Human Rights & Finance

What clients want, regulators expect, and investors should consider

Over the past few years, and following the adoption of the Paris climate agreement and the UN Sustainable Development Goals, responsible finance considerations, including ESG factors, have increasingly been in the spotlight. “Although there is no definitive list of which issues or factors are covered by the terms "ESG", they are, according to the United Nations Environmental Programme (UNEP) Inquiry and the United Nations Principles for Responsible Investment (UN PRI), broadly defined as follows: “(i) Environmental (E) issues relate to the quality and functioning of the natural environment and natural systems; (ii) Social (S) issues relate to the rights, well-being and interests of people and communities; and (iii) Governance (G) issues relate to the governance of companies and other investee entities.”[1] While environmental issues are very much in the focus and governance is also widely discussed (among others in terms of gender diversity and equality), less light has been shed on the “S” element, which very much relates to human rights issues.

This paper sets out the regulatory aspects linked to human rights in investments by financial service entities (be it through banks, insurance companies or asset managers/funds). This discussion is of particular importance to the Luxembourg financial industry as a major financial hub and the biggest fund industry in Europe. By depicting the recent legal developments in the financial sector, this paper outlines the different responsibilities and expectations for various stakeholders. Finally, practical recommendations to meet such expectations will be provided.

Luxembourg is widely recognised as the green bond capital of the world and has a strong record in sustainable investment, particularly in climate finance funds.[2] The recent National Action Plan[3] on business and human rights adopted by the Luxembourg Government provides a great opportunity for the financial sector to stay at the forefront of sustainable investment and use their leverage to detect and prevent adverse human rights impacts.

In 2018 the new Luxembourg Coalition Programme, which sets out the policies for the next five years, was adopted. The government commits to supporting European initiatives aimed at strengthening the social and environmental responsibility of transnational companies in the management of their supply chains, including binding and effective legislation.[4] In this context, the government will also study the possibility of a legislation on mandatory human rights due diligence for companies domiciled in the country to ensure respect for human rights and the environment throughout their value chain. This would be complementary to the National Action Plan on Business and Human Rights, which already emphasizes the importance of due diligence in preventing human rights violations and environmental damage caused by business activities.[5]

At the European Union (EU) level, the EU is currently examining how to integrate sustainability considerations into its financial policy framework. In March 2018, the European Commission issued its action plan on sustainable finance, followed by a proposal for a regulation on disclosures relating to sustainable investments and sustainability risks

[1] EU Commission Staff Working Document, Impact Assessment (SWD(2018) 264 final), 24.5.2018, page 11
[2] Luxembourg for Finance, Agency for the Development of the Financial Centre, ‘Sustainable Investment Funds’
[3] National Action Plan of Luxembourg for the implementation of the United Nations Guiding Principles on Business and Human Rights (2018)
[4] Accord de Coalition 2018-2023 Luxembourg page 218
[5] ibid

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and amending Directive (EU)2016/2341. This regulation will require institutional investors and asset managers to disclose on how they integrate environmental, social and governance (ESG) factors in their risk processes.

In January 2019, the EU Commission issued a proposal for a DELEGATED REGULATION amending *Delegated Regulation (EU) 2017/565* as regards the integration of Environmental, Social and Governance (ESG) considerations and preferences into the investment advice and portfolio management. At the same time, the EU Commission asked the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) for advice on integrating sustainability risks and factors in the UCITS[6], AIFMD[7], MiFID[8] and IDD[9] Directives.

What does "respecting human rights" mean for investors?

Human rights entail, at minimum, those rights recognised in the International Bill of Human Rights, i.e. the Universal Declaration of Human Rights, the UN Covenant on Civil and Political Rights with its two Protocols and the UN Covenant on Economic, Social and Cultural Rights, as well as those set out in the International Labour Organisation's Declaration on Fundamental Principles and Rights at work. [10]

In a business context, human rights are present along the entire value chain. Human rights concerns that might arise at the operational level that can affect company's workforce are for instance, the right to privacy, equal and fair treatment or freedom of association and collective bargaining. Likewise, the working conditions in the supply chain and at business partners could lead to serious human rights concerns, such as overtime, a lack of minimum wage, child labour, forced labour or serious health and safety deficiencies. In the context of the products and services a business delivers, human rights implications in relation to the right to privacy, health and safety, or impact on local community can occur. Respecting human rights in a business context means, the responsibility to be aware of these concerns, prevent them and address them when they occur.

According to Principle 13 of the UN Guiding Principles on Business and Human Rights, the instrument *par excellence*[11] which relates human rights responsibilities to the business sector is formulated as follows: "The responsibility to respect human rights requires that business enterprises (a) avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur; [and] (b) seek to prevent or mitigate adverse human rights impacts that are directly linked *to* their operations, products or services by their business relationships, even if they have not contributed to those impacts."

Businesses in the financial services industry are, like all other businesses, required to respect human rights along their value chain. Impact on human rights can for instance occur through labour standards vis-à-vis their own employees, and contracts with their service providers. Simultaneously, human rights impact might also occur in their core activity, i.e. the investment and financing operations on companies.

