Opportunities to Embed Fundamental Labour Rights in Capital Group's Investment Stewardship

June, 2022

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About the Gobal Unions' Committee on Workers' Capital (CWC) Asset Manager Report Series

The CWC Asset Manager Report Series examines the performance of the world's largest asset managers on social issues and global trade union priorities. The asset managers profiled rely on a client base that includes pension funds across the globe. Many of the trustees who sit on these pension funds are CWC network participants. The reports evaluate the strength of the asset managers' stewardship frameworks, the impact of their stewardship practices on social issues and the degree to which their policy interventions support workers' human rights and labour standards.

This report card considers information obtained through publicly-available sources, including company website and regulatory filings. This report on Capital Group is current up to June 9th, 2022.

I. Executive Summary

Capital Group is the world's 7th largest asset manager. The US-based firm is an active investor which often ranks as a top 10 shareholder in the companies where it invests, including priority cases among CWC participating trade unions, such as Amazon and Wizz Air. The manager has a client base in the Americas (Canada, the USA), Asia Pacific (including Australia) and Europe. Institutional investors (including pension funds) make up 37%, or USD 0.9tn of its client base.

The CWC Secretariat analysed Capital Group against three of the four categories that figure in the CWC Baseline Expectations for Asset Managers on Fundamental Labour Rights ("CWC Baseline Expectations").[1] The report comprises an analysis of the manager's: 1) stewardship framework, 2) stewardship practices in public equities (including shareholder engagement and proxy voting) and 3) its policy advocacy. The report can be read in conjunction with the CWC Secretariat's Asset Manager Analysis, which assesses global asset managers' policies and practices against the CWC Baseline Expectations.[2]

Capital Group acknowledges the responsibility of companies to uphold fundamental labour rights in its stewardship framework. It could improve alignment with the CWC Baseline Expectations by clarifying how it incorporates information provided by trade unions and providing examples of the labour rights it has identified as a result of its due diligence prior to and after investing in a company. The CWC's recommendations are the following:

- Incorporate double materiality analysis to its investment framework;
- Report the outcomes of its ESG due diligence process and describe actions taken;
- Clarify escalation criteria when engagements on labour rights fail;
- Describe how it acts on information provided by trade unions;
- Commit to an annual dialogue that is convened by the CWC.

In its engagement practices, Capital Group's approach falls short of the CWC Baseline Expectations in the level of commitment to fundamental labour rights and in the (lack of) details provided in its disclosures to appraise its performance. The CWC has the following recommendations for Capital Group:

- Adopt respect for fundamental labour rights as an engagement priority;
- Disclose the list of companies it engaged with and topic areas on a quarterly basis;
- Outline how it escalates engagements on labour rights and include collaboration as a tactic.

Capital Group could improve the frequency of its proxy voting disclosures and use voting as a tool to signal to portfolio companies that it expects them to uphold fundamental labour rights, in line with international norms and frameworks. The CWC's recommendations are the following:

- Publish its proxy voting record, including voting rationales, on a quarterly basis;
- Publish voting intentions at least 7 days prior to annual general meetings for shareholder resolutions related to fundamental labour rights at companies prioritized by CWC participants;
- Adopt a group-wide policy around the support for shareholder resolutions that promote respect for fundamental labour rights, and for shareholder resolutions that support workforce voice in corporate governance and/or worker directors standing for election.

Finally, on policy advocacy, the CWC recommends that Capital Group publish its responses to public policy consultations in a centralized location on its website on a quarterly basis.

