A powerful and balanced voice for business

IOE input to the Report of the UNWG on Business and Human Rights

"Development Finance Institutions and Human Rights"

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INTRODUCTION

Over the past decade, the broad institutional uptake of human rights due diligence by various actors ranging from companies themselves but extending to business and industry platforms, investors, States, and multilateral lenders has contributed to fulfilling one of the central objectives of the United Nations Guiding Principles on Business and Human Rights (UNGPs) by fostering convergence among the many different institutions that shape business conduct. Among these organisations, financial actors are important intermediaries at the heart of wealth and credit creation by mobilising savings for lending to businesses and individuals. This allows the private sector and the economy to create jobs, foster innovation and increase living standards.

Human rights are the foundation for sustainable investment and address the Environmental, Social and Governance (ESG) functions. Over the past years, due diligence has entered financial regulation, for example, in the European Union taxonomy and sustainable finance regulation. The UN Working Group on the issue of human rights and transnational corporations and other business enterprises recognised that "*financial actors have an unparalleled ability to influence companies and scale up on the implementation of the Guiding Principles*". This has led to the creation and diffusion of positive spillover effects in the private sector and society.

As part of this broad category of financial actors, **Development Finance Institutions (DFIs)** can play an important and positive role in advancing human rights and responsible business conduct. In particular, DFIs that have performance standards, such as the International Finance Corporation's Environmental and Social Performance Standards (IFC's performance standards), that companies can adopt represent an important tool for the private sector. DFIs are often set up to support economic growth, job creation, and poverty reduction, particularly in developing countries. They can provide funding for infrastructure projects, micro, small and medium-sized enterprises (MSMEs), and other initiatives that may have difficulty accessing financing from traditional lenders. DFIs may also offer technical assistance and other forms of support to help promote development.

The private sector is fully aware of its role as the **positive transformative power** of change. However, the private sector cannot do it all alone. States, public and international financial actors are key in supporting alignment and preparing investors for relevant due diligence regulations. These are also key actors in providing an enabling environment for sustainable business, economic growth and sustainable development. These actors should do so by considering the critical need for businesses to access finance and clear and practical guidance to implement effectively. The UNGPs have been used in responsible investment for years, but only by a subset of investors. A level playing field for responsible investment is emerging thanks to the UNGPs, but this requires a stronger commitment by States.

Against this backdrop, the **International Organisations of Employers** (IOE) appreciates the opportunity to provide input for the Working Group's report to be presented to the Human Rights Council at its 53rd session in June 2023 on "Development Finance Institutions and Human Rights".

DFIs AND THE STATE DUTY TO PROTECT HUMAN RIGHTS

States individually are the primary duty-bearers under international human rights law, and collectively they are the trustees of the international human rights regime. They have a duty to respect, protect and fulfil human rights and fundamental freedoms. As part of their duty to protect and in line with UNGP 3, States should "*provide effective guidance to business enterprises on how to respect human rights throughout their operations*". Additionally, according to the commentary of UNGP 3, they should also provide "*Guidance to business enterprises on respecting human rights should indicate expected outcomes and help share best practices. It should advise on appropriate methods, including human rights due diligence, and how to consider effectively issues of gender, vulnerability and/or marginalization, recognizing the specific challenges that may be faced by indigenous peoples, women, national or ethnic minorities, religious and linguistic minorities, children, persons with disabilities, and migrant workers and their families*."

As part of Pillar I, the role of States in ensuring that international, regional, sub-regional and national Development Finance Institutions (DFIs) respect human rights and the environment is critical. Public DFIs, as well as private sector finance institutions that often co-finance with other commercial banks and investors, are central players in pushing forward the realisation of the UNGPs 10+ Roadmap for the next decade of business and human rights.,

To achieve this objective, **states are responsible for creating an enabling environment for DFIs to operate consistent with international human rights and environmental standards**. DFIs, particularly private ones, need to benefit from legal clarity, certainty, and clear guidelines to operate effectively and deliver the needed finance to the private sector. **In this regard, the State's duty to provide an enabling environment for DFIs** comes with the need for States to provide the following elements:

- Companies can be involved with DFIs in several ways, depending on the nature of the business and the objectives of the DFI. Regardless, **States are responsible for establishing clear, realistic, understandable and implementable regulatory frameworks** that support DFIs to respect human rights and environmental standards and to disclose information about the potential impacts of their activities when applicable. These frameworks must be realistic and implementable and provide legal clarity for DFIs and, most importantly, for companies involved either as end recipients or as part of co-investor or partnerships. Therefore, the business should be consulted when these frameworks are crafted to consider the challenges faced by the entities that will be using or subject to them. States should also consider companies' feedback to ensure that the regulatory frameworks remain relevant and fit for purpose.

- States also play an executive and Board role in most global DFIs. They should use their presence and convening power to encourage DFIs to use their access to authorities and neutrality to have **conversations with governments to improve their standards, including in law.** This could represent an effective leverage from DFIs to governments to improve the situation at the local level and to be in line with international labour standards, including setting a minimum wage, laws to protect workers and human rights due diligence, etc.

- As part State's support to pillar II, **States must provide these frameworks with capacity-building measures and technical assistance** to both DFIs, to enhance their ability to respect human rights and environmental standards and the end recipients of such funding, as companies, in particular MSMEs. This is of particular relevance when DFIs:
    - provide **co-investment opportunities** to companies, where they invest alongside private sector investors to support specific projects or initiatives. This can provide additional capital and expertise to support a project and help to diversify and manage risks. Additionally, when co-investing in a business project with business, DFI's should further **strengthen their due diligence efforts on their standards** (such as IFC) on Joint Venture partners/operators of the project. Often this can be an important leverage for all joint-venture partners to have the same human rights/environmental standards when implementing a project.
    - provide **technical assistance** to companies to help them to improve their operations and meet international standards. This can include assistance with environmental and social sustainability, human rights due diligence, financial management, and other areas.
    - work with companies to establish **partnerships to support specific initiatives**, such as sustainable supply chains, renewable energy projects, or social enterprise initiatives. This can help align business objectives with development goals and create new opportunities for the DFI and the company.

- As part of Pillar I and III, **States must establish effective complaint mechanisms** that allow individuals and communities affected by DFI activities to raise concerns and seek remedies for any harm caused. Unfortunately, **important root causes and challenges** in many countries prevent the establishment of effective complaint mechanisms in line with the UNGPs. There is a need to address root causes and overcome these challenges, such as lack of political will and good governance, high levels of corruption, weak rule of law and legal frameworks, lack of adequate resources and capacity, and lack of engagement with the private sector and civil society. In such situations, grievance mechanisms operated by private DFIs and companies can represent an important tool to advance human rights. However, they cannot replace the need for access to effective remedies from national judicial authorities.

- When it comes to DFIs, **States may have conflicting priorities**, such as the need for economic development, that can make it difficult to prioritise human rights and environmental concerns. Although the need for economic development is critical for certain countries, States should not disregard their duty to protect human rights. Against this backdrop, a constructive dialogue and consultation process which place at its centre social partners and that also involves other stakeholders, including DFIs, private businesses, investors, and civil society, to discuss potential human rights impacts of development financing practices and identify ways to prevent and address such impacts is critical.

- States can lead in **facilitating constructive dialogue and consultation via multi-stakeholder Initiatives** that bring together DFIs, private businesses, investors, civil society, rights-holders, and trade unions to address the human rights impacts of development financing practices collectively.

Partnerships with the private sector are particularly critical given that business is on the frontline in terms of supply chains and consumers and communities.

Recommendations

There are several steps that states can take to help companies, particularly micro, small and medium-sized enterprises (MSMEs) to benefit from Development Finance Institutions (DFIs):

1. **Create an enabling environment:** States can create a conducive environment for investment and business growth by streamlining regulations, reducing administrative burdens, providing fiscal incentives, and improving the overall business environment. This can help attract more investment from DFIs and other sources, benefiting MSMEs.