[6] Undertakings for the collective investment in transferable securities (UCITS) - Directive 2009/65/EC
[7] Alternative investment fund managers (AIFM) - Directive 2011/61/EU
[8] Markets in financial instruments (MiFID) - Directive 2004/39/EC
[9] Insurance Distribution Directive (IDD) - Directive 2016/97/EU
[10] For further guidance on human rights, the remaining UN core international human rights instruments should be taken into consideration. Additionally, the standards set by the International Labour Organization (ILO) in the ILO core conventions are also relevant.
[11] This set of principles, endorsed by the UN in 2011, constitutes global, authoritative standards on business and human rights and outlines how businesses can prevent and address their impacts on human rights.

Poor human rights performance can materially impact a company's stakeholder relations, its financial outcome, its reputation and brand. In fact, human rights considerations allow investors to acquire a better understanding of the (prospective) investee company's operations, as their due diligence process takes into account more information in order to better manage risks connected to human rights violations. Apart from minimizing risks, integrating human rights in the investment process (e.g. as a matter of investment analysis, valuation and engagement with companies)[12] also brings new opportunities, such as long-term sustainable returns.[13]

A recent survey from Deloitte shows that millennial workers 'are eager for business leaders to be proactive about making a positive impact in society'.[14] Hence, there is an increased expectation towards businesses to integrate, incorporate social issues in their business strategy and daily operations.

Considering the leverage financial institutions may have to meet the expectations to respect human rights in a business context, principles, tools and guidance from voluntary initiatives within the financial sector have arisen to tackle ESG risks, including human rights-related elements. For instance, the United Nations Principles for Responsible Investment (UN PRI), which require including ESG information in investment decision-making to ensure that all relevant factors are considered when assessing risk and return, or the Equator Principles (currently under review)[15] which provide a risk management framework for financial institutions concerning specific financial products to determine, assess and manage environmental and social risks in specific projects. Similarly, the OECD Guidelines on Responsible Business Conduct for Institutional Investors provide *operational* guidance on what a due diligence process entails for institutional investors, aligned with the United Nations Guiding Principles (UNGPs) on Business and Human Rights.

An initiative within the banking sector for "taking human rights responsibility" is the *Thun Group*, an informal group of bank representatives that shares banking-sector expertise and experience to support the integration of the UN Guiding Principles on Business and Human Rights into the policies and practices of banking institutions. The UN Environment Programme Financial Initiative's (UNEP FI) Human Rights Guidance Tool for the Financial Sector constitutes an example of an online tool providing information on human rights risks for financial institutions. The UNEP FI recently launched the Principles for Responsible Banking, a comprehensive global framework to embed sustainability across business areas of banks, which are now open for consultation and that have just been endorsed by the European Banking Federation[16] and the Luxembourg Bankers' Association.[17]

In September 2018, the Financial Sector Commission on Modern Slavery and Human Trafficking Initiative, the so-called "Liechtenstein Initiative", was launched with the aim of putting the financial sector at the heart of global efforts to end modern slavery and human trafficking.

Finally, in its latest report, the UN Working Group on Business & Human Rights calls for entities in the investment community to implement human rights due diligence, to require

[12] Human Rights International Corporate Governance Network (ICGN) Human rights - Viewpoint (2015)
[13] Sonia Hierzig, ShareAction "Responsible Investment: Understanding the link between the investment system and human rights"
[14] 2018 Deloitte Millennial Survey page 2
[15] Review of the Equator Principles (2018)
[16] EBF endorses UN Responsible Banking Principles Initiative (2018)
[17] ABBL endorses UNEP FI Principles for Responsible Banking (2019)

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effective human rights due diligence by their investee companies and to ensure meaningful engagement with companies.[18]

(!) Take action: implementing human rights due diligence

The UN Guiding Principles require financial service entities to conduct human rights due diligence in their **investment decision-making processes** to make sure they are not involved in human rights abuses. Therefore, **financial service entities should:**

Formally embed human rights **through policy commitment**, i.e. state in clear terms the human rights expectations towards companies, including, if applicable, any specific human rights priorities in which the investor might want to put a focus on such as e.g. children's rights, or women's rights.

For instance, the Norges Bank establishes clear expectations towards companies on children's rights.[19] In fact, more and more institutional investors and sovereign wealth funds give themselves principles that directly influence the way target entities approach human rights. The Norges Bank Investment management targets the board of companies they invest in by requiring them to "ensure that the company has a policy to respect human rights and that relevant measures are integrated into corporate business strategies, risk management and reporting. Strategies for responsible business conduct should follow the UN Guiding Principles on Business and Human Rights, where applicable. Boards should ascertain that the ensuing responsibilities are clearly defined within the organisation and they should effectively guide, monitor, and review their management in carrying out these efforts".[20]

Identify and understand human rights risks in your portfolio. Investors should be aware of the human rights impacts through their operations, i.e. the risk that the investee might pose to adverse human rights impacts. The approach taken for the identification of human rights impacts may vary depending on the asset class.[21] Generally, the following could apply:

- Overall understanding/analysis of all types of activities/asset class, sectors, countries to acquire the overall risk picture.
- Prioritization of the areas with human rights risks for further assessment where appropriate.