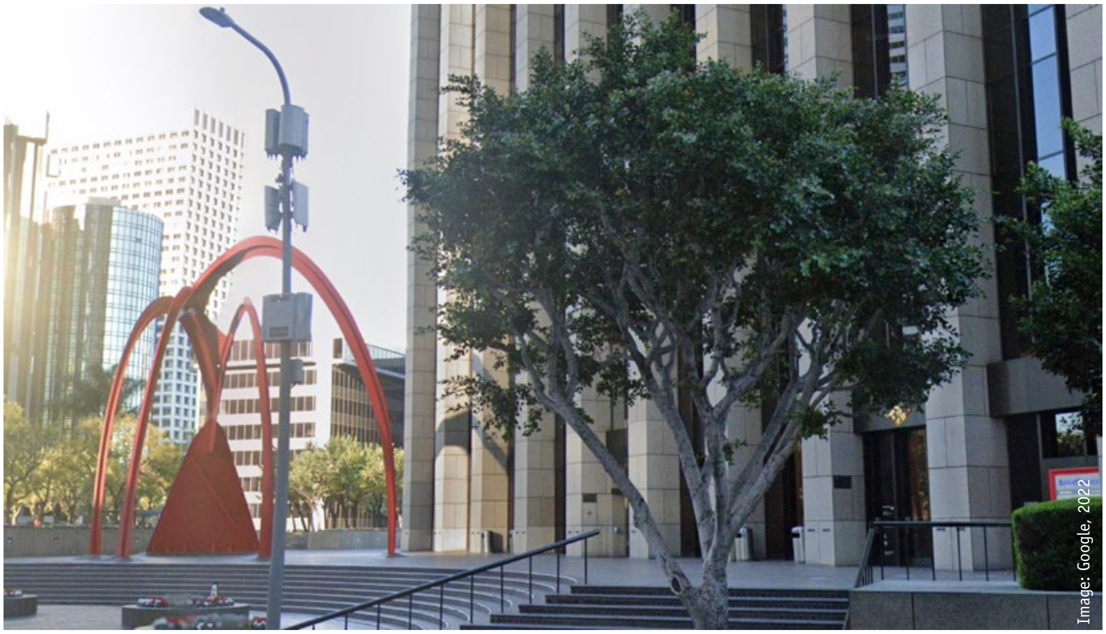


Image: Google, 2022

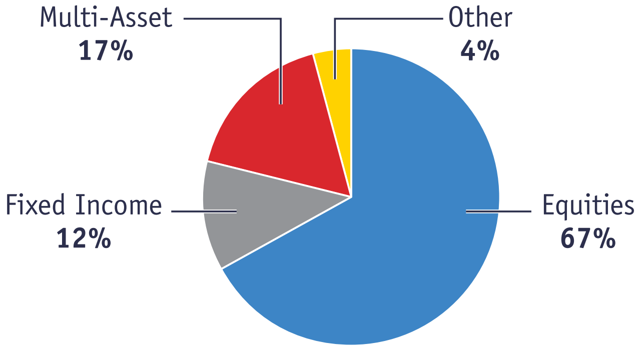
II. Capital Group at a Glance

Capital Group Companies, or "Capital Group," is a privately-held, US-headquartered global asset manager with USD 2.7tn in assets under management (AUM) as of December 31st, 2021.[3] Founded in 1931, Capital Group is currently the 7th largest asset manager in the world.[4] Capital Group primarily manages liquid assets (i.e., equity and fixed income) and is an active manager that employs a bottom-up approach.[5] Institutional investors – including pension funds – make up 37% (or USD 0.9tn AUM) of Capital Group's global client base, while retail clients make up 63% (USD 1.5tn).[6]

Capital Group manages equity assets through three independent divisions: Capital Research Global Investors, Capital International Investors, and Capital World Investors. Each of these divisions makes its own investment and proxy voting decisions.[7] Capital International Investors provides investment management for institutional clients.[8] Furthermore, all three divisions provide equity research and investment management for the American Funds (USD 2tn),[9] a family of approximately 40 mutual funds and other pooled investment vehicles.

