LSFI
Luxembourg Sustainable Finance Initiative

How to Integrate Human Rights Into Investment Decisions

Summary Report from the Masterclass 'Human Rights Integration into Investment Decisions', delivered at the LSFI Summit 2024.

October 2024

Executive Summary

This report summarises the key takeaways of the Masterclass 'How to Integrate Human Rights into Investment Decisions', delivered on October 18, 2024 at the LSFI Summit.

This masterclass brought together experts from various organisations to guide financial professionals in embedding human rights considerations into their investment processes. This summary report introduces key frameworks, standards, and best practices for responsible business conduct (RBC) and human rights due diligence, such as the OECD Guidelines for Multinational Enterprises and the OECD Due Diligence Guidance for Responsible Business Conduct. It also includes case studies of how asset managers and banks integrate human rights into investment decisions.

Disclaimer

The practical insights this report shares aim to provide an initial roadmap for financial professionals to navigate the complex landscape of human rights due diligence and responsible investment. However, this report is not intended to be comprehensive or be used as financial or business advice by the reader.

The report has been produced by the LSFI for information purposes only.

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1. About Human Rights

Human rights are the fundamental rights and freedoms that every individual is entitled to simply by being human. These universal rights are inherent to us all, regardless of nationality, sex, national or ethnic origin, color, religion, language, or any other status. They range from the most fundamental - the right to life - to those that make life worth living, such as the rights to food, education, work, health, and liberty[1].

These rights are characterised by their universality, inalienability, and indivisibility, meaning they apply to all individuals regardless of context, cannot be taken away, and all rights are equally important.

The Universal Declaration of Human Rights (UDHR)[2], adopted by the UN General Assembly in 1948, was the first legal document to set out the fundamental human rights to be universally protected. The UDHR consists of 30 articles that outline civil, political, economic, social, and cultural rights and is recognised as the most translated document globally.

Building on the UDHR, the International Covenant on Civil and Political Rights (ICCPR)[3] and the International Covenant on Economic, Social and Cultural Rights (ICESCR)[4], adopted in 1966, further extended human rights protections. Together with the UDHR, these treaties form what is known as the International Bill of Human Rights.

Human rights protection have since evolved, with multiple international, regional, and national frameworks expanding the scope. In Europe, the European Convention on Human Rights (ECHR) was a significant milestone, enforcing these protections. The impact of the ECHR is profound, as it compels States to provide remedies and reforms to prevent future human rights violations.

Human rights are also closely intertwined with the Sustainable Development Goals (SDGs)[5], recognising that addressing issues such as poverty, inequality, and environmental degradation requires a strong human rights foundation. Businesses, particularly financial institutions, are integral to this process by ensuring their operations and investments align with both human rights and sustainability goals.

2. Standards, Frameworks and Regulation for Integrating Human Rights into Business and Investment Decisions

As corporations, including financial institutions, have grown in influence, their responsibility to respect human rights has come to the forefront of global discussions. The intersection between business and human rights concerns how businesses impact human rights and how to prevent businesses from causing harm to people. The relation and impact of these are multi-dimensional and context-dependent, varying depending on the type of industry and business as well as the county and local context.

Several standards, frameworks and regulations have been developed to guide companies and financial institutions in incorporating human rights into their investment decisions. These frameworks offer comprehensive guidelines for due diligence and responsible business conduct. The following key frameworks were discussed in the masterclass.

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[1] https://www.ohchr.org/en/what-are-human-rights
[2] https://www.un.org/en/about-us/universal-declaration-of-human-rights
[3] https://www.ohchr.org/en/instruments-mechanisms/instruments/international-covenant-civil-and-political-rights
[4] https://www.ohchr.org/en/instruments-mechanisms/instruments/international-covenant-economic-social-and-cultural-rights
[5] https://sdgs.un.org/goals

The United Nations Guiding Principles on Business and Human Rights

In 2011, the United Nations Human Rights Council unanimously endorsed the UN Guiding Principles on Business and Human Rights (UNGPs)[6]. The UNGPs are the world's most authoritative, normative framework guiding responsible business conduct and addressing human rights abuses in business operations and global supply chains. It builts across 3 pillars:

- Pillar 1, specifies the State's duty to protect human rights in the context of business operations.
- Pillar 2, outlines how businesses can identify their negative human rights impact and demonstrate that they have adequate policies and procedures to address them.
- Pillar 3, stipulates that when a right is violated, victims must have access to effective remedies which are legitimate, accessible, predictable, equitable, transparent and rights compatible.

