

adidas Group Response to Recommendations from WRC: Yuen Yuen and Social Insurance in the People's Republic of China

On May 16, 2014 the Worker's Rights Consortium (WRC) published an assessment following a major strike at Yue Yuen (Holdings) Limited in China. The report sets out a number of recommendations to collegiate licensees who source product from Yue Yuen (YY), regarding the remediation of social insurance and other freedom of association issues arising out of the strike.

The following is our response to those recommendations, together with other updates on the remedial actions underway at the Yue Yuen's Y6 plant, which makes adidas Group product. The Y6 plant accounts for approximately 15 percent of the YY workforce. adidas Group's social compliance programme extends only to the Y6 plant and not to other factories within the 1.2 km² YY industrial complex, which produce for a number of international retailers and brands.

Remedy Violations of the Law

In order to remedy the violations of Chinese law, licensees should press Yue Yuen should do the following:

Immediately adjust its contributions to social insurance so that workers' accounts are credited based on the total income they have earned;

From May 1st 2014, YY has calculated their social insurance contributions using the previous month's actual wage for employees as the baseline. Effective of the same date, YY has instituted an additional allowance of RMB 230 per month for each employee, to offset the higher deduction - or as the workers perceive it, the loss of income - due to their having to co-contribute to the social insurance payments.

Provide retroactive payments to ensure that all legally required payments for all workers have been provided to the relevant government agencies. These payments should not be made conditional on workers' providing any retroactive payment, except insofar as this is required by the Chinese government;

In April, YY announced that it would provide back payments to all employees for any unpaid social insurance contributions. The process for these retrospective payments is being managed directly by the Social Insurance Bureau (SIB). The SIB has confirmed that worker contributions are also required, as per the law. YY engaged in an intensive round of communications with its employees, in order to answer questions and enquiries about the back payment process.

Applications are passed to the Social Insurance Bureau who verify the status of the employee and calculate the amounts required for retroactive payment into the fund, both from the employer and from the employee. Once ready, the calculated amounts are shared with the employee for their final confirmation and agreement. YY settle the back payments owed once they receive confirmation from the employee and a corresponding instruction from the SIB to proceed.

Employees may register at any time, if they wish to obtain back-payments.

Provide worker with clear documentation, both for the retroactive payment and for all future payments, of the amounts contributed to their social security accounts and the calculations upon which they are based; and

So that deductions and contributions are clearly understood YY has modified the workers' pay slips; these now provide more detailed information on the social insurance payments made, including the baseline for each social insurance element and the amount paid by employee and employer.

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YY has set up a Social Insurance & Housing Fund Service Center in each of the seven factories within the Yue Yuen industrial complex. These centers provide employees with information on their entitlements and answer questions related to their social insurance or housing fund payments. In parallel with this, the Social Insurance Bureau has assigned case officers to work in each of the YY factories, providing training and answering questions from workers on their legal rights, on how to register into SI and housing funds, as well as the calculation of back payments.

All retroactive payments are calculated by the Social Insurance Bureau directly. The SIB manage this process and inform those who have applied for back-payment of the amount they must contribute and the co-payments which are to be made by Yue Yuen.

Provide workers with all contractually or legally mandated payments, including any such payments for food and housing.

From May 1st 2014, YY has calculated contributions to the local government's Housing Fund using the previous year's average wage as the baseline. The housing fund benefit requires workers and employers to pay an equal amount on a monthly basis, with the minimum annual contribution being 5% of the baseline. The local Housing Fund Bureau in setting up new accounts for those employees who had not previously registered in the system. YY's contributory payments and those of its employees were included in the June pay slips. With respect to back payments, YY is working closely with Housing Fund Bureau to define these and to develop the appropriate communications for their employees. YY has begun back payments. All employees who have completed the housing fund registration will be eligible for the payment of past unpaid contributions, effective from the date that they took up employment with the factory.

Freedom of Association

In order to prevent further violations of workers' freedom of association, licensees should:

Press for Lin Dong and any Yue Yuen workers still in custody as a result of their participation in the strike to be released, and for all charges against Lin and these workers based on the exercise of associational rights to be dropped, both by communicating directly to the relevant government bodies and urging Pou Chen to do so;

We are surprised that the actions already taken by adidas, and previously shared with WRC, were not disclosed in your report to university community. The report leaves the impression that there was no engagement by brands to uphold the rights and freedoms of the workers, or the labour advocates who had offered advice and guidance during their strike.