2. **Increase access to finance:** States can help MSMEs gain access to finance by establishing credit guarantee schemes, providing financial education and literacy, and promoting financial inclusion through digital technologies. This can help MSMEs become more bankable and eligible for funding from DFIs.

3. **Target-specific sectors:** States can identify priority sectors likely to have a high impact on economic growth and job creation and work with DFIs to provide targeted financing and support to MSMEs in those sectors. This can help create a more focused approach to investment and ensure that limited resources are used effectively.

4. **Support capacity building:** States can provide support to companies, in particular MSMEs, to help them build their capacity in areas such as business planning, marketing, and financial management. This can help MSMEs become more attractive to DFIs and other investors and improve their chances of success. States can also provide critical guidance to companies to help them understand, respect and implement international and local human rights frameworks on business and human rights, particularly in countries where these have limited capacity to do so.

5. **Foster consultation and encourage collaboration**: States should foster continuous dialogue with social partners and other relevant stakeholders to encourage collaboration between DFIs, other investors, and companies to help build networks and share knowledge and resources. This can help create a more supportive ecosystem for companies to advance human rights and foster economic development.

DFIs AND THE RESPONSIBILITY TO RESPECT HUMAN RIGHTS

DFIs can include both **public DFIs** as well as private sector financial institutions that often co-finance with other commercial banks and investors. When it comes to public DFIs, these are typically created and owned by governments or public entities with a mandate to provide financing and support for development projects. As such, they fall under the scope of Pillar I; therefore, any potential human rights abuse by the public DFI may violate the State’s international law obligations. Regarding **private DFIs**, they have, as any other enterprise, a corporate responsibility to respect human rights.

DFIs may impose human rights requirements on companies as a condition of financing, but the extent to which they do so can vary depending on the DFI and the specific project or investment. Many DFIs have environmental and social (E&S) standards or policies that set out requirements for clients to manage potential adverse impacts on human rights and the environment. These policies often require clients to conduct environmental, social and health impact assessments (EISHA), engage and consult with local communities and stakeholders, and implement measures to avoid, mitigate, or compensate for negative impacts.

However, the extent to which DFIs require clients to comply with human rights standards can be limited by a range of factors, including the legal and regulatory frameworks in the countries where the projects are located, the level of capacity and resources of the clients, and the political and economic context of the project. **This is why the need to have an enabling environment for DFIs and companies, including clear legal frameworks provided by States, is of paramount importance. This should be accompanied by capacity-building and technical assistance**. For example, the IFC provides advisory services and capacity building to help clients improve their environmental and social management systems and meet the requirements of the IFC's Sustainability Framework. Similarly, the German Development Finance Institution (DEG) offers technical assistance and training to clients to help them develop sustainable business practices and comply with environmental and social standards. These practices should be mainstreamed and incorporated into the UNGPs.

Yet, although these requirements are important tools to promote responsible business conduct, they do however **carry different risks:**

- For development finance, IFC’s performance standards represent an important tool for companies. For example, IFC standards relate to EISHA and land and resettlement, Indigenous Peoples and Cultural Heritage. They give more concrete details on implementation but also on the need and condition to disclose more information, such as EISHA’s and Resettlement Action plans and higher levels of consultation. For this purpose, it is **important not to create new standards but to use the IFC standards as they are already being implemented**. Although they serve different purposes and are designed to be used in different contexts, there is some **overlap** between these and the UNGPs. Although the IFC Performance Standards are more granular and provide more detailed guidance on specific issues, these represent an additional layer of complexity and reporting in addition to the many other reporting requirements for many companies. These e**xtensive and complex requirements carry the risk of excluding many MSMEs,** which have an important need for financing. **To avoid overlap, there is a need for greater coherence between the UNGPs, the IFC’s standards and other DFIs requirements**.

