Corporate ESG Disclosure Standards and Long-Term Atrocity Risk Data

AIPG White Paper

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This white paper is based on a roundtable discussion hosted on 16 March 2022 by the Auschwitz Institute for the Prevention of Genocide and Mass Atrocities (AIPG). The roundtable focused on emerging European Union (EU) environmental, social and governance (ESG) disclosure and due diligence standards, evolving approaches to gathering long-term risk data used in atrocity prevention, and how these evolving standards and approaches will affect civil society and civil society organizations (CSOs).

Speakers:

- **Owen Pell**, President of the Board of AIPG (moderator)
- **Moritz Kilger**, Co-founder and Director of NKI Sustainable Finance Academy
- **Benjamin Goldsmith**, Professor at the Australian National University
- **Clare Connellan**, Partner at White & Case LLP

1. Introduction

The last five years have seen explosive growth in ESG-related laws and regulation around the globe. The EU and European Commission are proposing legislation and regulations designed to change dramatically how companies and investors approach both ESGs and ESG-related due diligence. Companies will be required to look beyond their immediate corporate family and assess data relating to the societies in which they operate and to their entire value chain, including as to potential long-term risks based on both financial and non-financial data that may relate to ESG objectives.

This emerging ESG analytical framework is likely to include data relating to the risk of genocide and other mass atrocities because, among other things, of the effects those events can have on businesses or the communities in which they operate (i.e., whether as to workers, consumers, or communities touched by a particular business). This type of data has proven useful in helping to predict the risk of genocide or atrocity crime outbreaks, and could be relevant to how certain long-term ESG risks are analyzed and disclosed, and how CSOs address those types of risks with companies and investors.
2. **ESG Trends and the EU Framework**

2.1 **General Trends**

The role of the ‘corporation’ in society has evolved over time – from the inception of corporate philanthropy, to the concept of corporate social responsibility, to emerging rules for ESG investing. The trend has shifted from voluntary reporting to mandatory requirements, and businesses are being told to refocus their efforts on two key areas: **disclosure** and **diligence**.

The pace of change in this area has accelerated over the last decade. Since the UN Guiding Principles on Business and Human Rights were endorsed in 2011, paving the way for a global standard for addressing the risk of and preventing adverse human rights impacts linked to business operations, many international organizations, including the World Bank, OECD, IFC, ICC and EU have incorporated these principles into their guidance for responsible business conduct.

As governments create mandated standards relating to human rights and environmental impacts, companies will face potential legal and regulatory liability (e.g., shareholder and investor lawsuits, and/or regulatory fines and costs), and reputational risks, all of which may result in financial losses and hinder a company’s ability to access capital. In addition, as specific social and environmental objectives are developed, companies will face increased pressure from a wide range of stakeholders (i.e., consumer groups, shareholder activists, investors, community groups and civil society, and industry groups) to enhance the measures taken to prevent human rights abuses, and to report on those measures. This will change how companies navigate their relationships with these stakeholder groups, and the data used in those interactions.

Companies also will be looking beyond financial information and short-term data to delineate and manage potential longer-term risks with respect to disclosure and diligence. Companies will be considering medium- to long-term data regarding their impact in environmental, social, and human rights contexts. This will require companies to assess what impacts their operations may have on the communities where they do business throughout their supply chain, including whether any part of their business operations could cause significant harm to environmental or social objectives, or fail to meet certain minimum standards defined by the UN or OECD. Among the data points that will be entering the mix of information for companies and investors will be sovereign data on income inequality, freedom of expression, human rights performance, corruption, political stability, and rule of law, among others—data that also relates to the risk of genocide or mass atrocity outbreaks.
2.2 The Emerging EU ESG Framework

In recent years, the European Union established itself as the global leader in ESG business practices, motivated by issues relating to climate change. To reach carbon neutrality by 2050, the EU continues to introduce and align its ‘green’ policies by adopting a suite of proposals and legislative measures for corporate sustainability reporting and for vetting green economic activity. This EU ESG framework is altering many of the norms that have governed disclosure and investment analysis, including how companies approach supply chain management and human rights issues.

At present, the EU ESG framework includes:

1. **Non-Financial Reporting Directive** (NFRD) (in force since 2018) – soon likely to be replaced by CSRD (as defined below) – requires companies to consider non-financial data in reporting on sustainability issues.

2. **Sustainable Finance Disclosure Regulation** (SFDR) (in force since March 2021), imposes mandatory obligations for asset managers and other financial market participants to provide standardized disclosures on how ESG factors are integrated at both an entity and product level. The regulation also requires due diligence and measurement of good governance practices.

3. **Corporate Sustainability Reporting Directive** (CSRD) (effective 1 January 2024 for reporting on fiscal year 2023), proposed to replace the NFRD, and would revise and strengthen existing rules, and extend reporting disclosure requirements to all large companies and listed companies in the EU. The CSRD also imposes ESG due diligence mechanisms and relies on reporting standards of EFRAG (European Financial Reporting Advisory Group) and ESRS (European Sustainability Reporting Standards).

