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OHCHR response to request from BankTrack and OECD Watch for advice regarding the application of the UN Guiding Principles on Business and Human Rights where private sector banks act as nominee shareholders

I. Introduction

On April 15, 2021, the Office of the UN High Commissioner for Human Rights (OHCHR) received a request from BankTrack and OECD Watch to provide advice regarding the application of the UN Guiding Principles on Business and Human Rights (Guiding Principles) in the context of financial institutions acting as custodian or nominee shareholder. Specifically, OHCHR was asked to provide advice and clarification on the following questions:

- Would there be a ‘business relationship’ under the UN Guiding Principles between a financial institution (“the FI”) and a company in which it holds shares (“the investee company”) on behalf of a client, as a custodian or nominee shareholder?
- If the answer to the first question is yes, how should an FI, acting as custodian or nominee shareholder, ensure that it meets its responsibility to respect human rights as set out in the UN Guiding Principles on Business and Human Rights, particularly in cases of severe human rights risks?

The purpose of the present note is to respond to this request by providing interpretive guidance regarding the application of the Guiding Principles to these questions.¹ The note does not express an opinion about any specific cases or the acts or activities of any specific institutions.

It is beyond the scope of the note to provide more comprehensive analysis of the many and varied aspects and modalities of nominee shareholding.

II. The Guiding Principles on Business and Human Rights and the financial sector

This note builds on, and aligns with, previous interpretive guidance notes published by OHCHR regarding the human rights responsibilities of the financial sector:

¹ As the principal United Nations office mandated to promote and protect human rights for all, OHCHR provides substantive expertise, technical assistance and other advice to relevant stakeholder on international human rights standards and principles and the protection of human rights worldwide. See also report by the United Nations Secretary-General: “Contribution of the United Nations system as a whole to the advancement of the business and human rights agenda and the dissemination and implementation of the Guiding Principles on Business and Human Rights”, A/HRC/21/21, paras. 32-33 and 96.

- In 2013, OHCHR elaborated on the applicability of the Guiding Principles to institutional investors with minority shareholdings, whether such shareholdings constitute a business relationship under the Guiding Principles, and the role of leverage in such circumstances.²
- In 2013, in response to a request from the Chair of the Working Party on Responsible Business Conduct of the OECD, OHCHR elaborated on the understanding and implications of the concept of “directly linked” under the Guiding Principles and the extent to which this provision applies to minority shareholders and investments in sovereign bonds.³
- In 2017, OHCHR elaborated on the application of the Guiding Principles to the banking sector with a focus on how to apply the concepts of cause, contribution, and direct linkage in the context of the retail banking sector, and on the implications for remediation and operational-level grievance mechanisms.⁴
- Over the years, OHCHR has also delivered numerous submissions to development finance institutions on how to ensure development financing activities and policies are consistent with international human rights standards and principles, and that human rights risk information is integrated into their due diligence processes.⁵

The note furthermore aligns with relevant reports and guidance produced by the UN Working Group on Business and Human Rights.⁶

The Guiding Principles clearly state that *the responsibility to respect human rights* applies fully and equally to all business enterprises regardless of their size, sector, operational context ownership and structure.⁷ This includes the entire spectrum of FIs. The responsibility to respect applies to an FI’s own activities (acts and omissions) and to adverse human rights impacts that are directly linked to their operations, products or services by their business relationships.⁸

While the underlying responsibility to respect human rights remains the same for all FIs, the Guiding Principles recognize that the means through which the responsibility should be proportional to, among other factors, its size, and may vary depending on whether, and the extent to which, it conducts business through a corporate group or individually. Consequently, the scale and complexity of the tools and strategies available to FIs such as retail banks, investment banks, brokerage firms, and pension funds to meet their responsibility to respect human rights will vary, at times significantly. Moreover, not all tools and strategies will be applicable to the full range of products and services offered by an individual institution.