The OECD Guidelines for Multinational Enterprises on Responsible Business Conduct

The OECD Guidelines for Multinational Enterprises (MNEs) on Responsible Business Conduct (RBC)[7] provide recommendations for businesses to align their activities with sustainable development and conduct due diligence to avoid adverse impacts on people, the planet, and society. The guidelines are adhered to by 51 governments and are supported by a network of OECD National Contact Points (NCPs), which have handled over the years more than 700 cases in 110 countries. A growing number of OECD countries also have regulations requiring sustainability due diligence in the supply chain, reflecting a strong alignment with the OECD's framework.

Likewise, the OECD Guidelines for MNEs on RBC highlight the importance of responsible business conduct (RBC), with financial institutions (FIs) playing a key role in supporting and enforcing these principles. They call on FIs to conduct thorough due diligence to prevent human rights violations in their investments. This responsibility extends beyond compliance with national laws to encompass all internationally recognised human rights standards.

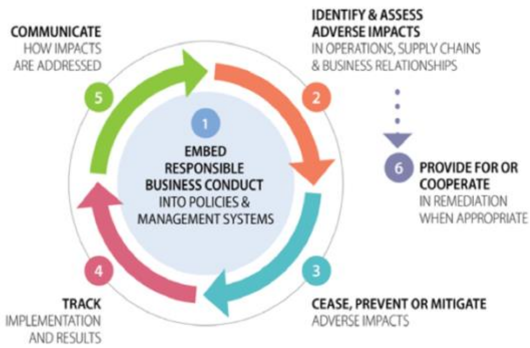
OECD Due Diligence Guidance for Responsible Business Conduct

The OECD Due Diligence Guidance for Responsible Business Conduct (RBC)[8] provides practical support to enterprises on the implementation of the OECD Guidelines for MNEs by including cross-cutting due diligence actions and characteristics that are applicable across companies and sectors. Implementing these recommendations can help enterprises, including FIs, avoid and address adverse impacts related to workers, human rights, the environment, bribery, consumers and corporate governance that may be associated with their operations, supply chains and other business relationships. The Guidance includes additional explanations, tips and illustrative examples of due diligence.

Did you know?
Due diligence is the process by which enterprises should identify, prioritise, prevent, mitigate and account for how they address adverse impacts on people and planet.

[6] https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf
[7] https://www.oecd.org/en/publications/oecd-guidelines-for-multinational-enterprises-on-responsible-business-conduct_81f92357-en.html
[8] https://mneguidelines.oecd.org/due-diligence-guidance-for-responsible-business-conduct.htm

The guideline outlines a six-step approach to due diligence, as per the image below.



Source: https://mneguidelines.oecd.org/due-diligence-guidance-for-responsible-business-conduct.htm

More in detail, some of these steps include:

- **Identification and assessment of adverse impacts:** a risk-based approach is essential for identifying potential risks. This process can build on existing risk screening methods, aiming to bridge any information gaps while enhancing the quality and availability of relevant data. By applying this, organisations can more effectively identify and assess potential risks.
- **Cease, Prevent, or Mitigate adverse impacts actions:** this should be prioritised based on the risk-based approach mentioned before, although other criteria may also be relevant. Existing stewardship activities should be leveraged to drive meaningful change while recognising that there may be limitations in the influence exerted over clients. Divestment should only be considered as a last resort. Engaging with clients is a critical component, as it helps develop action plans to remedy identified impacts. This process may involve collaboration, connecting clients with resources, or, when necessary, terminating or suspending relationships if clients fail to take corrective action.
- **Provide for or Cooperate in Remediation:** this can be achieved by ensuring grievance mechanisms are in place. These mechanisms enable FIs to address adverse impacts through remediation efforts, whether by encouraging clients to engage in human rights processes or embedding remediation expectations in financing agreements.
- **Effective Communication:** this is vital, including public reporting on FIs RBC policies and their implementation. Reports should highlight significant risks, adverse impacts, and the criteria used for prioritisation at the portfolio or business area level. For example, for high-risk projects or assets, FIs must share their efforts to prevent and mitigate adverse impacts, including the outcomes of those efforts. The report should also include future RBC plans, targets, and any exclusionary policies based on RBC considerations.