After *mapping* the portfolio in terms of human rights-related risks, investors will be able to identify the companies which might deserve *further examination* and ultimately, *further engagement*. Thus, investors can assess the (potential) human rights impact and decide whether to invest, reject the opportunity, or engage with the proposed investee to foster sufficient change in order to allow investment to move forward. For instance, Amundi created a database of general indicators to assess companies in its portfolio based on the UN Guiding Principles, which are applicable to all businesses, and more specific indicators by sector.[22]

Take action on identified prioritized human rights-related risk areas, which may include:

[18] Report of the UN Working Group on the issue of human rights and transnational corporations and other business enterprises (A/73/163) 2018, para 95
[19] Norges Bank Investment Management, Children's Rights – Expectations towards Companies
[20] Norges Bank Investment Management– Human Rights Expectations
[21] OECD Guidelines on Responsible Business Conduct for Institutional Investors page 31
[22] Amundi, Human Rights & Business (2017) page 27

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- developing a (specific) strategy for responsible investment, e.g. norms-based screening (screening of investments against business practice in accordance with international norms) or best-in-class screening (investment in sectors, companies or projects selected for positive ESG performance with respect to industry peers).[23]

- tailored requests: depending on the type of activity and sector, investors could require further substantive human rights issues that are relevant to that specific area. Good guidance examples are the Principles for Responsible Investment aimed at investors on how to promote responsible sourcing practices in the cobalt sector or on how to engage on labour practices in the agricultural supply chains or with apparel companies. For instance, BNP Paribas identified nine sensitive industrial sectors for its financing and investment actions. For that, it developed nine different sector policies in which it sets clear ESG requirements and evaluation criteria they consider when making financing and investment decisions in such sectors.[24]

- engaging with the investee company to exercise leverage in order to improve human rights performance where possible, e.g. direct contact, face-to-face meetings to raise human rights issues, or make use of voting rights to express views on these matters.[25] For instance, when it comes to engagement, BlackRock puts an emphasis on 'direct dialogue with companies on governance issues that have a material impact on long-term financial performance'.[26]

  In the case of financing a client as part of a group loan for the construction of a new petrochemical complex, the ING in its role as lender engaged an independent consultant for an environmental and social monitoring. After receiving the monitoring reports on the project, a potential case of forced labour was detected. ING decided to request additional information and engage further with the client on the matter. By requiring additional information, ING was able to manage human rights risks in more effective manner.[27]

- depending on the severity of the impact, reducing the investment position in that sector/company or divesting as a last resort.

Monitor human rights risks on an ongoing basis, which may include:

- continuously monitoring human rights risks in the portfolio;
- monitoring any changes in the investee company concerning its behaviour, policies or business operations and; in cases where the investee company needs to take action to improve human rights performance, monitoring to gain assurance that measures have been adopted.

Report, i.e. investors should publicly disclose their policies and approach, which may include how they address and manage human rights risks in their operations, the companies with which the investor has engaged and the outcome of such engagement, and divestment decisions.

With a robust human rights due diligence in place, financial service entities can play an important role in shifting corporate behaviour towards the promotion and protection of

[23] For an overview of the different types of strategies for responsible investment, see for instance Global Sustainable Investment Review (2016) page 6
[24] BNP Paribas, Financing and Investment Policies
[25] OECD Guidelines on Responsible Business Conduct for Institutional Investors page 32
[26] BlackRock, Global Corporate Governance & Engagement Principles page 3
[27] ING, Human Rights Report 2018 page 62

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human rights worldwide and ultimately, contributing to *businesses doing business* in line with international human rights and labour standards.

A call for action

Policy makers: adopt a holistic view on sustainability conceptually framing human rights in line with international standards, in particular considering the UN Guiding Principles.

Financial entities associations: foster discussion among members on the relevance of human rights; develop capacity building on human rights through trainings and workshops.

Financial service entities: revise current due diligence process to incorporate human rights in the investment decision-making process, upholding the UN Guiding Principles.

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About Finance & Human Rights (FaHR)

Finance & Human Rights (FaHR) is a non-profit organisation created in 2019. It serves as a knowledge hub that brings together strong expertise on business & human rights with extensive experience in the financial sector. With our offered services within Research, Networking and Professional Development, we provide a collaborative platform that promotes future-oriented financial development consistent with human rights. Click here to visit our LinkedIn page.

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With 30 years of experience, **Charles Muller** is the co-chair of FaHR and a well-known figure in the Luxembourg Investment Fund Industry. He started his working life at the time of the implementation of the first UCITS directive and during his time at the Luxembourg Investment Fund Association ALFI followed the coming to life of the AIFM directive. He is hence equally specialised in the mutual and alternative fund space. Today, he acts as an attorney and independent director for funds, management companies and depositary banks, trainer and conference speaker and as a consultant in European and Luxembourg public policy. He is the co-author of this paper.

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