Equity assets comprise the largest part of Capital Group's assets under management. The firm tends to take sizeable minority ownership stakes in companies (e.g., approximately 15% in the budget airline company, Wizz Air plc ("Wizz Air"), and nearly 9% in British American Tobacco Company). Furthermore, it has invested over USD 5bn in over 80 companies through six emerging markets private equity funds.[10] Emerging markets account for 3.2% of Capital Group's AUM, while developed markets account for 95.3%.[11]

Table 1: Capital Group at a Glance

Assets Under Management	USD 2.7 trillion (as of December 31, 2021)[12]
Ranking among global asset managers	7th largest (2021 P&I/TAI 500)[13]
Assets under management breakdown	
Company structure	Privately-held by current and retired employees
Headcount details	ESG staff at Capital Group: 41[14] Total employees: Over 8,000 employees across 32 countries
Headquarters	Los Angeles, United States of America

III. Labour Rights in Capital Group's Investment Stewardship Framework

The CWC's analysis of Capital Group's ESG stewardship framework found that the manager meets some of the CWC Baseline Expectations and that it references international norms and frameworks like the ILO Declaration on Fundamental Principles and Rights at Work. The manager could further align with the Baseline Expectations by acknowledging the role of trade unions as an authoritative source of evidence around worker rights violations, committing to an ongoing engagement with the CWC.

ESG responsibilities at Capital Group are structured in a "bottom-up" and "top-down" fashion. From a bottom-up perspective, every analyst and portfolio manager is responsible for "integrating ESG into the Capital System,"[15] in line with the fundamental investment analysis approach of active investors. Those investors generally take a smaller number of larger positions than other global asset manager which specialize in passive investment. Ownership positions taken by active investors like Capital Group are also time-bound, unlike passive investors whose investments can be of an indefinite duration.[16] The firm has a "top-down" approach to ESG: its ESG Oversight Group sets the strategic direction for its ESG agenda, approves the ESG policy and oversees the integration of ESG into its investment process.[17] It has a 13-person Global Stewardship & Engagement (GSE) team, which is responsible for executing Capital Group's stewardship efforts, and in particular proxy voting and governance issues alongside Capital Group's portfolio managers and in-house equity and fixed income analysts.[18]

> "Capital Group's recognition of investee companies' obligation to uphold these standards in their own operations and supply chains is important, but its ESG policy lacks details on the criteria for engagement with companies as well as escalation tactics used when severe adverse labour rights impacts occur."

Capital Group has three components to its ESG integration process: 1) investment frameworks, 2) a monitoring process, and 3) engagement and proxy voting. The asset manager's investment frameworks help analysts make security selection decisions. It has over 30 sector-specific frameworks that draw from the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-Related Financial Disclosures.[19] These frameworks focus on the identification of financially material sustainability risks to issuers, rather than adverse impacts that companies have on people and the environment (i.e., a company's outward impact). Given that Capital Group's investment frameworks are not publicly available, there are no clear indications that companies that uphold fundamental labour rights will be favoured - or that those that violate fundamental labour rights will be penalized – in the fundamental investment analysis that is carried out by the manager prior to investing in a company.

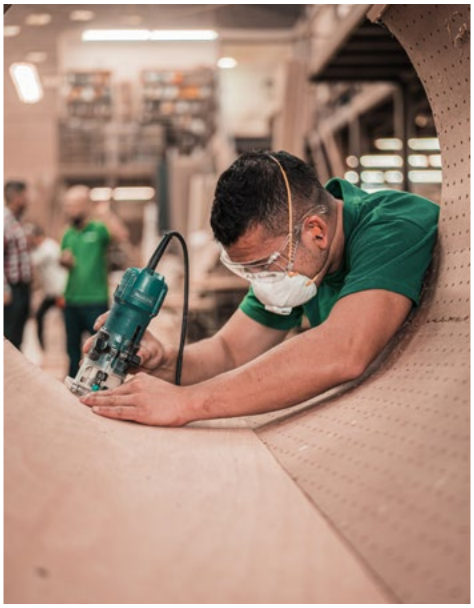
Encouragingly, fundamental labour rights do feature in the investment stewardship process of Capital Group (i.e., once an investment is made). The manager says the following on the ILO Declaration on Fundamental Principles and Rights at Work: "it is an essential obligation of our portfolio holdings to uphold these fundamental standards in their own operations and throughout their supply chains to maintain their license to operate".[20] Capital Group's recognition of investee companies' obligation to uphold these standards in their own operations and supply chains is important, but its ESG policy lacks details on the criteria for engagement with companies as well as escalation tactics used when severe adverse labour rights impacts occur. It could indicate more precisely how it "leverage[s]…[the] OECD as an overarching framework" to address this.[21] Furthermore, it could articulate how information provided by trade unions is utilized in shareholder engagements to press companies on upholding the right of workers to organize without fear of reprisals. Addressing these gaps would strengthen Capital Group's ability to fulfil its commitments under international norms and frameworks.

