

PAY YOUR WORKERS - RESPECT LABOR RIGHTS AGREEMENT

GUIDANCE FOR INVESTORS

In March 2021, over 1,000 Thai garment workers lost their jobs when Brilliant Alliance Thai, a Victoria's Secret supplier, went bankrupt. After months of protests for legally mandated severance pay-outs, the workers received an \$8.3 million settlement, with Victoria's Secret contributing through a loan. In another instance, the closure of Vald'or, a Haitian factory producing clothes for Tommy Hilfiger and Calvin Klein, left over 1,100 workers unemployed without severance pay. PVH, the owner of the brands, agreed to pay \$1 million in compensation, after the Worker Rights Consortium (WRC) intervened.

These cases highlight a growing trend of brands addressing wage and severance theft in the Textile,

Garment, Shoe, and Leather (TGSL) industry. Wage theft is the illegal withholding of wages or benefits, while severance is the compensation paid to workers laid off due to business closures or restructuring. The issue is endemic to the TGSL industry and is a key ESG risk for investors.

The Pay Your Workers-Respect Labour Rights (PYW-RLR) Agreement is a legally binding and enforceable agreement between brands, employers, and unions that addresses this risk. This document explains how TGSL sector companies can use the PYW-RLR Agreement to identify and mitigate risks related to wage and severance theft, and why investors should support and promote the Agreement.



The size of the problem

The Covid-19 pandemic exposed the issue of wage and severance theft in the TGSL industry. Factory closures and downsizing due to cancelled orders and reduced demand led to widespread job and income losses for workers. The pandemic also made it difficult for workers to organize, voice concerns, or demand better conditions, worsening an already serious labour rights deficit. Lockdowns and restrictive measures limited the freedom of association, while some production countries targeted union leaders and members, further weakening unions' bargaining power.

Quantifying the extent of wage and severance theft is challenging, but several studies highlight its pervasiveness in the TGSL industry. The Clean Clothes Campaign (CCC) found that garment workers were owed \$11.85 billion in unpaid income and severance from March 2020 to March 2021. A WRC study found that 13% of surveyed workers in Ethiopia, Honduras, India, and Myanmar had their contracts terminated, with nearly 80% not receiving full severance pay. The WRC also discovered that 31 factories owed about \$40 million in severance pay to 40,000 laid-off workers.

The Asia Floor Wage Alliance (AFWA) surveyed over 2,000 garment workers in six countries, finding that they lost an estimated \$164 million in wages in 2020 due to the pandemic's economic impact. Workers lost approximately three months of pay on average, and their debt doubled. In 2022, AFWA found that 9 out of 10 factories had not resolved wage claims from 2020, and more than half were not paying workers their owed overtime.

These figures likely underestimate the problem, as many instances of wage and severance theft go unreported or undocumented. Wage and severance theft affects millions of workers worldwide, particularly in the TGSL industry.

The solution

The PYW-RLR Agreement, endorsed by over 260 organizations, is a legally binding and enforceable initiative aimed at reducing wage and severance theft risks in the TGSL sector and protecting the right to freedom of association and collective bargaining. The Agreement sets up a Severance Guarantee Fund (SGF) to support stronger social protections for workers related to unemployment and severance benefits, in line with ILO conventions.

Workers employed in the supply chain of a signatory brand or employer can file a claim if denied severance when their factory closes or during mass dismissals. The SGF will address claims in cases where employers cannot be compelled to pay, or national legislation falls short. The fund will also provide financial support to improve social protection systems at the national level. Brands and retailers will contribute fees based on volume sourced from each country, and employer fees will be a percentage of their wage bill.

Company signatories must respect workers' rights, including the right to organize and bargain collectively. The Agreement includes a mechanism to identify and investigate non-compliance and worker grievances. Enforcement will involve a dispute resolution mechanism, where union signatories can ultimately take brands to court if they fail to uphold the Agreement.

Brands will pay a premium of 0.5% of their annual FOB, which can be reduced if they source from countries with credible social protection programs or if their suppliers contribute to the fund. The total premium, along with the estimated cost for brands to cover unpaid wages and benefits, will not exceed ten cents per t-shirt.

Legally binding agreements, like the Accord on Fire and Building Safety in Bangladesh, have proven beneficial for workers and businesses. The Accord made the garment industry in Bangladesh safer, contributed to the growth and competitiveness of the Ready-Made Garment (RMG) sector, and attracted international brands. Factory managers in Bangladesh reported that Accord inspections helped build a competitive advantage over factories in other countries not covered by the Accord. The Accord also led to a dramatic decrease in fatal accidents and fires, resulting in lower costs and increased employee satisfaction.

Risks associated with wage and severance theft

Brands and retailers must conduct due diligence in line with OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights. Their approach should address adverse risks related to worker pay in global supply chains, such as lack of social dialogue, irresponsible purchasing, unrealistic lead times, and unfair pricing.

