entities have proper policies, processes, and controls in place. This means that even the companies that are not directly in scope of this legislation, either geographically or because of its operation size, will also rapidly feel the indirect effects of this new legislation. They will also have to be proactive in developing their processes, their controls, to both assess and mitigate risks if they want to continue with their commercial relationship. So, it's really a domino effect.

And that third point that I would like to make is that the CSDDD is one very important example of a much wider wave of legislation that is being discussed and adopted around the world, mandating human rights and environmental due diligence in the value chain, some only in the upstream and some both in the upstream and downstream value chain. Definitely, this is not just a concern for European corporations. Just as the GDPR, for instance, became a standard of everyday business relationships across the world, so will human rights and environmental due diligence.

Host:

Thanks, Fernanda. Michael, why is it important for organizations to conduct human rights due diligence?

Michael Pollitt:

In the nine years that I've been working on human rights and modern slavery, the estimated number of victims has only increased. When I started working on the Modern Slavery Act back in 2014, the Global Slavery Index that the Walk Free Foundation puts out estimated that there were about 35.8 million people being held in situations of modern slavery globally. Last year, the International Labour Organization revised these estimates, putting the estimated total number of people held in modern slavery at more like 50 million, an increase of 40 percent compared with 2014.

We're now in a situation where nearly one in every 150 people in the world is thought to be held in a situation of modern slavery, and that includes both forced labor and forced marriage. But if we look at forced labor in particular, the private economy accounts for about 86 percent of cases, according to the ILO. So clearly, the problem of human rights abuse and modern slavery is getting worse, and the private sector has a lot to answer for in this regard.

I think robust human rights due diligence can have a positive effect on these circumstances in both a direct way and an indirect way. In a direct way, robust human rights due diligence is one of the most important tools that we can provide to clients who want to have a positive impact in the area of human rights or mitigate their negative impacts. By assessing their third-party relationships, private sector organizations can get a clearer picture of where the biggest risk areas are, what kind of risks they face, and how the specific risks can be mitigated.

In an indirect way, human rights due diligence programs can have an exponential effect on the standards in place across the rest of the private economy more broadly. Even if an organization is not within the scope of a specific due diligence requirement, they may still be affected by the due diligence requirements imposed on their clients who will need them to evidence the degree of human rights maturity as part of their own due diligence processes. In this way, the impact is broader, and it's not just confined to the large companies within the scope of the legally mandated due diligence requirements themselves.

For these reasons, any organizations choosing to conduct robust human rights due diligence, they stand to make a positive impact not only on their own organization, but across the organizations in their value chain.

Host:

That's great. Thanks, Michael. Fernanda, what are the lessons you have learned from previous experience of human rights due diligence, and what advice would you give based on those lessons?

Fernanda Farina:

Firstly, I would say that it's important to bear in mind that this is still a space in development. Mandatory human

rights due diligence legislation is still being debated and slowly adopted around the globe, and as such, there's still a lot of unknowns. For instance, there's still little clarity in terms of the threshold of liability for human rights harms and environmental harms caused across value chains. There's still not enough guidance for businesses on how to build their risk-based approach. But this lack of clarity doesn't mean that the risk do not exist. Rights violations do not wait for governments to pass on bills. That means that companies must be proactive in their efforts to map their value chains and understand what their salient human rights and environmental risks are.

The first lesson I've learned from my previous experience advising and undertaking human rights due diligence is that developing the necessary internal governance to deal with those risks takes time. It requires developing internal processes, controls, drafting and revising policies and contract clauses. It requires bringing in new team members, training your staff. All of that takes time and resources.

As I said it, companies are required to adequately map their value chains to really understand what the main human rights risks are in their up and downstream. That means going beyond their tier 1, because those risks might be in their tier-2-, sometime tier-3-level suppliers. All of this takes time, and companies should take the opportunity of this hiatus we have while we're waiting for legislation to be approved to start setting up their processes.

A second lesson that I've learned, I'd say that dialogue is essential. Dialogue can save a lot of time and resources. Firstly, internal dialogue between the different areas of a company, such as compliance, procurement, and the sustainability groups. This dialogue will allow teams to understand how the sustainability practices, where usually the human rights due diligence sits, how that integrates into other areas, such as anti-bribery and corruption practices, for instance, and how to integrate these so that you have processes that flow seamlessly and that procurement is not stalled for too much, for too long. Also, what systems they can use, what processes can be leveraged internally to make human rights due diligence more efficient and less costly.

The second type of dialogue is certainly the dialogue with commercial partners. Duty of care means that companies are responsible to conduct proper diligence and use their best efforts to prevent and remediate harm. Human rights risks are not static, they're not siloed. They're usually part of a much bigger and much more complex scenario. Companies should really leverage their commercial relationship and engage in a honest, transparent dialogue with their commercial partners to see how they can really together identify and address the risk to people and to the communities that are affected in their value chain. That can be done through industry-wide initiatives in cooperation with civil society working groups, or even bilaterally.