Capital Group's monitoring process screens both potential and current issuers for ESG issues by aggregating data from its own research and third-party ratings (including MSCI and Sustainalytics).[22] The asset manager may flag holdings and escalate for additional review by the Issuer Oversight Committee.[23] In 2018, Capital Group expanded its use of MSCI screens to incorporate their ESG ratings and UN Global Compact violators flags. According to the MSCI ESG Controversies Methodology, this screen "is designed to be consistent with international norms represented in numerous widely accepted global conventions, including the Universal Declaration of Human Rights, the ILO Declaration on Fundamental Principles and Rights at Work, and the UN Global Compact", scoring companies as either a Fail Watch List, or Pass.[24] Capital Group's flag threshold for monitoring includes companies that score a "Fail."[25] The inclusion of this screen in Capital Group's monitoring process is a positive step – but it would also be valuable for the manager to indicate how frequently such events occur and describe the actions it takes when they occur.

Following its signing of the UN Global Compact, Capital Group mapped out its engagements to the 5 Sustainable Development Goals (SDGs) that it identified as being the most material to the asset manager as an investor. The SDGs that is selected include gender equality, decent work and economic growth, and reduced inequalities. These are welcomed priorities; however, it is unclear how these SDGs inform Capital Group's engagement efforts in practice.

RECOMMENDATIONS: STEWARDSHIP FRAMEWORK[26]

- Incorporate double materiality – i.e., a company's outward impact on people and the planet – to its investment framework (prior to making an investment);
- Report the outcomes of its due diligence process by indicating how frequently it has encountered a "fail" on its MSCI ESG Controversies screen and describing actions taken;
- Clarify criteria for engagement and escalation tactics when engagements on fundamental labour rights do not meet objectives set by the manager;
- Describe how it incorporates, acts on and reports back when trade union provide evidence of adverse labour rights impacts;
- Commit to an annual dialogue that is convened by the CWC.



IV. Labour Rights in Capital Group's Investment Stewardship Practices: Public Equities

This section reviews Capital Group's engagement and proxy voting practices in public equities in relation to priority cases related to fundamental labour rights that have been flagged by CWC participants. Capital Group has important ownership stakes in CWC participants' priority companies such as Wizz Air, Amazon and British American Tobacco. While it references the ILO Fundamental Principles and Rights at Work, the manager needs to improve the quality and frequency of its engagement disclosures and it needs to clarify its escalation policy when it comes to worker rights violations. On proxy voting, in addition to improving its disclosures, the manager needs to adopt a group wide approach to address the issue of split voting within the Group when it comes to the responsibilities of companies to mitigate adverse labour rights, in line with international norms and frameworks.

1) Shareholder Engagement at Capital Group: Opportunity to Improve Transparency

While Capital Group engages with portfolio companies on a range of ESG issues, the manager underperforms relative to other global asset managers in terms of transparency, frequency of engagements of fundamental labour rights and use of escalation tactics.

