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Mandate of the Working Group on the issue of human rights and transnational corporations and other business enterprises

REFERENCE: RRDD/HRESIS/EA /ff

3 December 2013

Subject: Request for guidance on specific aspects the Guiding Principles and their meaning in the context of financial transactions and institutions

Dear Mr. Nieuwenkamp,

The UNWG's mandate is set out in Resolution 17/4 of June 7, 2011.[1] The resolution "invites international and regional organizations to seek the views of the Working Group when formulating or developing relevant policies and instruments" and mandates the Working Group to "cooperate and coordinate" work with international bodies in addition to UN bodies and agencies.[2] This letter is grounded in our mandate and responds to your request for guidance on three specific issues pertaining to the implementation of the Guiding Principles in general and in the financial sector.

The UN Working Group on Business and Human Rights welcomes the OECD's willingness to strive for coherence in its alignment with the UN Guiding Principles on Business and Human Rights. We acknowledge the steps taken so far incorporating the Guiding Principles in the OECD's guidance to States and companies, in particular through the 2011 update of the OECD Guidelines for Multinational Enterprises, and in work by the National Contact Points managing complaints related to human rights infringements, and the adoption of Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence in June 2012.[3]

As a preamble, let us restate unequivocally that the Guiding Principles apply to all business enterprises, "regardless of their size, sector, location and ownership and structure". The financial sector is no exception. Entities engaged in retail banking,

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[1] A/HRC/RES/17/4, June 7, 2011.
[2] A/HRC/RES/17/4, June 7, 2011. See sections 7 (g) and 8 of the resolution.
[3] See www.oecd.org/document/28/0,3746,en_2649_34889_2397532_1_1_1_1,00.html and TAD/ECG (2012)5, June 28, 2012.

investment and insurance, for example those in the Thun Group, have already been reflecting on the gaps they might have in the implementation of the Guiding Principles. [4]

So has the OECD's Working Party on Responsible Business Conduct, as reflected the 2013 report by Working Party on existing due diligence practices in the financial sector and during the panel discussion that took place at the OECD Global CSR Conference in June 2013.[5] Others have been advancing in closing such gaps, for example, various sustainable investment initiatives have begun incorporating new ESG Risk reporting requirements that include human rights as referenced in the Guiding Principles, and are seeking a global reporting standard to guide investors and stock exchanges.[6]

Your first question is: "What is meant by being "directly linked", both in general and for financial institutions specifically"?

In the Guiding Principles corporate responsibility is a function of impact. The required "action" to meet such responsibility is to conduct human rights due diligence to identify, prevent, mitigate and account for how they address their adverse human rights impacts. The extent to which a company is able to prevent or mitigate hinges on other factors, most notably "leverage."

Businesses can "cause" an adverse impact, they can "contribute" to it, or the adverse impact can be "directly linked" to their operations, products or services through its business relationships, even if they have not contributed to those impacts. Guiding Principle 19 says that in order to prevent and mitigate adverse human rights impacts, business enterprises need to take the necessary steps to address the "potential" and "actual" adverse impacts they might have on people. The expected "appropriate action" will vary according to the type of involvement of the business in the impact.

Your question seems to relate more directly to the third category, being "directly linked" but it allows us to review the various situations. The following sections explain what they are.

1) Causing adverse human rights impacts

It is well known that a business can cause an impact through its own activities. For example: retaining the passport of temporary foreign workers or migrant workers as a way to ensure their compliance with working schedules; affecting a communities' health through toxic emissions; or using threats to persuade peasants to sell their land to give way to a new infrastructure project. Financial institutions are not immune to such impacts. Examples of causing negative human rights impacts include, for instance: a manager discouraging women in the work force from having children in order to advance their careers in a bank; discouraging the creation of a union made up of bank

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[4] The Thun Group's October 2013 discussion paper states: "While the Guiding Principles are non-binding, they have nevertheless prompted legal developments which are relevant for banks. The European Union, the United States and other countries have introduced binding rules impacting on business responsibility for human rights. It is therefore advisable for banks to proactively engage in the ongoing debate around the Guiding Principles and their implementation." See discussion paper available at http://www.business-humanrights.org/media/documents/thun-group-discussion-paper-final-2-oct-2013.pdf

[5] Environmental and Social Risk Due Diligence in the Financial Sector, Report commissioned by the Netherlands in support of the Proactive Agenda of the OECD Working Party on Responsible Business Conduct, 2013, available at http://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct/2013_WS1_1.pdf

[6] See the Investor Network on Climate Risk's Listing standards proposal at http://www.ceres.org/resources/reports/incr-listing-standards-drafting-committee-consultation-paper-proposed-sustainability-disclosure-listing-standard-for-global-stock-exchanges/view.

employees; discriminating financial services to their clients on the basis of the race or gender.

2) Contributing to adverse human rights impacts

This can happen through businesses' own operations or through outside entities. Examples of this in the financial sector include: lending money to a company to construct a large processing plant built on a community land where a village was displaced to make way for the project without appropriate consultation or compensation as per international resettlement standards; providing client data to a Government that uses the data to trace and detain political dissidents; setting an unrealistic timetable for a construction firm hired to build the offices of the bank who then incurs in excessive overtime imposed on workers; or when the private security company hired by an insurance company to investigate a claim infringes on the civil and political rights of a person.