OECD sector-specific Due Diligence Guidelines

In addition, the OECD has developed sector-specific due diligence guidelines, such as those for investors & asset managers and banks. While the steps to be followed are similar, actions are tailored within each guideline following the sectors' needs and specificities, to ensure due diligence is effective.

For instance, due diligence with respect to investors includes:

- Embedding RBC into relevant policies and management systems for investors.
- Identifying actual and potential adverse impacts within investment portfolios and potential investments.
- Using leverage to influence investee companies causing an adverse impact to prevent or mitigate that impact.
- Accounting for how adverse impacts are addressed, by (a) tracking performance of the investor's own performance in managing RBC risks and impacts in its portfolio and (b) communicating results.
- Having processes in place to enable remediation in instances where an investor has caused or contributed to an adverse impact.

In the case of banks, among others, some actions to follow are:

- Adopting a policy which includes a commitment by the bank to observe relevant principles and standards on RBC issues.
- Identifying and assigning roles to relevant business units for carrying out steps of the due diligence process.
- Identifying and assessing the most significant areas of RBC risk across client portfolios based on information provided by clients and independent research.
- Drawing from the findings of risk identification to strengthen management systems to better track information and flag risks, before adverse impacts occur.
- Tracking clients' implementation of RBC commitments.

The reader can find additional information on the steps in the OECD Due Diligence Guidance for Responsible Business Conduct for Institutional Investors[9] and the Due Diligence for Responsible Corporate Lending and Securities Underwriting[10].

Regulatory framework

Jurisdictions across the globe are also developing regulatory frameworks on sustainable finance that include the integration of human rights into investment decision in convergence with existing international standards and frameworks. In the case of the European Union, the following regulatory pieces include human right integration within their requirements[11]:

- **Sustainable Finance Disclosure Regulation (SFDR):** The SFDR regulation requires financial market participants to report on Principle Adverse Impacts (PAIs), which include human rights violations. Financial institutions must ensure their investments do not contribute to human rights abuses and disclose their processes for ensuring compliance with the OECD Guidelines.

- **Corporate Sustainability Reporting Directive (CSRD):** The CSRD requires detailed reporting on company's human rights due diligence processes, particularly how these processes inform the assessment of material risks. Financial institutions must disclose how they integrate these practices into their decision-making and engagement with investee companies.

- **Taxonomy Regulation:** The Taxonomy sets out minimum social safeguards to prevent activities and investments from being regarded as "sustainable" if they do not align with

[9] https://mneguidelines.oecd.org/rbc-financial-sector.htm
[10] https://mneguidelines.oecd.org/rbc-financial-sector.htm
[11] https://lsfi.lu/eu-sustainable-finance-regulation/

minimum standards for RBC, including the OECD Guidelines, and requires companies to disclose information related to their “due diligence and remedy procedures”.

- **Corporate Sustainability Due Diligence Directive (CSDDD):** The CSDDD draws on the OECD Due Diligence Guidance for RBC, laying out due diligence expectations consistent with the six-step framework and key principles of the risk-based approach. It covers financial undertakings only with regards to their upstream supply chain.

3. Case Studies

During the masterclass, some practical case studies were explored, highlighting the challenges and successes of integrating human rights considerations into investment decisions.