Capital Group maintains that engagement is a sharper tool than exclusion,[27] and in line with its active investment strategy, most of its engagements involve meetings between investment professionals and senior management.[28] The topics it engages on include: "overall strategy, operational performance, capital structure, governance, environmental and social impacts, board composition, diversity, executive remuneration, disclosure and transparency, and many more topics that affect long-term results."[29] Capital Group could consider adding an engagement priority on fundamental labour rights, as stipulated in the CWC Baseline Expectations.

A key gap in Capital Group's engagement practices is that it does not publicly disclose the names of companies it engages with on its ESG priorities. The manager published four case studies in its 2021 stewardship report and none touched on fundamental labour rights (or human capital management). This level of disclosure is inferior to peers such as BlackRock and SSGA, which 1) disclose engagement case studies and company names in quarterly stewardship reports and 2) list broad topic areas. Capital Group could improve its engagement practices by disclosing the list of companies engaged on a quarterly basis and listing the topic areas the engagement focuses on.

Furthermore, Capital Group provides scant detail around the topics it engages companies on. In 2020, 85 of the 724 engagements (12%) conducted by the manager focused on social issues. The social bucket covers consumer protection, diversity & inclusion, employee welfare, human rights and privacy & data security – but more granular information is required to identify how many of the social engagements touched on labour rights.

Given the lack of disclosure around company engagements, the CWC Secretariat cannot determine if Capital Group has engaged privately with portfolio companies that have been flagged by CWC participants for alleged violations of fundamental labour rights (see Table 2).

Table 2: Capital Group and Engagements with Companies Flagged by CWC Participant Trade Unions for Violations of Fundamental Labour Rights

Company (HQ country)	Capital Group ownership stake[30]	Impacts to workers' rights raised by CWC participants	Capital Group engagement reported publicly
Amazon.com (USA)	2.2%	Employee concerns regarding workplace health and safety during the COVID pandemic, and an anti-union campaign in US warehouses.[31]	No
British American Tobacco (UK)	15.8%	OECD national contact point complaint was filed by the International Union of Food Workers alleging violations of farm workers' rights to freedom of association in the BAT supply chain in the US.[32] BAT declined the OECD national contact point offer of mediation.[33]	No
BHP Group (Australia/UK)	0.9%	OECD national contact point complaint was filed against Vale and BHP by the Buildings and Wood Workers' International (BWI), IndustriALL and CUT Brazil alleging a lack of adequate health and safety due diligence in mining activities related to the 2015 Fundão dam collapse in Brazil.[34] BHP declined the OECD national contact point offer of mediation.[35]	No
Starbucks (USA)	1.0%	Anti-union campaign in stores across the US; US National Labor Relations Board complaint issued for 29 unfair labour practice charges, including over 200 alleged violations of the US National Labor Relations Act.[36]	No
Teleperformance (France)	1.0%	Specific instance with OECD national contact point filed by UNI alleging retaliation and unsafe practices linked to COVID-19 in call centers in various countries. OECD national contact point final statement issued a set of recommendations including to strengthen due diligence on trade union rights and have engagement on matters of mutual concern.[37]	No
Vale (Brazil)	5.7%	OECD national contact point complaint was filed against Vale and BHP by BWI, IndustriALL and CUT Brazil alleging a lack of adequate health and safety due diligence in mining activities related to the 2015 Fundão dam collapse in Brazil.[38] Vale declined the OECD national contact point offer of mediation.[39]	No
Wizz Air (Hungary)	15.5%	A group of investors wrote to Wizz Air expressing concern regarding alleged violations of workers' rights to freedom of association and collective bargaining in various European countries.[40]	No

In respect to escalation tactics, Capital Group's states that additional engagement or voting against board members can be considered when initial engagements fails.[41] The manager does not state how frequently it escalated its engagements to this level. It could add further credibility to its ESG Policy by stating that it intends to escalate engagements on worker rights when: 1) ILO fundamental labour rights violations go unaddressed by management within 12 months or 2) when the company has refused to participate in mediation offered by a National Contact Point (NCP) under the OECD Guidelines for MNEs. Furthermore, it should consider adding collaborative engagements to its toolbox of escalation strategies.