3) Adverse human rights impacts being directly linked to a business' operations, products or services by a business relationship

Finally, the operations, products or services of a business can be directly linked to adverse impacts through a business relationship, even where the business has not caused the impact. For example: when a pension fund invests in a food and beverage company that systematically buys produce from farms with child labour in breach of standards; managing the assets of a corporate or individual client involved in human rights abuses; or investing in a company that buys or uses prospected minerals in countries of conflict.

The scope of financial institutions' human rights due diligence include employees, clients, business partners, investors, suppliers and other external stakeholders.

The three categories mentioned above (causing, contributing, being directly linked to) are important because they determine what businesses are expected to do according to the Guiding Principles when they are at risk of being involved with human rights impacts. However enterprises' ability to prevent and mitigate any adverse human rights impact depends on the leverage they can exert over their businesses relationships. Other factors that determine the appropriate action include the severity of the impact, and the degree of their involvement. Size, sector and the operational context of the business are also factors that will shape the means through which companies discharge their responsibility to respect human rights. Leverage is relevant for situations where businesses contribute to the adverse impact or where the impact is directly linked to its operations, products or services. Where they cause the impact, they should take the necessary steps to cease or prevent the impact.

The Interpretive Guide on Pillar 2 of the Guiding Principles (the Corporate Responsibility to Respect) sets out a decision matrix to consider the use of leverage and whether to end a business relationship in case of involvement in human rights violations.[7] As mentioned by the Working Group in the context of the Rana Plaza disaster in Bangladesh, the spirit of the Guiding Principles is not to push companies towards systematic divestment or severing of procurement contracts when human rights problems arise.[8] In fact, the Guiding Principles caution against terminating a business

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[7] OHCHR, The Corporate Responsibility to Respect Human Rights. An Interpretive Guide, 2012, HR/PUB/12/02, available at http://www.ohchr.org/Documents/Publications/HR.PUB.12.2_En.pdf

[8] See Working Group urged clothing brands no to disengage from Bangladesh. See public statement of May 2013, available at http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=13309&LangID=E.

relationship without assessing whether such a step would have adverse human rights consequences. The Guiding Principles encourage companies to exercise leverage on business partners in order to cease or mitigate any existing harms. If measures taken to increase leverage and provide solutions fail, then a company can consider severing its ties to its business partner. The Guiding Principles' intention is to maximize the opportunities for a culture change through the agency of business enterprises while providing a comprehensive framework for remedy.

Your second question asks: "To what extent and in what way are minority shareholders covered by this provision?"

As mentioned above, the Guiding Principles apply to all businesses and minority shareholders are not excluded. The issue, rather, lies in the extent of their leverage. Leverage will not only depend on size but on the means available to the business enterprise given the context, the nature of business sector and the business relationship, alongside the other factors mentioned in this letter. OHCHR has already produced advice on this matter in a reply to the Centre for Research on Multinational Corporations (SOMO) and OECD Watch on April 26, 2013, on the issue of minority shareholdings of institutional investors. In that letter, OHCHR clarifies:

"There is nothing in the text of the Guiding Principles to indicate that their scope of application is limited to the situations where institutional investors hold majority shareholdings. This may be relevant when considering the means through which a business enterprise meets its responsibility to respect human rights, including the leverage it can exercise in its business relationships…".[9]

Your third question asks: "To what extent and in what way do you consider investments in sovereign bonds to be covered by this provision?"

Investments in sovereign bonds can originate from or be carried out through private or state-owned enterprises. The Guiding Principles apply to them and to the transaction of purchasing or investing in sovereign bonds by business entities. The fact that the bond is held by a State does not exempt a business from assessing its involvement with adverse human rights impacts. As formulated in Guiding Principles 13, "´business relationships are understood to include relationships with business partners, entities in its value chain, and any other non-State or State entity". Business enterprises that purchase or invest in sovereign bonds are expected to understand the possible involvement they might have in adverse human rights impacts through these transactions as per Guiding Principles 11, 12 and 17.

In the case of sovereign bonds, the practical challenge lies on the scope of due diligence to identify the adverse human rights impact by the Government as a whole, or the specific state body carrying out the project for which funds are being raised. There is already emerging experience and concrete guidance with regards to project-related human rights due diligence. Conducting due diligence on each single action and potential action of a given State, across all its functions, agencies and businesses is not a reasonable expectation. Entities that purchase sovereign bonds can in any case consider the possible reputational risks they might face arising from such transaction, and the degree to which the transaction is consistent with their own foreign policies in the case of state-owned investors.

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[9] OHCHR Opinion issued in response to a request regarding the Guiding Principles and the financial sector, 26 April 2013. See: http://www.ohchr.org/Documents/Issues/Business/LetterSOMO.pdf

It is also worth noting that Guiding Principle 4 refers to the State-business nexus. Guiding Principle 4 places higher expectations on state-owned or state-controlled businesses because "they have greatest means within their powers to ensure that relevant policies, legislation and regulations regarding the respect for human rights are implemented." This means that if the entity investing in or purchasing sovereign bonds is state-owned, there will be an expectation of formal government guidance on the matter.

In general, the Guiding Principles were formulated and endorsed as a standard to prevent, mitigate and remedy the actual and potential adverse human rights impacts of businesses, recognizing the governance gaps posed by the increasing globalization of business transactions as well as changing social expectations on companies to avoid doing harm and to contribute to the welfare of societies.

Please do not hesitate to contact the UN Working Group for further discussions on this matter. We welcome proposed collaboration on the upcoming project related to guidance for the financial sector on the implementation of the Guiding Principles.

Yours sincerely,

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The Members of the UN Working Group on the issue of human rights and transnational corporations and other business enterprises