4. **EU Taxonomy Regulation** (in force since July 2020), creates a common classification system and language which investors can use everywhere when investing in projects and economic activities that have a substantial positive impact on delineated environmental and, eventually, social objectives. The Taxonomy defines “sustainable economic activity” based on two criteria: an activity must (i) contribute to at least one of the defined environmental or social objectives to be set out in the Taxonomy, and (ii) do no significant harm (the “DNSH” principle) to any of the other remaining objectives, while also respecting minimum safeguards for human rights and labor standards based on the OECD Guidelines for Multinational Enterprises, and the UNGuiding Principles on Business and Human Rights.
5. **EU Commission Proposal for a Directive on Corporate Sustainability Due Diligence** (published in February 2022, for entry into force in 2024), would impose on large EU (and some third-country companies doing business in the EU), a corporate due diligence duty. Companies would have to identify and take steps to remedy actual, and prevent or mitigate potential, adverse human rights impacts from the companies' operations, including as to subsidiaries and value chains. There is also pending a European Parliament due diligence proposal. In addition, three European countries have enacted national laws on corporate due diligence (France, Germany, Norway); two other nations have legislative proposals for a duty of vigilance and due diligence legislation (Belgium and the Netherlands); and six other countries have initiatives regarding due diligence requirements (Austria, Denmark, Luxembourg, Spain, Switzerland, Sweden).

The EU ESG and due diligence framework do not change the duty of corporate directors to maximize shareholder value. Rather, what is changing is how we understand value maximization. At its core, ESG refers to the risks and opportunities that could impact a company's ability to create value over the long term, and how a company is managing those risks and taking advantage of those opportunities to ensure its long-term economic stability.

Under the EU ESG framework, value will be assessed using financial and non-financial data. Value will be assessed beyond the short-term, and will include potential risks that could become material over time. Value will include assessing business impacts on environmental and social objectives, including over the long-term. Value assessment will involve new metrics and methodologies, and those making mandated disclosure must explain the methodologies used. As discussed during the roundtable, this change in how we understand value maximization will require companies, investors, and civil society (on behalf of workers, consumers and communities affected by business activities) to integrate social performance indicators into business analytical metrics in new ways. As also discussed, it is a myth that social indicators are too hard to measure, and, indeed, certain social performance data already are in use in monitoring the risk of genocide and mass atrocity violence.

3. **The Role of Data**

As discussed above, data collection and use will need to expand to inform ESG-driven risk assessments. The more robust the data and well designed the methodologies, the more willing companies and investors will be to considering them. Some sectors have started to work together with civil society to enhance their individual data collection capabilities—and the OECD Guidelines expressly encourage businesses to cooperate in addressing human rights issues.
An example of this are the Equator Principles. These are a risk management framework, adopted by over 130 global financial institutions, for determining, assessing, and managing environmental and social risks associated with project and infrastructure finance, and support responsible risk decision-making. Though voluntary in nature, the Equator Principles (and related principles formulated by the IFC) are often included in project financing contracts, increasing the attention on social/community standards and responsibility. They require engagement with interested stakeholders, and ongoing monitoring. This type of engagement is only possible through the collection of data in order to identify mitigants that address project-related human rights and other risks.

The need for data and a better understanding of data also will create opportunities for CSOs and civil society engagement. There already are examples of civil society and CSOs having access to certain types of data that might not otherwise be available to businesses. This suggests that businesses and investors should work with civil society to create pathways for access to a wider range of data, especially as to long-term risks and outcomes, including data specifically designed to identify risk factors for mass atrocity outbreaks.

As discussed during the roundtable, this access could take various forms. It could include CSOs having access into business organizations, including through engagement with corporate boards and management teams. It also could include capacity building within companies to educate corporate leaders and managers about how CSOs and civil society could better enable businesses to succeed with the EU ESG framework. Finally, companies and CSOs may need to find safe spaces for exchanging experiences and information, and for changing attitudes and minds about how business and civil society can interact to further ESG objectives.

4. Long-Term Atrocity Risk Data and Their ESG Potential

It has been widely documented that genocide and mass atrocity outbreaks have wide ramifications that go beyond terrible human costs. These ramifications include environmental, social, and economic costs that magnify the human suffering and societal harm associated with these awful events. As discussed at the roundtable, social scientists are able to produce estimates of future risks of genocide, other mass atrocities and civil war based on a set of data and quantitative modelling, using transparent, rigorous, replicable and increasingly sophisticated quantitative models. These models do not “predict” atrocities but rather they produce estimates of future risk, using the same methods used in many areas of scientific prediction from climate change and epidemiology to economic performance. They draw from extensive data sets (many freely available online, transparent as to source and methodologies, and often maintained by CSOs or universities) relating to political conflict and socio-economic conditions, including variables such as the increase or decrease in military forces, social unrest, civil war, genocide, targeted mass killing, conflict, terrorism, ethnic composition and polarization, among others.
For example, one of the leading projects in this regard, the Atrocity Forecasting Project at Australia National University, has used this type of data to analyze the risk of atrocities in 136 countries, producing a list ranking countries most at risk for genocide over three-year periods. This project guides many governments and institutions in making decisions about genocide and mass atrocity prevention.