Case Study 1: Asset Management firm’s approach to Human Rights Due Diligence

Asset management firms can follow several key steps to address human rights concerns per the Guidelines mentioned above. A first step might be related to internal organisation, resources, and policy development. This can include having a team of experts focused on specific topics and establishing strong human rights policies. For example, policies should be anchored at the board level and applied consistently across all business units and asset classes. These policies, such as human rights, exclusion, engagement and voting ones, should be updated annually. In addition, lower-level guidelines, procedures, and routines can be developed to ensure the consistent and systematic application of these policies throughout the firm.

Learn more:
The asset manager is involved in the Investor Alliance on Human Rights, which engages with companies to map and address human rights risks in their supply chains, particularly regarding forced labor in certain regions of China.

In general terms, the asset manager firm employs two approaches to integrate human rights. The reactive approach involves refraining from investing in companies involved in severe and systematic violations of international humanitarian law and human rights. Meanwhile, the proactive approach promotes the respect of human rights by engaging with investee companies, policymakers, and standard-setting bodies to encourage positive changes.

To identify risks associated with human rights breaches, the asset manager first screens the porfolios, including for example controversy screening and high-risk sector and country analysis. This is followed by assessing the identified risks to people. For example, controversies breaching human rights policies might lead to proactive engagement. Controversies affecting high-risk companies in high-risk sectors are being used for reactive engagement.

In order to manage human rights risks, the firm takes a multifaceted approach involving engagement, escalation, and voting. The firm collaborates with investor coalitions to enhance human rights practices across industries. Additionally, they use proxy voting and shareholder resolutions to push investee companies to address human rights concerns.

If a company repeatedly fails to show improvement, exclusion is considered a last resort, with certain sectors such as weapons, corruption, and human rights violations, being excluded from investments.

Learn more:
The asset manager, in 2022, voted at 1348 AGMs, representing 68,6% of invested capital. In 2023, it voted at 1999 AGMs, representing 90% of invested capital.

Case Study 2: Human Rights integration in Banking

A major development bank shared their comprehensive approach to human rights. The bank is committed to respecting human rights by explicitly and systematically conducting human rights due diligence across their investment process. In general terms, human rights integration is part of the entire investment process, including client selection, appraisal, disbursement, monitoring, ending, and other phases.

When integrating human rights there are some key areas of focus, these include developing or adhering to policies, establishing requirements such as considering the contextual risks, setting processes, having a legal covenant, having access to remedy and ensuring disclosure and transparency.

More in detail, when integrating human rights, a first step can be to do a salient exercise: this means looking at your human rights impacts. Salient human rights issues are those that can pose the most severe negative impact on people through the customers' activities or business relationships. Some of those are the right to live or the right to decent work[12].

Another key step includes having policies and commitments, and implementing standards and frameworks. The bank follows:

- United Nations Guiding Principles on Business and Human Rights (UNGPs).
- OECD Guidelines for Multinational Enterprises (MNEs) on RBC.
- The IFC Performance Standards.

In addition, this bank has launched in 2017 its own Human Rights Position Statement and has developed human rights toolkits for both direct and indirect investments. These toolkits are complementary to the IFC Performance Standards.

The toolkit for direct investment includes the following steps and actions:

- Clearance in Principle (CIP): This involves conducting a contextual risk assessment, early-warning screening for risks to human rights defenders, assessing Broad Community Support (BCS) and Free, Prior and Informed Consent (FPIC), and identifying any present human rights risks, among others.
- Financial Proposal (FP): This step includes performing due diligence, conducting further on-the-ground assessments of contextual risks, carrying out a more systematic evaluation of BCS and FPIC, and further assessing risks to human rights defenders, among other tasks.
- Monitoring: This involves addressing issues related to the implementation of environmental, social, and human rights due diligence, responding to human rights emergencies, and creating corrective action plans for newly identified human rights risks.

