**Submission to the UN Working Group on Business and Human Rights for its report on Investors, Environmental, Social and Governance and Human Rights**

**South Centre**

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The increase in adoption of Environmental, Social and Governance (ESG) reporting by corporations has been driven in part by the growing ‘business case’ for human rights, which emphasises how respecting and promoting human rights in the business operations and throughout the supply chains can promote the respect for human rights and also benefit the reporting corporations. Nonetheless, there are still many steps that investors and companies need to take in order to align their business practices to the ‘social’ element of ESG. In particular, the existence of different reporting criteria used by ESG rating firms, responding to their own algorithms, metrics and definitions results in there being no common understanding of what is covered under ESG. Further, such criteria frequently seek to identify the risks that companies and investors might face from ESG issues, rather that assessing the risk and impacts of the company’s operations on the environment, society or human rights.

Several jurisdictions have adopted non-financial reporting standards that require companies to account for how they respond to environmental and social issues. These efforts come at a time where it is well recognized that ensuring business respect for human rights and interests of all stakeholders is an essential element for responsible business conduct.

At the same time, civil society organisations have increased their focus on corporate conduct that harms human rights, including through advocacy and litigation. These efforts have widened the use of the United Nations Guiding Principles on Business and Human Rights (UNGPs) at the regional and domestic levels[[1]](#footnote-1), as well as increased awareness on how investments can harm human rights[[2]](#footnote-2). Therefore, investors and consumers are increasingly demanding that businesses operate ethically and responsibly, which includes respecting human rights in all their operations including throughout their value chains.

This has led to an increase in ESG reporting[[3]](#footnote-3) by large transnational corporations and some other business enterprises in recent years. ESG issues are also finding more space in the decision-making and business practices of investors, such as large private venture funds, asset managers, sovereign wealth funds etc. These may be present in the form of standalone ESG policies, or as part of the larger ‘sustainability’ or responsible sourcing initiatives of firms. However, such efforts are not intrinsically designed to increase the company’s human rights disclosures or implementation of the UNGPs.

**Defining ESG Investing**

ESG investing in recent years has shown a greater focus on the human rights and climate impacts of business conduct. The use of ESG has been portrayed as a business response to consider the interests of various stakeholders, including employees, communities, and society at large in business decisions.[[4]](#footnote-4) For companies, using ESG has the potential to reduce risks, enhance reputation and ensure better equity returns, especially for publicly listed and traded companies. For instance, it has been reported that the number of exchange-traded funds (ETFs) carrying an ESG label more than doubled since the onset of the COVID-19 pandemic, reaching almost 1,300 at the end of 2022.[[5]](#footnote-5)

Nevertheless, when discussing about ESG, there is a need to differentiate ESG investing from ESG reporting, as the policies applicable to them, as well as the objectives they pursue differ considerably. ESG investing considers the set of standards and principles applicable to a company, which are used by investors to screen impact of their potential investments. It serves as a tool for reducing investors’ risk from investments in companies operating in sensitive locations or sectors, or those with a track record of dubious or unethical conduct. While some investors pursue investments only if they lead to better ESG-related outcomes, others understand it in terms of a company’s exposure to financially material environmental, societal and governance risks. However, neither of these consider the existing responsibilities of businesses to prevent, mitigate and remedy human rights violations in the conduct of their business activities and relationships.

On the other hand, ESG reporting is based on the set of criteria and metrics used by companies for evaluating their vulnerability to ESG risks[[6]](#footnote-6). Some reporting criteria developed by ESG rating agencies might also allow for comparison with the company’s competitors.[[7]](#footnote-7) These methodologies can help firms to gain exposure in ESG markets, better position themselves as being environmentally or socially ‘conscious’ and benefit from special funds targeted towards attaining social or environmental objectives. For example, research suggests that there is a strong demand for ESG investments, with so-called “‘sustainable’ funds globally attracting net inflows of $49 billion in the first half of this year, while the rest of the fund industry saw outflows of $9 billion”[[8]](#footnote-8). In rare instances, investors have even pulled out their investment from companies that failed to meet or had insufficient ESG targets[[9]](#footnote-9).