As we stated in our earlier communications, during the strike we engaged daily with YY and monitored any reported incidence or rumour of worker arrests. We also called for the authorities to stand down their riot police, so as to not inflame the situation or intimidate the workers. And although no workers were reportedly detained from Y6, the plant that makes product for adidas, we did promptly write to the Dongguan authorities calling for any detained YY worker to be released.

With respect to the arrests of Mr. Zhang and Mr. Lin from Shenzhen Chunfeng Labor Disputes Services Center, we engaged with several labour rights groups in Southern China and offered our help to secure their release. Mr. Zhang was released by the police on April 25th, 2014. We wrote to the Dongguan mayoral office on April 29th, 2014, calling

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for Lin Dong's release. Mr. Lin was released on May 28th, 2014, without charge after a period of administrative detention.

Press Yue Yuen to allow all striking employees to return to work without penalty and refrain from any retaliation or discrimination against strikers; and

Throughout the course of the strike we actively engaged with workers, and responded to feedback received through our worker hotline service. We can confirm that at Y6, which produces for adidas, no worker was penalized or dismissed due to the strike. Moreover each worker received their full salary; no deductions were made due to their participation in the strike. There have been no reported incidences or allegation from workers that they have faced retaliation or discrimination.

We cannot confirm the allegation in your report that YY management physically prevented workers from joining the strike. There was no evidence of this at Y6 where our staff monitored closely the situation. What we observed was workers clocking-in in the morning, but then immediately leaving the work place and returning home. No one prevented them from doing so.

Press Yue Yuen to provide training to its managers and supervisors regarding international norms of freedom of association.

The industrial action at YY was led principally by middle managers and supervisors. Despite the government's legal restrictions on strikes these employees were able to express their grievances and mobilize the larger workforce to join them in their protest action. The process was largely peaceful, although there was a heavy police presence throughout the days of the strike.

As we have shared previously with WRC, the Dongguan authorities requested the City branch of the government-mandated union to engage directly with the Yue Yuen workforce. They consolidate the workers' grievances and represented them in discussions with the Yue Yuen management. The City-level union remains active in its engagement with the workers, the factory management and the plant level union.

In order to enhance general knowledge and understanding on the freedom of association principles, adidas Group will conduct the following training:

- 1. Provide refresher training on FOA for senior managers in Y6 and YY's Administrative Headquarter in Gaobu. The training will focus on adidas Group Workplace Standards on freedom of association and the application of our guidance on industrial dispute resolution.*
- 2. In parallel, we will provide freedom of association training to key staff in the Y6 Compliance Department, so that they can run their own training for supervisors and managers in the factory. adidas will closely monitor and track the execution of these training sessions.*

Audit Methodologies

University licensees must correct the gaps in their auditing practices that allowed Yue Yuen to under-contribute to workers' social security accounts for years. Both Nike and adidas should provide a detailed explanation of whether the noncompliance concerning social security contributions was detected by their auditors, and, if so, why it was not corrected or remedied. In addition, both licensees should adjust their internal guidance and

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auditing practices to make it clear that private agreements with local government authorities do not constitute a substitute for actual compliance with national laws.

It is not a question of detection it is a question of remediation. More specifically, how brand-led compliance programmes can address deeply embedded local government practices, at the same time ensuring business continuity and overcoming workers distrust of the social insurance system, a system that they are often unwilling to co-contribute to.

China's Social Insurance Law was 17 years in the making. Promulgated in 2010, it came into effect in July 2011. The national law sits at the apex of an administrative system which vests authority in local governments, who are required to deliver social security within their individual jurisdictions. Although the Social Insurance Law does mandate certain contribution levels, it functions "more as a statement of broad principles, leaving most of the implementation details for future clarification via additional regulations at the national and local level."¹

For the past 20 years it has been local administrators, primarily in the provincial and municipal governments (that is, China's 333 prefecture cities and 31 provinces) who have been tasked to manage social security and housing funds. To add further to the administrative complexity, there are different social insurance schemes for urban enterprise workers and for rural migrant workers, as well as for other categories of insured persons, farmers, etc. This has created a high level of fragmentation and variability across the country.