In European countries like France and Germany, human rights and environmental due diligence are legally required. The German Supply Chain Due Diligence

The business case for brands

The PYW-RLR Agreement offers a cost-effective due diligence solution for brands in the TGSL sector, helping them fulfil obligations under supply chain due diligence laws and mitigating legal risks. The Agreement demonstrates commitment to social responsibility and labour standards, enhancing reputation and attracting ethically conscious consumers. Addressing wage and severance theft collectively through the Agreement leads to economies of scale, reducing costs and resources associated with individual cases. It provides consistency, predictability, and encourages a proactive approach, reducing the likelihood of costly disputes and brand damage. The Agreement enables learning, improvement, and risk mitigation, while fostering collaboration and shared responsibility among brands, suppliers, and stakeholders, ultimately making the process of identifying, preventing, and redressing wage and severance theft more cost-effective.

Act mandates companies with headquarters or branches in Germany to conduct due diligence and set up a risk management system. The French Duty of Vigilance law requires companies to limit their activities' impact on human rights and the environment and to report their efforts.

The European Commission is developing a directive to impose due diligence obligations on companies in the EU, including penalties and civil liability for violations. The directive will apply to large EU companies and non-EU companies active in the EU, with criteria based on employee numbers and net worldwide turnover. The right to a fair and adequate living wage is considered a human right, meaning companies must address wage and severance pay risks in their supply chains.

Brands and retailers face several legal risks if wage and severance theft are found in their supply chains:

- **Fines and penalties:** companies not complying with due diligence requirements may face fines and penalties, such as up to €8 million or 2% of a company's global annual turnover under the German Supply Chain Due Diligence Act.
- **Exclusion from public contracts:** non-compliant companies may be barred from public procurement contracts in some jurisdictions, resulting in lost business opportunities.
- **Civil liability:** Companies may face lawsuits and financial compensation for not fulfilling their due diligence obligations.
- **Regulatory action:** non-compliant companies may face enforcement actions, including investigations, injunctions, and legal proceedings.

The PYW-RLR Agreement can help companies in the TGSL sector follow due diligence regulations by addressing wage and severance theft and union repression in global supply chains. It requires companies to ensure workers receive legally mandated wages, benefits, and contribute to a guarantee fund for severance and outstanding wages. This collaborative effort between brands, manufacturers, unions, and labour rights organizations fosters stakeholder engagement and transparency, aligning with due diligence expectations. By adopting the enforceable PYW-RLR Agreement, companies can show commitment to human rights, responsible business practices, and compliance with international labour standards.

The Difference from Private Insurance Schemes

Private insurance schemes, while offering some financial protection against wage and severance theft, do not address the underlying issue of labour rights violations or provide a mechanism for enforcing labour standards. In contrast, the PYW-RLR Agreement is a collaborative, legally binding Agreement that promotes workers' rights, freedom of association, and prevents wage and severance theft. It involves multiple stakeholders, aligns with ILO standards, and includes independent monitoring, reporting, and dispute resolution. The PYW-RLR Agreement's comprehensive framework, transparency, and accountability make it a more effective solution than voluntary private insurance schemes in addressing the root causes of wage and severance theft in the TGSL sector.

The value of the PYW-RLR Agreement for investors in Article 9 funds

Wage and severance theft is a material ESG risk with social, reputational, and financial implications for companies in the TGSL sector. Investors in Article 9 funds, which prioritize sustainable investments according to the EU Sustainable Finance Disclosure Regulation (SFDR), should encourage companies to address these issues by signing the PYW-RLR Agreement. The Agreement aligns with the social objectives of Article 9 funds, as it combats labour exploitation and inequality.

Investors can use their leverage to promote the PYW-

RLR Agreement and assess company performance on wage and severance payment. However, many Article 9 funds may not fully comply with the SFDR's "do no significant harm" criteria, as research shows exposure to companies that have violated the OECD Guidelines. Addressing wage and severance theft is crucial to meet Article 9 funds' social objectives.

Supporting the PYW-RLR Agreement aligns with responsible investing practices, emphasizing the impact of investments on society and the environment. It also helps mitigate financial risks associated with wage and severance theft, such as reputational and legal risks, which can negatively affect a company's financial performance.

Investors' support for the PYW-RLR Agreement

Investors can do the following to support the PYW-RLR Agreement:

- Sign an investor statement expressing support for the PYW-RLR Agreement and share it with their investee companies. This can help demonstrate the investor's commitment to social responsibility and ethical investing, and encourage companies to take concrete steps towards fair and sustainable labour practices.
- Invest in companies that are signatories to the PYW-RLR Agreement. This will provide assurance that these companies are committed to ensuring compliance with labour standards, and will help to mitigate reputational and financial risks associated with wage and severance theft in their supply chains.
- Include participation in the PYW-RLR Agreement as a criterion or indicator when appraising a (potential) investee's ESG performance.
- Support initiatives that aim to raise awareness and support for the PYW-RLR Agreement among companies and consumers. This can include engaging with companies to encourage them to become signatories to the Agreement, as well as educating their clients and investees about the importance of fair and sustainable labour practices in the TGSL industry.
- Support resolutions promoting workers' rights.
- Engage with workers' rights organisations and campaign groups to gain a deeper understanding of the issue of wage and severance theft and the importance of freedom of association.

By taking these steps, investors can help to promote labour rights, support sustainable development, build a more transparent and robust capital market that benefits all stakeholders, and make the S in ESG more concrete.