² <https://www.ohchr.org/Documents/Issues/Business/LetterSOMO.pdf>

³ <https://www.ohchr.org/Documents/Issues/Buis/LetterOECD.pdf>

⁴ <https://www.ohchr.org/Documents/Issues/Business/InterpretationGuidingPrinciples.pdf>

⁵ <https://www.ohchr.org/EN/Issues/Development/Pages/DFI.aspx>

⁶ The UN Working Group on Business and Human Rights has also elaborated on the human rights responsibilities of FIs, including by providing guidance and feedback to members of the Thun Group of Banks, the World Bank Group, the International Finance Corporation, the French Development Agency, and the Principles for Responsible Investment, as well as investor implementation of the Guiding Principles. See, for example:

https://www.ohchr.org/Documents/Issues/TransCorporations/WG_BHR_letter_Thun_Group.pdf;

https://www.ohchr.org/Documents/Issues/Business/WG/20200304_WG_BHRLetter_IFC_AccountabilityReview.pdf;

https://www.ohchr.org/Documents/Issues/Business/20200921_WG_BHR_submission_PRI.pdf.

[A/HRC/47/39/Add.1 - E - A/HRC/47/39/Add.1 -Desktop \(undocs.org\)](https://www.ohchr.org/EN/Issues/Development/Pages/DFI.aspx)

⁷ GP 14 and Commentary.

⁸ GP 13.

III. The Guiding Principles on Business and Human Rights and nominee shareholding

Question 1: Would there be a ‘business relationship’ under the UN Guiding Principles between a financial institution (“the FI”) and a company in which it holds shares (“the investee company”) on behalf of a client, as a custodian or nominee shareholder?

A number of authoritative resources have addressed the application of the Guiding Principles and the OECD Guidelines on Multinational Enterprises to a range of financial services.⁹ It has been established that under both instruments there is a business relationship between an FI and an investee company, including in the context of minority shareholdings and index fund investments even with multiple tiers of business relationships.¹⁰ However, the question of application of the Guiding Principles to nominee shareholder services has not so far been considered in any detail.

For the purposes of this note, a nominee is understood to be a natural person or an institution whose name is titled on securities or other property to facilitate certain transactions or transfers while leaving the actual or legal owner as the beneficial owner. A nominee shareholder holds shares under a custodial or nominee shareholder agreement. Certain FIs, such as investment banks and brokerage firms, provide nominee shareholding services. When acting as a nominee shareholder, FIs are entrusted with the safekeeping and trading of the client’s securities under the FI’s own name, while the beneficial owner may remain anonymous but retains control over investment decisions. In this way, the nominee serves as a custodian. Under most jurisdictions, the FI must keep records of all beneficial owners, buys and sells securities according to a beneficial owner’s directions, and passes money from sales or dividends to the beneficial owner.

In the Guiding Principles, “‘business relationships’ are understood to include relationships with business partners, *entities in its value chain*, and any other non-State or State entity directly linked to its business operations, products or services.” (emphasis added)¹¹

It follows from both the letter and spirit of the Guiding Principles, as well as from the various interpretive guidance on their application to FIs, that purchasing and holding shares of an investee company constitutes a “business relationship” between an FI and an investee company under the Guiding Principles. It appears to be no less the case that purchasing and holding shares in an investee company constitutes a linkage between the FI’s “operation, product or service” and the investee company when the FI does so at the request and on behalf of a client.

The Guiding Principles do not require that the FI provides the service to the investee company rather than to the client in order to establish a business relationship, but only that there is a direct link between its service and the investee company. Here that direct link is created by the fact that the service entails holding and trading shares in the investee.

Whether an FI invests its own financial resources in an investee company, acts as a custodian and carries out transactions at the request of beneficial owners, or actively or passively manages and advises the investment decisions of beneficial owners are factors that can determine the

⁹ See previous section, as well as OECD guidance on responsible business conduct in the financial sector: <https://mneguidelines.oecd.org/rbc-financial-sector.htm>

¹⁰ *Id.*; OHCHR: <https://www.ohchr.org/Documents/Issues/Business/LetterSOMO.pdf>.