As the World Bank notes:

"Geographic fragmentation has been driven by differences in basic programme features across localities, and it is reinforced by low levels of pooling and differences in financial capacity of local governments. As a result, workers face differences across provinces, and even localities within provinces, in such important parameters as contribution rates, the wage base, benefit levels and rules for indexation."²

In some localities local administrators have assigned pension contribution levels based on a specified wage, rather than based on an individual's payroll, as set out in the Social Insurance Law. Other authorities – due to their limited administrative capacities - simply negotiate a generic level of contribution for all insurances with the businesses in their locality. There is also variability in terms of the social insurance coverage which is supported by local governments in different parts of the country: at times not all 5 insurances are promoted, which itself departs from central government policy and legal mandates. Also the percentage of contribution by factory and worker can vary, as can the upper and lower wage bands for contributions; although that is permissible by law.

Given weak enforcement and other deficits in the social security system, coverage rates for social insurances have continued to fall short of State expectations, especially for migrant workers. The respected labour NGO, China Labour Bulletin, reported that:

"In 2011, there were a total of 359 million urban workers but less than 215 million of them had pensions. And out of a total of nearly 253 million migrant workers, only 41 million had joined the basic pension system, 46 million had health insurance and less than 24 million had unemployment insurance. However, 68 million migrant workers had work-related injury insurance, making up about 38 percent of all the 177 million workers covered by the scheme."³

¹ China Labour Bulletin, *China's Social Security System*, 8 August 2012 <http://www.clb.org.hk/en/content/china%E2%80%99s-social-security-system>

² John Giles, Dewen Wang, and Albert Park, 'Expanding Social Insurance Coverage in Urban China', The World Bank, June 5, 2012, p.13

³ China Labour Bulletin, *ibid*.

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This means that of nearly 253 million migrant workers, only 26.8% had work-related injury coverage, 16% have a basic pension, 18% had health insurance, and less than 9% had unemployment insurance.

In parallel with the administrative hurdles, there has been resistance from workers who have been unwilling to enrol and share in the co-payment of pension and unemployment insurance, which is mandated by law. This is due to the disproportionately high cost of those contributions (being 11 percent of total wages) and a lack of faith in securing any future payout from these funds. Indeed, the central government has yet to enable an easy transfer of funds from one city to another and currently the system is not able to integrate rural and urban social security. Graft and corruption also plays its part in the low levels of confidence in the administration of these funds.⁴

As recent research by World Bank concludes:

“Financed by a combined employer and employee contribution of 40 to 42 percent of payroll for the five basic insurance programs and a further 10 percent or even more for housing funds, China’s urban social insurance system carries heavy burdens for both employers and workers, and has significant implications for China’s long-run competitiveness. Moreover, the high implied tax wedge likely encourages informalization of the labor market: employers under report wages and game the system in numerous ways, while workers have incentives to opt out of formal contracts and participation in social insurance schemes.”⁵

To address these challenges adidas Group’s compliance programme has pressed suppliers to develop remedial plans which drive up the number of workers registered in the social security system. We have seen good progress, with enrolment levels in adidas’ suppliers well above the national averages cited earlier. At Yue Yuen for example, enrolment levels across the 5 insurances in the adidas production plant had reached almost 100 percent for those eligible to enrol, far higher than other manufacturing operations in Gaobu district.

Progressively we are also seeking to secure higher premium payments, but this calls for each supplier factory to gain the support and cooperation of its workforce and the local government, in terms of raising the contribution levels, with the ultimate goal of meeting the national requirements. It also requires suppliers themselves to make the necessary financial commitment to these funds.

To overcome the workers' concerns and lack of trust in the social insurance system, we have recommended that our suppliers conduct intensive training and communication with their workforce, together with local government, to build better awareness and understanding about the legal requirements and long term benefits of social security.

In the case of YY, the local social insurance and housing fund bureaux have assigned personnel to liaise directly with the workers to answer their questions and concerns. Local government officials from Hunan, the home province of the majority migrant workers employed at YY, were also invited to visit, to provide assurances to workers about the long term security and access to pensions in the provident fund. Such activities have been spurred of course by the recent strike.

Elsewhere however, securing cooperation from local government remains a significant barrier to achieving compliance. Our audit teams have engaged with local government officers and are fully aware of the embedded attitudes, which includes widespread opposition to raising contribution rates if this sets a precedent which can not be sustained by other businesses operating in the same locality.