**Public and Private Practices on ESG**

ESG reporting methodologies have also come to the attention of some regulatory authorities. For example, the EU is now considering a ban on sweeping environmental claims such as the use of “climate neutral” or “eco” labels unless companies can prove that the claim is accurate[[10]](#footnote-10). The U.S. Securities and Exchange Commission has also sought to take action against ESG-related misconduct and “greenwashing” by firms, bringing enforcement actions and levying fines[[11]](#footnote-11). In addition, there are concerns on how measuring the achievement of ESG targets is turning into a ‘box-ticking’ exercise, without sufficient or independent verification of the claims being made by the businesses[[12]](#footnote-12). This effectively results in undermining the value of ESG disclosures, while maintaining a semblance of transparency for investors and customers.

While some countries have established frameworks that require investors and corporations to respect human rights as part of their business operations and have mandatory human rights due diligence requirements[[13]](#footnote-13), the vast majority of these are still voluntary and non-binding in nature. Many such frameworks are also in the form of corporate social responsibility (CSR) requirements, which can intersect and complement ESG reporting, while still falling short of the threshold for protection and promotion of human rights, including for providing access to remedies to victims of human rights violations.

Several developing countries have been taking initiatives to include ESG reporting for listed and public traded companies operating within their territories, which are largely in the form of requiring reporting of non-financial data. Some regulatory bodies for stock exchanges have taken the lead in this effort.

The Brazilian Securities and Exchange Commission (CVM) has introduced regulations related to ESG reporting for publicly traded companies. The ESG information disclosure criteria spelled out in its Resolution No. 59 (RCVM 59)[[14]](#footnote-14) includes the requirement for the business to indicate “whether the report or document considers UN Sustainable Development Goals (SDGs) and what are the material SDGs for the issuer’s business”[[15]](#footnote-15). It also touches upon climate issues, asking whether the business carries out greenhouse gas emission inventories, and indicating the scope of any such inventoried emissions.

India’s Securities and Exchange Board (SEBI) has introduced regulations that require the top 1,000 listed companies to disclose their business responsibility reports, which include information on ESG aspects. This ‘Business Responsibility and Sustainability Report’ (BRSR) covers several important attributes of the business enterprise such as its greenhouse gas footprint, total water and energy consumption, waste management, employee well-being and safety, gender diversity among others[[16]](#footnote-16).

The Securities Commission of Malaysia has recently revised its Guidelines on Sustainable and Responsible Investment Funds[[17]](#footnote-17) which set out the reporting and disclosure requirements for a fund to qualify as a Sustainable and Responsible Investment Fund[[18]](#footnote-18). It has also come out with a Principles-Based Sustainable and Responsible Investment Taxonomy for the Malaysian Capital Market, which “aims to give clarity towards enabling proper and consistent identification and classification of various types of economic activities as well as the definition of sustainable investments. It also seeks to address concerns on the need to mitigate and manage the risks of greenwashing”[[19]](#footnote-19).

Similarly, the Financial Superintendence of Colombia has “issued requirements for integrating ESG and climate risks in the investment policy and governance arrangements of pension funds and insurance companies. It has also increased disclosure requirements for funds with ESG, sustainability and/or green claims, set ESG and climate risk reporting requirements for listed companies and published supervisory expectations on climate risk management for banks”[[20]](#footnote-20). Similarly, the Colombian Green Taxonomy, launched on 11 April 2022, is a “classification of environmentally sustainable economic activities and assets that will serve as guideline for green financing and will help align the private sector with the national objectives and international environmental commitments”[[21]](#footnote-21).

In Chile, the Chilean Commission for the Financial Market (*Comisión para el Mercado Financiero*, CMF) issued General Rule No. 461, which includes the ESG related information that must be disclosed in the end-of-year reports of the supervised entities. It requires them to disclose strategic commitments adopted in furtherance of the SDGs or other similar initiatives”[[22]](#footnote-22).

There has also been an uptick in the adoption of ESG reporting requirements in financial markets across the African continent[[23]](#footnote-23). For example, the Johannesburg Stock Exchange has developed a Sustainability Disclosure Guidance and a Climate Change Disclosure Guidance, which are “aligned with, and draw on the most influential global initiatives on sustainability and climate change disclosure”[[24]](#footnote-24).

**Challenges and Weaknesses of ESG reporting**

While the efforts mentioned above could support transparency and uniformity in ESG disclosures by businesses, ESG reporting currently faces several challenges and weaknesses. The public disclosure requirements as part of non-financial reporting is limited to publicly listed companies, which curtails their effectiveness in promoting a single standard for all businesses to follow. Similarly, the ESG designation is normally self-attributed by firms disclosing their reports, or by private firms specialised in providing ESG ratings. Currently, there are no specialized metrics on measuring companies’ impacts on social aspects, including human rights. The diversity of populations and unique societal contexts relevant to businesses also raise concerns when focusing on a single ‘social’ metric. Therefore, ESG alone is an insufficient tool to understand, measure or mitigate the human rights and other impacts of business activities, especially regarding the impacts on the most vulnerable peoples and communities in developing countries.