CASE STUDY: LABOUR RIGHTS VIOLATIONS AT BUDGET AIRLINE, WIZZ AIR

The European Transport Workers' Federation has alleged that the Hungary-headquartered budget airline, Wizz Air – in which Capital Group held a 15.5% stake as of May 2022 – has violated workers' rights to freedom of association and collective bargaining by firing workers in Romania and Ukraine.[42] In 2021, 14 investors from the UK, US, Denmark, Australia, and Spain called on the company to: a) publicly and formally recognize employees' rights to form and join unions; and b) commit to non-discrimination on the basis of union membership.[43] In February 2022, Danish pension fund, Akademiker Pension, announced its divestment from Wizz Air due to the company's failure to demonstrate that it is taking meaningful action on labour rights.[44] Given its significant stake in the company, Capital Group should engage with Wizz Air on the topic of respect for fundamental labour rights.

Photo: Anna Zvereva Follow Wizz Air, HA-LYT, Airbus A320-232

RECOMMENDATIONS: SHAREHOLDER ENGAGEMENT

- Adopting respect for fundamental labour rights as an engagement priority and including the analysis of OECD national contact point proceedings, trade union reports and the ITUC Global Rights Index as criteria to prioritize engagements;
- Disclosing the list of companies it engaged with on a quarterly basis and listing the topic areas the engagement focuses on;
- Outlining how it intends to escalate engagements in cases of workers' rights violations and including collaborative engagements as part of its escalation tactic.

2) Proxy voting at Capital Group: Improving Disclosures and Tackling Split Votes to Send a Clear Signal to Companies

Capital Group's Global Proxy Policy recognizes that social issues including "employee safety, community engagement and human rights (including with respect to a company's supply chain)" are important factors that are considered when reviewing shareholder proposals.[45]

The execution of proxy voting is carried out by the three distinct equity investment units within Capital Group. Analysis is first conducted by the Global Stewardship and Engagement Team, in accordance with guidelines. Then, it is shared with investment analysts overseeing specific companies to arrive at a recommendation. The result of this decentralized approach to proxy voting is that Capital Group's votes can be split at a given company.

> "Capital Group could improve its company-wide proxy voting policy by ensuring that votes align with the managers' responsibilities under international norms and frameworks."

Capital Group's proxy voting policies also diverge across subsidiaries and range in the level of detail they provide. For example, its proxy voting policy for the American Funds has a section on social issues, which specifies that "when evaluating proxy proposals relating to issues such as diversity and human capital management, decisions are made on a case-by-case basis."[46] In comparison, Capital International Inc.'s proxy voting policy is far shorter and does not mention human capital management.[47] Currently, none of Capital Group's proxy voting policies detail how the asset manager will vote on proposals that promote respect for fundamental labour rights. Capital Group could improve its company-wide proxy voting policy by ensuring that votes align with the managers' responsibilities under international norms and frameworks.

During the 2020 proxy season, at least one Capital Group division expressed a vote against management in 7% of the 22,170 proposals voted on.[48] Missing from Capital Group's annual stewardship report is data on how it voted on shareholder proposals focused on social issues, and in particular, labour-related proposals.