⁴ China Labour Bulletin, *ibid*, notes that the National Audit Office’s first thorough [audit of the system in 2012](#) discovered over 1.7 billion yuan in funds had been misused by local governments. Nearly a third of the money was used for unauthorized financial investments, according to the report.

⁵ Giles, et al, *ibid*, p.9-11

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Finally, we recognise that adidas acting alone can not deliver compliance; other buyers sharing the same facilities must also lend their support to this endeavour. We have seen the lowest enrolment rates for workers in social insurance in those suppliers where we are the minority buyer, and where we have insufficient leverage to drive the required changes.

In summary, adidas Group's has sought to develop policies and approaches that acknowledge the short comings of China's national social security scheme, but at the same time seeks to move suppliers, and workers, progressively, towards full compliance. We do not accept private agreements with local government authorities as a substitute for compliance with national laws and continue to work towards addressing the gaps that exist in the social security system.

Footwear Disclosure

Finally, adidas should review and correct the flaws in its disclosure procedure which resulted in the repeated delays in including footwear factories in the lists of facilities producing collegiate licensed goods that are provided to the WRC, even after this failure to disclose was identified by the WRC.

The recommendation to review and enhance the disclosure procedure was completed earlier in the year and we have a more complete disclosure of makers of collegiate licensed products. We have for years disclosed a complete supplier list to the Fair Labor Association, and the FLA's university affiliates can have access to that information from the FLA.

The WRC's receives the adidas supplier disclosure from the Collegiate Licensing Company. The CLC updates their records (and disclosure to the WRC) twice annually, June and December. These are the timelines for licensing renewals. We have identified a number of cases in 2012 and 2013 when new suppliers or exiting suppliers were not being updated in the CLC's disclosures and after an evaluation of the processes for disclosure at both adidas and CLC, enhancements were made to render the disclosures more accurate.

The gap in providing footwear supplier disclosure to the WRC (between October 31, 2012 and December 11, 2012) was due to the time necessary to ensure the factories being disclosed actually made collegiate licensed products. It is important to note again that the supply chain disclosure to the FLA includes all footwear factories regardless of their status as makers of collegiate licensed products, and as such, the disclosure is straightforward and timelier to assemble.

Supply chains are subject to change, and do. We have committed publicly that if a disclosure is impacted by factories movement in and out of the approved supply chain and rendering the disclosure incomplete, we will always investigate and follow up complaints.

Other Points of Clarification

The political sensitivities of the YY case cannot be understated. This is one of the rare occasions where we have seen the direct and public intervention by the Central Government in a local labour dispute.

We are concerned that the WRC report to the university community appears to simplify reality and place all accountability on the shoulders of the supplier. It fails to inform the colleges of the role the Dongguan City government played, in directing and setting the social insurance and housing fund contributions for the factories within the Yue Yuen industrial complex and more broadly in the district in which they are located.

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Given the scale and political fallout from the strike the local government did an about-face, and declared that Yue Yuen had "failed to meet national requirements". This was political expediency on their part. The local authority sought to distance itself from a situation where it too was culpable and responsible.

Accountability also rests with the Social Insurance Bureau. Where payments into the social insurance fund, including the calculation of baseline contributions, fail to meet legal requirements, the SIB is obliged to take action to remedy the situation. However up until the time of the strike the SIB raised no objection to the payments being made by the factory, at the levels prescribed by the Dongguan City government. This situation repeats itself across many of the jurisdictions in China.

Finally, readers are left the impression that the workers put forward a cohesive set of demands. However, as we had shared previously with WRC, there were conflicting requests from the employees with respect to the social and housing fund payments. Local Chinese middle managers and supervisors played a pivotal role in the Yue Yuen strike, and it was their concerns over pension entitlements and housing that drove much of the internal engagement with Yue Yuen management in settling this case.

In contrast, many of the rank-and-file workers demanded cash payouts, rather than paying higher or matching contributions into the social insurance scheme or housing fund. To overcome the line workers general unwillingness to co-contribute to these funds, YY offered a special monthly allowance of RMB230, to reduce the impact on the workers' take-home pay. With co-payments on social insurance and housing representing upwards of 16% of a workers total income, it is understandable why there is resistance to pay into these funds.