Call for Input: UN Working Group on Business and Human Rights' report on "Investors, ESG and Human Rights."

This submission is from the Investor Alliance for Human Rights, a collective action platform for responsible investment that is grounded in respect for people's fundamental rights, representing over 230 investors with over USD 13 trillion in assets.

ESG must be viewed through the lens of human rights

ESG investing approaches have rapidly expanded in the last decade[1] as a framework for long-term investors to assess risk and opportunity for portfolio companies related to environmental, social, and governance factors. ESG approaches seek, among other things, to improve non-financial risk management by portfolio companies to address concerns over environmental and social issues and consider the sustainability of investments while continuing to provide stable financial returns. While attention to ESG investing has grown significantly, ESG approaches are generally not based on international human rights norms and standards. The adoption of the UN Guiding Principles on Business and Human Rights (UNGPs) provides an opportunity for investors and their portfolio companies to solidly ground ESG approaches in international human rights norms and standards, as do the current efforts to advance legislation and other regulatory measures requiring business to undertake human rights and environmental due diligence (HREDD) and provide relevant sustainability disclosures.

ESG approaches that are not human rights-based confront several challenges:

- **Investors continue to view human rights as a subset of issues that fall under the "S" in ESG,**[2] as opposed to a set of authoritative normative standards central to environmental, social, and governance performance that should be upheld and integrated into all investee companies' and investors' institutional policies, governance systems, and operational decision making.

- While there is growing recognition that human rights pose significant risks to investments and financial performance, **investors' understanding of human rights risks and impacts and the international frameworks that govern them remains limited**. The expansion of ESG investing and data has not led to a greater understanding of the full range of civil, political, economic,

[1] Faith-based investors have long been addressing these risks in their portfolio, dating back over 50 years. Since 1971, the Interfaith Center on Corporate Responsibility has supported and coordinated faith-based and socially responsible investors (SRIs) in mobilizing their invested capital to build more sustainable, financially resilient companies.
[2] See UN Working Group on Business and Human Rights, Taking stock of investor implementation of the UN Guiding Principles on Business and Human Rights, p. 13.

social, and cultural rights that investors and their portfolio companies are connected to and, in fact, ESG approaches are often limited in the rights and rightsholder groups they focus on. Investors (and their portfolio companies) often do not fully realize the extent and ways business and state actors are connected to harms across value chains, or which contextual factors require business actors to exercise heightened efforts to respect human rights (e.g., distinct needs of vulnerable groups and exposure to conflict-affected and high-risk areas).

The dearth of human rights data available to investors has led a group of 15 investors and the Investor Alliance to engage with the largest data providers and proxy advisors to encourage better collection and standardization of data measuring corporate impacts on human rights, which could be integrated across portfolios and enable effective stewardship, as well as allow investors to meet growing regulatory requirements (see Investor Alliance member Aviva Investors' submission.)

- **ESG approaches measure human rights risks to the company rather than risks to people, as expected under the UNGPs.** Without grounding in a consistent set of standards derived from internationally recognized human rights or a consistent methodology, ESG rankings are not comparable, do not address the full spectrum or systemic nature of human rights risks, and are typically based on self-reporting by the rated companies, without independent analysis from human rights experts or consideration of rightsholders' perspectives. Nonetheless, ESG rankings "hold enormous power to steer the conversation about what counts as sustainable," as Ranking Digital Rights has noted, including among responsible investors. Further, studies have found that "ESG ratings have low associations with environmental and social outcomes," which underscores the disconnect between ESG approaches and actual human rights impacts.

It is also important to recognize the context in which ESG approaches are growing but also constrained in integrating human rights:

- **ESG investing is increasingly important to asset owners' long-term investment horizon.** Recognizing asset owners' concerns with the ESG impacts of their portfolio companies, asset managers are offering more ESG investment products and services such as ESG indexes and green bonds. These products, however, are not synonymous with a human rights-based approach to investing. Companies connected to human rights abuses, for example in Myanmar and the Uyghur Region, often end up included in ESG-labeled index funds, making it critical for investors to conduct ongoing HREDD of their holdings, including those labelled ESG.