¹¹ GP 13 Commentary.

degree of leverage the FI has to prevent and mitigate adverse impacts which it is connected to through its business relationships and the associated measures it can take.¹²

The Commentary to Guiding Principle 13 suggests an expansive interpretation of the scope of companies and business relationships covered. There is no indication that the intention was to carve out a potentially large swath of products or services offered involving different entities in the value chain of the financial sector. Furthermore, exempting certain relationships from the scope of responsibility could create incentives to conduct transactions in certain formats rather than others to avoid scrutiny and accountability.

Based on the above analysis, OHCHR is of the view that the relationship between a custodian or nominee shareholder (as the concept is understood for the purposes of this note, see above) and a company in which it holds shares on behalf of a client can and in principle would constitute a “business relationship” as defined in the Guiding Principles. However, it should be noted that there are a wide array of types of custodian arrangements which may warrant further analysis.

Question 2: If the answer to the first question is yes, how should an FI, acting as custodian or nominee shareholder, ensure that it meets its responsibility to respect human rights as set out in the UN Guiding Principles on Business and Human Rights, particularly in cases of severe human rights risks?

Under the Guiding Principle, the corporate responsibility to respect human rights entails that business enterprises identify, prevent, mitigate and account for how they address their impacts on human rights, including through the adoption of policies and processes appropriate to their size and circumstances.

In all instances, FIs should have in place a policy commitment to respect all internationally recognized human rights – understood, at a minimum, as those expressed in the International Bill of Rights and the principles concerning fundamental rights set out in the International Labour Organization’s Declaration on Fundamental Principles and Rights at Work. The policy should set out the FIs expectations of personnel, business partners, and other parties directly linked to its operations, products or services. It should also explain how the FI embeds human rights criteria across its activities, products, and services. This would include services such as nominee shareholding.

It follows that FIs are expected to carry out ex-ante and ongoing human rights due diligence in order to *know* if their activities, products and services are connected with human rights risks and *show* how they take steps to address these risks.¹³ Exactly what this entails will vary across FI services, but priority should be given to high-risk services and business relationships that are actually, or likely to be, associated with more severe risks. The complexity of an FI’s human rights due diligence processes depends on various factors, including on the size of the FI, the nature of its products and services, the severity of real and potential adverse human rights impacts, the number and types of clients (existing and prospective), and the operational contexts of investees.

Nominee shareholding may pose particular challenges in identifying human rights risks connected either to the beneficial owners or to the investee company. FIs may need to take this into account when deciding to act as a nominee shareholder. The limited visibility of human

¹² GP 19.

¹³ GP 17.

rights risks inherent to the construction of certain financial services does not change or constrain the responsibility of FIs to ensure they are not connected to human rights abuse through this kind of business relationship. Therefore, the FI's human rights due diligence processes need to be adapted to take this difficulty into account. For instance, processes that assess risks connected to beneficial owners could usefully rely on the various requirements, experiences, tools, and best practices of due diligence exercised for example in the context of anti-money laundering and combating the financing of terrorism and proliferation, which involve similar challenges to those of human rights due diligence.

In the nominee shareholding context (as it is understood for the purposes of this note), FIs would be expected to adopt a two-pronged approach to assessing actual and potential adverse human rights impacts:

1. **Clients (beneficial owners):** FIs are expected to assess risks connected to beneficial owner clients. For example, in the case of asset owner institutions (e.g., pension funds), FIs assess the alignment between the institution's policies and procedures, governance, reporting, and track-record on investment practices against the standards laid out in the Guiding Principles and as elaborated on by the OECD guidance on Responsible Business Conduct for Institutional Investors.¹⁴ This may be a standalone process or it may be done in the context of broader customer due diligence efforts meant to meet expectations under the Financial Action Task Force¹⁵ standards and as described in *A Beneficial Ownership Implementation Toolkit*.¹⁶
2. **Existing and potential investee companies:** Where an FI identifies risks associated with clients, including with regard to their ability or willingness to address risks to which they are connected to by way of investee companies, or where there is a particularly high risk section of its nominee shareholder portfolio (e.g., high-risk operating contexts or business models), the FI should undertake due diligence on higher risk investee companies. This involves assessing the investees' human rights policies, processes, and culture;¹⁷ management of their respective salient human rights issues; business model red flags that increase the likelihood of human rights harms;¹⁸ and the real-world impacts of the company on people, including the real-world outcomes of their due diligence efforts.