- Linked to this challenge, many DFIs include Environmental, Social, and Governance (ESG) criteria in their investment decision-making process. In recent years, there has been a growing recognition among DFIs that ESG considerations are critical to the long-term success of their investments. Yet, an **important challenge for companies** includes the growing request for them to report on a quarterly basis which makes it challenging for companies to have the time to develop sustainability strategies. Another critical challenge for companies is **data providers' lack of coherence among ESG metrics**. Because of a lack of clarity and coherence about social criteria metrics and many environmental and governance indicators, companies cannot effectively capture and reflect via ESG metrics their extensive effort in respecting and promoting human rights. Similarly, most financial actors fail to **connect human rights standards and processes with ESG criteria and investment**

practices due to a lack of understanding of social indicators, which include human rights. This problem is not new. There are currently over 600 ESG provisions globally, and this lack of standardisation and interoperability marks a significant challenge for financial institutions and businesses looking for investment. Similarly, there continues to be an inconsistent integration of the UNGPs across various reporting frameworks, benchmarks and other data and research products used by investors to assess companies. Without **harmonised ESG metrics, companies must navigate alone without support in the complex reporting environment.** Lastly, MSMEs are often not equipped nor have the resources to comply with the extensive requirements requested to benefit from DFIs. Consequently, the current extensive requirements from DFIs and financial actors on companies can potentially create **unintended negative consequences**. **There is a need for greater coherence and alignment of DFIs and ESG benchmarks, data providers and reporting frameworks with the UNGPs to reach the potential of investment institutions and leverage better human rights performance by companies.**

- A major issue for business remains on **how to engage with the finance sector without losing access to financing due to perceived potential human rights risks**. Access to credit remains one of the main challenges for MSMEs. **Discrimination in lending practices**, particularly to entrepreneurs, can also have significant consequences and represent a human rights violation as entire lending institutions may deny customers access to finance based on race, religion, or gender. DFIs and the finance sector can sometimes face difficulties in providing credit, which is essential for companies, notably MSMEs, to launch businesses, grow and thrive, and create wealth and employment. This holds particularly regarding **investment in important regional DFI infrastructure projects** (e.g., power stations, hydroelectric dams, etc.). Companies often face **challenging situations regarding the final State's decision to act**. This can put companies and financial actors in complex situations of trade-offs which should ultimately rest on governments' decisions, not businesses. In particular, when companies have duly completed their Human Rights Impact Assessment (HRIA) and due diligence process, but different interests are at stake, the ultimate decision and trade-off rest on the government, not on the financial company. Consequently, financial companies should not refuse loans to companies when the government have thoroughly decided to act in a certain way, and neither should they be blamed or suffer reputational and other damages to follow the government's legitim decision.

- **Access to finance for the informal sector remains out of the debate**. Businesses operating in the informal economy cannot apply for loans or credit as they do not exist officially. DFIs have not yet developed policies and frameworks for the informal sector. Financial actors such as DFIs can be key drivers for advancing business respect for human rights through funding and loaning opportunities for SMEs. However, for this to happen, there is a need for **an enabling environment for business as well as a transition from informality to formality**. Unless States do not effectively address the root causes of informality and weak governance, it remains extremely difficult to tackle informality and ultimately uphold human rights worldwide.

- Lastly, several challenges can arise from DFIs **disclosure requirements**. These challenges can include the following:

    - **Disclosure overload**: DFIs can require a significant amount of information from the entities that they finance, including financial information, environmental, social and health impact assessments, and other types of data. For multinational companies, disclosure requirements can, when well-crafted to consider business realities, provide better transparency on the management of impacts and proper consultation with impacted communities. However, these can be overwhelming for some companies, particularly smaller businesses that may not have the resources to generate the required information.

- **Compliance costs**: Meeting DFIs disclosure requirements can be expensive for businesses, particularly for smaller entities that may need to hire consultants or other experts to help them comply with the requirements. This can be a barrier to accessing finance from DFIs for some businesses, particularly those operating in sectors with thin margins.
- **Inconsistent requirements**: DFIs can have different disclosure requirements, creating inconsistencies in reporting for companies that receive financing from multiple DFIs. This can be confusing for businesses and can increase compliance costs.
- **Confidentiality concerns**: Some companies may be reluctant to disclose certain information, particularly if it is sensitive or proprietary. This can be a particular concern for smaller businesses that may feel that they are at a competitive disadvantage if they disclose too much information.
- **Lack of clarity on the use of disclosed information**: Some businesses may be concerned about how DFIs will use the information that is disclosed. There may be concerns about the use of the information by competitors or other third parties or about how the information will be used to inform the DFIs' investment decisions.