- **Although long-term investing is gaining traction among responsible investors, short-termism in financial markets still prevails, leading to detrimental societal and environmental impacts that create broader and longer-term systemic risks.** A fundamental problem with our capital markets is that the short-sighted obsession of investors with achieving "alpha" (excess return on an investment relative to a market index) incentivizes corporations toward short-term profit at the expense of long-term sustainability. This may result in negative "externalities," social and environmental costs with significant ramifications for society and the economy but little or no cost to the corporation. Examples of externalities include GHG emissions, pollution, deforestation, and loss of biodiversity; poor treatment of workers; tax avoidance; infringements on privacy and freedom of expression online; and corporate lobbying that distorts public policy.

Most institutional investors, in particular large asset managers, have widely diversified holdings and often are "universal owners" of the entire market. Universal holders have a financial interest in the well-being of the economy as a whole and, therefore, should ideally work to ensure capital markets prioritize the long-term sustainable health of the entire economy over the short-term profitability of any one company. Thus, institutional investors should focus their own investments and engagements with portfolio companies on mitigating systemic risks and creating a stable and sustainable environment for investments, businesses, and society to thrive. ESG approaches which focus on the value of individual companies may not be consistent with a systemic stewardship approach to address the impact of negative externalities on systems.

- **While efforts to regulate responsible corporate behavior advance, particularly in Europe, coordinated efforts to undermine ESG are growing in the U.S. with global implications.** The backlash against ESG investing has developed in the United States on multiple fronts, including state and federal policy;[3] legal attacks on collaborative engagement efforts; and the filing of anti-ESG shareholder resolutions. Largely funded by the oil and gas industry, these efforts aim to block investors and companies from adopting forward-looking ESG policies. As a result, there has been a significant decline in support by large asset managers for ESG-related shareholder proposals in the 2023 proxy season. These developments put the U.S. at odds with advances to legislate and regulate sustainability in the EU and create confusion and an uneven regulatory playing field for global investors. In response to the backlash, some asset owners are exercising their leverage over asset managers to emphasize the continued importance of ESG investing and proxy voting, as well as weighing in on anti-ESG legislative proposals at the federal and state levels.

Against this backdrop, a human rights-based approach to ESG can address these limitations and bring specific advantages:

- International human rights frameworks, widely agreed upon by States, are codified in regional and national law and supported by civil society, thereby providing common ground for consensus and action.

- A human rights-based approach ensures that rightsholders, including the most vulnerable, are at the center of human rights interventions and are empowered to participate in the realization of their rights. Such an approach also reinforces corporate accountability as central to enabling rightsholders' ability to access remedy.

- Integration of human rights into ESG allows for more consistent and harmonized definitions of social issues based on authoritative normative standards. This can guide the development of more precise and comparable ESG metrics and more accurate assessments of companies'

[3] In addition, proposed legislation from U.S. House Republicans also more directly attacked the overall shareholder advocacy process and the ability of the SEC to regulate corporate disclosures.

human rights performance, leading to better informed, data-driven investment decision making and stewardship.

State duty to protect human rights

To enable ESG approaches based on international business and human rights frameworks and for investors to effectively fulfill their human rights responsibilities, States must mandate laws and regulations that require investors to commit to respect human rights and undertake HREDD both at the institutional and investment levels.[4] Mandated measures must address the dual nature of an investor's responsibility - as a business enterprise with its own operations and relationships and as an investor with leverage over other business enterprises. When it comes to harms associated with investment relationships, regulation must reflect that investors can not only be directly linked to harms, but also potentially contribute to and cause harms, which entails varying degrees of investor responsibility to use and grow leverage to enable, contribute to, and provide for remedy.[5]

If investors adopting an ESG approach are to adequately understand and address the human rights impacts of portfolio companies, then States must ensure that regulations that codify investor and company HREDD and disclosure requirements are consistent, harmonized, and part of a coherent whole. For example, investors cannot undertake sufficient HREDD on their portfolio companies and meet their own sustainability disclosure requirements if HREDD and disclosure obligations of their portfolio companies are not rigorous and comprehensive as well.

As OHCHR has recently stated, if regulation (such as the proposed Corporate Sustainability Due Diligence Directive - CSDDD) is to align with the UNGPs and enable human rights respecting investment activities, there can be no carve-outs for the financial sector.[6] Indeed, many investors recognize the "investor case"[7] for obligatory HREDD and have called for a robust inclusion of the financial sector and due diligence requirements along the entire value chain, as well as director level oversight of due diligence processes and directors' remuneration tied to sustainability performance.[8]

In addition to financial materiality considerations, long-term, diversified investors should also consider "impact materiality," as codified in European regulation (but not sufficiently in other jurisdictions' uptake of "double materiality"). These investors recognize business impacts on people and the environment ultimately shape longer term societal-wide sustainability perspectives.

Corporate responsibility to respect human rights

To operationalize their human rights responsibilities laid out in the UNGPs, investors must fully embed human rights at both the institutional level and in their investment activities. Human rights

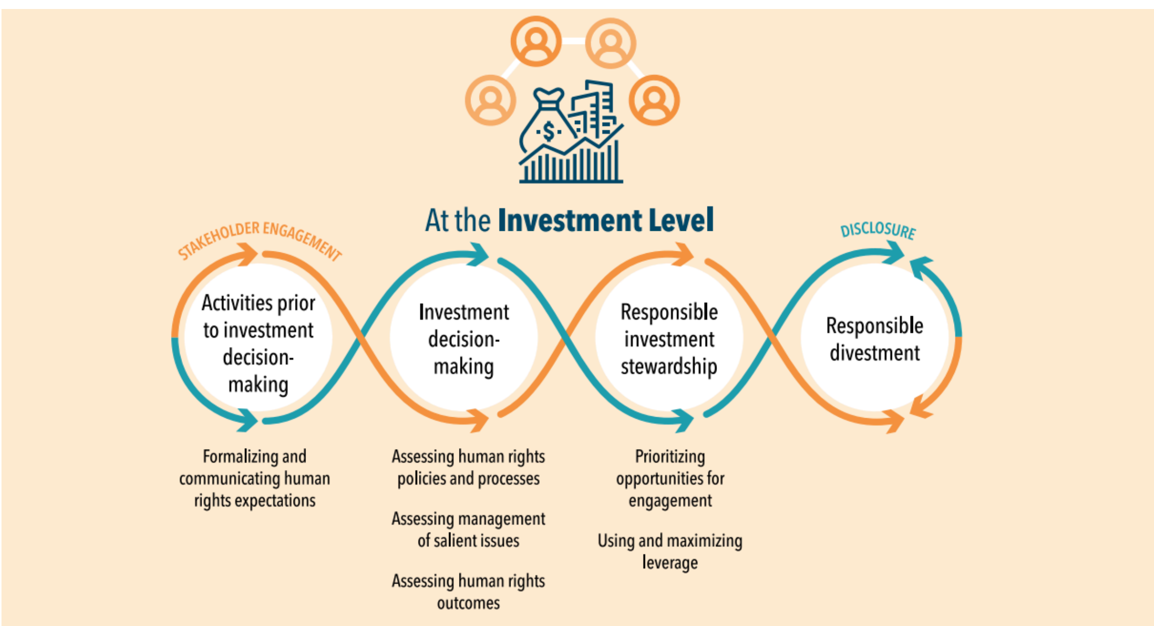
---

[4] See the Investor Alliance for Human Rights, Investor Toolkit on Human Rights, specifically the diagram on p. 14, Putting the Investor Responsibility Into Practice.
[5] See the recent position from the OHCHR on the Financial Sector and the EU CSDDD.
[6] Ibid.
[7] See the Investor Alliance for Human Rights statement, The Investor Case for Mandatory Due Diligence, supported by 105 investors representing USD 5 trillion in assets.
[8] See PRI, Eurosif, and Investor Alliance for Human Rights, Investor Statement of Support for an Ambitious and Effective European Directive on Corporate Sustainability Due Diligence.

practices at the investment and institutional levels are mutually reinforcing; by having their own robust institutional-level policies and processes in place (graphic 1), investors can undertake more credible and impactful engagements with portfolio companies throughout the investment lifecycle (graphic 2). When investors "practice what they preach,"[9] they can share their own experience and good practices with portfolio companies, providing more precise, applicable, and comprehensive guidance to address human rights impacts.

Graphic 1: At the institutional level[10]

Graphic 2: At the investment level[11]



[9] See the Investor Alliance for Human Rights, Investor Toolkit on Human Rights, p. 17, At the Institutional Level.
[10] See the Investor Alliance for Human Rights, Investor Toolkit on Human Rights, p. 14.
[11] Ibid.

Studies show that investors are significant drivers of change in corporate behavior on ESG issues. Investors can and are expected to use and maximize their leverage in multiple and diverse ways, in addition to individually and collectively directly engaging with their portfolio companies.

Some notable examples[12] include:

- **Using investor voice to amplify the need for rights-respecting policy and regulation**: Investors are actively engaging with policymakers to advocate for regulation that enables responsible business conduct on a level regulatory playing field. This includes calling for robust regulation to eradicate forced labor, promoting trustworthy AI and limiting its use in high-risk areas, and supporting mandatory HREDD.

- **Responsible contracting:** In their corporate engagements, investors are promoting responsible contracting,[13] reflecting buyers' and suppliers' human rights commitments and providing a clear process for upholding them. If companies see their contractual process as one means to address human rights risks, they can generate better human rights outcomes for the parties and other stakeholders, including workers, who, although not party to contracts, are at risk of being adversely impacted by them. The core principles underpinning responsible contracting also support regulatory compliance for companies subject to current and prospective HREDD laws.[14]

- **Proxy voting & shareholder resolutions:** Investors as shareholders have specialized forms of leverage over portfolio companies which can be deployed to establish board-level oversight of human rights risk management and encourage more responsible corporate behavior. For example, investors can use their proxy vote at the Annual General Meetings (AGM) of listed companies to indicate their disapproval of the board's response to human rights risks by voting against directors (see Top Glove). They can also escalate concerns that have not been adequately addressed by filing a shareholder proposal (where available under securities regulations) to be discussed and voted at the listed company's AGM. This brings human rights concerns and impacted rightsholders' voices to the attention of board members, other shareholders, and the public, as was the case with a 2022 resolution at Nike asking the company to address human rights risks in its supply chains, including Uyghur forced labor.

- **Engaging with civil society:** Collaboration with civil society helps investors improve their understanding of human rights risks and impacts to which rightsholders, and their portfolios, are exposed; better assess the quality of portfolio companies' human rights risk management; and informs more effective, evidence-based stewardship. Civil society in turn gains increased knowledge of the responsible investment ecosystem and investors' unique leverage. Over time, these exchanges can lead to ongoing and impactful two-way collaboration and joint

[12] See the Investor Alliance for Human Rights, Investor Toolkit on Human Rights, p. 29 – 32, for additional examples of investor leverage.
[13] The Model Contract Clauses (MCCs) is a template of contractual provisions designed to help buyers and suppliers better protect human rights in supply chains.
[14] E.g. The German Supply Chain Due Diligence Act and the draft CSDDD.

strategy setting. For example, the Investor Alliance regularly convenes dialogues between investors and digital rights experts, such as AccessNow and EDRi, similarly our work to end Uyghur forced labor is carried out in conjunction with the Coalition to End Forced Labour, comprised of CSOs, including Uyghur human rights groups, academics, and other experts.