The ability to maintain and produce these types of social science models can be a valuable tool for companies and investors, not only to assess geopolitical risks in a given country, but also to consider what might reduce the risks of adverse human rights impacts. As discussed at the roundtable, for purposes of ESG disclosure and due diligence obligations, the subsets of data that might be most useful for companies and investors to help develop include the following indicators:

- **Outcomes (dependent variable),** such as major political instability (as derived from civil wars or coups d’etat), mass atrocities (genocide, politicide, mass killing or one-sided violence), non-state actor atrocities (such as terrorism, rebel atrocities, inter-ethnic or communal violence); changes to political institutions (such as shifts toward more authoritarian government) and

- **Predictors (independent variable),** such as proximate factors (e.g. military or paramilitary expansion or systemic political violence), structural factors (e.g. State-led discrimination, civil society, ethnic fractionalization or polarization, anocracies and fragile states) and triggers (e.g. elections, assassinations or regional instability).

In terms of ESGs, these indicators could be made **more** revealing and relevant in at least five ways:

- **Making existing atrocity risk databases more robust by increasing the frequency of data updates across as many factors and countries as possible.**

- **Using data to assess which actors are most important (in terms of being influenced or avoided) in reducing atrocity risk.**

- **Using data to assess whether and how ESGs could be tailored to address sub-national differences in the causes or types of atrocity violence.**

- **Studying atrocity risk triggers to understand the types of socio-political resilience created by ESG investments.**

- **Using new statistical methods to better test for valid causal inference between ESG investments and certain types of positive or negative outcomes.**

Assessing these variables more deeply could allow companies and investors to make the most risk-reducing decisions based on the data, rather than moral drive or ad hoc legal obligations.
5. Conclusion

Investors, regulators, and other stakeholders increasingly are holding businesses to higher standards. As ESG disclosure standards and mandated human rights due diligence increases, businesses will face higher risk exposure for failing to account properly or completely for ESG issues. This trend, however, also creates significant opportunities by enabling companies to achieve greater strategic freedom and access to ESG-driven capital flows by making decisions based on long-term evaluations of potential risks tied to ESG factors. To unlock these opportunities, companies will need better data—and will need to engage with civil society to develop that data and the data-supported solutions to the risks better data may reveal.

As discussed at the roundtable, building reliable models to estimate accurately the complex long-term risk of mass atrocities occurring is extremely challenging. For example, the diversity of variables that often exist in unstable and less developed societies, which are more likely to have poor data sets and estimates, can result in systemic bias in the data. Moreover, under-developed data sets could lead to unintended ESG consequences, such as divestment from weaker societies that otherwise could benefit from ESG-sensitive business investments combined with respect for human rights and the local environment. To overcome these challenges of data access and gathering, corporations should work with civil society—broadly defined to include CSOs, trade unions, social movements, grassroots organizations, and academic social scientists—so as better to inform their ESG decisions. In particular, building deeper, more robust data sets, including those relating to risks of mass atrocity outbreaks, will allow for testing of potential mitigants that could be implemented to reduce the risk of atrocity outbreaks and the cascade of negative environmental, social and economic impacts that flow from these events. This type of data would support better disclosure relating to human rights and environmental objectives and risks, better business long-term decisions that would maintain or create value for investors, and could help reduce the long-term risk of mass atrocities. As also discussed at the roundtable, greater engagement between companies and civil society is crucial to building the types of data that will improve ESG disclosure and due diligence—and given the pace of ESG enhancement, time is of the essence to invest in developing the type of data.

The emerging ESG regime presents a novel opportunity for relating corporate activities to long-term atrocity prevention—an exercise that will yield other valuable information about a variety of long-term business risks. Companies will have to learn to use data relating to the societies in which they operate—including data used to gauge the risk of genocide and other mass atrocity outbreaks. Companies also increasingly will need to rely on the expertise and deep understanding of social dynamics offered by CSOs and other members of civil society. By working creatively with CSOs, companies can create sustainable business strategies that will attract capital and investors.

At the same time, the emerging ESG regime presents a powerful opportunity for civil society to work with businesses in pursuing important sustainability goals. In this way, the EU ESG
framework could create win-win situations involving new levels and forms of cooperation between business and civil society.

Long-term atrocity risk data presents an opportunity for developing a dialogue between businesses and civil society around building sustainable business strategies that also further atrocity prevention. AIPG is committed to working with businesses and civil society to help operationalize disclosure vocabularies, methodologies and metrics relating to ESG objectives and disclosure regimes.