I think the last, final dialogue that I would probably highlight is the dialogue with affected stakeholders, which again can be done through partnerships with civil society or directly. Oftentimes, it's difficult for companies to properly understand the social and labor dynamics that take place on the ground across their value chain. And as such, the risk can come as a surprise. What I would say it's probably

instead of being caught off guard after a serious human rights abuse has taken place, companies should again be proactive and initiate this dialogical process with local communities and affected stakeholders, making sure that there are adequate avenues, for instance, for grievance to be raised, and that is done in a confidential manner.

Host:

Thanks, Fernanda. Michael, if organizations are looking to get started in the area of downstream due diligence, how can they do this?

Michael Pollitt:

I think a great way to get started would be to read our latest blog. In the blog, which we're hoping to summarize in a short online video soon, we set out three top recommendations for organizations who are looking to get started in the area of downstream due diligence.

The first recommendation is to be proactive. Organizations who are not already affected by the downstream elements of existing legislation may be tempted to wait for this forthcoming legislation to force their hand on the issue of downstream due diligence. But I think it's important to remember that current negotiations on downstream due diligence, such as those we've seen in relation to the corporate sustainability due diligence directive, these are part of a broader trend which we've seen in which human rights laws are aligning now more closely with the requirements of international guidance, such as the UN Guiding Principles and the OECD guidelines for multinational enterprises. Firms should consider what actions they can take now to stay ahead of these longer-term trends.

The second recommendation we give in our blog is to work with what you have. Some organizations may be inclined to think that they lack the basic infrastructure or resources to manage due diligence requirements in relation to their complex downstream relationships. Organizations who are in this position should consider what governance structures they already have to manage more traditional due diligence activities associated with upstream relationships. Existing systems for risk-rating upstream suppliers, for example, or managing third-party risk, can be repurposed when necessary to help these organizations determine the level of human rights risk that is posed by their downstream relationships, so that due diligence activities can be prioritized on this basis.

And the third piece of advice we discussed in our blog is just to collaborate. Fernanda talked about the importance of dialogue, for example, and this is linked. When you're trying to identify the areas of greatest risk in the downstream value chain, it's going to be all the more important to identify civil society organizations who have a vested interest in mitigating those human rights impacts that might be associated with your downstream activities. When you're looking at community impacts in particular, organizations need to identify those populations on which the sale, distribution, transport, storage, and disposal of their products are likely to have the most meaningful or largest impact. And then you can seek to engage with the civil society organizations who represent those communities, so you can identify any adverse impacts and discuss in practice how they can be resolved.

Those were the three top recommendations that come out of our blog for organizations who are looking to get started with downstream due diligence. But the overarching advice was to stay ahead of the game, to prepare for additional downstream due diligence requirements now, rather than waiting for these requirements to be imposed and trying to play catch up later on.

Host:

Thanks, Michael. Fernanda, to wrap up our conversation today, in your opinion, what does the future hold for this space?

Fernanda Farina:

In the immediate future, end of this year, beginning of next year, we have the approval of the CSDDD that is an important mark for further legislation in Europe and across the world. In the next couple of years, we will continue to observe governments around the world proposing and implementing legislation mandating human rights and environmental due diligence, both upstream and downstream, which is a good thing. The more consistency that we have in terms of these legal frameworks, better legal certainty we have and clearer frameworks for companies to adhere to. This gives more security across global supply chains.

But beyond the increase in number of legislations mandating human rights due diligence across the globe, what we'll probably see in the future is further scrutiny in terms of the areas to be monitored. For instance, in the downstream value chain, the use of technology, artificial intelligence, data processing tools, social media — this all can have human rights impacts, and we will probably see regulators being harsher in terms of how companies are managing the risks associated to those things. As industry and public authorities become more mature in this space, the comprehension of the human rights risks and social impact across their value chain will also increase. This mean further

scrutiny over businesses' negative impacts on communities and vulnerable groups.

Talking about scrutiny, we are already seeing much higher scrutiny over businesses' impact in communities and environments, both from regulators and from consumers, but that will only increase. For instance, we have witnessed a sharp increase of litigation against businesses for human rights harms caused in their operations, by their suppliers, or even due to the use of their products. These legal cases are being brought by victims, by civil society and interested groups, and are often financed by third parties. And because the litigation in the space is relatively new, this is certainly a space to watch. The judicial system is certainly an important space to watch in terms of human rights due diligence. Judges and courts will be extremely important now in setting precedents about liability, threshold of liability for harms caused by third parties, for instance.

But in general, I'd say that I'm very optimistic about the future. I believe that we're going in the right direction from a human rights due diligence perspective. And although this moment might seem daunting due to a tsunami of new legislation and new guidance, the fact is that this legal framework will help bring more transparency to value chains and give much more of a needed protection to the affected stakeholders.

Host:

Fernanda and Michael, thanks again for speaking to us today. You've given our listeners a lot to think about.

Join us again next time for more insights from ESG leaders and innovators. You can also find our latest insights covering a range of ESG topics by visiting kpmg.com/ESG.

Thanks for listening!

Musical exit

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