The toolkit for indirect investment includes the followng steps and actions:

- Clearance in Principle (CIP): This focuses on regional or country-specific risks, sector-specific concerns, present human rights risks, and critical voices facing the risk of oppression.
- Financial Proposal (FP): This step aims to gain a better understanding of contextual risks in relation to financial institutions, fund managers, and their portfolios, identify potential measures to mitigate these risks, and assess the gap between the current situation and desired outcomes.

[12] https://www.fmo.nl/salient-human-rights

- Monitoring: This includes annual updates on contextual human rights risks, identification of new risks, and ensuring the implementation and compliance of environmental and social action plans.

The bank also developed training on human rights, with staff following mandatory e-learnings on the foundations of human rights. In addition, Environmental & Social officers receive training, job mentoring and coaching on human rights.

4. Challenges and Best Practices

Despite the progress made in integrating human rights into financial decision-making, significant challenges remain. Experts identified the following as key hurdles:

- **Data Gaps:** Inconsistent data on human rights risks across ESG providers makes it difficult for asset managers and banks to make fully informed decisions. Improved transparency and collaboration with data providers are necessary to bridge this gap.
- **Balancing the Green Transition with Human Rights:** As the world transitions to a green economy, there is often tension between environmental goals and human rights protection. For example, certain green technologies may rely on supply chains with human rights abuses, such as forced labor in the solar industry.
- **Evolving Regulatory Landscape:** Some regulations might increase the compliance burden on financial institutions. While these regulations may not directly apply to financial entities, they require more detailed disclosure and reporting on human rights risks.

Annexe

Speakers

We would like to express our gratitude to the masterclass speakers for their insights and for sharing their in-depth expertise in this matter with the masterclass audience:

Başak Bağlayan, Secretary General of Luxembourg's OECD National Contact Point for Responsible Business Conduct (RBC)

Dr. Başak Bağlayan is the Secretary General of Luxembourg's OECD National Contact Point for Responsible Business Conduct (RBC). She works as an expert on RBC in the Luxembourg Ministry of the Economy. Prior to her current position, Başak worked as a researcher at the University of Luxembourg. During her time in academia, she authored the National Baseline Assessment on Business and Human Rights and a study on potential human rights legislation for the Luxembourg government.

Barbara Bijelic, Head of Regulation and Standards, OECD Responsible Business Conduct (RBC) Centre

Barbara Bijelic is Head of Regulation and Standards at the OECD Responsible Business Conduct (RBC) Centre. She oversees the Centre's work on regulatory engagement, the financial sector, tech sector and environment. She has a JD from Columbia University and BA in International Development from McGill University.

Benjamin Michel, Analyst, OECD

Benjamin MICHEL is Policy Analyst at the OECD Centre for Responsible Business Conduct (RBC), where he works with policymakers and financial institutions in promoting the implementation of the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct and the OECD Due Diligence Guidance. Previously, Benjamin has been working in sustainable finance as a human rights expert, advising financial institutions in assessing and addressing ESG impacts and opportunities in investment decisions.

Kamil Zabielski, Head of Sustainable Investment, Storebrand

Kamil Zabielski has joined Storebrand's sustainable investments team in 2021. Previously, he was Head of Sustainability at the Norwegian Export credit Agency (GIEK), and advisor at the Council of the Ethics for the Norwegian Government Pension Fund — Global. His specialisations include human rights/labour rights, conducting due diligence of companies, and evaluating environmental and social risks and impacts of projects. He has an L.LM in International Law and an M. Phil in Human Rights Law from the University of Oslo.

Patricia Nicolau, Environmental, Social/Human Rights Advisor, FMO

Patricia Nicolau is a Social Development and Environmental Economist with over 20 years of experience in ESG integration and sustainability. Over the past 12 years at FMO, she has worked across various sectors of the organisation, including special operations, agriculture, and renewable energy, serving as an ESG officer, advisor, and manager. Patricia has played a pivotal role in embedding human rights into FMO's investment processes, ensuring it becomes a standard practice within the bank, while also advising clients on identifying and addressing human rights issues.

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LSFI
Luxembourg
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Initiative

Luxembourg Sustainable Finance Initiative
12, rue Erasme
L-1468 Luxembourg