Recommendations

DFIs can take several actions better to support businesses, including multinational companies and MSMEs. In particular, they should:

1. **Increase access to finance**: DFIs can provide financial resources and support to businesses that may have difficulty accessing funding from commercial banks or other financial institutions. This can include financing for working capital, capital expenditures, and expansion projects. In addition, once lending is provided – DFI's need to do **better assurance on the project/business,** including all partners, particularly governments, to adhere to their standards.

2. **Provide technical assistance and advisory services**: DFIs can provide technical assistance and advisory services to help businesses improve their operational performance, adopt sustainable business practices, and manage risks. This can include assistance with governance, environmental and social management, and human rights due diligence. DFIs should also strengthen their assurance/due diligence in implementing their standards.

3. **Facilitate partnerships and collaborations:** DFIs can bring together different actors, including businesses, governments, civil society organisations, and investors, to collaborate and leverage each other's strengths to achieve shared goals. DFIs can play a role in fostering public-private partnerships and collaborations among businesses to address complex development challenges.

4. **Foster innovation and entrepreneurship**: DFIs can support innovation and entrepreneurship by providing seed funding, mentorship, and business incubation services to start-ups and emerging businesses. DFIs can help create an ecosystem that supports innovation and entrepreneurship, which can be critical to driving economic growth and creating jobs.

5. **Support capacity building**: DFIs can support capacity building among businesses, including MSMEs, by providing training and skill development opportunities. This can help businesses improve their management practices, adopt new technologies, and enhance competitiveness. Considering clients' capacity and resources, DFI needs to do better assurance/audits and advocacy/capacity building on their standards.

6. **Better integrating the UNGPs and the IFC Performance Standards** will require a multi-faceted approach that involves alignment of standards, enhanced due diligence, improved monitoring and reporting, stakeholder engagement, impact management, and capacity building. By integrating these frameworks fully, DFIs can better ensure that the investments they support align with international human rights standards and contribute to sustainable development.

7. Regarding **disclosure requirements**, DFIs should work to ensure that their disclosure requirements are clear, consistent, and proportionate to the size and complexity of the businesses they finance. DFIs can also work with businesses to ensure that the disclosure process is streamlined and efficient and can support and guide businesses on complying with the requirements. Finally, DFIs can work to ensure that the information that is disclosed is used appropriately and that there are appropriate safeguards in place to protect sensitive or proprietary information.

DFIS' AND ACCESS TO REMEDY

Many DFIs have established operational-level grievance mechanisms to address human rights concerns related to their investments. Examples of DFIs that have established operational-level grievance mechanisms include the World Bank Group, the Inter-American Development Bank, the European Bank for Reconstruction and Development, and the Asian Development Bank, among others.

Many companies have established operational-level grievance mechanisms in the framework of DFIs to address human rights concerns related to their investments. These mechanisms are designed to provide affected communities or individuals with a means to raise concerns or complaints related to the social and environmental impacts of the company's activities. Companies with established operational-level grievance mechanisms can be found on the IFC PROJECT INFORMATION & DATA PORTAL. These companies have established grievance mechanisms to address concerns related to issues such as land rights, water usage, labour rights, and environmental impacts.

A major challenge observed in ensuring access to effective remedy in the context of DFI-funded projects is the **lack of an effective judicial system and the associated barriers linked to a failure of the state's duty to protect and provide effective remedy**. In many countries, a primary difficulty is accessing justice due to a lack of trust and confidence in the judiciary system from both sides. Practical and procedural barriers, such as overcoming bureaucratic obstacles indiscriminately, affects both the plaintiff and the defendant.

Through advocacy support and its active engagement in endorsing, promoting and disseminating among its members and networks the UN Guiding Principles on Business and Human Rights (UNGPs), as well as other government-backed instruments on responsible business conduct, IOE will actively continue to provide the vital to advance the Business and Human Rights and Responsible Business Conduct agenda.

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