In order to prevent and mitigate harms, FIs are expected to take appropriate action. What determines "appropriate action" will vary according to how a business enterprise is involved with the impact, either causing, contributing, or being directly linked to it. Previous OHCHR guidance elaborates on this point.¹⁹

Where risks or adverse impacts are identified by nominee shareholders, they are expected to use and build their leverage. Leverage refers to the "ability of a business enterprise to effect change in the wrongful practices of another party that is causing or contributing to an adverse human

¹⁴ OECD Guidance on Responsible Business Conduct for Institutional Investors, 2017: [RBC-for-Institutional-Investors.pdf \(oecd.org\)](https://www.oecd.org/tax/transparency/beneficial-ownership-toolkit.pdf)

¹⁵ International Standards on Combatting Money Laundering and the Financing of Terrorism Proliferation, October 2020: <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>

¹⁶ The OECD Secretariat of the Global Forum on Transparency and Exchange of Information for Tax Purposes Inter-American Development Bank, <https://www.oecd.org/tax/transparency/beneficial-ownership-toolkit.pdf>, 2019.

¹⁷ Leadership and Governance Indicators of a Rights Respecting Culture: <https://shiftproject.org/resource/lg-indicators/foreword/>

¹⁸ <https://shiftproject.org/resource/business-model-red-flags/red-flags-foreword/>

¹⁹ <https://www.ohchr.org/Documents/Issues/Business/InterpretationGuidingPrinciples.pdf>

rights impact.”²⁰ With beneficial owners, for example, nominee shareholders could include human rights clauses in nominee shareholding agreements that clarify the FI’s human rights expectations. The nominee may also seek to alert clients of human rights risks regarding an existing or potential investee companies, suggest they take action, provide advice on proxy voting, and track the effectiveness of these efforts. Contractual clauses could also allow the FI to exit the relationship with the client should efforts to prevent and mitigate harms connected to the investee company fail.

Where the nominee shareholder cannot use or build leverage with the beneficial owners sufficiently to address the impact, it will engage investee companies. While nominee shareholders may not be equipped with some of the leverage tools available to beneficial owners to effect change in an investee company’s conduct (e.g., filing shareholder resolutions or changing positions with respect to the asset), they have multiple avenues to exercise leverage. For example, nominee shareholders may participate in collaborative efforts with peers or through multi-stakeholder engagement platforms to put pressure on investee companies. They may also call on State institutions and other standard-setting bodies to promote responsible and accountable business practices through the creation of enabling environments for responsible business conduct. This may include publicly expressing support for robust regulatory responses that address legal and regulatory gaps that expose people to heightened risk.

Where the adverse risks and impacts are severe, FIs will need to see change in conduct more quickly. The Guiding Principles also clarify that in situations where an enterprise lacks the leverage to prevent or mitigate adverse impacts and is unable to increase its leverage, it should consider ending the relationship, taking into account credible assessments of potential adverse human rights impacts of doing so.²¹

Where human rights risks and adverse impacts connected to the FI’s activities, products, and services are severe, the Guiding Principles expect them to formally report on how they address them. Among other things, such disclosure should provide sufficient information to evaluate the adequacy of the FI’s response to the particular human rights impact involved, and should not pose risks to affected stakeholders, personnel, or to legitimate requirements of commercial confidentiality. Such disclosure provides a measure of transparency and accountability to rights-holders. Acting as a nominee shareholder does not detract from this responsibility. Therefore, how a particular financial service impacts the FI’s ability to communicate how it addresses salient human rights risks, as well as any legal restrictions that impose limitations in this regard, should be anticipated and considered before entering into the business of providing such a service.

²⁰ Interpretive Guide page 7.

²¹ Commentary GP 19 https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf