**Investors, ESG and Human Rights**

The ILO collaborates with stakeholders across the investment ecosystem. Our objective in this work is to reorient capital towards achieving decent work and economic inclusion, as envisioned by the UN’s Sustainable Development Goal (SDG) 8. In our collaborations, we shape standards and promote good practices that facilitate the integration of decent work into investment strategies. We conduct research and build the capacity of investors for better social and environmental risk and impact management. More information on our work with investors can be found [here](https://www.ilo.org/empent/areas/social-finance/WCMS_856595/lang--en/index.htm).

An overall comment on the upcoming paper and event: given the highly-fragmented and non-standardized context, we recommend not limiting the analysis of investors’ relations with human rights to initiatives or approaches explicitly using the term ESG, as this could refer to different things, and rather look at different approaches incorporating non-financial factors in decision-making by investors.

Kindly find below our answers from selected questions in your call for inputs on Investors, ESG and Human Rights.

**General**

*1. What do you understand Environmental, Social, and Governance (ESG) in finance to mean? How are human rights standards and frameworks considered by investors, if at all, in ESG?*

ESG is an approach to investing that takes into account Environmental, Social and Governance factors affecting investments. It originates from a risk-management approach in the understanding that ESG factors, if not adequately managed, will result in adverse consequences to the businesses therefore increasing financial risks.

Under this definition, ESG does not directly align with human rights standards and frameworks as it typically does not consider the perspective of rights holders, but limits the interpretation of risk to what can directly affect the investment. However, human rights element can be captured as a part of exclusion lists (values-based, norms based, standards based - to the extent that they include these human rights considerations), ESG controversy screenings or as a part of S component for some investors.

ESG can in theory partially align to human rights standards, particularly in the consideration of social aspects, in what relates to Fundamental Principles and Rights at Work.

That being said, ESG is part of a broader sustainable finance ecosystem, where concepts are not always standardized. Sustainable finance strategies, including ESG, evolve over time and a variety of them are applied by investors. This ecosystem tends to favour the “E” aspect of ESG, with the “S” part frequently receiving less attention.

*2. Which are the main types of investors using ESG approaches, for example, in decision-making or engagements? On what basis are they making decisions on human rights, climate change and other related matters?*

ESG approaches are used by a variety of investors, including in ESG-thematic vehicles (dedicated funds, thematic financing instruments) as well as general commercial institutions (which develop in-house ESG approach to their operations in general).

These different investors (as defined in the questionnaire) are increasingly incorporating ESG factors into their decisions as they recognise the long-term risks and opportunities associated with environmental, social and governance issues. This includes product development, investment appraisals and engagement with clients / investees. .

To inform decision-making, investors make use of ESG data providers, who might consider aspects related to human rights (e.g. risks of violations of workers’ human rights).

*3. To what extent do ESG approaches present constraints or opportunities for investors and businesses overall?*

With the growing number of asset owners adopting ESG requirements, asset managers and banks can increase their funding base by developing ESG approaches to investing. Likewise, companies can have access to additional sources of capital by meeting ESG requirements. This also means that actors which do not follow such approach might have reduced opportunities for obtaining financing.

Adopting ESG approaches can also help investors and businesses identify and address potential ESG risks in their operations, thus preventing potential future liabilities and potentially expanding their market reach.

Furthermore, investors and businesses that actively integrate ESG into their operations are often better positioned to engage with stakeholders, including communities, consumers, and regulators, leading to better relationships and trust.

Constraints for investors include potentially reduced investment universe due to exclusion of sectors, activities and practices on ESG grounds as well as costs associated with obtaining and processing ESG-related information. Companies as well bear costs for complying with ESG requirements as well as reporting and communicating this information to the investors.

*4. What responsibilities and capacity do ESG index and data providers have regarding the assessment of adverse human rights and environmental impacts, and how can ESG indexes and research products be improved to align with the UNGPs approach?*

ESG-investing takes place largely in public markets (e.g. listed stocks). In such markets, rating providers are a key actor to inform decision-making, as investors typically will not have the resources to perform detailed analysis of individual companies. However, ESG ratings vary significantly from one rating agency to another. [Research by the ILO](https://onlinelibrary.wiley.com/doi/full/10.1111/ilr.12370) discusses the varied approaches and constraints of ESG rating providers.

ESG Rating is one of the sources of information used by the widest scope of investors. Other bases include internal assessment of publicly available company information, information from NGOs, information on ESG controversies.

ESG index and data might be incentivized to integrate a human rights perspective and further build their capacity by the interest coming from the users of their services (investors, asset owners and companies which get rated) or regulation.

Furthermore, as businesses are increasingly exposed to potential liable for failure to undertake adequate due diligence, as for example in the German Supply Chain Due Diligence Act, demand will escalate for more rigorous and accurate ESG ratings. Therefore, it is fundamental for ESG index and data providers to have both a profound and integrated understanding of human rights, including labour rights – which currently does not seem to be the case. Moreover, they should not just identify adverse impacts but also elucidate on their severity and potential ramifications.

To achieve this, ESG index and data providers can benefit from partnerships with NGOs, local communities and international organizations (e.g. such as with the OHCHR and ILO, to gain deeper insights, either through advice or training, on the alignment and relevance of ESG indexes and with the UNGPs or international labour standards and the ILO MNE Declaration).

**State duty to protect human rights**

*1. What State, regional, and international mechanisms and regulations exist to promote or restrict investment/financing using an ESG approach that takes human rights into account and how do they align with the UNGPs? How do these mechanisms and regulations promote or inhibit business respect for human rights consistent with the UNGPs?*

Until recently, ESG has largely been unregulated, with investors being able to claim “using ESG” or “integrating ESG” based on self-assessment. Regulation has picked up in recent year (Fitch – a rating agency – has an interesting [tool](https://www.sustainablefitch.com/corporate-finance/esg-regulations-reporting-standards-tracker-30-05-2023?mkt_tok=NzMyLUNLSC03NjcAAAGMLoBEShwx4EORHylAg7FBBeQnSBdS29W9dZMVUH__DkFrINBYjxIp5JBHS8UQp2hTNquhdQv21Zq7q-PHIh9SeJnj7th78yN7zd3SiGxLxtHxixqbW7_L) monitoring such regulations globally).

One example of regional regulation is EU’s Sustainable Finance Disclosure Regulation, which has specific requirements for investment vehicles who intend to be labelled “Sustainable”. The SFDR requires investors to report on what it calls Principal Adverse Impacts (PAI). Among the PAIs with relevance for human rights are PAI 10 (investee companies that have been involved in violations of the UNGC principles or OECD Guidelines for Multinational Enterprises), PAI 11 (investee companies without policies to monitor compliance those reference frameworks) or PAI 14 (investee companies involved in the manufacture or selling of controversial weapons).

The EC’s Directive on corporate sustainability due diligence, applying to real economy actors is expected to have spill over effect on the activities of the financial sector actors. Finally, in June 2023, EC presented a proposal on a Regulation on transparency and integrity of ESG rating activities.

*3. How can States encourage and regulate accurate communication of ESG practices by businesses and investors to prevent misleading or unsubstantiated claims regarding respect for human rights?*

In recent years, there has been a proliferation of initiatives to develop sustainable finance taxonomies. Such taxonomies are an attempt to standardize and define what types of investments can be considered “sustainable” and are a positive development towards fighting unsubstantiated claims or greenwashing (though the process of developing such taxonomies – and the actors driving them – varies considerably).

Regulation concerning issuance of specific instruments (e.g. green, social or sustainable bonds) can also contribute to increased transparency (including by example requiring second party opinions to be included in such instruments).

*4. How can policies, programs, plans and activities in one State concerning regulation of investors in relation to human rights have potential or actual adverse or positive human rights impacts outside of their territory or jurisdiction?*

The SFDR example discussed above can drive such cross-border impacts, as a significant part of investors in emerging markets are based in Europe, therefore subject to such regulation. The question in this case is to what extent Europe-based investors will be able to comply with such requirements, given issues of data availability and internal capacities. Moreover, reporting on SFDR is done at the level of the national regulator in each member country, whom also needs to develop capacities and procedures to review such data. The investors not looking to comply with stringent (eg. European) regulation and bear the associated financial costs, or not interested in selling their products to European investors might chose to move to other jurisdictions, with much less stringent requirements, leading potentially to the opposite effect to what is sought by the regulation.

**Corporate responsibility to respect human rights**

*1. To what extent are investors aware of their responsibility to respect human rights? Are some types of investors more likely than others to align their practices with the UNGPs? Does it depend on the type of investor?*

Investors are increasingly aware of this responsibility and start building their capacities by putting in place human rights policies and hiring dedicated staff. Larger organizations with explicit sustainable focus are expected to lead the way, due to better availability of financial resources to cover associated operational costs and potentially higher relevance of the reputational risks for these types of actors.

Many pension funds have been actively using human rights frameworks in their investment decisions, going back well before the UNGPs.

*2. How effective are international instruments, institutions and guidance that promotes HRDD, such as by the UN Global Compact, Equator Principles, Principles of Responsible Investment, Investor Alliance for Human Rights, Business for Social Responsibility and other entities, effective in increasing awareness of human rights impacts among investors and other businesses? Please provide examples of participation, integration, or adherence of investors in these instruments and bodies.*

As an example, the Equator Principles have been influential, but that has been driven by syndicated lending between IFC (FMO, DEG and some other bilateral development banks) and Equator Banks. It would be interesting to compare their focus on human rights in the context of these syndicated loans with their investment decisions in other parts of the banks’ operations. A [2009 ILO study](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwj9s5H84vKBAxVv0gIHHTkqCK8QFnoECBMQAQ&url=https%3A%2F%2Fwww.ilo.org%2Fwcmsp5%2Fgroups%2Fpublic%2F%40ed_emp%2F%40emp_ent%2F%40multi%2Fdocuments%2Fpublication%2Fwcms_125545.pdf&usg=AOvVaw3Vruy9uJuJ9p0y7k5v5Fs2&opi=89978449) of the impact of the IFC performance standards and other DFIs using them or similar standards on lending and found a shift to alternative sources of lending, limiting the impact of the IFC PSs.

*3. How should investors integrate human rights considerations throughout the investment process, including when constructing, underwriting, and/or investing in an ESG product or service? How do these steps vary for different asset classes?*

Human rights (as other sustainability issues) need to be included in a holistic sustainability management system, connecting different sustainability objectives and integrated in investors’ operations. The [ILO-LSE Just Transition Finance Tool](https://www.ilo.org/wcmsp5/groups/public/---ed_emp/documents/publication/wcms_860182.pdf) strives to highlight this point and outline the concrete entry points for embedding social considerations (including human rights) alongside with climate objectives.

From a technical perspective, investors should develop internal capacities related to adequately manage ESG aspects. As part of a sustainability management system, a capacity building strategy needs to be developed. This will include building specific in-house capacity on themes such as the ILO's fundamental principles and rights at work, and also identifying situation where external expertise is required. [This article by the ILO](https://www.ilo.org/wcmsp5/groups/public/---ed_emp/documents/publication/wcms_753082.pdf) describes the step for developing a sustainability management system for investors.

This understanding ensures that the integration of human rights considerations throughout the investment process is not merely procedural. Instead, it is deeply rooted in comprehending the human rights implications at every investment stage, assisting investors in determining a company's commitment to labour rights.

Investors should engage with investee companies on human rights matters. Such discussions can be beneficial for both parties, sharing practices and addressing concerns. For equity investments, they should also exercise voting rights to influence company decisions related to human rights.

*5. What does appropriate investor action entail in the event that a client or portfolio company causes or contributes to a potential or actual adverse human rights impact?*

Among the required elements are: communicating clear expectations (to client/investee)/engagement with clients/ availability of clear escalation procedures outlining decision criteria and potential actions.

As an example, [this paper](https://www.ilo.org/empent/areas/social-finance/publications/WCMS_858641/lang--en/index.htm) discusses the responsibility of financial sector actors in eliminating child labour in the cocoa supply chain in Côte d’Ivoire and related actions they can take. The study concludes that banks providing trade finance to cocoa transactions are likely to contribute to cocoa being produced with child labour, and they possess leverage to improve the situation. It is important to note that leverage differs greatly depending on the type and size of the investors/investee, relative size of the investment, sector and region of operation as well as asset class and type of investment.

*11. Is the role of consultation with stakeholders, such as the local communities, women and Indigenous peoples, the same for an ESG approach and an approach set out by the UNGPs and, if not, in what way do they differ? What expectations and/or challenges do investors face in undertaking meaningful stakeholder consultation?*

The investors are often removed further away from the stakeholders of a project or a company. In many jurisdictions investors are not perceived as a partner for consultation by the stakeholders themselves and their grievance mechanisms of are not perceived to be suited (or are unknown) for reporting the grievances of stakeholders.

**Good practices**

*1. Please provide examples of any good practices, tools, guidance, policies, etc., regarding the integration of the responsibility to respect human rights by investors, including examples of investors actively preventing or mitigating (including by using leverage or undertaking a responsible exit) any adverse human rights and environment impacts of the businesses in which they invest.*

The ILO has developed a [Just Transition Finance Tool](https://www.ilo.org/empent/areas/social-finance/publications/WCMS_860182/lang--en/index.htm), which provides investors on guidance on how to integrate just transition considerations in banking and investment activities. The tool includes examples of good practices in different stages of the investment cycle.

The Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration) is the ILO normative framework to guide businesses on how to contribute positively to economic and social development. The MNE Declaration includes specific provisions on the role businesses can play in upholding and respecting labour rights throughout their operations as well as in their supply chains.