Similarly, the use of multiple methodologies and the lack of a universal ‘taxonomy’ on ESG, raise concerns about the divergences in the interpretation of ESG disclosures by private firms[[25]](#footnote-25). These divergences and the lack of clear standards allow companies to indulge in ‘green-, blue- or pink-washing’[[26]](#footnote-26), which can mislead the public and their stakeholders into believing that the business is doing something to protect the environment, respond to climate change challenges or respect human rights[[27]](#footnote-27). For example, some corporations have made claims about becoming ‘carbon-neutral’ despite having no credible evidence for the same[[28]](#footnote-28). This has already triggered lawsuits against such firms for false and misleading advertising[[29]](#footnote-29). Likewise, even in cases where ‘clearer’ criteria exist, such as for measuring the carbon footprint of companies, rating firms can decide to not consider greenhouse emissions of a company to allow their ESG rating to be upgraded.[[30]](#footnote-30)

Given that ESG ratings are commercial products of private rating firms, these scores can be freely adjusted to be showcased to investors and customers and respond to their needs[[31]](#footnote-31), rather than requiring companies to change their behaviour and integrate responsible business practices in their operations and corporate culture. In addition, research has shown that current methodologies used for ‘social’ scoring by rating agencies include limited or no indicators on human rights.[[32]](#footnote-32) The fact that existing human rights principles and standards applicable to businesses’ operations are not directly included in ESG ratings marginalizes the importance of human rights in the social aspect of ESG, and ignores the basic responsibility of corporations to respect human rights, including their duty to establish due diligence processes to identify, prevent, mitigate and account for human rights violations and impacts in their activities.

The objectives and nature of ESG reporting demonstrate that these alone are insufficient to identify, mitigate and account for the human rights impacts of business activities. Indeed, if ESG reporting were extended to all businesses and not limited to large corporations, there will be a need to take into account the proportionality of the impacts and relevant capacities of small and medium sized enterprises in developing countries, which may not have the necessary resources or expertise available to fulfil such reporting requirements.

**Recommendations**

Although ESG ratings can be a tool to support business’ efforts towards identifying and responding to risk, multilateral, regional and intergovernmental organizations should support developing countries in establishing their own legal and policy frameworks to regulate business enterprises at the national level and ensure that they respect human rights in all their operations and throughout their supply chains. Embedding mandatory human rights due diligence (mHRDD) will be important to support countries efforts to uphold human rights and achieve the SDGs. States can encourage and require businesses, including foreign investors, to comply with their human rights responsibilities through various means, including standards set in National Action Plans, domestic legislation and international agreements.

The adoption of human rights due diligence requirements at national, regional and international levels can help prevent and mitigate the negative effects of business operations on human rights and provide access to effective remedy. Embedding these practices in business operations can also allow for better monitoring and reporting of their effectiveness. The potential of mHRDD legislation to strengthen the prevention of human rights violations, while also addressing remediation after the occurrence of harm through State-based mechanisms, could be facilitated through the establishment of international standards on this matter.[[33]](#footnote-33)

Similarly, adopting responsible investment standards, such as the need to balance the rights and obligations of foreign investors and respect the right of States to regulate in their public interest, are essential for achieving the SDGs and the realization of human rights, and should be included in the international investment policies and agreements. Special attention should be paid to the recently adopted Protocol on Investment to the African Continental Free Trade Agreement (AfCFTA)[[34]](#footnote-34), which in Chapter 5 includes binding obligations for foreign investors. Particularly, Article 33 on Business Ethics, Human Rights and Labour Standards requires investors and their investments to comply with high standards of business ethics, investment-related human rights and labour standards; Article 34 lays out an obligation to respect and protect the environment, in accordance with the human right to a clean, healthy and sustainable environment. Further, Article 38 on Corporate Social Responsibility requires investors to endeavour to achieve the highest possible level of contribution to the sustainable development of the Host State and the local community through the adoption of a high degree of socially responsible practices; and Article 39 on Corporate Governance requires investors to meet national, regional and internationally accepted standards of corporate governance, in particular in respect of transparency and accounting. This Protocol can be a standard setter for investment agreements and a model for other countries seeking to strengthen ESG and human rights requirements for foreign investors.

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