Table 3: Capital Group Vote on Shareholder Resolutions Filed by CWC Participants (2021)

Company (HQ country)	Capital Group ownership stake	Proposal	2021 Vote[49]	Rationale	Vote aligned with CWC recommendation
Amazon.com (USA)	2.2%[50]	Proposal 9: Oversee and Report on a Civil Rights, Equity, Diversity and Inclusion Audit	Split	–	Split
Amazon.com (USA)	2.2%[51]	Proposal 10: Adopt a Policy to Include Hourly Employees as Director Candidates	Against	–	No
Dollarama Inc (Canada)	1.9%[52]	Proposal 4: SP 1: Production of an Annual Report on Risks to Human Rights Arising Out of the Use of Third-Party Employment Agencies	Against	–	No
McDonald's Corporation (USA)	1.3%[53]	Proposal 1e: Elect Director Enrique Hernandez, Jr.	Against	Board nominees have not acted in the best interest of shareholders.	Yes
Mondelez International (USA)	4.4%[54]	Proposal 4: Consider Employee Pay in Setting CEO Pay	Against	–	No
Starbucks (USA)	1.0%[55]	Proposal 4: Adopt a Policy to Include Non-Management Employees as Prospective Director Candidates	Against	–	No
Walmart Inc (USA)	0.1%[56]	Proposal 6: Report on Alignment of Racial Justice Goals and Starting Wages	For	–	Yes

Capital Group gives specific attention to diversity, equity, and inclusion (DEI) in its ESG framework. It expects that investee companies in developed markets have diversity on their boards of directors and it encourages all portfolio companies to disclose the demographics of their workforce and board "in a regionally appropriate manner, including gender, racial and ethnic demographics at different levels of seniority."[57] With respect to director elections, the manager states that "diversity of expertise, gender and, subject to local norms and expectations, race and ethnicity among board members enhances the overall quality of their decision-making."[58] Capital Group could strengthen its stewardship practice on DEI by stating its position on shareholder resolutions asking companies to carry out racial equity audits (in relevant jurisdictions) and outlining how it will vote at companies where it identifies a lack of diversity on the board.

RECOMMENDATIONS: PROXY VOTING

- Publish proxy voting records, including voting rationales, on a quarterly basis;
- Publish voting intentions at least 7 days prior to annual general meetings for shareholder resolutions related to fundamental labour rights at companies prioritized by CWC participants;
- Adopting a group-wide policy around the support for shareholder resolutions that promote respect for fundamental labour rights (in line with international norms and frameworks), and support for shareholder resolutions that support workforce voice in corporate governance and/or worker directors standing for election.

V. Policy Advocacy

In recent years, global asset managers have had increasing opportunities to position themselves and respond to public policy consultations on ESG and sustainable finance. As per the CWC Baseline Expectations, asset managers are encouraged to publish their responses to policy consultations on their websites so that they are easily accessible.

RECOMMENDATIONS: POLICY ADVOCACY

- Publishing all policy consultation responses in a centralized location in the stewardship section of its website on a quarterly basis.

ENDNOTES

[1] Global Unions' Committee on Workers' Capital. (2022). *Baseline Expectations for Asset Managers on Fundamental Labour Rights*. Retrieved 06 24, 2022 from https://workerscapital.org/baseline-expectations-for-asset-managers-on-fundamental-labour-rights

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[16] On average, the equity-focused American Funds hold their investments for 2.9 years, whereas their peers hold their investments for 1.9 years, based on the equal weighted blended averages across each of the 20 equity-focused American Funds' respective Morningstar active categories. From: Capital Group. (2022). *The Capital System*. Retrieved 05 30, from https://www.capitalgroup.com/institutional/about-us/capital-system.html

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[26] All recommendations can be cross referenced with the CWC Baseline Expectations table.

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About the Global Unions' Committee on Workers' Capital (CWC)

The Global Unions' Committee on Workers' Capital (CWC) is an international labour union network for dialogue and action on the responsible investment of workers' retirement savings. A joint initiative of the International Trade Union Confederation (ITUC), the Global Union Federations (GUFs), and the Trade Union Advisory Committee to the OECD (TUAC), the CWC has brought trade union representatives and worker-nominated trustees from across the world together since 1999. The pension fund board members who participate in the CWC network oversee the retirement savings of millions of workers.

For more information on the CWC: info@workerscapital.org